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PRINCIPLES
OF BUSINESS LAW

PRINCIPLES OF BUSINESS LAW

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FOURTH EDITION

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Note

The forms contained in this book have been carefully selected in order to cover the situations and problems of the subject matters as completely as possible. They will be useful to lawyers for adaptation to specific situations in connection with which they are to be used. Laymen will find them informative on the contingencies and problems which should be considered, but should consult their own legal counsel before executing any will or entering into any contract or business arrangement based on these forms.

PREFACE TO FOURTH EDITION

In the preparation of the fourth edition, the authors have presented the material in the same general way that was followed in the previous editions. In order to strengthen the work and to care for new trends, some reorganization and revision of text was called for. Several new cases have been added to give the text a present day flavor. Many old cases have been retained, however, because it is felt that they offer the best illustration of and the soundest reasons for the principle of law involved.

During the past few years, major developments have taken place in numerous fields of the law. Nowhere is this more noticeable than in the field of labor relations. As a consequence, the book dealing with "Trade Regulations" has been reorganized and a new chapter added which is concerned exclusively with Labor Law. Because the Taft-Hartley amendment has not been construed by the courts, its provisions have been inserted somewhat in outline form without too particular an attempt to interpret or explain them.

We again sincerely express our appreciation of the suggestions made by those who have made use of the previous edition. Although in a work of this character it is impossible to incorporate all changes suggested, they have been exceedingly valuable to the authors in the production of this new edition. Many changes are the direct result of comments made by previous users.

E. R. D.
C. G. H.

PREFACE TO SECOND REVISED EDITION

In preparing this second revised edition, the authors have kept in mind their dual purpose in writing the text: namely, to offer an effective method of approach through a combination of text and case material, and in the main to use the legal grouping of subjects as a basis for presenting the relation of law to business. Consequently, such alterations as have been made deal primarily with the subject matter included, rather than with the method of approach.

During the past seven years, increased use of certain new business devices has made necessary the inclusion of new fields of law; increased activity in certain fields of business has made vital other fields of interest; and legislative enactments have in several instances changed materially laws in effect at the time the earlier edition was written. To meet these situations, new material has been included on trust receipts and banks and banking, while the section of the text relating to bankruptcy has been entirely rewritten. In addition, at the request of many of our users, we have added a book on trade regulations which deals with regulation of business and business torts. Some slight reorganization of material has been made elsewhere, and various minor changes have been instituted to make the text more accurate, interesting, and usable.

It is our desire to express again grateful recognition of the many helpful criticisms and suggestions offered by those using the book. Without them, this work would fall short of attaining its coveted goal, namely, to aid the student of business to plan wisely his future business conduct. We are greatly indebted to those who have aided and assisted us in many ways.

E. R. D.
C. G. H.

PREFACE TO SECOND EDITION

In general, the authors have followed in the second edition the same plan which dominated the first edition. Likewise, the same objectives have been kept in mind: namely, to acquaint the student of business with the legal principles that govern the conduct of business and to train him in their application.

Although no radical changes have been made in the new edition, certain minor departures from the former organization are apparent. First, the subjects that deal with security relations, with the exception of real estate mortgages, are grouped together under a new division called "Security Relations." Second, the subjects of negotiable instruments and business organizations have been materially reorganized in order to present the material in what is felt to be a more logical sequence. Third, in numerous places throughout the text new material of importance will be found.

Concerning the case material, it will be noted that many recent and better illustrative cases have been added. In some instances old cases have been deleted to make room for them, but quite generally the new cases are illustrative of points not previously covered. Many of the original cases have been reëdited to include more of the factual situations and more complete excerpts from the opinions.

The authors appreciate greatly the constructive criticisms given to them by users of the earlier edition. To them and to those who have aided in the preparation of the present manuscript, we are greatly indebted.

E. R. D.
C. G. H.

PREFACE TO FIRST EDITION

In writing this book, the authors have had two distinct objectives in view. The first is the preparation of a text supplemented with case material in such form that both the student and the teacher may have before them a brief statement of the fundamental principles, correlated with a selection of cases that will demonstrate how these principles apply to concrete cases. It has been the experience of the authors in teaching business law by the case system in universities and colleges that the time allotted is too short to cover as many subjects as should be touched upon by the business law student. In addition, they have also found that most textbooks on business law do not contain enough material adequately to present the subject matter for a complete and full course in business law. Their second objective, therefore, is to combine the text method and the case method so that the usual business law subjects taught in colleges and universities may be covered in the time allotted for such subjects.

Any course planned to prepare a student for the profession of business should be so designed as to accomplish two objectives: (1) It should acquaint the student with the general principles which are followed in business; and (2) it should train him in the application of those principles to typical business situations. Therefore, it is the opinion of the authors that a text on business law should set forth the fundamental legal principles which relate to the usual business transactions, and, by the use of case material, should aid the student in his application of the general principles to definite situations.

No material rearrangement of the subject matter has been made in this book, primarily because the authors feel that any extensive regrouping that might be made would be a change in terminology rather than in content. The authors appreciate the attempts made to reorient business law along the lines of the so-called functional approach. They feel, however, that linking the cases with the text matter through footnotes gives an opportunity to both teacher and student to see how the fundamental principles operate in practical situations.

The authors have chosen cases which illustrate the application of legal principles to typical business situations, and which also contain certain of the courts' legal reasoning in support of the principles applied. In abstracting the cases, they have restated the

facts, and, where possible, have eliminated all procedural material, so that the student will not be burdened with the reading of the adjective law and thus will have an opportunity to devote his full time to a study of how the courts apply principles to facts.

In conclusion, proper recognition should be given to Dr. L. P. Simpson and Mr. J. L. le Master, both of the business law staff of the University of Illinois, for their valuable suggestions concerning the subject matter and for their aid in the selection of cases. The authors also wish to acknowledge their indebtedness to Professor George W. Goble and Professor William E. Britton, of the Law School of the University of Illinois, for their valuable suggestions and assistance in the preparation of the manuscript.

E. R. D.
C. G. H.

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PRINCIPLES
OF BUSINESS LAW

Chapter I

THE NATURE AND CLASSIFICATION OF THE LAW

Sec. 1. In general.—Law may be said to consist of rules for the guidance of man in his relations with other men and in his relation to organized society. A single person, if isolated, would be unaffected by such rules, since they operate only in the presence of other persons. Of course, there are laws pertaining to physical matter, such as the laws of chemistry and physics, but with these we are not concerned. There are also many rules controlling human conduct which have no legal significance, such as rules with respect to manners and social conduct in the restricted sense. Human conduct necessarily causes friction, and some plan governing and regulating uniformity of action is required. In order to produce the result desired in playing a game, certain rules must be followed. A departure from any of these rules defeats the purpose of the game. With every breach of these rules of control, there follows some result detrimental to all the participants and to the violator of the rule. To the violator of the rule, it is the condemnation of the other players. To the other players, it is the loss of the desired result. In organized society a breach of the rules which form the law produces a like result.

In an organized state, agencies, such as courts, sheriffs, and other public officials, are created to punish persons for violating the rules of conduct determined by organized society. Whether the rule violated is one determined by organized society as a whole is not always clearly defined. If, however, agents of society, such as the courts, the sheriffs, and the public officials, will act at the request of the public or of the injured party for its or his benefit, the rule violated is a rule of law in the strict legal sense.

Sec. 2. Origin and source of law.—These rules of conduct discussed above, known as rules of law, are formulated by an ever-developing process. The first source of the law is the customary conduct of community life. Group life creates customs, and when these customs become stabilized to the extent that each member of society is justified in assuming that every other member of society will respect them and will act in conformity with them, it can be said that rules of conduct have been formulated. When these rules of conduct have received the recognition of the community in gen-

eral and have become formally expressed in legislative enactments or in judicial decisions, the "Law" is made.

Conflicts between members of society arise from time to time as to the application of these rules of conduct, and, in order to determine whether a member of society has violated a rule, or whether a member of society has a right to be recompensed for an injury by reason of the violation, courts are set up to settle the dispute.

The court, by its decision, lays down a principle based upon a custom or convenience, and thus creates a precedent which will be controlling in similar future controversies. The reports of such controversies are published in books known as "reported cases." In these books will be found the *unwritten law,* or the *common law.* Although the common law is written, it is called unwritten law, in contradistinction to those rules which have been formulated into law by legislative action. These legislative enactments are called *written law,* or *statutory law.*

Sec. 3. Written, or statutory, law.—The constitution of the United States and the constitutions of the various states are the fundamental written law. All other law must conform to, or be in harmony with, these constitutions. The constitutions define and limit the powers of government for the purpose of giving protection to the individual who lives under the government, and for whose benefit government is formed.

Legislative enactments by Congress, by the various state legislatures, by cities and towns, and by other smaller governmental units must conform to the constitutions and find in them their authority, either express or implied. Such legislative enactments, called statutes, form a greater part of the written law.

Sec. 4. The common law and the civil law.—The term "common law" has several meanings. In the section above the term is used to distinguish the law developed by the courts from that enacted by legislatures. The term is also used, probably in its largest sense, to distinguish between the English system of law and the systems of law developed in other sections of the world.

The sources of the American common law for the most part are found in the English law. The colonists were governed by charters granted by the King of England. These charters were general in their nature and left much to be worked out by the people of the colonies. Since most of the colonists were of English origin, they naturally were controlled by the customs of their mother country. In Louisiana, and, to some extent, in Texas and California, the Civil law or the Roman law is the basis of the legal system, because these states were founded by French and Spanish peoples. The law of Continental Europe is based more directly upon the Roman law.

Sec. 5. Public and private law.—Anglo-American law may be divided into two main divisions—public law and private law. Public law is the law pertaining to the public as a whole, and may be divided into three general classes. (1) Constitutional law concerns itself with the powers of the federal and state governments which are exercised through legislation and executive orders. The extent of the powers of Congress and state legislatures to pass laws and of the executives of the federal government and the states to issue orders involves questions of constitutional law. (2) Administrative law is concerned with officials, boards, and commissions created by legislative enactments for the purpose of carrying out legislative functions. Orders and decrees of administrative boards, such as the Interstate Commerce Commission, the Federal Trade Commission, the National Labor Relations Board, and so forth, fall within the field of administrative law. The term also includes the remedies granted to an individual who is injured by the illegal acts of administrative officers, boards, and commissions. (3) Criminal law consists of statutes and general maxims which forbid certain conduct as detrimental to the welfare of the state and which provide punishment therefor.

Private law is all that body of law which pertains to the relationships between individuals as such in organized society. It may be broken down into certain fields, such as contracts, agency, sales, negotiable instruments, business organizations, and so forth. The law in these areas and others pertaining to business law are fully treated in the main text material of this book. The law of crimes and torts will, therefore, be briefly discussed in the sections to follow.

Sec. 6. Criminal law.—Actions between persons are called civil suits, or actions. Criminal actions are prosecuted by the state as the moving party (plaintiff) against any citizen for the violation of a duty prescribed by the common or statutory law. Crimes are either common law crimes or statutory crimes and in states where a criminal code has been adopted, all crimes are statutory in character. Conduct which violated custom or Christian principles and shocked the community sense of propriety constituted a crime at common law. Blasphemy, murder, rape, riot, adultery, and conspiracy are illustrations. By statute, "a crime or public offense is an act or omission forbidden by law, and punishable upon conviction by either of the following punishments:—1. Death; 2. Imprisonment; 3. Fine; 4. Removal from office; 5. Disqualification to hold and enjoy any office of honor, trust, or profit under the constitution or laws of this state." In the absence of complete codification, common law crimes are still recognized, and incomplete stat-

utes are supplemented by common law as to mode of indictment and punishment. Crimes against the United States are enumerated and defined by federal statute.

Crimes are classified as treason, felonies, and misdemeanors. Treason is defined by the federal constitution as follows: "Treason against the United States shall consist only in levying war against them, or in adhering to their enemies, giving them aid and comfort." A like provision is found in state constitutions.

Felonies are offenses usually defined by statute to include all crimes punishable by death or by imprisonment in the state prison. Examples are murder, grand larceny, arson, rape, and so forth.

Crimes of lesser importance than felonies, such as petty larceny, simple assault, drunkenness, trespass, disorderly conduct, vagrancy, and so forth, are called misdemeanors, and are usually defined as any crimes not punishable by death or by imprisonment in the state prison, but are punishable by fine or confinement in the local jail. It is sometimes said that every statute for the breach of which there is a penalty by way of fine or imprisonment in the local jail is a criminal statute. There is a difference of opinion as to whether acts in violation of city ordinances which provide for fine and imprisonment as a penalty are crimes. Violation of traffic ordinances, building codes, and similar municipal ordinances, where prosecution takes place before a city magistrate, are sometimes termed "petty offenses," or "public torts," and are not included within the term "crime."

Sec. 7. Law of torts.—The law of contracts deals with the enforcement of rights and duties arising out of agreements created by the mutual assent of the parties. The law of crimes deals with the enforcement of duties imposed by the state. The law of torts deals with the enforcement of duties existing between individuals as members of society. A breach of such duties may be both a tort and a crime; for example, assault and battery, trespass, and nuisances. Each member of society is entitled to have certain interests protected. Some of these interests are (1) Freedom from bodily harm or apprehension of bodily harm. Invasions of these interests are called assault, battery, and false imprisonment. (2) Freedom from injury to property. Invasions of this interest are called trespass to goods, conversion of chattels, and trespass to land. (3) Freedom from disparagement of reputation. Invasions of this interest are called defamation, libel, and slander. (4) Freedom from invasion of the right of privacy. (5) Freedom from interference with business relationships. Invasions of this interest are called deceit, threats and intimidations to customers, inducement of breach of contract, slander of title, and trade name. For a more

complete discussion of the law of business torts, see Book VIII. If any member of society invades such protected interests of another, the party injured has a right to be reimbursed in damages for the wrong committed. This wrong is called a "tort."

Sec. 8. Tortious conduct.—Conduct is tortious if any of the following elements are present: (1) If it is intentional; that is, if the actor intends his conduct to result in injury to another. *A* strikes *B* accidentally while mingling in a crowd. *A* here intends no harm. *A*'s conduct is not tortious. *A* must intend harm. (2) If it is in such "reckless and wanton disregard of the safety of others" that the actor should know or should have reason to know that harm will likely result. *A* recklessly and knowingly drives through a stop light. *B* is injured. *A*'s conduct is tortious. (3) If it is negligent; that is, if there is failure to exercise due care. Due care is what a reasonable man, guided by those circumstances which ordinarily regulate the conduct of human beings, would do or would not do under the circumstances. *A*, a garage owner, or his employees, leave oil-soaked rags and waste near *B*'s stored cars. The rags ignite and burn the cars and adjacent buildings. *A* is liable for loss of the cars and adjacent buildings. *A* was negligent in leaving the highly inflammable material where it might cause damage. *A*'s lack of knowledge of the dangerous quality of the oily rags is immaterial. Manufacturers of chattels which are likely to be dangerous because of hidden defects are liable for injury caused by reason of the defective materials used. *B* is injured by reason of the collapse of an automobile wheel. The manufacturer of the car is liable because he was negligent in using defective material and in providing improper inspection. (4) Conduct is tortious under certain unusual situations where absolute liability is imposed, even though the actor is innocent and exercises reasonable care. Harm caused by dangerous or trespassing animals, blasting operations, and escape of fire are examples. Strict liability is also imposed by workmen's compensation statutes. (5) "The unreasonable and unlawful use by a person of his own property, either real or personal, or from his own unlawful, improper, or indecent activity, which causes harm to another's person, or the use of his property, or the public generally" is tortious conduct. This conduct is generally described as a nuisance. Nuisances may be either private or public. A private nuisance is one that disturbs the interest of some private individual, whereas the public nuisance disturbs or interferes with the public in general and is in violation of some penal statute, and hence is a crime.

"An owner of property, although conducting a lawful business thereon, is subject to reasonable limitations and must use his prop-

erty so as not to unreasonably interfere with the health and comfort of his neighbors, or to their right to the enjoyment of their property." Trade, business, and industrial activities are often nuisances by reason of their location, and liability is imposed even in the absence of negligence. For example, slaughterhouses, stables, chemical works, refineries, and tanneries, because of their offensive odors, may interfere with the peaceful enjoyment of property of adjacent landowners. Likewise, garages, filling stations, rock crushers, and skating rinks may be nuisances because of noise; factories and smelters by reason of the escape of noxious gases. Whether a particular trade, business, or industrial activity constitutes a nuisance depends upon the locality in which it is conducted and the nature and extent of the harm resulting from its operation. The principle of law here involved is the basis of the zoning ordinances by which cities regulate the location of business enterprises. Likewise, under the power of the state to protect health, morals, and general welfare of its citizens, known as police power, the legislature may declare what activities of a trade or business constitute a nuisance and may destroy or limit such activities.

Sec. 9. Privilege and justification.—A person committing a harm may be excused or have a justification by way of defense. Excuses or justifications that will deprive an act of its tortious character are (1) consent; (2) self-defense; (3) authority of the law given sheriffs, firemen, public health officials, and other special officers; (4) recapture of chattels by the true owner on the land of another; (5) abandonment of nuisances and military restraints. Likewise, one may have a defense in an action for tort because the injured party by his own conduct is guilty of contributory negligence, which conduct is as much the cause of the injury as the previous tortious conduct of the other person. A complete presentation of the law of torts is not here attempted. Two of the more frequent torts, trespass to goods and trespass to land, are discussed in the following sections.

Sec. 10. Trespass to goods.—Unlawful interference by one person with the property of another is a trespass. One is entitled to have exclusive possession and control of his personal property and may recover for any physical harm to his goods by reason of the wrongful conduct of another. Conversion is the wrongful disposition and detention of goods of one person by another. A party in possession of the goods of another, who upon demand wrongfully or for insufficient cause refuses to return the same, is guilty of conversion. Any exercise of dominion by another of the true owner's goods is a tortious act entitling the owner to recover either the goods or damages. For example, the wrongful sale of goods by a bailee, by an agent, or by a pledgee of goods is trespass to goods.

Sec. 11. Trespass to land.—The one in exclusive possession of land is entitled to enjoy the use of the land free from interference of others, either by direct interference or by indirect interference through instrumentalities placed upon the land. Entry upon the land of another is a trespass even though the one who enters is under the mistaken belief that he is the owner by purchase, or has a right, license, or privilege to enter thereon. Intention to enter or invade the premises of another without consent of the owner is a trespass. In absence of negligent conduct, no trespass is committed if a person or his goods are accidentally placed upon another's land; thus, property placed upon another's land without negligence on the part of the owner does not make the owner of property a trespasser.

At common law, the owner owns the air space above the land. Consequently, stretching telephone and high-tension wires above one's property without consent is a trespass. Whether airplanes flying over the land of another is a trespass raises some doubt. The interference with the right of exclusive possession is the basis of trespass. It is doubtful whether an owner of land has exclusive possession of the atmosphere above the land. The United States Air Commerce Act of 1926 and the Regulations of the Secretary of Commerce, 1928, as well as the Uniform State Law for Aeronautics, provide that the "navigable air space" above the "minimum safe altitudes of flight" shall be "subject to a public right of freedom of interstate and foreign air navigation." The Uniform State Law provides that "The ownership of the space above the land and waters of this state is declared to be vested in the several owners of the surface beneath, subject to the right of flight. . . . Flight in aircraft over the lands and waters of this state is lawful, unless at such a low altitude as to interfere with the then existing use to which the land or water, or space over the land or water, is put by the owner, or unless so conducted as to be imminently dangerous to persons or property lawfully on the land or water beneath." Landing aircraft on another's land is unlawful, except where a forced landing is necessary. Although such forced landing is not a trespass, nevertheless, the owner of the aircraft is liable for all damages caused by such landing.

Sec. 12. Law and equity.—The term "equity" is peculiar to Anglo-American law. Equity arose because of the failure of the law to give adequate and proper remedy. In early English law, the courts could not give remedies for injuries received unless the King's original writs covered the particular remedy sought. Consequently, the proceedings at law were so limited that it was often impossible to obtain justice in the King's Court.

In order that justice might be done, the person seeking a remedy

sought redress from the King in person. Since the appeal was to the King's conscience, he referred such matters to his spiritual adviser, the Chancellor. Such an individual was usually a church official, and in giving a remedy he usually favored the Ecclesiastical law and the Civil law.

By such method there developed a new system of procedure and new rules. Actions involving these rules were said to be brought in "Chancery" or in "Equity," in contradistinction to suit "at law" in the King's Courts.

Many rights not recognized in the common law were created and enforced. For example, trusts in lands were recognized; rescission was allowed on contracts created through fraud; injunction and specific performance were developed.

Law as a remedy gives only money damages, whereas equity gives the plaintiff what he bargains for. Thus, *A*, by contract, agrees to deliver to *B*, for a consideration, a very valuable article, something that cannot be duplicated. Upon *A*'s breach *B*'s only remedy in law is money damages, which are not adequate, because it is the specific article that *B* desires. In equity, however, *B* can, by specific performance, force *A* to deliver the article.

Again, if *A* persists in trespassing upon *B*'s land, *B*'s remedy in law is damages for injury done. *A* may pay the damages and trespass again. In equity, however, *B* may enjoin *A* from going on his land, and, if *A* continues, he is subject to arrest for contempt of court.

Further, a trustee, having legal title and the right to manage and control an estate, may sell the estate or employ it for his own use. By a bill in equity, however, the beneficiary may enjoin the trustee from further misuse and may force him to give an accounting.

In a few states, courts of equity are separate and distinct from courts of law. In most states the equity and law courts are organized under a single judge who has two dockets—one in law, the other in equity. Whether the case is in equity or law is determined by the remedy desired. Modern Civil Practice Acts have abolished the common law names heretofore used to distinguish different forms of actions at law and in equity. The first pleading in civil actions, whether at law or in equity, usually is called the "complaint." The first pleading by the defendant is called the "answer."

Review Questions and Problems

1. Give a definition of law. Is there law or the need of it where there is only one inhabitant in a locality?

2. What is the source of the common law? How are its principles derived? From what country did we receive it?

3. Distinguish between public and private law. Name three general classes of public law; private law.

4. Who are the parties in a criminal action; in a contract action?

5. What kind of crimes are burglary, arson, and rape; trespass, vagrancy, and petty larceny?

6. *A* receives a ticket from a traffic policeman for over-parking. Has he committed a crime?

7. Distinguish between the law of contracts, crimes, and torts.

8. *A* hits and slightly injures *B* during a friendly scuffle. Is *A* guilty of a tort? *A* throws a brick in a crowded street intending to break *B*'s window, but hits and injures *C*. Is *A* liable to *B* and *C*? Has *A* committed both a tort and crime?

9. *A*, a patent medicine manufacturer, without *B*'s permission, publishes an advertisement including *B*'s picture, with laudatory statements by *B* of the value of the medicine. *B* is a doctor. Is *A* liable to *B*?

10. *A* is invited as a guest to come upon *B*'s land. *C* without invitation enters *B*'s land with *A*. Is *C* a trespasser?

11. *B* has *A*'s permission to place his automobile upon *A*'s lot for three weeks. After three weeks have elapsed, *B* goes upon *A*'s lot to get his car. Is *B* guilty of trespass?

12. *A*, while engaged in blasting stumps upon his land, exercises every reasonable caution, places warning signs, and so forth. However, rocks and debris are thrown upon *B*'s adjoining land. Is *A* liable to *B*?

13. *A*, driving his car in a reckless manner, collides with *B*, causing *B*'s car to enter *C*'s yard, throwing out *D*, who lands in *C*'s yard, causing damage to *C*'s property. Is *A* liable to *B*? Is *B* liable to *C*? Is *D* liable to *C*?

14. *A* parks his car upon a dark street without parking lights. *B*, while negligently driving down the street, hits and damages *A*'s car. Has *B* a defense in an action by *A*?

15. *A*, an aviator, while flying above the prescribed statutory height above *B*'s land, is compelled because of engine trouble to land upon *B*'s property. Is *A* liable as a trespasser? In landing, *A* damages growing crops. What liability has the owner of the aircraft?

16. *A* has owned and operated for a number of years a smelter and foundry. A large residential district has developed near the factory. A small stream adjacent to the factory passes through a park created within the residential district. Pollution of this stream by the factory has become obnoxious to the residents. Fumes and noises from the factory are harmful and disturbing to the people of the vicinity. What remedy, if any, has a resident of the community against *A*?

17. Where did equity law have its origin? When are the laws of equity applicable? Who usually presides at the equity courts?

18. What is the written law? What forms the foundation of the written law?

Chapter II

THE COURTS

Sec. 13. Classification of courts.—The courts of the United States are created by the authority of the constitution, and their jurisdiction is limited by the grant of power given to the federal government by the states through the constitution. The constitution of the United States provides in Section 1, Article III, that "The judicial power of the United States shall be vested in one Supreme Court and in such inferior courts as the Congress may from time to time ordain and establish. The judges both of the Supreme and inferior courts shall hold their offices during good behavior, and shall, at stated times, receive for their services, a compensation which shall not be diminished during their continuance in office."

The Supreme Court of the United States, created by the constitution, is the court of last resort to which cases, upon proper question from the inferior courts, are appealed. The United States circuit courts of appeal are distributed geographically into ten federal jurisdictional circuits. Three judges usually occupy the bench of each of these courts. At present there are 48 circuit judges. These courts review cases appealed from the federal district courts. The trial courts of the federal judicial system are called the United States district courts. Each state in the union contains one or more federal districts, and each district has one federal district court and one or more district judges. At the present time, there are 84 federal districts and approximately 163 federal district judges. The judges in all federal courts are appointed by the President of the United States, by and with the consent of the senate.

The state courts, although not subject to uniform classification, for the sake of convenience may be grouped as follows: state supreme courts, or courts of higher appeal; courts of claim; intermediate courts of appeal; and trial courts. The trial courts may be further classified into circuit courts, municipal courts, county courts, probate courts, and justice of the peace courts. Courts in the latter classes are said to be courts of original jurisdiction, and may be further divided, depending upon the particular subject matter adjudicated. For example, the circuit courts in some states may hear damage suits as a civil or law court, criminal cases as a criminal court, and equity cases as a court of equity. In other states there may be separate and distinct courts which adjudicate

probate cases, such as the administration of estates, the relationship of guardians and wards, and so forth. The minor courts, such as the justice of the peace courts, have jurisdiction over cases involving small sums of money and minor violations of the law.

For an exact classification of the courts of any state, the laws of the particular state involved should be consulted.

Sec. 14. The jurisdiction of courts.—"Jurisdiction means the power given to a court by the constitution or the legislature to adjudicate concerning the subject and parties, to determine the cause, to render a judgment, and to carry such judgment into effect." For example, "probate courts shall have the original jurisdiction of all probate matters, namely, the settlement of estates of deceased persons, the appointment of guardians and conservators, the settlement of their accounts, the regulation of all matters relating to apprentices and the supervision of the sale of real estate of deceased persons for the payment of debts."

Sec. 15. Jurisdiction over the subject matter.—In order that a court may act, it must have jurisdiction over the subject matter coming before it. That is, the subject matter of the cause must come within the limits of the court. For example, a probate court would not have jurisdiction to determine questions of law involving a civil suit for damages. Likewise a court has certain geographical limits within which it must act. A circuit court in one county would have no jurisdiction to determine title to the land lying within the boundaries of another county. Likewise a court in one state would have no jurisdiction to hear a case upon an actionable cause arising in another state.

Courts are also limited in their jurisdiction as to the amount of money involved in the suit. For example, a "justice of the peace shall have jurisdiction in all actions on book accounts where the amount of the balance owing to the plaintiff shall not exceed $200."

Sec. 16. Jurisdiction over the person.—In order to render a binding judgment, a court must have jurisdiction not only over the subject matter, but also over the person of the defendant.

This jurisdiction is accomplished by a summons which issues out of the court in which the case is to be tried, and is delivered to the sheriff to be served upon the individual made defendant in the suit.

Every person sued is entitled to such notice, either by personal service or by publication, in order that opportunity may be given to defend.

The summons must be served within the geographical limits of the court, because the officers of one governmental unit have no authority to serve a summons outside their particular county or state. For example, a sheriff of a county in Illinois would have no author-

ity to serve a person in the state of Missouri. By statute in some states, a summons issuing out of an equity court in one county can be served by a sheriff of another county in the same state. In other instances the summons can be served only by the sheriff of the county in which the court sits and which is within its jurisdiction. If a person comes into the state or county, as the case may be, and is served with a summons by the sheriff, such person is then under the authority and jurisdiction of the court.

In case the defendant is a nonresident of the place where the suit is brought, service may be had by publication. This situation, however, does not give the court authority to render a personal judgment for damages. Accompanied by proper attachment proceedings, service by publication does bring under the court's jurisdiction all attached property of a nonresident which lies within the territorial limits of the court, so that such attached property is liable for the judgment debt and may be used to satisfy the judgment.

Review Questions and Problems

1. Name and classify the various federal courts. By what authority is the United States Supreme Court created? How does it differ from the lower federal courts?

2. Name four state courts. What jurisdiction does the justice of the peace court have?

3. Over what must the courts have jurisdiction in order to render a judgment? Has one court any jurisdiction over a matter arising in another county? May a court render a judgment against a person who is not found in the county?

CHAPTER III

COURT PROCEDURE

Sec. 17. Instituting suit.—A legal proceeding is initiated when the plaintiff files with the clerk of the court a complaint, a declaration, or a petition, as the case may be, depending upon the jurisdiction. This paper, called the "first pleading," has for its purpose the statement of alleged facts upon which the plaintiff rests his cause of action. The pleading indicates the remedy he desires and serves to inform the defendant of the nature of the lawsuit. Upon the filing of the complaint or petition, a summons is issued out of the office of the sheriff and served upon the defendant. Sometimes, particularly if the remedy sought is in equity, a copy of the complaint or petition is delivered to the defendant.

Suits at law or in equity under Modern Practice Acts are called "civil actions," as distinguished from criminal actions, proceedings in attachment, ejectment, eminent domain, forceable entry and detainer, claim and delivery, and other proceedings regulated by special statutes. Civil actions arising out of injuries to property or persons are called "tort actions," and suits for damages arising out of breach of contract are included within the term "civil actions." Suits which seek specific performance of contracts, bills for accounting against trust officers, also suits to prohibit injurious conduct and continuing trespass upon real property, are called "equitable actions."

Sec. 18. The summons.—The clerk of the court issues the summons, which the sheriff of the county serves upon the defendant.

The following is the usual form of a summons:

COURT SUMMONS

In the Name of the People of the State of Illinois. In the .... Court of .... County, Illinois.

John Doe
Plaintiff

vs. } No. ....

Richard Roe
Defendant

To the above named defendants:

You are hereby summoned to answer the complaint in the above entitled cause.

Take notice that you must file your answer or otherwise make your appearance in said court held in the court house in the city of ...., Illinois, on or before the first (or third) Monday in the month of ...., 19.., provided this writ shall be served upon you not less than 20 days prior to said date.

If this writ shall be served upon you less than 20 days before said date, you will file your answer or otherwise make your appearance in said court on or before the third (or first) Monday in the month of ...., 19...

If you do not appear according to the command of this writ, plaintiff may take judgment against you by default.

This summons must be returned by the officer or other person to whom it was given for service, with indorsement thereon with service and fees, if any, not later than 5 days after service thereof and in no event later than the date first above named.

WITNESS .... the clerk of said court and the seal thereof, at ...., Illinois, this .... day of ...., 19...

(Seal)

....
Clerk

Plaintiff's attorney (or plaintiff, if he be not represented by attorney)

....
Address

....

Sec. 19. Service of the summons.—The sheriff, upon receipt of a summons, proceeds at once to search out the defendant. The defendant must be served personally; that is, the sheriff must leave a copy of the summons with the defendant in person. A corporation is served with process when a copy of the summons is left with its president, if he can be found in the county in which the suit is brought; if the president cannot be found in the county, then service may be had if a copy of the summons is left with any agent of the corporation found in the county. The method of service is not always the same in the various states. In a few jurisdictions the summons may be left with an adult member of the defendant's household or with some person at the defendant's place of business.

A defendant may waive service of process and enter his appearance, or he may authorize his attorney to accept service for him. Such entry of appearance must be in writing and must be made a part of the record, in order that jurisdiction may be had over the person of the defendant.

Sec. 20. Return of summons.—A definite period of time is pre-

scribed by statute within which a sheriff must make service and return the summons to the clerk. For example, in some jurisdictions service must be had twenty days before the court convenes. Otherwise, the suit goes over to the next term for want of service. When the summons is served, the sheriff indorses in writing on the back of the summons when, where, and upon whom served, with a statement of his fees. This procedure is called the sheriff's "return."

Sec. 21. Judgment by default.—After the return of the summons by the sheriff, the court has jurisdiction over the person of the defendant. The defendant must show why judgment should not be entered against him. If the defendant fails to defend his case by filing proper pleadings, or fails to appear within a definite period of time, a judgment will be given against him for want of plea or of appearance. This judgment is called a judgment by default. The plaintiff may then proceed to prove his damages and to secure judgment for damages and costs. After proof, the court enters the amount of damages and costs upon the court docket, which stands as a judgment against the defendant as shown by the record of the court.

Sec. 22. Framing the issues.—As heretofore stated, the first pleading must clearly and accurately allege facts sufficient to give a right of action to the plaintiff. The purpose of such a pleading is to inform the defendant of the charge that the plaintiff has against him. The defendant's attorney, after studying the complaint, may choose one of several different ways to meet it. On motion to the court the defendant may object to the complaint, pointing out specifically its defects. If such defects be true, the court may dismiss the action or give the plaintiff an opportunity to amend. The defendant's attorney, through such motion, may admit all of the facts alleged in the complaint by arguing that those facts are not sufficient to give the plaintiff a cause of action. Such motion, formerly called a demurrer, raises a question of law, not a question of fact. If the court finds the complaint sets forth facts sufficient to give the plaintiff a cause of action, it will overrule the demurrer. The court will then grant leave to the defendant to answer the complaint, or, on the defendant's failure to do so, enter a judgment by default for the plaintiff. If the court finds, however, that the complaint fails to state facts sufficient to give the plaintiff a cause of action, the court will sustain the demurrer or motion and grant leave to the plaintiff to amend.

After the determination of the sufficiency of the complaint the defendant will file his pleading, called an answer, which answer may admit certain facts and deny others. By this process, called pleading, the issues of the suit are determined by arriving at some point

of law or fact, affirmed by one party and denied by the other party, by which the court and jury will know what questions of law and of fact are to be decided.

Sec. 23. The trial.—The issues having been framed, the case is ready for trial. The judge will set a day for the trial at which jurymen will be present, unless the parties agree to have the case heard by the court rather than by a jury. The jury is selected by the lawyers from the existing panel. The witnesses are then called, each one being sworn before testimony is received from him or her. No evidence will be permitted to come before the jury unless it has a direct bearing upon the issues as raised by the pleadings. The witnesses for the plaintiff are heard first; then the witnesses for the defendant are called. After all the evidence is in, the lawyers argue the case and try to convince the jury of the merits of their clients' positions. The court, at the close of the arguments, instructs the jury as to the law, whereupon the jury retires to make its decision. The foreman of the jury, usually the first person approved by both attorneys, reads a verdict, in some such form as follows: "We, the jury, find the issues for plaintiff [or defendant, as the case may be] and assess the damages that he is entitled to recover at ...... dollars."

During the trial the attorneys are careful to note any errors as to procedure, introduction of testimony, or instructions to the jury. Either of the attorneys may object to the introduction of certain testimony upon the theory that it is not pertinent to the issues. If the objections are overruled, the attorney will take an exception to the ruling of the court, and, upon an appeal to a higher court, will use such admissions of evidence as grounds for a reversal of the verdict. Likewise, exceptions may be made and appeal taken because of prejudicial statements made by the court or the attorneys, or for wrong instructions given to the jury.

Sec. 24. A suit in equity.—The first pleading in equity, as in law, is called a complaint. The chronological method of procedure in equity is similar to a suit at law. Equity suits arise when there is no adequate remedy at law.

Proof and hearings.—Usually a suit in equity is tried before the judge without a jury. By statute in some states a jury may be had to hear the evidence, such as in divorce cases. The verdict of the jury in these cases is advisory only, and is not binding on the court. The judge passes upon questions of both law and fact and may decide the case upon the bill and answer without the introduction of oral testimony. If the facts are voluminous and complicated, the judge often refers the case to another person, called a master, to take the testimony. This is the usual procedure where an ac-

counting is required. The master hears the evidence and reports back to the judge his conclusions of fact and law. Sometimes the master's duty is confined only to the hearing and reporting of testimony.

Decrees.—The decision of the court in equity is called a decree. A judgment in a court of law is measured in damages, whereas a decree of a court of equity is said to be "in personam"; that is, it is directed to the defendant, who is to do, or not to do, some specific thing.

If the remedy sought is not damages but some affirmative act on the part of the defendant, that is, specific performance of contract or other equitable remedy, and the defendant fails to file an answer, or if the filed answer is stricken and an amended answer is not filed within a period prescribed by statute, the plaintiff is entitled to a decree "pro confesso." Such decree is like a judgment by default in a court of law.

Decrees are either final or interlocutory. A decree is final when it disposes of the issues in the case, reserving no question to be decided in the future. A decree quieting title to real estate, granting a divorce, or ordering specific performance is final. A decree is interlocutory when it reserves some question to be determined in the future. A decree granting a temporary injunction, appointing a receiver, and ordering property to be delivered to such a receiver would be interlocutory.

Contempt of court.—Failure upon the part of the defendant to obey a decree of a court of equity is contempt of court. Any person in contempt of court may be placed in prison or fined by order of the court.

Sec. 25. Administrative law.—During the past two decades there has been a noticeable increase in the use of administrative boards and commissions to perform quasi-judicial functions. These agencies, created by legislative enactment, are charged with the administration of laws which are general in character. Such laws demand interpretation when applied to specific situations and, as a consequence, numerous hearings are held to determine the rights and duties of various parties who may be protected by or are subject to their provisions. Based upon evidence submitted to the administrative unit, appropriate orders are issued. These orders have the effect of law and may be enforced in courts and, in many instances at the request of an aggrieved party, may be reviewed by the courts.

The rules of procedure for hearings before such administrative bodies are usually formulated by them and are made available to those who may be interested in them. The hearings are often

somewhat informal in character, but on the whole they follow the pattern set by the courts in hearing and weighing evidence, as well as in the initiation of the action. A hearing normally originates with the filing of a petition or complaint, and the interested parties are then notified that a hearing will be held at a stated time, that the interested parties are given an opportunity to file pertinent documents in the interim, and that they will have an opportunity to present evidence at the time of hearing.

As in equity cases, the board often appoints a person to conduct the hearing, listen to the evidence, submit his findings of the facts, and make his recommendations to the board regarding the disposition to be made in the case. The board studies the report and issues such orders as the law in the case appears to demand.

The rules of procedure differ as between the various administrative agencies, and any interested party should obtain a copy of them before enlisting the aid of a particular board. It should be emphasized that the goal of such boards, including the utility commissions, labor boards, and trade commissions, is to see that a general law which controls a certain area of economic activity is complied with, and that the boards may adopt whatever reasonable procedure for hearings best accomplishes that objective.

Review Questions and Problems

1. What is the first step in a suit at law? What is a court summons? Who serves it? Must he find the party served?
2. What is meant by a judgment by default or a decree "pro confesso"?
3. What is meant by the term "framing the issues"? Describe the steps used in framing the issues.
4. What relationship exists between the framing of the issues and the introduction of evidence? Why?
5. What may the party do against whom the court has sustained a motion by way of demurrer? Who renders the verdict?
6. What is the difference between a final and an interlocutory decree in a court of equity?
7. What is administrative law and who administers it?

Book I

CONTRACTS

CHAPTER I

NATURE OF A CONTRACT

Sec. 1. Introduction.—The law of contracts forms the oldest branch of the law relating to business or to commercial transactions. In one form or another it has existed from the beginning of organized society. Just as the safety of person and of property depends upon the rules of criminal law, so the security and stability of the business world are dependent upon the law of contracts. Although not recognized as such, many contracts are formed daily by the average person. The acceptance of an order for groceries, the dropping of money in the coin box on a bus, the purchase of a ticket to a theatre, or the formal signing of an agreement to purchase a residence constitutes the formation of a valid and binding contract.

Furthermore, the law of contracts furnishes the foundation for the other branches of commercial law. The laws of agency, suretyship, sales, negotiable instruments, corporations, and partnerships are all superimposed upon the general principles of contract law. In a sense they are only specialized fields of contracts. They relate to particular types of agreements about which have grown up special bodies of contract law necessitated by the peculiar conditions surrounding them. For these reasons a study of the general rules of contract law naturally precedes the invasion of any other field.

Sec. 2. Classification.—Contracts may be classified as follows:

1. Formal and informal.
2. Executed and executory.
3. Express and implied.

Sec. 3. Formal and informal contracts.—History indicates that during ancient times promises were not enforceable unless they were accompanied by some prescribed formality. The early English law enforced only promises that were written, signed, and sealed. The seal consisted of a waxen impression which was attached to the writing immediately following the signature. It is only during the last few centuries that the doctrine of consideration has been developed to such an extent that strictly informal agreements are recognized. Today, not even a writing is required for the formation of a binding contract except as state statutes, usually designated as the Statute of Frauds, require certain agreements to be evidenced by writing. It may be written or oral at the pleasure

of the parties, although certain advantages are attached to the written agreement. By the law of most states, deeds and recognizances must still comply with certain formalities. The signature is followed by the signer's seal, which in many instances has been reduced to a mere "L. S.," denoting "place for seal."

Sec. 4. Executed and executory contracts.—An executed contract is one which has been fully carried out by the contracting parties. An executory contract is one which is yet to be performed. An agreement may be executed on the part of one party and executory on the part of the other. Thus, a contract for the purchase of a suit of clothes on credit, followed by the delivery of the suit, is executed on the part of the dealer and executory on the part of the purchaser.

Sec. 5. Express and implied contracts.—All the terms of a contract may be definitely expressed in the verbal or the written agreement between the parties. Such an agreement results in an express contract. An implied contract, in fact, is one which is implied largely from the conduct and actions of the parties. The entire agreement may be a matter of implication; or some understanding may exist without any definite agreement as to certain major terms. In such a case the terms are implied from the surrounding circumstances.

The term "implied contracts" is also used to denote situations in which the courts imply a contract in law, regardless of the intention of the parties. If some benefit has been received by one party at the expense of another, the court often compels the recipient to pay a reasonable amount for the benefit received. This is true, although the parties had no intention of entering into a contract. These obligations implied by law are properly designated "quasi contracts." Technically, implied contracts are only those which are enforced because the parties by their conduct have exhibited an intention to contract.

Sec. 6. Elements of a contract.—A contract has been defined as "an agreement enforceable by law." A more complete definition follows: A contract is an agreement between two or more competent persons, having for its purpose a legal object, wherein both persons agree to act or to refrain from acting in a certain manner. This definition breaks up logically into four component parts:

1. Agreement—offer and acceptance.
2. Competent parties.
3. Legal object.
4. Mutuality—consideration.

These elements are all essential in an enforceable agreement. They will be considered in detail in the chapters which follow, although not in the particular order in which they have been mentioned.

Review Questions and Problems

1. Give a definition of a contract.
2. Are contracts of frequent or of infrequent occurrence?
3. Name the essential elements of a contract.
4. What is the difference between a formal and an informal contract?
5. What is the true meaning of an implied contract?
6. Must a contract be in writing?
7. When is a contract executory?

CHAPTER II

OFFER AND ACCEPTANCE

Formation of an Offer

Sec. 7. Definition.—As noted in the previous chapter, one of the first steps in the formation of any contract lies in arriving at an agreement between the contracting parties. This agreement is sometimes spoken of as a meeting of the minds, but is more commonly known as offer and acceptance. An agreement can be reached only after one of the parties has made a definite proposal to the other. Such a proposal constitutes an offer.

An offer is the communication by one party, known as the offeror, to another party, called the offeree, of the former's willingness to act or to refrain from acting along certain lines, if the latter will act or refrain from acting as requested.

Sec. 8. Communication.—No offer becomes effective until it has been communicated to the offeree.[1] The mere desire to enter into an agreement, which remains hidden in the recesses of one's mind, can never constitute an offer. The writing of a letter embodying a definite proposition will also prove futile unless the letter is mailed and reaches the offeree.

An offer must be communicated by the offeror or his duly authorized agent. If the offeree learns of the offeror's intention from some outside source, no offer results. It must be communicated through the medium or channel selected by the offeror.

An offer to the public may be made through the newspapers or the posting of notices, but it is not effective so far as a particular individual is concerned until he learns that the offer has been made.

Sec. 9. Meeting of minds.—It is generally said, although the statement is subject to qualification, that no agreement is effective unless the minds of the contracting parties have met on the subject matter of the contract. If Jones offers to sell his used Chevrolet car to Brown for $75 and Brown agrees to buy it, no contract results in case Jones, who has two such cars, was thinking of one, while Brown had in mind the other. The rule that the minds of the parties must be in accord is limited in one important respect; namely, the intention of the parties is to be determined by their individual conduct—and what it leads the other party reasonably to believe—rather than by their innermost thoughts, which can be

[1] Broadnax v. Ledbetter, 1907, 100 Tex. 375, 99 S.W. 1111; p. 471.

known only to themselves. Thus, if *A* signs an agreement to purchase a certain gold watch for $50 from *B*, the agreement is binding although *A* later testifies that he never actually intended to purchase it. By his conduct he led *B*, as a reasonable man, to think that he would purchase it. Such conduct is all that the law requires.

Offers clearly made in jest or under the strain or stress of great excitement are usually not enforced, because one is not reasonably justified in relying on them.

The courts hold the minds of the parties to have met when a written agreement is signed. Each person who signs a written document with the idea of entering into contract is presumed to know the contents thereof. Since the act of signing manifests a person's intention to be bound by the terms contained in the writing, he is in no position at a later date to contend effectively that he did not mean to enter into the particular agreement. All contracts should be read carefully before they are signed.

Sec. 10. Offer must be definite.—Not all communications that invite future business transactions take the form of offers. Many of them are of a preliminary nature and are issued for the purpose of inducing an offer from others. Within this class of communications fall most of the catalogues, circulars, and advertisements issued by commercial houses.[2]

The chief reasons why such information is not deemed to constitute an offer are that it is indefinite as to many important terms and it indicates no intention to enter into a contract with every person receiving it. An offer must be definite. Because of this rule, many courts have made the statement that a mere quotation of price does not constitute an offer. Something which indicates a willingness to contract with a particular party at the prices quoted must accompany the quotation of price, and enough must be stipulated to enable a court at some later date to determine whether the contract has been performed by the parties in case a controversy develops. General statements which do not include quantities, terms, and prices are usually inadequate unless it is clear that they may be implied.

An advertisement may constitute an offer, but to do so it must be very definite in form and must set forth clearly the proposed terms of the agreement.

Sec. 11. Auctions and advertisements for bids.—When articles are sold at public auction, the offer is said to be made by the bidder and accepted by the seller at the drop of the auctioneer's hammer. Because of this rule, the seller can withdraw his article from sale

[2] Montgomery Ward and Co. v. Johnson, 1911, 209 Mass. 89, 95 N.E. 290; p. 471

at any time during the auction. Likewise, the purchaser may withdraw his bid at any time before the auctioneer has concluded the sale. In a few states, where an auction sale is advertised to be held "without reserve," the seller may not withdraw his property but the bidder probably has the right to withdraw his bid.[3]

When one advertises that bids will be received for construction work, it is held that the advertiser makes no offer but that the party who submits a bid is the offeror. The one calling for the bids may reject any or all of them. The same is true of public construction. Although the statutes of many states provide that public work must be let to the lowest and best bidder, most courts hold that all bids may be rejected. However, in these states, any contract for public work which is consummated must be let to the lowest responsible bidder.

Sec. 12. Tickets.—Tickets purchased for entrance into places of amusement or as evidence of a contract for transportation often contain small printed matter which attempts to limit or define the rights of the holder. Some conflict exists relative to the effectiveness of these stipulations, but it is generally held that they become a part of the offer and are accepted by the holder if he is aware of the printed matter even though he does not read it. There are some cases, such as those involving steamship tickets, in which the purchaser is presumed to know about the printed matter even though his attention is not called to it at the time the ticket is delivered.

If a ticket is received merely as evidence of ownership and is to be presented later as a means of identification, the provisions are ineffective unless the recipient's attention is directed to them at the time the ticket is accepted. Thus, tickets given at checkrooms or repair shops are received usually as a means of identifying the article to be returned rather than with any idea of the ticket embodying the terms of a contract.

Finely printed material found on the back of written contracts or on letterheads which is not clearly embodied in the terms of the contract by reference thereto does not form a part of the agreement. If it is desired to make it part of the agreement, some reference should be made to it in the body of the writing. Where attention is called to the fine print, the provisions are not always enforceable as they often attempt to relieve public utilities and carriers of responsibility for their own carelessness. Further discussion of this is deferred until the material dealing with illegal contracts is considered.

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[3] McPherson Bros. Co. v. Okanogan County, 1907, 45 Wash. 285, 88 Pac. 299; p. 472.

Duration of Offer

Sec. 13. Duration.—An offer that has been properly communicated continues as such until it lapses, or until it is revoked, rejected, or accepted. The offeror is considered to be continually renewing the offer until one of the above takes place.

Sec. 14. Offer lapses after reasonable time.—An offer does not remain open indefinitely, although the offeror fails to withdraw it. If the offer stipulates the period during which it is to continue, it automatically lapses at the end of that period. An attempted acceptance after that date could only amount to a new offer being made by the offeree of the original offer. An offer which provides for no time limit remains open for a reasonable time—a reasonable time being such period as a reasonable person might conclude was intended. Whether an offer has lapsed because of the mere passage of time is usually a question of fact for the jury to decide after it has given proper weight to all surrounding circumstances. One of the most important factors to be considered in such a case is the nature of the property. An offer involving property which is fluctuating greatly in value remains open a relatively short time in comparison with property of a more stable character.[4] Other facts that should be given weight are: the circumstances under which the offer is made, the relation of the parties, and the means used in transmitting the offer. An offer made orally usually lapses when the parties involved separate. It remains open thereafter only when the offeror clearly indicates that the matter may be considered further by the offeree.

Sec. 15. Death or insanity.—The death or the insanity of the offeror or the offeree causes an offer to lapse. This statement is true even though the other party has no notice of the death. An offeror cannot continue to make an offer after his death; neither can an offeree accept an offer after death. At the time the contract is consummated, both parties must be capable of entering into the agreement. It should be emphasized at this point, however, that the death or the insanity of one of the parties does not cause a rescission of a contract which has previously been formed.

To illustrate, let us assume that Adams offers to sell to Barnes a certain farm for $5,000. Barnes, unaware of Adams' death, mails his acceptance and then enters into a contract with Curtiss to sell the property at a profit. Adams' estate is under no duty to convey the property to Barnes, because the offer automatically lapsed upon the death of Adams. Had the acceptance become effective

[4] Minnesota Linseed Oil Co. v. Collier White Lead Co., 1876, Fed. Cas. No. 9, 635, 4 Dill. 431; p. 473.

before the death of Adams, the estate would not have been relieved of its duty to make a conveyance of the property, since death does not ordinarily excuse one from performing a contract previously made.

Sec. 16. Revocation.—An offer may be revoked by the offeror at any time before it has been accepted, despite the fact that the offeror may have informed the offeree of his willingness to hold it open for a definite period of time. So long as it is a mere offer, it can be withdrawn whenever the offeror desires.[5] This rule applies, even though the offer expressly stipulates that it may not be withdrawn without the consent of the other party.

The revocation of an offer becomes effective only when it has been communicated to the offeree. The mere sending of a notice of revocation is insufficient. It must be received by the offeree. Communication of the revocation differs from that of the offer, since, in the case of revocation, notice of any kind is sufficient, even though it is received in an indirect manner or from some party not an authorized agent of the offeror. Knowledge from any source of an act on the part of the offeror which shows his intention to revoke the offer is sufficient. To illustrate: An offeree, who learns from a neighbor of the offeror that a farm offered for sale has been sold to a third party, cannot now accept the offer. The offer is revoked as soon as the offeree learns of the sale, regardless of the source of his information.

Sec. 17. Revocation of public offers.—It would be impossible for the offeror of a public offer to give personal notice of revocation to all persons who may have learned of the offer. Because of this fact, the offeror may withdraw his offer by giving the same general publicity to the revocation as he gave to the offer. Thus, a public offer made through the newspapers in a certain locality may be withdrawn through the same medium. As a result, it is possible for such an offer to be withdrawn without the offeree's having learned of the withdrawal.

Sec. 18. Option contracts.—An option contract consists of an agreement to hold an offer open for a definite period of time upon the payment of a certain sum of money by the offeree. In such a case the offer cannot be withdrawn until the option period expires. The offer is no longer a mere offer but has been transformed into a contract of option, and is based upon a consideration given by the offeree. If the offeror receives no compensation for his promise to hold his offer open for a certain time, it can be withdrawn by him at any time he desires by giving notice.

[5] Bosshardt & Wilson Co. v. Crescent Oil Co., 1895, 171 Pa. St. 109; p. 474.

Sec. 19. Rejection.—Rejection by the offeree causes an offer to lapse, even though the original offer was to have remained open for a longer period. The offeree cannot, after his rejection, change his mind and accept the offer. An attempt to do so will, at best, amount to a new offer, which must be accepted by the original offeror.

An attempted acceptance which varies in any particular the terms of the offer is in effect a rejection of the offer. Such an acceptance is deemed a counteroffer, which may or may not be accepted by the party making the original offer. By making a counteroffer, one impliedly rejects the original offer,[6] unless the offeree uses language which makes it clear that he is still considering the original offer. A counteroffer is a rejection only because it implies that the original terms are not acceptable to the offeree.

An acceptance embodying terms other than those contained in the offer should be distinguished from a mere request for additional information. This distinction is especially necessary where the request for further information suggests that the original offer is still being considered. Thus, an offer to sell two thousand steel fence posts at $30 a hundred would not be rejected by an inquiry which requested a price on one thousand posts. If, however, the offeree had ordered one thousand posts at $30 a hundred, the offer would have lapsed.

Rejection of an offer is not effective until it has been communicated to the offeror.[7] Such communication must be carried directly by the offeree or his chosen agent, and is not effective until it reaches the offeror.

Acceptance

Sec. 20. Definition.—An agreement consists of an offer by one party and its acceptance by the person or persons to whom it is made. As an unaccepted offer hangs in large measure like a suspended question, the acceptance should be a positive answer to that question. The offeror, in effect, says, "I will sell you this article for two hundred dollars. Will you buy it?" The acceptor answers the question in the affirmative. An acceptance is an indication by the offeree of his willingness to be bound by the terms of the offer. It may, if the offer permits, take the form of an act, the signing and delivering of a written instrument, or of a promise communicated to the offeror.

Sec. 21. Acceptance of unilateral offer.—Contracts are either unilateral or bilateral in nature, depending upon whether the offer

[6] Morrison et al. v. Parks, 1913, 164 N.C. 197, 80 S.E. 85; p. 475.

[7] Diebel v. Kaufman, 1945, (Ohio App.) 62 N.E.(2) 770; p. 476.

must be accepted by an act or whether a promise to perform will create the contractual relation. A unilateral offer is one which, by its language and surrounding circumstances, indicates that it may be accepted only by completion of the particular action requested. A bilateral offer, on the other hand, ripens into a contract when the offeree indicates his willingness to perform. Most agreements are of the latter class, and, in case an offer is ambiguous, the courts tend to construe it as bilateral. The fact remains, however, that a sizable portion of our contracts are unilateral in form. The offeror in such cases does not require, in fact does not desire, a promise or assurance of performance, but insists on completion of the act requested before a contract is created.

Since a unilateral offer is not accepted until completion of the task assigned, the offeror is at liberty to withdraw his offer at any time prior to final performance. If the offeree has incurred expenses preparatory to carrying out the terms of the offer or in partially completing the act requested, he has no recourse against the offeror unless the work done has proved of benefit to the offeror.[8] In the latter case he must be paid the value of the benefit conferred. Acceptance of a unilateral offer becomes effective as soon as completion of the act is effected. Notice of completion need not be given to the offeror, since it is assumed that knowledge of performance will be readily available to him.

To distinguish further between these two types of contracts, let us consider the following typical situations. A hardware merchant is approached by a salesman of a manufacturer and signs a purchase order for certain goods, the order being subject to the approval of the manufacturer's home office. The acceptance is effective as soon as that approval has been communicated to the dealer, because the offer was bilateral in nature, suggesting that it was to be accepted by a promise to ship. Until notice of approval is received, the offeror is at liberty to withdraw his offer. On the other hand, if we assume a dealer is immediately in need of several items of merchandise and mails a letter to a certain concern asking for immediate shipment of the articles listed, a unilateral offer has doubtless been made. Acceptance takes place as soon as the goods are placed with a common carrier for shipment, even though the buyer has no knowledge of that fact. Until they are placed with the carrier, however, the buyer is free to withdraw his order in spite of the fact that the manufacturer has incurred certain expenses in anticipation of delivery. In general, no contract is created until the act requested in the unilateral offer has been fully performed.

[8] Butcher's Advocate Co. v. Berkhoff et al., 1916, 158 N.Y. Supp. 160, 94 Misc. 299; p. 477.

Sec. 22. Bilateral offer.—A bilateral offer is accepted by a promise to do the things requested in the offer. The promise must be communicated to the offeror and may consist of any conduct which unequivocally evinces an intention to be bound by the conditions prescribed in the offer. Such intention must be brought to the attention of the offeror. The acceptance may take the form of a signature to a written agreement or a nod of the head. No formal procedure is required by the laws of acceptance. If the offer is made to a group of people in the aggregate, the acceptance is not complete until each person of the group has indicated his acceptance. Until then the offeror is at liberty to withdraw.

Where the agreement takes the form of a written instrument, the acceptance is effective only when the document has been signed and delivered, unless it was clearly the intention of the parties that the earlier verbal agreement be binding and that the writing act merely as a memorandum or better evidence of their oral contract.

Sec. 23. Silence as assent.—The offeror cannot force the offeree to speak. In most cases, therefore, mere silence never amounts to acceptance, although the offeror in his offer may have suggested that such be the case. A previous course of dealing between the parties, or the receipt of goods under certain circumstances, might well raise a duty upon the part of the offeree to speak in order to avoid contractual relationship.[9] Mere silence *of itself* never constitutes an acceptance.

Sec. 24. Acceptance by offeree.—Only the person to whom the offer is made can accept the offer.[10] An offer cannot even be assigned to a third party. Quite often goods are ordered from a firm which has discontinued business, and the goods are shipped by its successor. In such case the offeror is under no duty to accept the goods. If he accepts the goods knowing that they were shipped by the successor, he then impliedly agrees to pay the new concern for them.

Offers to the public may be accepted by any member of the public who is aware of the offer.

Sec. 25. Acceptance must follow offer.—The acceptance, in order to be effective, must conform to the terms of the offer. If the acceptance contains any new terms or conditions, or if it varies in any manner the terms of the offer, it becomes a counteroffer and therefore rejects the original offer. The mere addition of a request for a favor or of a condition which does not in any way qualify the legal effect of the offer will not affect the acceptance. A stipulation

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[9] Hendrickson v. International Harvester Co., 1927, 100 Vt. 161, 135 Atl. 702; p. 478.

[10] Boston Ice Co. v. Potter, 1877, 123 Mass. 128; p. 479.

in the offer relating to place, time, or manner of acceptance must be strictly complied with by the offeree.

Sec. 26. Time of taking effect.—As noted before, the acceptance of a unilateral offer takes effect as soon as the act requested is completed. The acceptance of a bilateral offer becomes effective as soon as it is communicated to the offeror. Communication is effected in most states as soon as the offeree places his acceptance with the means of communication used or suggested by the offeror. The contract is formed at that time. Thus, if the offeror transmits his offer by mail, the acceptance is complete as soon as it is properly addressed, stamped, and placed with the postal authorities. An offer dispatched by telegram is accepted as soon as the reply is handed to the telegraph company. In other words, if the offeree transmits his acceptance by the mode of communication which the offeror uses, the acceptance is complete as soon as it is deposited with that agency. In case the offeror stipulates the means of communication to be used in response to his offer, the acceptance will be effective at the date of delivery only if the acceptance is delivered to the stipulated agency.[11] If no mode of communication is held out by the offeror, the offeree is at liberty to use the mails.

The ultimate effect of these rules is to place upon the offeror any possible loss resulting from misconduct on the part of his communicating agency. Thus, a contract exists, although a letter of acceptance is lost in the mails. The offeror, in such cases, is duty bound to perform, even though he may have entered into other contracts as a result of his failure to receive a reply. He can avoid this result only by stating in his offer that the acceptance shall be ineffective until it is actually received by him.

An offer is effective even though it be delayed in reaching the offeree. Since the delay normally results from the negligence of the offeror's agent or his chosen means of communication, he should bear the loss resulting from the delay. However, if the delay is apparent to the offeree, his acceptance will be good only if it reaches the offeror within a reasonable time after the offer would normally have been received.

Sec. 27. Effective when received.—The transmission of an acceptance by some agency other than the one held out by the offeror does not affect the validity of the acceptance. Its effectiveness is merely postponed until the time of delivery to the offeror. In such a case the offeree accepts the risk of delay or of failure to deliver. If an offer stipulates that the acceptance must be received, the date of acceptance is delayed until it reaches the offeror.

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[11] Lucas v. Western Union Telegraph Co., 1906, 131 Iowa 669, 109 N.W. 191; p. 480.

Sec. 28. Implied.—A contract may be implied from the conduct of parties, as well as from their language. One who knowingly receives a benefit at the expense of another under such circumstances as to negative the possibility of a gift immediately assumes an obligation to pay an amount equal to the reasonable value of such benefit; however, no promise can be implied from his conduct if he is unaware that the benefit is being conferred. To illustrate the latter point: *A*, by mistake, during the absence of *B* on a fishing trip, makes repairs on *B*'s residence. *B*, upon his return, is under no duty to pay for such repairs, even though he has been benefited. No promise, in fact, can be implied from his conduct.

Review Questions and Problems

1. Define the term "offer." Why is it essential to the formation of an agreement?

2. One *L* lost a mare and publicly offered a reward of $150 to the finder. *R*, not having learned of the reward, found and returned the mare to the owner. May *R* recover the reward?

3. What factors must be considered in the determining of the duration of an offer?

4. *A* offered to sell his house to *B* for $5,000. *B* offered to give him $4,500, which *A* refused to accept. Later, *B* tendered *A* $5,000, which was refused. Had the offer been rejected before the tender?

5. How is a public offer revoked?

6. *A* offered, on March 13, to sell his grocery store to *B* for $3,000. On March 15 *B* mailed his acceptance, which reached *A*'s office on March 18. On March 17 *A* died. May *A*'s executor recover from *B* in case he fails to perform?

7. How is a unilateral offer accepted? May such an offer be withdrawn after the offeree has started to perform?

8. *A* wrote a letter to *B* and offered to sell *B* a certain diamond ring for $300. He added that unless he heard from *B* within the next ten days, he would conclude that *B* had accepted. *B* failed to make any reply. Was there a contract?

9. *A* advertised for bids on a certain construction job. *B* submitted the lowest bid. *A* wrote to *B*, saying: "You are the lowest bidder. Come on down." Was this an acceptance of the bid?

10. *G* offered to sell a carload of oats to *P* at 42 cents a bushel. *P* wired his acceptance and added that the city scale weights should be accompanied by an affidavit. Was this an effective acceptance?

11. Can there be an implied contract in fact without the recipient's knowingly receiving the benefit?

12. A certain school board advertised for bids on a new high-school building. A statute in that state provided that all contracts for public works should be let to the lowest and best bidder. *A*, a responsible bidder, submitted the lowest bid, but the board rejected all of the bids. Has *A* a good cause of action against the school board?

CHAPTER III

CONSIDERATION

Sec. 29. Definition.—During the early history of contracts some formality was required to accompany a promise before the courts would enforce it. This feature early took the form of a waxen impression, which followed the promisor's signature, and was known as a seal. Although the seal is now a mere scroll, or L.S., it is still required in certain cases. The doctrine of consideration, which made possible the enforcement of an oral promise, originated during the fifteenth century. This doctrine was gradually developed until such time as it practically supplanted the use of the seal. In a few states the seal is still effective as a consideration for the purpose of giving effect to a promise, although by legislative enactment in the majority of the states the seal is merely presumptive evidence of consideration. Generally speaking, therefore, consideration is a requisite of all contracts. In order that the promisee may enforce the promisor's promise, the promise itself must be supported by some consideration.[1]

To illustrate, if *A* merely promises to make a gift of $500 to *B*, the promise will not be enforced by the courts; *B* has furnished no consideration to support it. In other words, there must be mutuality—each party doing or agreeing to do something.

Consideration has been defined in various ways. It may be something of detriment to the promisee or of benefit to the promisor. Perhaps the most satisfactory definition is: Consideration constitutes the waiving of, or a promise to waive, a legal right at the request of another.[2] It is, in reality, the price which the offeror demands for agreeing to carry out his part of the contract.

Sec. 30. Adequacy of consideration.—The value of any given consideration is usually unimportant. So long as the promisee gives the consideration demanded by the promisor, the courts are satisfied. Although the act requested is of little value, and the promise given is relatively of much greater value, the courts seldom give any attention to that fact, except as it may be some evidence of fraud. Nevertheless, it should be borne in mind that a promise unsupported by any consideration and which exacts no action or promise by the promisee is unenforceable. Some consideration must exist. A promise in the nature of a gratuity is unenforceable.

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[1] Sandelli v. Duffy, 1944, 131 Conn. 155, 38 A.(2) 437; p. 481.

[2] Hamer v. Sidway, 1891, 124 N.Y. 538, 27 N.E. 256; p. 481.

The mere fact that the recipient of the proposed gift must take certain steps to place himself in a position to receive it cannot be substituted for consideration. If, however, the promisee is requested to act in a certain manner, and the action is considered to be the price paid for the promise, the taking of such action as is requested will function as consideration.

A gift, once it has been executed, cannot be set aside by the donor because of the lack of consideration. Once a gift has been completed, the property involved belongs to the donee.

Sec. 31. Payment of a lesser sum.—There is one exception to the general rule relating to the adequacy of consideration. If the consideration on each side involves money—money given to satisfy a money debt or to support a promise to pay money in the future—the consideration given must equal in value the promise made. Because of this rule an existing debt which is due cannot be settled by doing no more than making payment of, or promising to make payment of, less than the amount owing. Although a creditor agrees to receive half of the debt in full satisfaction thereof, he may later reject the proffered payment and bring suit for the full amount. He may also accept the partial payment and later sue for the balance unless the debt has been discharged by some other rule of law.

Where the debt consists of a note or written agreement, the cancellation and return of the evidence of indebtedness will act to discharge the debt. There are also a number of cases to the effect that, if the partial payment is accompanied by a receipt in full for the account, an executed gift is made of the unpaid balance. This is particularly true where the receipt or writing indicates in some way an intention to make a gift of the unpaid portion.

Sec. 32. Lesser sum and other consideration.—Payment of a lesser sum, where accompanied by additional consideration, will discharge a larger sum. Since the value of consideration is ordinarily unimportant, the added consideration may take any form. Because the general rule recorded in the previous section has proved to be unpopular, the courts have seized upon almost any act as supplying the needed consideration. Payment in advance of the due date, payment at a place other than that agreed upon, surrender of the privilege of bankruptcy, and the giving of a *secured* note for less than the face of the debt have all been found sufficient to discharge a larger amount than that paid.

The mere giving of a negotiable note for a lesser sum than the entire debt will not release the debtor of his duty to pay the balance. The note is merely a promise to pay, and consequently the mere promise to pay less than is due will not discharge the debt.

Sec. 33. Disputed claims.—In a controversy between two parties over the amount of indebtedness owing, it is possible to compromise at any figure which is not less than both parties admit to be correct.[3] That is, if *A* denies that he owes over fifty dollars, while *B* insists that *A* owes him one hundred dollars, a settlement at fifty dollars or more is binding. Even though at a later date *B* offers convincing evidence that the amount was in excess of the agreed figure, no recovery can be had. The consideration for *B*'s promise to settle for less than one hundred dollars was *A*'s surrender of the right to enter court in an attempt to reduce the figure below that amount.

Sec. 34. Composition of creditors.—When all of the creditors agree with each other and with their debtor to accept a certain percentage of their claims in full satisfaction thereof, the agreement is binding. This combined agreement is known as a composition of creditors and bars them from enforcing the balance of their claims. Under our Bankruptcy Act a composition of creditors may take place before or after bankruptcy proceedings have been instituted.

Sec. 35. Gratuitous promises.—A mere promise to give a sum of money to some worthy or charitable cause is unenforceable. It is not supported by any consideration. In order to avoid the harsh effect of this rule, the courts have grasped at various theories which would enable them to enforce the promise. The majority of the courts today enforce such promises as soon as the beneficiary of the promise has incurred liabilities in reliance upon the promise.[4] The offeror may, however, withdraw his offer at any time before obligations have been incurred in reliance thereon. Only those gratuitous promises which are made for a definite purpose are thus enforceable. A promise to make a gift of a thousand dollars to an individual would not be enforceable, although the latter did incur liabilities in reliance thereon.

Some states enforce gratuitous promises when other promises are made at the same time, especially where the paper signed provides that each promise is made in consideration of the promise of the other parties appearing thereon.

Sec. 36. Performance of contractual obligation.—An agreement which offers for its consideration the performance of an existing contractual duty by one of the parties is unenforceable. Performance by the promisee is nothing more than the courts would compel him to do. He has waived no legal right. Hence, an owner who promises a contractor an additional sum, provided the contractor completes a job already contracted for, is not legally bound

[3] Nardine v. Kraft Cheese Co., 1944 (Ind. App.) 52 N.E.(2) 634; p. 483.
[4] Furman University v. Waller et al., 1923, 124 S.C. 68, 117 S.E. 357; p. 484.

to pay the additional sum. If, however, the promisee agrees to do anything other than or different from what the original contract demanded, ample consideration is provided. Therefore, the contractor who agrees to complete his work at a different date or in a different manner may always recover on a promise of the owner to pay an additional amount. Furthermore, the cancellation of the original contract and the formation of an entirely new agreement is always possible.

Some conflict exists concerning those cases in which the promisee is under a duty to perform for some third party. The majority of the courts hold that a promise made to a third party to perform an existing contractual obligation offers no consideration. Thus, a promise by a third party to a contractor to pay an additional sum upon the latter's completion of a certain construction job is unenforceable, although the contractor executes his contract, when otherwise he would have refused to perform. Here also, if anything new or different is requested, the contract becomes binding because of the new consideration.

Sec. 37. Unforeseen difficulties.—A promise to pay additional compensation for the completion of a contract is usually deemed binding where unforeseen difficulties were encountered after the original agreement was entered into.[5] In such a case the result is most often justified on the theory that in effect the parties rescinded the old agreement, because of the new circumstances, and formed a new one. Even in such cases, however, it is safest for the contractor—the party under duty to perform—to have some new consideration provided for or to rescind the old agreement and execute a new one. Unforeseen difficulties are those which seldom occur and are extraordinary in nature. Price changes, strikes, bad weather, and shortage of material are not unforeseeable. However, even though difficulties are unforeseen, the promisor is obligated to perform at the original contract price unless the other party indicates a willingness to make an adjustment.

Sec. 38. Performance of statutory duty.—The performance of some duty imposed by statute will not constitute a valid consideration for another's promise. Thus, a promise to appear as a witness at a trial, or an arrest, or a promise to make an arrest, by a public officer, will not support a promise to pay money therefor. If the party promises to go beyond what the law demands, then he has waived a legal right and consideration has been given.

Sec. 39. Forbearance to sue.—Forbearance to sue, or a promise to forbear, where requested, will support a promise by another. Surrender of the right to bring suit acts as the consideration.

[5] Linz v. Schuck, 1907, 106 Md. 220, 67 Atl. 286; p. 485.

Should the promisor want assurance that the promisee will not institute legal proceedings, there must be a promise to forbear. Mere inaction in such a case will not suffice, since the promisor wants a bilateral agreement rather than a unilateral one. Perhaps in most cases involving the surrender of suit a bilateral agreement is desired and, thus, mere refraining is inadequate to support the promise.

A claim must be made in good faith for its surrender to act as consideration. Consequently, if one makes a claim in bad faith without any intention of prosecuting suit, the waiver of suit will not make the promise of the other party to settle for a certain sum enforceable. Forbearance to sue constitutes consideration only if the party forbearing thinks he has a genuine cause of action. Whether he could win in court is unimportant so long as he thinks he has cause for action.

Sec. 40. Mutuality of engagement or illusory promises.—A promise for a promise may, and usually does, constitute sufficient consideration. However, both must be bound or neither is bound. Therefore, if one of the promises, when analyzed, is not a promise and does not clothe the promisor with a duty to act or refrain from acting, no contract results.[6] Promises which appear to assure something of value but, when fully understood, do not embody such an assurance, are called illusory promises, because real mutuality is lacking. Let us consider the following agreement: *B* promises to purchase from *S* all of *S*'s ten-pound jelly pails that he wants at fifty cents a dozen, and *S* promises to sell all that *B* wants at that price. Careful analysis of this agreement makes it clear that *B* has not agreed to buy any of the pails. He has promised to purchase only in case he wants them, which is equivalent to no promise at all. Since *B* has thus given *S* no consideration for his promise, *B*'s promise being illusory, *S* is at liberty to withdraw, and his withdrawal becomes effective as soon as notice thereof reaches *B*. Until withdrawn by *S*, the above agreement stands as a continuing offer on his part. Consequently, any orders received prior to revocation must be filled at the quoted price.

In the above case, if *B* had been engaged in a business requiring the use of jelly pails of the size indicated and he had agreed to buy his requirements of pails from *S*, the agreement would have been binding. Whenever the buyer is certain to have needs or requirements, an agreement to purchase all of one's needs or requirements, will support the promise to supply them, even though the amount is uncertain, since past experience will, in a general way, aid the seller in estimating the number required.

[6] Bailey et al. v. Austrian, 1873, 19 Minn. 465; p. 487.

Often a buyer purchases a limited amount of goods and obtains a guaranteed price on other goods of like character that are ordered within an agreed time. Such an agreement constitutes an option as to the future goods, the consideration for the option being the purchase of some of the goods. The seller in these cases is under a duty to deliver the goods ordered within the agreed period.

Sec. 41. Past consideration.—Past consideration is insufficient to support a present promise. The consideration must consist of some present waiver of a legal right. Some act which has taken place in the past will not suffice.[7] Hence, a warranty concerning certain goods made after the sale has taken place is not enforceable.

A seeming exception to this rule exists in those cases in which one person requests another to perform some work for him without definitely specifying the compensation to be paid. After the work is completed the parties agreed upon a certain sum to be paid for the work. It appears as if the work done in the past furnishes the consideration to support the promise made later to pay a definite sum. This assumption is scarcely correct. As soon as the work is completed, the party performing it is entitled to reasonable compensation. Later he surrenders this right in consideration of a promise to pay a definite sum. It is the surrender of this right to reasonable compensation, rather than the work, which forms the consideration for the promise to pay a definite sum.

Sec. 42. Moral consideration.—A moral duty, however strong it may be, will never constitute consideration. An extreme case arises when a benefit is unintentionally conferred upon an individual and he later promises to pay for the benefit he has received. His promise is unsupported by any valid consideration and cannot therefore be enforced.

Sec. 43. New promise after bankruptcy.—After a debtor has been discharged from his obligations through bankruptcy proceedings, a new promise to pay his old obligations is sufficient to revive them. No new consideration is necessary. It is sometimes said that, in those cases in which an obligation is cut off by a positive rule of law, no consideration is needed to support the new promise to pay. The promise to pay in such cases must be definite and cannot be implied from a mere admission of the debt or from part payment. The promise must also be made directly to the creditor or his agent.

Sec. 44. Statute of Limitations.—A promise to pay a debt which has been outlawed by the Statute of Limitations is enforce-

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[7] A. F. Savage et al. v. Markey Machinery Co., 1924, 128 Wash. 433, 223 Pac. 2; p. 488.

able, although no new consideration is given.[8] In this case an unqualified acknowledgment of the existence of the debt will imply a promise to pay. The same is true of a voluntary part payment.[9] If the new promise is conditioned in any manner by the debtor, his promise cannot be enforced until the contingency has happened. Some states, by statute, require these promises to be written before they can be enforced. The statutes of particular states should be consulted.

Review Questions and Problems

1. Why is consideration an essential element of a contract?

2. Give a definition of consideration.

3. *A* contracted to sell to *B* a certain farm for $25 an acre. Later he refused to carry out the agreement. His defense was that the farm was worth much more than the contract price. May he thus set up failure of consideration?

4. Mrs. *B* promised the pastor of *X* Church that she would donate to the trustees of the church $2,500 with which to pay off a mortgage, if they would obtain subscriptions for the balance of the mortgage. The balance was subscribed, but Mrs. *B* refused to pay her share. Were the trustees allowed to recover on the promise?

5. *A* continually quarreled with his father because the latter had given more to the other children than he had to *A*. The father promised not to collect a note for $500 if *A* ceased to complain. Did the failure to complain act as consideration for the father's promise?

6. *B*, being insolvent and faced with the possibility of bankruptcy, called all his creditors together and agreed to refrain from bankruptcy and to pay each one of them 10 cents on the dollar, if they would release him. All the creditors agreed to the proposition. The payment was made. Later, *B* became prosperous, and *C*, one of the creditors, attempted to recover the balance of his claim. Had *C* any grounds for trying to collect?

7. What is meant by past consideration? Is it ever sufficient to support a present promise?

8. *A* contracts to build a barn for *B* at a cost of $1,000. Because of an increase in the cost of labor and materials, *A* refuses to perform. *B* promises to pay *A* an additional $300 if the barn is completed. May *A* recover on this promise, assuming that the barn is completed? Suppose *A* had agreed to complete the barn within a certain date at the time the second promise was made. Would the result have been the same?

9. What is an illusory promise? Is a promise of a manufacturer to furnish all of the Balata belting required by a retailer binding? Assume that the retailer promises to purchase all of that kind of belting he needs at an agreed price, but that he is not, by the nature of his business, required to use Balata belting.

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[8] Pittman v. Elder, 1886, 76 Ga. 371; p. 488.

[9] Nilsson et al. v. Kielman et al., 1945 (S.D.) 17 N.W.(2) 918; p. 489

10. May a sheriff recover a reward offered for an arrest, the arrest being one that his duties require him to make?

11. *A* owed *B* $500 which was past due, and, since *B* was having difficulty in collecting the account, he accepted $400 in full satisfaction, at the same time giving *A* a receipt in full of the account, which stated that the $100 balance had been forgiven. At a later date, *A* was able to pay, and *B* brought suit to recover the balance. Should he have been allowed to recover?

12. An agreement was entered into whereby the plaintiff promised to refine a minimum of 400 barrels and a maximum of 1,500 barrels of oil a day at certain agreed rates because the defendant desired to have certain of its oil refined in the plaintiff's plant. The agreement was signed by both parties but contained no definite promise on the part of the defendant to supply any oil for refining. Was the defendant, who failed to supply any oil for refining, liable?

Chapter IV

VOID AND VOIDABLE CONTRACTS

Sec. 45. Voidable contracts.—A voidable contract is one which, for some reason satisfactory to the court, may be set aside at the request of one of the parties. It is sometimes incorrectly said that such a contract is void. It differs, however, from a contract which is void, in that the latter cannot be enforced by either party, while the former may be binding unless the injured party sees fit to avoid the agreement. Even in such cases, the contract can be avoided only between the immediate parties to the agreement. The rights of later innocent third parties in the property sold are not disturbed.

Capacity of Parties

Sec. 46. Competent parties.—Our definition of a contract provides that the agreement must be entered into between competent parties. All persons are presumably competent to contract—except infants, insane persons, intoxicated persons, married women, and corporations. The power of a corporation to contract is limited by its charter, and will be considered later under the subject of corporations. By legislation in most states married women today are accorded the same right to contract that is granted to anyone else. Under the common law, unmodified by statute, a married woman has few contractual powers.

The law concerning insane persons and drunkards is similar to that which governs the rights of infants. It will be considered separately only in those cases in which the rules differ.

Sec. 47. Infants' contracts are voidable.—An infant normally reaches his majority at the age of twenty-one, although some states have provided that women become of age at eighteen. An infant's contract is voidable only by the infant; the adult may be forced to carry out the terms of the agreement unless the infant desires to disaffirm.

It is said by many courts that the appointment of an agent by an infant is absolutely void and has no effect whatever. The tendency of the courts at present, however, seems to be to place contracts of this nature in the same category as any other agreement of the minor, thus requiring the infant to avoid contracts made by his agent in order to evade liability.

If an infant has entered into a partnership agreement, he may withdraw from the partnership at any time, regardless of the terms

of the agreement, and avoid liability in damages to his partners. The capital which he has invested is nevertheless subject to firm debts; therefore, to the extent of the capital which he has invested, he cannot avoid the payment of firm creditors. With this exception, all other contracts of the infant may be avoided. Where the contract is purely executory—not performed on either side—the matter is quite simple, as any act on the part of the infant which clearly indicates an intent to disaffirm the agreement will have that effect. After such conduct on the part of the infant, any attempt by the adult to recover damages for breach of the agreement would be utterly futile.

Sec. 48. Executed contracts.—The fact that both parties to the contract have fulfilled their promises does not affect the right of the infant to avoid the agreement. If he is in possession of the consideration which has passed to him, he must return it to the other party, as he cannot disaffirm the contract and at the same time retain the benefits of the agreement. Any burdens imposed by the contract upon the infant must continue to be met until he decides to disaffirm the agreement. The right of an infant to disaffirm a contract differs from other voidable contracts, in that he may demand the return of goods from innocent third persons who have purchased from his immediate transferee. In those states which have adopted the Uniform Sales Act this procedure is no longer possible in the case of personal property. In all other instances, however, an infant may disaffirm as against innocent third parties.

The states are somewhat in conflict concerning those cases in which the infant has spent or squandered what he received and is, therefore, unable to return it. The majority of the states hold that the infant may, nevertheless, disaffirm the contract and demand the return of the consideration with which he has parted.[1] Hence, an infant might purchase an automobile, and, after driving it for a year or two, rescind his contract and demand the full amount which he paid for it; or, after having an accident which demolished it, he might follow the same procedure. A few of the courts, however, hold that if the contract is advantageous to the infant and the adult has been fair in every respect, the contract cannot be disaffirmed unless the infant returns the consideration which he received.

If the minor has the consideration received by him but in a different form—for example, if he has traded it for something else—he is probably bound to return the consideration which he has, as a basis of his disaffirmance.

A provision in the contract that the minor is of age does not de-

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[1] McGuckian v. Carpenter, 1920, 49 R.I. 94, 110 Atl. 402; p. 491.

prive him of his right to rescind; nor does the fact that he is in business or has all the appearances of an adult or possesses a business acumen beyond that of the average adult. The right of a minor to disaffirm his contract is subject to almost no limitations.

A contract cannot be avoided in part only. It must be disaffirmed *in toto* or not at all.

Attention is called to legislation in a few of the states which permits a minor, upon compliance with the terms of the statutes, complete freedom of contract. Before such permission is granted, he is usually required to present evidence of sufficient experience and maturity of judgment to protect his own interests.

Sec. 49. Time of disaffirmance.—With the exception of sales of real estate, an infant may avoid his contract and demand the consideration with which he has parted, at any time during his minority. This right continues until a reasonable time after he becomes of age. A reasonable time depends on the nature of the article involved and on the surrounding circumstances. In the case of real estate sold by the infant, it may consist of several years.

A minor cannot disaffirm a sale of his real estate until after he reaches his majority. This provision is said to result from the fact that the land will always be there; thus he cannot be materially injured by being forced to wait until he becomes of age. He may, however, prior to disaffirmance, enter into possession and take over the management of the property, thus appropriating to himself the income from it while title rests in the adult. Where the minor does not avail himself of this protection, many states permit him at the time of disaffirmance of the sale of real estate to recover from the adult for the use of the property while he has been out of possession.

Sec. 50. Ratification.—An infant may avoid his contract during his minority, but he can ratify it only after he becomes of age. When he reaches his majority, the option arises. If his contract is wholly executory, continued silence would import disaffirmance. On the other hand, receipt of the goods or an express statement that he expected to perform the contract would amount to ratification.

An executed contract is ratified after majority through the retention and use of the article for an unreasonable time; by acceptance of the benefits incident to ownership, such as rents, dividends, and interest; by selling the property; or by any other act which clearly indicates his satisfaction with the contract made during his minority.[2] Many states hold that the acts of the minor after he becomes of age do not ratify unless he is aware of his right to disaffirm. The weight of authority, however, appears to be otherwise.

[2] Boyden v. Boyden, 1845, 9 Metc. (Mass.) 519; p. 492.

Sec. 51. Liability for necessaries.—It is often said that an infant is liable on his contracts for necessaries. Such a statement, technically speaking, is not true, as he is liable on quasi contract only for the reasonable value of necessaries received by him, after proper consideration is given to his station in life. Hence, an executory contract of an infant for necessaries is never enforceable.[3] Furthermore, an infant is not liable for the contract price, but only for the reasonable value of the necessaries which he receives, after his station in life is properly considered.

Before goods can be considered as necessary, it must be established that the infant is in need of them.[4] Thus, if an infant is already possessed of four suits of clothes, and his station in life does not demand more, another suit cannot be considered a necessary, although, as a general rule, clothing falls within the list of necessities.

Likewise, if he is adequately supplied with necessaries by a parent or a guardian, a further supply made available by a merchant cannot be classed as necessaries.

Necessaries consist of such things as clothing, food, lodging, medical attention, and a certain amount of education. Although other things may occasionally be deemed necessaries, the majority of the courts closely limit the list to those enumerated. Contracts relating to the minor's estate, property, or business do not involve necessaries. Thus, insurance contracts, agreements for the repair of property, or the employment of people to look after property or business may be avoided by the minor. Such agreements should be made with his guardian. Money borrowed to purchase necessaries need not be repaid unless the lender supervises its spending.

Sec. 52. Parent's liability for infant's contract.—Many people seem to labor under a misapprehension concerning the parent's liability for the contracts of an infant. The parent is never liable on such contracts unless he has in some manner appointed the infant as an agent and thus clothed him with authority to enter into the agreement in the name of the parent. In such cases the parent is liable if the article purchased is charged to his account.

It should also be noted that a parent who signs a contractual obligation along with the minor is liable on his contract. This procedure is the customary method which businessmen adopt for their protection when dealing with infants.

Furthermore, the parent, being under a duty to support his family, and having failed or refused to do so, is responsible for any necessaries furnished the infant by third parties. At the same time

[3] Gregory v. Lee, 1894, 64 Conn. 407, 30 A. 53; p. 493.
[4] Davis v. Caldwell, 1853, 12 Cush. (Mass.) 512; p. 493.

it should be noted that the parent is entitled to any compensation which an infant earns unless he has in some manner surrendered this right. Payment to the infant does not discharge this duty owed to his parent, unless the parent has authorized the payment or has left the minor to support himself.

Sec. 53. Infant's torts.—An infant is liable for his own torts. If, considering his age, an infant negligently injures the person or property of another, he thereby creates a legal liability in favor of that person. For this reason an infant who, by misrepresenting his age, induces an adult to enter into a contract, may rescind the agreement, but he is liable for any resulting damage in an action of deceit.[5] Such conduct possesses all the elements of fraud, which forms the basis for the tort action of deceit.

The parent is responsible for his children's torts only if they are committed at his direction or in his presence.

Sec. 54. Contracts of insane persons.—Contracts of insane persons, according to the view of most courts, are voidable much the same as those of infants. There is a tendency, however, to go a step further and hold that an insane person cannot disaffirm unless he can return the consideration received, provided the contract is reasonable and no advantage has been taken of the disabled party's condition. The appointment of a conservator for an insane person vests the conservator with full control over the property of his charge. For this reason any contracts made by a lunatic after such an appointment are absolutely void and not merely voidable.

Sec. 55. Drunkard's contracts.—If a person becomes so far intoxicated as to be incapable of understanding the effect of his action, he is thereby incapacitated, and his contracts are voidable. They differ, however, from those of the infant and the insane person in that they could not be disaffirmed if the disaffirmance would injure a third party who had subsequently in good faith purchased the property involved. Drunkards, like infants, are liable in quasi contract for necessaries.

Fraud

Sec. 56. Definition.—Since misrepresentation and fraud are similar in most respects, they will be treated together. An intentional misstatement concerning a material existing fact which induces another to act thereon to his damage is fraud. From this it will be seen that the chief elements of fraud are intention to mislead, misstatement, material fact, reliance upon the statement, and injury to the defrauded party. Misrepresentation is alike in all particulars except the first; intention to mislead is not a requisite of

[5] Rice v. Boyer, 1886, 108 Ind. 472, 9 N.E. 420; p. 494.

misrepresentation. An unintentional misstatement of fact, made honestly and in good faith, gives the injured party remedies which are in all respects, save one, identical with those arising in case of fraud. Consequently, the material in the sections which follow is applicable to both unless otherwise indicated.

Sec. 57. **Untrue statement.**—The very gist of fraud or misrepresentation is an untrue statement. The statement may involve a verbal or written expression which is clearly untrue, or the untruth may be the result of a course of conversation the net result of which is to mislead. Although each statement, taken alone, may be true, there is fraud if all of them, taken together, tend to mislead the party to whom the statements are made. A partial truth, when full information is requested, in reality becomes an untruth whenever it creates a mistaken impression and is designed to do so.[6]

Sec. 58. **Failure to disclose as misrepresentation.**—In the absence of a fiduciary relationship—one of trust and confidence such as exists between principal and agent, or guardian and ward—one party is under no duty to inform the other party to an agreement of special facts and circumstances known only to him, and which vitally affect the value of the subject matter under consideration.[7] In other words, silence, of and by itself, does not constitute fraud. To this rule three exceptions exist: First, it is the duty of the vendor of property which has a known latent defect—one not apparent upon inspection—to inform the purchaser of the defect; second, if one party knows the other to be harboring a misapprehension concerning a material fact, which material fact is such that it would constitute a mutual mistake if both parties carried the same impression, he must inform the innocent party of the error; and, third, a person who has misstated an important fact at some previous occasion is obligated to correct the statement when negotiations are renewed.

The gist of all these exceptions is that one of the parties rests under the impression that certain things are true, whereas the other party is aware that they are not true and also knows of the misunderstanding. A typical illustration involves the seller of farm land for a lump sum, the buyer indicating that he thinks there are eighty acres in the tract. If the seller knows there are only sixty acres in the particular property, he is duty bound to notify the buyer of that fact. Similarly, if there had previously been a house on the tract but, unknown to the buyer, it had been destroyed, the seller should make known such fact to the buyer provided he is in possession of

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[6] Newell v. Randall, 1884, 32 Minn. 171, 19 N.W. 792; p. 495.

[7] Guaranty Safe Deposit & Trust Co. v. Liebold, 1904, 207 Pa. St. 399, 56 Atl. 951; p. 496.

the information. This does not mean that a potential seller or buyer has to disclose all the factors about property which are in his possession relating to its value. It is only where he knows that the other party to the agreement is harboring a misunderstanding relative to some vital matter that the duty to speak arises.

Sec. 59. Physical concealment of facts.—A misrepresentation may be made by conduct as well as by language. Any physical act which has for its ultimate object the concealment of the true facts relating to the property involved in a contract is in effect a misstatement.[8] One who covers up the hole to a cave so that it cannot be discovered, fills a motor with heavy grease to keep it from knocking, or paints over an apparent defect—in each case thus concealing the defect—asserts an untrue fact as effectively as though speaking. Such conduct, if it misleads the other party, amounts to fraud and makes rescission possible.

Sec. 60. Material facts.—To constitute fraud the misstatement must relate to some material existing fact—one that has a moving influence upon the conduct of the contracting party. Statements of opinion are not statements of fact and as a rule do not justify one in relying thereon. A statement of fact relates to something that exists at present or that has taken place in the past, whereas a statement of opinion is usually qualified, directly or indirectly, by such terms as "I think" or "I believe," and merely purports to be the impression or present understanding of the speaker. Statements of value or as to the manner in which an article will act or react in the future are merely expressions of opinion.[9] An expert—one who by experience or position is better qualified to judge than another—who misstates his opinion misstates a fact, his opinion being the fact. Many of the courts have gone beyond this in holding that all who intentionally misstate their opinion are guilty of fraud.

A promise to perform some act in the future is not a misstatement of a present fact, and a rescission of the agreement will be denied, even though the promisor fails to perform. In such cases the injured party is limited to an action to recover damages for breach of the contract. However, if the promisor never intended to carry out his promise at the time he made it, he misstated his intention and fraud resulted.[10]

An intentional misrepresentation concerning existing local or state law affords no basis for rescission, since the law is presumably a matter of common knowledge, open and available to all who desire to explore its mysteries. A misstatement as to the law of an-

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[8] Kuelling v. Roderick Lean Mfg. Co., 1905, 183 N.Y. 78, 75 N.E. 1098; p. 496.

[9] Cash Register Co. v. Townsend, 1905, 135 N.C. 652; p. 497.

[10] Donaldson, Assignee v. Farwell et al., 1876, 93 U.S. 631; p. 498.

other state or nation, however, is one of fact and may be used as a basis for redress.

Sec. 61. Reliance by injured party.—Clearly, if the party to whom the misrepresentations are made does not rely upon them, but, after pursuing his own investigation, makes his decision as a result of information obtained by himself, fraud is lacking. Some states go a step further and hold that, if all the information is readily available for ascertaining the truth of statements, reliance upon the misrepresentation is not justified. In such a case the party is said to be negligent in not taking advantage of the facilities available for confirmation of the statement. Extreme care should be exercised in the application of this rule to limit it to cases in which no effort or expense is required to determine the true facts.

In order to establish fraud, the party relying upon the misstatement must offer proof of resulting damage, although, normally, such damage is proved by evidence which indicates that the contract would have been more valuable provided the statements had been true.

Sec. 62. Effect of fraud.—Fraud gives to the injured party a choice of several remedies. If the contract is executory, he may plead fraud as a defense in case action is brought against him; where the contract has been executed, he may demand a rescission and a return of the consideration parted with, in which case he must offer to restore the consideration which he has received. In addition, if the injured party desires to do so, he may carry out the terms of the contract and bring a tort action of deceit to recover the damages he has suffered by reason of the fraud.

It should be noted that rescission is permitted only in case the defrauded party acts with reasonable promptness after he learns of the fraud. Undue delay on his part effects a waiver of his right to rescind.

Sec. 63. Unintentional misrepresentation.—Occasionally one unwittingly makes a misrepresentation because of a mistaken conception on his part as to existing facts. Although no fraud results, a contracting party who has relied upon such a statement is as effectively injured as though the statement had been intentionally made. The remedy in such a case is rescission, the right to sue and recover damages for misrepresentation being denied.

In the case of fraud, an action to recover damages may be prosecuted successfully against one who misrepresents intentionally, even though he is not a party to the contract. Of course, if the statement is made with no intention to mislead, no action can be maintained against the third party. However, if one makes a statement of fact as being true, with reckless disregard for whether

it is true or false, and it is later proved to be false, an action for damages will lie. A person should not make a statement as true when he is uncertain concerning its truth or knows it to be true only with certain qualifications. Although the person making such a statement is not a contracting party, he will be liable to any one injured by reliance upon the statement[11] if the statement is expected to be relied upon.

Mistake

Sec. 64. Unilateral mistake.—A contract entered into because of some mistake or error on the part of one of the contracting parties affords no basis for relief. The majority of such mistakes result from carelessness or lack of diligence on the part of the injured party, and should not, therefore, affect the rights of the other party, who, without any misconduct, entered into the agreement.

This rule is subject to one well-recognized exception. Where a mistake has been made in the calculation or transmission of the figures which form the basis of a contract, and such mistake is clearly apparent to the other party, the contract may be avoided. Hence, a contractor who, in arriving at his estimates for a bid on construction work, uses the wrong figure, through error, may be relieved of his contract if it becomes apparent to the other party, prior to acceptance, that some mistake in the calculations must have been made. The courts, in such a case, refuse to allow one party knowingly to take advantage of another's mistake.

Sec. 65. Bilateral mistake.—An agreement entered into as a result of a mutual mistake concerning some material fact is voidable and relievable in equity.[12] Some writers state that the mistake must relate to the identity, existence, or quantity of the subject matter involved, but the weight of authority appears to allow rescission whenever the mistake relates to any material or controlling fact. Thus, a mutual mistake concerning the number of acres in a plot of ground or the metal of which some commodity is made has been held sufficient ground for relief.

In ordinary business it is customary upon many occasions to dispose of property about which the contracting parties willingly admit that all the facts are not known. In such instances the property is sold regardless of the quality or characteristics which it possesses, and the agreement may not be rescinded where it later appears that the article contains certain properties which neither of the parties had reason to believe existed or is more valuable than either party had reason to suspect. Under such conditions the par-

[11] State Street Trust Co. v. Ernst et al., 1938, 278 N.Y. 104, 15 N.E.(2) 416; p. 499.
[12] Fraser v. Glass, 1941, 311 Ill. App. 336, 35 N.E.(2) 953; p. 500.

ticular property forms the subject matter of the agreement, regardless of what its nature happens to be. Thus, *A* sells *B* a farm, and shortly thereafter a valuable deposit of ore is discovered on it. Clearly, such an agreement could not be rescinded on the ground of mutual mistake.

Sec. 66. Reformation of written agreements.—All written contracts should be carefully read before they are signed. Normally; the parol evidence rule forbids the introduction of any evidence to vary the terms of a written agreement. The writing is the best evidence of the nature of the contract entered into between the parties; however, if it can be established definitely that a mistake has been made in reducing an agreement to writing, the injured party may demand that the writing be reformed by a court of equity, in order to conform to the intention of the parties. In such a case the evidence must clearly indicate that the scrivener made an error, and that the agreement as written did not represent the intention of either of the parties. Occasionally a mistake is made in the execution of a contract, such as an error in the description of land conveyed by a deed. If the deed does not convey the land called for by the contract, it may, upon petition, be altered to conform to the agreement, unless the rights of innocent third parties have intervened.

Duress

Sec. 67. Nature of duress.—Every agreement presupposes that the parties thereto are free to enter into the agreement or not, as their best judgment dictates. Therefore, if the will of one of the parties is coerced through fear of the other, the contract is not a voluntary one and may be avoided by the injured party. The essence of duress is the inability freely to exercise one's will at the time of the formation of an agreement because of fear, usually the result of misconduct on the part of the other party.

Such fear may result from a threat of bodily injury, or it may be induced by a threat of criminal prosecution of the contracting party or some close relative. The guilt or innocence of the party charged with the crime has no bearing on the rescission unless the guilty party is asking the rescission. A contract made by him for the purpose of adjusting the effect of his crime is enforceable even though induced by threat, but, if the contract is made by some close relative, it is voidable. Threat of a civil suit—one to recover a debt, property, or for some injury—has never been held to constitute duress.

Unlawful retention of, a threat to retain wrongfully, or a threat to destroy the property of another, if used to compel the owner's

consent to the terms of an unfavorable contract, is duress.[13] Such pressure robs the owner of the property of the free exercise of his will and gives him the right to avoid the agreement. Thus, if a lease has expired and the tenant threatens to destroy the property unless the lease is renewed, any renewal contract can be rescinded.

Review Questions and Problems

1. What is a voidable contract? How does it differ from one which is void?

2. What persons are not fully competent to contract?

3. An infant agrees with an adult to purchase from the adult a $60 watch. Before the watch is delivered, the adult learns for the first time that the other party is an infant. May the infant recover damages for breach of the contract if the adult refuses to perform?

4. *A*, an infant, procures a policy of life insurance from the *X* Company. Shortly after he becomes of age, he demands that the company return the amount of the premiums which he paid while an infant. May he recover it?

5. *M*, a minor, shortly before reaching his majority purchased some corporate stock. Three years later, the stock having paid no dividends, he desires to rescind, although he has been of age for two years. Has he the right to do so?

6. An infant purchases an overcoat for which he promises to pay $125. What are the factors to be considered in determining his liability? Would the result be the same if the overcoat had not been delivered?

7. What is the liability of the parent for necessaries furnished his children?

8. What are the elements of fraud?

9. *A* procured from *B* a deed to certain land upon the strength of *A*'s promise to erect a factory upon the land. *A* failed to erect the factory. May the deed be set aside because of fraud?

10. *A*, being desirous of selling some stock in the *X* Company to *B*, made the statement that the bottling works were selling two cars of the product daily and that the profit was $2 a case. As a matter of fact the company was selling only half the stated amount and the profit was only $1 a case. The company, however, is earning sufficient to pay a fair dividend. May *B* rescind a contract for the purchase of stock under such circumstances?

11. The owner of a race horse desired to sell the animal because its legs were in bad condition, the horse being well known to the racing world because of its previous performances. He advertised the horse for sale, keeping it in a dark stable which was heavily bedded with straw, where he showed it to a prospective purchaser and ultimately effected a sale. The buyer, upon discovering the defect, desires to rescind because the straw and dark stable made it impossible to discover the defect. Was fraud present?

[13] Slade v. Slade et al., 1941, 310 Ill. App. 77, 33 N.E.(2) 951; p. 503.

12. *A* submitted a bid to the City of *B* on the construction of a water main. Being hurried in his bid, he figured the weight of the pipe per foot instead of the price per foot. When his bid was received, the city engineer called attention to the fact that the bid proposed to install the pipe for less than the pipe could be purchased. Nevertheless, the city council immediately notified *A* of its acceptance. May *A* avoid the contract because of the mistake?

13. *W* took a stone to *B*, a jeweler, for inspection. *W* did not know the nature of the stone, but had been informed that it was probably a topaz. *B* examined the stone, but was also uncertain as to its value. He offered to purchase it, such as it was, for $1, and the sale was consummated. It appeared later that the stone was an uncut diamond worth about $700. *W* brings an action to rescind. What should be the result?

14. *A* sold a watch to *B*. Both parties dealt on the assumption that the watch was made of gold. Later it was found to be made of some base metal. May *B* rescind?

15. What is meant by duress?

16. *A*, being insolvent but unaware of that fact, purchased $500 worth of goods from *B* on credit. After the goods were delivered, *B* learned of *A*'s insolvency. May he have the contract avoided and recover possession of the goods sold?

17. *O* sold real estate to *A, B, C,* and *D* for $16,000, each purchaser paying $4,000 for his undivided interest. The property was of little value and, unknown to *D, O* had agreed to give a rebate of $3,000 each to *A, B,* and *C*. When this was discovered by *D,* he alleged fraud and sought to rescind. Was he entitled to rescission?

CHAPTER V

UNENFORCEABLE CONTRACTS

Sec. 68. Nature of illegal agreements.—Agreements possessing those essentials normally required in the formation of a contract may be unenforceable for one of two reasons: (1) either the object sought to be accomplished by the agreement is illegal; or (2) the parties have failed to reduce the agreement to writing, as required by the Statute of Frauds. An illegal agreement is one which calls for the performance of an illegal act by one of the parties. A contract may be illegal (1) because it is definitely forbidden by statute; or (2) because it is inimical to the best interests of society.[1] Since the character of the laws differs from state to state, certain contracts may be legal in one state and illegal in another. Those agreements which are more or less uniformly held to be illegal are considered in the following sections.

Sec. 69. Wagering contracts.—The essence of a wagering agreement is that one of the parties is to win at the expense of the other, the winner being determined largely by chance. England, from a very early date, has continued to regard such agreements as legal. In this particular the United States has failed to follow the precedent established by her mother country; therefore, in the majority of the states, wagering contracts are considered illegal and unenforceable.

A contract to purchase grain futures or corporate securities on margin, to the extent it is not forbidden by legislation, is legal if the agreement is so drawn that delivery must be accepted if tendered. However, if the agreement indicates an intention on the part of the parties that one is to pay the other a certain sum, dependent upon the rise or fall of the market price, it is illegal. Such an agreement is merely a wager as to the future course of the market, and as a gambling contract is unenforceable.[2] Where the contract makes it possible for one of the parties to demand delivery—and is thus legal—a subsequent agreement made at the time for performance, whereby the parties agree to settle on the basis of the change in price level, is legal. In effect, the new agreement merely establishes the damages for failure to perform the original contract.

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[1] Tooker v. Inter-county Title Guaranty and Mortgage Co., 1946, 295 N.Y. 386, 68 N.E.(2) 179; p. 507.

[2] Pope v. Hanke, 1895, 155 Ill. 617; p. 508.

All transactions on the stock exchanges or boards of trade provide for ultimate delivery and are, therefore, legal.

Sec. 70. Insurance contracts.—An insurance contract, although in essence a wager upon the continued existence of life or property, is so beneficial to society as to form an exception to the general rule concerning wagering agreements. So long as the person applying for the insurance has an insurable interest in the person or property insured, the contract is legal. If no such interest exists, the contract becomes a mere wager upon the life or property of another and is, therefore, illegal. Briefly, an insurable interest exists when a destruction of the property or life insured might involve the applicant in a pecuniary loss. A more complete discussion of insurable interest is found in a later chapter which deals with the subject of insurance.

Sec. 71. Usurious contracts.—Most states limit the amount of interest which may be charged upon borrowed money or for the extension of the maturity of a debt. Any contract by which the lender is to receive more than the maximum allowed by the statute is illegal. In the majority of the states he is denied the right to collect any interest in such cases, although a few of the states permit the recovery of the legal rate. The law against usury is not violated by the collection of the legal maximum in advance, by making a service charge which is no larger than is necessary to cover the incidental costs of making the loan—inspection, legal, and recording fees—in addition to the maximum interest rate, or by charging a higher price for goods sold on credit than for cash sales. It is the latter principle which makes it possible to add a finance or carrying charge, in addition to the maximum interest, on long-term credit transactions.

The purchase of a note or bill of exchange at a discount greater than the maximum interest rate is not usurious. A note or bill of exchange is considered the same as any other personal property and may be sold for whatever it will bring upon the market. There are some courts, however, which hold that, if the seller indorses the negotiable paper and thus remains personally liable on it, a discount greater than the legal rate of interest is usurious. This is particularly true if the paper is considered worthless except for the indorsement. In such a case the sale of the paper merely amounts to a loan for the period the note has yet to run.

So long as one lends the money of others he may charge a commission in addition to the maximum rate. A commission may not be legally charged, however, where one is lending his own funds,[8] even though he has to borrow the money with which to make the

[8] Sanford et al. v. Kane, 1890, 133 Ill. 199, 24 N.E. 414; p. 5(

loan. The various states have also enacted laws governing the operations of pawnshops and small-loan companies, which, under certain well-defined limitations, may charge a much higher rate of interest than is permitted on ordinary loans. An exception to the general rule is also made in favor of corporations; bonds of incorporated companies may bear any rate the particular industry is willing to pay.

Sec. 72. Sunday contracts.—The validity of contracts entered into on Sunday is dependent upon the law of the particular state in which they are made. In some states all such contracts are legal; in others, practically all of them are illegal. The western states are very liberal in such matters, while the eastern states are more conservative and refuse to enforce most Sunday contracts.

Sec. 73. Limitation of liability.—Provisions in contracts whereby institutions quasi public in nature attempt to relieve themselves of the consequences of their own negligence are illegal. A quasi-public business is one which holds itself out as being ready and willing to serve any member of the public who makes application for the particular service and one which has become an everyday necessity in the lives of certain groups of people. Railroads, telegraph and telephone companies, public warehouses, and other businesses of like nature, therefore, are restricted as to the terms which they may include in their contract.[4] For example, a clause in a bill of lading issued by a railroad stating that all goods are shipped at the owner's risk will not relieve the company of liability if the goods are destroyed or damaged as a result of the negligence of a railway employee.

Sec. 74. Contracts to influence governmental action.—A contract, except for strictly professional services, whereby one proposes to use his influence to secure executive, legislative, or judicial action, is illegal. For this reason an agreement whereby one is to use his influence to bring about the election or appointment of another to public office is unenforceable.

A contract whereby one agrees in any manner to obstruct the wheels of justice falls under the same heading. To illustrate: *A* agrees to pay *B* one thousand dollars if the latter will absent himself from the state during the time a certain case is being tried. *B* upon his return cannot legally recover the money promised. His only possibility of recovery rests upon a voluntary payment by *A*.

Contracts quite similar to those involving the relation of one to his government are those which involve the relation of an employee to his employer. Any attempt by contract to persuade an employee to violate his duty to his employer is illegal. Likewise, any

[4] Inland Compress Co. v. Simmons, 1916, 59 Okla. 287, 159 Pac. 262; p. 509.

agreement whereby one person is to injure the person or property of another in any manner is illegal.

Sec. 75. **Effect of illegal contracts.**—It is incorrect to say that illegal contracts are void. They are merely unenforceable. The courts, in such cases, simply refuse to grant any relief. Although one of the parties has fully carried out his part of the agreement, he may neither demand performance nor force a return of his consideration. The court leaves the parties just as it finds them;[5] fully or partially executed contracts are left undisturbed.

Sec. 76. **Exceptions.**—To this general rule there are at least three exceptions. If the refusal to grant affirmative relief has the indirect effect of enforcing an illegal contract, the court will give the necessary aid to relieve the injured party from further performance of the illegal agreement. Again, where the situation is such that the best interests of a large portion of the public demand that the contract be enforced, the court will see that the terms of the agreement are carried out. Thus, a contract whereby a bank loans to a customer more than the law permits is illegal; however, the interests of other depositors being involved, the borrower must repay what he has borrowed. Where certain contracts are made illegal to protect society, or a certain segment of it, the injured party is usually granted relief if he is one of the group which the law was designed to protect.

A party who performs an illegal contract in ignorance of the fact that it is illegal, because certain important facts are not revealed to him, may recover for his performance. Thus, a drayman who carries intoxicating liquors contrary to law, thinking that he is transporting groceries, may recover for his services as a carrier.

Sec. 77. **Contracts illegal in part.**—Contracts which contemplate the performance of various acts, some legal and some illegal, may be enforced to the extent that they are legal. This is true only in those cases in which the contract, by nature, may be so divided that the legal portion may be segregated from the illegal portion.

Statute of Frauds

Sec. 78. **Written contracts.**—As a general rule, contracts are enforceable, although not reduced to writing. An oral agreement, if proved, is as effective as a written one. A written agreement signed by the parties, however, possesses at least two distinct advantages over an oral one. In the absence of a writing it often becomes difficult to prove the existence of a contract. Thus, if one of the parties denies the existence of an agreement, and no outside

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[5] Brilson v. Moffatt et al., 1916, 173 Cal. 685, 161 Pac. 259; p. 510.

witness was present when the contract was formed, it becomes quite difficult to prove to a jury that a contract exists. No contract is of value in court unless it can be proved.

Contracts that are reduced to writing as a rule leave few matters open about which a dispute may arise. A written agreement cannot be varied by parol evidence. Too often an oral agreement leaves much to conjecture, with the inevitable result that disagreements occur and the courts are called upon to settle the dispute. Although a written agreement is not always essential, in many cases it is desirable nevertheless.

Although it is best to modify a written agreement by a new writing, an agreement originally reduced to writing may be effectively rescinded or modified by a subsequent oral agreement. This holds true only where the agreement does not deal with subject matter which is required to be in writing under the Statute of Frauds.

To illustrate, let us assume a written agreement has been made for the erection of a certain building in accordance with specifications for $50,000. Parol evidence would not be admitted later to show that the original specifications or price were other than those shown in the writing. However, it would be possible to present oral evidence that the specifications and price had been changed after the original agreement had been entered into. On the other hand, a contract for the sale of real estate which had been reduced to writing could not be altered by a later oral agreement, because such contracts are required by the Statute of Frauds to be in writing.

Sec. 79. Statute of Frauds.—At an early date in English history there was enacted what is known as the Statute of Frauds. This statute provided that certain contracts could not be enforced unless they were reduced to writing and signed by the parties sought to be bound thereby. It was designated the Statute of Frauds because its purpose was to prevent fraud on the part of those who attempted to establish a valuable contract by the false testimony of their friends. The law varies somewhat from state to state and those provisions which are fairly uniform in the various states are discussed in detail in the sections which follow. In addition to these, many states require the following to be in writing:

1. The appointment of an agent to sell real estate.
2. The creation of a trust.
3. The promise to pay a debt which has been outlawed by the Statute of Limitations or which has been barred by bankruptcy.
4. An agreement to bequeath property to someone under the terms of a will.

Sec. 80. Debt of another.—Contracts whereby one becomes responsible for the debt, default, or miscarriage of a third person must be reduced to writing. Such agreements are called contracts of guaranty, and are not enforceable if made orally. To illustrate: *A* orally agrees to become responsible for *B*'s grocery bill at *C*'s store during the next six months. *B* purchases $300 worth of groceries and fails to pay for them. Although *A*, in a sense, is morally bound to make good his promise, it cannot be enforced, as it was not in writing.

A contract of guaranty exists only where the promise of the guarantor is collateral or secondary to the promise of some other party. If the agreement is such that the promise of the other party is cancelled or merges in the present agreement, no guaranty results, but the promise becomes an original one and no writing is required. Thus, in the previous illustration, if the credit had been extended directly to *A*—the goods being charged to his account—or had been extended to both *A* and *B* jointly, the oral agreement would have been binding. In such a case *B* merely becomes an agent of *A*, with power to purchase groceries. There is no other debt or promise in favor of *C* to which *A*'s promise is collateral. Although *A* may recover from *B* the amount expended, so far as the grocer is concerned the debt is that of *A*.

An agreement which has for its object the substitution of one debtor for another does not fall within the statute. No writing is required in such a case. Thus, if *A* says to *Y*, "If you will release *B* from his liability to you, I will pay the same," and *Y* consents, the agreement is binding, although made orally, because it is a primary promise of *A* and not secondary to *B*'s promise, as in a guaranty contract.

In case a guarantor agrees to become responsible for the default or debt of another because of some material advantage which he may gain from the transaction, no writing is required.[6] Thus, an oral guaranty by a del credere agent is enforceable. Since the agent obtains a commission for selling the merchandise, his pecuniary interest in the consignment disposes of the necessity of a writing, and the consignor may collect from the consignee on the oral guaranty if the purchaser fails to pay.

Sec. 81. Contracts of executors.—Agreements entered into by those administering estates, whereby they agree to become liable out of their own property for the debts of the estate, must be in writing. In such a case the executor or administrator is in reality agreeing to become responsible for the debts of another, namely, the estate.

[6] Bailey v. Marshall, 1896, 174 Pa. St. 602, 34 Atl. 326; p. 510.

Sec. 82. Contracts in consideration of marriage.—Contracts, the consideration for which is the marriage of one of the parties, fall within the Statute of Frauds. Thus *A* promises $500 to *B* upon his marriage to *Y*. Such a promise cannot be enforced if made orally. Engagement contracts are not included in the act and are enforceable, although there is no written evidence of such an agreement.

Sec. 83. Sale of real estate.—Contracts for the sale of real estate have always been deemed very important by the law. From the date when people first aspired to become owners of land, certain formalities were required at the time of its transfer. In order to prevent a forced transfer of land as a result of false testimony, it is provided that all agreements for the sale of any interest in or concerning real estate shall be in writing. The language is broad enough to include an estate for life, a mortgage, or a lease, as well as an estate in fee simple. The statute in most states excludes from its operation leases of short duration; thus, in practically all states, a lease for one year requires no writing. Although timber, wild grass, or fixtures permanently attached to real estate are considered part of the realty, an oral contract for their sale will be enforced, provided the agreement indicates that title is to pass after they are severed from the land. To illustrate: *A* orally agrees to deliver to *B* one hundred twelve-inch trees from certain timber land. Later he refuses to deliver the trees and denies any liability. Inasmuch as it is apparent that title was to pass only after the trees were severed from the land, the agreement is enforceable without any written evidence, unless the price is enough to bring the case under the personal property rule.

Sec. 84. Part performance.—In general, it may be said that part performance by the buyer of his contract to purchase real estate does not make the contract enforceable. The writing is not dispensed with merely because he has made a down payment or taken possession of the property. If the seller refuses to carry out the oral agreement, the buyer has as his only remedy the right to recover all payments made and the reasonable value of all improvements which have been added by him. If the *buyer* refuses to perform, he may not recover the payments he has made or the value of the improvements.

Occasionally, the buyer has progressed to the point where money will not restore him to his former position, and in extreme cases courts of equity will enforce the oral contract.[7] If his health has been undermined in an attempt to carry out the oral agreement or repairs have been so extensive that the nature of the property has

[7] Veeder, Rec. v. Horstmann et al., 1903, 85 N.Y. App. Div. 154; p. 511.

been materially altered, the courts in order to do equity may disregard the Statute of Frauds.

Sec. 85. Contracts of long duration.—A contract which by its terms must continue for a period longer than one year from the making thereof must be reduced to writing. Thus, an agreement to work for another for a period of years, or a contract which gives to a party exclusive territory for eighteen months, is not enforceable if made orally. Where the contract is possible of completion within a year, no writing is essential, although actual performance is spread over a period of years. For illustration, let us assume that *A* agrees orally to build a house for *B* at a cost of $15,000. No date is set for final completion of the contract. The work progresses over a two-year period, at the end of which time *B* denies the existence of a contract and sets up the Statute of Frauds as a bar to *A*'s action. *A* may recover, nevertheless, as the contract is such that *A* could have fully performed within a year had he seen fit to do so. The real test is: Do the terms of the agreement permit of its performance within the period of one year? Is performance within one year merely improbable rather than impossible? If so, no writing is essential, regardless of when the performance is completed. Thus, if the time for performance is of uncertain duration, being dependent upon the happening of a contingency such as death, the arrival of a certain ship, or the sale of certain property, no writing is required despite the fact that actual performance extends over several years. Since it is possible for such contingencies to occur within a year, the contract falls outside the statute. Attention should also be called to the fact that the year is figured from the date of the agreement, and not from the time performance is to begin. Thus, an oral contract to work for one year at a certain salary, employment to begin two days later, would have to be in writing.

In contracts which provide for performance over a period in excess of one year, full performance of all of his obligations by one of the parties, which has been accepted by the other, makes the agreement enforceable. Thus, if a present sale of goods is made, followed by delivery, the oral agreement is binding, although the buyer is to make his payments over a period of eighteen months. Some few states go even farther and hold that, where the contract calls for complete performance by one of the parties within a year, the agreement is effective.

Sec. 86. Sale of personal property.—The old English Statute of Frauds provided that any contract for the sale of personal property involving more than ten pounds sterling should be in writing.

This provision has become part of the law of every state and varies only as to the amount. In one state any sale involving over thirty dollars must be written, while in another any sale of personal property for less than five hundred dollars may be oral and still be enforced. In determining whether the value of property which is the subject of sale is enough to fall within the statute, it often becomes necessary to decide how many contracts have been entered into. Thus, *A* orders from *B* fifteen bushels of potatoes to be delivered at once, and ten barrels of apples to be delivered ten weeks later. Either item considered alone is worth less than $50; both items total over $50. If the parties intended only one contract, the Statute of Frauds is applicable; however, if two contracts were entered into, no writing is required. The intention of the parties in these cases is gleaned from such factors as the time and place of the agreement, the nature of the articles involved, and other surrounding circumstances.[8]

In some states—perhaps in most of them—the statute is so worded or construed as to include both tangible and intangible property. A contract for the sale of notes, bonds, or stock, involving a sum in excess of the stipulated amount, would, in such states, be enforced only when evidenced by a writing.

Sec. 87. Delivery of part of the goods.—Where the statute requires contracts for the sale of personal property to be in writing, acceptance and receipt of a portion of the goods make a writing unnecessary. The acceptance, which consists of the buyer's consent to become the owner of certain designated articles, may take place either before or after he receives the goods. Delivery is said to take place when the buyer assumes control of the property which he has purchased. Both acceptance and receipt of the goods, or a part of them, are required to take the case out of the statute.

Partial payment by the purchaser for the personal property or a transfer of something in earnest to bind the bargain will also have the effect of taking the case out of the statute. The payment may consist of money or anything else which the parties deem to have value.

Sec. 88. Manufacture of special articles.—A contract for the sale of personal property which is to be specially manufactured for the purchaser does not require a writing, even though the purchase price exceeds the limit prescribed by the statute. However, if the article to be manufactured is something which is regularly manufactured and readily salable, a writing is required, although the article must be produced before delivery takes place. The former

[8] Weeks v. Crie et al., 1900, 94 Me. 458, 48 Atl. 107; p. 512.

case is much like an agreement for labor and materials;[9] whereas the latter is a mere contract to sell property which must yet be manufactured.

Attention should be called to the fact that a writing is just as essential in a contract of sale as in an agreement to sell. Although, according to the law of sales, title to ascertained property passes at the time of the agreement—and thus becomes a contract of sale—if the amount involved exceeds that provided in the statute, no action can be maintained, unless the article has been delivered to the purchaser and accepted by him, or the other requirements of the statute have been met.

Sec. 89. Nature of the writing.—The writing required by the Statute of Frauds is not a formal written document signed by both parties. The law merely requires that some note or memorandum concerning the transaction be signed by the party sought to be bound by the agreement. Thus, a situation exists in which one party may be bound by an agreement, although the other party is not bound. Such a result may be explained on the theory that the agreement is legal in all respects, but proper evidence of such an agreement is lacking, unless the person sought to be charged with the contract has signed a writing. Any kind of note or memorandum that describes the property involved, sets forth the major terms, and indicates the parties to the agreement is sufficient. If one memorandum is incomplete, but it is clear that two or more writings relate to the same subject matter, they may be joined to supply the necessary written evidence. This is true only if it is clear that the writings relate to the same agreement.

The signature may be quite informal and need not necessarily be found at the close of the document.[10] It may be in the body of the writing or elsewhere so long as it identifies the writing with the signature of the person sought to be held.

Sec. 90. Effect of no writing.—It is said that a contract which requires a writing dates from the time of the oral agreement, but is unenforceable until written evidence of it is available. The agreement is valid in every respect, except that proper evidence is lacking. However, if, at any time before suit is started, the party sought to be held signs any statement which indicates the existence of such a contract, he furnishes the necessary evidence. Such a writing may be obtained by the connection of certain letters exchanged in correspondence concerning the subject matter involved. Other evidence, regardless of how authentic and preponderant it is,

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[9] Goddard v. Binney, 1874, 115 Mass. 450; p. 513.

[10] Cohen v. Arthur Walker and Co., Inc., 1922, 192 N.Y. S. 228; p. 514.

cannot be substituted. The Statute of Frauds is complied with only by the securing of some note or memorandum in writing signed by the proper party.

Review Questions and Problems

1. *G* and *H* are both seeking a state appointment. They reach an agreement whereby *G* contracts to withdraw from the race and to aid *H*. Because of *G*'s action *H* agrees to pay to him one half of the fees collected. Is the agreement enforceable?

2. What is meant by a usurious contract? May the effect of such a contract be avoided by the charging of a commission?

3. Are all insurance contracts enforceable? What is meant by an insurable interest?

4. *A* ships goods over the *X* Railway Company. The bill of lading stipulates that all goods are shipped at the owner's risk. The goods are destroyed en route as a result of the negligence of a railway employee. May *A* recover?

5. *A* is employed to work in *B*'s drug store. He is to receive a salary of $50 a week. One half of his time is spent in waiting on trade at the counter, and the balance is spent in illegally dispensing liquor. May he recover any of his salary from *B*?

6. What are the advantages of a written contract? What is the purpose of the Statute of Frauds?

7. *A* held a claim against *B* and *C* for $500. He was threatening to sue them when *F*, the father of *B*, promised *A* to pay the amount if *A* would refrain from bringing suit for eight months. No suit was brought during that period, and *A* now desires to recover from *F*. Assuming that the agreement was not in writing, is it enforceable?

8. *O* gave *M* a written mortgage on certain real estate as security for a loan of $3,000. A later oral agreement provided that the mortgage should secure an additional $500. Was the oral agreement binding?

9. *A* made an oral contract with *B* whereby *A* was to convey certain real estate to *B* for the price of $6,000. In reliance upon the oral agreement, *B* hauled certain fertilizer to the farm, piped water to the feed lots, and made cement platforms for feeding livestock. Under these conditions was the oral agreement enforceable?

10. *A* orally agrees to build a garage for *B* at a cost of $400. The garage is not completed until two years from the date of the agreement. Is a writing required in such a case? When does the one-year period begin to run in such cases?

11. When must a sale of personal property be in writing? What is the effect of partial delivery? Will part payment eliminate the necessity for a writing?

12. What is the nature of the writing required to comply with the Statute of Frauds? How many must sign the agreement? When must the writing take place?

13. An injured employee entered into an oral contract with his employer to surrender any claim he might have, in consideration of the employer's promise to employ him at a certain job so long as the employee lived or his work was satisfactory. Was the oral agreement enforceable?

14. A mortgagee charged the mortgagor $3,750, in addition to the maximum interest, as an expense of refinancing a mortgage of $75,000. Will the mortgagee be able to collect the interest?

CHAPTER VI
PERFORMANCE OF CONTRACTS

Conditions

Sec. 91. Failure to perform.—For every breach of a contract, regardless of how small or trifling the provision violated, the injured party, usually called the obligee, is entitled to some relief. For a violation of minor significance, he has as his only remedy the right to recover damages. However, in an executory contract where the provision is one of vital importance and the breach is material, rescission of the agreement may be demanded. To illustrate: *A* agrees to build a brick house for *B*, according to agreed specifications, for $10,000, and to have it completed by a certain date. *A* is ten days late in finishing the house. The breach being of minor importance, *B* must accept and pay the contract price, less any damages sustained by reason of the delay. On the other hand, let us assume that the breach consisted in building a five-room house instead of a seven-room house called for by the contract. Unquestionably, the breach of such an important provision would justify *B* in rescinding the agreement by refusing to carry out the obligations which it imposed upon him.

Those terms of a contract, the breach of which justify rescission, are called conditions. Conditions are of three kinds: namely, conditions precedent, conditions concurrent, and conditions subsequent. For purposes of our discussion, only the first two will be considered.

Sec. 92. Conditions precedent.—Most contracts are so drawn that one of the parties must perform some duty before he obtains a right against the other party. The performance of this duty is called a condition precedent. In other words the promise to perform by the second party is dependent upon performance by the first party. To take a simple illustration: *A* agrees to work for *B* one month for $200. *A*'s work for the month is a condition precedent to his right to recover the $200.

Not all of the terms which impose a duty of performance on a person are of sufficient importance to accord them the weight of conditions precedent. If a provision is relatively insignificant, its performance is not always required to precede recovery from the second party. In such cases the party who was to receive performance merely deducts damages for the breach before performing on his part. Three tests have been applied by the courts to determine whether contract terms shall be treated as conditions precedent.

The first test consists in answering this question: Is the breach of major or of minor importance? Provided it is of major import, the term breached is deemed a condition precedent, while if it is of minor significance it may usually be said that it is not a condition precedent. The second guide is somewhat like the first, in that courts consider a term breached not a condition precedent if damages are an adequate remedy for such a breach; a term breached which cannot well be remedied by a payment of money damages, or one in which it is extremely difficult to measure in money the resulting damages, is a condition precedent and justifies rescission of the entire contract.[1] The third test, which really gets at the gist of the matter, runs somewhat as follows: Does the failure to perform the particular provision change essentially the nature of the entire agreement?[2] Does it defeat the justifiable expectations of the party entitled to performance? To illustrate: *A* agrees to ship to *B* one thousand pounds of tea at a certain price and to send a representative to put on a two-day demonstration at *B*'s store. He fails to send the representative, but desires to collect the purchase price of the tea, less any damage suffered by his failure to send the representative. Whether he may recover depends upon the effect produced by his failure to send the salesman. If *B* had never before sold tea, or if the tea is a new brand just being introduced, undoubtedly such a breach would materially alter the balance of the contract and therefore bar *A*'s recovery. However, if *B* had sold this same tea before, the failure to send the representative would not fully defeat the justifiable expectations of the retailer.

Sec. 93. Time as a condition.—Certain contract terms have become so important as to merit special consideration. Among these is the provision contained in various contracts calling for performance within a certain time. What is the result of a failure to perform within the time set? May the agreement be rescinded or not? The answer to these questions depends upon the circumstances. The time stipulated for the completion of a contract, which involves primarily the expenditure of labor and materials or the production of a commodity of little value to anyone other than the contracting party, is normally not considered of major significance. Thus, the failure of a contractor to complete a house by the date set in the contract would not justify rescission by the owner. He could, however, deduct from the contract price such damages as resulted from the delay.

A clause calling for performance within a certain time of a contract for the sale of marketable goods is usually held to be a con-

[1] Tichnor Bros. v. Evans, 1918, 98 Vt. 278, 102 Atl. 1031; p. 515.

[2] Bettini v. Gye, 1876, Q.B. Div. 183; p. 515.

dition precedent.[3] In contracts whereby retailers purchase goods which are normally bought and sold in the market, performance by the seller on the exact date specified is considered quite important. Sales promotion campaigns and provision for the normal needs of customers are built around delivery dates. To replace merchandise not received promptly, other sources must be tapped. Failure to comply in detail with the time provisions of such contracts usually justifies the buyer in rejecting performance at a later date.

An extended delay eventually becomes material in the performance of any contract and ultimately justifies rescission. If partial performance has not taken place, a relatively short delay may justify rescission, whereas if performance is under way and time is not of the essence, a delay of some time may be required before rescission is justified. In those cases which provide no specific date for performance, it is implied that performance will take place within a reasonable time, the length of time being dependent upon the nature of the commodity involved and the surrounding circumstances.

In those contracts in which time for performance normally is deemed not to be a condition precedent, performance on time may be made a condition precedent by adding a clause that "time is the essence in this agreement." In other words, the parties may stipulate that something shall be important in a particular contract which ordinarily is not so considered. In such a case, failure to perform on time affords ground for rescission.

Sec. 94. An architect's certificate as a condition.—The majority of building contracts involving large sums of money provide that payments to the contractor shall be made only upon presentation of a certificate signed by a certain architect. In case the architect for some reason refuses to issue the certificate, the question often arises as to whether the contractor may bring suit to recover on the contract without producing the certificate. The majority of the courts consider the procuring of the certificate, where the contract calls for one, a condition precedent, but excuse the failure to present it in certain cases. Thus, if the architect agreed upon dies, becomes insane, or fraudulently, whimsically, or for no particular reason refuses to give his certificate, it is dispensed with. Some conflict exists where the architect acts unreasonably, although he honestly and in good faith refuses to grant the certificate. The better view in such a case seems to be that recovery on the contract should be denied until the contractor does what is necessary in order to obtain the certificate.

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[3] Sunshine Cloak & Suit Co. v. Roquette et al., 1915, 30 N.D. 143, 152 N.W. 359; p. 516.

Sec. 95. Concurrent conditions.—Many contracts are so drawn that the parties thereto are to act simultaneously as to certain matters. Thus, an agreement which calls for a conveyance by *A* of a certain farm upon payment of $20,000 by *B* is illustrative of such a situation. The deed is to be delivered at the time payment is made. Those terms of a contract which require both parties to the agreement to perform at the same time are designated concurrent conditions. Under the terms of such an agreement, neither party is placed in default until the other has offered to perform. Such offer on his part is called a tender; actual performance is unnecessary. For this reason *B* could not successfully sue *A* for failure to deliver the deed until he had offered to make the payment required. Actual payment is not required unless *A* offers to deliver the deed; tender of payment is sufficient.

Sec. 96. Tender and its effect.—A valid tender of money owing to a creditor has certain rather important effects. Although it does not discharge or pay the debt, it extinguishes any lien which secures the debt and stops interest from accruing thereafter, and, in case the creditor later brings suit recovering no more than the amount tendered, he must pay his own court costs. Thus, any mortgage or pledge of property is discharged by a tender as well as by payment of the debt.

A valid tender consists of an unconditional offer to pay in legal tender the proper amount at the proper time to the creditor or his agent. A tender before the maturity of an obligation is not a proper tender, and the creditor rests under no duty to accept it. Tender of payment in something other than legal tender—such as a check—is good unless the creditor refuses it because it is not legal tender. If he refuses it for some other reason, a proper tender has been made.

Sec. 97. Divisible contracts.—An agreement may provide for complete performance at one time, or the parties may have an understanding that the contract may be performed in stated installments. In such instances two important questions arise: (1) Is the contract divisible on both sides, such that the second party is under a duty to perform in part after the first party performs an installment? (2) Does a material breach of any installment justify a rescission of the balance of the agreement? The answer to the first question depends largely upon the wording of the contract. Where the intention of the parties is not clear, it has to be gleaned from previous dealings, custom of the trade, and surrounding circumstances. To illustrate: *A* contracts to purchase from *B* ten thousand tons of coal at $5 a ton. It is provided that *B* shall deliver

one thousand tons a month as it is ordered out by *A*. Assuming that *B* delivers the first month's supply, is *A* under a duty to pay for it at the end of the month? Or may he wait until all of the coal has been delivered? The tests set forth above must be applied to the case. If, in the past, all shipments have been paid for at the end of each month, the contract is probably divisible on both sides.

The answer to the second question is in the affirmative.[4] Thus, in the above illustration, assuming that *B* delivers only four hundred tons the first month, *A* has the right to refuse subsequent shipments. He may, however, waive the breach and demand full performance.

Sec. 98. Anticipatory breach.—The majority of the contracts which are not fully performed are breached during the period of performance or after the time for performance has arrived. It is possible, however, for one party by his conduct to give the other party a cause of action before the time for performance has arrived. This situation is known as anticipatory breach. Thus, if one party to an agreement should directly inform the other that he will not perform, the latter may take him at his word and terminate the agreement. This termination may be immediately followed by an action to recover damages, although the time for performance has not yet arrived.[5] An anticipatory breach may be retracted unless it has been acted upon by the one entitled to performance. Unless the latter has changed his position or reached some new agreement in reliance upon the breach, the obligor is free to change his mind and to carry out the original agreement.

The rule of anticipatory breach is not applicable to a promise to pay a money debt, such as a note, bond, or book account. Although the debtor, before maturity, denies that he will pay the debt when it falls due, the creditor must wait until maturity before bringing suit. In such cases it is not essential that he take action immediately in order to reduce the damages that might otherwise accrue, whereas, in the case of a contract for the erection of a building, it is necessary for the injured party to make another contract as soon as possible after he is informed that the contractor has refused to proceed with the contract.

Excuses for Nonperformance

Sec. 99. Waiver.—Certain situations may arise after a contract has been entered into which have the effect of excusing nonper-

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[4] Producers' Coke Co. v. Hillman et al., 1914, 243 Pa. St. 313, 90 Atl. 144; p. 517.

[5] Amberg Granite Co. v. Marinette County et al., 1945, 247 Wisc. 36, 18 N.W.(2) 496; p. 518.

formance. When one of the parties to the contract by his conduct evidences an intention not to hold the other party to certain terms, he is said to waive such provisions; and he thereby paves the way for noncompliance with such provisions. The essence of waiver is conduct which indicates an intention not to enforce certain provisions of an agreement. Usually waiver takes place after some default, and is determined by the proving of some action on the part of the one entitled to performance which shows a willingness on his part to forgive the breach.[6]

Sec. 100. Prevention.—There arises in every agreement an implied condition that neither party will interfere with the other in his performance.[7] Should such interference take place, the one attempting performance is relieved of performing and may bring an action to recover damages because of the other's breach of this implied condition. To illustrate: Assume that *A* agrees to build a garage for *B* for a certain sum. *A* sends out the necessary materials, but each time *B* refuses to allow them to be carried onto the premises. Under such circumstances *A* may refuse to proceed and can immediately demand restitution by way of damages.

Sec. 101. Additional hardship.—One who desires to be relieved of his duty to perform in the event that unusual circumstances later intervene had best provide therefor in his contract.[8] To this end the contracts of many industrial concerns provide that the manufacturer shall be released in case of fire, strikes, difficulty in obtaining raw materials, or other incidents over which it has no control. To be effective, however, it is generally held that such provisions must be included in the body of the agreement. The mere fact that such a statement appears at the top of a letterhead upon which the agreement is written does not affect the rights of the parties unless attention is directed to it at some place in the agreement.

In this connection it should be emphasized that conditions arising to make performance more difficult or burdensome never afford ground for rescission. Thus, if a building which has been almost completed is destroyed by a tornado, the contractor is still under a duty to build; he should have protected himself with insurance during the course of construction or shifted the risk to the owner by a provision in the contract.

Sec. 102. Impossibility of performance.—True impossibility of performance stems from the nature of the thing promised rather

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[6] Jacob Trinley & Sons v. Gotter et al., 1945, 93 N.H. 268, 41 A.(2) 243; p. 519.

[7] Seggerbruch v. Stosor, 1941, 309 Ill. App. 385, 33 N.E.(2) 159; p. 521.

[8] City of Minneapolis v. Republic Creosoting Co. et al., 1924, 161 Minn. 178, 201 N.W. 414; p. 523.

than from the inability of the particular party to carry out his agreement, except in those cases involving personal services. Real impossibility normally relieves a promisor of his duty to perform, but if such impossibility develops out of negligence or lack of diligence on his part, no release is granted to him. Furthermore, in some cases the ability to perform is the essence of the contract, it having been contemplated at the time of the agreement that performance may or may not have been possible. A promisor who knowingly accepts the risk of performance under such circumstances is in no position to ask relief when it is later determined that he will be unable to perform.

To illustrate, let us assume that *A* contracts to sell and deliver 500 bales of cotton from a certain plantation. Actually *A* raises only 200 bales and seeks to be released of his duty to deliver the balance. Naturally, if his inability to deliver has developed out of the fact that he failed to plant a sufficient acreage or was careless in his planting, cultivation, or harvesting of the crop, *A* should not be relieved of his duty to deliver. However, if he planted enough to have produced 800 bales under normal conditions, but the weather or other factors were such as to decrease the yield materially below that which was normally grown, failure to perform would be excused. In such a case he is obligated to deliver the 200 bales at the contract price, providing the buyer desires such partial performance. Had the parties at the time of making the contract taken into account such contingencies and *A* had nevertheless promised performance, impossibility could not be effectively urged by him as a defense. It is because people seldom take such factors into consideration when making a contract that relief is provided when impossibility develops.

Sec. 103. Change of law.—There are four groups of cases in which impossibility of performance may properly be offered as an excuse for nonperformance. The first of these deals with those situations in which performance becomes illegal because of the enactment of some law or some act on the part of the government. Illustrative of this situation are those instances in which a manufacturer is prevented from making delivery of merchandise because the armed forces make a superior demand for it. In this connection it should be noted that governmental action which merely makes an agreement more burdensome than was anticipated does not afford a basis for relief.

Sec. 104. Death or illness.—Death or incapacitating illness of one party to a contract requiring personal services constitutes another form of impossibility. Ordinary contracts are not terminated by reason of the death or illness of one of the contracting

parties. Thus, if *A* contracts to furnish *B* with fifteen tables according to certain specifications for a price of $10 each, the tables must still be delivered, although *A* becomes ill and is unable personally to do the work as he had orginally planned. However, had *B* provided that the tables were to be built personally by *A*, failure to perform would have been excused by *A*'s illness.

All contracts which require the personal supervision or services of one of the parties are terminated by the death of such party. In contracts for personal services, illness excuses a laborer for his inability to perform but it does not bar the employer from terminating the contract of employment, provided the employee's absence constitutes a material breach. In such cases, the employee is merely relieved of paying damages for the breach.

In a contract for personal services—one in which the employer-employee relationship exists—death of the employer, as well as of the employee, terminates the relation. His estate is not liable to the employee in damages for prematurely terminating the contract in such a case.

Sec. 105. Destruction of subject matter.—Many agreements involve certain subject matter, the continued existence of which is essential to the completion of the contract. As a result, we have the rule that destruction of any subject matter which is essential to the completion of the contract will operate to relieve the parties from the obligations assumed by their agreement. Another situation somewhat analogous arises where property which one of the parties expected to use in performance is destroyed. If a factory from which the owner expected to deliver certain shoes is destroyed by fire, performance is not excused, inasmuch as performance is still possible, although an undue hardship may result.[9] But, had the contract stipulated that the shoes were to be delivered from this particular factory, its destruction would have operated to excuse a failure to perform. Stated in other language, the destruction of the source from which one of the parties *expects* to make performance does not relieve him. He is still under duty to obtain the property from some other source. A destruction of the source from which he has *agreed* to make delivery will excuse him, as he is not at liberty to use any other source.

A few of the liberal states have held that, if both parties understood delivery was to be made from a certain source, even though it was not expressly so agreed, destruction of the source of supply will relieve the obligor from performing. In these few states the courts read in an implied term to the effect that delivery is to be made from the anticipated source.

[9] Booth v. Spuyten Duyvil Rolling Mill Co., 1875, 60 N.Y. 487; p. 524.

Sec. 106. Essential element lacking.—This last form of impossibility has never been very satisfactorily defined. Apparently, where some element or property which the parties assumed existed or would exist, and which is essential to the performance of the contract, fails to exist, the agreement may be rescinded. Mere additional burden or hardship is not sufficient to relieve one of the duties imposed by the agreement; but it must definitely be proved that performance is substantially impossible because of the missing element. To illustrate: *A* contracts to build an office building at a certain location. Because of the nature of the soil, it is utterly impossible to build the type of building provided for in the agreement; the agreement must therefore be terminated. The missing element is a proper condition of the soil.

Sec. 107. Right to recover for part performance—impossibility.—Often impossibility of performance becomes apparent only after the agreement has been partially performed. Thus, one coat of paint is placed upon a house before it is destroyed. In such cases, is the loss of the work already completed to fall upon the one doing the work, or upon the party who was to have the benefit of the labor? Most states permit the person who has partially performed to recover for the benefit the other party would have received had impossibility not arisen. This is simply another way of saying that the recipient of the work must pay for all labor and material expended up to the date of impossibility, provided the labor and material had attached to the property of the one for whom the work was being done.[10]

Care should be taken in such cases, however, to differentiate between impossibility and mere additional burden. The destruction of a partially completed building does not make possible recovery for the work done. Performance is still possible by starting construction anew, although the cost will be greater than was anticipated. The additional cost in the latter case must be borne by the contractor.

Part performance also arises in a different connection; namely, in those cases in which the seller is unable to deliver all the goods or produce called for by the contract. In such cases, if the buyer elects to accept delivery of the limited amount available, he must compensate for it at the agreed rate of payment. A seller who has obligated himself to several buyers, but because of impossibility has only a limited supply, is required to apportion his product among the various buyers who desire to take part performance.

Sec. 108. Willful breach—recovery for benefits.—Contracts which are willfully breached after part performance has taken place

[10] Carrol v. Bowersock, 1917, 100 Kan. 270, 164 Pac. 143; p. 524.

may or may not confer some benefit on the promisee. Even though a benefit has been conferred, it may be such a one as the promisee may or may not be able to return to the other party. In construction contracts and others of similar nature, in which the benefit received from partial performance cannot be returned, the person entitled to performance is not required to pay for the benefit conferred upon him.[11] The other party is penalized to that extent because of his failure to perform. Where the breach is unintentional —resulting from a mistake or a misunderstanding—the party must pay for the net benefit which he has received.

In those contracts in which benefits are conferred through partial performance, which benefits can be returned, the benefited party must either return the benefits or pay the reasonable value of the benefit which he has received. Thus, in contracts for the sale and purchase of goods, the buyer who receives only a portion of the goods contracted for must either pay their reasonable value, less the damages resulting from the failure to receive the balance of the goods, or return the goods received. He cannot keep the goods and at the same time refuse to pay for the benefits received from them.

In a somewhat similar situation, however, the courts seem to reach a different result. Where real estate is sold on an installment contract, title to be conveyed when all installments are paid, the courts hold that in case the buyer discontinues his payments, the seller may retain all payments made prior to default.

Damages

Sec. 109. Specific performance distinguished.—As stated before, every breach of a contract, regardless of how trivial in nature, gives rise to a cause of action by the injured party. He is in all cases permitted to recover a judgment which will compensate for the damages sustained. In addition, there are a few instances in which a court of equity will compel the promisor to carry out the express terms of the contract. This is known as specific performance, and can be insisted upon only in exceptional cases—situations in which the recovery of damages does not fully compensate the injured party.[12] That line of cases in which the contract calls for the delivery of property having some peculiar or intrinsic value furnishes the most typical illustration of contracts which may be specifically enforced. Thus, an agreement which calls for the delivery of a relic of ancient days may be specifically enforced. A more

[11] Johnson et al. v. Fehsefeldt, 1908, 106 Minn. 202, 118 N.W. 797; p. 525.
[12] Rigs v. Sokal et ux., 1945, 318 Mass. 337, 61 N.E.(2) 538; p. 526.

common type of contract, which is often the subject of specific performance, involves contracts for the sale of real estate. The courts have always held that a certain piece of real estate may have intrinsic worth; therefore, recovery of damages may not fully compensate. Specific performance may be demanded whenever the grantor refuses to deed real estate as provided by agreement.

Sec. 110. Measure of damages.—The amount of damages recovered in any case is usually a matter for the jury to determine, after proper instructions have been received from the court. The recovery allowed is dependent largely upon the evidence presented to the jury. The amount of the judgment varies directly with the proof concerning the injury. It is the duty of the jury to compensate the plaintiff for the loss he has suffered; therefore, if the evidence discloses that no material injury resulted from a breach, only nominal damages are allowed—nominal damages being some small and inconsequential sum allowed merely to denote that a cause of action existed. However, assuming that the breach causes actual loss, it becomes the duty of the jury to place the plaintiff in as good a position as he would have enjoyed—so far as the payment of money can do so—had performance taken place. The judge accepts the conclusion reached by the jury, unless he feels that it has given improper weight to the evidence, in which case he may set aside the verdict of the jury and order a new trial.

The plaintiff in a cause of action is not entitled to recover the amount which he expends for attorney's fees, unless the contract so provides or special legislation permits it in the particular case. Court costs, however, which include witness' fees, filing costs, and so forth, are assessed against the defendant in case judgment is rendered against him.

Sec. 111. Damages must result from breach.—The damages which the jury find to be sustained in any case must be such as the parties contemplate would normally arise from the breach. Unusual and unexpected damage resulting from peculiar facts unknown to both parties at the time the agreement was entered into should not influence the amount of the recovery. The time-worn example of this rule is a case in which an owner of a grist mill contracted for the transportation of a broken shaft to an engineer, who was to make another one for him. The carrier was unaware that the mill could not be operated without it, and there was some delay on its part in transporting the shaft. It was decided that the owner was not entitled to recover in damages an amount equal to the loss of profits during the period of the delay. Such might have been the result, however, had the carrier been notified of the purpose for which the shaft was being shipped.

Sec. 112. Duty to mitigate damages.—As soon as a contract has been breached, it becomes the duty of the party suffering damages to reduce the actual loss to the lowest possible point. He cannot add to his injury or permit the damages to be enhanced when it is reasonably within his power to prevent such occurrence.[13] Thus, an employee who has been wrongfully discharged cannot sit idly by and expect to draw his pay. A duty is imposed upon him to seek other work of the same general character. This burden is not extended to the point where he must leave a particular locality and look for work elsewhere; neither is he required to accept work of an entirely different nature.

Sec. 113. Liquidated damages.—In order to avoid the expenses of litigation, it is customary in certain types of contracts to provide for the amount of damages to be paid for the breach of particular terms. These provisions are legal, and will be enforced so long as the court does not consider the stipulation to be a penalty for failure to perform, rather than compensation for damages. Should the court find the term to have been inserted primarily to force actual performance and not to compensate for probable injury, it will not be enforced. In order to be construed as liquidated damages, the amount of recovery agreed upon must bear a close relation to the probable damage to be sustained by the breach. Once having arrived at the conclusion that the parties intended to compensate for possible damages, the court will not permit either of them to introduce evidence showing the amount of actual damages; recovery is allowed for the amount agreed upon by the parties, although actually the damages suffered may vary somewhat from those agreed upon in the contract.[14]

Review Questions and Problems

1. What is a condition precedent? What is the effect of failure to perform a condition precedent? What tests are employed in the determination of whether a particular provision is a condition precedent?

2. *A* contracts to paint a picture of *B*'s wife and to have it completed by October 1. He fails to complete the picture until the following January. May *B* rescind the agreement?

3. *A* contracts to build a house for *B* with the provision that payments are to be made to *A* only after a certificate is issued by *C*, who prepared the plans for *B*. *C* refuses to issue any certificate because he is not employed by *B* as a supervising architect. May *A* recover without the certificate?

4. What circumstances determine the divisibility of a contract? What is the effect of a material breach of one installment of a contract?

[13] Clark v. Marsiglia, 1845, 1 Den. (N.Y.) 317; p. 528.

[14] Keeble v. Keeble, 1888, 85 Ala. 552, 5 So. 149; p. 529.

5. *X* Company sold some lightning rod cable to *R*, a retailer, and promised to send a salesman to introduce it in that territory. *R* had not previously sold lightning rod of this type and *X* Company failed to send a salesman to help him introduce it in his area. *R* desires to rescind his agreement and return the cable to *X* Company. Has he the right to do so?

6. *A*, a school teacher, is hired by the *B* School Board for a term of eight months at $100 a month. After school has been in progress for two months, the school building is destroyed by fire. The Board refuses to pay any further salary to *A*. May he recover?

7. What is meant by impossibility of performance? Name four situations in which impossibility will operate as an excuse for failure to perform.

8. *A* contracted to install a ventilating system in a specified building. The work had been completed, with the exception of connecting one of the fans, when the building and its contents were destroyed by fire. Must *A* or the owner of the building bear the loss of the ventilating system?

9. What effect has death or illness upon the ordinary contract? Does the same result obtain in a contract for personal services?

10. *A* contracted to perform certain excavation work for the city of Chicago. After he had completed about one half of the work he refused to continue, because of the pressure of other work. The city procured another contractor to complete the work at approximately one half the original contract price. Has the original contractor a right to recover for the work performed by him?

11. *A* contracted to sell to *B* a necklace worn at one time by Queen Elizabeth of England. The contract price was $15,000. *A* refused to perform and offered to pay damages. *B* brought a bill for specific performance of the agreement. Should he succeed?

12. What should be the proper measure of damages for breach of a contract? May one party to an agreement enhance the damage by full performance when the other party has refused to proceed with the agreement?

13. What is meant by liquidated damages? How do they differ from a penalty? When would a clause calling for the payment of liquidated damages be inserted in a contract?

14. *M*, who had given to *H* a mortgage on certain property as security for a loan of $3,000 and interest, offered at maturity the proper amount in payment of the debt. *H*, being mistaken as to the amount of interest due, refused to accept the payment. He later began foreclosure proceedings. Had he a right to foreclose?

15. *P*, at an agreed rate, contracted to haul the cement needed by *D* on a certain job. Later *D*'s employees unionized and refused to unload the cement from *P*'s trucks because the drivers of the trucks were not members of a union. *D* engaged another hauler to deliver the cement and when sued for damages by *P* asserted impossibility as a defense. Was the defense good?

Chapter VII
RIGHTS OF THIRD PARTIES

Assignment

Sec. 114. Nature of assignment.—A contract creates both rights and duties. It gives to the contracting parties certain rights protected by law and at the same time imposes upon them prescribed duties. An assignment consists of some act whereby one party transfers his rights under a contract, or some portion of them, to a third party. The transferor is known as the assignor, while the one receiving the assignment is called the assignee.

Sec. 115. Requisites of assignment.—No particular formality is essential to an assignment. Consideration, although usually present, is not required; however, an assignment without consideration, where the right involved has not been realized through the collection of money or receipt of other performance, may in most states be rescinded by the assignor by notice to the debtor or obligor.

In general an assignment may be either written or oral, although it is best to have it in writing. Any contract, including the rights arising therefrom, may be assigned provided both parties to the agreement are willing. The more important question deals with the effect of an assignment where the third party refuses to respect it. In the sections immediately following, an attempt is made to suggest the particular legal principles which are helpful in determining those rights and contracts that may be assigned even over the protest of the other party.

Sec. 116. Personal rights.—Contracts often grant rights which are quite personal or confidential in character, the very nature of which seems to forbid their transfer. Clearly such rights may not be assigned effectively without the consent of the person against whom the right is to be enforced.[1] Illustrative of such rights are: (1) the right to work for a certain person; (2) the right to have a portrait painted by a particular artist; and (3) the right to represent a manufacturer by selling his product in a certain territory. Except as limited in later sections, all rights—as distinguished from contracts as a whole—which are not personal in character may be assigned without the consent of the other party.

Sec. 117. Purchases on credit.—If the assignment of a contract right places an additional burden or risk upon the third party

[1] Marcelle, Inc. v. Marcus Co., 1931, 274 Mass. 469, 175 N.E. 83; p. 581.

which was not contemplated at the time he made the agreement, the assignment is not effective unless he assents to it. Such appears to be true of sales of merchandise on credit. One who has agreed to purchase goods on credit may not assign his right to the goods to a third party, since the latter's credit may not be as good as that of the original buyer. Although, upon delivery of the goods to the assignee and his failure to pay, the seller could look to the assignor for payment nevertheless, the courts incline to the view that an assignment of the right to buy on credit is not enforceable by the assignee against the seller. In those contracts involving the sale of real estate or personal property on installments secured by a mortgage or retention of title, the seller is fairly well secured regardless of the credit standing of the buyer. Consequently, the right to buy in such cases is generally held to be assignable.

Sec. 118. Wages.—An employee entitled to wages under a contract of employment can make a binding assignment of his wages. In case the wages have been earned, the assignee has the right immediately to collect them. If they have not been earned, the assignment is nevertheless valid; the right to collect is deferred until they are earned.

The power to assign wages is limited in one particular. A mere expectancy cannot be assigned. Therefore, an assignment of future wages to be earned at a certain profession or trade when the assignor at the time is not employed is ineffective. Such an assignment is valid, provided the assignor is employed, although the duration of his employment depends upon the will of the employer.[2]

Recently a tendency has been observed to enact legislation which limits the portion of future wages that may be effectively assigned. Many states now provide that an assignment of more than one fourth of future wages shall not be enforceable, and have indicated the method for determining the priority where various assignees are involved. Other safeguards have been established to protect the employee against unusual and unsuspected assignments being included in ordinary contracts of sale.

Sec. 119. Delegation of duties.—Certain duties imposed by contract are so personal and confidential in character that it is unreasonable to assume that any person can perform them except the contracting party. If the duties are not of this type and may be performed as well by one person as another, it is said that they can be delegated. Contracts which call upon a party to perform such nonpersonal duties may be assigned in such a way as to give the assignee the privilege of performing the duties which are conditions precedent to the right he seeks to enforce. To illustrate, a build-

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[2] Rodijkeit v. Andrews, 1906, 74 Oh. St. 104, 77 N.E. 747; p. 531.

ing contractor is not expected to do all the work on any particular building, it being understood that he will delegate responsibility for certain portions of the structure. Consequently, his agreement to build is assignable. It is presumed that all contractors are able to follow specifications, and, since the duties are mechanical in nature, the owner is bound to permit the assignee to build. When and if the building is completed, the assignee also becomes entitled to payment. In some respects two rights are assigned, the right to build and the right to collect the contract price when the work has been completed.

Sec. 120. Responsibility for performance.—Failure on the part of the assignee to perform the duties gives rise to a cause of action by the third party. In the majority of the states he can elect to sue either the assignor or the assignee, provided the assignee has agreed, expressly or by implication, to assume the burdens of the contract. The mere assignment, without more, of a contract which calls for the performance of affirmative duties by the assignor does not impose those duties upon the assignee unless he undertakes to perform as a condition precedent to his recovery. To illustrate, if a tenant assigns a lease, the assignee is not liable for future rents, after he vacates the property, unless he expressly assumes the burdens of the lease at the time of the assignment. This is true even though he vacates the property before the lease expires. To the extent that an assignee accepts the benefits of a contract which are predicated upon the performance of duties later to be undertaken, he becomes obligated to perform those duties. However, if he merely receives the assignment of a right to purchase or to lease, he is not liable for the purchase price or the rental unless he demands title to or possession of the realty.

The assignor, of course, is not released by an agreement on the part of the assignee to assume the burdens of the contract. In such a case, the third party has his choice of holding either the original contracting party or the assignee. He cannot be denied his claim against the assignor without his consent.[3]

Sec. 121. Claims for money.—All claims for money may be assigned, and it is generally held that a partial assignment of a claim is enforceable against the debtor. A question often arises concerning the liability of the assignor in case the assignee is unable to collect from the debtor. If the assignee takes the assignment merely as security for a debt owing from the assignor to the assignee, it is clear that if the assigned claim is not collected, the assignor is still liable to pay his debt. On the other hand, it should be equally plain that if the assignee purchases a claim against a third party,

[3] Martin v. Orndorff, 1867, 22 Iowa 504; p. 532.

he should have no recourse against the assignor unless the claim proves invalid for some reason. This view is accepted by most of the courts, although a few have adopted the contrary view.

In any event the assignor warrants that the claim which he assigns is a genuine claim. In case there is a defense available to the third party debtor and the claim cannot be collected, the assignor must return the amount which he has received from the assignee.

Sec. 122. Notice.—Immediately after the assignment, the assignee should notify the third party of his newly acquired right. This notification is essential for two reasons:

1. In the absence of any notice of the assignment, the third party is at liberty to perform—pay the debt or do whatever else the contract demands—for the original contracting party. In fact, he has no knowledge of the right of anyone else to require performance. Thus, the right of the assignee to demand performance can be defeated by his failure to give notice. The assignor who receives performance under such circumstances becomes in turn a trustee of funds or of property received, and can be compelled to turn them over to the assignee. As soon as notice is given, however, the third party must perform for the assignee.

2. The notice of assignment protects innocent third parties. The assignor has the power, although not the right, to make a second assignment of the same subject matter. If notice of the assignment has been given, it has much the same effect as the recording of a mortgage. It furnishes protection for the parties who may later consider taking an assignment of the same right. One taking an assignment should, therefore, always confirm the existence of the right by communicating with the third party. If the third party has not been notified of a previous assignment, and if the assignee is aware of none, the latter can, in many states, feel free to take the assignment, and should immediately give notice to the third party. In other words, the first assignee to give notice, provided he has no knowledge of a prior assignment, has a superior claim to the right assigned.[4]

In many other states, it is held that the first party to receive an assignment has a prior claim, regardless of which one gives notice first. In all states, however, the party who is injured by reason of the second assignment has a cause of action against the assignor to recover the damages which he has sustained.

Sec. 123. Rights of the assignee.—The assignee receives under the assignment the identical rights of the assignor. Any defense of the third party available against the assignor is available against

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[4] Adamson v. Paonessa et al., 1919, 180 Cal. 157, 179 Pac. 880; p. 533.

the assignee.[5] Thus, part payment, fraud, duress, or incapacity can be set up against the assignee as well as against the assignor.

Under the common law the assignee has no right to bring suit in his own name; in case the third party fails or refuses to perform for him, the action must be brought in the name of the assignor. The legislatures of most states have altered the common-law rule by conferring upon the assignee the right to bring suit in his own name.

It is customary for certain contracts to contain a provision that they are nonassignable. The majority of the states strictly enforce such a provision. A few hold an assignment of such a contract to be valid, although allowing damages to be recovered for a breach of this provision.

Contracts for Benefit of Third Parties

Sec. 124. Nature of such contracts.—Contracts are often made with the express purpose of benefiting some third party. In such cases, what are the rights of the third parties? The most typical example of such agreements is the contract for life insurance in which the beneficiary is someone other than the insured. The insured often never expects to benefit personally from the contract; he is making provision for others who may have an interest in his life.

Another illustration may be taken from mortgages. Real property is often conveyed with an outstanding mortgage against it, and in such cases it is customary for the purchaser to assume and agree to pay the mortgage debt. Indirectly, at least, the holder of the mortgage stands in a position to benefit from this promise.

It should be noted that these examples illustrate two entirely different situations. In the first case the party to be benefited is a pure donee; in the second case he is a creditor of the party to whom the promise is made.

Sec. 125. Donee beneficiary.—Has a donee, who is to be benefited by the terms of a contract, a right to succeed in a suit against a promisor who fails to perform? The early law limited recovery to those instances in which the third party was a close relative of the promisee. Recovery was denied in other cases, because no privity of contract existed between the parties; the third party had no contractual relation with the promisor. Gradually the rule permitting recovery was extended until, today, perhaps a slight majority of the states allow the third party donee, in all cases, to bring

[5] American Bridge Co. et al. v. City of Boston, 1909, 202 Mass. 374, 88 N.E. 1089; p. 533.

suit against the promisor for failure to perform. The chief reason advanced for the extension of this doctrine is that to deny the third party a recovery would be to bar substantial recovery by anyone. The promisee could not recover substantial damages, because he was not to benefit by performance, and, therefore, would not be materially damaged by failure of performance. Nevertheless, a considerable number of states deny recovery by the third party in such cases, unless there is a close relationship. In all states, by statute or otherwise, the beneficiary of a life insurance contract is permitted to recover from the insurer.

Sec. 126. Benefit must be direct.—A donee beneficiary is entitled to recover only where the contract is expressly made for his benefit. If he is to benefit only indirectly, the contract gives him no right. Thus, an action by an orphanage was not sustained, where it was based on the breach of an agreement between several parties to close their places of business on Sunday; and, in case any one or more of them kept open on Sunday, each one keeping open was to pay one hundred dollars to the orphanage. The contract was entered into primarily to benefit the contracting parties, and the orphanage was only indirectly to be a beneficiary. Contracts of guaranty which assure performance of construction contracts by contractors have been held in many states to benefit the material men and laborers. A few states have held otherwise, indicating their belief that the agreement was made primarily to protect the owner.

In many states a contract made for the express purpose of benefiting a third party may not be rescinded without the consent of the beneficiary.[6] The latter has a vested interest in the agreement from the moment it is made. Thus, in these states an insurance company has no right to rescind an agreement with the insured without the consent of the beneficiary, unless the contract itself gives this right.

Sec. 127. Creditor beneficiary.—The example of the person who buys mortgaged real estate and assumes the mortgage debt furnishes an illustration of a contract made for the benefit of a third party who is a creditor. It has been urged by the courts of several states that the third party in such cases should not be allowed to sue. The reasons given are the following: (1) A proper analysis of the situation indicates that the contract is not made primarily for the benefit of the creditor, but in reality it is expected to benefit the debtor, in that it relieves him of the burden of performing. (2) Failure to perform on the part of the promisor does materially damage the promisee, and thus a suit by him would result in a

[6] Bassett et al. v. Hughes, 1877, 43 Wis. 319; p. 534.

judgment for substantial damages. Despite this rather sound reasoning, a slight majority of the states allow the third party creditor beneficiary to recover. Certain states allow a donee to recover, but not a creditor; other states allow a creditor to recover, but deny the right to a donee; and a considerable number of the states allow recovery in both cases.

Review Questions and Problems

1. What is an assignment? What is the one making the assignment called?

2. *A* rented some wagons to *B* and agreed to keep them in repair personally during the period of the lease. *A* subsequently sold the wagons to *C* and assigned the lease. *B* refused to carry out the terms of the lease, claiming that he was released because of the assignment. Is it possible to assign such an agreement?

3. *C*, a contractor with wide experience in organizing and building canning factories, contracted with *A* and *B* to form a corporation and construct a canning factory. He assigned the contract to *H*, who knew nothing about canning factories. Are *A* and *B* bound to permit *H* to carry out the agreement?

4. May wages be assigned? Is it possible to assign wages to be earned at certain employment, although no definite period for employment has been agreed upon between employer and employee?

5. Suppose *A* contracts to build a house for *B* at a certain contract price. *A* later assigns the contract to *C*, who agrees to complete the building. What right has *B* against *A* in case *C* fails to build the house?

6. *M*, who held a $30,000 interest in the estate of an uncle, made an assignment of one half of his interest to his wife, without receiving any consideration therefor. Later he assigned all of his interest to the *X* Company. The company immediately notified the executor of the estate of the assignment. *M*'s wife had failed to give such notice until some time after the second assignment. Whose claim is superior?

7. *A* sold to the *X* Company his used automobile on sixty days' credit for $400. He later purchased, on credit, $200 worth of automobile tires from the *X* Company. Sometime after the last transaction he assigned to *C* his $400 claim against the *X* Company and received payment in full therefor. *C* immediately notified the *X* Company of the assignment. The *X* Company refuses to pay more than $200. How much is *C* entitled to recover?

8. *Y* Company contracted with *A* and *B*, partners, whereby the latter were to represent it in a certain territory in selling automobile tires and accessories in commission for a period of three years. Shortly thereafter the partnership was dissolved and the contract was assigned to *B*. Is *Y* Company obligated to permit *B* to represent it in the area?

9. *A* gave a mortgage to *B* to secure a loan of $10,000. Later *A* sold the property to *C*, who assumed and agreed to pay the mortgage debt.

Does this give to *B* an action against *C* if he fails to pay the debt at maturity? Does the agreement release *A* from further liability?

10. In what cases may the assignee, who fails to recover from the third party, recover from the assignor?

11. *A* assigned to *B* a portion of a note and mortgage. At the maturity of the debt, the debtor was unable to pay and later became a bankrupt. Will *A* be able to share with *B* in the amount realized on the debt or will *B* receive his portion first?

12. *A* was engaged by a milk producers' association for one year to pick up and deliver milk of the members to a certain dairy company, the compensation being an agreed amount for each hundred pounds delivered. *A* assigned the contract to *B*. Was the association bound to permit *B* to pick up and deliver the milk?

CHAPTER VIII

DISCHARGE OF CONTRACTS

Sec. 128. Performance payment.—The customary manner of obtaining a discharge of a contract is by complete performance. After all the terms of the agreement have been fully complied with by both parties, the contract no longer exists.

The final step in the performance of many contracts consists of the payment of a money debt. Keeping in mind the Statute of Limitations, and the law of suretyship in some instances, it becomes important to know on what particular obligations payments have been, or should have been, applied. Three principles appear controlling in such cases: (1) the person making the payment has the right to specify the particular obligation against which he desires the payment to apply; (2) in the event that no stipulation is made by the debtor, the creditor is given the right to direct where the payment shall apply; and (3) if neither of the parties has indicated, at the time when the payment is made, how the payment is to be credited, the court implies that the first credits shall be applied against the first debits falling due.

In cases in which the creditor has the option of application, he is permitted to apply it against an outlawed claim as well as against one that is current. Likewise, he may protect his own interest by crediting an unsecured claim instead of one that is secured. To gain the maximum protection, the debtor should clearly express at time of payment the particular items which are being paid or upon which payment is being made.

Executory agreements may be discharged by mutual agreement of the parties; the release of one party to the contract furnishes the consideration for the release of the other. An agreement which is fully performed on one side and executory on the other may not be discharged in this manner. The agreement to discharge the party under duty to perform is, in such a case, without consideration to support it.

Sec. 129. Accord and satisfaction.—An accord consists of an agreement between contracting parties whereby one of them is to do something different from that called for by the contract. This accord is satisfied when the terms of the new agreement are fully performed. Both accord and satisfaction must take place before the old obligation is discharged, unless the new agreement expressly states that it is being substituted for the old. The new agreement

of itself does not terminate the old agreement. To illustrate: *A* purchased a horse from *B,* and agreed to pay him $100 within sixty days. *A* failed to pay *B* at the end of the period, and a new agreement was entered into, whereby *A* was to deliver one hundred bushels of corn in full payment of the debt. At any time before the corn is delivered, *B* may recover upon the original contract. The delivery of the corn constitutes the satisfaction of the accord, and thus discharges the old contract.

Sec. 130. Novation.—Novation is an agreement whereby an original party to a contract is replaced by a new party. In order for his substitution to be effective, it must be agreed to by all of the parties. The remaining contracting party must agree to accept the new party and at the same time consent to release the withdrawing party.[1] The latter consents to withdraw and permits the new party to take his place. The new party agrees to assume the burdens and duties of the retiring party because of some consideration which he receives. Provided none of these essentials is missing, the withdrawing party is discharged from the old agreement. To illustrate: *A* purchases an automobile from *B,* and, after making a small down payment, agrees to pay the balance of $400 within six months. Finding times somewhat hard, *A* sells the car to *C,* who agrees to pay the balance to *B.* Both parties notify *B* of this arrangement. As yet no novation is completed, because *B* has not agreed to release *A* and to look to *C* for payment. If *B* releases *A, A* is discharged from any duty arising under the original agreement and a novation is created.

Sec. 131. Cancellation and alteration.—An intentional cancellation or alteration of the written evidence of an agreement will have the effect of discharging it. This situation arises most frequently with negotiable instruments. An intentional material alteration of a note or check avoids the instrument.

Sec. 132. Statute of Limitations.—The time within which an action may be brought upon a contract is limited by statute.[2] The real purpose of this limitation is to make it impossible to bring suit long after the cause of action originates, during which period material evidence relating to the agreement may have passed out of existence because of the death of an important witness, or of some other cause. Such a statute is known as the Statute of Limitations.

The statutes often differentiate between written and oral contracts. Thus, in Illinois, an action upon an oral contract must be

[1] Lowe v. Blum et al., 1896, 4 Okla. 260, 43 Pac. 1063; p. 536.
[2] Shapiro v. Friedman, 1945, 132 N.J.L. 456, 41 A.(2) 10; p. 537.

started within five years after the cause of action arises, while ten years is allowed in the case of a written agreement.

The Statute of Limitations is usually so worded that, when debts are involved, the period does not begin to run until the debt falls due or the last credit has been made against it. An item in an account is considered current so long as payments are being made on it.

A promise to pay a debt which has been outlawed by the Statute of Limitations is enforceable without any new consideration, provided it is made directly to the creditor or his agent. Many states, however, require such a promise to be in writing before it is enforceable.

Bankruptcy[3]

Sec. 133. **Kinds of bankruptcy.**—The federal government has by statute—the Bankruptcy Act—provided a procedure whereby, under certain conditions, one may be discharged from his obligations. He is permitted to start his business life anew, unfettered by weighty obligations assumed in the past. The filing of a voluntary petition in bankruptcy usually accomplishes this result. The federal court, through its designated officers, takes control of all property involved, turns it into cash, pays all expenses, and uses the balance to pay off creditors so far as possible.

At the same time the Bankruptcy Act has made it possible for a creditor of an insolvent debtor to get his full share of the insolvent's estate, by filing an involuntary petition in bankruptcy against the debtor. A person cannot be forced into involuntary bankruptcy unless his liabilities equal at least $1,000. Provided twelve or more creditors exist, the petition must be signed by at least three of them —otherwise only one need sign. The petitioning creditors must also own unsecured claims totaling $500 or more. Relatives, persons holding fully secured claims, and other biased creditors are not counted in determining the number of creditors required to sign the petition. Thus, if there are only eleven creditors other than relatives, one creditor may bring about involuntary bankruptcy regardless of the total number of creditors involved.

Sec. 134. **Who may become bankrupts.**—Any person, firm, or corporation may become a voluntary bankrupt, with the exception of five types of corporations. Railway, banking, insurance, municipal, and building and loan corporations may not become vol-

[3] A number of the sections included under bankruptcy do not bear on the subject of discharge of contracts, but, because of those which do, the subject is conveniently treated at this point.

untary bankrupts. Other laws provide for their liquidation in case of insolvency. A recent amendment does provide, however, that an insolvent railway may petition a bankruptcy court for confirmation of a reorganization plan, provided the plan has first been approved by the Interstate Commerce Commission.

The provisions of the act relating to involuntary bankruptcy make exception not only of the types of corporations just mentioned, but also of noncommercial corporations, farmers, and wage earners, provided the wage earner does not earn more than $1,500 a year in the course of his employment.

Therefore, a person engaged primarily in farming may not be forced into involuntary bankruptcy. He is deemed to be so engaged when he spends the major portion of his time on the farm and derives most of his income from it, although he is incidentally engaged in some business enterprise.[4] Farming includes tilling of the soil, raising livestock, and dairying. Furthermore, a wage earner, as restricted above, regardless of the amount which he owes, may not be forced into bankruptcy.

Sec. 135. Acts of bankruptcy.—The purpose of involuntary bankruptcy is to force an equal distribution of an insolvent debtor's assets. In this connection it should be noted that mere insolvency affords no basis for a petition in involuntary bankruptcy. Unless a debtor has committed some act which indicates an intention to abuse or to prefer certain creditors, or has done something which shows a willingness to have his assets distributed, involuntary bankruptcy is impossible. The Bankruptcy Act sets forth six acts, one of which must be committed within four months prior to the petition before involuntary bankruptcy proceedings are possible.

Acts of bankruptcy by a person shall consist of his having:

1. Conveyed, transferred, concealed, or removed, or permitted to be concealed or removed, any part of his property with intent to hinder, delay, or defraud his creditors, or any of them;

2. Transferred, while insolvent, any portion of his property to one or more of his creditors with intent to prefer such creditors over his other creditors;[5]

3. Suffered or permitted, while insolvent, any creditor to obtain a lien upon his property through legal proceedings and not having vacated or discharged such lien within thirty days from the date thereof or at least five days before the date set for any sale or other disposition of such property;

4. Made a general assignment for the benefit of creditors;

5. While insolvent or unable to pay his debts as they mature,

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[4] Rice v. Bordner, 1905, 140 Fed. 566; p. 538.

[5] In re Stovall Grocery Co., 1908, 161 Fed. 882; p. 539.

procured, permitted, or suffered voluntarily or involuntarily the appointment of a receiver or trustee to take charge of his property;

6. Admitted in writing his inability to pay his debts and his willingness to be adjudged a bankrupt.

Attention should be called to the fact that the second, third, and fifth acts must be accompanied by insolvency at the time they are committed. With respect to the first, fourth, and sixth acts, insolvency is not required. Another provision of the act, however, makes solvency at the time the petition is filed a good defense to the first act of bankruptcy. In none of the other acts is solvency at the time the petition is filed important. In the first three instances mentioned it is a matter of insolvency at the time the act is committed.

It should be emphasized, concerning the third act, that it is not the lien which constitutes the act of bankruptcy but is the failure to vacate it within the time allotted to the debtor.

The petition in involuntary bankruptcy must be filed within four months of some act of bankruptcy. Whenever recording is required in order to render a transfer fully effective, the four months' period is calculated from the date of recording and not from the date of the transfer.

Sec. 136. Officers of the court.—The bankruptcy petition is filed with the clerk of the Federal District Court, and is then referred to the referee, who is appointed by the court to hear the evidence and to submit his findings to the court. All dividends are ordered paid by the referee.

A trustee is elected by the creditors at their first meeting, a majority in number and amount of claims held by those present at the meeting being necessary for election. The trustee then takes title to all property, both real and personal, owned by the bankrupt at the time the petition was filed. It becomes his duty to dispose of the property as best he can, under the supervision of the court, for the benefit of creditors. Personal property, purchased by an innocent party from the bankrupt after the filing of the petition but before the trustee or receiver takes possession, remains with the purchaser. Any property received by the bankrupt after the filing of the petition belongs to his new estate, except that all devises, bequests, or inheritances received within six months thereafter belong to the trustee. Executory contracts may be accepted or rejected within sixty days after the petition in bankruptcy has been passed upon. If the trustee chooses to reject a long term contract, the other party is then permitted to file a claim for damages against the bankrupt estate. In case of leases, however, the landlord may not file a claim in excess of one year's rental.

A receiver is a temporary officer appointed by the court to take charge of a bankrupt's property until a trustee is appointed. He is appointed only when someone is required to care for the property in this intervening period, in order to avoid waste or loss.

Sec. 137. Recoverable preferences.—Any transfer of property by an insolvent person to a particular creditor, which has the effect of preferring that creditor to the others, constitutes a preference. A preferential transfer may be recovered by the trustee if it took place within the four months preceding the filing of the bankruptcy petition, and if the creditor, at the time of the transfer, knew, or had cause to believe, that he was obtaining a greater percentage of his claim than other creditors could recover.[6] The transfer may consist of the payment of money, the delivery of property, or the giving of property by pledge or mortgage as security for a prior indebtedness. Such a mortgage or pledge may be set aside as readily as payment, providing it is received by the creditor with knowledge of the debtor's insolvency. Such pledge or mortgage can be avoided, however, only if it was received within the immediate four months prior to the filing of the petition of bankruptcy and was obtained as security for a previous debt. In the case of the mortgage, the four months' period dates from the recording of the mortgage rather than from its signing.

If the property received by a preferred creditor has been sold to an innocent third party, recovery of the property may not be had, but its value may be obtained from the creditor. A creditor, however, who in good faith extends additional credit after having received a preference, may deduct from the recoverable preference the amount of any unpaid credit items. In this manner, a creditor who attempts to help an insolvent debtor out of his financial difficulties is not penalized if, after obtaining payment, he extends no greater credit than the old claim amounted to.

Any judgment lien obtained within the four months' period is void, irrespective of knowledge, so long as it continues to maintain the character of a lien at the time the petition in bankruptcy is filed.

Sec. 138. Exceptions to recoverable preference rule.—Payment of a secured claim does not constitute a preference, and, therefore, may not be recovered.

Transfers of property for a present consideration may not be set aside. Thus, a mortgage given to secure a contemporaneous loan is valid, although the mortgagee took the security with knowledge of the debtor's insolvency. An insolvent debtor has a right to extricate himself, so far as possible, from his financial difficulty.

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[6] Batchelder v. Home Nat. Bank, 1914, 210 Mass. 420, 105 N.E. 1052; p. 540.

Any debtor of a bankrupt may set off against the amount he owes the bankrupt estate any sum which the estate owes him.[7] To the extent of his claim against the estate, he becomes a preferred creditor, legally entitled to his preference. This rule is not applicable where the claim against the bankrupt has been purchased with the express purpose of set-off. Thus, a bank, which has loaned a bankrupt $2,000 and happens to have $1,500 of the bankrupt on deposit at the time of bankruptcy, is a preferred creditor to the extent of the deposit. This set-off must be allowed, unless the evidence discloses that the deposit was made with the express purpose of preferring the bank. In such a case the deposit becomes part of the bankrupt estate.

Sec. 139. Provable claims.—Not all claimants against a bankrupt may share in his assets. Those claims upon which dividends are paid are called provable claims and must be filed within six months after notice of the first creditors' meeting. All claims founded upon a contract are provable; thus, any debt or claim for damages because of breach of contract may be filed. Those contract claims which have not been made certain at the time for filing are liquidated by court decree or agreement prior to the payment of dividends by the trustee.

Tort claims—demands made because of injury to person or property—are not provable unless they have been liquidated by judgment or agreement prior to the petition in bankruptcy, except that in torts involving negligence the injured party may prove his claim if he has instituted suit prior to the filing of bankruptcy proceedings. Thus, *A*, who has an action against *B* because of an assault by the latter, is deprived of any share in *B*'s bankrupt estate, provided the petition in bankruptcy is filed before *A* has reached an agreement with *B* or started suit against him. As noticed in the succeeding section, however, the claim is not discharged, and may be enforced against any new assets *B* may acquire.

Claims for costs in suits started against the bankrupt or in cases started by him and abandoned by the trustee are also provable. Taxes also represent provable claims.

A claim by a creditor who has received a recoverable preference is not allowed until he has returned the preference. Thus, if a creditor has knowingly received a portion of his claim from an insolvent debtor within four months of bankruptcy, he is not entitled to prove the balance of his claim until he has surrendered the preference that he received.

Sec. 140. Claims which are discharged.—All provable claims, with a few exceptions, are discharged by a discharge in bankruptcy.

[7] Frank v. Mercantile Nat. Bank, 1905, 182 N.Y. 264, 74 N.E. 841; p. 540.

The most important of these exceptions are claims for taxes, losses resulting from fraud or breach of trust by one acting in a fiduciary capacity, liability resulting from willful or malicious tort, wages earned within three months of filing of the petition in bankruptcy, and damages for loss of property or money obtained under false pretenses. Nonprovable claims, not being discharged, also continue as claims against the bankrupt after his discharge.

It becomes the duty of the bankrupt, as soon as a petition in bankruptcy is filed, to schedule all his creditors and the amount due each. The claim of any creditor who is not listed and who does not learn of the proceedings in time to file his claim is not discharged. The bankrupt, under such circumstances, still remains liable.

In addition to providing that certain claims are not discharged, the Bankruptcy Act provides a number of circumstances under which the bankrupt may not obtain a discharge. In such a case the assets of his present estate are distributed among his creditors, but he remains liable out of future assets for that portion of the claims that remains unpaid after all assets have been liquidated and distributed. The Bankruptcy Act states the following about the discharge of bankrupts:

"The court shall grant the discharge unless satisfied that the bankrupt has (1) committed an offense punishable by imprisonment as provided under this Act; or (2) destroyed, mutilated, falsified, concealed, or failed to keep or preserve books of account or records, from which his financial condition and business transactions might be ascertained,[8] unless the court deems such acts or failure to have been justified under all the circumstances of the case; or (3) obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing or causing to be made or published, in any manner whatsoever, a materially false statement in writing respecting his financial condition,[9] or (4) at any time subsequent to the first day of the twelve months immediately preceding the filing of the petition in bankruptcy, transferred, removed, destroyed, or concealed or permitted to be removed, destroyed, or concealed, any of his property, with intent to hinder, delay, or defraud his creditors; or (5) has within six years prior to bankuptcy been granted a discharge . . . ; or (6) in the course of a proceeding under this Act refused to obey any lawful order of, or to answer any material question approved by, the court; or (7) has failed to explain satisfactorily any losses of assets or deficiency of assets to meet his liabilities."

Any of the circumstances mentioned may be set up by a creditor

[8] Rosenberg v. Bloom et al., 1938, 99 Fed.(2) 249; p. 541.
[9] In re Savarese, Appeal of State Bank, 1913, 209 Fed. 830; p. 542.

as a bar to a discharge, or they may be set up by the trustee, when he has been authorized to do so by the creditors. Furthermore, if any creditor can show reasonable cause for believing that the bankrupt has done any of the things mentioned, the burden shifts to the bankrupt to show that he has not committed an act which will bar discharge. In addition, it should be suggested that the discharge of a partnership does not act as a discharge of the individual members of the firm. They are discharged only upon action of the court in their behalf as individuals.

Sec. 141. Exemptions.—The bankrupt is allowed as exempt property the exemption provided by the law of the state in which he resides. Such laws usually provide for a certain sum in cash or personal property and, if the bankrupt owns his homestead, some additional amount.

Sec. 142. Preferred claims.—The trustee's title to property is only the title previously held by the bankrupt. Any valid lien against the property continues after bankruptcy and must be paid first if the trustee desires to dispose of the property free of encumbrances; otherwise, the lienholder merely enforces his lien. Should a sale of the property fail to pay the entire secured debt, the creditor then becomes an unsecured creditor for the deficit.

The Bankruptcy Act provides a definite order for the payment of provable claims. Such claims are paid in the following order:

1. Costs of preserving and administering the bankrupt estate.
2. Claims of wage earners not exceeding $600 to each claimant, provided the wages have accrued within the three months preceding bankruptcy.
3. Claims for money expended in defending against or setting aside arrangements of the bankrupt debtor.
4. Claims for taxes.
5. Claims for rent granted priority by state statute and any claims allowed priority by federal law. Many of the claims held by the federal government have been given priority under this provision.
6. Claims of general creditors.

In case funds are insufficient to pay in full any particular class of creditors, the funds available for such group are distributed in proportion to the amount of each claim, all classes falling lower in the list receiving no payment. For example, if the assets are insufficient to pay the claims of wage earners of $600 per person and earned within the previous three months in full, the wage earners would share proportionately the amount available, but the claims for taxes and general creditors would not share, no payment being made on them.

Sec. 143. Fraudulent conveyances.—Conveyances of property to relatives or friends which are made for the purpose of hindering, delaying, or defrauding creditors may always be set aside by the creditors. This rule applies whether or not bankruptcy has intervened. In any case where the conveyance leaves the transferor without sufficient assets with which to pay his debts, the transfer is said to be fraudulent.[10] The courts insist that one must be "just before he is generous."

If the one to whom the property has been transferred is innocent and has given value for it, the transfer can be set aside only in case the purchase price is refunded to him. If he is not an innocent purchaser—that is, if he knows of the debtor's intention at the time the transfer is made—the transfer can be set aside without recompensing the third party. The latter then becomes a general creditor of the debtor's estate and shares like any other creditor in the event of bankruptcy. The states usually impose no time limit in which an action may be brought by creditors to set aside a fraudulent conveyance. Whenever creditors discover that such a transfer has been effected, they are free to institute an action for the purpose of restoring the property to the debtor's estate, in which it may be attached and sold by his judgment creditors or used by a bankruptcy court in paying creditors.

Reorganizations

Sec. 144. Introduction.—Until recently, the law made it possible for a small minority of creditors to jeopardize the interests of the majority whenever a debtor became financially embarrassed. They could force the debtor into bankruptcy and insist upon liquidation at unfavorable times; they could demand, in many instances, foreclosure of mortgages or threaten lengthy and expensive receiverships unless the other creditors purchased their claims at exorbitant figures; or they could effectively block any plan for rehabilitation of the debtor until their demands had in large measure been satisfied. Late amendments to the Bankruptcy Act have sought to relieve this situation and have, in the 1938 revision of the Act, been woven together in such a way as to meet several distinct needs. In general, the method chosen by this legislation is to coerce the minority interests to follow a plan which has been approved by a larger group and sanctioned by the court. It is this legislation which is considered in the sections which immediately follow.

Sec. 145. Arrangements involving unsecured creditors.—Any person, including a corporation capable of becoming a voluntary bankrupt, may, if he is insolvent, is unable to pay his debts as they

[10] Peerless Mfg. Co. v. Goehring et ux., 1944, 131 Conn. 93, 38 A.(2) 5; p. 542.

mature, or is at present involved in bankruptcy proceedings, file a petition with the bankruptcy court to settle or extend his unsecured debts. The petition incorporates the plan which the debtor proposes to have approved and is accompanied by his statement of assets and liabilities. Provision is made for an independent appraisal of assets in case the court feels it desirable.

The plan outlines in detail the arrangement for settling or extending the claims and the means whereby the debtor expects to be able to meet its terms. It may treat all creditors on a parity, or they may be divided into classes with each group accorded different treatment. Those executory contracts which are burdensome to the debtor may be terminated where the plan indicates, the injured parties in such cases filing claims for their damages. A copy of the plan, with financial statement attached, is then mailed to all creditors with notice of a meeting at which the matter will be considered.

The plan can be approved by the court only after it has been sanctioned in writing by the majority in number and amount of all the claims filed and approved at the meeting. Thereafter, if the court finds that the plan is fair, free from fraud, and feasible, it may approve it, unless the debtor has committed some act or failed to perform certain duties which would bar a discharge in bankruptcy. Thus, a debtor that has transferred property within one year, with the intention of delaying or defrauding creditors, cannot take advantage of this section of the Act.

Lack of approval of the proposed plan gives the court, at its discretion, the right to proceed with the liquidation of the estate in the ordinary course of bankruptcy. A petition for an arrangement which is not adopted thus becomes a petition in voluntary bankruptcy. Likewise, if the terms of the plan are not carried out by the debtor, the court may proceed as in any other case of bankruptcy.

Sec. 146. Creditors secured by real property.—The procedure outlined for an arrangement affecting secured creditors differs in four important particulars from that set out in the preceding section: (1) the provisions are available only to debtors other than corporations; (2) the plan has to be accepted by two-thirds in amount of all claims, the number of claimants being unimportant; (3) after the petition has been filed, a creditor, whose plan has been approved by twenty-five per centum of the claims in any group and at least ten per centum of all creditors' claims, may file a plan; and (4) provision is made for carrying the plan into operation even though less than the requisite two-thirds in a particular group approve the plan. In case the plan does not appeal to the holders of two-thirds of the claims of a particular group, the plan must make

provision for payment, of their equity, to such dissenting creditors. The amount to be paid them may be determined by a sale of the property or by an independent appraisal of the value of their claims.

If the claims of unsecured creditors are settled at the same time the secured claims are handled, the excess of the secured claims above the appraised value of the security is treated as an unsecured claim. Claims of bondholders who cannot be located or who fail to file claims after receiving notice may be filed by the trustee appointed in the trust deed or mortgage. Such claims are not considered, however, in determining the number essential to approve the plan.

A petition to arrange secured debts must be filed before the property involved has been sold under a foreclosure decree. If the sale has not been effected at the time the petition is filed, the fact that foreclosure proceedings have been instituted does not preclude the adoption of a plan for the relief of the debtor. The foreclosure proceedings are stayed until final action is taken on the petition to arrange the debts.

Sec. 147. Wage earners' plans.—A wage earner, as defined for this purpose, is one who works for wages, salary, or hire at a rate of compensation which, when added to all other income, does not exceed $3,000 a year. One who desires to compromise or extend his obligations out of his future earnings may file a petition to effect this purpose. Approval of the plan in this case is dependent upon the written consent of the majority in number and amount of all unsecured claims and the consent of all secured creditors whose claims are to be materially affected by the plan.

Since future earnings are involved, requiring some court appointee to handle the funds received, it is only natural that the matter of exemptions and priorities be involved. All costs of administration and all priorities allowed by state law are paid before the general creditors receive a dividend. After the debtor has made all the payments called for by the plan, the debtor receives a discharge from all debts covered by the plan. If, after three years have elapsed, all payments have not been made, the court may grant a discharge if it is convinced that failure to make the payments was not occasioned by the fault of the debtor but was the result of causes beyond his control. The law permits the debtor to claim the exemption allowed by state law at the time the plan is placed in operation. In other respects, wage earners' plans are similar to those affecting unsecured claims.

Sec. 148. Reorganization of corporations.—In general the provisions of the Act relative to reorganization of corporations are similar to those indicated for arrangements of unsecured claims, and

reference will be made only to provisions which are not in accord with those for arrangements. This chapter of the Act is available to any corporation which is insolvent or unable to meet its obligations as they mature, provided the corporation is such a one as might become a bankrupt. The petition for reorganization may be filed by the corporation, an indenture trustee—one appointed in a trust deed or mortgage—or three creditors holding noncontingent claims aggregating $5,000. If the corporation is not in bankruptcy at the time the petition is filed, the trustee or creditors, if they file, must prove an act of bankruptcy has been committed, or that a trustee, receiver, or mortgagee is in possession of all or most of the property of the debtor, or that foreclosure of all or most of the property is pending.

If the petition is approved, a list of assets and creditors is made available to the interested parties and a trustee is appointed to take control of the property unless the claims are less than $250,000, when the debtor may be allowed to remain in possession. After the trustee has been appointed, it becomes his duty to prepare a plan of reorganization, at a hearing upon which any creditor, stockholder, or the debtor may propose a substitute plan. If the corporation is a small one and the debtor is allowed to remain in possession, a plan may be presented by the debtor, a creditor, a stockholder, or the indenture trustee.

After the plan has been presented and the hearing held, at which other plans may be presented, the court approves those plans which it feels are fair, equitable, and feasible. Until the court gives its tentative approval of a plan, no one is at liberty to solicit the acceptance of any plan. Any person, or committee, who represents twelve or more claimants must file a copy of the agreement, by which he represents them, with the court, and the court is at liberty to disregard any of the terms of these agreements that it feels hinders the acceptance of a fair plan. As soon as the court gives its tentative approval to one or more plans, a copy of the plan is mailed to all interested parties. The proceedings are then delayed until one of the approved plans has been accepted in writing by the holders of two-thirds of the total claims in each class and by a majority of each class of stockholders. If the corporation has been found to be insolvent, the consent of stockholders does not have to be obtained, and, likewise, if the claims of a certain group of creditors are not to be affected by the plan, their consent is not required. Furthermore, the plan may make provision for protecting a group of creditors in case it fails to approve the plan. The plan then becomes operative without their acceptance, each creditor in the group receiving such reasonable protection as the plan outlines.

The plan itself sets forth the modification of rights of the various interested groups and specifies the means used to protect groups that fail to assent to the proposed reorganization. The provisions for effecting the reorganization, such as new issues of security, the formation of a new corporation, and so forth, are set out in detail. The plan must include a restriction on the use of nonvoting stock and must make provision for election of directors by the preferred stock in the event of a default in payment of dividends upon such stock.

After the proper number of acceptances have been filed with the court, it sets a date at which a hearing is held for confirmation. Again the court must find that the plan is fair, equitable, and feasible before confirming it. After final approval by the court the plan becomes binding on all creditors, stockholders, the debtor, and any new corporation proposed by the plan. The plan is then consummated, and distribution in assets and new securities is made in accordance with it. Creditors are given at least five years thereafter to file their claims and to obtain the rights and privileges accorded to them by the plan. If not filed within the period allotted to them by the court, any property to which they were entitled passes automatically to the old corporation or its successor. Thus, all liabilities and claims of the corporation are discharged, except as they are reserved by the plan. Minorities which in the first instance were recalcitrant and refused to cooperate in mending the defective financial structure of the corporation have been compelled to accept such property or other securities for their claim as the plan called for.

Railroads, although unable to avail themselves of the Bankruptcy Act, may be reorganized under rules quite similar to those for other corporations.

Review Questions and Problems

1. Name three methods by which a contract may be discharged.

2. What is meant by accord and satisfaction? Is a contract discharged by an accord?

3. *A* sold a printing machine to *B* on the installment plan. *B* sold the machine to *C*, who agreed to pay the balance of the purchase price. Both parties notified *A* of the arrangement. *C* failed to make the payments and *A* now seeks to hold *B*. May he do so?

4. On April 1 *B* purchased a typewriter on credit at a price of $150 and on July 1 he purchased bookkeeping machines at a cost of $325, both items being purchased of *C*. On August 1 he mailed his check of $200 to *C* and instructed him to apply it on the $325 item. Assuming a five year Statute of Limitations, how much will *C* be able to recover of *B* as of June 1 five years later?

5. What is the difference between voluntary and involuntary bankruptcy? May all persons become voluntary bankrupts?

6. *A* is a farmer and earns by the operation of the farm the sum of $4,500 a year. As a result of some unwise investments, he becomes insolvent and gives a mortgage on his farm to secure one of his creditors. May other creditors force him into involuntary bankruptcy?

7. Name the acts of bankruptcy. How many of them require insolvency at the time the act is committed?

8. *A*, while insolvent, paid an obligation for $300 in favor of *B*. Although *A* was insolvent at the time, he was clearly unaware of the fact. Has he committed an act of bankruptcy?

9. Who is the referee in bankruptcy? Who is the trustee?

10. *B* owed *C* a past due indebtedness of $500 and induced the latter to extend the maturity of the indebtedness three years at 6% interest by giving a chattel mortgage as security. Sixty days after the mortgage was given, *B* filed a petition in voluntary bankruptcy. Under what conditions, if any, will the trustee in bankruptcy be able to avoid the mortgage?

11. *A* became a voluntary bankrupt. At the time the petition was filed, he owed *B* the sum of $2,000, which was to fall due sixty days later. *B* owed *A* on a separate transaction the sum of $1,000, which was due at the time the petition was filed. May the trustee collect the $1,000 and force *B* to become an ordinary creditor as to the $2,000?

12. Are all claims discharged? Can you name any that are not?

13. *A* holds a valid mortgage against some property of *B*, a bankrupt. What is his status among the creditors? What limitations are imposed upon the rights of laborers to a preference in the distribution of assets?

14. In 1927, *A* deeded certain property to his wife's uncle in order to avoid the payment of large obligations maturing in 1930. In 1931, *A* was declared a bankrupt. May the trustee recover the property conveyed to the uncle?

15. *B* owed his bank a note for $15,000 and, at a time when he was insolvent, arranged to deposit all receipts with the bank. He was not to draw any checks until the balance exceeded the note owing to the bank. He became a bankrupt at a time when the balance was only $10,500. May the bank set off the balance against the note and file a claim for the difference?

16. *A* filed a petition for a composition of his debts out of future wages, the approved plan providing that he pay $2,000 a year for the next three years out of his salary. At the end of two years he lost his job and was unable to make the payments. Will he be able to obtain a discharge from his debts at the end of the third year?

17. A corporation had its petition to effect a reorganization accepted, and the plan, as presented, was accepted by the requisite number of creditors and stockholders, with the exception of the banks. Will it be possible for the plan to become operative without their acceptance if the banks are classed as a distinct group of creditors by the plan?

18. Who may present a plan to the court for the arrangement of un-

secured claims by a debtor? By a corporation in the process of reorganization?

19. *A* filed a petition in voluntary bankruptcy and was adjudicated a bankrupt on March 1, 1939. Three months later his aunt died and bequeathed him $15,000. Will he be able to retain this amount or will it revert to the trustee in bankruptcy?

Book II

AGENCY

CHAPTER I

CREATION OF THE AGENCY

Classification of Agents

Sec. 1. Introduction.—We are still witnessing a period in which big business seems to be the order of the day. The corporate form of organization seems to be most desirable for the conduct of such business. Clearly, therefore, much, and, under corporate organization, all, of the business must be conducted through representatives or agents. The law of agency is of relatively recent origin, very little attention having been paid to it until somewhat over a century ago. It is only with the advent of large business projects that the necessity for many agents arose.

Some maintain that there is no law of agency, but that the relations arising from the use of agents may all be settled through the employment of the familiar principles of contracts. However, as the business conducted by agents has grown and peculiar situations have arisen from time to time, definite principles relating only to agency have evolved and a new body of law has gradually developed.

Sec. 2. Definition.—In the broad sense agency is the relation created by employment. Strictly defined, however, agency is the relationship which arises when one party authorizes another to create, to modify, or to terminate contractual relations between the former and third parties. The one granting the authority is known as the principal, while the one who is given the power is called the agent. Agency as defined in this limited sense excludes the relationship of master and servant, as the latter has no power to create contractual relations. For an agent to act, three parties are necessary: the principal, the agent, and a third party with whom contracts may be formed. To create the master and servant relation, only two parties are necessary. However, as the laws relating to master and servant are analogous to those governing principal and agent, and as the two relations often merge by an agent's performance of the duties of a servant, and vice versa, the rules of agency herein set forth will be deemed to apply to either situation unless otherwise stipulated.

Sec. 3. Agent distinguished from independent contractor.—A person may contract for the services of another in such a way as to have full and complete control over the manner in which the latter conducts the work, or he may contract for a certain result. If the

agreement provides that the second party is to accomplish a certain result, and has full control over the manner and methods to be pursued in bringing about the result, he is deemed an independent contractor and the one receiving the benefit of his services is in no sense responsible to third parties for his actions.[1] On the other hand, if the second party places his services at the disposal of the first in such a manner that their identity practically merges and the action of the second is controlled by the former, an agency relation is established. To illustrate: *A* contracts to build *P* a boat for $100, according to certain specifications. In such a case it is clear that *A* is an independent contractor with the completed boat as the result, and *P* in no sense becomes responsible for lumber or other material purchased. However, had *P* engaged *A* by the day to build the boat and had authorized *A* to purchase the necessary materials, it is equally clear that an agency would have been created.

Sec. 4. Classification of agents.—First, agents may be classified as actual and ostensible. An actual agent is one upon whom authority has been expressly conferred by the principal, while an ostensible agent is one who has no actual authority, but who the principal has, by conduct, led third persons to believe is clothed with authority, thus making, in certain instances, the principal responsible for his conduct.

Second, agents may be either general or special. To distinguish between them is an exceedingly difficult task. A general agent is one who has been granted power to do a series of acts, and his employment is of a continuous nature. A special agent is created usually for only a single transaction. Under existing law little reason exists for determining which kind of agent is appointed, except that occasionally it may aid in determining just what incidental authority custom or usage has fastened upon him because of the nature of the appointment.

Appointment of Agent

Sec. 5. Proper parties.—It is generally stated that anyone who may act for himself may act through an agent. To this rule there is one fairly well-recognized exception. An infant may enter into a contract, and, so long as he does not disaffirm, the agreement is binding. However, the weight of authority is probably to the effect that any appointment of an agent by an infant is void. Therefore, any agreement entered into by such an agent would be ineffective, and an attempted disaffirmance would be superfluous. Many recent cases hold, however, that only the act of the agent is voidable,

[1] **Moreland et al. v. Mason, Sheriff, et al., 1927, 45 Idaho 143, 260 Pac. 1035; p. 547.**

being subject to rescission or ratification by the minor after he reaches his majority.

Nevertheless, an infant may act as an agent for someone else, and any agreement which he makes while acting for his principal is binding. Although the infant has a right to terminate his contract of employment at his convenience, so long as he continues in the employment his acts become those of his employer.

Contracts which delegate authority to an agent, like any other agreements, must have for their purpose a legal object. As in the case of other illegal contracts, the courts would not force the parties to carry out an agency agreement with an illegal purpose, but would leave the parties without any legal redress.

Sec. 6. Express delegation of authority.—The usual procedure followed in the creation of an agency is for the principal expressly to confer certain authority upon the agent. The agreement may be explicit, setting forth in detail the rights and duties of the respective parties, or it may consist of general terms, in which event they depend upon various factors, such as custom and business usage, to construe their agreement for them.

Usually no particular formalities are essential to such an appointment; it may in most cases be either written or oral. To this rule there are two well-defined exceptions. First, where the purpose of the agency can be fulfilled only by the signing of a formal document under seal, the agency must be created under seal. Where a formal sealed instrument is used for the conferring of authority upon the agent, he is said to possess a power of attorney.[2]

In addition to the above, the law in the majority of the states requires that any agent who is given power to sell or to convey any interest in or concerning real estate must obtain such power by a written authorization from the principal. The ordinary real estate broker, however, would not need a written agreement, as his authority is merely to find a buyer with whom the seller is willing to contract. Normally, he is not given any authority to enter into a binding contract to convey the property and to sign his principal's name thereto.

Some few states go so far as to hold that the authority must possess the same dignity as the act to be performed. In these states an agent who possesses authority to sign a contract which is required to be in writing must receive his appointment by an instrument in writing. Such is not the law in most states.

In any of the cases suggested, the agency may be disclosed in such a manner that the agent acts openly for his principal, or he

[2] See form # 1.

may act in his own name without disclosing the fact that he is representing another. In the latter case the employer is known as an undisclosed principal.

Sec. 7. Authority by estoppel.—No agency ever arises without some action or conduct on the part of the principal. The proposed agent cannot by his own conduct alone establish the relationship. An agency is a matter to be proved, and third persons dealing with an agent do so at their peril. The duty rests upon the third party to ascertain the nature and extent of the agent's authority. Generally speaking, if the agent has no authority or it is insufficient to authorize the particular act involved, the principal is not bound. Nevertheless, conditions often develop under which the principal, because of his conduct, is estopped to deny the existence of an agency. An agent under such conditions is called an ostensible agent, and the agency is said to arise by estoppel. Two factors are essential in order to create an agency by estoppel: (1) The principal must conduct himself in such a manner as to lead third parties reasonably to believe that an agency exists. (2) The third party must know of such conduct and act in reliance thereon.[3] No estoppel can arise except where the third party relies upon facts known to him at the time he transacts business with the agent, which facts would have led a reasonably prudent person to assume that an agency existed.

An agency by estoppel may arise from a course of dealing on the part of the agent, which is constantly ratified by the principal, or it may result from the agent's holding himself out as such without any dissent on the part of the principal and under conditions where the principal owed a duty to speak. To illustrate: Upon several occasions *A* indorses his principal's name to checks and has them cashed at the bank. The principal has never given the agent such authority, but no objection is raised until the bank pays one of the checks, the proceeds from which have been appropriated by the agent. The principal then attempts to recover from the bank. Clearly, by ratification of the agent's previous misconduct, the principal has led the bank reasonably to assume that the agent possesses such authority.

Sec. 8. Agent's power to appoint subagents.—Agents are usually selected because of their personal qualifications. Owing to these elements of trust and confidence, a general rule has developed that an agent may not delegate his duty to someone else and clothe the latter with authority to bind the principal. An exception has arisen to this rule in those cases in which the acts of the agent are

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[3] Pettinger v. Alpena Cedar Co.. 1913, 175 Mich. 162, 141 N.W. 535; p. 548.

purely ministerial or mechanical. An act which requires no discretion, and is purely mechanical, may be delegated by the agent to a third party.[4] Such a delegation does not make the third party the agent of the principal or give him any action against the principal for compensation. The acts of such third party become in reality the acts of the agent and bind the principal only so long as they are the authorized acts of the original agent. Acts which involve the exercise of skill, discretion or judgment may not be delegated without permission from the principal.

The agent may, however, have power to appoint subagents for his principal in such a manner as to make them agents of the principal. Such a power on the part of the agent is rarely implied, and the situation must be such as to make it impossible to carry out the purpose of the agency without the appointment of such agents. Thus, a manager who is placed in charge of a branch store is presumed to possess the necessary authority to employ the required help.

Ratification

Sec. 9. Definition.—An agent may purport to act for another when, as a matter of fact, he possesses no authority to do so. Contracts entered into under such circumstances are ineffective unless they are subsequently adopted by the principal. Ratification consists of the affirmance of an act performed by one party for another without authority. Such affirmance cures the defect of lack of authority, and the relation of the parties assumes the status that would have existed had authority been granted before the act took place.

Sec. 10. Conditions required for ratification.—Various conditions must exist in order that ratification be effective and thus bring about a contractual relation between the principal and the third party. It should be borne in mind in this connection that ratification is used only where no authority, either actual or otherwise, can be shown. Furthermore, by reason of ratification, the authority reverts back and becomes effective as of the date of the act performed by the agent. Because of this fact, ratification can be effective only where both the principal and the agent were capable of doing the act at the time it was performed and are still capable at the time of ratification. For this reason a corporation may not ratify contracts made by its promoters before the corporation was formed. For the corporation to be bound by such agreements a novation or assumption of liability must be shown. Rati-

[4] Groscup v. Douney, 1907, 105 Md. 273, 65 Atl. 930; p. 549.

fication is impossible because the corporation was not in existence when the agreement was formed and could not possibly have entered into a contract at that date.

Sec. 11. Other conditions.—An agent's act may be ratified only when he holds himself out as acting for the one who is subsequently charged with the agreement. In other words the agent must have professed to act as an agent. A person who professes to act for himself and who makes a contract in his own name does nothing which can be ratified even though he intends at the time to let another have the benefit of his agreement. It is because of this fact that an agent of an undisclosed principal, who exceeds his authority, may never bind his principal, even though the transaction is later adopted by the principal. The agent in such a case does not disclose his principal.

The states are slightly in conflict as to whether the third party may withdraw before ratification takes place. The better view, and that which apparently has the support of most of the states, is to the effect that the third party may withdraw from the transaction at any time before it is ratified by the principal. If not permitted to withdraw, he would be unable to hold the principal and at the same time would not be free to act with others concerning the subject matter until the principal had exercised his option. It seems only fair, therefore, to permit the third party to withdraw at any time before the principal has indicated his adoption of the transaction. However, it should be pointed out that ratification does not require notice to the third party. As soon as conduct constituting ratification has been indulged in by the principal, the third party loses his right to withdraw.

Furthermore, it is laid down as a general principle that ratification does not bind the principal unless he acts with full knowledge of all the important facts. Of course, where ratification is expressed and the principal acts without any apparent desire to know or to learn the facts involved, he may not later defend himself on the ground that he was unaware of all the material facts. Where, however, ratification is to be implied from the conduct of the principal, it must be apparent that he acts with complete understanding of all important details. Thus, *A*, a salesman with authority only to solicit orders, contracts to sell certain of his principal's goods to *T*, and signs *P*'s name to the order. As an inducement to *T* to enter into the agreement, *A* sells all of the articles at a 10 per cent discount. *A* informs *P* of the sale, and the duplicate sales slip is filed. At the time the order is ready to be shipped, it is noted for the first time that the discount is to be allowed. Clearly no ratification can be implied from *P*'s conduct.

A few states hold that a principal may not ratify an unauthorized act after all risk involved in the contract has passed. However, most of the states appear to hold to the contrary and allow a principal to ratify an unauthorized policy of insurance after a fire loss has occurred.

Sec. 12. Conduct constituting ratification.—What conduct on the part of the principal will amount to ratification? Ratification may be either express or implied. Where certain formalities, such as a writing or an authorization under seal, are required to create a particular agency, the ratification must follow the form required for the creation of the agency. Aside from this, any conduct which definitely indicates an intention on the part of the principal to adopt the transaction will constitute ratification. It may take the form of words of approval to the agent, a promise to perform, or actual performance, such as delivery of the product called for in the agreement. Accepting the benefits of the contract or basing a suit on the validity of an agreement clearly amounts to ratification.

At this point it should be mentioned that an unauthorized act may not be ratified in part and rejected in part.[5] The principal cannot accept the benefits and refuse to assume the obligations. Because of this fact it is said that a principal, by accepting the benefits of an authorized agreement, ratifies the means used in procuring the agreement unless, within a reasonable time after learning of the true facts, he takes steps to return, so far as possible, the benefits which he has received.[6]

Some conflict exists as to whether silence or inaction on the principal's part can be construed as ratification. Where the situation is such that failure to speak misleads the third party, causing him to rely upon the validity of the agent's acts, it seems that a duty to speak develops. Failure to protect the third party by prompt disaffirmance of the agent's acts after they are known by the principal is likely to result in ratification.

Review Questions and Problems

1. Give a definition of agency. What are the parties to an agency relation called? How many parties are necessary before the agency relation can function?

2. The roof of *P*'s building needed repairs. He had *A* inspect it and estimate what it would take to put it in first-class shape. It was estimated that the cost would be $400, whereupon *P* contracted with *A* for the repair of the roof at that figure. In performing the work it became necessary for *A* to purchase $250 worth of materials. The materials

[5] Casady v. Manchester Fire Ins. Co., 1899, 109 Iowa 539; p. 550.
[6] Kessler et ux. v. Troast et ux., 1927, 101 N.J. Eg. 536, 138 Atl. 371; p. 550.

were purchased on credit. Is *P* liable for the materials in case *A* fails to pay for them?

3. Who may be an agent? What is the difference between an actual and an ostensible agent? Is any particular form required for the appointment of an agent?

4. *P* authorized *A* to borrow $500 of *C* and to sign *P*'s name to a note for that amount. *A* requested one *B* to sign *P*'s name to the note, which *B* did in the presence of *A*. Is *P* liable on the note?

5. *A* operated a meat market in the name of his mother. He also deposited the money in his mother's name and she signed a number of checks in blank with which *A* might pay the bills. She never gave her son any authority to represent her, and he was actually carrying on his own business. The business failed and one of the creditors, who had relied upon the credit of the mother, desires to recover from her. May he do so?

6. What is meant by ratification? Name three acts that would constitute implied ratification.

7. *A* entered into a contract with *T* for *P* for the purchase of 300 bushels of potatoes at 50 cents a bushel. *A* possessed no authority to represent *P*, and *T* attempted to withdraw from the contract before it was ratified by *P*. Was the rescission effective?

8. May an agent's act be ratified where he presumes to act in his own name, although it is his intention to give a principal the benefit of his action? May an act be ratified when the principal does not exist at the time the agent acts?

CHAPTER II

PRINCIPAL AND THIRD PARTY

Liability of Principal

Sec. 13. Scope of agent's authority.—The principal is responsible for those acts of the agent which are performed within the scope of his authority. Stating the rule in a negative form, he is not liable for the conduct of the agent when the latter exceeds his actual or apparent authority. The real difficulty arises when an attempt is made to ascertain the scope or limits of the agent's authority in any particular instance.

Certain general principles have been worked out, however, and may be used as signposts to aid in determining the powers created by the appointment of different agents. Without question, the agent possesses all those powers which are expressly conferred upon him. In addition, he possesses other powers—known as incidental powers—which are required for carrying out the major purpose of the agency.[1]

To illustrate: *P* appoints *A* to act as his agent to sell a certain automobile for $600. As an incident to the authority conferred, *A* has power to enter into a written contract with the purchaser and sign *P*'s name to the agreement. Whether he has any authority to make express warranties or to sell on credit instead of for cash are questions which depend on the rules set forth in the following sections.

Sec. 14. Custom and usage.—The confines of an agent's powers may be broadened or narrowed by the existence of general usage or custom in the locality in which the agent operates. Thus, the answer to the question suggested in the previous section concerning the agent's power to sell on credit may be said to depend upon the custom of the locality.

Furthermore, the custom of a particular line of business has an important influence on the authority of the agent.[2] For example, a sales agent might well have power to warrant the quality of fish to be delivered, but might not possess an implied power to warrant the quality of a pair of rubber boots.

The customs of the particular principal in the conduct of his business have an important bearing on the incidental powers of his

[1] Bowman v. Press Pub. Co., 1934, 316 Pa. 531, 175 Atl. 483; p. 552.

[2] Westurn v. Page, 1896, 94 Wis. 251, 68 N.W. 1003; p. 553.

agent. Thus, generally speaking, a departmental buyer for a large mercantile establishment possesses no authority to bind his principal by a contract of purchase. His business is to select needed goods, subject to the approval of some superior official. However, a well-defined custom of *P* to give all buyers power to purchase could be relied upon in a special case, although it later appeared that no such authority had been delegated to the agent involved.

Sec. 15. Secret limitations.—It is said that secret limitations imposed upon the powers of an agent do not bind third parties unless their attention has been drawn to them. In other words the third party, having established that an agency exists and having determined in a general way the limits of the authority, is not bound to explore for unexpected and unusual restrictions. He is justified in assuming, in the absence of contrary information, that the agent possesses those powers which like agents customarily have.[3] Thus, an instruction not to sell to a certain individual, or not to sell him on credit, could not affect the validity of a contract effected by an agent with a third party, although the agent might be liable to the principal for any resulting damages.

Sec. 16. Powers enlarged by emergency.—An existing emergency which necessitates immediate action on the part of the principal or his representative may add sufficiently to the agent's powers to enable him to meet the situation. However, if time permits and the principal is available, any proposed remedy for the difficulty should be submitted to the principal for approval.[4] It is only when the principal is not available that the powers of the agent are extended. Furthermore, the agent receives no power greater than that sufficient to solve the difficulty. Thus, the power of an agent to borrow money on the strength of his principal's credit is rarely implied. Suppose, however, that a C. O. D. shipment arrives for the principal during his absence and money is not available to pay for the goods. Clearly, his representative in charge of the business might borrow sufficient funds to pay for the goods and thus avoid demurrage charges and other possible losses. The principal would not be liable for any excess borrowed beyond that required to pay for the particular shipment.

Sec. 17. Notice to agent.—Notice or knowledge acquired by an agent while acting within the scope of his authority binds the principal. This fact is true, because the agent is the principal's other self, and, therefore, what one knows, the other knows. For the principal to be bound, the notice must have been acquired by an agent who represented the principal in regard to the particular sub-

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[3] Hichhorn Mack & Co. v. Bradley, 1902, 117 Iowa 130, 90 N.W. 592; p. 554.

[4] The Terre Haute & Indianapolis R.R. Co. v. McMurray, 1884, 98 Ind. 358; p. 555.

ject matter involved.[5] Thus, an agent, who is acquiring property for his principal and has knowledge of certain unrecorded liens against the property, takes the property for his principal subject to those liens. Knowledge of some other agent who had never represented the principal in the particular transaction, and who did not receive the notice definitely for his principal, could not affect the principal's interest.

Considerable dispute has arisen as to whether notice acquired by an agent before he became such can affect the principal. The better view is that notice which is acquired before the creation of the agency and is later retained by the agent while representing his principal is notice to the latter.

Notice to the agent, where he is under a duty to some third party not to disclose the information, does not affect the principal. Furthermore, notice to the agent, combined with collusion or fraud between him and the third party which would defeat the purpose of the notice, would not bind the principal. Thus, notice by a third party of an unrecorded mortgage on property, where the agent agreed not to disclose the mortgage to his principal because of a certain compensation, would not subject the property to a lien in the hands of the principal.

Peculiar Powers

Sec. 18. Real estate broker.—The ordinary real estate broker possesses no authority, in the absence of an express grant, to enter into a contract for the sale of property listed with him. It is his business to find a party who is willing to purchase the property upon the proposed terms. The owner reserves the right to contract or not, as he sees fit, at the time the broker's prospective buyer is presented.

The same is true of many solicitors—often called salesmen—whose authority is limited to obtaining orders for merchandise which are subject to approval by the principal. If such a limitation conforms to the custom or usage, the buyer's contract is ineffective until it has been approved by the seller.

Sec. 19. Right to collect.—The power of an agent to collect a bill owed to his principal may not readily be implied. Thus it has been held that possession of a statement upon the principal's billhead and in the principal's handwriting did not justify an assumption of such authority.

A question of considerable difficulty is encountered concerning the power of a salesman to collect. Clearly, the agent behind the counter who sells the goods has an implied power to collect for

[5] People ex rel. Carr v. Gullborg, 1927, 324 Ill. 538, 155 N.E. 324; p. 556.

them at the time of the sale. If, however, the sale is on credit, no power exists to collect at a later date unless the business is a relatively small one in which the agent performs a rather general service.

The agent who delivers goods which have been sold for cash undoubtedly has a right to collect all payments due at the time of delivery. Otherwise the ordinary delivery boy has no authority to collect unless it is expressly conferred or arises through custom.

The traveling salesman who covers certain designated territory for his principal and merely solicits orders has no authority to collect as payments fall due, except those payments to be made at the time the order is obtained.[6] In the absence of express authority, payments made to such agents, which fail to find their way into the principal's possession, may again be collected from the debtor.

Authority to collect gives the agent no authority to accept anything other than money in payment. He is not empowered to accept negotiable notes or property in settlement of an indebtedness unless expressly authorized. It is customary to accept checks as conditional payment. Under such circumstances the debt is not paid unless the check is honored. If the check is not paid, the creditor is free to bring suit on the contract which gave rise to the indebtedness or to sue on the check, at his option.

Sec. 20. **Purchase on credit.**—An agent who is given special authority to purchase is limited to the quantity and quality of goods set forth by the principal. Such limitations imposed upon a general purchasing agent at a particular occasion would, however, amount to secret limitations and would not, therefore, be effective against innocent third parties. A general agent placed in charge of a business presumably has power to purchase either on credit or for cash. If the principal provides him with cash and instructs him not to purchase on credit, the majority holds that the principal is not liable for goods purchased on credit.[7] This rule is true only where the agent has not in some manner been held out as possessing greater authority.

Sec. 21. **Written agreements—how executed.**—The principal is liable upon all contracts made by the agent so long as they relate to matters within the scope of his authority and are properly executed. So far as simple contracts are concerned, although the signature does not indicate definitely who the real contracting party is, most of the states permit the use of parol evidence to show the intention of the agent and the third party.[8] Without question this

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[6] Zazzaro v. Universal Motors, 1938, 197 Atl. 884; p. 557.

[7] Americus Oil Co. v. Gurr, 1902, 114 Ga. 624, 40 S.E. 780; p. 558.

[8] Goodenough v. Thayer, 1882, 132 Mass. 152; p. 558.

is true whenever the signature is ambiguous. It is possible, however, for the third party to desire to contract with the agent alone and on the strength of his credit. Where such is true, the principal is not liable.

There is a rule of law relating to negotiable instruments to the effect that no one can be held thereon unless his name is attached thereto. Because of this fact, the agent should exercise care to see that any negotiable paper executed by him bears his principal's name and his own, preceded by "by" or "per," following his principal's. If this procedure is not followed the ultimate holder of the paper may be able to hold both the principal and the agent, or the agent alone. Although considerable conflict exists, according to the law of most states parol evidence may be introduced to explain a signature to negotiable paper which is clearly ambiguous. Some states hold that unless the instrument as a whole explains the signature, the agent shall be held liable.

Undisclosed Principal

Sec. 22. Undisclosed principal's contracts.—For various reasons a principal often desires to hide his identity. In such instances he appoints an agent to act for him; the agent enters into all contracts in his own name, leaving the third party unaware of any principal. Such agreements are always entered into on the strength of the agent's credit, as no principal is disclosed. Although such is the case, the third party, upon learning of the principal's identity, may elect to collect from the principal rather than from the agent.[9] The principal is responsible for all contracts entered into by the agent within the scope of the agent's authority. Furthermore, even though the agent has been definitely limited, the courts hold the principal liable for acts which would have been within the apparent scope of the agent's authority had the principal been known.

The undisclosed principal is never liable upon a negotiable instrument signed by his agent, as his name does not appear thereon. It is possible in many such cases for the third party to waive the note and sue upon the agreement which furnished the consideration therefor, thus avoiding the difficulty encountered by a suit on the note or bill of exchange.

Sec. 23. Settlement between principal and agent.—In the preceding section it was indicated that the third party, after learning of a principal's interest in any transaction, might elect to look to the principal for performance. Suppose, in such a case, that the principal supplied the agent with money to purchase the goods, but

[9] Kayton v. Barnett. 1889, 116 N.Y. 625, 23 N.E. 24; p. 559.

they were delivered to the agent on the strength of his own credit. What should be the result? It is clear, under such circumstances, that the principal is relieved of all responsibility. A slightly different problem arises where the principal settles with the agent after the contract is made and the goods are delivered, but before his disclosure to the third party. Any bona fide settlement before disclosure apparently relieves the principal. A settlement cannot have this effect, however, when it is made after the third party has learned of the existence of the principal and the principal is aware of that fact.

Such a rule seems to be fair to the third party, in that it gives him all the protection which he originally bargained for, and at the same time helps the principal, in that it protects him against a second demand for payment.

Sec. 24. What is election.—Election means choice, and a choice becomes possible only when the third party learns of the existence of a principal.[10] If a settlement has taken place previously, no election is possible; otherwise, the third party may look to either the agent or the principal for performance until such time as he definitely elects to hold one or the other. No conduct on his part which precedes the disclosure of the principal can constitute an election. Thus, it has been held that an unsatisfied judgment obtained against the agent before disclosure of the principal will not bar a later action against the principal.

After disclosure, the third party may evidence his election by obtaining a judgment against one of the parties, or by making an express declaration of his intention. It has been held that the sending of a statement to one of the parties does not indicate an election. Most states also hold that the receipt of a negotiable instrument from one of them does not show an election. The mere starting of a suit against one of the parties has been held insufficient to cause an election. From these illustrations it can be seen that very definite action is essential to constitute an election. The third party is usually free at any time to sue the particular party whose credit is best.

Liability for Agent's Torts

Sec. 25. Negligent acts.—The principal becomes liable to third parties for any damage occasioned them by the negligence of the agent so long as the latter is acting in the course of his employment. Should the agent be engaged in his own business when the tort is committed, having left temporarily his principal's business, the principal is relieved of any liability. The fact that he may

[10] Lindquist v. Dickson, 1906, 98 Minn. 369, 107 N.W. 958; p. 560.

have been in the possession of his employer's vehicle does not extend the liability of the principal.[11] The real test is: Was the agent about his principal's business when the tort was committed? The mere fact that he has combined his own with the principal's business does not release the principal, unless the agent has quite definitely departed from his principal's business at the time of the accident.

The principal cannot avoid liability by showing that he has instructed the agent not to do the particular act complained of.[12] Neither is he released by evidence that the agent was not doing the work his principal had instructed him to do, where the agent had misunderstood the instruction. So long as the agent is attempting to follow out his principal's business, the principal is liable.

Sec. 26. Willful acts.—Thus far attention has been given to a situation in which the third party is damaged by negligent conduct of the agent. Suppose, however, the agent willfully and deliberately injures the third party. Is the principal liable? Clearly, if the willful misconduct of the agent has nothing to do with his principal's business and is animated entirely by hatred or a feeling of ill-will toward the third party, the principal is in no respect liable. Where the predominant motive is not to work off a personal grudge, but rather to advance his principal's interests, it has been held that the principal is liable.

Furthermore, where the principal has invited the public to his premises, it is said that he owes them a special duty of protection from the misconduct of his employees. Thus, the proprietor of a business is liable for an unprovoked attack upon a customer by one of his employees. Again, if the agent has been intrusted with the use of physical force in the performance of his duties, the principal becomes responsible for an excessive use of the force.

Sec. 27. Notice in event of termination.—Termination of the agency, as explained elsewhere, may take place by act of the parties or by operation of law. If the parties by their own action have terminated the agency, it is the duty of the principal to notify all third parties, who have learned of the existence of the agency, of its termination.[13] Those entitled to such notice may be divided into two groups: (1) those who have previously relied upon the agency by dealing with the agent; and (2) those who have never previously dealt with him, but who, nevertheless, have learned of the agency. The principal's duty to the first class can be satisfied only by the actual receipt of notice by the third party. He satis-

[11] Jones v. Cook, 1922, 90 W.Va. 710, 111 S.E. 823; p. 561.
[12] Cosgrove v. Ogden, 1872, 49 N.Y. 255, 10 Am. Dec. 361; p. 562.
[13] Meeker v. Mannia, 1896, 162 Ill. 203, 44 N.E. 397; p. 563.

fies his duty to the second group by giving public notice, such as newspaper publicity, in the location involved. If any one of the second group, not having seen the newspaper account of the termination, relies upon the continuation of the agency to his detriment, he has no cause of action. If a member of the first group has not received direct notice from the principal, but has learned indirectly of the severance of relation or of facts sufficient to place him on inquiry, he is no longer justified in extending credit to the agent.

Where the agency is terminated by action of law, such as death, insanity, or bankruptcy, no duty to notify third parties devolves upon the principal. Such matters receive publicity through newspapers, official records, and otherwise, and third parties normally become aware of the termination without the necessity for additional notification.

Liability of Third Party

Sec. 28. Contracts for disclosed principal.—The disclosed principal may sue the third party upon any contract made by the agent for the former's benefit. This rule applies to all simple contracts in which the principal is the real party in interest, despite the fact that they are made in the agent's name. Furthermore, any contract made for the benefit of the principal, although the agent acted outside the scope of his authority, entitles the principal to performance, provided the contract has been properly ratified before withdrawal.

Sec. 29. Undisclosed principal.—The undisclosed principal is entitled to performance by third parties of all simple contracts made for his benefit by the agent. In the ordinary case, it is no defense for the third party to say that he entered into no contract with the principal. Where, however, the contract is one which involves the skill or confidence of the agent, and which would not have been entered into but for this skill or confidence, its performance may not be demanded by the principal. In other words, whenever a contract made for the benefit of an undisclosed principal is such that it cannot be assigned, the principal cannot demand its benefits.

In all cases the principal takes over the contract subject to all defenses which the third party could have established against the agent.[14] Thus, if the third party contracts to buy from such an agent, and expects to be able to set off an account which he has against the agent, he has this same right of setoff against the undisclosed principal.

[14] F. T. Banking Corp. v. Gerseta Corp., 1923, 237 N.Y. 265, 142 N.E. 607, 31 A.L.R. 732; p. 563.

Review Questions and Problems

1. For what acts of the agent is the principal responsible? What is the effect of custom and usage on the powers of the agent?

2. Mrs. *G* owned a store and placed her son in general charge thereof. She gave him very definite instructions not to enter into any contracts for advertising without her consent. Nevertheless, he entered into a contract for advertising, which would compare favorably with advertising in other stores of like size. Is the mother liable?

3. *A* operated a department store and for each department there was a party known as the buyer, although he possessed no actual authority to purchase. The duty of each buyer was to select the goods and submit his choice to the management for approval. *T* sold an order of goods to one of the buyers and the goods were shipped without the approval of the management. Was *A* liable?

4. What effect has an emergency upon the powers of an agent? Are there any limitations upon the powers of an agent under such circumstances?

5. One *A* was the traveling salesman for *P*. He sold and delivered to *T* goods amounting to $300. At the time of delivery he collected the sale price, but failed to turn it in to *P*. Will *T* have to pay again? Would the result be the same if *P* had shipped the goods and *A* had collected at the end of the month? Suppose *A* had sold the goods in exchange for groceries and had used the groceries. Would *P* have been able to collect again of *T*?

6. *A*, while acting as traveling salesman for *B*, is informed of the dissolution of the firm of *X* & *Y*. Later *A*, being now employed by *P*, sells goods to *Y*. *P* assumes that *X* is still a partner, inasmuch as the same firm name is continued. Is *P* charged with notice of the dissolution?

7. What are the duties of a real estate broker? May he enter into a binding contract of sale?

8. Has a purchasing agent any implied authority to purchase on credit? Suppose the agent is one in general charge of a business. What is the result if the principal furnishes such an agent with cash to carry on the business?

9. Is the principal always liable on a written contract made for his benefit regardless of how the agent signs? Who is liable on an ordinary contract to which the signature is ambiguous? How should negotiable instruments be signed where an agent is acting for his principal?

10. *A* was the purchasing agent of *P* for the purpose of buying poultry and farm produce. In all his transactions with the farmers *A* acted as the principal and purchased on the strength of his own credit. *A* failed to pay for certain of the produce purchased. The farmers, having ascertained that *P* was the true principal, seek to hold him. May they do so? Suppose *P* had previously settled with *A*?

11. What is meant by election? May election take place before the principal is disclosed?

12. *A*, a delivery boy for *P*, was instructed never to drive the truck over

fifteen miles an hour and never to drive on the left side of the street. While disobeying both of these instructions, *A* ran into and injured *T*. Assuming that *A* was engaged in delivering goods for *P* at the time of the accident, is *P* liable to *T*?

13. *P* ordered *A* to make collection from *T* of the final payment on a diamond ring and instructed him, if he could not obtain payment, to repossess the ring. *T* refused to make the payment or to surrender the ring. *A* became enraged and in the fight which ensued, seriously injured *T*. *T* sued *P* in an attempt to recover damages for the injury. Should he have been permitted to recover?

14. *J* discharged his collection agent and published notice thereof in a local paper. The agent thereafter collected a $250 account from *S*. Under what circumstances, if any, is *S* still liable to *J*?

15. *A*, a traveling salesman for the *X* Company, checked his trunk containing samples for transportation over the *Y* Railway Company. The goods were lost in transit. May the *X* Company recover from the *Y* Railway Company?

CHAPTER III
PRINCIPAL AND AGENT

Duties and Liabilities of Agent

Sec. 30. Classification.—The extent of the duties imposed upon the agent are largely governed by his contract of employment. In addition to the duties expressly assumed by the agent, certain others are implied from the nature of the relationship. These duties divide themselves roughly into five groups. The agent is: (1) to be loyal to his principal; (2) to obey all reasonable instructions; (3) not to be negligent; (4) to account for all money or property received for the benefit of the principal; and (5) to inform the principal of all facts which materially affect the subject matter of the agency. A duty arising under any specific circumstances will usually be found to fall within one of these groups.

Sec. 31. Duty to be loyal.—As an organic part of every contract of employment, an implied duty arises on the part of the agent to be loyal to the interests of his principal. Because of this fact, it is held that he should undertake no business venture which competes or interferes in any manner with the business of his employer. This same rule forbids a sales agent to sell his principal's property to himself, unless the principal assents to the sale.[1] The rule also prevents a purchasing agent from buying his own property or that in which he has an interest. Transactions violating these rules may always be rescinded by the principal, despite the fact that the agent acted for the best interests of his principal and the contract was as favorable as could be obtained elsewhere. The general rule is applied without favor in order that every possible motive or incentive for unfaithfulness may be removed.

In any case in which the agent obtains the consent of the principal to deal with himself, the agent must disclose fully all facts which materially influence the situation. In such a case they do not deal at "arm's length," and the circumstances demand the utmost good faith on the part of the agent.

Because of the loyalty demanded of an agent, a broker is denied the right to represent both the seller and the buyer in the same transaction unless both have been informed of his dual relationship. His desire to earn the commission is apt to cause him to disregard the best interests of one of his principals.

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[1] Rich v. Black & Baird, 1895, 173 Pa. St. 92, 33 A. 880; p. 565.

If a contract is entered into between the two principals, it may be avoided when it is learned that one agent represented both parties. Even though the agreement is fully performed, the agent who, unknown to the parties, acted in a dual capacity is denied the right to compensation for his services. He should have notified the parties of his peculiar relationship.

Sec. 32. Use of confidential information.—Loyalty demands that all information of a confidential character acquired while in the service of the principal shall not be used by the agent to advance his interests in opposition to those of the principal. An employee who learns of secret processes or formulas or comes into possession of lists of customers may not use this information to the detriment of his employer.

Thus, an employee who, having learned of a valuable lease held by his employer, leases the property for himself, may be forced to hold the lease in trust for his employer. If the agent "steals a march" on his principal, the profit belongs to the principal and not to the agent. The rule is applied with equal severity whether the agent acts before or after he severs his connection with the principal. An employee who copies a list of his employer's customers may not circularize such a group after he enters business for himself. A distinction must be drawn, however, between the use of secret information and the use of skill acquired at a certain employment. The latter may be used, although it affects injuriously his former employer. For this reason there is nothing to hinder a person who has made the acquaintance of his employer's customers from later circularizing those whom he can remember. His acquaintanceship is part of his acquired skill. The employer may protect himself in the latter case by a clause in the employment agreement to the effect that the employee will not compete with the employer or work for a competitor for a limited period of time after his employment is terminated.

Sec. 33. Profits from violation of duty.—All profits made by an agent while violating his duty may be recovered by the principal. Such profits include rebates, bonuses, commissions, or divisions of profits received by an agent for unfaithfulness in dealing with a particular third party. Here again the contracts may have been favorable to the employer, but the result is the same.[2]

An agent is presumed to give all his time wholeheartedly to furthering his principal's cause. Suppose, however, that he takes part of his time, unknown to his employer, to perform work for someone else and obtains compensation for it. Clearly, such compensation belongs to the principal. Thus, a traveling salesman who,

[2] Patterson v. Missouri Glass Co., 1897, 72 Mo. App. 492; p. 566.

without the consent of his employer, carries a sideline which he sells to customers of his employer, may be compelled to turn over his sideline commissions to his principal.

This duty of the agent refers only to the time which the contract demands be spent on the principal's business. Any money made after hours, or during a period when he is not expected to be working for his principal, unquestionably remains the property of the agent.

Sec. 34. To obey instructions.—It becomes the duty of an agent to obey all instructions issued by his principal so long as they refer to duties contemplated by the contract of employment. Burdens not required by the agreement cannot be indiscriminately imposed by the employer. An instruction may not be disregarded merely because it departs from the usual procedure and seems fanciful and impractical to the employee. It is not his business to question the procedure outlined by his superior. Any loss which results while he is pursuing any other course makes him absolutely liable for the result.

Furthermore, an instruction of the principal does not become improper merely because the motive is bad. He may be well aware of the agent's distaste for certain tasks, yet, if those tasks are such as may be called for under the employment agreement, it becomes the agent's duty to perform them. Failure to perform often results in proper grounds for his discharge.

This obligation on the part of the agent to follow carefully his principal's orders applies to an agent who acts gratuitously, as well as to one who receives pay for his services. Although the former is under no duty to perform, even though he has promised to do so, yet, if he undertakes to carry out his commission, he must follow explicitly the instructions received.

Closely allied to the duty to follow instructions is the duty to remain within the scope of the authority conferred. Because of the doctrine of estoppel, it often becomes possible for an agent to exceed his authority and still bind his principal. In case of such a violation of his contract, the employee clearly becomes responsible for any resulting loss. He is in this instance failing to follow the instructions set forth in his contract with his employer. These instructions must be fully complied with, as well as those issued later by the principal.

Sec. 35. Unusual circumstances.—Occasionally circumstances arise which nullify instructions previously given. Because of the new conditions, the old instructions would, if followed, practically destroy the purpose of the agency. Whenever such an emergency arises, it becomes the duty of the agent, provided the principal is

not available, to exercise his best judgment in meeting the situation.

An instruction to do an illegal or immoral act, or an act which will impair the security or position of the agent, may be disregarded. To illustrate: A factor has a lien on goods in his possession for all money advanced to his principal. An order from the principal to return the goods or to sell them on credit could be disregarded until such time as all advances had been paid.

The usual effect of a failure to follow instructions is that it makes the employee liable for resulting damage. In addition, if the performance requested is of the essence of the agency, it may justify a termination of the relationship. On the other hand, if the violation merely consists in the manner in which the task is performed, the agent may not be discharged unless he persists in his failure to follow orders.

Sec. 36. Duty not to be negligent.—All agents are presumed to exercise that degree of skill and diligence ordinarily expected of those who perform like undertakings. An agent who agrees to perform a particular task implies that he possesses the requisite skill and training. His duty is to exercise only a reasonable degree of care, and he is not liable for a failure to use the highest degree of care possible. Thus, an agent may be intrusted to loan the money of another. If he exercises ordinary prudence in ascertaining the state of the title to property securing the loan and reasonably estimates its value, he cannot be held liable upon nonpayment of the loan at its maturity.[3] In a previous chapter it was observed that the negligence of an agent might, under certain conditions, make the principal liable to third parties. Where the agent is clearly responsible for the damage, the principal may recover from the agent the amount paid by him to the third party. The burden in such cases may ultimately be shifted to the negligent party.

Sec. 37. Duty to account.—Money or property intrusted to the agent must be accounted for to the principal. Because of this fact, the agent is required to keep proper records showing receipts and expenditures, in order that a complete accounting may be rendered. Any money collected by an agent for his principal should not be mingled with funds of the former. If they are deposited in a bank, they should be kept in a separate account and so designated that a trust is apparent. Otherwise any loss resulting from an insolvent bank must be borne by the agent.

The principal may follow any funds misappropriated by the agent until they fall into the hands of a third party. Even then the principal may follow the proceeds and impress a trust upon them, so long as they have not reached an innocent third party.

[3] Whitney v. Martine, 1882, 88 N.Y. 535; p. 566.

Furthermore, if such proceeds can be shown to have increased the estate of the agent, a trust may be imposed upon the agent's estate to that extent.

Sec. 38. To give notice.—It becomes the duty of an agent to tell his principal of all facts which vitally affect the subject matter of the agency and which are obtained within the scope of the employment. Matters learned while outside the scope of the employment and which the agent never expects to use need not be communicated to the principal.

This rule extends beyond the duty to inform the principal of conflicting interests of third parties in a particular transaction, and imposes upon the agent a duty to give all information which materially affects the interest of the principal. Thus, knowledge of facts which have greatly advanced the value of property placed with an agent for sale should be communicated before the property is sold at a price previously established by the principal.

Duties and Liabilities of Principal

Sec. 39. To employ.—First and foremost, it becomes the duty of the principal to employ the agent in accordance with their agreement and to pay him the agreed compensation.[4] If no definite compensation has been agreed upon, there arises a duty to pay the reasonable value of such services. Whenever the party performing the services is a stranger to the employer, the obligation to compensate exists. However, where relatives are working for one another and no express agreement has been formulated, the courts are likely to infer that the services so rendered should be considered as gratuitous.

Whether the agent is entitled to have actual work to perform in addition to his compensation is questionable. Where, however, his skill depends upon constant practice, it is doubtful whether the employer fulfills his agreement by merely paying the agreed compensation without offering him any work to do.

Sec. 40. Real estate broker's commission.—In the absence of an express agreement, the real estate broker earns his commission at either one of two times. As soon as he finds a buyer who is ready, willing, and able to meet the terms outlined by the seller, he has earned his commission.[5] The owner cannot rob him of his compensation by refusing to deal with the prospective purchaser or by withdrawing the property from sale. Likewise, he cannot relieve himself of the duty to pay the commission by terminating the agency and later contracting directly with the broker's prospect.

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[4] Walsh v. Isgro, 1938, 121 N.J.L. 165, 1 Atl.(2) 391; p. 567.

[5] Knowles v. Henderson, 1945, 156 Fla. 31, 22 S.(2) 384; p. 568.

The fee is earned if it is shown that the broker was the inducing cause of the sale.

The commission is also earned as soon as the owner contracts with the purchaser, even though it later develops that the buyer is unable to meet the contract's terms. The owner assumes the risk of performance if he is willing to, and does, contract with the buyer presented by the broker. The broker's commission is contingent on payment by the purchaser only when his contract of employment so states. An owner who lists property with several brokers is obligated to pay the first one to find a satisfactory purchaser, at which time the agency of other brokers is automatically terminated.

Sec. 41. Compensation of sales representatives.—Salesmen who sell merchandise on a commission basis have problems confronting them which are similar to those of the broker unless the employment contract is specific in its details. To illustrate, let us assume that *X* Co. appoints *A* as its exclusive sales representative in a certain territory on a commission basis, and that the employer is engaged in producing and selling electrical equipment. *T*, a business man in the area involved, sends in a large order for merchandise directly to the home office of *X* Co. Is *A* entitled to a commission on the sale? It is generally held that such a salesman is entitled to a commission only on sales solicited and induced by him, unless his contract of employment gives him greater rights.

The salesman usually earns his commission as soon as an order from a responsible buyer is obtained, unless his contract of employment makes payment contingent upon delivery of the goods or collection of the sale's price. If payment is made dependent upon performance by the purchaser, the employer cannot deny the salesman his commission by terminating the agency prior to collection of the account. When the buyer ultimately pays for the goods, the seller is obligated to pay the commission.

An agent who receives a weekly or monthly advance against future commissions is not obligated to return the advance if commissions equal thereto are not earned. The advance, in the absence of a specific agreement, is considered by the courts as a minimum salary.

Sec. 42. Reimbursement and indemnity.—Money expended by the agent in behalf of the principal may be recovered. It must appear that the money was reasonably spent and that its expenditure was not necessitated by the misconduct or negligence of the agent.

The agent is justified in presuming that instructions given by the principal are such as he lawfully has a right to give and that performance resulting from such instructions will not injuriously affect third parties. Where this is not the case, and the agent incurs a liability to some third party because of trespass or conversion, the

principal must indemnify the agent against loss.[6] In like manner, it becomes the duty of the principal to make possible performance by the agent whenever the latter has entered into a contract in his own name for the former's benefit. The undisclosed principal must fully protect his agent.

Termination of Agency

Sec. 43. By act of the parties.—An agency may be terminated by an act of the parties or by operation of law. An agency which is created to continue for a definite period of time ceases, by the original agreement, at expiration of that period. If the parties consent to the continuation of the relationship beyond such period, the courts imply the formation of a new contract of employment. The new agreement contains the same terms as the old one, and continues for a like period of time.[7]

An agency created to accomplish a certain purpose automatically ends with the completion of the task assigned. In such a case third parties are not entitled to notice of the termination. Furthermore, where it is possible for one of several agents to perform the task, as selling certain real estate, it is held that performance by the first party terminates the authority of the other agents.

Any contract may be terminated by mutual agreement; therefore, the agency relationship may be severed in this manner. Furthermore, either party to the agreement has full power to terminate it whenever he desires, although he possesses no right to do so. Wrongful termination of the agency by either party subjects him to a suit for damages by the other party. An exception to these rules exists in the case of so-called agencies coupled with an interest. Such agencies cannot be terminated without the consent of the agent, and a full discussion of them will be found in a subsequent section.

Sec. 44. Wrongful termination and its effect.—An employment at the will of the parties may be terminated at any time. On the other hand, if the employer wrongfully terminates a contract which was to continue for an agreed period, he becomes liable for damages. However, if the agent is discharged for cause, such as failure to follow instructions or to exercise proper care, or for nonperformance of various other duties, he may not recover damages from his employer.

The employee who has his employment wrongfully cut short is entitled to recover his compensation for work done before his dismissal and an additional sum for damages. Most of the states permit him to bring an action either immediately following the breach,

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[6] Hoggan v. Cahoon, 1903, 26 Utah 444, 73 Pac. 512, 99 A.S.R. 837; p. 570.

[7] Sines v. Superintendents of the Poor, 1885 58 Mich. 503; p. 571.

in which he recovers prospective damages, or after the period has expired and thus recover the damages actually sustained. In the latter case he is compelled to deduct from the compensation called for in the agreement the amount which he has been able to earn during the interim. Under such circumstances the employee is held to a duty to exercise reasonable diligence in finding other work of like character. Apparently this rule does not require him to seek employment in a new locality or to accept work of a different or more menial character. His duty is to find work of like kind, provided it is available in the particular locality.

Sec. 45. Termination by law.—Certain acts are held by law to terminate the agency. Among these are death, insanity, or bankruptcy of either of the parties. Bankruptcy has such an effect only in case it affects the subject matter of the agency.

It is said of such cases that the agency is immediately terminated and that no notice need be given to either the agent or the third parties. However, with reference to insanity, unless the principal has been publicly adjudged insane, it is believed that his agent's contracts are binding on the principal unless the third party is aware of the facts.

Sec. 46. Agency coupled with an interest.—It is said that an agency coupled with an interest cannot be terminated without the consent of the agent. Such agencies are of two classes: those in which the agent has a legal or equitable interest in the subject matter; and those in which the agency is created as a source of reimbursement to the agent because of money owed him by the principal. This latter type is most often called an agency coupled with an obligation. Although it cannot be terminated by the principal during his lifetime, it is terminated by death, whereas a true agency coupled with an interest is not terminated in either case. To illustrate: A mortgagee who receives a mortgage in which is included a provision giving him the right to sell in case of default could not have this right taken away during the lifetime or by the death of the principal. On the other hand, an agent who is given the right to sell a certain automobile and to apply the proceeds on a claim against the principal has his right cut off by the death of his principal.

Under either type of agency it should be clear that the interest in the subject matter must be greater than the mere expectation of profits to be realized.[8] In other words, a principal who has appointed an agent to sell certain goods on commission could certainly terminate the agency at any time he desired, although his conduct might constitute a breach of the agreement.

[8] Flanagan v. Brown, 1886, 70 Cal. 254; p. 571.

Review Questions and Problems

1. Name the five duties which the agent owes to the principal.

2. *A*, while employed by *P*, learns that a lease held by *P* is very valuable. Just before the lease expires *A* obtains a new lease in his own name at a slightly increased rental. May *P* compel *A* to assign the lease to him?

3. Should an agent act as the representative of the two contracting parties? If he does act for both, unknown to the parties, may he later recover compensation for his services?

4. *A*, while acting as a traveling salesman for *P*, for which work he is paid a regular salary, carries a sideline which nets him $75 a month. If *P* learns of this fact, may he recover the profit from *A*?

5. Assuming that *P* gives *A* an instruction which appears unreasonable and impractical, may *A* disregard the instruction? Suppose the instruction is one which falls within the list of *A*'s duties, but it is one known to be distasteful to him; may he disregard it?

6. *A* collects money for *P*, but deposits it in *X* bank in his own name. The bank becomes insolvent and is expected to pay about 40 cents on the dollar. Who must bear the loss?

7. *A* invests for *P* $1,000 in a note secured by a first mortgage on real estate. Are there any circumstances under which *A* might be liable in case the mortgagor failed to pay the note and the real estate did not prove to be ample security?

8. *P* takes *A* into his home and treats him as a child of his own, furnishes him with the necessities of life, and makes possible his education. After *A* becomes of age, may he recover the reasonable value of various services rendered to *P* while he was a minor?

9. What is the difference between reimbursement and indemnity? May an agent of an undisclosed principal always recover from the principal for liabilities incurred while representing him?

10. *A*, appointed to sell merchandise in a certain area for *P*, was to receive a commission of 2% on all sales. He received a weekly advance of $40 for ten weeks but his commissions only averaged $20 a week. Does he owe *P* the $200 difference?

11. How long does an agency relationship continue? What is the result of a wrongful termination?

12. What is the difference between an agency coupled with an interest and one coupled with an obligation running from the principal to the agent? *P* gives *A* a mortgage to secure a note and in the mortgage gives A the right to sell the property in case of default. Does the right to sell cease upon the death of *P*?

13. *A* acted as *P*'s agent in a sale of real estate to *T*, for whom he was also acting as purchasing agent. After the transaction had been completed *P* first learned of the dual agency and he refused to pay *A* his commission of $1,320. Assuming *P* obtained the full price at which the property was listed, is *A* entitled to his commission?

CHAPTER IV
AGENT AND THIRD PARTY

Liability of Agent to Third Party

Sec. 47. Liability on contract.—The agent seldom incurs any liability to the third party upon contracts entered into for a known principal. In such cases he negatives any personal responsibility by a proper execution of the contract. Only if the agent carelessly executes a written agreement may he find himself bound by the contract. To use an illustration suggested previously, the agent who signs a negotiable instrument for his principal, but fails to indicate clearly the principal's existence and his relation to the instrument, is personally liable.

It often happens that the third party, for certain reasons, desires to add the credit of the agent to that of the principal, or to contract with the agent alone. The credit of the principal may be weak or his credit rating may be unknown. Under such circumstances, the third party, who is well acquainted with the agent, is perfectly willing to contract with the latter but not with the former. Where, therefore, the agent voluntarily assumes the burden of performance in his personal capacity, he unquestionably becomes liable in the event of nonperformance by his principal.

In addition to the above situation, the agent of an undisclosed principal always assumes personal liability. So far as the third party is informed, he is the only principal involved. The contract is made with the agent, and he takes on full responsibility for its performance. It should be noted in this connection, however, that the third party has an option. He may elect to hold either the agent or the principal, provided he acts within the proper time after he learns of the existence of the undisclosed principal. If the agent is held liable, he in turn has recourse against the principal.

Sec. 48. Warranty of authority.—Occasionally an agent attempts to act for a principal when he possesses no power to bind the latter. In such instances he may or may not be aware of the limitation of his power; he may honestly think his authority extends to the act complained of, or he may be well aware that he was never appointed an agent. In either event he becomes liable to third parties for the damages resulting from his failure to bind the principal. His liability is said not to rest upon the contract itself, but to result from breach of an implied warranty. Every agent impliedly warrants to third parties that he possesses power to affect

the contractual relations of his principal.[1] If in any particular transaction he fails to bear such a relation to his principal, he violates this implied warranty. In addition, an agent who intentionally misrepresents his authority may be liable in an action of deceit. In such a case all the elements of fraud are present. Presumably, in either event, the damages would be those suffered because the agent failed to possess the authority which he attempted to exercise.

The agent may escape liability for damages arising from lack of authority by a full disclosure to the third party of all facts relating to the source of his authority. Where all the facts are available, the third party is as capable of judging the limits of the agent's powers as is the agent. In other words the third party must rely upon the warranty in order to hold the agent for its breach. Where he has full knowledge of all particulars, he relies upon his own judgment and not upon the agent's representation of authority.

The liability of the agent is qualified in one other respect, He is not liable when, unknown to him, his agency has been cut short by the death of his principal. Such an event as death is usually accompanied by sufficient publicity to reach third parties. At least the facts are equally available to both parties.

Sec. 49. Competent principal.—Every agent who deals with third parties warrants that his principal is in existence and is capable of being bound. Thus, an agent who acts for a minor or for a corporation not yet formed may find himself liable for the nonperformance of his principal. The same rule enables the third party to recover from the agent where his principal is an unincorporated association. In such a case, since there is no entity capable of being bound, a breach of the warranty results. The third party has a right to insist that the principal be a person, a firm, or a corporate entity capable of entering into an enforceable agreement. An unincorporated body has no legal entity, and only those voting for the particular transaction, or later adopting it, are liable.

Where, however, the third party is fully informed that the principal is an unincorporated organization, and he agrees to look entirely to it for performance, the agent is relieved.[2] The evidence must clearly indicate such an agreement, as the normal presumption is that the third party expects to look to one party and not to the membership for performance.

In case the principal is a corporation, the agent does not warrant that his principal has legal capacity to enter into the particular transaction. In other words the agent is not responsible for ultra

[1] Boelter v. National Mfrs. Bank et al., 1927, 194 Wis. 1, 215 N.W. 436; p. 573.
[2] Codding v. Munson, 1897, 52 Nebr. 580, 66 A.S.R. 524; p. 574.

vires contracts. The limits of a corporation's powers are governed by its charter. Since charters are usually made a matter of public record, the powers of the corporation are equally available to the agent and to the third party.

Sec. 50. To account for money received.—An agent who, in the course of his employment, receives money from third parties for the benefit of the principal owes no duty to account to the third parties. If such money does not find its way into the principal's hands, it may be recovered in an action by the principal against the agent. This rule adequately protects all parties. On the other hand, money paid to an agent who has no authority to collect it, and which is not turned over to the principal, may be recovered in an action by the third party. To illustrate: A traveling salesman normally has no authority to collect for his principal. Should he do so and surrender the money to his principal, the debtor has no cause of action. A failure on his part to account to his principal, however, subjects him to an action by the third party.

A different problem is presented when money is paid to an agent in error, such as occurs by overpayment of an account. If the agent has passed the money on to his principal before the mistake is discovered, it is clear that only the principal is liable.[3] Nevertheless, money which is still in the possession of the agent when he is notified of the error should be returned to the third party. The agent does not relieve himself of this burden by subsequently making payment to his principal.

Any payment made in error to an agent and caused by his mistake or misconduct may always be recovered from him, although he may have surrendered it to his principal. Likewise, any overpayment may be recovered from the agent of an undisclosed principal. In such a case the agent is dealt with as the principal.

Sec. 51. Liability for torts.—An agent may not defend an action against him for his misconduct by offering proof that he was about his principal's business at the time. The agent is always liable to third parties for the result of his negligence. The same ruling is also true of conversion or trespass. The agent may believe, and have good cause to believe, that he is handling his principal's property. Yet, should it prove to belong to a third party, he is liable for conversion. The same is true of trespass. The principal may definitely instruct his agent to cut certain timber. The agent, assuming that it belongs to his employer, proceeds with the work. It is later discovered that the timber belongs to some third person. It is clear in such a case that the agent is liable for

[3] Cabot v. Shaw and Others, 1889, 148 Mass. 459; p. 575.

the damage caused, although he may in turn recover indemnity from his principal.

Liability of Third Party to Agent

Sec. 52. On contract.—Normally the agent possesses no right to bring suit on contracts made by him for the benefit of his principal. It is only where the agent binds himself to the third party, either intentionally or ineptly by a failure properly to express himself, that he may maintain an action. To illustrate: An agent of an undisclosed principal always binds himself. As a result, he may, in his own name, sue the third party in the event of nonperformance by the latter. Under the circumstances outlined, either the agent or the principal might bring suit. But, in case of a dispute, the right of the principal is superior.

Custom has long sanctioned an action by the agent, based upon a contract in which he is interested because of anticipated commissions. As a result, a factor may institute an action in his own name to recover for goods sold. He may also recover against a railroad for delay in shipment of goods sold or to be sold.

Similarly, an agent who has been vested with title to commercial paper may sue the maker thereof. The same is true of any claim held by the principal which he definitely placed with the agent for collection and suit where such is necessary. In all cases of this character, the agent retains the proceeds as a trust fund for his principal.

Sec. 53. In tort.—Most torts committed by third parties give rise to a cause of action irrespective of an agency. There are two distinct cases, however, in which the employment becomes important. First, any third party who maliciously influences the principal to terminate his agent's employment thereby commits a tort. He must compensate the agent for any damages which result from such conduct.[4] Second, any third person who influences another in breaching a contract in which the agent is interested thereby renders himself liable to the agent. To illustrate: The agent has sold goods to *T* upon which he is entitled to a commission. Anyone who causes *T* to refuse to carry out the agreement thereby damages the agent and is correspondingly liable.

Review Questions and Problems

1. Is an agent ever liable on contracts made for the benefit of his principal? What liability does the agent of an undisclosed principal incur?
2. Does an agent always warrant his authority to act? Suppose that

[4] Loughery et al. v. Huxford et al., 1910, 106 Mass. 324, 92 N.E. 328; p. 576.

A, thinking that he possesses authority to represent *P* in a certain transaction, but possessing no authority, nevertheless acts for *P*. Is *A* liable to the third party for damages suffered because of his lack of authority?

3. *A*, acting for a corporation which is soon to be formed, orders two delivery trucks from *T*. The corporation is formed, but refuses to ratify the contract. Under what circumstances is *A* liable to *T*?

4. *T*, by reason of an error on the part of *A*, an agent for *P*, overpays to the extent of some $300 his account with *P*. Before *A* pays the money over to *P*, *T* discovers the error and demands the excess from *A*. Is *A* under a duty to return the money to *T* or may he turn it over to *P*?

5. Is an agent liable to third parties for his torts, although at the time they are committed he is performing some service for his principal? Is the same true where the agent is unaware that he is committing a tort?

6. Name two instances in which the agent may sue the third party for breach of a contract, the contract being made for the benefit of the principal.

7. *T*, because of his dislike of *A*, persuades *P* to discharge *A*. Assuming that *A* does not have a contract for any definite period, may he recover damages from *T*?

Book III

NEGOTIABLE INSTRUMENTS

Chapter I

INTRODUCTION TO THE LAW OF NEGOTIABLE INSTRUMENTS

Sec. 1. Definition of the term "negotiable."—The commercial world has for many years used the term "negotiable" as an adjective describing a certain type of written contract designed as a vehicle to represent credit. The term "negotiable" is of Latin origin. It is derived from the Latin word "negotiatus," consisting of the following prefix and root—"neg," meaning "not" or negation, plus the root "otium," meaning leisure—making the combination not-leisure or non-leisure, plus the suffix "able," meaning capable of. The idea as expressed by the Latin words was easily applicable to business. It was further developed to mean the capacity of certain kinds of paper to pass like money, from person to person, and was soon used as a substitute for a medium of exchange.

Sec. 2. History.—Just when this usage was first adopted cannot be definitely determined. In Greek history, we find Isocrates, about 40 B. C., relating an incident of a corn merchant, who came to Athens with cargoes, giving an order upon a banker in a town on the Black Sea with whom he had credit. And there are also references to the use of what may be termed "bills of exchange" during the time of Cicero. At the end of the twelfth century, this method of extending credit was used quite extensively among the merchants of Italy.

The use of such paper, as of many other things, arose out of necessity. The inconvenience and lack of safety in the transportation of coins and metal as money necessarily led to the extensive use of paper, which transferred credit rather than the physical money used as a medium of exchange.

The paper was most extensively used in foreign trade and therefore derived the name bills of exchange. The idea of using paper for this purpose was soon introduced into France and then into England. An examination of the very early English law reports, however, will not disclose any reference to commercial paper. This lack of reference is due to the fact that the common-law courts of the early days did not entertain disputes involving business transactions.

All disputes between merchants were adjudicated in special courts set up by the merchants themselves. The decisions were reached after an application of the usage and customs of the mer-

chants. Out of this system arose a very definite form of what is known as the "lex mercatores," or law merchant. The greater part of commercial activity in England was conducted at great fairs, to which all merchants came, both foreign and local, to display their wares. At each of these fairs a court sat to adjust differences between buyers and sellers. The very nature of the situation demanded speedy and permanent termination of the disputes. These special mercantile courts were called the Courts of Piepoudres (pieds poudrés), so called because justice was administered as the dust still fell from the litigants' feet. These courts were later created by statute, and continued as separate bodies until about 1756. The King's Court by this time, being jealous of the administration of justice by others, through royal prerogative gradually won its way and absorbed the merchants' courts. However, in deciding commercial cases, the King's Court applied the law merchant. When determining suits between merchants, or when a merchant was a party to the suit, before the court would recognize the law merchant in such cases, the party pleading such custom and usage was under a duty to show himself to be a merchant. This rule prevailed until about two hundred years ago.

The absorption of these merchants' courts by the King's Courts over a period of thirty years, under Lord Mansfield, wove the law merchant into and made it part of the common law. The practice of permitting the proof of custom and usage of the merchants in the common-law courts made possible the development of separate rules which became established rules of law. The union of these mercantile customs with the legal system already operating resulted in the formation and further development of the law merchant by judicial action.

Until 1882 in England and in all of the United States except California, the law merchant was to be found largely in the reports of judicial decisions, where previous usage and custom were interpreted and applied according to the prevailing and established usage of the particular community. This situation led to varying interpretations, much confusion, and a lack of uniformity. In order to find the law, it was necessary to examine many decisions, and the result of such search would often be futile, owing to the many conflicts and contradictions of important rules.

Consequently, in England, in 1882, Parliament enacted what is known as the Bills of Exchange Act. The Act codified in a very complete manner the law as found in the decisions, and harmonized, as far as possible, the existing rules in a very complete and comprehensive manner.

In 1895, in the United States, under the leadership of the Amer-

ican Bar Association and the American Bankers Association, a commission was appointed for the purpose of revising and codifying the law merchant in the United States. This committee, taking the English Bills of Exchange Act as a model, derived, with modifications, our present Uniform Negotiable Instruments Law. This act was completed in 1896, and was submitted to the legislatures of the various states with recommendations for adoption. The act has now been adopted, with some changes best suited to the state, by every state.

In the text matter following, the quotations of the Negotiable Instruments Law are from the Uniform Negotiable Instruments Act as originally adopted. In some instances, however, reference is made to changes adopted by some of the different states.

Negotiable Instruments Distinguished from Other Claims for Money

Sec. 3. Claims for money.—The right that one person may have against another for money may arise out of many different situations. It may arise out of a contract for the sale of goods, for services rendered, or for injuries received. The evidences of such claims may be simple contracts, either written or oral. Consequently, the words and language used in simple contracts and other claims for money lack uniformity and vary with each particular circumstance. However, claims for money evidenced by negotiable instruments must comply, with reference to the use of words and language, with certain rules of uniformity prescribed by the law. It is not necessary that the same words be used in the same place in each instrument, but it is necessary that the same meaning be expressed. A discussion of the language which must appear upon the face of an instrument to give it the character of negotiability will be taken up in the following chapter.

Another distinguishing feature between negotiable instruments and other claims for money is the method of transferring title from one person to another. Nonnegotiable contract rights are transferred by assignment, whereas negotiable contract rights are transferred by negotiation.

Sec. 4. Difference between negotiation and assignment.—In the book on Contracts, we learned that contract rights were transferable by a legal process called assignment. Suppose *A* owed *B* $100 for goods sold by *B* to *A*, or for services rendered by *B* for *A*. *B* has a right that *A* pay him $100. *A* is under duty to *B* to pay this $100. This type of contract right owed by *A* is called a chose in action. Under the early common law, this type of right for money due was not transferable. Under the modern rule, this right

is transferable by the process of assignment. *B* may sell to *C* his right to collect $100 from *A*. Let us suppose that *A* had a counterclaim against *B* for $35 for any number of reasons, either that the goods sold were not as required by contract or that the contract was induced by fraud on the part of *B*. If so, then the right that *C* purchased from *B* would be subject to *A*'s defense of fraud, or failure of consideration. *C*, the assignee, would secure no better right against *A* than the original right held by *B*, the assignor.

In the example given above, let the situation be changed, so that the evidence of the debt is not a simple contract for money, but a negotiable promissory note given by *A* to *B*. Under the law merchant, the right that *B* now has against *A* is superior to the right *B* had as evidenced by the simple contract right. The distinguishing feature of the latter is its unique capacity of transferability. *B* sells the note to *C*. Assuming that *C* is a purchaser in good faith before maturity, *C* will get a better title as purchaser of the negotiable paper than as purchaser of the simple contract right; that is, *C*, as holder of a right evidenced by negotiable paper, takes title free from defenses that are available against the original party to the paper. This feature is the very essence of negotiability. Business convenience requires this characteristic by reason of the very purpose for which the paper is created. A businessman would not be willing to take a note, a check, or a bill of exchange from the payee if he incurred all the risk of an assignee of an ordinary contract right. Negotiability eliminates all personal defenses between the original parties, thus making negotiable paper free to pass from person to person as money, fulfilling the purpose for which it was created.

Sec. 5. Negotiability of instruments other than bills and notes.—In the preceding section it is stated that written claims for money, in order to have the attributes of negotiability, must satisfy certain formal requisites as to certainty and uniformity prescribed by the Negotiable Instruments Law.

The Negotiable Instruments Law defines only three kinds of negotiable instruments: promissory notes, drafts, and checks. Section 126 states: "A bill of exchange (draft) is an unconditional order in writing addressed by one person to another signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or bearer."

Section 184 states: "A negotiable promissory note within the meaning of this Act is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time a sum certain in

money to order or bearer. When the note is drawn to the maker's own order, it is not complete until indorsed by him." Section 185 defines a check as "a bill of exchange drawn on a bank payable on demand."

Three problems are raised by reason of the codification of the Negotiable Instruments Law. Does codification mean that other types of credit instruments, generally accepted in commerce and shown by the usage of business to have the characteristics of negotiability, are nonnegotiable unless such instruments strictly comply with the terms of the Act? Should the language of the Negotiable Instruments Law be broadly interpreted in order to cover new instruments developed in commerce which in fact pass freely in trade? Should the Negotiable Instruments Law be strictly limited in its application to bills of exchange, promissory notes, and checks, leaving other instruments, by custom and usage or legislative enactment, to acquire their own particular attributes of negotiability?

Section 196 of the Negotiable Instruments Law states, "in any case not provided for in this Act, rules of the law merchant shall govern."

The following instruments are illustrative of types of credit paper which are not defined by the Negotiable Instruments Law, but which carry some characteristics of negotiability: corporate bonds containing language referring to trust deeds, registered bonds, municipal warrants, interim certificates, interest coupons, trading stamps, conditional sale contracts, insurance policies, warehouse receipts, stock certificates, and bills of lading. If, however, negotiable character is measured by the strict language of the Negotiable Instruments Law, these instruments must be held nonnegotiable. To meet business needs, uniform acts have been adopted specifically giving negotiable character to such instruments as bills of lading, warehouse receipts, and certificates of stock. Where the legislatures have not enacted statutes giving negotiable attributes to instruments other than bills of exchange, promissory notes, and checks, negotiability has been given to such instruments by court decisions. In some jurisdictions, bonds of a joint stock association otherwise negotiable in form but nonnegotiable under the Negotiable Instruments Law because of a provision making them payable out of the assets of a firm assigned to a trustee as security, have been held negotiable. However, interim certificates issued by bankers stating that the bearer of such interim certificates is entitled to foreign bonds on surrender of the certificates are held nonnegotiable under the Negotiable Instruments Law because they do not contain an unconditional order or promise to pay a sum cer-

tain in money.[1] By statute, however, such instruments now may be given negotiable character.[2]

Review Questions and Problems

1. What is the purpose of a negotiable instrument?
2. Were the early cases relating to negotiable instruments decided in the common-law courts? Where must reference now be made to determine the law of negotiable instruments?
3. How do negotiable instruments differ from other claims for money?
4. Which transfers the greater rights, an assignment or a negotiation? What is the difference between the two? Does this affect the transferability of claims?
5. Discuss the methods by which negotiable characteristics are given to new kinds of commercial paper not defined in the Negotiable Instruments Law.

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[1] Manhattan Co. v. Morgan, 1926, 242 N.Y. 38, 150 N.E. 594; p. 579.
[2] Laws of New York, 1926, Ch. 704.

Chapter II

TYPES OF NEGOTIABLE INSTRUMENTS

Promissory Notes

Sec. 6. Definition.—Negotiable instruments are of two types—negotiable promissory notes and bills of exchange. Their classification depends upon the particular language used and the number of parties necessary for the creation of the instruments. A negotiable promissory note, as defined by the Uniform Negotiable Instruments Act, is "an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time a sum certain in money to order, or to bearer." [1] This type of instrument has two parties, the one making the promise, called the maker, and the person to whom the promise is made, called the payee.

Sec. 7. Classification of promissory notes.—Promissory notes may be classified with respect to the kind of security given by the maker to support his promise to pay money. A simple promissory note carries only the personal security of the maker. Business convenience often requires a high degree of certainty that the money will be paid by the maker on the day it is due. Consequently the personal promise of the maker to pay money is often supported by another contract, appearing sometimes upon the face of the instrument and sometimes in separate agreement. This contract may be called a security contract.

This additional source from which the payee or holder of the note may secure his money may be security, or another person, called a comaker, or an accommodation party.

Sec. 8. Collateral note.—A note may be secured by personal property in the nature of other notes, bonds, or stock temporarily placed within the control of the payee, or holder. The property transferred is called collateral and such note is a collateral security note.[2]

Sec. 9. Judgment note.—The maker may sign a contract as additional security, which permits a judgment to be taken against him without a trial in case he fails to pay on the due date. This form of note is called a judgment note.[3]

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[1] See form #2 and #3.
[2] See form #4.
[3] See form #5.

Sec. 10. Conditional sale note.—In order to secure payment for the sale of merchandise, the contract of sale may be set forth upon the face of the instrument. The contract usually provides that title to the chattel sold shall remain with the payee-vendor until the note given is paid in full, and, further, that in case of default in payments as shown upon the note, the vendor may repossess the chattel. A note in this form is called a conditional sale note.[4]

Sec. 11. Mortgage notes, chattel and real.—A security contract separate from the simple promise to pay money is illustrated by the mortgage. There are two kinds of mortgages, depending upon the character of the property used as security. When the maker conveys to the payee as security a right in the title of chattels, the note so secured is called a chattel mortgage note. When the right in the title conveyed is in real property, the note so secured is called a real estate mortgage note.

Sec. 12. Certificate of deposit.—The classification of different types of promissory notes is sometimes controlled by the character of the maker. This is true of the certificate of deposit and of the bond. A certificate of deposit is a promissory note given by a bank to a depositor, as a receipt for the deposit, promising to pay the amount to the order of the depositor. Care must be taken to distinguish this type of certificate of deposit from the usual receipt given by the bank when a depositor deposits sums to his checking account. There is no uniformity in the former type of paper. The language used in many instances does not satisfy the requirements for negotiable paper; consequently, many such certificates are not negotiable.

Sec. 13. Bond.—A bond may be said to be a promissory note under seal, issued by a corporation, public or private. Bonds are formal instruments and in general are so worded as to satisfy the requirements for negotiability, but, owing to additional language referring to the separate security contract supporting the promise in the bond or owing to requirements for registration, their negotiability is impaired. Bonds are either coupon bonds or registered bonds. Coupon bonds have attached coupons which are promissory notes, payable either to order or to bearer, in amounts representing the interest due from time to time upon the bond. In general, coupons are negotiable. Registered bonds are bonds payable to a payee whose name is registered upon the books of the maker corporation, and are transferable only by the registration of the party's name to whom transferred. Bonds are secured by a mortgage given to a trustee who holds the mortgage in trust for the

[4] See form #6.

benefit of the bondholders. Otherwise, a separate security contract or mortgage would have to be created for each bondholder.

Sec. 14. Nature of bills of exchange.—A bill of exchange as defined by the Uniform Negotiable Instruments Act is "an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or to bearer."[5] This type of instrument has three parties: the party drawing the paper, the drawer; the party to whom the instrument is addressed, the drawee; and the party to whom payable, the payee. When the paper is accepted by the drawee, he then becomes the acceptor. The acceptor's liabilities are similar to the liabilities of a maker of a promissory note.

A bill of exchange differs from a promissory note in that it is a three-party paper and contains an order instead of a promise. A further difference lies in the actual situation which gives rise to the instrument. A bill of exchange presupposes the existence of a debtor-creditor relationship between the drawer and the drawee. This being true, the drawer-creditor merely orders the drawee-debtor to pay the money to a third party, the payee.

Sec. 15. Classification of bills of exchange.—Bills of exchange may be classified with respect to situations in which they are used. The bill of exchange in most general use is the check. It is an order addressed to the bank-drawee by the depositor-drawer to pay the payee the sum indicated. It is a demand bill of exchange.

Sec. 16. Bank draft.—A bank draft is a banker's check; that is, it is a check drawn by one bank on another bank, payable on demand.

Sec. 17. Trade acceptance.—Another type of bill of exchange, used largely by manufacturers and merchants, is the trade acceptance. A trade acceptance is taken by the seller as payment for goods purchased at the time of the sale. The seller draws on the purchaser to his own order for the goods sold. When the draft is accepted by the purchaser, it becomes his primary obligation. The seller usually discounts trade acceptances at the bank, or uses them as collateral for loans. The buyer, having acknowledged the debt by his acceptance, cannot later dispute the debt as against a holder of the trade acceptance.

Sec. 18. Banker's acceptance.—A banker's acceptance is a draft accepted by a bank according to a previous arrangement made with the bank by a buyer of goods. The seller of goods often refuses to deliver goods to the buyer upon the buyer's credit alone; or the seller of the goods may wish to secure in payment for his goods a

[5] See form #7.

negotiable instrument which has a ready sale. A draft accepted by a bank would have stronger credit than a trade acceptance accepted only by the buyer. For example, *B* informs his banker that he expects to purchase goods from *A* and requests the bank to accept a draft on it drawn by *A*. *B* usually deposits collateral with the bank or agrees to keep a certain amount on deposit in order that the bank will be assured of funds at the time of payment. The collateral often consists of shipping documents, warehouse receipts, and bills of lading carrying the title to the goods from *A* to *B*. By this means the bank is not making a loan, but merely *lends its credit* to the buyer, thus giving selling capacity to the negotiable paper that *A* receives in payment for his goods. *A* can dispose of his paper more readily and on better terms than if the negotiable instrument were a trade acceptance accepted only by the original buyer, *B*.

This type of instrument is not new, but its use is relatively new in the United States. Prior to the Federal Reserve Act, national banks could not accept drafts of this nature. Under this Act, however, national banks may now accept such drafts, and many state banks by their charters are given the same authority. The Federal Reserve Act regulates in detail the issuance of such drafts.

Sec. 19. Sight and time drafts.—Bills of exchange called drafts are also classified as to time. Sight drafts are bills of exchange payable at sight. This type of paper is termed call paper. Time drafts are drafts payable at a future time, as thirty or sixty days after date or acceptance.

Review Questions and Problems

1. How many parties are there to a negotiable note? Name them.
2. Name four kinds of negotiable notes. What is a conditional sale note? What is a bond? When is it used?
3. Define a bill of exchange. Name the parties to such a bill.
4. What is a trade acceptance? What is the difference between a trade acceptance and a banker's acceptance?
5. What is the difference between a sight draft and a time draft?

CHAPTER III

CREATION OF NEGOTIABLE INSTRUMENTS

Language and Words Required to Create Negotiable Paper

Sec. 20. Requirements of a negotiable instrument.—The Uniform Negotiable Instruments Act provides that "An instrument to be negotiable must conform to the following requirements:

1. It must be in writing and signed by the maker or drawer;
2. Must contain an unconditional promise or order to pay a sum certain in money;
3. Must be payable on demand, or at a fixed or determinable future time;
4. Must be payable to order or to bearer; and
5. Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty."

Sec. 21. Writing and signature.—The Uniform Negotiable Instruments Act provides that an instrument, to be negotiable, must be in writing and signed by the maker or drawer. This stipulation is necessarily a requirement, because the language used must remain uniform throughout the entire time of the paper. It is not required that any particular type or kind of writing be used, neither is it necessary that the signature be at any particular place upon the instrument.[1] The signature of the maker or drawer may be in any form: printed, written, or stamped. A sign or any kind of written words is sufficient, if it is clear that such method was intended to represent the signature of the party creating the liability in a note.[2]

Sec. 22. The necessity of a promise.—A note must contain a *promise* to pay money. It is not required that the exact word "promise" be used, but the language must make it clear that a promise was intended.[3] Mere admissions or written acknowledgments of a debt are not promises. The following are illustrations of acknowledgments of indebtedness and contain no promise:

I owe my brother $100.00.

Due Bronson and Brown $18.40.

I O U Sam Smith the sum of $110.30.

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[1] In re Donohoe's Estate, 1922, 271 Pa. St. 557, 115 Atl. 878; p. 581.

[2] Planters' Chemical and Oil Co. v. Morris, 1924, 19 Ala. App. 670, 100 So. 200; p. 581.

[3] Shemonia v. Verda, 1927, 24 Ohio App. 246, 157 N.E. 717; p. 582.

Sec. 23. The necessity of an order in a bill of exchange.—A bill of exchange must contain an order. The purpose of the instrument is to order the debtor to pay a person other than the creditor. It is necessary, therefore, that plain language be used, showing an intention to make an order. The language must be imperative. It must signify more than a request; it must unequivocally show a right to ask and a duty to obey. The order must be further distinguished from an authority to pay. A written authorization to a debtor to pay a third person would not be sufficient. The following are illustrations of language which cannot fairly be interpreted as orders to pay:

Please let the bearer have $10.00 and place to my account.

We hereby authorize you to pay, on our account, to the order of William Green the sum of $400.

Sec. 24. The promise or order must be unconditional.—The Uniform Negotiable Instruments Act states that an instrument, to be negotiable, must contain an unconditional promise or order. The promise or order to pay must not depend upon the happening of some outside event. It must be payable absolutely; otherwise its negotiable character would be impaired, in that no person would wish to purchase paper, if the right to recover depended upon the happening of some event. Although the event upon which the instrument is payable occurs, this fact does not remove the objection. If a condition is stated upon the face of the paper, it is impossible to tell from an examination of the paper whether the event has happened or ever will happen. The happening of the event will not cure the defect.

A question of whether or not the promise or order is conditional often arises when additional language is added; that is, when there is a reference to a contract which gives rise to the instrument, or when there is a reference to a particular fund out of which payment may be made, or when there is a security contract supporting the promise. Whether these different situations, stated upon the face of the instrument, make the promise or order conditional, depends upon how they are referred to and how closely the promise or order is related to them.

Sec. 25. Statement of transactions giving rise to the instrument.—A statement upon the face of a note of the consideration which gives rise to the instrument will not of itself make the promise conditional.[4] Likewise, a mere reference to some contract out of which the note develops does not destroy the negotiability of the instrument. Whether the language on the face of the instrument

[4] Siegel et al. v. Chicago Trust and Savings Bank, 1890, 131 Ill. 569, 23 N.E. 417; p. 582.

is merely an indication of the source of the consideration for which the paper was given or language showing an intention to condition the promise is a question of the construction of the language. The words used and their place upon the paper are important in determining the relationship between the statement and the promise. The courts usually construe the language so as to make the instrument negotiable whenever possible and refrain from implying conditions, on the grounds that the parties could have expressly conditioned the promise. The words "as per contract" are generally held not to make the promise conditional, but the words "subject to contract" will ordinarily be construed as making the promise conditional and the instrument nonnegotiable.

Sec. 26. An indication of a particular fund out of which reimbursement is to be made.—An instrument may state upon its face that a certain account is to be debited or charged. This statement does not make the promise or order depend upon the existence of the funds in such an account, but indicates that these funds are to be used. If it is clear that the order or promise is to be paid at all events, irrespective of whether the funds in the account are sufficient, then the promise or order is not conditional. An instrument drawn upon or payable out of a particular fund, whether the fund has already accrued or is to accrue in the future, contains a conditional promise and is not negotiable,[5] since it does not carry the general personal credit of the drawer, and is contingent upon the sufficiency of the fund on which it is drawn. An illustration of such promise or order is as follows: To *A*. Pay to *B*, or order, $500 out of funds due me from the *X* estate. Signed, *Y*.

Sec. 27. Security contracts upon the face of notes and bonds.—The two types of security contracts most frequently written upon the face of notes or bonds, or incorporated therein by reference, are conditional sales and mortgages. In either case the purpose is to make clear to the holder that the promise to pay is secured by something in addition to the general credit of the maker, and, as a consequence, a mere reference to the security does not destroy negotiability.

Notes given in settlement of property purchased on installment usually provide that title to such property shall not pass to the maker of the note until all payments called for have been made. Only upon full payment does the title to the goods pass to the buyer. In other words, the transfer of title to the property is made conditional on payment of the note, but there is nothing to indicate, other than by implication, that payment is dependent on the transfer of title. As a matter of fact, title passes automatically when

[5] Glendora Bank v. Davis et al., 1928, 204 Cal. 220, 267 Pac. 311; p. 583.

final payment is completed. Hence there is no sound reason for holding conditional sale notes nonnegotiable. The majority of the courts follow this line of reasoning,[6] but there are a few states which hold conditional sale notes to be conditional and therefore nonnegotiable.

Notes and bonds which are secured by a mortgage or trust deed usually make mention of such fact. A mere statement to the effect that they are "secured by" a certain mortgage or deed in no respect affects negotiability.[7] However, notes and bonds are occasionally made "subject to" the terms of a particular trust deed or mortgage, or the language of the note or bond is so worded as to incorporate all the terms of a trust deed or mortgage and make such terms a part of the instrument. In either case the note or bond is made nonnegotiable,[8,9] because it is not clear from the face of the paper whether or not the promise is unconditional; reference must be made to some other document to determine the net effect of the promise.

Sec. 28. Time and other events as conditions.—Notes and bills of exchange that are payable when *X* marries, when certain goods are sold, when pay check arrives, when work is completed, when goods arrive, and so forth, are clearly not negotiable because payment is conditional upon the happening of the event.

Sec. 29. The sum must be certain.—The language used in creating negotiable paper must be certain with respect to the amount of money promised or ordered to be paid. Otherwise, its value at any period cannot definitely be determined. If the principal sum to be paid is definite, the negotiability is not affected by the fact that it is to be paid with interest, or in installments, or with exchange at a fixed or current rate, or with costs of collection and attorney's fee in case payment shall not be made at maturity.[10] If at any point of time during the term of the paper its full value can be determined with certainty, the requirement that the sum must be certain is satisfied. When the amount of costs and attorney's fees is left blank, some courts hold that a reasonable amount is recoverable. The obligation to pay costs and attorney's fees is part of the security contract, separate and distinct from the primary promise to pay money, and does not, therefore, affect the requirement as to a sum certain. The certainty of amount is not affected if the instrument specifies different rates of interest before

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[6] Welch v. Owenby, 1918, (Okl.) 175 Pac. 746; p. 584.
[7] Page v. Ford, 1913, 65 Or. 450, 131 Pac. 1013; p. 585.
[8] Hull v. Angus, 1911, 60 Or. 95, 119 Pac. 284; p. 586.
[9] Enoch v. Brandon, 1928, 249 N.Y. 263, 164 N.E. 45; p. 587.
[10] Huston v. Rankin, 1922, 36 Ida. 169, 213 Pac. 345; p. 588.

or after maturity;[11] neither is certainty affected if no rate of interest is given, because the legal rate is then payable.

Sec. 30. Instruments must be payable in money.—An instrument, to be negotiable, must be payable in money; but *its validity and negotiable character are not affected by the fact that it designates a particular kind of current money in which payment is to be made.* Instruments payable in chattels, such as one hundred bushels of wheat or one ounce of gold, are called promissory notes, and by statute in some states pass by indorsement. Such instruments, however, are not negotiable. Negotiable paper, passing as money, must have a uniform standard of value, which commodities generally do not have.

Just what is meant by "money" and "current money" is not clear. The better view on this problem is that "money" and "current money" shall mean *"such circulating media as are legal tender or are lawfully and actually circulating at par with legal tender at the time and place of payment."* Under such an interpretation the instrument will have a known and uniform value.

The weight of authority seems to be that an instrument payable in "current funds" is negotiable. Likewise, a bill or note payable in specific foreign money is generally negotiable, because its value is determinable by the rate of exchange, and therefore satisfies the requirement as to certainty of the sum.

Time of Payment Must Be Certain

Sec. 31. In general.—As a substitute for money, negotiable paper would be of little value if the holder were unable to determine at what time he could demand payment. It is necessary, therefore, that there be certainty as to time of payment. The law, as codified by the Negotiable Instruments Act, requires that a negotiable instrument be payable on demand or at a fixed or determinable future time.

Sec. 32. Demand paper.—An instrument is payable on demand when it so states, when payable at sight or presentation, when no time of payment is given, or when the instrument is issued, accepted, or indorsed after it is overdue. In general, the words "payable on demand" are used in promissory notes, the words "at sight" in bills of exchange. If nothing is said about the due date, the instrument is demand paper. A check is a good illustration of such an instrument; it is a demand bill of exchange. Overdue paper is necessarily demand paper, because the holder has an immediate right of action for the money promised.

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[11] Union National Bank of Massillon, Ohio v. Mayfield et al., 1918, 71 Okl. 22, 174 Pac. 1034; p. 590.

Sec. 33. Payable at a fixed or determinable time.—An instrument is payable at a fixed date when it is payable on a definite date, such as June 1, 1933. Just what is a determinable time, however, is a question of some difficulty. The Uniform Negotiable Instruments Act states that an instrument is payable at a determinable future time when it is payable at a *fixed period after date or sight*, that is, "ninety days after date," or "sixty days after sight, I promise." Time, by the Act, is determinable when the instrument is expressed to be payable *on or before* a fixed or determinable future time specified therein, as on or before thirty days after date. Time is also determinable within the meaning of the Act when the instrument is payable on or after a *fixed period after the occurrence of a specified event*, which is certain to happen, though the time of happening be uncertain. For example, a note payable on the death of *X* or one year after *X*'s death is payable at a determinable time. But an instrument payable on a contingency—which may or may not occur—is not determinable, and the happening of the contingency does not cure the defect. A note payable "twenty days after I become twenty-one" is not negotiable. Such an instrument also lacks an unconditional promise, for the payment is conditional on an event which may never take place. Since the promise is conditional, the time is not necessarily fixed or certain.

Sec. 34. Accelerating clauses.—A type of provision often found in a negotiable instrument that hastens or accelerates the maturity date of the instrument is called an accelerating clause. One type of accelerating provision in constant use provides that in case of default in payment of interest or of an installment of the principal, the entire note shall become due and payable. A second type of accelerating provision is one which stipulates that on default by the maker in carrying out a collateral agreement, the whole instrument shall become due and payable at once.[12] An infinite variety of collateral agreements may be incorporated into an instrument; for example, the instrument shall become due on failure to pay the taxes on Blackacre, on failure to insure a building, on the removal of said goods, in case an incumbrance is placed on the machine, in case of failure to supply additional security, and so forth. Other types of acceleration provisions are those giving the holder an option to declare the instrument due and payable when he feels insecure, or giving the maker an option to pay the whole of the said principal sum or any multiple thereof at any time or upon any interest paying date. These and many other types of acceler-

[12] McCormick and Co., Bankers, v. Gem State Oil and Products Co., 1923, 38 Ida. 470, 222 Pac. 286; p. 591.

ating provisions are being used increasingly in instruments by the commercial world, and the courts of the country are faced with the problem of deciding whether such provisions destroy the negotiability of an instrument otherwise negotiable. As might be expected, the courts are not entirely in accord as to whether such clauses impair negotiability.

The first type of accelerating provision mentioned above is uniformly held not to affect negotiability, although it contains a provision that on default by the maker in the payment of interest or principal the whole amount shall become due and payable at once. The Act expressly provides that such a clause does not render uncertain either the time or the amount.

The courts are in conflict as to the effect of an accelerating provision specifying that on default of the maker in carrying out a collateral agreement the whole sum shall become due and payable. The weight of authority seems to be that such provisions do not affect the negotiability, but a respectable minority holds that such clauses not only violate the rule as to certainty of time but also require the performing of acts other than the payment of money. While logically the minority seems to have the best of the argument, the majority rule is most practical and useful in that such provisions aid in securing payment, thus making the instrument more salable and acceptable in the business world.

With regard to the provision which allows the holder to declare the instrument due when he feels insecure, the weight of authority is against negotiability,[13] the objection being that the date of maturity is placed *wholly* under the control of the holder and that maturity may be accelerated upon his whim or caprice and is independent of any act done or omitted by the maker. However, such a provision in a demand instrument is not material, for the time of payment is primarily at the volition of the holder in any event.

A provision which gives the maker the option to pay the whole or any part of the principal at any interest-paying date or at any time before maturity is generally held not to affect negotiability. Provisions which permit the maker to hasten payment do not impair the negotiability of paper.

Payable to Order or to Bearer

Sec. 35. The words "or order" and "or bearer."—The words "or order" and "or bearer" are said to be the words of negotiability. It is not necessary that these exact words be used. Words expressing the same meaning and manifesting an intention that the instru-

[13] First State Bank of Cheyenne v. Barton, 1928, 129 Okl. 67, 263 Pac. 142; p. 592.

ment be negotiated are sufficient. In order to make certain the negotiability of the paper, words of negotiability should be used.[14] In the absence of such words, the paper has no capacity to pass current as money. The maker of a promissory note, made payable to *X* or order, may be said to make two promises. The maker promises to pay *X* if *X* holds the paper; he also promises to pay any other person that *X* may order him to pay. A drawer of a bill of exchange orders the drawee to pay the named payee, or any person named by the payee. Likewise, in any instrument payable to *X* or bearer, the maker promises to pay *X* or any person who is in possession of the instrument. If the instrument is payable to the bearer *X*, it is nonnegotiable, because the maker promises to pay only one specific person.

Sec. 36. Order paper.—According to the Uniform Negotiable Instruments Act, an instrument is payable to order when it is drawn to the order of a specified person, or to him or his order. It may be drawn payable to the order of any person, or to the order of the maker, drawer, or drawee, or to two or more persons jointly, or in an alternative to one of several persons, or to the holder of an office for the time being. When a note is drawn to the maker's own order, it is not complete until indorsed by him.

Instruments payable to order require an indorsement for negotiation, whereas bearer paper is negotiated by delivery.

Sec. 37. Bearer paper.—The Uniform Negotiable Instruments Act defines bearer paper as follows: "The instrument is payable to bearer: (1) when it is expressed to be so payable; (2) when it is payable to a person named therein or bearer; (3) when it is payable to the order of a fictitious or nonexisting person and such fact was known to the person making it so payable; (4) when the name of the payee does not purport to be the name of any person; or (5) when the only or last indorsement is an indorsement in blank."

Under (1) and (2) whether paper is bearer paper is self-evident. Under (3) when an instrument is payable to the order of a fictitious or nonexisting person and this fact is known to the person creating it, it is bearer paper. This result follows because a fictitious or nonexisting person would have no physical capacity to indorse the paper; therefore, the maker or drawer intended title to pass by delivery. For example, *A* draws a paper payable to the order of *Y*, knowing that *Y* does not exist; or, if he does exist, *A* does not intend that *Y* shall have any interest in the paper. Such a paper is bearer paper; however, when the payee is fictitious but the fiction is not known to the drawer, or maker, the paper is or-

[14] Wettlaufer v. Baxter, 1910, 137 Ky. 362, 157 S.W. 741; p. 593.

dinarily held not to be bearer paper.[15] Likewise, under (4), if the name of the payee does not purport to be the name of any person, the paper is bearer paper. Checks for convenience, drawn payable to "cash" or order, to "bills payable" or order, to "draft" or order, are bearer paper.[16] Here, since we have no payee capable of indorsing the instrument, title to the instrument passes by delivery; otherwise the paper could not be circulated as the maker or drawer undoubtedly intended that it should. But if the drawer of a check draws a line through the blank space where the payee's name usually is inserted, the check is not bearer paper and is void for the lack of a payee. An instrument originally order paper becomes bearer paper when the only or last indorsement is an indorsement in blank. For example, if an instrument is payable to the order of *X*, and *X* indorses it to *T* by signing "*X*," or if *X* indorses "pay to the order of *Y*," and *Y* indorses it to *T* by signing "*Y*," *T* is the holder of bearer paper. (For further discussion of this topic see Section 53 under "Indorsement of bearer paper," p. 169.)

Factors Not Affecting Negotiability

Sec. 38. Additional language not affecting negotiability.—Additional language may be added to the formal words which create negotiable paper without affecting its negotiability. Such additional language usually pertains to security transactions as already mentioned, or gives other privileges and options to the holder, in that he may elect to take something in lieu of the payment of money.

The Uniform Negotiable Instruments Act definitely states that authorization for the sale of collateral security in case the instrument is not paid at maturity, and confession of judgment on default by the maker, do not affect its negotiability. Likewise, the waiver of rights given by statute to the obligor does not affect the negotiability. For example, the statutes of the various states usually provide that a certain amount of property may be exempt from a judgment sale. There are any number of rights which may be the subject of an exemption in a negotiable paper. Certain kinds of rights cannot be waived. Whether or not the right is waivable will not affect the negotiability of the paper.

A confession of judgment clause is in the nature of a security agreement for the benefit of the holder. It usually provides that

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[15] United Cigar Stores Co. v. American Raw Silk Co., Inc., 1918, 171 N.Y. Supp. 480; p. 594.

[16] Mechanics Bank of the City of New York v. Straiton, 1867, 423 Keyes (N.Y.) 365; p. 594.

the holder of the instrument may secure a judgment in any Court of Record if not paid on the date of maturity by the maker. This type of note is called a judgment note.

The law provides that a person cannot proceed against another unless the person sued is notified by a summons. If the debtor cannot be found, no suit can be brought. Furthermore, before a judgment can be reached in a court, it is necessary to have a trial by court or jury—a procedure which means some delay and expense. The holder of the note, therefore, may have to wait a long period of time before he can secure a judgment, which will be a lien upon the property of the maker. During this period of time, the debtor, or maker, may lose his property, conceal it, or convey it away, so that the judgment will be valueless.

The effect of a confession of judgment clause is to waive the summons and the trial by court or jury, and to permit a confession of the debt, allowing a judgment to be entered by the court against the maker, or debtor, immediately after default of any interest or payment of the principal. Immediately following the entry of the judgment, any of the property owned by the maker may be sold to satisfy the judgment, or his wages and bank account or other credits may be attached or garnished. This method of securing a judgment requires less than one-half hour, whereas, without such a judgment clause to secure the holder, a judgment by trial might not be obtained for weeks or months.

The law in at least one state, Illinois, apparently permits the holder to take judgment any time after the date of the instrument, without affecting the negotiability of the paper. However, in most states an instrument which contains a provision authorizing a confession of judgment at any time after the date of the instrument makes the instrument nonnegotiable because it permits the holder to declare the instrument due at his option and thus violates the rule as to certainty of time.[17] The majority rule may thus be stated that a provision in an instrument otherwise negotiable, authorizing the holder to confess judgment after maturity or after the instrument becomes due, does not render the instrument nonnegotiable.

Sec. 39. Election by the holder to require something to be done in lieu of the payment of money.—The negotiable character of an instrument otherwise negotiable is not affected by a provision which gives the holder, at maturity, an option to take something, or to require something to be done, in lieu of money.[18] It should be made absolutely clear, however, that the option is given to the

[17] Clark v. Tallmadge, 1920, 171 Wis. 133, 176 N.W. 906; p. 595.
[18] Pratt v. Higgenson, 1918, 238 Mass. 256, 119 N.E. 661; p. 596.

holder and not to the maker. For example, an instrument which permits the maker either to pay money, or to deliver certain property, or to perform certain services is nonnegotiable. However, if the instrument merely provides that the holder may elect to take either money, property, or services, the negotiability is not affected.

Sec. 40. Omissions in negotiable instruments not affecting negotiability.—The Uniform Negotiable Instruments Act suggests certain formal language to be used in order to give an instrument its negotiable character. Nevertheless the instrument need not include the exact language of the Act, but may use any terms which clearly indicate an intention to conform to the requirements of the Act. Many words which would appear to be essential are, in fact, nonessential. The validity and negotiable character of an instrument otherwise negotiable are not destroyed by the fact that it is not dated, or that the words "value" or "value received" are omitted, or that it does not state what value was given for it. Neither is it necessary that a negotiable instrument bear a seal. However, it may bear a seal and its negotiability will not thereby be affected.

The instrument is negotiable although it does not specify the place where it is drawn or the place where it is made payable.

Sec. 41. Omissions and blanks—when they may be filled.—Any person in possession of an instrument has the power to complete it by filling in any blanks. Such person is presumed to have this authority, and this presumption continues until the person who is liable thereon is able to show by some evidence that there was no authority to complete the blanks or that the authority had been improperly exercised. The law provides that, where the instrument is wanting in any material particular, the person in possession thereof has prima facie authority to complete the same by filling in the blanks; as, for example, the amount, the date of payment, and so forth. If a person signs his name to a blank paper and *delivers* it to another person, this delivery carries the authority of the person signing the instrument to fill it in, provided the omissions are supplied in compliance with the authority. If, after the completion of the instrument, it is negotiated and comes into the hands of a holder in due course, such holder may enforce the instrument for the full amount against the person who signed the incomplete instrument, even though the instrument was completed in violation of authority. But if the holder is not a holder in due course, or if there is not a holder in due course prior to him in the chain of title, then such a holder can enforce the instrument against persons who became parties thereto prior to its completion only when the instrument has been completed strictly in accordance with the authority given and within a reasonable time after its

delivery. For example, suppose that *D* signed his name to a check and handed it to his agent, *A*, with the instruction that *A* make it payable to *P*, for $200, the amount of a debt that *D* owed *P*. Disregarding instructions, *A*, a year later, made it payable to *X* for $1,000 and gave it to *X* as a gift. Since *X* is not a holder in due course, having given no consideration, he cannot enforce it against *D* because it was not completed in accordance with *D*'s instructions or within a reasonable time.

Sec. 42. Antedated and postdated instruments.—The mere fact that an instrument is postdated or antedated does not affect its negotiability, unless such dating is for some illegal or fraudulent purpose. The person to whom the instrument is delivered acquires title to the instrument; that is, he becomes the owner upon the date of the delivery and may negotiate it immediately. It is not necessary to hold the instrument until the day it is dated before transferring it to another.[19] Neither does antedating or postdating make the instrument irregular on its face. If a check is postdated, payment may be stopped the same as on a check dated the day it is issued. The bank on which a postdated check is drawn may not pay the check until the date on the check, because to do so would be to pay before ordered by the depositor.

The date appearing on the instrument or on the acceptance or on any indorsement is presumed to be the true date of the making, drawing, acceptance, or indorsement, as the case may be; and the burden is on the person disputing the correctness of the date to establish that the named date is not the correct one.

The holder of an undated instrument which is made payable on a fixed period after issue may insert therein the true date of the instrument and it will be payable accordingly. To illustrate: *P* is the holder of a promissory note payable 60 days after date, but the note does not contain the date of issue; *P* may insert the true date of issue. Likewise the holder of a bill of exchange payable at a fixed period after sight, the acceptance of which is not dated, may insert the true date of acceptance. The insertion of a wrong date does not void the instrument in the hands of a subsequent holder in due course; but as to him, the date so inserted is to be regarded as the true date. However, it seems that insertion of a different date from the true one, without the authority of all persons who signed the instrument, renders the instrument void in the hands of all those who are not holders in due course or have not taken title through a holder in due course.

Sec. 43. Ambiguous language, construction of.—When the meaning of the words and language used in a negotiable instrument

[19] Triphonoff v. Sweeney, 1913, 65 Or. 299, 130 Pac. 979; p. 597.

is not clear or when there are omissions in it, certain rules to determine the meaning are given in the law and are set out in the Uniform Negotiable Instruments Act as follows:

"1. Where the sum payable is expressed in words and also in figures and there is a discrepancy between the two, the sum denoted by the words is the sum payable; but if the words are ambiguous or uncertain, reference may be had to figures to fix the amount.

"2. Where the instrument provides for the payment of interest, without specifying the date from which interest is to run, the interest runs from the date of the instrument, and if the instrument is undated, from the issue thereof.

"3. Where the instrument is not dated, it will be considered to be dated as of the time it was issued.

"4. Where there is a conflict between the written and printed provisions of the instrument, the written provisions prevail.

"5. Where the instrument is so ambiguous that there is doubt whether it is a bill or a note, the holder may treat it as either, at his election.

"6. Where a signature is so placed upon the instrument that it is not clear in what capacity the person making the same intended to sign, he is to be deemed an indorser.

"7. Where an instrument containing the words 'I promise to pay' is signed by two or more persons, they are deemed to be jointly and severally liable thereon."

Sec. 44. Liability of person signing as an agent.—Liability on negotiable paper may be created by an act authorizing another person to sign the instrument for or on behalf of the party charged. The person signing the instrument is called the agent, and the agent's authority to sign may be written, oral, or implied. Whether the instrument was signed in compliance with an authority given is a question arising under the law of agency considered under the section on Agency.

The Uniform Negotiable Instruments Act states that, where the instrument contains, or when a person adds to his signature, words indicating that he signs for or on behalf of a principal or in a representative capacity, he is not liable on the instrument if he was duly authorized;[20] but the mere fact that he adds words describing himself as an agent or as filling a representative capacity without stating clearly or disclosing who is his principal does not exempt him from personal liability on the paper.

If the agent merely describes himself as an agent and the instrument contains no words which show for whom he is acting, he will be personally liable on the instrument to the holder, who has no

[20] Jump v. Sparling, 1914, 218 Mass. 324, 105 N.E. 878; p. 597.

knowledge of such fact. Thus, John Smith, agent, treasurer, secretary, trustee, and the like, creates a personal liability on the instrument. However, some conflict exists among the authorities as to the right to admit parol evidence to show representative capacity, where such fact was known to the payee, or holder. Following the well-established rule in contracts, many courts hold that parol evidence is not admissible to prove the agency, but some authorities hold that even though there is nothing on the instrument to show that it was issued by an agent, or where words merely indicating agency are used, parol evidence may be introduced to show that the parties intended the instrument to be issued for and in behalf of a principal. If the agent signs the instrument without authority, he is personally liable, whether or not it discloses the name of the pretended principal. The safest way for an agent to sign a negotiable paper is to sign the name of the principal first, followed by his own name; as, for example, "The Urbana Foundry Company, per Henry Brown, Secretary." This method is used by corporation officers signing corporate obligations.

A person conducting a business under a trade name, or acting under an assumed name, may sign a negotiable instrument by the name of such business or by such assumed name, and is liable in the same manner and to the same extent as if he had signed the instrument in his own name.

Sec. 45. Liability of infants and corporations.—Under the general law of contracts, transactions entered into by infants may be avoided. Therefore, any negotiable instrument created by an infant is voidable, in that the infant cannot be liable as a primary party and he may disaffirm the instrument before or after he arrives at maturity. An infant is liable for necessaries, but his liability does not arise by reason of his having signed a check or a note for such necessaries. Although the paper created by the infant cannot, under the law, bind the infant, nevertheless, the infant has the power, as a secondary party, to pass title to the same by indorsement or assignment. When a note or a bill of exchange passes through the hands of an infant, the indorsement upon it by the infant transfers title to the holder as though the infant were under no disability, and the instrument may be enforced against all other parties on the paper before or after his indorsement. Such parties cannot be heard to say that the person suing on the note has not good legal title merely because he made his title through the infant's indorsement. This rule is true in spite of the fact that such infant may disaffirm all liability on the instrument. However, the power of an infant to pass the property in the instrument by indorsement does not affect his power to disaffirm his indorsement and recover

the instrument even against an innocent indorsee for value.[21] It seems that after notice of disaffirmance by the infant, payment of the instrument must be made to the infant or else the instrument is not discharged. An instrument executed, accepted, or indorsed by an infant is usually considered as being voidable until ratified by him.

A corporation has only those powers given to it by its charter or such as are necessary and incident to carrying out the purposes for which it was created. A corporation cannot be held for acts done by its officers outside the scope of its corporate powers. However, like an infant, a corporation may pass title to negotiable paper, even though the transaction was made outside the powers given by the charter.

Review Questions and Problems

1. Must the maker of a negotiable note sign it in ink? Must he sign it at the bottom of the instrument?

2. Is the following a negotiable instrument?

If possible, pay to my brother Bill or order $250.

(Signed) Henry Rood.

3. *S* was a real estate agent and was attempting to find a buyer for a house owned by *M*. The consideration which *S* was to receive in the event a buyer was found was set at $250. Therefore, *M* gave the following note to *S:*

I promise to pay to the order of *S* $250 if he sells my house.

(Signed) *M.*

Is the note negotiable? If *S* sells the house, is it negotiable?

4. *A* purchases an automobile from *P* and gives *P* a note which contains the following statement:

"This note is given in payment of one used Overland car, title and the right to possession of which rest in the payee until this note is fully paid."

The note was negotiated to a third party, who is now attempting to recover on it. *A* desires to set up as a partial defense the fact that the car was not as represented. May he do so?

5. Is an instrument payable in oats or wheat negotiable? If an instrument is payable in either money or a commodity, at the option of the holder, is it negotiable?

6. *A* promised to pay to *B* or order the sum of $300 and the amount of taxes to be paid upon a certain stipulated mortgage. Could such an instrument be negotiable? Suppose it had been $300 and New York exchange?

7. May an instrument be negotiable, if no time of payment is specified? What is such an instrument called?

8. Is a note which has the following clause negotiable?

"Payable June 1, 1927, or sooner in case I sell my house."

[21] Murray v. Thompson, 1916, 136 Tenn. 118, 188 S.W. 578; p. 598.

Suppose it had read "on or before June 1, 1927"?

9. Is a note payable to the "order of a box of soda crackers" negotiable? Name four instances in which paper is bearer paper. How is bearer paper negotiated? May the name of a real person become a fictitious payee?

10. A note contains a clause which permits the holder to obtain a confession of judgment immediately after the note is issued. Does this fact affect the negotiability of the paper?

11. A note otherwise negotiable contains no date, rate of interest, or place of payment. Is it negotiable?

12. When there is a conflict between the figures and the words in a check, which prevails?

13. How should an agent sign a negotiable note? May an infant negotiate commercial paper?

CHAPTER IV

NEGOTIATION

Sec. 46. In general.—Negotiation is the transferring of an instrument from one person to another in such manner as to convey title and to constitute the transferee the holder thereof. If the instrument is payable to bearer, it is negotiated by delivery; if it is payable to order, it is negotiated by the indorsement of the holder and by delivery. Thus *A* may negotiate a check payable to his order by indorsing it "Pay to the order of *B*, (signed) *A*" and by delivering it to *B*. Negotiation is not the exclusive method of transferring the property in a negotiable instrument. In the above illustration *A*, by delivery without indorsement, might have transferred the property in the check to *B*, but such a transfer would not have given *B* a title free from any equities the drawer might have had against *A*. In the latter case, *B* would not be a holder of the instrument.

The indorsement, in the case of order paper, must be written on the instrument itself; or if no space is available on the instrument itself, it may be placed on a paper firmly attached thereto. Such a paper is called an *allonge*. The signature of the indorser, with or without additional words, is a sufficient indorsement. Thus, a statement that the indorser "hereby assigns the within instrument" is usually held to constitute an indorsement and negotiation unless language is used which clearly indicates a different intention.[1]

The indorsement must be for the entire instrument; that is, *A* cannot indorse to *B* $50 out of a $100 check; he must indorse the whole amount to *B* or the negotiation is invalid. Likewise, where *A* purports to transfer the instrument to *B* and also to *C*, severally, this transfer does not operate as a negotiation; but a negotiation to *B* and *C* jointly is valid. Both *B* and *C* must indorse, unless the one indorsing has the authority to indorse for the other. In case part of an instrument has been paid, it may be indorsed as to the *residue*.

It should be remembered that indorsement is necessary for *negotiation* only in the case of *order* paper. The forms of indorsement that appear upon order paper are of several types and create different rights and liabilities between the parties. The Uniform Negotiable Instruments Act states that the indorsements may be

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[1] Farnsworth v. Burdick, 1915, 94 Kan. 749, 147 Pac. 863; p. 599.

either in blank, special, qualified, conditional, or restrictive. These types of indorsements will be briefly considered in turn.

Negotiation by Indorsement

Sec. 47. Blank indorsement.—A blank indorsement consists of the indorser's name written on the instrument or the paper attached thereto for that purpose, and is the form of indorsement most generally used. This indorsement changes order paper to bearer paper when it is the only or last indorsement. For example, a check, on its face, payable to "Henry Smith or order," if indorsed "Henry Smith," carries a blank indorsement. By this indorsement, coupled with delivery, Henry Smith has relinquished all rights that he had to the instrument, without directing that it be paid to any particular person. Consequently, any person who bears the paper or has possession thereof may recover on the same, regardless of how he received it. A thief or a finder could, by delivery, pass title to the instrument or could present the instrument for payment to the primary party, and, if payment were made, the primary party would be protected against the real owner.

A person receiving an instrument indorsed in blank may protect himself by changing the indorsement from blank to a special indorsement.

Sec. 48. Special indorsement.—By this form of indorsement the indorser designates a certain indorsee to whom the instrument is payable. It is not necessary that the indorsement contain the words "or order." Since the indorser specially names a person who is to receive payment of the instrument, the paper continues order paper and such special indorsee must indorse the paper if further negotiation of the instrument is made. The following is an example of a special indorsement: "Pay to William H. Lee." This is equivalent to "Pay to the order of William H. Lee."

Sec. 49. Qualified indorsement.—A qualified indorsement is so named because it qualifies or limits the liability of the indorser. By indorsing an instrument with a blank or special indorsement, the indorser attaches liability to himself conditional upon the failure of the primary party to pay. Each indorsement of this character adds additional security to the instrument. There are many situations, however, in which the holder of negotiable paper would not care to assume this liability; that is, where the solvency of the primary party is doubtful; or where the holder of the paper is a mere trustee for others entitled to the beneficial interest, such as the trustees in trust deeds used as securities for loans. Liability is avoided, in part, by the indorser under such conditions through use of a qualified indorsement which includes the words "without re-

course," or any words of similar import. These words mean "not to be liable as an indorser." The effect of such indorsement relieves the indorser of his conditional liability. That is, the indorser, in effect, assumes the liability of an assignor. It must be noted, however, that words of assignment used in an indorsement do not necessarily make the indorser a qualified one. It is held by a majority of the courts that the language, "I hereby assign the within instrument to *A*" is a special unqualified indorsement.[2] This type of indorsement does not affect the negotiability of the instrument; neither does it prevent a holder from becoming a holder in due course.

Sec. 50. **Conditional indorsement.**—A conditional indorsement is a special indorsement with added words creating a condition which must happen before the special indorsee is entitled to payment. This condition is binding, between the indorser and subsequent purchasers, but the primary party on the paper may disregard such condition and pay the holder, whoever he may be, whether or not the condition has been met. Until the condition is met, any holder who receives the proceeds of the paper holds the same as a trustee for the conditional indorser. Consequently, any person who takes the paper after such a conditional indorsement is charged with knowledge of the condition. The following is an example of such indorsement: "Pay to the order of L. P. Simpson upon the delivery of one Ford car No. 79643 on June 3, 1947."

Sec. 51. **Restrictive indorsement.**—There are often many situations in which the holder of negotiable paper may desire to part with the possession of his paper, and yet at the same time reserve to himself the right of the proceeds of the paper. It has been noted that by blank and special indorsements not only the possession of the paper but also the right to the proceeds of the paper is passed to the indorsee, with power to transfer both possession and right to the proceeds. Under a restrictive indorsement, only possession of the paper is transferred. Consequently, this type of indorsement restricts further negotiation of the instrument, and either makes the indorsee an agent of the indorser or invests title in the indorsee in trust for or to the use of some other person. The indorsee has the right, however, to receive payment of the instrument, or to sue on the same, and may transfer such rights as he has to another indorsee if a right of transfer has been given.

The following are examples of restrictive indorsement: "Pay to K. Schmidt only." Such an indorsement prohibits any further negotiation of the instrument, in that K. Schmidt is the only person entitled to receive payment. "Pay to the First National Bank in

[2] Fay v. Witte, 1933, 262 N.Y. 215, 186 N.E. 678; p. 599.

Champaign for collection only." This indorsement constitutes the First National Bank in Champaign an agent of the indorser and passes possession of the paper to the indorsee, who, upon collection of the money, holds it as an agent of the indorser. This last type of indorsement is in general use among banks for the collection of negotiable paper. But the indorsement "Pay to the order of any bank or banker," in general use among banks, for the purpose of forwarding an instrument for collection through intermediary banks, is by some courts held not a restrictive indorsement because "There is nothing on the face of this indorsement which prohibits the further negotiation of the instrument, or constitutes the indorsee the agent of the indorser, or vests title in the indorsee in trust for the use of some other person; and hence, by the most elementary principles of statutory construction, the plain meaning of the language must be observed, and it must be held that the indorsement was not restrictive." Some courts state, and the uniform bank collection code provides, that such an indorsement is restrictive and equivalent to an indorsement for collection only, as illustrated above, and that title remains in the indorsing bank.

A restrictive indorsee receives no better right in the instrument than that possessed by his indorser unless he is made a trustee for a third party. In the latter case, he may become a holder in due course.

Sec. 52. Transfer of unindorsed order paper.—Negotiation of bearer paper is accomplished by delivery, whereas negotiation of order paper is accomplished by indorsement and delivery. However, this difference does not mean that order paper may not be transferred without indorsement. An instrument may be transferred without the indorsement of the payee or the special indorsee. The person who receives the paper, however, cannot be called an indorsee, but is properly designated as a transferee of unindorsed order paper. This transferee occupies the same position and has only such title as the transferor had. His position is somewhat superior to that of the assignee of a simple contract, in that he has the additional right to have the indorsement of the transferor. In the absence of a different understanding, a transferee appears to have the right to an unqualified indorsement. Such transferee, therefore, may become a holder in due course at the time he receives the indorsement, if he has received no knowledge of defenses prior to such indorsement.[3] By a regular indorsement the indorsee receives a better title than the indorser. A transferee, however, receives only such title as the transferor had.

[3] Karsner v. Cooper, 1922, 195 Ky. 8, 241 S.W. 346; p. 601.

Sec. 53. Indorsement of bearer paper.—Bearer paper is negotiated by delivery, and requires no indorsement. Whether negotiable paper is bearer paper is determined either at its origin, or when the only or the last indorsement of order paper is in blank. Under Section 40 of the Negotiable Instruments Act, an instrument payable to bearer, indorsed specially, may nevertheless be further negotiated by delivery; but the person indorsing specially is liable as an indorser only to such holders as make title through his indorsement. For example, Brown, the holder of White's note, payable to bearer, negotiates it to Smith by special indorsement—"Pay to Smith, (signed) Brown." Smith negotiates the note to Dorsey by delivery. Dorsey becomes the holder of the note, being bearer thereof, but he obtains no right against the indorser Brown, because his title was not made through Brown but by delivery from Smith. If Smith had indorsed the note to Dorsey, Dorsey might have looked for payment not only from White, the maker, but also from Brown and Smith, the indorsers. Thus, it is generally said of a negotiable instrument: Once bearer paper on its face, always bearer paper; but order paper is order or bearer depending upon the last indorsement.

Sec. 54. Surrender to the drawee not negotiation.—It is customary for a holder, when presenting a check or other bill of exchange to the drawee for payment, to write his name across the back of the instrument. Such writing is not an indorsement, and the transfer of the instrument from the holder to the drawee for payment and discharge is not a negotiation. A negotiable instrument, when transferred from one person to another by delivery or indorsement, is a sale of the instrument, thus enabling it to pass as money. The passing of an instrument from the holder to the drawee, on the other hand, is a surrender of the instrument for discharge, and is not a negotiation. Therefore, no indorsement is necessary to entitle the holder to receive payment. If the drawee refuses payment because of the failure of the holder to indorse, the drawee breaches a contract with the drawer, because the drawee by his contract has promised to pay any person ordered by the drawer to be paid. A person signing his name on an instrument before surrender to the drawee has no liability as an indorser, because the drawee does not occupy the position of a holder. The drawee, however, becomes a holder if he purchases the bill before maturity with intention further to negotiate it. In the absence of this situation, the signature upon a bill of exchange before surrender to the drawee for payment merely acts as a receipt for money so far as the drawee is concerned.

Review Questions and Problems

1. Name the two methods of negotiating commercial paper. May only a part of a negotiable paper be transferred? Must the indorsement appear on the instrument?

2. What is a blank indorsement? What is its effect? Should such an indorsement be used where the instrument is to be retained some time by the indorsee? How may it be changed?

3. How is a qualified indorsement effected? What is its purpose?

4. *A* takes a note to his bank for collection. What type of indorsement should he use in order adequately to protect his interest?

5. *P* transfers to *H* negotiable order paper without indorsement. May *H* enforce payment of the instrument against the maker? What right has *H* against his transferor?

6. Is it necessary to indorse bearer paper in order to pass good title? To whom is such an indorser liable?

7. *A* takes a check made payable to his order to the drawee bank and demands payment. The bank asks him to indorse it and he refuses. Is the bank under a duty to pay without the indorsement? What is the effect of an indorsement under such circumstances?

Chapter V

HOLDERS AND HOLDERS IN DUE COURSE

Sec. 55. Who is a holder.—As defined by the Negotiable Instruments Act a holder means the payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof. A person in possession of a negotiable instrument may occupy two very different positions. A holder may be in no better position than the assignee of any simple contract right. That is, he may be subject to any personal defenses which the maker or drawer or other parties prior to him may have against the payee. Again he may be a holder free from such personal defenses, where his rights against the primary party or other prior parties are superior to those possessed by the former holder or owner of the instrument. Such holder is said to be a holder in due course. The law requires that a holder in such a position satisfy very definite requirements. Such a holder must be a holder for value, a purchaser before maturity, and a purchaser in good faith—that is, one who takes the instrument complete and regular on its face and without knowledge of any defects in the title or of any infirmity in the instrument.

Requirements for the Holder in Due Course

Sec. 56. Must be a holder for value.—Although a contract generally is not enforceable against a person unless he receives some consideration for his promise, the same cannot be said for a negotiable instrument. Such an instrument may be negotiable and circulate even though the party issuing it obtains nothing, but, before payment can be demanded of him, someone must have given value for the instrument. A holder for value, thus, is one who has given some value for a negotiable instrument. Value as defined here means any consideration which will support a simple contract, or any antecedent debt. That is, one who receives a negotiable instrument in settlement of a previous indebtedness becomes a holder for value.

A holder who purchases an instrument for less than its face value becomes a holder for value to the full amount of the instrument, but, if the discount is exceedingly large, it may, along with other factors, be evidence of bad faith on the part of the holder.[1] One does not become a holder for value merely by promising to pay for an instrument, but only when he has parted with value for it. Be-

[1] Ham v. Merritt, 1912, 150 Ky. 11, 149 S.W. 1131; p. 603.

cause of this fact, a bank which discounts, or accepts for deposit or collection, commercial paper and credits the account of the owner does not become a holder for value until the depositor checks out part or all of the particular item of deposit. At that moment, the bank becomes a holder for value, and, in determining whether the item arising from the discounted paper has been checked against, the courts apply the "first in, first out" theory.[2]

In other cases, as well, the courts hold that a mere promise to pay for negotiable paper does not make one a holder for value. Unless payment has been made at the time the holder learns of a defense, his rights are no better than those of the party from whom he acquired the paper. If the promise to pay is negotiable in form, however, the purchaser immediately becomes a holder for value. For example, a drawer who issues his check for a negotiable note becomes a holder for value even before the check is cashed. He is not obligated to take steps for the recovery of his check in an attempt to protect the maker of the note which he has acquired. Where the holder has paid only a portion of the consideration which he has agreed to pay and then learns of a defense against the instrument, he is a holder for value only to the extent of the amount paid prior to the time he receives notice of the defense. He should at that point refrain from paying the balance of the contract price.

One who receives a negotiable instrument as collateral security for another indebtedness is a holder for value only to the extent of the lien.[3]

Sec. 57. Must be a purchaser before maturity.—A holder in due course must be a holder who has purchased the paper before it is due.[4] The law presumes that every person under a duty will perform on the date that performance is due, and, if such person fails to perform—that is, fails to pay the instrument—it is presumed that he has some defense or valid reason for not performing. Consequently, a purchaser of overdue paper would be charged with the knowledge that some defense must exist. Where an instrument is payable on a fixed date, any purchaser thereafter would not be a holder in due course.

If the instrument is payable on demand, it is said to be overdue an unreasonable length of time after issue. What is a reasonable or an unreasonable time is determined by a consideration of the nature of the instrument, the usage of the trade or business, and all the circumstances and facts involved in each particular case. It is

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[2] People's State Bank v. Miller, 1915, 185 Mich. 565, 152 N.W. 257; p. 603.

[3] John Davis & Co. v. Bedgesoff et al., 1930, 155 Wash. 127, 283 Pac. 665; p. 604.

[4] State and City Bank and Trust Co. v. Hedrick et al., 1930, 198 N.C. 374, 151 S.E. 723; p. 605.

impossible to state the precise period of time after which a check may be said to be overdue. The conclusion in each case is determined by due consideration of the special circumstances surrounding the parties and the transaction. The retention of a check by a holder for a considerable time, without presentment, is unusual; and this circumstance is sufficient to put a party taking it upon inquiry as to whether any defenses exist against it. It has been held, in particular cases, that a check is not overdue, so as to let in defenses existing between the drawer and the payee, when it is purchased the same day it is issued, two days, four days, eleven days, twenty-four days,[5] and up to two and one-half months after issue, although under normal conditions a check would certainly be considered stale before it had been outstanding two and one-half months.

Where the instrument is due upon a fixed date, but subject to an early maturity by reason of an accelerating clause, the instrument would not be overdue until the option to mature the paper had been exercised by the holder. And even though this rule were true, a holder would be a holder in due course, occupying the position of a purchaser of paper before maturity, unless he had knowledge that the option to declare the paper due had been exercised. A past due installment, however, bars one from becoming a holder in due course as effectively as if the entire instrument were past due. Past due interest, on the other hand, does not impart notice of any defect in the instrument.

Sec. 58. **Must be a purchaser in good faith.**—A holder in due course must be a purchaser who takes the instrument complete and regular upon its face; that is, if mere inspection of the instrument will show its defect, such as erasures, alterations, blank spaces,[6] or other infirmities, a purchaser of such instrument cannot be said to be a taker of such instrument complete and regular upon its face. But the courts almost uniformly agree that a postdated check—which passes to a bona fide purchaser before the date stated—is complete and regular. The purchaser of a postdated check may be a holder in due course if he fulfills the other requirements. A holder, to be one in good faith, must also be a person who takes the instrument without knowledge of any facts relative to defects in the title, that is, rights and defenses that the primary party or other persons may have against the instrument. But if the purchaser knows, or is in a position where he ought to know, that the paper was secured from the maker by fraud, he would not be a good-faith purchaser; or, if a purchaser had knowledge that his transferor of

[5] Anderson v. Elem, 1922, 111 Kan. 713, 208 Pac. 573; p. 606.

[6] In re Estate Philpott, 1915, 169 Iowa 555, 151 N.W. 825; p. 607.

bearer paper was a thief or a finder, he would be charged with knowledge of the defect in the title and of the rights of the true owner, and would not be a good-faith taker. Mere suspicion is not sufficient, but a holder who suspects defects in title to such an extent that he fears investigation lest a defense be disclosed is not a purchaser in good faith.

Likewise a taker of corporation negotiable paper given to pay the personal debts of an officer of the corporation, the particular officer having signed the paper for the corporation, is a bad-faith taker, because the face of the instrument represents that the creditor has appropriated the corporation's money to the payment of the individual's debt. On the other hand, where corporation paper is payable to the order of an officer of the corporation or to a third party and is indorsed by the payee, officer, or third party and transferred in payment of the officer's individual debt, the transaction on its face does not represent that corporation money is appropriated to pay the corporate officer's debt. Therefore, the creditor may be a good-faith taker, although the result may be dependent on the surrounding circumstances.

Sec. 59. Payee may be a holder in due course.—Under the Uniform Negotiable Instruments Act, a holder means the payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof. If, therefore, a payee can satisfy the requirements of a holder for value before maturity and in good faith, such payee should be a holder in due course. Although the courts are in serious conflict on the question as to whether a payee may be a holder in due course, most jurisdictions sustain this position. Since the payee of the instrument usually deals directly with the primary party, he ordinarily has knowledge of any defects that the primary party might have, and for this reason cannot be a holder in due course. However, if the payee receives the paper complete and regular upon its face from an agent of the primary party under circumstances where he would not be put on guard as to the creation or purpose of the instrument, he satisfies the requirements for a holder in due course.[7] For example, *A* signs his name to an instrument complete, except for the amount, payable to the order of *P*, and directs his agent to fill in the amount for a specified sum. The agent, in violation of this authority, completes the instrument for a sum larger than that authorized and delivers it to *P*, complete and regular upon its face. *P* is not immediate to *A* in the transaction and has no knowledge of the unauthorized act of *A*'s agent in completing the instrument. Since the instrument was given by *A* in payment of a preëxisting debt to *P*, it is given for value. There-

[7] Liberty Trust Co. v. Tilton, 1914, 217 Mass. 462, 105 N.E. 605; p. 608.

fore, *P* has satisfied all the requirements of a holder in due course, and should be free from the defense of unauthorized completion by the agent of *A*.

Sec. 60. A holder from a holder in due course.—A holder who gets his title from a holder in due course and who is not a party to any fraud or illegality affecting the instrument has all the rights of a holder in due course, although such holder may not satisfy all the requirements of a holder in due course. When negotiable paper has passed through the hands of a holder in due course, its negotiability has been permanently established, in that all the personal defenses of the primary party have been cut off.[8] For example, *A* fraudulently induces *B* to create a promissory note for $100, payable to *A*. *B*, therefore, has a defense of fraud against *A*. *A* negotiates this note to *C*, a taker for value before maturity and in good faith. *C*, the holder in due course of the note, is now free from *B*'s defenses. *C* gives the note by negotiation, after maturity, to *D*, who has knowledge of the fraud perpetrated upon *B* by *A*, but who took no part therein. Although *D* has purchased the instrument after maturity and with knowledge of an outstanding defense, he nevertheless takes the instrument free from *B*'s defense. Since *D* derived his title through *C*, a holder in due course, and was not a party to the fraud, he has all the rights that the holder in due course, *C*, had.

Likewise, if *D*'s position was that of a transferee of an unindorsed order paper from *C*, a holder in due course, he would have all the rights that *C* had, because he is an assignee from a holder in due course.

Sec. 61. Reacquirer.—Where an instrument is negotiated to a person who formerly held the same, such holder is a reacquirer, and he may reissue or further negotiate the instrument. He is not, however, entitled to enforce payment against any intervening persons to whom he was liable. The courts generally construe this rule also to apply in certain cases to the acceptor or maker of an instrument. That is, if the acceptor or maker reacquires before maturity, he may reissue it; but if he reacquires it at or after maturity, such reacquisition amounts to discharge of the instrument. For example, *A*, a holder of paper, but not one in due course, negotiates to *B*, a holder in due course. *B* negotiates back to *A*. It would appear that *A*, having taken title from a holder in due course, would have all the rights of a holder in due course; but since *A* is a reacquirer, he is remitted to his former rights as a holder and does not occupy the position of a holder in due course merely by having purchased from a holder in due course. However, if *A* had been a

[8] Miles v. Dodson, 1912, 102 Ark. 422, 144 S.W. 908; p. 609.

holder in due course in the first instance, he would occupy that position when he reacquired the instrument.

Review Questions and Problems

1. Is consideration an essential element of a negotiable instrument?

2. Will the preëxisting debt furnish ample consideration to support a negotiable instrument? Is it sufficient to make one a holder in due course?

3. Who is a holder of a negotiable instrument? Is there any difference between a holder and a holder in due course? If so, of what does the difference consist?

4. Name the requisites of a holder in due course.

5. *A* obtains from *D* a check in payment of a carload of flour. The flour is not as represented and *D* stops payment of the check at the drawee bank. In the meantime *A* has deposited the check in his bank, the bank having no knowledge of the fraud. Is the bank in which the check has been deposited a holder in due course?

6. *H* received a check by indorsement from *P* in payment of some jewelry. At the time he received the check it had been issued some sixty days. Was *H* a holder in due course? When must a purchaser obtain a negotiable instrument in order to be a holder in due course?

7. What is meant by a purchaser in good faith? May one be a holder in due course of an instrument which shows erasures and alterations on its face?

8. *D* signed some checks in favor of her grocer and handed them to her husband to deliver to the payee. The husband delivered them to the payee, but told him that the checks were to be applied upon his own bill. The grocer credited the account of the husband. Is the grocer a holder in due course of the check in payment of the husband's account or will he be compelled to credit *D*'s account?

9. *F*, a holder in due course of a check, transfers it to *H*, who has knowledge of a defense to the check. Is *H* a holder in due course? Would the result be the same if the transfer took place beyond a reasonable time after the check was issued?

10. Who is a reacquirer of commercial paper? If he formerly held the paper other than as a holder in due course, may he become a holder in due course by purchasing it from a holder in due course?

11. *P* sold a $1,000 negotiable note to *H* for $300 and indorsed it without recourse. *H* gave his check in payment, but before it had been cashed, *M*, the maker, notified *H* of a defense against the note. How much, if any, will *H* be able to collect on the note from *M*?

12. *A* held a check for $200 made payable to the order of *A*, agent of *P*. He indorsed the check to *H* in payment of a personal indebtedness. If *P* later claims the proceeds of the check, may *H* maintain that he took the instrument in good faith and so became a holder in due course?

Chapter VI

RIGHTS AND LIABILITIES OF PARTIES

Sec. 62. Classification of parties.—The parties on negotiable paper may be divided into two groups—primary parties and secondary parties. The primary parties are the makers of promissory notes and the acceptors of bills of exchange. The secondary parties are drawers of bills of exchange, drawers of checks, indorsers, and accommodation parties. This classification is helpful in distinguishing the liabilities of the two types of parties. A primary party is primarily liable; that is, he is a person who, by the terms of the instrument, is absolutely required to pay the same. A secondary party is secondarily liable; that is, he becomes liable only when the primary party fails to pay and the holder performs certain conditions precedent, namely presentment, notice, and dishonor, which will be discussed more in detail in Chapter VII.

Primary Parties

Sec. 63. The maker.—Under the Uniform Negotiable Instruments Act, the maker of a negotiable instrument, by making it, engages that he will pay it according to its tenor and admits the existence of the payee and his capacity to indorse. He is under an absolute obligation to pay the instrument, when it is due, according to its terms. If he makes the instrument payable to himself and then indorses it, he is nevertheless liable as a maker.

Sec. 64. The acceptor.—The acceptor of a bill of exchange is the primary party upon the paper. By accepting the instrument, he engages that he will pay it according to the tenor of his acceptance, and admits the existence of the drawer, the genuineness of his signature, his capacity and authority to draw the instrument, the existence of the payee, and his then capacity to indorse. Before accepting the bill of exchange, the acceptor is called the drawee. The instrument may be drawn by the drawer and negotiated to several persons before its acceptance by the drawee. The instrument may also be accepted by the drawee before it is drawn, in which case the acceptance is usually on a separate sheet or piece of paper and is attached to the bill when it is drawn. As mentioned before, one who draws a bill of exchange (drawer) is usually a creditor of the drawee or has arranged with the drawee to draw on him. Some credit or contract right probably exists in the drawer against the drawee. For instance, John Doe enters into an agreement with the First National Bank whereby the latter agrees to accept bills

of exchange for a certain amount drawn on the bank by John Doe. The bank is not liable to the payee of the bill until it accepts the bill. If it does not accept, it is only liable to John Doe for breach of contract to accept. After acceptance, the bank is liable to the payee as well as to the drawer.

The promise constituting the acceptance must satisfy the requirements of a promise in a promissory note, and must be in writing and signed by the drawee-acceptor. Acceptance is usually made by the drawee's writing the word "accepted," with his name and the date, across the face of the instrument, although the use of the word "accepted" is not necessary.[1] The acceptance, however, is not completed until delivery of the instrument or notification of the acceptance.

Sec. 65. Acceptance on a separate sheet of paper.—Section 134 of the Uniform Negotiable Instruments Act provides that, where an acceptance is written on paper other than the bill itself, it does not bind the acceptor except in favor of a person to whom it is shown, and who, on the faith thereof, receives the bill fór value. Thus, suppose a salesman who is traveling in Eugene, Oregon, wishes to draw a draft on a bank located in New York, but the hotel is unwilling to cash the draft unless the drawee bank will accept it. The salesman may wire the bank for an acceptance of the draft. If the hotel, upon receipt of the wired acceptance, discounts the draft, it can, in case of nonpayment, sue and recover from the bank. Some states provide that the acceptance is good as against the acceptor, even though the acceptance is not shown to the person purchasing. In those states, reliance upon such acceptance is sufficient.

Sec. 66. Promise to accept.—Section 135 of the Uniform Negotiable Instruments Act states that "an unconditional promise in writing to accept the bill before it is drawn is deemed an actual acceptance in favor of every person who upon the faith thereof receives the bill for value." But such promise must be positive and unequivocal.[2] Some states provide that an unconditional promise to accept a bill before or after it is drawn is an actual acceptance. However, the purchaser of a bill of exchange, who takes it in ignorance of such a promise to accept, cannot bind the acceptor, because the paper was not purchased on the faith of the promise of the acceptor. A drawee, therefore, may be an acceptor under these circumstances to one holder and not to another.

Sec. 67. Kinds of acceptance.—An acceptance may be general, qualified, or implied. The general acceptance is the usual type of

[1] Lawless v Temple, 1926, 254 Mass. 395, 150 N.E. 176; p. 610.

[2] Flathead County State Bank v. First Nat. Bank, 1922, 282 Fed. 398; p. 611.

acceptance, being an assent to pay without qualification, according to the order of the drawer.

A qualified acceptance is conditional, partial, local, or qualified as to time. The conditional acceptance is a promise to pay, depending upon a condition. A partial acceptance is an acceptance to pay only a part of the amount for which the bill is drawn. A local acceptance is an acceptance to pay at a particular place only; and one qualified as to time is an acceptance to pay at a particular time. An acceptance is qualified also if less than all of the drawees accept. If the acceptance is qualified, the holder may refuse to take such acceptance and may treat the bill as dishonored by nonacceptance. If the holder takes the qualified acceptance, the drawer and the indorsers are discharged on the bill unless they have expressly or impliedly authorized or subsequently assented to the taking of the qualified acceptance. However, the drawer and the indorsers must express their dissent within a reasonable time after they are notified of the qualified acceptance, or they will be deemed to have assented thereto and will be bound.

An implied acceptance is an acceptance which may be presumed from the acts of the drawee. Under the Uniform Negotiable Instruments Act, the drawee is allowed twenty-four hours after presentment in which to decide whether he will accept the bill. If the drawee destroys the bill, or refuses to return it within twenty-four hours or within such other period as the holder may allow, he will be deemed to have accepted the bill. Some courts hold that a destruction of the bill does not constitute an implied acceptance, but an unauthorized taking of the bill. It is clear that an intentional destruction of the instrument acts as an acceptance, but some question exists as to whether mere retention for more than twenty-four hours, in the absence of a demand for its return, constitutes an acceptance. A few courts hold that there has been no refusal to return the bill by the drawee until the holder has asked for it, but the weight of authority clearly supports the contention that mere retention of the bill in excess of the allotted time is an acceptance. This is particularly true of checks which have been forwarded to the drawee bank for payment. The bank is obligated to pay the instrument or to return it within twenty-four hours or such other period as has been agreed upon. Failure to return it promptly acts as an acceptance.

Secondary Parties

Sec. 68. In general.—In the previous sections we have considered the liabilities of the maker and the acceptor, the parties primarily liable on the instrument. In the following sections we shall

consider the liabilities of the secondary parties, the indorsers, accommodation indorsers, and the drawers of bills of exchange. The indorsers of negotiable paper may be divided into unqualified and qualified indorsers, with respect to the extent of their liability.

Sec. 69. Unqualified indorsers.—The unqualified indorsers are those who indorse by blank and special indorsement. Their liability is of two kinds—conditional and unconditional. The qualified indorsers have only one type of liability, namely, unconditional liability. The difference in liability between these two types of indorsers is determined by the contract of indorsement. The unqualified indorsers, by reason of blank and special indorsements, indicate that they will pay the instrument, in case of default of the primary parties, on the happening of certain conditions precedent: namely, presentment, dishonor, and notice. This promise to pay is termed the conditional liability of the unqualified indorsers. The unconditional liability of the unqualified indorser is practically the same as the liability of the qualified indorser and arises by reason of the fact that all indorsers, by the transfer of the instrument, sell a chattel. In effecting the sale, both the qualified and the unqualified indorsers make certain warranties which are unconditional. We will now consider the nature of the liabilities of the unqualified indorser.

Sec. 70. Conditional liability.—The conditional liability of unqualified indorsers is set forth in the Uniform Negotiable Instruments Act as follows: "Every indorser who indorses without qualification . . . engages that on due presentment, the instrument shall be accepted or paid or both as the case may be, according to its tenor, and that if it be dishonored and the necessary proceedings on dishonor be duly taken, he will pay the amount thereof to the holder or to any subsequent indorser who may be compelled to pay it."

In order, therefore, for the holder or the holder in due course to recover against an unqualified indorser on his conditional liability, three conditions precedent must be satisfied. First, the instrument must be presented to the primary party for payment; second, the instrument must be dishonored by the primary party; third, notice of the dishonor must be given by the holder to the indorser to be charged. The indorser's duty arises when and only when the above-named conditions precedent have been satisfied and thus make the liability of such indorser conditional. If any one of the three conditions is omitted, no conditional liability will vest in the unqualified indorser. Thus, suppose *P* indorses a check in blank or specially to *X*, a holder in due course. *X* presents the check to the drawee bank for payment, but payment is refused because the

drawer has not sufficient funds to cover the check. *X* then notifies *P* of the dishonor. *P* is now liable to *X* for the tenor of the check. *P* would not have been liable if *X* had not presented the check for payment or if *X* had not given *P* notice of dishonor.

Sec. 71. Unconditional liability.—The warranties of the unqualified indorser are set forth in the Act as follows: "Every indorser who indorses without qualification warrants to all subsequent holders in due course: (1) that the instrument is genuine and in all respects that which it purports to be; (2) that he has good title to it; (3) that all prior parties had capacity to contract; (4) that the instrument is, at the time of his indorsement, valid and subsisting." Under this section a liability immediately attaches at the time of the indorsement. This liability arises out of the fact that the indorser is a seller of property, and every seller of property makes certain warranties. Therefore, one who passes negotiable paper of necessity impliedly warrants the paper to be that which it purports to be, including the other warranties enumerated above. For example, if *A* sold *B* a watch and the article delivered was not a watch, *B* should recover from *A*. Likewise, if *A* sold *B* a paper purporting to be a negotiable instrument and the paper delivered was not genuine, *B* should recover from *A*. The indorser is liable to his vendee, irrespective of whether the holder has fulfilled the conditions precedent mentioned in the preceding section and even before maturity of the instrument, because the warranties, enumerated above, if breached, are breached at the time of the delivery of the instrument. For example, *A* indorses to *C* a note which purports to be signed by *B*. *B*'s signature is a forgery. *C*, the holder in due course, is, upon presenting the note to *B*, faced with a real defense. *A* is liable to *C*, in that, by his sale of the instrument to *C*, he warranted the instrument to be genuine and in all respects what it purported to be. Since it was void for forgery, *C* may recover from *A* on *A*'s unconditional liability.

Sec. 72. Qualified indorsers.—A qualified indorser is one who indorses without recourse. When an indorser places the words "without recourse" after his indorsement or when he passes a bearer instrument by delivery, he states, in effect, that he will not be liable in case of nonpayment of the instrument. That is, he does not guarantee the solvency of the primary party. By such an indorsement the indorser is merely relieved of the conditional liabilities of the special and blank indorser, in that he makes no offer to be bound, even though the conditions precedent—presentment, dishonor, and notice—have been satisfied. The transferor of bearer paper who passes title by delivery occupies a similar position, in that such transferor has no conditional liability.

The qualified indorser and the transferor by delivery, however, do have unconditional liabilities as set forth in the Uniform Negotiable Instruments Act: "Every person negotiating an instrument by delivery or by qualified indorsement warrants: (1) that the instrument is genuine and in all respects what it purports to be; (2) that he has a good title to it; (3) that all prior parties had capacity to contract (the provisions of subdivision (3) of this section do not apply to persons negotiating public or corporation securities, other than bills and notes); (4) that he has no knowledge of any fact which would impair the validity of the instrument or render it valueless.[3] But when the negotiation is by delivery only, the warranty extends in favor of no holder other than the immediate transferee." The warranties of an unqualified indorser, however, extend to all subsequent holders of the indorsed paper.

For example, if *P* indorses a check: "Pay to *X*, without recourse, (signed) *P*," *X* will have no recourse against *P* in case of nonpayment; but if it appears that the check was issued by an infant or an insane person, who has disaffirmed his contract, *P* will be liable to *X* by reason of the breach of his warranty that all prior parties had capacity to contract. If *P* delivers a check, payable to bearer, to *X*, who delivers it to *Y*, *P* will be liable on his unconditional warranties to *X*, his immediate transferee, but not to *Y*. *X*, in turn, would be liable to *Y* on his unconditional warranties. The unconditional warranties of a qualified indorser are practically the same as the unconditional warranties of an unqualified indorser.

One who indorses bearer paper, specially or in blank, is liable as an indorser on both the unconditional and the conditional liabilities, to such holders as make title through his indorsement.

Sec. 73. Accommodation indorsers.—An accommodation indorser is one who signs his name upon an instrument, without receiving any consideration therefor, for the primary purpose of lending his name as surety for some other person. Such an indorser is liable to a holder in due course, even though the holder in due course knows that such an indorser is an accommodation party. Such an accommodation indorser occupies a very different position from that of other indorsers, in that the accommodation indorser never has title to the paper. He never becomes an owner of the instrument unless the instrument is not paid and he pays it. Under these circumstances the accommodation indorser becomes a purchaser or holder.

In determining the parties to whom the accommodation indorser is liable, it is necessary to note at whose request his signature is placed upon the instrument and when. Section 64 of the Uniform

[3] Leekley v. Short et al., 1933, 216 Iowa 376, 249 N.W. 363; p. 611.

Negotiable Instruments Act provides as follows: "Where a person not otherwise a party to an instrument places thereon his signature in blank before delivery, he is liable as indorser in accordance with the following rules: (1) if the instrument is payable to the order of a third person, he is liable to the payee and to all subsequent parties; (2) if the instrument is payable to the order of the maker or drawer or is payable to bearer, he is liable to all parties subsequent to the maker or drawer; (3) if he signs for the accommodation of the payee, he is liable to all parties subsequent to the payee."

The Uniform Negotiable Instruments Act states, in Section 63, that where a person places his signature upon an instrument otherwise than as a maker, drawer, or acceptor, he is liable as an indorser unless he clearly indicates by appropriate words that he is bound in some other capacity.

From an inspection of the instrument, therefore, it would be impossible to tell whether an indorser's name was one for accommodation or for negotiation. Under the Act it seems the accommodation indorser is liable upon both conditional and unconditional liabilities even though such accommodation indorser never had title to the instrument. Since an accommodation indorser is not in the chain of title, it would seem that the unconditional liabilities or warranties of a vendor of chattels should not bind him. The courts are in conflict on this point, some permitting the introduction of oral evidence to show the liability of the accommodation indorsers, and others permitting only the admission of such evidence as shows the time and place that the signature was placed upon the instrument.

Under the Act the accommodation indorser is an indorser and is, therefore, entitled to notice by the holder where the instrument has been presented for payment to the primary party and dishonored.[4]

Sec. 74. Order of liability of indorsers.—A holder of an instrument which has been dishonored may hold all those indorsers liable who have indorsed unqualifiedly, provided he has complied with the conditions precedent. He may seek recovery from the last indorser, or from the first indorser, or from intermediate indorsers. In many states he may join all the indorsers in one action. But an indorser who pays an instrument may recover only from an indorser prior to him. Indorsers are liable prima facie in the order in which they indorse; but evidence is admissible to show that between or among themselves they have agreed otherwise. For example: *A, B, C, D,* and *E* are indorsers on a check drawn by *M, A* being the first indorser, and *E* the last. *H,* the holder, on nonpay-

[4] Rockfield et al. v. First National Bank of Springfield, 1907, 77 Oh. St. 311, 83 N.E. 392; p. 612.

ment of *M*'s check, may recover from *D*. If *D* pays, *E* is no longer liable. *D* may seek payment from *C*, and *C* from *B*, and *B* from *A*. However, if *A* and *B* had an agreement whereby *A* was not to be liable to *B*, *A*, in an action by *B*, would be permitted to introduce this evidence in order to avoid liability.

Sec. 75. **Drawers of bills of exchange, excepting drawers of checks.**—The drawer of a bill of exchange has both conditional and unconditional liabilities, but his unconditional liability is not so extensive as the unconditional liability of the indorser. The conditional liabilities of the drawer, with the exception of the drawer of checks, are exactly the same as those of the indorser. With respect to unconditional liabilities, the drawer makes no warranties, although he cannot deny the existence of certain facts; that is, by drawing an instrument, he admits the existence of the payee and his then capacity to indorse. The liability of the drawer of a check will be considered in a later chapter.

Defenses of Parties

Sec. 76. **In general.**—We learned in the last chapter that a holder in due course occupies a protected position and holds the instrument free from certain defenses. The defects to which the holder in due course is not subject are called personal defenses. There are certain defenses, however, which the maker and the acceptor may successfully maintain even against the holder in due course. These defenses are called real defenses. If the holder of the instrument is not a holder in due course, personal as well as real defenses may be successfully interposed against him, just as though the instrument were nonnegotiable.

Real and personal defenses are also available to secondary parties in suits brought by the holder, just as they are available to the maker and the acceptor. In short, an indorser may set up his real defenses against any holder subsequent to him, and he may set up personal defenses, such as failure of consideration, against his immediate indorsee.

Personal Defenses

Sec. 77. **Nature.**—Personal defenses are those which relate to the consideration for which the instrument was given and to losses resulting from some negligence on the part of the primary party in creating or executing the instrument. They may be classified as follows: fraud in the inducement or consideration; lack, failure, or illegality of consideration; payment; improper delivery of a com-

pleted instrument; slight duress; unauthorized completion; and material alteration made possible by negligent conduct.

Sec. 78. Fraud.—Fraud in the inducement or consideration is fraud pertaining to the consideration for which the instrument is given.[5] The primary party intended to create an instrument, but was fraudulently induced to do so. Such a defense is not available against a holder in due course, but is available against any other holder. For example, *A* is induced by *B*, through fraud, to purchase stock. *A*, in settlement therefor, executes and delivers to *B* his promissory note. *B* negotiates this note to *C*, a holder in due course. *A*, upon learning that the stock is valueless, cannot set up this defense against *C* on the date of maturity. He could have set it up against *B* if the latter had retained the note.

Sec. 79. Lack, failure, or illegality of consideration.—While lack, failure, or illegality of consideration is not a defense against a holder in due course, it is a defense against one not a holder in due course, just as it would be a defense in any action on a simple contract. For example, *A* gives *B* his promissory note in payment for merchandise. The merchandise does not meet the requirements of the contract, or it is never delivered. *B* negotiates the note to *X*, who has knowledge of the breach. *X* negotiates the note to *C*, a holder in due course. *C*, the holder in due course of *A*'s note, may recover on the same, free from *A*'s defense,[6] but *X*, had he retained the note, would have been subject to the defense.

If the consideration for the instrument arises out of an illegal transaction, the fact that the consideration is illegal is a defense in a suit between the immediate parties; but if the instrument gets into the hands of a holder in due course, the illegality of consideration will be no defense. Thus, *A* gave *B* a check for the rent of a house, which *B* knew *A* was using contrary to the law as a gambling and liquor den. *B* negotiated the check to *X*, a holder in due course. Payment of the check is not enforceable by *B*, but is enforceable by *X*, the holder in due course.

The problem of illegality will be further considered in connection with Real Defenses.

Sec. 80. Payment before maturity.—Payment of a negotiable instrument prior to maturity is only a personal defense, and one making such a payment should do so only if the instrument is surrendered. Likewise, payment to the wrong person is not available as a defense against a holder in due course. In this connection it is well to remember that the primary party to commercial paper

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[5] W. M. Barnett Bank v. Chiatovich, 1925, 48 Nev. 319, 232 Pac. 206; p. 613.

[6] Lozano v. Meyers, 1929, Tex. Com. App., 18 S.W.(2d) 588; p. 614.

has no right to assume that it remains in the hands of the original party. Since a negotiable instrument may be freely negotiated without notice thereof reaching the primary party, the burden rests upon him to locate the instrument before making payment.

The question of discharge by payment at or after maturity will be considered further in the chapter on Discharge.

Sec. 81. Nondelivery of a completed instrument.—An instrument may be drawn in correct form, executed upon consideration, may reach the hands of the payee, and yet be unenforceable because of the lack of another requirement: namely, delivery. The Uniform Negotiable Instruments Act provides that every contract on a negotiable instrument is incomplete and revocable until delivery of the instrument for the purpose of giving effect thereto. Delivery means transfer of possession, actual or constructive, from one person to another.

What, then, is the liability of a party whose signature appears on a completed instrument which has never been delivered but which in some way gets into circulation? The Uniform Negotiable Instruments Act provides that, as between immediate parties and as to remote parties, other than holders in due course, the delivery, in order to be effective, must be made either by or under the authority of the party making, drawing, indorsing, or accepting the instrument. As between immediate parties, the delivery may be shown to be conditional or for some special purpose only, and not for the purpose of transferring title in the instrument until the happening of some event. For instance, in a suit by *B, A* may show that he delivered to *B* a certain check to be negotiated only on condition that *B* first paint *A*'s picture. Evidence of *B*'s failure to paint the picture is a good defense as against *B*.

A holder in due course of an instrument which is complete in every respect except delivery can enforce it against all prior parties whose names appear thereon. If a completed instrument falls into the hands of a holder in due course, delivery is conclusively presumed.[7] Consequently, a holder in due course is not concerned with the question of the delivery of an originally completed instrument. Thus, if a completed instrument has been lost or stolen and can be negotiated without the forging of an indorsement, a holder in due course can obtain good title thereto.

Sec. 82. Duress.—If the party can show that he signed or indorsed an instrument because of duress, which consisted of threats and no more, his defense is personal and cannot be raised as against a holder in due course, but it may be interposed as to any other holder. Duress so extreme that it robs the party of his freedom of

[7] Angus v. Downs, 1915, 85 Wash. 75, 147 Pac. 630; p. 615.

action, so severe that his act is not his own but becomes that of another party, is a real defense. For instance, if a person's hand is forcibly taken and he is compelled to write his name, the signature is not his act, and no contract has been made, whether the purchaser of the paper knows the facts or not. Duress of this type is a real defense available against a holder in due course.

Sec. 83. Completion not as authorized.—Where a holder intrusts an instrument to another for the purpose of completing it as to the amount, payee, and so forth, the fact that the instructions were not obeyed is usually held to constitute no defense to an action by a holder in due course. Such a violation of authority would be a defense to an action by one not a holder in due course.

Sec. 84. Effect of negligence on liability of a party.—There are three outstanding situations in which negligence has an important bearing on the rights of the parties. First, negligence over the control of an incomplete instrument bars the drawer, or maker, from asserting lack of delivery as a real defense. Whenever an instrument originally incomplete finds its way in completed form into the hands of a holder in due course, as a result of negligence, lack of delivery becomes a personal defense only. As between the holder in due course of an instrument and the maker or drawer whose carelessness, or the negligence of whose agent, made it possible for the instrument to get into circulation, the loss should be borne by the maker or drawer. The second situation is somewhat similar. If a maker, or drawer, of a negotiable instrument, by failing to fill all of the blank spaces, makes alteration thereof easy,[8] some courts hold the maker, or drawer, liable to a holder in due course in accordance with the terms of the altered instrument. Failure to fill in with a wavy line the blank space following the amount has been held by these courts as carelessness on the part of the drawer of a check.

Third, normally, a bank which pays a forged check drawn on it must suffer the loss unless it can recover from the forger. A drawer who is negligent in scanning his cancelled checks, however—and thus facilitates the forging of other checks or the escape of the forger—should bear the loss which results from his failure promptly to report the forged signatures. Failure to notify the drawee bank within a reasonable time after a forged check has been returned is negligence and makes the drawer responsible for any loss occasioned thereby.

So far as a drawee bank is concerned, one who signs checks in blank is always deemed to be negligent. Since the bank is bound

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[8] National Exchange Bank of Albany v. Lester, 1909, 194 N.Y. 461, 87 N.E. 779; p. 616.

to respect and honor the checks of its depositors, lack of delivery of an incompleted instrument is only a personal defense so far as the drawee bank is concerned.[9] The bank is justified in paying such a check before it receives notice of the theft and may charge it to the drawer's account.

Real Defenses

Sec. 85. Nature.—A real defense, sometimes called an absolute defense, is one that is available to the primary or secondary parties against the holder in due course, as well as against other holders. A real defense arises by virtue of the fact that no instrument or liability was ever created in contemplation of the law; or if such instrument or liability was created, it is rendered void by public policy or statute, or it is rendered void to the extent of the alteration, if materially altered; or if such instrument or liability was created, the person suing cannot enforce payment because of lack of title as the result of a forged indorsement. If, therefore, no instrument or liability was created in the first instance, or if such instrument or liability has been destroyed, no right or title passes into the hands of the holder. Real defenses available to a party against the holder are: fraud in the inception; forgery; duress (see Personal defenses); lack of title; material alteration, to the extent of the alteration; incapacity; illegality; and theft of an incompleted instrument.

Sec. 86. Fraud in the inception.—Fraud in the inception or execution exists where a negotiable instrument is procured from a party when circumstances are such that the party does not know he is giving a negotiable instrument. Therefore, since the party primarily to be bound has no intention of creating an instrument, none is created. For example: *A*, intending to sign a lease at the request of *B*, unknowingly and by trickery on the part of B, signs a negotiable instrument. *B* negotiates the instrument to *C*, a bona fide purchaser. Upon presentation of this instrument by *C* to *A* for payment, *A* will have a real defense of fraud in the inception. Since *A* created no paper, *C* purchased none.

Carelessness on the part of the maker which facilitates or makes easy fraud in the execution robs him of a real defense, reducing it to one which is personal only. Thus, in the above illustration, if *A* had signed the so-called lease without reading it and had allowed himself to be deceived into thinking the negotiable instrument he signed was a lease, he would have been liable to a holder in due

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[9] Trust Co. of America v. Conklin, 1909, 65 Misc. (N.Y.) 7, 119 N.Y. Supp. 367; p. 617.

course of the instrument. In such a case, he cannot throw the loss occasioned by his negligence on the holder in due course.

Sec. 87. Forgery.—It is clear that a person whose signature or indorsement is forged upon an instrument should not be bound thereon, in the absence of negligence or estoppel, because no instrument is created by the person whose name is forged. Between the person whose name is forged and the holder in due course, the loss should fall on the holder in due course. He will have a right against his immediate vendor and all prior parties subsequent to the forgery. Thus, the loss ultimately falls upon the person who dealt directly with the forger. The Uniform Negotiable Instruments Act states: "Where a signature is forged or made without the authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument or to give a discharge therefor or to enforce payment thereon against any party thereto can be acquired under such signature, unless the party against whom it is sought to enforce such right is precluded from setting up the forgery or want of authority." Therefore, a forged indorsement would not only fail to pass title, but would give the indorser, whose indorsement was forged, a real defense against all subsequent parties.

Sec. 88. Lack of title.—A forged indorsement by a thief or finder of order paper passes no title to the indorsee. Consequently, any subsequent party will be unable to enforce payment of the same against prior parties. Lack of title is a real defense and can be asserted against a holder in due course. The true owner of the paper, however, may hold the wrongdoer as a converter. It should be pointed out that bearer paper requires no indorsement. Consequently, a forged indorsement of paper which at the time is payable to bearer does not affect the title obtained by the purchaser. A thief or finder of such paper may pass good title to a holder in due course, although the title of such thief or finder was defective.

Signing another's name without authority is not forgery in all cases, particularly when the person so signing indicates he signs as as agent. Nevertheless, if he fails to possess the authority to make the indorsement which he attempts to execute, the purchaser acquires no title to the instrument.

Occasionally, one person impersonates another, and persuades a third person to make a check or note payable to the person who has been impersonated and, having received the instrument from the maker, the impersonator indorses on it the name of the payee. Such an indorsement is not considered a forgery, and the indorsee obtains good title to the instrument.[10] Under such circumstances,

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[10] Stricker v. Buncombe County et al., 1934, 235 N.C. 536, 172 S.E. 188; p. 618.

the maker of the instrument really intended the impersonator to obtain the money, although he thought him to be somebody else.

When two people have the same name, and the person not intended to be the payee gains possession of a negotiable instrument and adds his indorsement to it, forgery has taken place. Some cases hold that if the maker or drawer is careless in delivering the instrument to the wrong party, he may be held liable thereon.

Sec. 89. Material alteration to extent of alteration.—Material alteration is not a defense against a holder in due course in an action to recover the original tenor of the instrument. It is a defense, however, even against a holder in due course, to the extent of the alteration. Thus, when an instrument is raised from $100 to $1,000, the maker, acceptor, drawer, or prior indorsers have an absolute defense to the extent of $900, the amount of the alteration, unless the alteration has been facilitated by their negligence.

Sec. 90. Incapacity.—Negotiable paper executed by infants, insane persons, drunkards, and other persons under legal disability is not legally binding as to such persons. Therefore, such persons may, at their election, assert a real defense against any holder. Incapacity is available only to the incapable parties and is not a defense to the other parties on the instrument. The indorsement or assignment of any person under legal disability passes title in the instrument; but this fact in itself does not give subsequent parties a right to recover against such persons under legal disability. Such persons may disaffirm their indorsement and recover possession of the instrument from any subsequent holder; or they may set up their incapacity as a real defense if they are makers, drawers, or acceptors.

Sec. 91. Illegality.—The statutes of many states make void particular kinds of contracts, such as gambling and usurious contracts.[11] An instrument that carries a usurious rate of interest which is declared void by statute continues void even in the hands of a holder in due course. The consideration out of which an instrument arises may be illegal. Nevertheless, the instrument itself, unless specifically or impliedly made void by statute, is valid.

Sec. 92. Nondelivery of an incompleted instrument.—The question arises as to the liability of a party whose signature is placed on an incompleted instrument which has never been delivered, but is in some way subsequently completed and placed in circulation. The Uniform Negotiable Instruments Act provides that where an incompleted instrument has not been delivered, but is taken, completed, and negotiated without authority, such an instrument is not a valid contract in the hands of *any* holder as

[11] Sabine v. Paine, 1918, 223 N.Y. 401, 119 N.E. 849; p. 619.

against any person whose signature was on the instrument before it was taken. Thus, suppose *A*, without negligence, leaves a promissory note lying on his desk, which note was signed by himself but which named no payee and specified no amount. *B* finds the note and completes it without authority, making it payable to himself for $1,000. *B* sells the note to *X*, who takes it in good faith, without notice, before maturity and for value. The note is invalid as to *A*; but it is enforceable against *B*, who became a party to it after the taking of the note.

It must be noted that the above situation is different from one where the incompleted instrument was in fact delivered by the maker, or drawer, but was not filled out in accordance with the authority given. Here the maker, or drawer, is liable to all holders in due course for the amount of the instrument, for he delivered the instrument and authorized its completion. In the former situation he did neither. In effect he issued no instrument and therefore can be held liable on none.

Review Questions and Problems

1. Must a bill of exchange be accepted before it is negotiable? How is it customary to accept a bill of exchange?

2. *D*'s signature is forged to a bill of exchange drawn in favor of *P* on drawee *Y*. *P* takes the bill to *Y* and has it accepted and then negotiates it to *H*, a holder in due course. *H* presents it for payment to *Y*, who refuses to pay because he has learned of the forgery. May *H* recover from *Y*?

3. Must an acceptance be in writing? May it be on paper other than the bill of exchange? Suppose *A* purchases a bill of exchange which has been accepted by the drawee upon another piece of paper. Under what circumstances may he hold the drawee?

4. *H*, a holder, presents a bill of exchange to *Y* for payment. *Y* takes the bill of exchange, but for three days he refuses either to return or to pay it. Is he liable to *H*, although he later offers to return the paper?

5. What is the meaning of personal defenses? Against whom are they available?

6. *A* determines to make a gift to his son *P*, but not having the "ready cash" he makes a note for $1,000 to *P*. *P* immediately negotiates the note to *H*, a holder in due course. May *A* set up the defense of lack of consideration against *H*?

7. *M* pays his negotiable note to *P* thirty days before maturity, but fails to take up the paper. Shortly thereafter *P* negotiates the note to *H*, a holder in due course. May *H* compel *M* to pay the note a second time?

8. *A* leaves with his agent a check signed in blank, to be filled in and delivered to a certain creditor. The agent makes it payable to *P*, a

friend, and *P* negotiates it to a holder in due course. Can the holder recover from *A*, who has stopped payment at the bank?

9. What is meant by fraud in the execution? Is it a real or a personal defense?

10. *A* found a negotiable note made payable to the order of *P*. He indorsed the name of *P* thereon and transferred it to *H*, who had no knowledge of his misconduct. May *H* recover from the maker of the note?

11. What is the effect of a material alteration by the payee? May a later holder in due course recover on the note?

12. A statute in Illinois provides that all checks, bills, and notes given in payment of a gambling debt shall be null, void, and of no effect. Suppose such a note falls into the hands of a holder in due course; may he recover from the maker?

13. What is necessary to establish the conditional liability of the indorser?

14. *H* holds a note which, unknown to him, has been forged. He, by a qualified indorsement, indorses it to *A*, a holder in due course. It is presented and payment is refused. *A* desires to hold *H* liable on his indorsement. May he do so?

15. Name the warranties of a qualified indorser. What is the difference between the warranties of a mere transferor of bearer paper and those of a qualified indorser?

16. What is an accommodation indorser? Is he entitled to notice of dishonor?

17. *X* accused *Y* of an assault, and threatened criminal prosecution. *Y* admitted his wrong and offered to settle. *Y* tendered to *X* his note for $300, to be held by *X* for three days until *Y* considered the matter. If *Y* did not appear, the note was to be taken as a settlement. If *Y* did appear, the note was to be cancelled and other arrangements were to be made. *Y* appeared at the end of the third day and demanded the note, which *X* refused to return. *X* sues *Y* on the note. *Y* sets up a defense of nondelivery. What is the result?

18. *D* drew a draft on the *Y* Company in favor of the *X* Company. The *X* Company secured an acceptance of the draft from the *Y* Company and indorsed it to *P*. At the time of the acceptance it was orally agreed between the *X* Company and the *Y* Company that if the acceptor, the *Y* Company, could not meet the draft when presented for payment, *D* would renew the draft. *P* had knowledge of these facts. *P* sues the *Y* Company on the draft. The *Y* Company sets up defense of nondelivery. What is the result? Suppose *P* had no knowledge of the understanding between the *X* Company and the *Y* Company?

19. *M* signed the following note, leaving it on his desk:

Seattle, Washington.
May 4, 1940.

On or before six months from date I promise to pay to the order of ....

.... Dollars ....

(Signed) *M*.

A, an agent, stole and completed the instrument. He then negotiated the note to *Y*, who indorsed to *P*. *P* sues *M*, who sets up the defense of nondelivery. What is the result?

20. *D* drew a check payable to *P* or bearer, leaving the check on his desk. *P* took the check and transferred it to *X*. Has *D* a defense against *X*? Against *P*?

21. *D* signs a number of checks in blank for the benefit of his clerk and locks them securely in his safe. The safe is robbed and one of the checks is completed and finds its way into the hands of an innocent party. May the innocent party recover on the check?

Chapter VII

PERFORMANCE OF CONDITIONS PRECEDENT TO CHARGE SECONDARY PARTIES

Sec. 93. Introduction.—In the preceding chapter we discussed the liability of the secondary parties, namely, drawers and indorsers of negotiable paper. It was pointed out that their conditional liability to the holder does not arise until the performance of certain conditions precedent, namely, due presentment for payment, dishonor by the primary party, and the giving of due notice of dishonor to the drawer or indorser. In this connection it must be remembered that these conditions may be waived by the parties to a negotiable instrument. A waiver set forth in the body of a note is effective as to all parties whose names appear on the instrument, while a waiver which is part of an indorsement applies only to the indorser, unless the language used is broad enough to cover later indorsers. Attention now will be given to the various conditions precedent which normally must be fulfilled to establish secondary liability.

Presentment for Payment

Sec. 94. Time of presentment.—The time when presentment should be made varies with the different types of negotiable paper. If the instrument is due at a fixed date, it must be presented on that date. If the instrument is payable on demand, time of presentment will depend upon whether the instrument is a demand note, a demand bill of exchange, or a bill of exchange in the nature of a check. Presentment with respect to bills of exchange may be either for acceptance or for payment.

Sec. 95. Time of presentment for payment of demand notes.—If a note is payable on demand, it must be presented for payment within a reasonable time after issue. "Issue means the first delivery of the instrument, complete in form, to a person who takes it as a holder." Demand instruments are due at the moment of issue. This rule does not mean, however, that they are due with respect to presentment for payment. Otherwise such instruments would have no period of time in which to circulate. The law provides that such paper may circulate a reasonable length of time after issue before becoming overdue. In determining what is a reasonable time, the courts apply the same test that they use in determining whether a purchaser is a purchaser of overdue demand

paper. That is, due consideration must be given to the use of the paper, the nature of the trade or business, and the facts of each individual case. It has been held in particular cases that delay in presentation was not unreasonable where there was a delay of months or years. Other cases have held that fourteen months is unreasonable.[1] Even twenty-five days has been held unreasonable. The statute of the state of New Hampshire specifically provides that if a demand note is not presented within sixty days, the indorsers shall be discharged.

Sec. 96. Time of presentment for payment of demand bills of exchange other than checks.—On bills of exchange, there are two groups of secondary parties, the indorsers and the drawers. In order to fix the conditional liability and to preserve the same against indorsers and the drawer of a demand bill of exchange other than a check, it must be presented within a reasonable time after the last negotiation thereof. It will be noted that this time differs very much from the time of presentment for a demand note. The demand note must be presented for payment within a reasonable time after issue. In the case of a bill of exchange, the conditional liability of the drawer and the indorsers will be preserved if the instrument is presented by the last holder within a reasonable time after he receives it. In determining for what period of time a holder may hold a demand bill of exchange after receiving it and before presenting it for payment, we may apply the same test of reasonableness of time as is indicated above for demand notes, though in this case a shorter period of time is usually considered reasonable.

Sec. 97. Time of presentment for payment of checks—drawers.—A check is a demand bill of exchange drawn on a bank, and, in order to preserve liability against the indorsers of checks, the rule is the same as for any other bill of exchange, namely, that the check must be presented for payment within a reasonable time after the last negotiation.[2] With respect to the liability of a drawer of a check, however, the holder must present the check for payment within a reasonable time after issue; otherwise, the drawer will be discharged to the extent of the loss which is caused by the delay. In the case of the ordinary demand bill of exchange, the drawer is entirely discharged if the instrument is not presented within a reasonable time after the last negotiation. It is to be noted, therefore, that the liability of the drawer of a check to pay is absolute rather than conditional insofar as presentment is concerned, unless he is damaged as a result of the delay. For example, suppose that

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[1] Leonard v. Union Trust Company, 1922, 140 Md. 192, 117 Atl. 318; p. 622.
[2] Columbia Banking Company v. Bowen, 1908, 134 Wis. 218, 114 N.W. 451; p. 622.

A draws his check on *D* bank, payable to *B* on March 1, 1948, the *D* bank being in the same community as *A* and *B*. A reasonable time after issue under these circumstances would demand that the instrument be presented for payment at *D* bank at least within the business hours of the next business day. *B* negotiates the check to *C*. *C* keeps the check for four days. Five days after its issue, *C* presents the check to *D* bank for payment. The *D* bank dishonors. *C* gives notice to *A*, the drawer, and to *B*, the indorser. Although the check has been presented for payment an unreasonable time after issue, *A* is still liable, because he suffered no loss on account of the delay. However, if, between the date of issue of the instrument and the date of presentment by *C*, the bank had become insolvent and *A* had lost 60 per cent of the money he had on deposit in the bank, *A* would be discharged on the check held by *C* to the extent of 60 cents on the dollar. *B*, the indorser, is discharged in either case, if it is determined that presentation four days after *C* receives it is an unreasonable time after the last negotiation.

Sec. 98. Time of presentment for instruments bearing a fixed maturity.—An instrument with a fixed maturity date must be presented for payment on the day it falls due. When the date of maturity falls on Sunday or a holiday, the instrument is payable on the next succeeding business day. If the instrument is payable at a bank, presentment for payment must be made during banking hours, unless the person liable has no funds at the bank to meet the instrument at any time during the day. In such a case presentment at any hour before the bank closes is sufficient. Under this rule the party liable has the right to deposit money in the bank up to the last hour of closing. Therefore the instrument cannot be dishonored until after the closing hour of the bank.

Sec. 99. Presentment, how made.—An instrument, in order to be properly presented for payment, must be exhibited or shown to the person from whom payment is demanded. Otherwise the presentment will be insufficient and the indorsers or drawers discharged. The party presenting the instrument for payment must also be in such position that, when the instrument is paid, the same can be delivered to the party paying it. If the holder cannot exhibit and surrender the paper, payment being offered, there is no legal presentment for payment. A formal request for payment is insufficient. An instrument payable at a definite place is not properly presented if the holder calls the maker by telephone and asks what he is going to do about it. An answer by the maker that he could not pay would, therefore, not be a dishonor, and all the indorsers on the instrument would be discharged for want of sufficient presentment.[3]

[3] Gilpin v. Savage, 1911, 211 N.Y. 167, 94 N.E. 656; p. 624.

Sec. 100. Presentment, place of.—When an instrument is made payable at a bank, or when a definite place is specified for payment, it must be presented for payment at such place.[4] If no place of payment is specified, it is sufficient if presentment is made at the address of the person who is to make payment. If the address is not given, presentment may be made at the usual place of business or the residence of the party bound. In other cases the instrument may be presented wherever the primary party can be found, or at his last known place of residence. If an instrument is payable to the order of a bank and is made payable at the bank, possession by the payee bank constitutes a sufficient presentment and demand.

Sec. 101. By whom and to whom made.—Presentment for payment must be made by the holder or some person duly authorized to receive payment for him. Presentment is not necessary in order to charge the persons primarily liable on the instrument, but it must be made to the person primarily liable on the instrument in order to charge the indorsers and the drawer. If the primary party is not available, the instrument may be presented to any person found at the place where presentment is to be made. If the person primarily liable is dead, presentment may be made to his personal representatives if, with the exercise of reasonable diligence, they can be found. If the persons primarily liable on the paper are partners, presentment for payment may be made to any one of them, even though the partnership has been dissolved. If there are several persons primarily liable on the paper and they are not partners and no place of business is given, presentment must be made to each person primarily liable.

Sec. 102. Excuses for failure to present.—If, after the holder has exercised reasonable diligence, the primary party cannot be found, presentment for payment may be dispensed with; likewise, where the primary party is a fictitious person, or where waiver of a presentment is either expressed or implied, presentment is unnecessary.

Delay in presentment for payment is excused when the delay is caused by circumstances beyond the control of the holder, and where such holder is not guilty of any negligence or misconduct. When the cause for delay is removed, presentment must be made at the earliest possible moment.

Presentment for Acceptance

Sec. 103. In general.—Presentment for acceptance is not applicable to promissory notes, but it is often required in the case of bills of exchange. The drawee of a bill of exchange is not bound upon the instrument as a primary party until he accepts it. The

[4] Neldon v. Grondahl, 1904, 13 N.D. 363, 100 N.W. 1093; p. 625.

holder may, in most cases, wait until maturity and present his bill for payment to the drawee, or he may present it to the drawee for acceptance before maturity in order to give credit to the instrument during the period of its term. The holder may present the bill for acceptance to the drawee at any time. The drawee is under no legal duty to accept; but if he refuses, the bill is dishonored by non-acceptance and a right of recourse arises immediately against the drawer and the indorsers, and no presentment for payment is necessary.

For example, the holder of a bill of exchange due in six months may present it for acceptance to the drawee immediately upon receipt of the instrument; or he may wait until the maturity date of the paper and present it for payment on that date. If the drawee dishonors when the instrument is presented for acceptance, the holder, after giving due notice, may immediately sue the drawer or any other secondary parties thereon.

Sec. 104. Time allowed drawee to accept.—Under the Uniform Negotiable Instruments Act, the drawee is allowed twenty-four hours after presentment in which to decide whether he will accept the bill; but the acceptance, if given, dates as of the day of the presentation. If the instrument is not accepted after demand is made, the holder is not permitted to wait and present the instrument for payment at maturity but must give notice of dishonor to all secondary parties or he loses his right of recourse against them. When the holder leaves the bill with the drawee and the drawee refuses to return the bill or destroys it, the drawee will be deemed to have accepted and will be required to pay.

Sec. 105. When presentment for acceptance is required.—In most instances it is not necessary to present an instrument for acceptance. Presentment for payment alone is usually sufficient, but in the following cases presentment for acceptance must be made:

1. Where the bill is payable after sight, or where presentment for acceptance is necessary to fix the maturity of the instrument.
2. Where the bill expressly stipulates that it must be presented for acceptance.
3. Where the bill is drawn payable elsewhere than at the residence or place of business of the drawee.

Notice of Dishonor

Sec. 106. Dishonor and notice.—Dishonor, or refusal to accept or pay, by the primary party, is one of the conditions precedent necessary to charge secondary parties. An instrument is dishonored when it is duly presented for acceptance or payment and acceptance or payment is refused or cannot be obtained, or when

presentment is excused and the instrument is overdue and unpaid.

The third condition precedent which must occur before a right of recourse arises against secondary parties, after presentment and dishonor, is notice of dishonor. When a negotiable instrument has been dishonored by nonpayment or nonacceptance, notice of dishonor must be given to the drawer and to each indorser. Each party who does not receive notice is discharged.

Sec. 107. Requirements of notice.—The notice may be written or oral. It must be sufficiently clear to identify the instrument which has been dishonored, and it may be delivered personally, by agent, or through the mails. The written notice need not be signed, and if any information is lacking which is necessary to notify the secondary party of the dishonor, it may be supplemented by verbal communication. Any information so given is sufficient, provided the party who receives it is not misled thereby.[5]

Sec. 108. Time when notice must be given.—The notice may be given as soon as the instrument is dishonored; and unless the delay is excused, notice must be given within the time fixed by the Act. The Uniform Negotiable Instruments Act provides as follows: "Where the parties reside in the same place, notice must be given within the following times:

1. If given at the place of business of the person to receive notice, it must be given before the close of the business hours of the day following.

2. If given at his residence, it must be given before the usual hour of rest on the day following.

3. If sent by mail, it must be deposited in the post office in time to reach him in the usual course on the day following."

It has been held that impossibility of giving oral notice, because of the temporary absence of the indorser from the city, does not excuse the holder from giving the notice within the time prescribed by this section. He should comply with the requirements of the section by mailing notice, as provided in subsection 3.[6]

Where the parties reside in different places, the Uniform Negotiable Instruments Act provides as follows:

"1. If sent by mail, it must be deposited in the post office in time to go by mail the day following the day of dishonor,[7] or, if there be no mail at a convenient hour on that day, by the next mail thereafter.

2. If given otherwise than through the post office, then within

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[5] Myers v. Bibee Grocery Co., 1926, 148 Va. 282, 138 S.E. 570; p. 625.

[6] Price v. Warner, 1911, 60 Or. 7, 118 Pac. 173; p. 626.

[7] First National Bank of Shawano v. Miller, 1909, 139 Wis. 126, 120 N.W. 820; p. 627.

the time that notice would have been received in due course of mail, if it had been deposited in the post office within the time specified in the last subdivision."

Where a secondary party receives notice of dishonor, he may likewise give notice to all secondary parties prior to himself, and, after receipt of such notice, he has the same time to give notice to all prior parties that the holder had, after the dishonor.

Sec. 109. What constitutes mailing.—If the notice of dishonor is properly addressed and deposited in the post office, notice is assumed to have been given, although the letter is never received. It is presumed that if the letter was properly mailed it was received. Although the nonreceipt of a duly mailed notice of dishonor does not discharge an indorser, evidence that the instrument was never received is competent on the question as to whether the notice was actually mailed. A deposit of the notice in a letter box or any branch post office is a sufficient mailing. However, a notice properly addressed and left where the mail is usually collected by the postman is not a mailing, in that the notice is deposited in a place not under the control of the post office.

Sec. 110. Place where notice must be sent.—The Uniform Negotiable Instruments Act provides, in Section 108, that if a party has added an address to his signature on the instrument, notice of dishonor must be sent to that address; but if he has not given such address, then the notice must be sent as follows:

"1. Either to the post office nearest to his place of residence, or to the post office where he is accustomed to receive his letters;[8] or,

2. If he lives in one place and has his place of business in another, notice may be sent to either place; or,

3. If he is sojourning in another place, notice may be sent to the place where he is sojourning.

But where the notice is actually received by the party within the time specified in the Act, it will be sufficient, though not sent in accordance with the requirements of this section."

Sec. 111. By whom notice must be given.—Notice must be given by the holder of the instrument after dishonor, or by his duly authorized agent, or by any person who might be compelled to pay the instrument to the holder. A collecting bank, as agent for the holder, will be liable to its customer if it fails to give notice upon dishonor. An agent may give notice in his own name or in the name of his principal, or he may give the notice to his principal. The agent must give his notice within the same time as if he were a holder, and the principal has a like time to give notice to the secondary parties.

[8] H. H. Dickinson Co. v. Hickey, 1926, 235 Mich. 638, 209 N.W. 848; p. 628.

Sec. 112. To whom notice must be given.—Notice must be given to the secondary party or parties from whom payment is sought; it may be given either to the party himself or to his duly authorized agent. If a secondary party is dead and this fact is known to the holder or party giving the notice, the notice must be given to a personal representative of the deceased person, if such can be found; or, if there is no personal representative, notice may be sent to the last-known place of business or residence of the deceased. Where the secondary parties are partners, notice to one is notice to both. If the secondary parties are jointly liable, notice must be given to each of them, unless each is an agent of the other. If the secondary party has become bankrupt or insolvent, or has made an assignment for the benefit of his creditors, notice may be given either to the secondary party or to his trustee or assignee.

Sec. 113. Effect of notice given by or on behalf of a holder.—The Uniform Negotiable Instruments Act provides that where notice is given by or on the behalf of a person entitled to give notice, it benefits all subsequent holders and all secondary parties who have a right of recourse against the party to whom it is given. When a holder has given notice of dishonor, or when someone has given notice for his benefit to all the secondary parties, it is not necessary that any prior holder who is entitled to recover give notice. The notice by the holder to all the secondary parties on the instrument operates for the benefit of all.

Sec. 114. Excuses for failure to give notice.—Notice of dishonor may be excused when, after the exercise of reasonable diligence, it cannot be given, or when circumstances beyond the control of the holder make notice impossible. This rule holds true only when such holder is not guilty of any default, misconduct, or negligence. The Uniform Negotiable Instruments Act also provides that notice of dishonor need not be given to the drawer where the drawee is a fictitious person; where the drawer has no right to expect that the drawee will accept; or where the drawer has countermanded payment, as in the case of a stop order on a check. The drawer, having stopped payment on the check, is responsible for its dishonor, and, therefore, is not entitled to notice. If the drawer withdraws all his funds from the bank and does not deposit sufficient funds for the purpose of paying the instrument, he is not entitled to notice.

The Uniform Negotiable Instruments Act further provides that notice of dishonor is not required to be given to an indorser in any of the following cases: (1) where the drawee is a fictitious person or a person not having capacity to contract and the indorser was aware of the fact at the time he indorsed the instrument; (2) where

the indorser is the person to whom the instrument is presented for payment; and (3) where the instrument was made or accepted for his accommodation. Where the drawee is fictitious or under a disability and the indorser knows of the fact, he is already informed of the dishonor. Likewise, an indorser to whom the instrument is presented for payment would have knowledge of his own refusal. Where the instrument is made or accepted for the indorser's accommodation, his duty is not affected by lack of notice, because he himself is liable for the payment of the debt as evidenced by the instrument. Even though the Uniform Negótiable Instruments Act provides that, under certain circumstances, notice is not necessary, it is recommended, nevertheless, that notice be given to each person charged upon the instrument, although such notice may appear to be undue precaution.

Sec. 115. Protest—when necessary.—Protest is a written notice that the instrument has been presented by a notary for acceptance or payment and has been dishonored; it is under the hand and seal of the notary making it. Protest may also be made by a respectable citizen in the presence of two or more credible witnesses. It is necessary to protest foreign bills of exchange in the case of nonacceptance or nonpayment, provided they show on their face that they are foreign. Bills of exchange are divided into two kinds with respect to the place where they are drawn and payable. A foreign bill of exchange is drawn in one state and payable in another. An inland bill of exchange is drawn and payable in the same state. An inland bill of exchange, as well as a foreign bill of exchange, may be protested for nonacceptance or nonpayment. It is not necessary, however, that an inland bill of exchange be protested, oral notice or notice of any other character being sufficient. The purpose of the protest or written notice of dishonor is to preserve the evidence as proof that the conditions precedent, namely, presentment, dishonor, and notice, have been satisfied in order to charge the indorser and the drawer. If a foreign bill of exchange is not protested, the indorsers and the drawer are discharged.

Sec. 116. What constitutes protest.—Protest must be attached to the bill itself or must contain a copy of the bill. It must be given under the hand and seal of a notary public, and must state the following facts:

1. The time and place of presentment.
2. The fact that presentment was made and how made.
3. The reason for the protest; that is, not sufficient funds, no account, and so forth.
4. That a demand was made and what answer was given, or whether the drawee or the acceptor could be found.

Sec. 117. Time within which protest must be made.—Section 155 of the Uniform Negotiable Instruments Act provides that, when a bill is protested, such protest must be made on the day of the dishonor unless the delay is excused. When a bill has been duly noted, the protest may subsequently be extended as of the day of the noting. There are usually two steps taken in protesting a bill. The first step includes the presentment of the instrument for payment, dishonor, demand, and failure to obtain payment. If this be the case, the person protesting the instrument must state that he does protest the instrument and must write upon it the fact of the protest, the reasons, the date when it was done, the demand made, the answer given, his name or initials, and such other information as may be required to make out a formal protest. This procedure is called noting the instrument and is for the purpose of securing information to make a formal protest. The second step is the formal protest, which may be made at any time after the noting. This step is called extending the protest. Extending the protest is issuing the formal certificate of protest, which must contain the information enumerated above. If the formal protest is not sent in time to serve as a notice of dishonor to secondary parties, notice should be sent, followed later by the formal certificate. If the notice is given before the formal protest, this fact is usually recited upon the certificate. The protest may now be relied upon as absolute proof that presentment and demand were made and all the necessary steps taken in order to fix the liability of secondary parties.

Excuses for failure to protest are the same as the excuses for failure to give notice of dishonor.

Review Questions and Problems

1. Why is presentment for payment necessary? Is it necessary to charge the maker of a note? What is the proper time to present a demand note?

2. *M* draws a demand bill of exchange upon *D* in favor of *P*. *P* holds the bill for six months and then negotiates it to *A*. *A* holds the bill for a year and then negotiates it to *H*, who immediately presents it to *D*. *D* is insolvent and unable to pay. Upon giving proper notice of dishonor, may *H* recover from either *P* or *M*?

3. Name two instances when presentment for acceptance is required.

4. What is the proper place at which to present negotiable paper?

5. A bill of exchange comes into *X* Bank for collection. The bank calls the drawee on the telephone and demands payment, and is refused. Has there been sufficient presentment to charge secondary parties?

6. When is presentment for payment dispensed with?

7. To whom should notice of dishonor be given? Is it necessary to

give notice to all indorsers? Whom does notice benefit? Supposing you were fourth in the line of indorsers, and had been given notice of dishonor by the holder, would you feel it necessary to notify prior indorsers?

8. Where should the notice be sent? How soon should it be dispatched after dishonor? When is notice unnecessary?

9. What is meant by protesting negotiable paper? When is it required?

CHAPTER VIII

DISCHARGE

Sec. 118. In general.—There are three groups of persons whose liability must be considered when the instrument is discharged: the primary parties liable on the instrument—the maker and the acceptor; parties secondarily liable—indorsers and the drawer; and sureties, either primarily or secondarily liable. The Uniform Negotiable Instruments Act enumerates the following methods of discharge:

1. Payment.
2. Cancellation.
3. Material alteration.
4. Renunciation.
5. Any act which discharges a simple contract for the payment of money.
6. Acquisition at or after maturity of the instrument by the party primarily liable.

Discharge of Primary Parties—Maker and Acceptor

Sec. 119. Discharge by payment.—Where the instrument has been paid in due course for or on behalf of the principal debtor, or where it has been paid by an accommodated party—when the instrument is made or accepted for accommodation—the instrument is discharged.[1]

An intention to pay is not a payment. The mere fact that a negotiable instrument is stamped "paid" will not of itself constitute payment. For example, a check, upon being received by a bank on which it is drawn, is not paid until the drawer's account is charged or the actual money is paid out by the bank.[2] If anything other than money is offered and received as payment—a negotiable note, check, or draft—there must be an intention that such instruments, given or received, discharge the former instrument; and in the absence of an agreement between the parties that the new note or check is to be received as payment, the former instrument is not discharged. An old note which is surrendered at the time a new note is given is generally considered paid, but if the old note is retained, the second note is considered to be collateral for the first.

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[1] Nelen v. Smith Bros. Auto Sales, Inc., 1923, 45 R.I. 245, 121 A. 394; p. 630.
[2] Hunt v. Security State Bank, 1919, 91 Or. 362, 179 Pac. 248; p. 630.

Similarly, a check given in settlement of a note which is surrendered acts as payment.

Sec. 120. Discharge by cancellation.—An intentional cancellation by the holder discharges the instrument. Where a cancellation has been made unintentionally or by mistake, without the authority of the holder, the instrument is not discharged. The burden of proof, however, lies with the party who states that the cancellation was made unintentionally or under a mistake.

Sec. 121. Discharge by material alteration.—Where an instrument has been materially altered without the consent of all the parties liable thereon, the liability of such parties is extinguished; or, if the alteration of a written instrument is made by a holder with a design and intention to defraud the maker, not only is the instrument itself discharged, but the debt represented by the instrument is also discharged.[3] However, when an instrument has been materially altered and is in the hands of a holder in due course not a party to the alteration, he may enforce payment according to the original tenor.

Contracts for credit sales of merchandise often conclude with a negotiable promise to pay a sum equal to the purchase price. Is the severance of this negotiable promise from the balance of the contract to be deemed a material alteration? Unless the right to detach has been expressly or impliedly given, such a separation is considered to be a material alteration. However, if a perforated line follows the contract and immediately precedes the negotiable promise, the right to sever is often implied.

Sec. 122. Discharge by renunciation.—The holder of an instrument may expressly renounce his rights against any party thereon before or after maturity. A renunciation, to effect a discharge, must be in writing, unless the instrument is delivered to the person primarily liable, and it must be absolute and unconditional. A renunciation does not affect the rights of a holder in due course who later acquires the instrument.

Sec. 123. Discharge by act which will discharge a simple contract.—A negotiable instrument is discharged by any act, such as novation, accord and satisfaction, the Statute of Limitations, and bankruptcy, which will discharge a contract for the payment of money. These various methods of the discharge of a simple contract are discussed in the book on Contracts.

Sec. 124. Discharge by acquisition of title from the holder.—When a primary party or the principal debtor of a negotiable instrument becomes the owner at or after maturity, the instrument is discharged unless the primary debtor becomes a holder as an agent

[3] Columbia Grocery Co. v. Marshall, 1915, 131 Tenn. 270, 174 S.W. 1108; p. 632.

for another, or unless the instrument is delivered to the primary party in return for an invalid instrument. The mere fact that the primary party receives possession of the instrument is not sufficient to evidence a discharge. The primary debtor must become the owner of the instrument in his own right.

Sec. 125. Discharge of secondary parties, other than sureties.—The Uniform Negotiable Instruments Act, in Section 120, states that a person secondarily liable on the instrument is discharged:

"1. By an act which discharges the instrument.

2. By the intentional cancellation of his signature by the holder.

3. By the discharge of a prior party.

4. By a valid tender of payment made by a prior party.

5. By the release of the principal debtor, unless the holder's right of recourse against the party secondarily liable is expressly reserved.

6. By any agreement binding upon the holder to extend time of payment, or to postpone the holder's right to enforce the instrument unless made with the assent of the party secondarily liable, or unless the right of recourse against such party is expressly reserved."

The conditional liability of a secondary party to a holder at maturity will be discharged if the holder fails to give him notice of dishonor of the instrument. This failure to give notice, however, discharges only those secondary parties who were not duly notified. If the instrument itself is discharged, all secondary parties are discharged. The above sections refer to the discharge of all the parties.

Sec. 126. Discharge of surety.—The Uniform Negotiable Instruments Act provides that where a person's name appears upon an instrument and it is not clear in what capacity he signed, he will be liable as an indorser unless words are used to show that he is to be liable otherwise. Therefore, all accommodation parties are secondarily liable, and, as such, would be discharged under the rule controlling the liability of indorsers. If a surety is a maker or an acceptor, he is not a secondary party but a comaker, and liability depends upon the rules of suretyship. If the holder extends the time of payment to a certain time without the knowledge or consent of the surety, such extension operates to discharge the instrument so far as the surety is concerned. For other principles controlling the right of surety, see the chapter on Suretyship.

Review Questions and Problems

1. Name four methods whereby a primary party may be discharged from liability on negotiable paper. What is the effect of an intentional cancellation?

2. *A* received from *M* a note for $200. In an attempt to recover an additional amount, *A* added a clause calling for the payment of 7 per cent interest. How much, if any, may he recover on the note? Assuming that the note was given for a debt, may he recover the amount of the original debt?

3. *H* is a holder of a negotiable bill of exchange upon which there are six indorsers. *H* desires to release the fourth on the list. If he does, what will be the effect?

4. *H* holds a negotiable note upon which there are three indorsers. The maker is unable to pay it at maturity and desires additional time. *H* consents to give him an additional thirty days in which to make payment. At the end of thirty days the note is not paid. Assuming that *H* made proper presentment and gave notice of dishonor at the maturity date, may he recover from the indorsers?

5. *A* is a comaker, with *M*, of a negotiable note, although he is merely acting as surety. This fact is known to the holder. Do the rules of suretyship apply?

CHAPTER IX
CHECKS

Sec. 127. Distinction between checks and other bills of exchange.—In the previous chapters some mention has been made of checks and of the liability of the parties thereon, especially with respect to the legal effect of the failure of the holder to present a check for payment within a reasonable time after issue and of his failure to give notice of dishonor.

The drawer of a check occupies a somewhat different position from the drawer of other bills of exchange. That is, he is from the very creation of the instrument absolutely liable except for one situation; namely, if the holder fails to present a check within a reasonable time after issue, the drawer will be discharged if he suffers any loss by reason of the holder's failure promptly to present the instrument for payment. Such loss arises when the bank upon which the check is drawn becomes insolvent after the issuance of the check, but before its presentment.

A check is presumed to have been made for immediate presentment, that is, within a reasonable time after its issue. A holder, therefore, owes a duty to the drawer to present the check for payment at the earliest possible moment, and if the holder delays unreasonably he should suffer any loss occasioned by such delay.

A check is a demand bill of exchange drawn upon a bank. It differs from other bills of exchange in that it is always supposed to be drawn upon a fund which is in existence at the date the instrument is created. Such fund is with the drawee and stands to the credit of the drawer.

Sec. 128. A check is not an assignment of funds.—A check of itself is not an assignment of part of the depositor's account.[1] It is merely an order upon the drawee bank directing the bank upon presentation to pay to the holder the amount of the check. Such an order may be countermanded at any time before it is acted upon. A countermand of a check is called a "stop order." The order to stop payment must be obeyed by the bank to the same extent as a depositor's order to pay.

Since the check is not an assignment of funds, the bank is under no legal duty to pay the holder. If the bank refuses to pay when the depositor has sufficient funds in his account or has not recalled

[1] Northern Trust Company v. Rogers et al., 1895, 60 Minn. 208, 62 N.W. 273; p. 634.

the instrument, the bank breaches a contract with the depositor and is liable for any damages caused to the depositor by reason of injury to his credit.

Sec. 129. Certification of checks.—When the bank upon which a check is drawn accepts or certifies it, such an act operates as an appropriation of so much of the drawer's deposit as is required to pay the instrument. Sufficient funds out of the drawer's account are set aside for the purpose of paying the check when it is later presented.

The certification of a check by the bank upon which it is drawn, at the request of a holder, is equivalent to an acceptance. The bank thereby becomes the principal debtor upon the instrument. The liability of the bank is the same as the liability of an acceptor of any other bill of exchange. The bank admits that the drawer's signature is genuine; that the depositor's account contains sufficient funds to pay the check; and that the money will not be withdrawn.

The certification must be in writing and signed by the proper officer of the bank. A certification adds much to the salability of the paper, as it carries with it the strength and credit of the bank.

The certification may or may not change the legal liability of the parties upon the instrument. When the drawer has a check certified, such a certification merely acts as additional security and does not relieve the drawer of any liability.[2] The holder of such an instrument, if it is dishonored after presentment, is still under a legal duty to satisfy the conditions precedent to charge the secondary parties. On the other hand, when the holder of a check secures certification by the drawee bank, he thereby accepts the bank as the only party liable thereon. Such an act discharges the drawer and all prior indorsers from liability. The effect of such certification is similar to a payment by the bank and a redeposit by the holder.

The refusal of a bank to certify a check at the request of a holder is held not to be a dishonor of the instrument. The bank owes the depositor a duty to pay but not necessarily to certify checks which are drawn on it.

Review Questions and Problems

1. *A* draws on *D* Bank a check for $150 in favor of *P*. *P* holds the check for ninety days, and, when he presents it, he finds that *A* has no money in his account. At the time the check was drawn, *A* had more than sufficient funds there to meet it. May *P* recover from *A* on the check?

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[2] Minnot v. Russ, 1892, 156 Mass. 460, 31 N.E. 489; p. 634.

2. Would the result be the same in the previous case, if the bank had become insolvent in the interim?

3. *M* drew a check on *D* Bank in favor of *P*. *P* presented the check to the bank, but the bank refused to make payment, although they had sufficient funds belonging to *M* to do so. Has *P* an action against the bank?

4. *P* is the payee of a check drawn on *D* Bank. He takes the check to the bank and has it certified. He then indorses it and mails it to *H* in payment of an account. Before the check reaches *D* Bank, the bank closes its doors. May *H* recover from *P* on his indorsement? May *P* recover from the drawer of the check? Assume proper presentment and notice in both instances.

Chapter X

BANKS AND BANKING

Sec. 130. Formation.—Banks, institutions organized for the purpose of receiving deposits and discounting commercial paper, are required by the laws of most states—and, in the case of national banks, by the federal government—to operate under the corporate form of organization. In addition, the statutes usually stipulate a minimum of capital required at the time of incorporation, the amount being dependent upon the size of the community in which the bank is located. In other respects, the organization of a banking corporation is quite similar to the organization of other corporations.

It should be noted, however, that under the laws of most of our states preferred stock may not be issued. Recently the National Banking Act has been amended so as to provide, within certain limits, for the issuance of preferred as well as common stock.

Sec. 131. Agents and liability for their acts.—A bank, like any other principal, is responsible for the acts of its agents so long as the latter are performing duties within the scope of their authority. Whenever they exceed their actual or apparent authority, the liability of the bank for their conduct ceases. There are, however, three or four situations which merit particular attention.

The matter of theft, by one of the bank's agents, of assets left with the bank for safekeeping has always presented a difficult problem for solution. The majority of the courts deny any recovery against the bank in such cases on the theory that the employee is acting outside the scope of his authority when the embezzlement takes place. There are a few recent cases to the effect, however, that the bank should bond its employees in order to protect those who deposit property with the bank for safekeeping against loss. Even where the bank is not required to place its employees under bond to protect those who leave property with it for safekeeping, it is always incumbent upon the bank to exercise reasonable care in the selection and retention of its employees.

A second situation of importance arises when a customer of the bank leaves securities with a bank's agent for discounting. In case the agent takes the paper and tells the customer that his account will be credited, but instead has the bank officials credit his personal account with the amount derived from discounting the paper, the bank is liable to the true owner for the value of the paper, provided

the agent was one authorized to discount commercial paper. In this connection it should be borne in mind that the cashier is the true financial officer of the bank. An individual has a right to assume that the cashier is vested with authority to discount commercial paper and to make small loans. The president of a bank, on the other hand, has no implied authority as a financial officer. His powers are only those which are expressly delegated to him.

The authority of the officers of a bank to recommend investments for depositors in the bank is a matter of some dispute. Of course, if the bank possesses securities of its own, the agents of the bank authorized to dispose of them would bind the bank by any statements made in connection with a sale thereof, except a guaranty of payment which has been held by the courts to be ultra vires. However, where an officer of the bank is authorized by a depositor to make investments through drawing on the depositor's account, it is very questionable if any liability rests on the bank in case the officer makes unsound investments[1] or mishandles the funds. The officer in such a case acts as an agent of the depositor and not as an agent of the bank.

A cashier who issues a certificate of deposit when he receives no consideration therefor binds the bank as effectively as though the purchaser of the certificate had paid for it, if the certificate reaches the hands of an innocent third party.

The directors of the bank are in reality responsible for its management and loan policy. In case the affairs of the bank are conducted in a negligent and improper manner without due regard for the interests of the depositors or stockholders, the directors are personally liable for the resulting losses.

The absence of the directors from meetings, or the fact that meetings are not regularly held, does not relieve them. If they do not supervise the loans, or if the officials in active charge make excessive loans to projects in which they are personally interested, the directors are personally liable for the losses which result.[2] Statutes usually place limitations on loans which may be made to a single individual. In case of excessive loans, the directors are personally liable for resulting losses.

Sec. 132. Special deposit.—There exist in the eyes of the law three distinct types of deposit in which the legal relationship of the bank and depositor are essentially different. These types of deposit are called special, specific, and general. A special deposit consists of a bailment relationship. It arises whenever property

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[1] Downing v. Lake County State and Savings Bank et al., 1930, 133 Or. 322, 290 Pac. 236; p. 636.

[2] Gamble v. Brown et al., 1928, C.C.A. 29 F.(2d) 366; p. 636.

is placed with the bank for safekeeping. In such cases the bank owes a duty to the depositor to exercise reasonable care for the safekeeping of the items deposited. The courts treat the relationship as a mutual benefit bailment, this being true whether the bank receives any compensation for the service or not.[3]

In case the bank of deposit becomes insolvent, the depositor should be able to obtain possession of his deposit at any time he can identify it. In case the property is or has been improperly converted by the bank and used in its business, the depositor's rights are dependent upon several facts. If the items of deposit were bearer negotiable instruments and were sold to holders in due course, the depositor is limited to his right against the bank. If he can trace the items or proceeds into the bank's assets, he will be treated as a preferred creditor. If he is unable to trace them into the assets, he has a claim on the same plane as any other depositor, being an ordinary creditor of the bank,[4] provided he can establish that the negligence of the bank or its officials occasioned his loss.

As to those items which are not negotiable instruments payable to bearer, the depositor may reclaim them wherever he can find them. No one can pass better title to such property than he has. Therefore, any purchaser of them would necessarily be called upon to return them to the true owner.

Sec. 133. Specific deposit.—Whenever money or commercial paper is left with a bank for a special purpose, a specific deposit is created. Such a relationship arises whenever the bank is made an agent or a trustee of the depositor. Deposits of items for collection, of amounts left with the bank for the payment of taxes or for purposes of investment by the bank or which the bank is to use in satisfaction of a particular obligation of the depositor offer illustrations.[5] All escrow transactions are likewise of this type. The theory of such deposits is that the bank has no right to commingle the deposits with the other assets of the bank. Since it is an agent or a trustee of the particular deposit, a duty rests upon it to keep the deposit intact for the purpose specified.

Since the deposit should be segregated from the other assets of the bank, at time of insolvency the depositor should be able to identify his deposit and thus recover in full any amount which he might have left with the bank. In case the bank violates its duty to the depositor by mingling the deposit with the general assets of

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[3] Holmes v. First National Bank, 1929, 105 N.J.L. 621, 147 A. 441; p. 637.

[4] Harmer v. Rendleman, 1933, 64 Fed.(2d) 422; p. 638.

[5] Andrew, State Superintendent of Banking, v. Peoples Saving Bank, 1930, 209 Ia. 1147, 229 N.W. 907; p. 639.

the bank, the depositor becomes a preferred creditor. It is necessary in such a case that the assets be traced into the general funds of the bank. It is not enough to show that the bank used the deposit or reduced its liabilities with the items, but it is necessary to show that it became a part of the general assets of the bank, thus swelling the total remaining at the time of insolvency. If the deposit is traced into the general funds of the bank, it is presumed to remain there unless the cash items of the bank fall, in total, below the amount of the specific deposit. In other words, it is assumed that the bank uses its own funds first in making payments from its cash items.

If a bank collects an item drawn upon itself, the weight of authority is to the effect that a specific deposit arises as soon as it charges the account of its depositor. The federal courts, however, have held otherwise. They conclude that as soon as the item is collected the bank becomes a debtor of the party for whom the collection was made.

Sec. 134. General deposit.—A general deposit is one which creates a debtor-creditor relationship between the bank and its depositor. It is broad enough to include, in addition to ordinary checking accounts, deposits in savings accounts, certificates of deposit, and purchases of bank drafts or cashier's checks. In fact, any deposit which makes a bank the debtor of its depositor creates a general deposit. In case a bank becomes insolvent, the general depositor becomes an ordinary creditor. In the case of deposits of all kinds, it should be borne in mind that the proper place to make the deposit is in the bank. There are numerous cases in which it has been decided that persons who had made deposits to agents of the bank at places other than the bank had no claim against the bank, where the agent violated the confidence reposed in him and failed to turn over the deposit to his principal.

Sec. 135. Checking accounts.—The outstanding duties of a bank to its depositors of checking accounts are: (1) to pay out when, and only when, ordered to do so by the depositor; and (2) to pay in strict accordance with the terms of the depositor's order.

Whenever an account stands in the name of two or more individuals, it is necessary for all of the parties to sign the checks issued against the account unless each has authorized the issuance of checks by certain designated persons. In the case of a joint account—one which goes to the survivor in case of death—either party may draw checks against it during his or her lifetime.

Postdated checks—checks dated later than the time they are issued—are properly paid by the bank only when the date inserted

on the check arrives. In case a postdated check is paid by the bank before the date indicated thereon, thus resulting in a loss to the depositor, the bank must suffer the loss.

An error in the balance of a depositor's account can always be corrected. Thus, if the balance resulting from the mistake is larger than it should have been, it may be reduced to the proper amount. If the remaining balance is insufficient to care for the error, the depositor must make good the deficit. Likewise, if the mistake favors the bank, the bank is obligated to correct it. This is true even though the error may be discovered some time after it is made. The language on the statement issued to a depositor demanding that he report all errors within a reasonably short period of time cannot relieve the bank of its duty to correct its own mistakes.

A bank which fails to pay a check properly drawn on it is liable in damages to the depositor who drew the check. If the depositor is a businessman, substantial damages are implied from the very nature of his position in the community. In other instances the depositor must present evidence of actual injury sustained. It should be pointed out that the bank owes the holder of a check drawn on it no duty of payment unless the check has been certified. The holder's recourse, in case an ordinary check is dishonored, is against the drawer or indorsers thereof and not against the bank.

Sec. 136. Forgeries.—Forgeries, so far as checks are concerned, are of three kinds: (1) forged signature of the drawer; (2) forged indorsement of an indorser; and (3) an alteration of the face of the instrument.

Since a bank is authorized to pay out funds only when instructed to do so by the depositor, it should be clear that payments made as a result of a forged signature of the depositor are erroneous. Such payments give the bank no right to charge the account of the depositor. In such cases, however, it becomes the duty of the depositor to notify the bank of the forgery within a reasonable time after the cancelled checks are returned to the depositor. What is not quite so readily understood, however, is the bank's inability to recover the amount from the person to whom it paid the money or from the indorsers. Since it is the bank's duty to recognize the signature of its depositors, and since payment is in effect an acceptance, which warrants the genuineness of the signature of the drawer, the bank is prohibited from recovering of anyone except the forger.[6]

To this rule there is one well-recognized exception. If the person or concern taking the check from the forger is negligent in any

[6] First National Bank v. U.S. National Bank, 1921, 100 Or. 264, 197 Pac. 547; p. 639.

manner, the drawee bank may recover from the party first taking the check from the forger. A bank of deposit which takes such a check without identifying the forger is certainly careless and, as between it and the drawee bank, should suffer the loss.[7]

A second exception has been worked out with reference to savings accounts. Since the account book should be presented at the time of withdrawals, and since the bank has little opportunity to familiarize itself with the signature of the depositor, the bank is not liable for payments made, provided it has exercised reasonable care in making the payment to the one in possession of the bankbook.

Depositors are required by the courts and statutes to report to the bank of deposit all cases of forged signatures promptly after the cancelled checks have been returned. The depositor is obligated to review his checks within a reasonable time after they have been returned and, in case forgeries are involved, to give notice thereof to the bank. If such is not done, and other forgeries follow, the loss will fall upon the depositor. Quite often the cancelled checks are returned to the person who has been guilty of the forgery, usually an employee of the depositor. Naturally, in such a case, the forgery will not be called to the attention of the drawer. He is held liable, however, even under such circumstances, if he does not report promptly the forged instrument. He is responsible for his agent's act in not calling attention to the forgery.

Sec. 137. Forged indorsements.—Upon payment of order paper which bears a forged indorsement, the situation so far as the bank and depositor are concerned, is quite similar to one in which the signature of the drawer has been forged. By paying to a person not possessed of title, the bank fails to follow the order of the depositor. Consequently, a bank which pays a check as a result of a forged indorsement has no right to charge the account of the drawer. It must surrender the check to the true owner,[8] but it does, in this instance, have a right to recover from the indorsers of the check who became such subsequent to the forgery. Likewise, the bank may recover from the person to whom it made payment of the check, even though that party did not indorse the instrument. It is suggested, however, that if the person who collected the money from the drawee bank acted merely as an agent, and, not having indorsed the instrument or guaranteed prior indorsements, has accounted to his principal for the amount collected, the drawee bank has recourse only against the principal.

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[7] Louisa National Bank v. Kentucky National Bank, 1931, 239 Ky. 302, 39 S.W.(2d) 497; p. 641.

[8] Goodall Real Estate and Insurance Company v. North Birmingham American Bank, 1932, 225 Ala. 507, 144 S. 7; p. 642.

The drawee bank is liable to the true owner of a check which has been paid to a person having no title, upon the following theories: payment to the wrong party is an acceptance in favor of the true owner; wrongful payment is a conversion of the instrument; the return to the true owner of the check with the forged indorsement revives all the rights previously held by the true owner on the instrument.

To illustrate, let us assume that *P*, the payee of a check, loses it, and his name is indorsed by a forger. *H*, the indorsee, presents it to the drawee bank and receives payment. The loss and forgery are later discovered. In many states, *P*, the true owner, has a three-way choice. He may recover from the bank of *H* the amount of the check; he may sue the bank for damages for conversion of the check; or he may repossess the check with its original status.

The drawer of a check which bears a forged indorsement is under duty to report to the drawee bank promptly after the forgery is discovered, although in many cases the discovery is not made until long after the cancelled checks have been returned.

If the forged indorsement is executed by an employee of the drawer or payee, and the latter is negligent in not uncovering such forgeries if they have continued over a period of time, the loss must be borne by the employer-drawer. He should have such internal accounting controls in his business as would make loss from such indorsements difficult, if not impossible.

Sec. 138. Altered checks.—In the case of raised or altered checks, the only recourse is to recover from the party to whom payment was made or from indorsers who became such following the alteration. The drawer is not liable for the altered amount, although in a majority of the states he is liable to the drawee bank which has paid the check if he has facilitated the alteration by leaving blank spaces in the check. A few of the states hold the drawer liable to a holder in due course in such cases.

There seems almost no authority to the effect that the drawer must protect the bank or third parties by using pen rather than pencil or by using a checkwriter. The use of protective devices does, however, avoid much inconvenience in cases of this character, since if they are not used and alteration takes place, there is often much conflict as to how the check was originally drawn or whether the drawer was negligent in leaving blank spaces. The use of a machine usually obviates any uncertainty as to the original tenor of the instrument.

Sec. 139. Payment.—In case a bank is made aware of the true ownership of a fund, it then becomes its duty to make payment to the true owner regardless of the fact that the fund has been depos-

ited in another's name. Thus, if an agent deposits in his own name his principal's money, the bank upon notice of such fact must account to the principal therefor.

If the bank in such a case changes its position in reliance upon the deposit, it is under no duty to account for the money to its detriment. On the other hand, if the agent becomes insolvent while owing the bank money, the bank in satisfaction of the indebtedness has no right to appropriate the bank account, which belongs in reality to the principal. It must pay the deposit to the true owner, and recover as best it can from its debtor. Of course, if the loan was made in any sense in reliance upon the deposit, the bank might be entitled thereto as against the true owner.[9]

In this connection it is well to observe that some confusion has existed in the law relative to rights obtained when checks are indorsed by fiduciaries or drawn to the order of a fiduciary by himself in his fiduciary capacity. So far as banks are involved, there are two distinct problems. First, if a fiduciary, such as a trustee, executor, or agent, is in possession of a check or bill of exchange drawn by a third person to the order of the fiduciary in such a manner that the fiduciary relationship is indicated, is the bank free to permit the fiduciary to indorse the instrument and deposit it in his personal account? There is authority to the effect that, since the bank is placed on notice by the nature of the instrument, it is not a taker in good faith of the instrument. Consequently, if the fiduciary mishandles the proceeds, the bank would be liable. Legislation has been enacted in many states which permits the bank to accept deposits of such instruments to the credit of the fiduciary's individual account and to pay them out as he directs without any liability to the true owner of the fund unless the bank has knowledge of the breach of trust.[10]

Second, if a fiduciary, or an agent who has been authorized to draw on account of his principal, executes a check to his own order, is the bank free to pay it or is the bank charged with notice of the fact that normally an agent should not be using his principal funds for personal use? Legislation has again been enacted which authorizes the bank to pay out money even though the instrument is drawn by the fiduciary to himself personally. This legislation leaves the bank unprotected in two cases. First, the bank has no right to accept a check drawn to its own order in payment of a personal obligation of the fiduciary to the bank, and second, the bank has no right to pay such an instrument drawn by or payable to the

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[9] Berg v. Union State Bank, 1932, 186 Minn. 529, 243 N.W. 696; p. 643.

[10] Boston Note Brokerage Co. v. Pilgrim Trust Co., 1945, 318 Mass. 224, 61 N.E.(2) 113; p. 644.

fiduciary if it knows he is violating the trust reposed in him. However, if the check is drawn to the order of the fiduciary personally and is then indorsed by him, even in payment of a personal obligation, the third party may accept it in good faith.

The right to pay checks is terminated by the known death of the depositor or by a stop order given to the bank within a reasonable time before the check is presented for payment. The stop order may be oral or written. In case it is written and contains a statement to the effect that the signer releases the bank from damages in case the bank pays the item through mistake, accident, or oversight, the statement according to the majority view is binding. A clause releasing the bank from liability under circumstances indicated therein imposes upon the depositor the loss arising from failure to stop payment.

Sec. 140. Payment effective when.—In cases of forgery, the insolvency of a bank, or the cashing of a check where insufficient funds exist for payment, a question often arises as to the time when payment is made. If money is passed over the counter to the holder of the check by the drawee bank, payment is effective. In such cases the fact that the drawer has insufficient funds on deposit to meet the check or has no account with the bank is immaterial. Since payment has taken place, the bank's only recourse is to recover from the drawer of the check.

In general, it can be said that payment takes place whenever the *drawee* bank credits the account of the holder. This situation arises where the holder of the check and the drawer deposit with the same bank. By reason of statutes in many states, and in numerous other cases by reason of contract between the bank and the depositor, the bank reserves the right, during the next business day, of reversing an entry if it finds that the check should not have been paid. Thus, if the holder's account is credited, and later, when the check is to be charged, it is discovered that the account of the drawer is insufficient to meet it, the holder's account may be corrected accordingly. Unless something intervenes, however, to indicate that payment is improper, payment dates from the time the account of the holder is credited.

It can also be said that payment takes place whenever the account of the drawer is charged.[11] Statutes in many states have created one exception to this rule. If checks are sent for collection directly to the bank on which they are drawn, the sending bank has an option in those cases in which the check is cancelled and charged to the drawer without any remittance being made to the sender. Where the drawee bank closes before remitting in cash or

[11] In re Goebel's Estate, 1946, 295 N.Y. 73, 65 N.E.(2) 174; p. 646.

solvent credits, the sender may elect to treat the check as dishonored or to file a preferred claim against the insolvent bank. In those states where no legislation has been enacted, most of them have held that payment was concluded at the time the drawee bank charged the drawer. They then permitted the sending bank to file a preferred claim against the bank that had failed to remit in solvent credits.

If the drawee bank is a member of a clearinghouse and the check is charged to the drawee bank by the clearinghouse, it is paid at that time unless notice of dishonor is given within the time and according to the provisions of the clearinghouse agreement.

Sec. 141. Depositor's indebtedness.—Normally a bank has a right to charge a depositor's account for any money due and owing to it. That is, whenever a note of a depositor matures, the bank is at liberty to charge it against the account of the depositor, and it is not necessary that the depositor be notified thereof. Even though checks are issued by the depositor before the maturity of the debt, the bank is under no duty to pay them if the balance is inadequate after satisfying the indebtedness in favor of the bank. The right to dishonor the depositor's check exists only if the account has been charged with the indebtedness before checks are presented. Until such time as the account is actually charged, it must pay the checks as presented. The bank has no right to charge the account in case it holds ample securities for the payment of the debt.

In many states, by reason of a provision in the Uniform Negotiable Instruments Act, a note which is payable at a particular bank is, at maturity, equivalent to an order on the bank for payment. In such cases the bank pays the note when it is presented to it and charges the account of the depositor.

If a bank holds a note upon which there are sureties, the bank owes a duty to the sureties to charge the account of the drawer. If it fails to do so when it might thus have recovered the indebtedness from the principal debtor, it loses its right to recover from the sureties.

Sec. 142. Collection items.—As indicated in a previous section, items left with a bank for collection form a specific deposit and give peculiar rights in case the bank becomes insolvent. Whether a deposit of items is for collection or deposit often becomes a very pertinent question.

Title to checks deposited may be retained in the depositor until such time as collected, thus making the bank of deposit a collection agent, by one of three devices: (1) by agreement, usually indicated on the deposit slip, that all items are received by the bank as a collecting agent only; (2) by a restrictive indorsement such as "for

collection," "for collection and deposit," "for deposit," or "for collection and remittance"; or (3) by reason of enactment in a particular state of the Bank Collection Code.

On most bank deposit slips will be found a statement to the effect that the bank accepts all items for deposit or collection as a collection agent only and is not to be liable except for failure to exercise due care in the selection of agents during the collection process. More recently the Bank Collection Code, which has been adopted in quite a number of the states, reaches the same result by containing substantially the same language. It ought to be clear in such cases that, since the bank is acting only as an agent, title to the items deposited remains in the depositor until such time as they are actually collected. This seems to be the result worked out by a majority of the courts, and it is not affected by the fact that the bank has credited the depositor with the amount of the items in dispute, except that, if checks are drawn against the account, the bank has a lien on the items for the amount drawn against the deposit.[12] There are a few states, however, which state that the crediting of the depositor's account and the courtesy of permitting him to check against the deposit clearly indicate an agreement to have title pass to the bank despite the statement on the deposit slip or statutory provision.

Clearly, in all cases, a restrictive indorsement is an effective manner of retaining title until the collection process is completed. As soon as collection is completed, title to the proceeds passes to the bank and the item becomes at that time a general deposit unless it is indorsed for collection and remittance. In the latter case it remains a specific deposit until the proceeds are actually surrendered to the depositor, and the bank has no right to confuse the proceeds of collection with its general assets.

Sec. 143. Effect of retention of title by depositor.—If title passes to the bank of deposit at the time items on other banks are deposited, the debtor-creditor relationship arises. The checks and bills belong to the bank, and the depositor's account should be credited, giving the depositor a right to draw against it. Of course, if any of the items are not paid, upon their dishonor the bank may give notice and charge them back to the depositor's account, because of the indorsement of the depositor. Likewise, the bank, even though it acts only as a collection agent, may, if it so desires, permit the depositor as a matter of convenience to draw against the deposit before collection is completed.

If during the collection process the bank of deposit which takes

[12] Ware v. Hogansville Banking Company et al., 1930, 171 Ga. 167, 155 S.E. 4; p. 6[illegible].

title becomes insolvent, the depositor is an ordinary creditor and must share alike with other depositors of the bank,[13] whereas, if title had been retained by the depositor, he could have seized the proceeds of collection from the agent in possession of them at the time of insolvency. Thus, there is no loss to him who retains title to items in the collection process at the time his bank is closed. If the items are collected by the bank's receiver after closing, they must be held in trust by the receiver for the benefit of the depositor.

There is another important difference between passing title to the bank and retaining title. If title passes to the bank at the time of deposit, the bank is responsible during the collection process. It selects its own agents to aid in the collection procedure and is responsible for any misconduct on their part. Thus, if a collecting agent defaults or becomes insolvent, thus causing a loss, the loss falls upon the bank of deposit rather than upon the depositor. On the other hand, where title is retained by the depositor, the bank of deposit acts as an agent and has authority to appoint other agents —subagents—to aid in the collection. Thus the depositor is accountable for the acts of any agent in the collection chain. If any loss results from an agent's misconduct, it falls upon the depositor. It is for this reason that the banks have sought by contract and by statute to be regarded merely as agents. It relieves them of responsibility for the acts of those who aid in collection of items left for deposit, although in a strong minority of the states all agents in the collection process become agents of the first bank rather than agents of the depositors, unless a different agreement is reached between the depositor and his bank.

Sec. 144. Duty of collecting agent.—Where statutes have not intervened to change the law, it is held that a bank which is entrusted with items for collection has no right to send them directly to the bank upon which they are drawn or to accept anything other than money in payment thereof.[14] Since this ruling greatly encumbered the means of collection and did not coincide with banking practice, statutes in many states were enacted providing that items might be sent directly to the bank on which they were drawn and that bills, drafts, or cashier's checks might be accepted as conditional payment thereof. In those states which have not adopted such legislation, the same result is usually accomplished by a contract—on the deposit slip—giving the bank the right to follow the customary banking procedure in such matters.

Assuming that a bank is permitted to send an item directly to the

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[13] In re Receivership of Washington Bank, 1898, 72 Minn. 283, 75 N.W. 228; p. 647.

[14] First National Bank v. Commercial Bank and Trust Company, 1926, 137 Wash. 335, 242 Pac. 356; p. 650.

bank on which it is drawn, it is possible in such cases for the drawee bank to charge the depositor's account and to mark the check "paid" without remitting to the collecting bank; or, in case remittance is made by mail, it is possible for the remittance to be dishonored because of the failure of the remitting bank. In such cases, the question arises as to whether or not the item was paid. The weight of authority holds that the item is paid as soon as it is charged to the drawer's account. If for any reason the remittance fails, these courts in most instances hold that the collecting bank is a preferred creditor.[15] The federal courts, however, have refused to allow a preferred claim, and hold that the person having title to the item possesses only an ordinary claim. To care for this situation, the Uniform Bank Collection Code provides that in such cases the collecting bank may treat the item as dishonored and look again to the drawer, even though he is actually in possession of his canceled check, or it may present a preferred claim payable out of the general assets of the closed bank.

Sec. 145. Assessment of bank stock.—The statutes of most states and those of the federal government provide for the assessment of bank stock. Thus, whenever the bank examiner discovers that the capital of a bank has been depleted through losses of any kind, the stockholders may be called upon to pay an assessment sufficient to restore the capital to par. In case an assessment is levied, most of the statutes give the stockholder an option. He is permitted to pay the assessment or to surrender his stock, or at least enough of it to realize the amount of the total assessment from a sale thereof. If he surrenders his stock, he incurs no personal liability for the assessment.

Payment of an assessment does not relieve a stockholder of his double liability in event of the bank's later insolvency. In those few states which have retained double liability, he must contribute again at that time.

Preferred stock, now authorized in the case of national banks, is not subject to assessment.

Sec. 146. Right of setoff.—A bank is said to be insolvent whenever its liabilities exceed its assets or whenever it cannot meet its current demands. As soon as a bank reaches such a state it is placed in the hands of a receiver, unless it continues to operate illegally.

When a receiver takes charge, the rights of the depositors immediately present numerous issues. Perhaps the most important rule is one which gives to the depositor the right of setting off

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[15] Federal Reserve Bank of Richmond v. Peters et al., 1924, 139 Va. 45, 123 S.E. 379; p. 651.

against what he owes the bank the amount that he has on deposit at the time of closing.[16] Thus, if a depositor owes a bank $3,000 and has on deposit $2,500 at the time of the bank's closing, his account is applied to his indebtedness and he owes the bank a balance of $500.

This right of setoff applies only where the accounts are similar. A husband may not use his wife's account to pay his obligation or a partner use a firm's deposit to pay his individual obligation. A surety may not use his balance to pay an obligation upon which he is surety unless he can clearly show that it will be impossible for him to recover from the principal debtor. In case the debtor is hopelessly insolvent, the surety may exercise the right of setoff. It must be borne in mind that the claims which one seeks to set off against an indebtedness owing to the bank must have existed at the closing of the bank. A claim may not be purchased thereafter for the express purpose of setting it off.

The right of setoff does not apply to an obligation which has been discounted by the bank to some third party. The depositor must pay his obligation to the third party and take his loss on the deposit along with other bank creditors. If the obligation, along with others, has merely been pledged as security for an obligation of the bank, two possibilities exist. If the bank receiver uses cash on hand or collected to pay off the obligation and redeem the collateral, the right of setoff will be applicable as soon as the collateral is returned to the receiver. If it is not returned to the receiver, the debtor may insist that the holder collect first from those who have no setoff. Thus, if the third party can realize the total amount of the indebtedness in this manner, the balance of the obligations will return to the receiver, with the right of setoff undisturbed.

Sec. 147. **Double liability.**—A few state statutes or constitutions provide that, in case a bank is closed and insufficient assets are available to satisfy all creditors, stockholders may be assessed an additional par value. Thus, a holder of bank stock at time of insolvency loses not only his investment but is called upon to pay an additional par value to the receiver. In this case he may not set off a deposit in the bank against his liability. Since the double liability is to benefit all creditors, he may not pursue this method of receiving all of his deposit.

Paid-in surplus offers no help in cases of this kind. The stockholder who has created or helped to create a paid-in surplus is nevertheless liable for an additional par value. Usually the double liability continues only for a definite time—60 days after the trans-

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[16] Rossi Brothers v. Commissioner of Banks, 1933, 283 Mass. 114, 186 N.E. 234; p. 652.

fer if the transfer is bona fide. It ceases after the end of that time for the old stockholder, but is assumed by the new one.

Double liability has recently been discarded for national banks by federal legislation, and the same result has been obtained for state banks in most of the states by similar legislation. Requirements for the creation of specified surpluses and more careful inspection are relied upon for protection of the depositor rather than double liability. The insurance protection given to certain deposits may likewise be considered as a substitute for double liability in these states. There are a few states, however, which retain double liability as well as these other devices for the protection of depositors.

In Illinois and two other states, by reason of peculiar language used in the constitution or statute, there is no release from the liability, and, if it is necessary to satisfy creditors on claims which arose while they were stockholders, all stockholders, past and present, are independently liable for the full par value.

The double liability cannot be avoided by constructing a corporation that is intended for the express purpose of holding bank stock and that does not possess other assets from which the double liability might be realized. Neither is the liability of stockholders discharged when another bank takes over its business and assumes all of the old liabilities. It is only where a merger or consolidation takes place and the old bank loses its identity that the old stockholders are released.

Sec. 148. Preferred claims.—Preferred claims are paid before general claims in those cases where sufficient cash assets exist to satisfy them. It might be well to suggest first some claims which are not preferred. Bank drafts, certified checks, cashier's checks, certificates of deposit, and savings accounts do not give rise to preferred claims. Such claims, merely because of their form, are not superior to other claims which are based upon the debtor-creditor relationship. Of course, if the bank draft or cashier's check has been issued in payment of an item collected by the bank, thus becoming in essence a specific deposit, it results in a preferred claim.

All specific deposits which are traced into the general assets of the bank are preferred claims.[17] Likewise, deposits made after the bank is known by its officials to be insolvent create a preferred claim if they can be identified at the time of closing. Many states allow a preferred claim in such cases if the bank's assets are definitely increased as a result.

By reason of recent legislation, all banks, both national and state,

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[17] Jefferson Standard Life Insurance Company v. Wisdom C.C.A., 1932, 58 F.(2d) 565; p. 653.

which are members of the federal reserve system must likewise be associated with the Federal Deposit Insurance Corporation. Because of contributions made by the various banks to this corporation, all accounts up to five thousand dollars are guaranteed in the event of insolvency. If an account is in excess of that amount, the excess will be subject to loss if the bank fails to pay all its indebtedness.

Sec. 149. State funds.—Undistributed state funds, especially when deposited in a state bank, form a preferred claim at the time of insolvency. If the claim is that of a certain county, city, or school official, no preference exists, since the money is no longer state money but belongs to the particular local unit involved. As a result, it has become customary for local units of government to demand collateral security for deposits made by them. If no statute exists which permits such practice on the part of the bank, a question arises at to the legality of this pledge, since the rights of other depositors are prejudiced thereby. The majority of courts enforce the lien in case of public officials, but hold that the contract is ultra vires and unenforceable so far as ordinary depositors are concerned.[18] Therefore, an ordinary depositor whose account is secured by collateral is unsecured unless definite legislation authorizes the banks in a particular state to secure ordinary depositors.

Sec. 150. Illegal acts.—An official of a bank, whether he be an officer or a director, who accepts deposits after knowing that his bank is insolvent is guilty of criminal conduct. The penalty varies from state to state, but usually carries with it the possibility of imprisonment for each offense.

One who, with intent to defraud, issues a check without sufficient funds to meet it is subject to criminal prosecution. The gist of the crime is not the issuance of the check without funds to meet it, but is, rather, the intent to defraud.

Review Questions and Problems

1. Distinguish between the three types of deposit. To which class does a savings account belong?

2. First National Bank sold certain bonds to *H*, and guaranteed ultimate payment of them. The bonds were not paid and suit was brought by *H* against the bank as guarantor. Was it liable?

3. State Bank collected a bill of exchange from the drawee, the bank acting only as a collection agent. After the proceeds had been remitted by the bank to its principal, it was discovered that an essential indorsement was forged. Will the drawee be able to recover from State Bank the money paid?

4. A bank statement carried a printed provision to the effect that all

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[18] Texas & P. Ry. Co. v. Pottorff, C.C.A. 1933, 63 Fed.(2d) 1; p. 654.

errors were to be reported within ten days after canceled checks were returned. Thirty days after *M* received his canceled checks, he learned that one of them carried a forged indorsement. Will he be able to return the check and have the bank credit his account for the wrongful payment?

5. *M* gave his check to *P* in payment of merchandise, but, when the merchandise failed to arrive, stopped payment on the check. The stop order which he signed contained language to the effect that the bank was to be relieved in case it paid the check through error or mistake. The check was paid at the lunch hour by an assistant to the teller. Will the loss fall upon *M* or the bank?

6. *M* drew a check for $500 in favor of *P* in payment of a used car. The check was drawn on State Bank and deposited by *P* in National Bank, which mailed it directly to State Bank for collection. The latter charged the check to *M* and mailed a Chicago draft to National Bank in settlement of the item. Before the draft could clear, State Bank closed, the draft, as a result, being dishonored.

   a. Was the check paid? May *M* still be held on the check?
   b. May National Bank have a preferred claim against State Bank?
   c. If a collection loss develops, will it be borne by *P* or National Bank?

7. *M* owed his bank a note for $1,500, which matured on August 1, 1939. The bank charged it to his account on that day, the result being that several of *M*'s checks were dishonored. Does *M* have a cause of action against his bank?

8. Suppose the note in the above case had been drawn in favor of *P*, merely being payable at *M*'s bank. Would the bank have had a right to pay it without further authorization?

9. *M* drew his check for $1,750 in favor of *P* on National Bank in payment of grain purchased. Although *P* received the check after banking hours, he gained admittance to the bank and received a duplicate deposit ticket for the check. No entries were made on the bank's records and the bank failed to open the next morning. Who suffers the loss, *M* or *P*?

10. *D* had on deposit in the bank a large sum of money when the bank failed. A corporation, of which he was the principal stockholder, owed the bank money. He desired to have the note set off against his account. Was he entitled to have such action taken by the receiver?

11. Does the holder of a certified check have a preferred claim at time of the drawee bank's insolvency?

12. *M*'s name was forged by *B*, his bookkeeper, to a $750 check. When the canceled checks were returned, they were handed to the bookkeeper and, as a consequence, the bank was not notified of the forgery. Six months later the forgery was discovered and the bank was notified, but other checks amounting to $7,500 have been forged in the meantime. Will the loss fall upon *M* or the drawee bank?

13. A check was stolen from *P*, the payee, and was paid to a holder after *P*'s indorsement had been forged. Has the drawee bank the right to charge the check to the drawer's account?

Book IV

BUSINESS ORGANIZATIONS

PART I

PARTNERSHIPS

Chapter I

CHARACTERISTICS AND DISTINCTIONS

Sec. 1. History and definition.—In general, organizations for the conduct of business are of four distinct types—individual proprietorships, partnerships, corporations, and business trusts. Partnerships are mentioned and probably have their source in the Roman law. They were well known among the merchants of the Middle Ages. Like the law of negotiable instruments, cases involving questions of partnership are not found in the early common-law reports of England, because such cases were tried in the mercantile courts. The law of partnership was introduced into the common law from the law merchant. The Uniform Partnership Act defines a partnership to be an association of two or more persons to carry on, as co-owners, a business for profit, which definition has been adopted by somewhat less than a majority of the states. In most respects the Act has codified the common law; the attention of the reader will be directed to those instances where it varies.

A partnership is the result of an agreement. As between themselves, the existence of a partnership depends upon the intention of the parties, manifested either by an interpretation of their words, spoken or written, or by their conduct.[1] If the agreement is clear, the mere fact that the parties did not think they were becoming partners is immaterial. If the parties agree upon an arrangement which is a partnership in fact, it is immaterial that they call it something else or that they declare that they are not partners. On the other hand, the mere fact that the parties themselves call the relation a partnership will not make it so if they have not, by their contract, agreed upon an arrangement which by the law is a partnership in fact.

Sec. 2. Partnership distinguished from a corporation.—The distinguishing features between a partnership and a corporation are, first, a partnership is the result of an agreement between two or more parties, whereas a corporation comes into existence not by reason of a contract, but by reason of an act of the state. A part-

[1] Worden Co. v. Beals et al., 1926, 120 Or. 66, 250 Pac. 375; p. 659.

nership, therefore, is a creature of contract, whereas a corporation is a creature of the state. Second, the liability of the partners is unlimited, that is, each partner is individually liable for all the debts of the organization created in pursuit of the partnership business; whereas the liability of a member of a corporation is limited to the extent of any unpaid balances due upon stock owned by him. Although a partnership comes into existence by virtue of a contract, nevertheless, partnership liability may be created where no contract exists between the parties. This liability arises from circumstances under which the parties have led third persons by words spoken or written, or by conduct, to believe that a partnership actually exists when in fact it may not exist. Other distinctions between partnerships and corporations will become apparent as the law of corporations is studied.

Sec. 3. Who may become partners.—A partnership is composed of two or more persons. A person as defined by the Uniform Partnership Act, includes individuals, partnerships, corporations, and other associations. The members of most partnerships are individual human beings. Corporations cannot be partners unless authorized by their articles of incorporation or by statute. Subject to agreement, unincorporated associations may become members of a partnership.

An infant's partnership agreement is voidable, and may be disaffirmed by him as against the other partner. An infant upon disaffirmance is entitled to recover his contribution to capital without loss. Some authorities, however, subject the infant's capital contribution to the claims of unpaid creditors and to whatever losses have been sustained by the firm.

Sec. 4. To carry on as co-owners a business for profit.—The essential attributes of a partnership are a common interest in the business and management and a share in the profits and losses. The presence of a common interest in property and management are not enough to prove a partnership; likewise, an agreement to share the gross profits of a business is no evidence of an intention to form a partnership. If all of these elements are present, prima facie evidence of a partnership exists. The presumption that a partnership exists by reason of sharing net profits may be overcome by evidence that the share in the profits is received for some other purpose.[2] Subsection 4 of section 7 of the Uniform Partnership Act provides that the receipt by a person of a share of the profits in the business is prima facie evidence that he is a partner in the business. However, no such inference shall be drawn if such profits are received in payment of a debt by installments, as wages of an em-

[2] Whayne Supply Co. v. McGowan, 1926, 213 Ky. 102, 280 S.W. 491; p. 660.

ployee, as rent to a landlord, as an annuity to a widow or representative of a deceased partner, as interest on a loan, or as the consideration of a sale of the good will or other property of a business by installments. Payment of wages to employees in amounts determined by net profits does not make such employees partners. Payment of rent from profits does not change the relationship of landlord and tenant to that of partners. Evidence of the control by the landlord of the tenant's business may be of such character as to impose partnership liability for the benefit of creditors. Upon the death of a partner the continuation of the partnership by agreement for the benefit of a dependent or a widow of the deceased partner by way of annuities derived from a share of the profits does not create a partnership relationship. A loan to the partnership under an agreement for the payment of interest out of profits does not make the creditor a partner.

Sec. 5. Partnership liability by estoppel.—Where a person, by words spoken or written, or by conduct, represents himself or consents to another's representing him to be a partner in an existing partnership or a partner with other persons not in a partnership, he is liable to any party to whom such representation has been made. Such liability, created by estoppel, does not arise, however, unless the third party gives credit to the firm or other persons in reliance upon such representation.

The first essential in partnership liability by estoppel lies in the fact that the party sought to be held has either held himself out as a partner or knowingly permitted others to do so. Under such circumstances, to relieve him would work an injustice on those who have relied upon such representations.

The second essential consists of a reliance by the party who extends the credit.[3] If the facts in any particular case indicate that such party knew the true facts, or should reasonably have known them, no partnership relation is created.

Estoppel may arise when one of the partners in an existing partnership is acting outside the scope of his authority. For example, if one partner, with knowledge of the other partner, uses the firm name for the purpose of giving credit on negotiable instruments for other persons on matters outside the scope of the partnership business, and this course of conduct is allowed by the other partner to continue for a long time, the firm will be bound on the indorsement of the negotiable paper, under the doctrine of estoppel.

If less than all the members of a firm permit another to hold himself out as a partner, any liability incurred by the latter party will

[3] Standard Oil Company of New York v. Henderson, 1928, 265 Mass. 322, 163 N.E. 743; p. 660.

bind only those who assent to the holding out. Those who do not participate in the holding out are not subject to estoppel.

Review Questions and Problems

1. Give a definition of a partnership. Name the features which distinguish a partnership from a corporation.

2. May a partnership arise otherwise than by the intention of the parties? Suppose the partners, so called, stipulate that their arrangement shall not constitute a partnership; what is the result?

3. May other than natural persons be members of a partnership?

4. *A*, *B*, and *C*, infants, form a partnership. *A*, as agent for the partnership, purchases goods from *D*, creating a firm obligation of $250. May *A*, by reason of his infancy, disaffirm the contract with *D*?

5. *A* is hired to operate a store owned by *P*. It is agreed that *A* shall receive for his services one-third of the net profits. No profits result, but losses are incurred. Must *A* share in these losses? Is he a partner?

6. *A* and *B* are co-owners of a large office building. Does this ownership indicate a partnership? How do the rights of partners differ from those of tenants in common of property?

7. Is an agreement to share profits and losses necessarily a partnership? Is it evidence of a partnership? May the evidence be rebutted by the introduction of competent evidence?

8. *A*, a grain broker, and *B*, his brother, a farmer, entered into an agreement whereby each was to pay to the other annually for three years one-half of the profits of his business, and also to make good one-half of the losses that might be suffered by the other. The ownership of each individual business was to be distinct. *B* became bankrupt. To what extent, if any, could *A* be made to satisfy the claims of *B*'s creditors?

9. *A* agreed to loan money to *P* and to indorse notes for him in order that *P* might operate a lumber mill. For this accommodation, *A* was to receive one-third of the profits. Was there a partnership?

10. What is meant by liability by estoppel? Can there be a partnership liability by estoppel in which the one sought to be held has no knowledge of the situation?

CHAPTER II

PARTNERSHIP PROPERTY

Sec. 6. What constitutes partnership property.—What constitutes partnership property is determined by the agreement between the partners. In absence of an express agreement, what constitutes partnership property is ascertained from the conduct of the parties and from the purpose for and the way in which property is used in the pursuit of the business. The mere use of property by a partnership is not sufficient to justify a conclusion that it is partnership property. Such property may be owned by a third person or by the partners individually, the partnership possessing only the right to use the property. The partners may own, as tenants in common, real estate used in the firm business, yet such property may not be firm assets.[1]

The Uniform Partnership Act in general terms states: (1) All property originally brought into the partnership stock, or subsequently acquired by purchase or otherwise on account of the partnership, is partnership property. (2) Unless the contrary intention appears, property acquired with partnership funds is partnership property.

Sec. 7. Firm name and good will as firm property.—In the absence of statutory requirements a partnership may carry on its business under any name the partners choose to use. In some states, by statute, restrictions are placed upon the adoption of a firm name in that the firm must not, by the use of the words "and Company," lead the public to believe that it is a corporation; but such words may be used if they represent an actual partner or partners. In some states, partners doing business under a fictitious or an assumed name must file a certificate with the county clerk setting forth the name under which the business is to be conducted and the true and real names of the parties conducting the business. Failure to comply with this statute does not make contracts with third parties void, but a partnership that has not registered its name cannot sue on such contracts.

A firm is a collection of individuals, and the partnership name is used primarily in identifying the group. A firm name is an asset of the firm, and as such will be protected by law. It may also be sold, assigned, or disposed of in any way that the parties agree upon.

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[1] Taber-Prang Art Co. v. Durant, 1905, 189 Mass. 173, 75 N.E. 221; p. 663.

Good will is based upon the justifiable expectation of the continued patronage of old customers and the probable patronage of new customers resulting from good reputation, satisfied customers, established location, and past advertising. It must be considered in evaluation of the assets of the business, and is capable of being sold and transferred. Upon dissolution caused by the death of one of the partners, it must be accounted for by the surviving partner to the legal representatives of the deceased partner.[2]

The purchaser of the good will of a business, in the absence of an agreement to the contrary, secures the right to advertise to the public generally that he is a successor of the old firm and is carrying on its business. For example, he may advertise "Brown and Smith, successors of Smith, Watson and Company." In some jurisdictions the purchaser of the good will does not acquire the name of the business, and the use of the name may be enjoined if injury is caused thereby.

In the absence of an agreement, the vendor of the good will may establish a new business of like character in the same locality, but he cannot advertise that he is carrying on the old business. In many jurisdictions he is under a duty to refrain from active solicitation of business from old customers. This is particularly true where the dissolution sale is a voluntary one. Such business of the old firm as comes to him from general advertisements or ordinary business activity, he is free to accept. The vendor may not use his own name in the establishment of a new business, if, by doing so, the public is led to believe that he is continuing the old business.

Sec. 8. Partnership capital.—In the eyes of the law, partnership capital consists of the total credits to the capital accounts of the various partners, provided the credits are for permanent investments made in the business. Such capital represents that amount which the partnership is obligated to return only at the time of dissolution, and it can be varied only with the consent of all the partners. Undivided profits which are permitted by some of the partners to accumulate in the business do not become part of the capital. They, like temporary advances by firm members, are subject to withdrawal at any time.

The amount which each partner is to contribute to the firm, as well as the credit he is to receive for assets contributed, is entirely dependent upon the partnership agreement. Even though a person makes no capital investment, it is still possible for him to be a partner. His services or standing in the community may, for income purposes, balance the capital investment of others. Such a partner, however, has no capital to be returned at the time of liqui-

[2] Slater et al. v. Slater et al., 1903, 175 N.Y. 173, 67 N.E. 224; p. 664.

dation. Only those who receive credit for capital investments—which may include good will, patent rights, and so forth, if agreed upon—are entitled to the return of capital when dissolution occurs.

As suggested, investments may be made in forms other than money. In cases of this kind, as soon as the particular asset is contributed, it no longer belongs to the contributing partner. He has vested the firm with title and he has no greater equity in the property than any other party. At dissolution he recovers only the amount allowed to him for the property invested.

Title to Partnership Property

Sec. 9. Personal property.—For the purpose of conducting business the title to personal property may be contracted for, acquired, held, and transferred in the firm name. This is true even though the firm name is other than the names of the individuals within the firm. Such an artificial name is merely representative of the individuals making up the partnership entity. Bills of sale, chattel mortgages,[3] warehouse receipts, bills of lading, and other legal documents used in business involving personal property, whether tangible or intangible, are effectively executed under the firm name.

Sec. 10. Real property.—A partnership, for many purposes heretofore discussed, is a distinct entity, separate from its members. This is particularly true with reference to the title to personal property, to taxing statutes, and to some extent to bankruptcy law.

The Uniform Partnership Act recognizes such entity for the purpose of taking, holding, and conveying title to real property in the partnership name. Title so acquired can be conveyed in the partnership name; and a conveyance to a partnership in the partnership name, though without words of inheritance, passes the entire estate of the grantor, unless a contrary intent appears. Where title to real property is in the partnership name, any partner may convey title to such property by a conveyance executed in the partnership name. Such a conveyance must be with the consent of all the members of the firm, or within the pursuit of the partnership business.

In those jurisdictions still controlled by the common law and which have not adopted the Uniform Partnership Act or do not recognize the entity idea, the method of taking title to real property rests upon a different footing. The common law requires that the title to real property rest in a person, either natural or artificial. A partnership as such, therefore, at common law, cannot hold title to real estate in its own name. In these states, a deed containing

[3] Hendren et al. v. Wing et al., 1895, 60 Ark. 561, 31 S.W. 149; p. 665.

the name of a partnership as a grantee is a nullity for want of a person to receive legal title. If the grantee in the deed includes the names of all the partners in the firm, the legal title rests in the individual partners as tenants in common. If the firm name used as grantee includes the name of one of the partners, the whole legal title vests in him, as trustee, for the benefit of the firm. The same is true where title is expressly taken in the name of one of the partners for the benefit of the partnership.

Property Rights of a Partner

Sec. 11. Partner's rights in specific partnership property.—A partner is a co-owner with his partners of specific partnership property, and, subject to any agreement between the partners, a partner has an equal right among his partners to possess partnership property for partnership purposes. He has no right to possess specific partnership property for other purposes without the consent of the other partners. A partner has a right that the property shall be used in the pursuit of the partnership business and to pay firm creditors. A partner does not own any particular part of the partnership property. He, therefore, has no right in specific partnership property that is assignable, and any sale by him, as an individual, of a particular part of the partnership property does not pass title to the specific property.[4] He has no right to use firm property in satisfaction of his personal debts and he has no interest in specific partnership property that can be levied upon by his personal creditors.[5] For example, *A, B,* and *C* are partners and the firm owns three trucks of about equal value. *A* does not own one of the three, nor does he own a one-third undivided interest in the three trucks. He has no power to sell any of the trucks except in the pursuit of the partnership business, and a personal creditor of *A* could not, after obtaining a judgment against him, levy upon and sell any of the trucks. The trucks are owned by the firm and are to be used in its business or in the satisfaction of firm obligations.

Sec. 12. Partner's interest in the partnership.—A partner's interest in the firm consists of his rights to share in the management of the business, to share in the profits which are earned, and, after dissolution and liquidation, to the return of his capital and such profits as have not been distributed previously. This assumes, of course, that his capital has not been absorbed or impaired by losses. A partner may pledge his interest in the firm as security for a per-

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[4] McNair v. Wilcox, 1888, 121 Pa. St. 437, 15 Atl. 575; p. 666.

[5] R. A. Myles and Co. v. A. D. Davis Packing Co., 1919, 17 Ala. App. 85, 81 So. 863; p. 666.

sonal obligation, or a personal creditor may levy upon it and have it sold at public auction. Under the Uniform Partnership Act, the firm is not dissolved by the pledging or forced sale of the interest. The purchaser at the sale obtains only the right to the profits and to the return of capital at dissolution. If the partner, after his interest is sold, withdraws from the firm, the partnership is dissolved. The purchaser of the partner's interest may become a partner, with the assent of the remaining partners, and thus participate in the management.

Sec. 13. Partnership insurance.—A partner has an insurable interest in partnership property and may legally carry insurance upon it to secure him personally against loss arising through its destruction. Similarly, the firm may carry insurance against various hazards, and in the latter case the proceeds are payable to the firm in case of loss. Very little controversy arises over indemnity insurance, but, where life insurance is carried on a member of the firm, numerous problems develop.

If the surviving partner is the beneficiary, does he keep the proceeds or hold them in trust for the firm; if payable to the firm, must they be used to purchase the interest of the deceased partner; and, if so, must the estate accept the proceeds of the insurance in full payment of the deceased partner's interest? Since the answers to these questions are not clear, the partnership agreement should cover all questionable matters relating to partnership life insurance. If insurance is carried upon the life of a partner and the premium is paid by the firm, it would seem that the proceeds should belong to the business, even though the named beneficiary is the surviving partner,[6] although there are cases to the contrary.[7] If the partnership is the beneficiary, the surviving partner is not obligated to use the insurance for acquiring the interest of the deceased partner. Provision for such procedure should be made in the partnership contract or in the policy of insurance, preferably in the former. If the survivor is to use the funds to purchase the interest of the deceased partner, he must pay the full value of the interest, unless some contract establishes the amount which will be paid to the estate of the deceased.

Powers with Respect to Property

Sec. 14. Power to sell personal property.—Each partner has implied authority to sell to good-faith purchasers personal property which is held for the purpose of resale, and to execute such doc-

[6] Quinn v. Leidinger, 1930, 107 N.J. Eq. 188, 152 Atl. 249; p. 667.
[7] Rush v. Howkins, 1910, 135 Ga. 128, 68 S.E. 1035; p. 668.

uments as are necessary to effect a transfer of title thereof. Of course, if his authority in this connection has been limited and such fact is known to the purchaser, the transfer of title will be ineffective or voidable. A partner has power to sell the fixtures and equipment used in the business only when he has been duly authorized. Such acts are not a regular feature of the business and a prospective purchaser of such property should make certain that the particular partner has been given authority to sell. The power to sell, where it is present, gives also the power to make such warranties as normally accompany similar sales.

Sec. 15. Power to sell realty—Wrongful conveyance.—As said in a previous section, the right to sell firm real property is to be inferred only if the firm is engaged in the real estate business.[8] In other cases, the right to sell and convey realty exists only where the sale has been approved by a majority of the partners. Since the execution of deeds in most cases must be under seal, authority to execute a deed must normally be created under seal.

Under the Uniform Partnership Act title may be taken in the firm name and any member of the firm has power to execute a deed thereto by signing the firm name. In such a case, what is the effect of a wrongful transfer of real estate that has been acquired for use in the business and not for resale? The conveyance may be set aside by the other partners since the purchaser should have known that one partner has no power to sell without the approval of the others. However, if the first purchaser has resold and conveyed the property to an innocent third party, the latter takes good title.

If the title to firm property is not held in the firm name, but is held in the names of one or more of the partners, a conveyance by those in whose names the title is held passes good title unless the purchaser knows or should know that title was held for the firm. There is nothing in the record title in such a situation to call the buyer's attention to the fact that the firm has an interest in the property.

Sec. 16. Power to pledge or mortgage firm property.—The power to mortgage or pledge firm property is primarily dependent upon the power, later discussed, to borrow money and bind the firm. A partner with authority to borrow may, as an incident to that power, give the security normally demanded for similar loans. Since no one partner, without the consent of the others, has the power to commit an act which will destroy or terminate the business, the power to give a mortgage on the entire stock of merchandise and fixtures of a business is usually denied. Such a mortgage would make it possible, upon default, to liquidate the firm's assets,

[8] Robinson et al. v. Daughtry, 1916, 171 N.C. 200, 88 S.E. 252; p. 669.

and thus destroy its business. Subject to this limitation, the power to borrow carries the power to pledge or mortgage.[9]

Review Questions and Problems

1. *A* owned a flour mill. Later, he and *B* formed a partnership for the manufacture of flour, and the mill was used in the business. No rent was paid to *A* for the use of the mill, but all repairs were paid for by the firm. In a dispute between firm and individual creditors the question arises as to whether the property is firm or individual property. What is your opinion?

2. *A* and *B* formed a partnership and *A* contributed an unpatented invention. He later took out the patent in his own name. To whom does the patent belong upon dissolution?

3. *A* invests $10,000 and *B* $5,000 in a certain business for profit. With the investment they purchase fifteen pianos. What is the interest of each one in the pianos?

4. *A* and *B* were equal partners in the transfer and drayage business. They owned six trucks with which they conducted their business. *C*, a creditor of *A*, levied on three of the trucks and had them sold to *H*. Did *H* obtain good title to the trucks?

5. *A* and *B* are partners. *A* dies and *B* continues the business in his own name. In accounting for the firm assets, he refuses to make any allowance for good will. May the executrix of *A* recover an additional sum for the good will of the business? Give a definition of good will.

6. How is title to partnership personal property held? Is the same true of real estate? Has the Uniform Partnership Act changed the law in this respect?

7. *A*, *B*, and *C* formed a partnership to purchase and develop a subdivision of suburban real estate. Title to some of the property was taken in the name of College Crest Realty Company, other portions of the realty were taken in the name of *A*, *B*, and *C* jointly, and some in *C*'s name. In each of the above situations what will be necessary to convey proper legal title to a purchaser?

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[9] Maercklein v. Maercklein, 1934, 64 N.D. 733, 256 N.W. 180; p. 671.

Chapter III

RIGHTS AND DUTIES OF PARTNERS AMONG THEMSELVES

Relations of Partners to One Another

Sec. 17. In general.—The rights which a partner has as against his copartners, as well as his duties to them, may in a very large measure be defined by the partnership agreement. The amount of his investment, his right to interest thereon, and the share of the profits to be credited to him, along with his right to share in the management of the business or to receive compensation for such, are matters one might well expect to see controlled by the articles of copartnership. When the agreement is silent on these matters, the rules found in the following sections control.

Sec. 18. Partner's rights to indemnity and contribution.—If any partner, in the pursuit of the partnership business, makes any payments or advances beyond his capital for the aid of the partnership, he is entitled to contribution for such advances. If a partner makes a loan to the partnership, he is a creditor of the firm and is entitled to contribution with interest from the date of such loan. For example, a partner would have a right to contribution for expenses legitimately incurred in the pursuit of the partnership business.

The right to indemnity arises where a partner, through negligence or lack of diligence, has caused a loss to the firm. The partner at fault must indemnify the other partners. This liability generally arises when a partner has done some act, in violation of the partnership agreement, which has caused a partnership loss.

Sec. 19. Sharing of profits and losses.—Subject to an agreement among themselves, each partner has a right to share equally in the profits of the enterprise. Likewise, each partner is under a duty to contribute equally to the losses, in the absence of a different agreement, whether such losses be capital losses or otherwise. Capital contributed to the firm, in the absence of an agreement to the contrary, is a debt owing by the firm to the contributing partners. If, on dissolution, there are not sufficient assets to repay each partner his capital, such amount is considered as a loss, and must be met like any other loss of the partnership.

Occasionally articles of copartnership specify the manner in which profits are to be divided, but neglect to mention possible

losses. In such cases, the losses are borne in the same proportion that profits are to be shared. In the event that losses occur when one of the partners is insolvent and his share of the loss exceeds the amount owed him for advances and capital, the excess must be shared by the other partners. They share this unusual loss, with respect to each other, in the same ratio that they share profits.

Sec. 20. Partner's right to interest.—Contributions to capital, in the absence of an agreement, are not entitled to draw interest.[1] The partner's share in the profits constitutes the earnings upon his capital investment. In absence of an expressed provision for the payment of interest, it is presumed that interest will be paid only on advances above the amount originally contributed as capital. Advances in excess of the prescribed capital, even though credited to the capital account of the contributing partners, are entitled to draw interest.

The Uniform Partnership Act provides in Section 18 that a partner who, in aid of the partnership, makes any payment or advance over the amount of capital which he agreed to contribute shall be paid interest from the date of the advance. A partner is entitled to interest on capital contributed by him only from the date when repayment should be made.

Unwithdrawn profits remaining in the firm are not entitled to draw interest. Such unwithdrawn profits are not considered advances or loans by the mere fact that they are left with the firm. However, custom, usage, and circumstances may show an intention to treat such unwithdrawn profits as loans to the firm.

Sec. 21. Right to participate in management.—In the absence of an agreement, all partners have equal rights in the management and conduct of the firm business. The partners may, however, by agreement, place the management within the control of one or more partners. The right to an equal voice in the management and conduct of the business is not determined by the share that each partner has in the business.

In the absence of an agreement, in regard to ordinary matters arising in the conduct of the partnership business, the opinion of the majority of the partners is controlling.[2] If the firm consists of only two persons, and they are unable to agree, and the articles of partnership make no provision for the settlement of disputes, dissolution is the only remedy.

The majority cannot, however, against the consent of the minority, change the essential nature of the business by altering the partnership agreement or by reducing or increasing the capital of the

[1] Grant v. Smith, 1902, 70 App. Div. 301, 75 N.Y. Supp. 82; p. 672.
[2] Clark et al. v. State Valley Ry. Co., 1890, 136 Pa. St. 408, 20 Atl. 562; p. 672.

partners; or embark upon a new business; or admit new members to the firm.

There are certain acts other than those enumerated above which require the unanimous consent of the partners, in order to bind the firm, namely: (1) assigning the firm property to a trustee for the benefit of creditors; (2) confessing a judgment; (3) disposing of the good will of the business; (4) submitting a partnership agreement to arbitration; (5) doing any act which would make impossible the conduct of the partnership business.

Sec. 22. Partner's right to be compensated for services.—It is the duty of each partner, in absence of an agreement to the contrary, to give his entire time, skill, and energy to the pursuit of the partnership affairs. No partner is entitled to payment for services rendered in the conduct of the partnership business unless an agreement to that effect has been expressed or may be implied from the conduct of the partners. A surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs.

Sec. 23. Right to information and to inspection of books.—Each partner, whether active or inactive, is entitled to full and complete information concerning the conduct of the business and may inspect the books to secure such information.[3] The partnership agreement usually provides for a bookkeeper, and each partner is under a duty to give the bookkeeper whatever information is necessary efficiently and effectively to carry on the business. It is the duty of the bookkeeper to allow each partner access to the books, and to keep them at the firm's place of business. No partner has a right to remove the books without the consent of the other partners. Each partner is entitled to inspect the books and make copies therefrom, provided he does not make such inspection or copies to secure an advantageous position, or for fraudulent purposes.

Sec. 24. Fiduciary relation of the partners.—Section 21 of the Uniform Partnership Act provides: Every partner must account to the partnership for any benefit, and hold as a trustee for it any profits gained by him without consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership, and account for any use by him of the partnership property. This duty also rests upon representatives of deceased partners engaged in the liquidation of the affairs of the partnership.

The partnership relation is a personal one, and each partner is under duty to exercise good faith, and to consider the mutual wel-

[3] Katz v. Brewington, 1889, 71 Md. 70, 20 Atl. 139; p. 673.

fare of all the partners in his conduct of the business.[4] If one partner attempts to secure an advantage over the other partners, he thereby breaches the partnership relation, and he must account for all benefits that he obtains. Where a partner, in the transaction of the partnership business, obtains a secret commission from a third person without the consent of the partners, he must share such commission or profit with his partners. A partner cannot buy commodities for the firm at one price and sell them to the firm at another price. Likewise, one partner cannot sell his interest in the partnership to another partner without disclosing all facts concerning the value of the interest sold. One partner cannot use information secured by him in the pursuit of the partnership business for any purpose which would compete with the firm, without accounting to the firm for any profits obtained by the use of such information. Neither may a partner, while a member of a firm, engage in a competing business, unless such conduct is approved by the other members of the firm.

Sec. 25. Partner's right to an accounting.—The partners' proportionate shares of the partnership assets, or profits, when not determined by a voluntary settlement of the parties, can only be ascertained by a bill in equity for an accounting. A partner cannot maintain an action at law, against other members of the firm, upon the partnership agreement, because, until there is an accounting and all the partnership affairs are settled, the indebtedness between the firm members is undetermined.[5] Therefore, in order that a partner may determine his interest in the firm, he is entitled to an accounting in equity. Partners ordinarily have equal access to the partnership books, and there is no reason why they should be subject to formal accountings to determine their interest. However, each partner is entitled to a complete accounting in a proper case in equity, in order to show the financial condition of the firm. An accounting will not be permitted to settle incidental matters of disputes between the partners, however, unless the disputes are of such a grievous nature as to make impossible the continued existence of the partnership.[6]

In all cases a partner is entitled to an accounting upon the dissolution of the firm. In addition he has a right to a formal accounting without a dissolution of the firm in the following situations:

1. Where there is an agreement for an accounting at a definite date.

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[4] Kaufer v. Rothman, 1926, 78 N.J. Eq. 467, 131 Atl. 581; p. 674.
[5] Jones et al. v. Cade, 1922, 94 So. 255, 19 Ala. App. 27; p. 674.
[6] Lord et al. v. Hull, 1904, 178 N.Y. 9, 70 N.E. 69, 102 Am. St. Rep. 484; p. 675.

2. Where one partner has withheld profits arising from secret transactions.

3. Where one partner has been expelled from the firm.

4. Where there has been an execution levied against the interest of one of the partners.

5. Where one is in such a position that he does not have access to the books.

6. Where the partnership is approaching insolvency and all parties are not available.

Upon an agreement between themselves, the partners may make a complete accounting and settle their claims, without resort to a court of equity.

Review Questions and Problems

1. *A* and *B* entered into a partnership for the purpose of conducting a grocery business. *A* invested $10,000 and *B* $5,000. At the end of the first year, no profits had been made and all capital had been lost. *A* desires to recover $2,500 from *B*. In the absence of any agreement concerning the division of profits and losses, is he entitled to recover?

2. *A* advances to a partnership, for a period of sixty days, the sum of $19,000 in addition to his agreed capital. Is he entitled to interest on the advance?

3. Are unwithdrawn profits remaining in the firm entitled to interest?

4. *A*, *B*, and *C* are partners. *A* and *B* desire to move to a new location, but *C* objects to the plan. May *A* and *B* bind the firm to a lease on the new location without the consent of *C*?

5. Name four occasions upon which a partner may have an accounting without dissolution. Has he always a right to an accounting at the time of dissolution?

6. *A* and *B* were partners in the conduct of a hotel. Considerable money had been spent by the firm in furnishing and equipping the building, which was leased from a third party. Shortly before the lease was to expire, *A* obtained a new lease in his own name. May he be compelled to hold the lease for the benefit of the firm?

7. *A* was a partner in a retail grocery business and acted as the purchasing agent for the firm. He was also a partner in a certain milling industry. He purchased flour from the mill for the grocery, purchases which, because of his interest in the mill, netted him $500 during the year. Assuming that his partners were unaware of his interest in the mill, but later ascertained the true facts, should *A* be allowed to retain his profits?

8. *A* and *B* have been partners for a number of years. Upon *A*'s death, *B* spent considerable time in winding up the partnership affairs. Is he legally entitled to compensation for his services?

Chapter IV

POWERS AND LIABILITIES OF PARTNERS IN RELATION TO PERSONS DEALING WITH THE PARTNERSHIP

Sec. 26. Powers of partners in general.—The extent of the power of partners to bind the firm is determined by the law of agency. Section 9 of the Uniform Partnership Act provides as follows:

"Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.

An act of a partner which is not apparently for the carrying on of the business of the partnership in the usual way does not bind the partnership unless authorized by the other partners.

Unless authorized by the other partners or unless they have abandoned the business, one or more but less than all the partners have no authority to:

(a) Assign the partnership property in trust for creditors or on the assignee's promise to pay the debts of the partnership,
(b) Dispose of the good will of the business,
(c) Do any other act which would make it impossible to carry on the ordinary business of a partnership,
(d) Confess a judgment,
(e) Submit a partnership claim or liability to arbitration or reference.

No act of a partner in contravention of a restriction on authority shall bind the partnership to persons having knowledge of the restriction."

Sec. 27. Express and implied powers.—By express agreement, authority that cannot be exercised by any of the other partners may be given to a particular partner. This authority may be limited to a particular act, it may be general, or it may be authority which would seem to go beyond the scope of the usual authority of an agent not specially authorized. The limitation of the authority of

a partner as an agent does not bind third persons who have no knowledge of the limit of authority.

In the absence of an express agreement describing the powers of the partners, each partner has implied power to do all acts necessary for carrying on the business of the partnership. The nature and scope of the business, and what is usual in the particular business, determines the extent of the implied powers.

Sec. 28. Trading and nontrading partnerships.—Partnerships for the purpose of determining the limit of a partner's powers may be divided into two general classes—trading and nontrading partnerships. A trading partnership is one which has for its primary purpose the buying and selling of commodities. In such a trading firm, each partner has an implied power to borrow money and to extend the credit of the firm, in the usual course of business, by signing negotiable paper.

A nontrading partnership is one which does not buy and sell commodities, but which has for its primary purpose the production of commodities, or is organized for the purpose of selling services, such as professional partnerships. In such partnerships, a partner does not have implied power to borrow money or to bind the firm on negotiable paper.[1] However, where the act is within the scope of the partnership business, a member of a nontrading partnership may bind the firm by the exercise of implied authority just the same as a partner in a trading partnership.

Sec. 29. Notice and admissions.—Each partner has implied authority to receive notice for all of the other partners concerning matters within the pursuit of the partnership business; and knowledge, held by any partner in his mind but not revealed to the other partners, is notice to the partnership. Knowledge of one partner is knowledge of all. This knowledge, however, must be knowledge obtained within the scope of the partnership business. If the partner could have and should have communicated knowledge to the other partners and fails to do so, his failure would be chargeable to the firm. This rule does not apply, however, if fraud is perpetrated on the partnership by the partner having such knowledge.

Admissions or representations, pertaining to the conduct of the partnership business, made by a partner may be set up as evidence against the partnership.

Sec. 30. Ratification.—Acts of the partners with respect to third parties, which have been committed without authority express or implied, may be ratified by the copartners, thus binding

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[1] Snively v. Matheson et al., 1895, 12 Wash. 88, 40 P. 628; p. 677.

the firm. Whether there is a ratification is always a question of fact in each particular case, and such question is determined by the general law of agency.

Joint and Several Liability

Sec. 31. Contractual liability.—Even though a partnership is considered a legal entity for some purposes, the liabilities of the partnership ultimately are the liabilities of the persons within the firm. All obligations and risks assumed by contract in the pursuit of partnership business are joint obligations of the partners. Hence, where two or more persons make one single promise, the liability is joint. In a suit for recovery on such promises, all persons making the single promise must be made party defendants.[2] Thus a contract between *A, B,* and *C,* as partners, with *Y,* a fourth person, is a joint contract by which *A, B,* and *C* jointly bind themselves to *Y.* Although the partners are bound jointly, nevertheless, each individual partner is liable for the obligation if sued alone, unless he pleads nonjoinder of his copartners. An individual partner may, however, enter into a personal agreement with a firm creditor in such a manner as to make himself responsible for the goods sold to the firm. A release of one of the joint promisors, since there is only one promise, will release all. Statutory regulations in some states provide that partnership liability is joint and several.

If the liability is several, there are as many individual promises as there are partners. If the liability is joint and several, there is one more promise than there are promisors—the combined promise of all and the several promises of each. Therefore the release of one partner on his promise or liability does not release the others; a separate cause of action may be had against each promisor.

Sec. 32. Tort liability.—In tort the partners are jointly and severally liable.[3] The obligation does not arise by reason of any intention of the parties, but by reason of some injury or loss caused to a third party by some member or members of the firm in the scope of the partnership business, or for the tort of a servant or agent of the partnership within the scope of his employment. By the law of agency the principal is liable for the torts of his agent, and, since a partner is an agent of the other partners and the partnership, the firm is liable for the torts of its partners. Not only is the firm liable for the tort committed, but the partner committing the tort is personally liable.

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[2] Page v. Brant, 1856, 18 Ill. 37; p. 678.
[3] Boston Foundry Company v. Whiteman, 1910, 31 R.I. 88, 76 A. 757; p. 678.

Review Questions and Problems

1. *A* and *B* are partners in the hardware business. It is expressly agreed in the partnership agreement that the full duties of management shall be intrusted to *A* and that he shall be the only purchasing agent of the firm. Despite this fact, *B* orders from the *X* Company certain hardware for the firm. *A* refuses to accept the goods for the firm. Is the firm liable in damages to the *X* Company?

2. What is the difference between express and implied powers? Distinguish between a trading and a nontrading partnership.

3. *A* and *B* are partners in the retail clothing business. Being short of funds in the business, *A*, without the consent or knowledge of *B*, borrowed $500 from *C* and gave him a chattel mortgage upon the fixtures. Is the mortgage good?

4. May a partnership become liable for the acts of a partner outside the scope of the partnership business? How?

5. *A*, *B*, and *C* are partners. The firm owes *X* $500 for goods furnished to it. *X* obtains a joint judgment against *A* and *B* for the amount. They are unable to pay the judgment. May *X* recover in another action against *C*? Suppose *X* had released *C* from all liability upon the debt, what would have been the effect upon *A* and *B*?

6. What is the difference between joint and several liability? May an individual member of a partnership be held liable for a tort committed by an agent of the firm?

CHAPTER V

DISSOLUTION

Sec. 33. Nature of.—Dissolution of a partnership is effected when the partnership relation is destroyed by any partner's ceasing to be a member of the firm. Under the Uniform Partnership Act, dissolution may occur without violation of the partnership agreement: (a) by the termination of the stipulated term or particular undertaking specified in the agreement; (b) by the express will of any partner when no definite term or particular undertaking is specified; (c) by the express will of all the partners who have not assigned their interest or suffered them to be charged for their separate debts either before or after the termination of any specified term or particular undertaking; or (d) by the expulsion, in good faith, of any partner from the business, in accordance with such a power conferred by the partnership agreement.

Sec. 34. Dissolution by act of partner when for definite term.—A partnership agreement, originally created to continue for a definite term, in which no provision is made for dissolution prior to the expiration of the period, may be dissolved by the acts of one of the partners "in contravention of the partners' agreement." By reason of the partnership agreement there exists between the partners a principal and agency relationship. As in the law of agency, each partner has the power to revoke such relationship but in so doing is made liable for damages. A partnership is not indissolvable. Because of the peculiar personal relationship necessary in the formation and carrying out of a partnership agreement, a court of equity will not grant specific performance for the continuance of a partnership, even though the agreement provides that such partnership shall continue for a long period of time. As a consequence of such breach the withdrawing partner becomes liable for the damages sustained by the other parties.

Sec. 35. By operation of law.—If, during the period of the partnership, events occur which make it impossible or illegal for the partnership to continue, it will be dissolved. Such events or conditions are: death or bankruptcy of one of the partners, or a change in the law which makes the continuance of the business illegal.

A partnership is a personal relation existing by reason of contract. Therefore, when one of the partners dies, the partnership is dissolved. The former partners cannot bind the estate of the deceased partner by a new contract, even though it was expressly

intended by the decedent that the partnership be continued. Although partnership agreements occasionally provide for the continued existence of the partnership after the death of the partner, the agreement does not bind the legal representatives of the deceased partner to continue the firm in existence. Since a deceased partner cannot continue as a partner or compel his heirs or legal representative to become a partner, he occasionally provides that his interest in the firm may be retained by the survivors for a limited period. If the period is not too long—three to five years—the courts usually enforce it. The balance of his estate is not thereby made liable for any future debts or losses, but his estate is delayed in obtaining a final accounting from the surviving members of the partnership and may share in the profits for the period involved.

If, during the period of a partnership, a law is passed which makes continuance of the business illegal, the partnership will be dissolved. Also a partnership composed of residents of different countries could not legally continue, upon the declaration of war between such countries, because such parties would be enemies.

The bankruptcy of a partner will dissolve the partnership, because the control of his property passes to his assignee or trustee, for the benefit of the creditors, in somewhat the same way that the control of the property passes to the legal representatives upon the death of a partner. The mere insolvency of a partner will not be sufficient to justify a dissolution, unless there has been an assignment of his assets. Neither will a dissolution take place if a partner is involuntarily placed in bankruptcy by one of his copartners. The bankruptcy of the firm itself is a cause for dissolution, as is also a valid assignment of all the firm assets for the benefit of creditors.

Sec. 36. Dissolution by court decree.—Where a partnership, by its agreement, is to be continued for a term of years, circumstances may arise which might make the continued existence of the firm impossible and unprofitable. Therefore, upon the application of one of the partners to a court of equity, the partnership may be dissolved. The following are the circumstances and situations which will give a partner a right to go into a court of equity for dissolution:

Where a partner becomes totally incapacitated to conduct business and to perform the duties required under the contract for partnership, the court of equity will, upon application by any of the partners, declare a dissolution. Insanity of one of the partners does not necessarily dissolve the partnership. If, however, a partner is declared insane by a judicial process, the partnership is dissolved.

Where a partner is guilty of gross misconduct and neglect or breach of duty to such an extent that it is impossible to carry out the purposes of the partnership agreement, a dissolution will be decreed at the request of the remaining partners. The court will not interfere and grant a decree of dissolution for mere discourtesy, temporary inconvenience, differences of opinion, or errors in judgment.[1] The misconduct must be of such gross nature that the continued operation of the business would be unprofitable. Where a partner willfully and persistently commits a breach of the partnership agreement, misappropriates funds, or commits fraudulent acts, the partnership will be dissolved. A partnership which was entered into by reason of fraud may be dissolved on the application of an innocent party. But, if the defrauded partner continues in the partnership with the knowledge of the fraud, no decree of dissolution will be granted.

Effect of Dissolution Between the Partners

Sec. 37. Where dissolution is caused by acts other than death or bankruptcy.—Upon dissolution, a partnership is not terminated, but continues in existence for the purpose of winding up the partnership affairs. Dissolution terminates all the authority of any partner to act for the partnership, except in-so-far as it may be necessary to create liability to complete unfinished transactions, or to liquidate the assets of the firm in an orderly manner.

In the event of dissolution, title to partnership property remains in the surviving partners for purposes of liquidation. Should death of one of the partners occur, both real and personal property is, through the survivors, made available to creditors. If all of the realty is not required to satisfy firm obligations, the disposition to be made of the remaining real estate depends on whether the firm operates under the common law or the Uniform Act. Under the Act, all realty is treated as though it were personal property,[2] the surviving partners finally accounting, usually in cash, to the personal representative of the deceased partner for the latter's share in the proceeds of liquidation. In those states which have not adopted the Uniform Act, the surviving partners are authorized to sell only that portion of the realty which is needed for the payment of debts. The unsold portion, to the extent of the deceased partner's interest therein, passes directly to the latter's heirs and is subject to widow's dower and the ordinary incidents of real property which passes by descent.

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[1] Lish v. Earnshaw, 1872, 66 Ill. 402; p. 680.

[2] Wharf v. Wharf, 1922, 306 Ill. 79, 137 N.E. 446; p. 680.

Sec. 38. Dissolution caused by death or bankruptcy.—Under the Act, if the dissolution is caused by the act, death, or bankruptcy of one of the partners, each partner will be liable, just as if no dissolution had taken place, upon any contracts entered into after the dissolution, unless the acting partner had knowledge or notice of the dissolution. In those states where the Uniform Partnership Act has not been adopted, and the partnership is dissolved by death or bankruptcy, each person, including the partners, must take notice of such death or bankruptcy whether or not they have actual knowledge of the fact. Therefore, if *A*, a partner in the firm of *A*, *B*, and *C*, enters into a contract after the death or bankruptcy of *C*, he must assume the entire liability of the contract, although he or the other partner is ignorant of the death or bankruptcy of *C*. Under the Uniform Partnership Act, however, *A* may call upon *B* and the estate of the deceased partner to assume their proportionate share of the liability and to contribute to any loss which may be sustained on account of such contract.

Sec. 39. Right of partners after dissolution.—Where the dissolution is caused by any act other than the breach of the partnership agreement, each partner, as against his copartners or their assignees, has a right to insist that all the partnership assets be used first to pay firm debts. After firm obligations are paid, remaining assets are used to return capital investments,[3] proper adjustments for profits and losses having been made. All of the surviving partners, except those who have caused a wrongful dissolution of the firm, have the right to participate in the winding up of the business. The majority may select the method or procedure to be followed in the liquidation, but the assets, other than real estate, must be turned into cash unless all the partners agree to distribution in kind. Under the Uniform Act, realty is treated the same as any other asset and should be liquidated. Should the last surviving partner die prior to the final accounting, it becomes the duty of his legal representative to complete the liquidation.

Sec. 40. Continuation of the business after dissolution.—If a partnership which is to continue for a fixed period is dissolved by the wrongful withdrawal of one of its members, the remaining members may continue as partners if they have settled with the withdrawing partner for his interest in the partnership. The remaining partners, in determining the interest of the withdrawing partner, have the right to pay him his share in cash, less damages. In the calculation of his share, the good will of the business is not taken into consideration. Under the Uniform Partnership Act, if no accounting is made at the time that the partner withdraws, the

[3] Word v. Word, 1890, 90 Ala. 81, 7 So. 412; p. 682.

remaining partners may continue the business for the agreed period by securing the payment of such withdrawing partner's interest by a bond approved by the court, covering not only the partner's interest at the time of the withdrawal, but also indemnifying him against any future liabilities of the continuing partnership.

The right of the partners to expel one of their number is determined entirely by the partnership agreement. Thus, the right to continue after expulsion, as well as the amount which the expelled partner is to receive, depends exclusively upon the articles of copartnership.

Effect of Dissolution as to Third Parties

Sec. 41. Liability existing prior to dissolution.—Although the dissolution of a partnership terminates the authority of the partners to create future liability, it does not discharge the existing liability of any partner. An agreement between the partners themselves that one or more of the partners will assume the partnership liabilities does not bind the firm creditors. However, upon dissolution, a partner may be discharged from any existing liability by an agreement to that effect in which he, the partnership creditors, and the remaining partners join. Such an agreement must satisfy all the requirements for a novation. If, upon dissolution of a partnership, an incoming partner or the remaining partners promise to assume the liabilities of the dissolved partnership, such liabilities will be discharged as to the withdrawing partner if any creditor of the partnership, knowing of the agreement, changes or alters the character of the liability or the time of its payment by agreement with the new firm.

The individual estate of a deceased partner is liable to third parties for all debts created while he was a partner, subject, however, to the payment of his separate debts.

Sec. 42. Notice to the creditors of the firm.—Transactions entered into with former creditors of the firm who have not received actual knowledge of the dissolution continue to bind any partner who has withdrawn. Notice of the dissolution is not necessary at common law, where the dissolution has been caused by the operation of the law. If the dissolution has been caused by agreement or an act of the parties, notice which carries knowledge to all persons who are creditors to the firm is required, as in the revocation of agency.[4] Therefore, a retiring partner, who fails to give notice of dissolution to those who have extended credit to the old firm, assuming that knowledge of the dissolution has not been acquired

[4] Joseph, Gaboury & Co. v. Southwark Foundry & Machine Co., 1891, 99 Ala. 47; p. 682.

in some other manner, will be liable on contracts of the new firm. Under the Uniform Partnership Act notice of dissolution is required even though the dissolution is caused by operation of law, except where a partner becomes bankrupt. In the latter case notice is not required.

Sec. 43. Notice to the public generally.—Where the dissolution is caused by an act of the parties, the partners will continue to be liable to all persons who formerly dealt with the firm, but not on credit, and to all other persons who extend credit on the faith of the old firm, unless notice of such dissolution is given to the public at large. This does not mean that notice of the dissolution must be brought to the attention of all third parties. Notice by publication in a newspaper in the community where the business has been transacted or notice of the dissolution by a properly addressed envelope placed in the mailbox is sufficient.

The duty to impart notice is broadened by the Uniform Act to include those situations where dissolution results from operation of law. Thus, in states operating under these laws, it becomes the duty of the estate of a deceased partner to see that notice is given. Should the continuation of the business become illegal, however, notice is not required, since all are presumed to be aware of the illegal nature of the enterprise.

Where a partner has not actively engaged in the conduct of the partnership business and credit has not been extended to the firm on the faith of such partner, he is under no duty to give notice to either of the groups mentioned above.

Sec. 44. The liability of an incoming partner.—Under the common law an incoming partner causes a change in the personnel of the partnership to the extent that a new firm is formed, and he is, therefore, not liable as a member of the new firm to creditors of the old firm. He may make himself liable, however, to old firm creditors by assuming the liability. This agreement may take the form of a novation, a contract of suretyship, or a mere contract for the benefit of third parties. Under the Uniform Partnership Act, however, a person admitted as a partner into an existing partnership is, as a member of the firm, liable to the extent of his investment for all obligations created before his admission, as though previously he had been a partner. His separate estate is not liable for such obligations, and the creditors of the old firm can look only to the firm assets and to the members of the old firm.[5]

Sec. 45. Creditors of the old firm and the new firm.—Under the Uniform Partnership Act, if the business is continued without liquidation of the partnership affairs, creditors of the first, or dis-

[5] Freeman v. Huttig Sash & Door Co., 1913, 105 Tex. 560, 153 S.W. 122; p. 684.

solved, partnership are also creditors of the partnership continuing the business. Likewise, if the partners assign all their interest to a single partner, who continues the business without liquidation of the partnership affairs, creditors of the dissolved partnership are also creditors of the single person so continuing the business. Likewise, when all the partners or their representatives assign their rights in the partnership property to one or more third persons who promise to pay the debts and to continue the business, the creditors of the dissolved partnership are also creditors of the person or persons continuing the business.

Distribution of Firm Assets and Liabilities of Partners on Dissolution

Sec. 46. Distribution of firm assets where firm is solvent.—Upon the dissolution of a partnership and a winding up of its business, an accounting is had to determine its assets and liabilities. Before the partners are entitled to participate in any of the assets, whether firm creditors or not, all firm creditors other than partners are entitled to be paid. After firm creditors are paid, the assets of the partnership are distributed among the partners, as follows:

1. Each partner who has made advances to the firm, or has incurred liability for or on behalf of the firm, is entitled to be reimbursed.
2. Each partner is then entitled to the return of the capital which he has contributed to the firm.[6]
3. Any balance is distributed as profits, in accordance with the partnership agreement.

Sec. 47. Firm creditors against firm assets.—When the firm is insolvent and a court of equity has acquired jurisdiction of the assets of the partnership, together with the assets of the individual partners, the assets are distributed in accordance with certain well-defined rules.

Persons entering into a partnership agreement, by virtue of the contract itself, impliedly agree that the partnership assets shall be used in the payment of the firm debts before the payment of any debts due to the partners themselves. Consequently, a court of equity, in distributing firm assets, will give priority to firm creditors in firm assets as against the separate creditors of the individual partners. This rule does not apply, however, if a partner conceals his existence and permits another member of the firm to deal with the public as an individual proprietor. Under these circumstances the dormant partner by his conduct has led the creditors of the active partner to rely upon firm assets as separate property, and by

[6] Livingston v. Blanchard, 1881, 130 Mass. 341; p. 684

reason of his conduct he is estopped from demanding an application of the equity rule that firm assets shall be used to pay firm creditors in priority, and individual assets to pay individual creditors. Since the firm creditors' right to firm property rests upon the partners' right that firm assets be used to pay firm debts, the conduct that estops a partner also denies the creditors such a preference. Furthermore, the creditors who relied upon the assets in the hands of the sole active partner cannot claim a preference when later they learn such assets were partnership assets.

Sec. 48. Firm creditors against individual assets.—Just as the individual creditors are limited to individual assets, firm creditors are limited to firm assets. Therefore, firm creditors are not entitled to payment out of the individual assets of the partners until the individual creditors have been paid. This rule applies, even though the firm creditors may, at the same time, be individual creditors of a member of the firm. There are two main exceptions to this general rule. (1) Where there are no firm assets and no living solvent partners. The rule for the limit of firm creditors to firm assets applies only where there are firm assets. If no firm assets or no living solvent partner exists, the firm creditors may share equally with the individual creditors in the distribution of the individual estates of the partners.[7] (2) If a partner has fraudulently converted the firm assets to his own use, it follows that the firm creditors will be entitled to share equally with individual creditors in such partner's individual assets.

Review Questions and Problems

1. *A*, *B*, and *C* are partners, and by the terms of the agreement the partnership is to continue for a period of five years. At the end of the third year conditions have arisen, which indicate that the firm cannot continue except at a loss. *B* and *C* refuse to quit and *A* files a bill to obtain an order for dissolution. Should he succeed?

2. Name three events which automatically cause a dissolution. Name three situations in which a court will decree a dissolution.

3. What contracts does a partner have a right to make after dissolution? What change did the Uniform Partnership Act make in the liability of partners for contracts made on behalf of the firm, following bankruptcy and death?

4. *A*, *B*, and *C* are partners under an agreement whereby the firm is to continue in business for ten years. *A* causes a wrongful dissolution of the partnership and demands his interest therein. May he demand that firm assets be liquidated? Is there any asset in which he is not entitled to share?

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[7] Emanuel v. Bird, 1851, 19 Ala. 596, 54 Am. Dec. 200; p. 685.

5. *A* withdraws from a firm under an agreement with the surviving partners that they shall assume and pay all outstanding liabilities. *A* notified all creditors of his withdrawal from the firm. The surviving partners failed to pay the debts. Has *A* avoided liability therefor?

6. *A*, *B*, and *C* take a new partner, *D*, into their business. He invests $3,000. What is the extent of his liability, if any, to creditors of the old firm? What are the rights of creditors of the old firm, in comparison with creditors of the new firm, in the firm assets?

7. To what parties does a withdrawing partner owe a duty to give notice of his withdrawal? How should this notice be given?

8. Name the order of payment of firm assets in the case of a solvent firm.

9. In the event of the insolvency of a firm at dissolution, have individual creditors of an insolvent partner any right to share in firm assets?

10. Do the creditors of an insolvent firm ever share in the insolvent individual estate of a partner?

11. *A*, *B*, and *C* are partners. The firm is insolvent and is being wound up in a bankruptcy court. The firm assets amount to $40,000, its liabilities to $80,000. *A* has personal property worth $12,000; his personal liabilities are $6,000. *B* has personal property worth $20,000; he owes personal creditors $15,000. *C* has no personal property and owes personal creditors $5,000. Marshal the assets of the firm and make the proper distribution between firm and individual creditors.

12. *A*, *B*, and *C* are partners. *A* contributed $10,000, *B* contributed $4,000, and *C* contributed his services. Upon dissolution it was found that the firm had assets of $50,000 and liabilities to outside creditors of $20,000. *C* had loaned the firm $1,000 and had paid $300 in taxes and $450 insurance. Make the proper distribution of the firm assets.

PART II

CORPORATIONS

CHAPTER VI

CHARACTERISTICS OF CORPORATIONS

Sec. 49. Essential features.—The corporation is the most effective vehicle yet discovered to manage and control modern business enterprises. It permits, with the minimum risk of loss to investors, the combination of capital and skill for vast business operations. No other method has been found by which large amounts of capital are so easily assembled for huge business control. A great portion of the business today is conducted by means of the corporate organization.

A corporation is a collection of individuals but in law is treated primarily as an entity.

Since a corporation is regarded in the law as a person, for the purpose of convenience, there is a limitation with respect to what it can do, in that it has only those rights and powers which are given to it by the state. In order that it may function as a person, a legal entity separate and distinct from its members, it has certain inherent rights and powers: a corporation may sue and be sued in its own name; it has the capacity of perpetual succession, although there may be a change in its members by death or withdrawal; it may take, hold, and transfer property, both real and personal, in its own name as a legal entity, separate and distinct from its members; it may enter into contracts with its own members; it may take and convey property from its own members; and it may sue and be sued by them as a distinct person.

A corporation is a resident and a citizen, for jurisdictional purposes, of the state which creates it. Wherever the word "person" or "persons" is used in constitutional and statutory provisions, corporations "are deemed and considered persons when the circumstances in which they are placed are identical with those of natural persons expressly included with such statute."[1] Thus, a corporation is a person within the meaning of the fourteenth amendment to the federal constitution, which provides that "no state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state de-

[1] Judge McKinley—Beaston v. Bank, 12 Pet., 102.

prive any person of life, liberty, or property without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws." However, a corporation is not included within the word "person" under the fifth amendment to the constitution, which pertains to rights of natural persons in criminal proceeding; also, a corporation is not a "citizen" within the meaning of section 2, article IV of the constitution of the United States, which provides that "the citizens of each state shall be entitled to all privileges and immunities of citizens in the several states."

Private corporations, according to the character of their organization, may be either stock corporations or nonstock corporations. In stock corporations the membership is represented by shares of stock. In nonstock corporations there are no shares of stock, but the membership is determined by rules and regulations set out in the by-laws. The stock corporations are organized for the purpose of profit, whereas the nonstock corporations are organized as not-for-pecuniary-profit corporations, such as mutual benefit associations, fraternal organizations, clubs, and the like.

Sec. 50. Entity disregarded.—Occasionally, the courts feel free to look behind the corporate entity and take action as though no entity separate from the members existed. There are three distinct situations in which the entity is often disregarded. First, if the use of the corporation is to defraud or to avoid an otherwise valid obligation, the court may handle the problem as though no corporation existed. To illustrate, let us assume that *A* and *B* sold a certain business and agreed not to compete with the buyer for a given number of years. Desirous of reentering business, in violation of the contract term, they organize a corporation, becoming the principal stockholders and managers. The buyer may have the corporation enjoined from competing with him as effectively as he could have enjoined *A* and *B* from establishing a competing business.

A parent corporation, owning a controlling interest in a subsidiary, often completely dominates the activity of the latter so that it becomes purely an agent or arm of the parent company. Under such circumstances, the courts have often held the parent company liable for torts committed by the subsidiary. Occasionally, if the finances of the two companies have been used somewhat indiscriminately to meet the obligations of either company, ordinary creditors of the subsidiary are permitted to sue the holding company.

The stock of a corporation is often held by one or two persons. If the stockholders in such a case treat the corporation as though it were their own personal business, not a separate entity, they are not in a very good position to demand that outsiders treat the cor-

poration as a separate entity. The law in this situation has not been fully developed, but some courts treat the parties as though no corporation had been formed.

Sec. 51. Foreign corporations.—A corporation organized under the laws of a particular state or country is called within that particular state or country a "domestic corporation." A corporation doing business within another state or country is called a "foreign corporation." Nearly all corporations transact business across state lines, and in order to do so must satisfy the requirements of the particular state in which the business is conducted as to right of admission, service of process, and taxation, and must comply with such other restrictions as the state may see fit to impose.

A corporation is a creature of the state which grants it a charter, and it has no existence beyond the boundaries of the state creating it. "It must dwell in the place of its creation and cannot migrate into another sovereign." It may, however, like a natural person, enter into contracts, hold title to property, have agents, and engage in business in other states, subject to such limitations as those states prescribe. The constitution of the United States provides that "the citizens of each state shall be entitled to all privileges and immunities of the citizens in the several states." Under this constitutional provision a citizen of one state has a right to go into another state for the purpose of engaging in lawful commerce, trade, or business. However, a corporation has been held by the Supreme Court of the United States not to be a citizen entitled to the rights or protection of this particular constitutional provision. Therefore, an absolute power remains in the states to restrict or to exclude therefrom foreign corporations.

Sec. 52. Conditions under which foreign corporations may "do business."—Since a state may absolutely exclude or prescribe the conditions under which a foreign corporation may do business within its territorial limits, many states have taken advantage of this power by enacting statutes requiring foreign corporations to register by filing a copy of their articles with the secretary of state, to appoint an agent upon whom service of process may be served, to pay license fees, to designate and maintain an office in the state, to keep books and records, and to deposit bonds or securities with the treasurer of the state for the purpose of protecting any individual who might suffer loss by reason of the corporation's conduct. Refusal or failure by a foreign corporation to comply with these requirements justifies the state in denying the corporation the right to engage in business. Contracts of noncomplying foreign corporations are void and unenforceable by the corporation, because such

corporations are denied the use of the courts by the state in which they are doing business without authority. But noncompliance cannot be used as a defense by the corporation when sued by a third party. If a contract is fully performed, neither party may seek restitution. Transacting business within the state without complying with the statute subjects the corporation or its officers to penalties.

A state cannot impose arbitrary and unreasonable requirements, particularly after having once admitted a foreign corporation to do business within the state. Such state cannot deny the corporation the equal protection of the law granted under the fourteenth amendment to the federal constitution. Discriminatory license taxes on capital stock, denial of the right of appeal to the federal courts, regulations interfering with interstate commerce by imposing taxes and license fees on the right to transport goods into or through the state from another state, are illustrations of unconstitutional restrictions upon "foreign corporations."

Sec. 53. What constitutes "doing business" by a foreign corporation.—The term "doing business" is not reducible to an exact and certain definition. The Uniform Foreign Corporation Act in Section 2 defines the term to mean that a foreign corporation is "doing business" when "some part of its business substantial and continuous in character and not merely casual or occasional" is transacted within a state. Section 2, II, of the Uniform Foreign Corporation Act states that a corporation is not "doing business" in a state merely because:

"(a) It engaged in a single or isolated transaction in this state where its action in engaging in such single or isolated transaction indicates no intent or purpose of continuity of conduct in that respect; or . . .

(e) It does any act or acts which is or are merely preliminary to or looking toward the future transaction of business in this state; or

(f) It does any act or acts in this state relating solely to the management or control of the internal affairs of the corporation, such as the holding of corporate meetings, issuance of stock certificates, authorization of issue of bonds, making of calls on stock, or other acts of like nature; or

(g) It acquires and holds stock of domestic corporations and exercises in this state the incidents of such ownership unless through such stock ownership the domestic corporation is controlled by the foreign corporation and is in reality acting as the agent of the foreign corporation and doing business in this state for it and in its behalf . . ."

Section 6 of the Uniform Foreign Corporation Act states that a foreign corporation shall not be required to obtain a license to do business or to file amended articles by reason of the fact that:

"(a) It is in the mail order or a similar business, receiving orders by mail or otherwise, in pursuance of letters, circulars, catalogs or other forms of advertisement, or solicitation, accepting such orders outside this state and filling them with goods shipped into this state from without same direct to the purchaser thereof, or his agent; or

(b) It employs salesmen, either resident or traveling, to solicit orders in this state, either by display of samples or otherwise (whether or not maintaining sales offices in this state), all orders requiring approval at the offices of the corporation without this state, and all goods applicable to such orders being shipped in pursuance thereof from without this state to the purchaser; provided that any samples kept within this state are for display or advertising purposes only, and no sales, repairs, or replacements are made from stock on hand in this state . . ."

A foreign corporation licensed to do business, or doing business without a license, or whose license has been canceled, is subject to suit upon any cause of action arising in the state, or upon any cause of action arising outside the state, if the plaintiff was a resident of the state when the cause of action arose.

Sec. 54. Incomplete corporations—de jure and de facto.—A corporation de jure is a corporation which has been formed in compliance with the law authorizing such a corporation. A corporation de facto is one which operates as a corporation for all practical purposes, but has failed to comply with some provision of the law with respect to its creation and has no legal right to its corporate existence. Its corporate existence can be challenged only by the state itself, and not by third parties. Where persons have attempted in good faith to organize a corporation under a valid statute, but have failed in some particular and thereafter have assumed to exercise corporate power, a corporation de facto is said to exist.[2] It must be clear that the three following situations are present: (1) a valid law authorizing such a corporation; (2) a bona fide attempt to organize and comply with the statute; (3) the exercise of corporate power. The corporation de facto can make contracts, purchase and hold real estate, sue and be sued in its corporate name, and do any and all things necessary to its corporate existence that a de jure corporation may do. The mere illegalities in the organization can be questioned only by the state itself.

If persons hold themselves out as a corporation and create lia-

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[2] Finnegan v. The Knights of Labor Building Association et al., 1893, 52 Minn. 239, 53 N.W. 1150; p. 687.

bility, and such organization is less than a de facto corporation, they are generally held liable as partners. Some courts, however, hold that the liability rests not upon partnership relationship but upon the theory that such persons are agents for the other members of a pretended corporation. A few jurisdictions and authorities maintain that shareholders of a defectively organized corporation less than de facto should not be held individually liable on contracts, because the persons dealing with the pretended corporation contracted for corporate liability instead of for individual liability. For example, *A, B,* and *C* represent to *X* that they are a corporation, whereupon *X* purchases stock. *X* takes no part in the management of the pretended corporation. The pretended corporation contracts with *Y*, and *Y*, upon learning the fact that *A, B,* and *C* are not a corporation, sues *X* as a partner. Under these circumstances it would seem that *Y*'s claim should be merely a corporate one and *X*'s cause of action should be against *A, B,* and *C* individually.

Promoters

Sec. 55. Who are promoters.—A promoter is one who usually performs the preliminary duties necessary to bring a corporation into existence. He calls together and supervises the first meeting of the organizers; enters into pre-corporation contracts with brokers, bankers, and subscribers; draws the preliminary articles of incorporation; and provides for registration and filing fees. He prepares the advertising, usually called a prospectus, which has for its purpose the informing of the public as to the character of the investment, so that they may be induced to subscribe for stock or other securities created by the company when organized.

Sec. 56. Corporate liability on contracts of promoters.—The corporation, after its creation, may become bound by "adoption" upon contracts made by its promoter. The term "adoption" does not mean ratification as applied in the law of agency, because, at the time the contract was made by the promoter with a third party, the corporation as principal was not in existence. More accurately, what occurs is a novation. When the corporation assents to the contract, the third party agrees to discharge the promoter and to look to the corporation. The discharge of the promoter by the third party is consideration to make binding the corporation's promise to be bound upon the contract.

In the absence of evidence to show that such a novation has occurred, the promoter will continue to be personally liable on the contract. Since the contract made with the promoter was made in anticipation of the formation of a corporation, the acceptance of

the contract by the corporation after its creation is some evidence from which to draw an inference that a novation has occurred, but usually both the promoter and the corporation[3] are liable, since the latter merely assumes, by implication, the obligation of the promoter without any agreement as to his release.

Sec. 57. Corporate liability for expenses and services of promoters.—Corporations are generally not liable for expenses and services of promoters, unless specifically made so by statute or by charter. However, a promise made after incorporation to pay for expenses and services of promoters will be binding and supported by sufficient consideration, on the theory of services previously rendered.[4] It is held in some jurisdictions that corporations are liable by implication for the necessary expenses and services incurred by the promoters in bringing them into existence, and such expenses and services inure to the benefit of the corporation.

Sec. 58. Duty of promoters to corporation and stockholders.—Promoters occupy a fiduciary relationship toward the prospective corporation and have no right, therefore, to secure any benefit or advantage over the corporation itself or over other stockholders, because of their position as promoters. A promoter cannot purchase property and then sell it to the corporation at an advance, nor has he a right to receive a commission from a third party for the sale of property to the corporation. In general, however, he may sell property acquired by him prior to the time he started promoting the corporation, provided he sells it to an unbiased board of directors after full disclosure of all pertinent facts.

Sec. 59. Procedure for incorporation.—Corporations are created under either a special or a general law. In most states corporations are now created under a general law. A general law authorizing the formation of a corporation defines the purposes for which corporations may be formed, and prescribes the steps to be taken for the creation of the corporation. Such general law usually prescribes that any number of adult persons, usually not less than three, who are citizens of the United States and at least one of whom is a citizen of the state of incorporation, may file an application for a charter. The application usually requires the names and addresses of the incorporators; the name of the corporation; the object for which it is formed; its duration; the location of its principal office; the total authorized capital stock, preferred and common; the number of shares, with their value; and, if the statute provides for stock without par value, the number of shares

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[3] Battelle v. The Northwest Cement and Concrete Pavement Company, 1887, 37 Minn. 89, 33 N.W. 327; p. 688.

[4] Kridelbaugh v. Aldrehn Theaters Co., 1923, 195 Iowa 147, 191 N.W. 803; p. 689.

of such stock. It also requires the names and addresses of the subscribers to the capital stock, and the amount subscribed and paid in by each subscriber. It further requires the amount and the character of capital stock proposed to be issued at once, and whether the stock is paid for in cash or in property. This application, signed by all the incorporators and acknowledged by a notary public, is usually forwarded to the Secretary of State. The Secretary of State then issues a charter which contains all the information on the application, and usually sets out the powers, rights, and privileges of the corporation as prescribed by the general incorporation act. The law usually requires that, upon the receipt of the charter, it be filed in the proper recording office located in the same community as the principal office of the corporation. A fee is usually charged, payable in advance, for filing an application for a charter, and no charter will be issued until such fee is paid. Where the application is for a corporation not for pecuniary profit, no detailed information is required relative to issues of stock, shares, and so forth. The requirements for securing a charter vary greatly in the different states and in different types of business in the same state. The requirements of the statute must be satisfied and complied with in detail for the formation of a de jure corporation.

After the charter has been received and filed, the board of directors and stockholders meet, draft by-laws, and elect officers. The receipt of the charter and its filing are the operative facts which bring the corporation into existence and give it authority and power to operate.

The charter of a corporation is a contract and cannot be repealed or amended by the legislature unless such power has been reserved by the state when the charter was granted. The charter may be amended, however, by the consent of all of the stockholders or a certain portion thereof, as provided by the statute of the state.

Review Questions and Problems

1. Who holds title to property purchased by the corporation? How long does a corporation exist? Where does it derive its powers? How is the stockholder's share in a corporation represented? What effect has the death of a stockholder upon the life of the corporation?

2. Distinguish between "domestic corporations" and "foreign corporations."

3. What must a "foreign corporation" do before it may transact business within a state?

4. Explain what is meant by the term "do business," as applied to foreign corporations.

5. Distinguish between public and private corporations. What is the

purpose of nonstock corporations? How is their membership determined?

6. *A*, *B*, and *C* petitioned for a corporate charter for the purpose of conducting a retail shoe business. All the statutory provisions were complied with, except that they failed to have their charter recorded. This was an oversight on their part, and they felt that they had fully complied with the law. They operated the business for three years, after which time it became insolvent. The creditors desire to hold the members liable as partners. May they do so?

7. What relation does the promoter bear to the corporation? Who is liable on contracts made by him before the corporation is formed?

8. *A* and *B* obtained an option upon a building which had been used for manufacturing pianos. They acted as the promoters for the corporation and turned over the building to the new corporation for $100,000 worth of stock. As a matter of fact, their option on the building called for a purchase price of only $60,000. The other stockholders desire to have $40,000 of the common stock canceled. Can they succeed in an action to have it canceled?

9. State the general procedure to be followed in obtaining a charter.

10. Are all corporations organized under the same general law?

CHAPTER VII

POWERS OF CORPORATIONS

Sec. 60. In general.—The corporation has only such powers as are expressly conferred upon it by the state. The state may grant any power to a corporation that it desires, if such grant is not limited by the state or federal constitution. The express powers of a corporation are found within its corporate charter and the statute which created it. It can do no acts which are not specifically set forth in the charter, unless such acts are impliedly inferred as reasonably necessary and proper for carrying out the express powers granted.[1]

Sec. 61. Incidental powers.—Under general incorporation acts now in force in most states, the powers incidental to corporate existence are generally enumerated. The following incidental powers have at various times been said to exist, as necessary for corporate existence: (1) to have a corporate name, to control, to own, to convey property, to sue and to be sued therein; (2) to have continued existence during the period for which created; (3) to have a common seal; (4) to make by-laws; (5) to purchase and to hold real estate for the purpose of the corporation, unless forbidden by its charter or statute; (6) to borrow money when necessary to carry out the corporate purpose.

The corporate name may not be deceptively similar to those of other business enterprises and by the law of many states must conclude with either the word "Company," "Corporation," or "Incorporated." The name may be changed by charter amendment at any time without affecting corporate contracts or title to corporate property in any way.

Sec. 62. To purchase and hold property for corporate purposes.—A corporation has implied power to take and to hold title to real and personal property for all purposes that are not foreign to the objects for which it is created.[2] Such power is usually expressly given by statute or in its charter. In the absence of express restriction, it has implied power to purchase any real or personal property that is reasonably necessary for carrying on its business. For example, a manufacturing corporation has implied power to purchase all the materials necessary for the production of the article which it is to manufacture. But it cannot buy material for the

[1] Williams v. Johnson, 1911, 208 Mass. 544, 95 N.E. 90; p. 691.
[2] Williams v. Johnson, 1911, 208 Mass. 544, 95 N.E. 90; p. 691.

purpose of resale. Likewise, a railroad owning animals for the purpose of carrying out its business may purchase grain, but it cannot purchase grain for the purpose of transportation and sale.

Sec. 63. Power to take and to give mortgages or to pledge property.—A corporation has implied power to take a mortgage on real estate to secure a debt, or to hold personal property as a security. Likewise, a corporation has implied power to mortgage or to pledge its own property when necessary in order to borrow money or to secure debts which have been created in accomplishing its corporate object.[3] The officers cannot, in absence of statutory authority, mortgage the assets of the company without the consent of the stockholders. The officers may, with the consent of a majority of the stockholders, when the corporation is insolvent, make an assignment of all the property for the benefit of creditors. In the absence of statutory authority, a corporation cannot sell or mortgage its franchise or charter.

Corporations vested with the public interest, such as public utilities, cannot mortgage or sell their property without authority from the state creating them.

Sec. 64. To borrow money when necessary to carry out the corporate purpose.—In order to secure money for the purpose of carrying out its corporate objects, a corporation, in the absence of express restrictions, has power, with the consent of the stockholders, to issue bonds. The statute usually specifies the procedure necessary for issuing such bonds, and if the statute is not complied with, the bonds are invalid. Corporate bonds are merely a form of negotiable instruments.

A corporation likewise has implied power to take or to indorse promissory notes and to accept or to indorse bills of exchange in the usual course of its business. A corporation has no implied power to loan money or become a surety or guarantor, in absence of express authority, unless it is strictly necessary for the purpose of carrying out the objects of the corporation.[4]

Sec. 65. Power to enter into partnership agreements.—A corporation is without power to enter into a partnership or combination with other corporations for the purpose of bringing the management of the partnership or corporations under one control. A corporation does not have authority to share its corporate management with natural persons in a partnership because it would expose the stockholders to risks not contemplated by the stockholders' contracts, although it may enter a joint-venture. A corporation may,

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[3] Brown v. Citizens' Ice and Cold Storage Co. et al., 1907, 17 N.J. Eq. 437, 66 Atl 181; p. 691.

[4] Woods Lumber Co. v. Moore, 1920, 183 Cal. 497, 191 Pac. 905; p. 692.

however, provide in its charter, when authorized by statute, that it has authority to become a partner.

Sec. 66. Power of a corporation to subscribe and to hold stock in another corporation.—A corporation, in absence of statutory authority, has no implied power to subscribe to, purchase, or hold the stock of another corporation whose chartered purpose is totally foreign to its own. To permit such action would subject the stockholders to risks not anticipated by them. By court decision or statute, the corporations of most states are now empowered to subscribe for, or purchase, the stock of other corporations for the purpose of furthering their own objectives. It may invest idle funds in the stock of other corporations or accept such shares in settlement of an indebtedness owing to it. A certain phase of its business may be transacted by means of a subsidiary for whose organization it is responsible or whose control it has acquired by stock purchase.[5] In such cases, the parent company may, or may not, be a holding company organized for the express purpose of acquiring stock of other corporations. A corporation is forbidden, however, to acquire the stock of a competing corporation for the purpose of eliminating or restraining competition.

Sec. 67. Power to hold its own stock.—A corporation is somewhat restricted in its power to purchase its own stock, because the purchase of its own stock might effect a reduction of its capital to the detriment of creditors and stockholders. In most states a corporation is permitted to purchase shares of its own stock only out of accumulated profits or surplus.[6] This retains an investment in the corporation by stockholders equivalent to the original capital as a protective cushion for creditors in case subsequent losses develop. A few states, however, permit a corporation to acquire treasury stock as long as the corporation is not insolvent. A corporation may also acquire its own stock in payment of or in security for an antecedent debt due the corporation. It may also take its own stock for nonpayment of an authorized assessment made by the company on the stock, or it may take it as a gift. A corporation which has issued preferred stock has the power to redeem such stock, where there is no injury to, or objection by, creditors. Here again, many of the states require the preferred stock to be redeemed out of surplus or demand that authority to reduce the capital stock be obtained from the state.

Treasury stock—stock of its own issue acquired by a corporation —is not automatically canceled. It lies dormant in the treasury of the corporation without the right to vote or to share in dividends

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[5] State v. Missouri Pac. Ry. Co., 1911, 237 Mo. 338, 141 S.W. 643; p. 694.

[6] Fraser v. Ritchie, 1881, 8 Ill. App. 554; p. 695.

until it is again sold and transferred to a stockholder. The capitalization of a corporation can be reduced only with the authority of the state which approved the original capital, and the procedure outlined in the state corporation laws must be followed in effecting the reduction.

Review Questions and Problems

1. *T* & Company is incorporated for the purpose of manufacturing and selling jewelry. It is incorporated as a manufacturing concern. Has *T* & Company a right to purchase jewelry manufactured by others and to sell it?
2. A corporation is formed under the name of Maybe Butter Company. Promoters for another concern desire to incorporate under the name of Mayby Butter Company. Will those responsible for granting charters grant them one under that name?
3. May the name of a corporation be changed without affecting title to property owned by it?
4. A literary society was incorporated for the purpose of "advancing the mental development of its members by means of literary exercises, debates, and lectures, and to foster sociability among its members." Later, the members adopted by-laws which pledged their support to a certain presidential candidate. Can a member who refuses to support that candidate be expelled?
5. *A*, the treasurer of the *X* Company, borrowed $5,000 from *Y* Bank and gave a mortgage on the property of the *X* Company as security. The stockholders contend that the mortgage is ineffective, because they had not authorized the officers to issue or to sign any mortgage. Are the stockholders correct?
6. The *X* Company was incorporated for the purpose of conducting a lumber mill. *A*, its president, desired to borrow money, and caused the company to become surety upon his obligation. Assuming the contract of suretyship to be signed by the treasurer of the *X* Company, the proper officer, is the company liable?
7. Has a corporation power to enter into partnership with a firm or another corporation? May such act be provided for in the charter?
8. Has a corporation power to purchase stock in another corporation? Why? What are holding companies? What is their purpose?
9. Under what conditions may a corporation purchase its own stock?

CHAPTER VIII

ULTRA VIRES ACTS

Sec. 68. In general.—Any acts of a corporation which are beyond the authority given to it by the state are said to be ultra vires acts. No liability attaches to the corporation upon contracts outside the scope of its corporate powers, because the corporation has capacity only to do those things expressly authorized within its charter or which are incidental thereto.[1] This does not mean, however, that the corporation is free from liability for wrongful acts, such as torts and criminal liability, simply because such acts would be outside the scope of its authority. Like natural persons, a corporation has power to do wrong, and is liable therefor. There are certain exceptions to the above rules as to liability of the corporation, depending upon the nature of the acts and whether the contracts involved are partially executed or executory.

Sec. 69. Who may object to them.—If a corporation performs acts or enters into contracts to perform acts which are ultra vires, the state creating such corporation may forfeit its charter for misuse of its corporate authority. The extent of the misuse is controlling in determining whether the state will take away its franchise or merely enjoin the corporation from carrying out the ultra vires acts. A third party has no right to object to the ultra vires acts of a corporation. A stockholder or member, however, may enjoin a corporation from performing an ultra vires act. In addition, the corporation may recover from the directors who are responsible for the ultra vires contracts any losses or damages sustained because of the ultra vires venture. When they exceed corporate powers, they become personally liable for resulting losses.

Sec. 70. Effect of an ultra vires contract.—The courts are somewhat in conflict concerning the rights arising out of an ultra vires contract. In general, however, the following rules are applicable:

1. Since a corporation has only that authority expressly conferred upon it by the state, any contracts made in excess of such authority are ultra vires and in essence illegal.

2. An ultra vires contract which is purely executory cannot be enforced by either party to the agreement.[2]

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[1] National Home Building & Loan Association v. Home Savings Bank, 1889, 181 Ill. 35, 54 N.E. 619; p. 697.

[2] Nassau Bank v. Jones, 1884, 95 N.Y. 115, 47 Am. Rep. 14; p. 698.

3. A contract in excess of charter powers, which is fully executed by both parties, will not be disturbed by the courts.

4. If an ultra vires contract has been fully performed by one of the parties thereto, so that it becomes inequitable and unjust for the other party to retain such performance and to refuse to perform on its part, the majority of the courts will enforce the ultra vires contract. The federal courts and a strong minority of the state courts refuse to enforce the contract even in such cases. They do, however, compel the other party to the agreement to pay the reasonable value of what he has received or to return it. The only essential difference between these two views is that the majority of the courts enforce the agreement, while the minority allow recovery for the reasonable value of the benefit received unless the benefit is returned.

The statutes, in providing for the procedure for creating a corporation, require that its charter be filed, for the purpose of giving public notice of its object and purpose and limitation of powers. Persons dealing with a corporation, therefore, are charged with notice of the extent of its corporate powers, and cannot set up a defense that they had no knowledge that the corporation entered into contracts in excess of such power. However, if persons enter into a contract with a corporation, which is in excess of its corporate powers, under circumstances in which it would be impossible for such persons to have knowledge of the limitations of the corporation, the corporation may be held liable.[3] In other words, if the contract involves a subject matter which may fall within the scope of the business, but, because of the improper use to be made of it in this particular instance, is outside the corporate powers, the contract is unenforceable unless the other party had knowledge of the intended use. A corporation may purchase such real estate as is needed in its business but has no right to purchase it for other purposes. A contract to purchase real estate for speculative purposes is ultra vires, but such a contract would be binding unless the seller knew of the improper use to be made of it. A corporation has power to take title to real estate in excess of its needs, and, once acquired, the corporation's title may not be questioned. Although it may not have the right to purchase and sell real estate, it has the power to do so until it has been enjoined.

Those few states which have adopted the Uniform Business Corporation Act provide that all ultra vires contracts are enforceable. Neither party to such a contract may use ultra vires as a defense. In these states ultra vires conduct on the part of the corporation may be enjoined by the state or any stockholder, but contracts pre-

[3] J. P. Morgan & Co. v. Hall & Lyon Co., 1912, 34 R.I. 273, 83 Atl. 113; p. 699.

viously made are binding whether they be wholly executory, partially executed, or fully performed. In such cases, the directors are liable for losses suffered as a result of engaging in ultra vires activities.

Sec. 71. Ratification of ultra vires contracts by officers and stockholders.—An ultra vires contract cannot be ratified by the stockholders of a corporation. However, some courts hold that all the stockholders may ratify the ultra vires acts of the corporation, where the rights of the public in general or the rights of creditors are not involved.

Sec. 72. Liability for tort.—A corporation, being an artificial person and impersonal, cannot personally commit a tort. But a corporation is liable for the torts of its agents committed in the pursuit of the corporate business, under the laws applicable to principal and agent. Although a corporation has no authority to act outside of the statute creating it or its charter, it has the capacity through its agents to do acts which may cause injury to others; therefore, it is liable for every wrong committed, even though the injury arises out of an act which is ultra vires.[4] A few courts hold, however, that a corporation is not liable for the torts of its employees in ultra vires transactions, even if it has authorized the ultra vires act—but the weight of authority is otherwise. A corporation is liable for fraud committed by its officers or agents within the scope of their authority. It is also liable if the act is apparently within the general authority of the agents. Corporations are not only liable for acts committed by their agents in the pursuit of the corporate business, but they are likewise liable for injury caused by their agent's omitting to perform duties of the corporation. A corporation is liable for the negligence of an agent in failing to keep its property in safe condition.

Sec. 73. Liability for crimes.—A corporation cannot commit crimes which involve intent or personal violence. However, a corporation may be criminally liable for the violation of a law which imposes a duty upon the corporation to do, or not to do, an act. For example, a corporation may be fined for failure to comply with some statute which specifies certain things to be done by the corporation—such as supplying protection for employees and making reports—and for the violation of regulatory statutes under the police power of the state.

A corporation may be indicted for improperly performing an act which it may lawfully do. For example, a corporation may be indicted for conducting a perfectly legal business in such a manner as

[4] Chamberlain v. Southern California Edison Company, 1914, 167 Cal. 500, 140 Pac. 25; p. 700.

to be guilty of maintaining a nuisance. Corporations cannot be held liable for criminal acts involving personal violence, but may be held criminally responsible for failure to comply with statutes which have prohibited certain acts. Corporations have been criminally liable for unlawful conspiracies to restrain trade, for knowingly and fraudulently concealing property under the Bankruptcy Act, and for giving rebates to shippers in violation of federal statutes.[5] Corporations may also be held for contempt of court by reason of acts or omissions of their agents, where they have violated an injunction. The court may punish such corporations by the levy of a fine, the same as against a natural person.

Review Questions and Problems

1. What is meant by an ultra vires act? Is the commission of a tort or a crime an ultra vires act?

2. The *X* Company had no power under its charter to purchase land. It did upon one occasion purchase a small tract of land, but later sold it. May the state cause a forfeiture of the charter of the *X* Company? What are the rights of stockholders where ultra vires acts are being committed?

3. The *X* Company purchases real estate in excess of its needs, but obtains title thereto. Assuming the purchase to be ultra vires, may the grantor have the transaction set aside?

4. A corporation received, under an ultra vires contract, property which it is unable to return. May the unpaid vendor of such property recover for the property sold? On what theory, if any?

5. May ultra vires acts be ratified by the stockholders?

6. Is a corporation liable for torts committed by its agents? May a corporation commit a crime?

7. *X* Company was by its charter authorized to sell fire insurance. Without amendment of its charter, it accepted the premium and issued a policy of hail insurance to *A*. After a loss from hail, *A* sued *X* Company and was met with the defense of ultra vires. Will *A* be able to recover from *X* Company?

8. *A* Company was incorporated for the purpose of manufacturing and selling ice cream. *B* Company was chartered to buy and sell milk at retail and wholesale. *B* Company, without altering its charter, began to manufacture and sell ice cream. *A* Company started an injunction suit against *B* Company, requesting the court to enjoin the latter from manufacturing and selling ice cream. Should the injunction be issued?

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[5] New York Central & H. R. R. Company v. U.S., 1909, 212 U.S. 481, 29 Sup. Ct. 304; p. 701.

Chapter IX

MEMBERSHIP IN CORPORATIONS

Sec. 74. Membership in nonstock corporations.—Where the corporation is a nonstock company, membership is regulated by the by-laws.[1] No one can become a member of such corporation, except in compliance with the method prescribed by the by-laws.

Sec. 75. Membership in stock companies.—Membership in a stock corporation is acquired by a contract with the corporation; this membership is evidenced by a certificate showing ownership of shares of stock. The right to membership may be acquired by a stock subscription before the corporation is created, or by a purchase of shares of stock from the corporation after it is organized, or by a transfer of shares from some person who owns the stock.

Sec. 76. Capital stock and capital.—Much confusion has arisen by reason of the different meanings attributed to the terms "capital stock" and "capital." Strictly speaking, from the viewpoint of the corporation, its capital stock is the expressed equity of the stockholders in corporate assets resulting from their investments before the latter have been influenced by profits or losses. It should equal the amount of money, services, and property paid in or subscribed by the stockholders for the purposes of carrying on the corporate business. It is sometimes said to be the sum fixed in the corporate charter. This amount always remains the same unless changed by an amendment of the charter. However, if the subscriber pays more than par to the corporation for his stock, the excess is usually credited to capital surplus rather than capital stock.

The term capital stock has also been used to mean the representative interest of the shareholders in the total assets of the corporation, measured by its tangible and intangible property, franchise, and good will.

The term capital stock, as used in some statutes for taxation purposes, refers to the total value of the property owned by the corporation. The first of these three views is generally considered to express correctly the true meaning of capital stock.

On the other hand, capital means the net assets of the corporation, including not only the original investment but also all gains and profits realized from the conduct of the corporate business.

[1] The American Live Stock Commission Company v. The Chicago Live Stock Exchange, 1892, 143 Ill. 210; p. 703.

For example, if a corporation is incorporated with a capital stock of $50,000, fully paid, and it makes a profit of $20,000, which is kept in the business and is not distributed as dividends, it has a capital of $70,000. Its capital stock, however, is the $50,000 originally placed in the business.

Sec. 77. Shares of stock.—A share of stock is said to consist of a number of rights which the owner acquires in the corporation. These rights are primarily three in number: the right to share in profits, to participate in the control of the corporation, and to receive a portion of the assets at time of dissolution. A share of stock is representative of an investment made in the corporation, but it gives the holder no right to share in the active management of the business. A share of stock is personal property and in its nature a chose in action, even though the corporation owns nothing but real estate. Like other personal property it falls under the Statute of Frauds, which requires a memorandum in writing to evidence a sale or a contract to sell that involves more than a certain sum of money. Like other personal property a share passes, on the death of a shareholder, to his legal representatives and not to the heirs.

By statute, a share of stock is subject to execution and attachment by creditors of the stockholder. The statutes usually provide the method by which a levy and a sale of a share of stock for the payment of debts are made. A levy or an attachment by a sheriff of a share of stock is not good, unless the sheriff seizes actual possession of the certificate.

Sec. 78. A certificate of stock.—A certificate of stock is a written evidence of the ownership of a certain number of shares of stock of a corporation. The certificate itself is not property, but is merely evidence of the stockholder's right in the corporation. The certificate of stock shows upon its face the character and the number of the shares which it represents and the method of transfer, and may state a part of the contract existing between the shareholder and the corporation, or the other shareholders. A subscriber often becomes a stockholder before the certificate is issued. The certificate merely indicates that the corporation recognizes a certain person as being a stockholder.

Sec. 79. Bonds and shares.—A bond differs from a share of stock in that it is an obligation of the corporation to pay a certain sum of money in the future, at a fixed interest rate. It is generally secured by a mortgage on the assets of the corporation. Thus, a bondholder has a lien upon the assets of the corporation, whereas a stockholder merely has a right to participate proportionately in the assets of the corporation after all creditors have been paid. A

bondholder has no right to vote or to participate in the management and control of a corporation, unless, upon insolvency, such rights are given by contract; whereas a shareholder, in the absence of contractual limitations, has a right to participate in the corporate control.

There are certain contracts with corporations which are difficult to classify. Is the holder of a preferred share of stock, which guarantees a dividend at a given rate and contains a promise of redemption at a given time but which carries no right to vote, a shareholder or a creditor? Similarly, is a bondholder, whose bond draws interest payable only out of profits, and who is subordinated to the claims of general creditors in case of insolvency, and whose bond gives the holder the right to vote in case interest payments are not made, an investor in a corporation or a creditor? The law in regard to these questions has not been made clear at the present time. The answers are determined largely by the terms of the agreement.

Sec. 80. Stock warrants.—A stock warrant is a certificate which gives to the holder thereof the right to subscribe for a given number of shares of stock in a corporation at a stated price. It is usually issued in connection with the sale of other shares of stock, or of bonds, although the law of some states permits the issuance of stock warrants entirely separate and apart from the sale of other securities. Usually the warrants are transferable, although in some cases they are personal only. The option to purchase contained in the warrant may or may not be limited as to time. The warrant has value and can readily be sold on the market only when the option to purchase is at a price which is below the market price of the stock covered by the stock warrant.

Stock Subscriptions

Sec. 81. Stock subscriptions before incorporation.—Where a number of persons subscribe for stock in a corporation to be formed in the future, there is generally no contract between the various subscribers. Unless provided otherwise by statute, it stands as a mere continuing offer by each subscriber to the corporation to take stock when the corporation is formed, and may be revoked at any time before acceptance by the corporation.[2] In some jurisdictions a subscription paper signed by a number of persons, prior to the formation of a corporation, constitutes a binding, irrevocable offer to the corporation, by reason of the mutual promises of the parties, and amounts to a subscription when the corporation is formed.

Subscriptions for shares are often made subject to the happening of certain conditions precedent. The subscriber agrees to take

[2] Hudson Real Estate Co. v. Tower et al., 1892, 156 Mass. 82, 30 N.E. 465; p. 704.

shares conditioned upon the promoter's securing certain other persons to take shares, or upon a certain number of shares being subscribed. Until these conditions are met, the subscriber neither is liable for his subscription nor does he become a stockholder. However, if creditors of the corporation and third parties will be prejudiced thereby, the nonperformance of these conditions will not relieve the subscriber of liability. Unless conditions precedent are written in the subscription contract, they cannot be used as a defense by the subscriber in an action by the corporation.

Certain conditions are inherent in the subscription contract. The subscriber will not be liable unless the corporation is completely organized as a de jure corporation, the full amount of the capital stock has been subscribed in absence of an express agreement to the contrary, and the purpose, articles, and by-laws of the corporation are as originally stated. Conditions express or implied are often waived by the subscriber who, with knowledge of the nonperformance, participates in stockholders' meetings, pays part or all of his subscription, or acts as an officer or director of the corporation.

A distinction must be made between a subscription on a condition and a conditional delivery of a subscription contract. In an action against the subscriber, oral evidence may be admitted that the subscription contract was conditionally delivered and that in absence of the happening of the condition no subscription contract was to come into existence. Such evidence, however, cannot be introduced to show that the subscription was a conditional one if other parties have been misled thereby.

Sec. 82. Subscriptions after incorporation.—A subscription to stock of a corporation already in existence is a contract between the subscriber and the corporation, and such a contract may come into existence by reason of an offer either made by the corporation and accepted by the subscriber or made by the subscriber and accepted by the corporation. If the corporation opens subscription books and advertises its stock, it is seeking for an offer to be made by the subscriber. The corporation may, however, make a general offer to the public, which may be accepted by the subscriber in accordance with the terms of the general offer.

One must exercise care in distinguishing between a present subscription to stock, by which contract the subscriber immediately becomes liable as a stockholder, and a contract to purchase stock. Where the contract is for the purchase of stock, the purchaser does not become a stockholder until a certificate of stock has been delivered to him. Upon the breach of such contract and the tender of the stock certificate by the corporation, recover is limited to damages for failure to purchase. Under a present subscription con-

tract, however, the subscriber is liable upon his promise to pay for the full amount of the stock subscribed, even though the corporation has not tendered the stock certificate.

An underwriter's contract to place a certain block of stock, or, if unable to dispose of it, to purchase it himself, is not a subscription contract. Such an underwriter may, however, be held liable for as much of the stock as he guaranteed to dispose of but was unable to place. For his services in this connection, the underwriter receives a certain commission on stock sold.

Kinds of Stock

Sec. 83. Common stock.—Common stock is the simplest type of corporate stock, and entitles the owner to share in the profits and assets of the corporation in proportion to the amount of common stock he holds. Such a stockholder has no advantage, priority, or preference over any other class of stockholders.

Sec. 84. Preferred stock.—Preferred stock is stock which has a prior claim to dividends, or to assets on dissolution, over other classes of stock. The most important right given to a preferred stockholder is the right to receive a certain specified dividend, although the earnings are not sufficient to pay a like dividend to common stockholders. If the dividend is guaranteed, such preferred stock is sometimes called guaranteed stock. Guaranteed stock, however, does not mean a guaranty of the payment of dividends. It merely means that dividends will be paid if they are earned.

Preferred stock may be provided for by the charter; but, if no provision is made for the issuance of preferred stock by the charter or statute, such stock cannot be issued without the unanimous consent of the common stockholders.

Preferred stock may be cumulative or noncumulative. If the certificate of the preferred stock evidencing the contract provides that the preferred shares shall be entitled to a dividend of a certain per cent annually when earned, and that the arrears, if any, in one year or more, are payable out of the earnings of the subsequent years, the dividends are said to be cumulative. If the dividends are to be paid out of current profits only, the preferred stock is said to be noncumulative. If nothing is said about the payment of the dividends, the stock is cumulative, and preferred dividends and all arrears thereon must be paid before a dividend is declared on common stock.[3] Whether preferred stock is cumulative or noncumulative usually depends upon the statute or the contract on the face of the certificate of stock.

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[3] Fidelity Trust Co. et al. v. Lehigh Valley Ry. Co., 1906, 215 Pa. 610, 64 Atl. 829; p. 704.

Preferred stock may be participating or nonparticipating. If the preferred stock is given the right to share in dividends equally with other classes of stock, after the payment of the preferred dividends, it is generally designated as participating preferred stock.[4] Such participating preferred stock is entitled to dividends, however, only after the common stock has had an equal dividend for the current year. If, however, it is limited in its dividend to a fixed amount, it is designated as nonparticipating preferred stock. The term "participating preferred stock" is also used to designate a preferred stock which gives a preference in the assets on dissolution and liquidation of the corporation, and assures the holder a future right to share with other classes of stock in the assets which remain after all stock has been fully satisfied on the original investment. To determine whether preferred stock has equality in the participation in dividends with other classes of stock, after the payment of its fixed dividend, it is necessary to examine not only the contract evidenced by the stock certificate but also the articles of incorporation, the by-laws, and the statute. In the absence of an agreement, preferred stock has no preference in corporate assets at dissolution.

Sec. 85. Watered stock.—Watered stock is stock which has been issued as fully paid, when in fact its full par value has not been paid in money, property, or services.[5] The capital stock of a corporation represents the total par value of all the shares of the corporation, and the public has a right to assume that the capital stock has all been paid in full, so that the corporation will have assets sufficient to meet liabilities equal to its capital stock. If stock is issued in excess of the actual assets in money value of the corporation, it is said to be watered stock, and original holders of such stock are liable to creditors for its par value.

In suits by creditors against stockholders to force payment on watered stock, it is maintained by many jurisdictions that the capital stock is a "trust fund" for the payment of the corporate debts and that the law implies a promise by the original stockholders to pay their stock in full when called upon by the creditors.

Another basis upon which creditors seek recovery against holders of such stock is called the "holding out" theory. Under this doctrine the right of creditors to compel the holders of bonus stock to pay for it, contrary to their actual agreement with the corporation, rests not upon an implied contract or upon any trust fund doctrine but simply upon the ground of fraud. This right applies only to those creditors who have relied upon the stock as representing actual capital paid in; therefore, payment cannot be enforced against

[4] Scott v. Baltimore & Ohio Ry. Co. et al., 1901, 93 Md. 475, 49 Atl. 327; p. 706.
[5] Handley v. Stutz, 1891, 139 U.S. 417, 35 L. ed. 227; p. 707.

stockholders in favor of those creditors who became such before the bonus stock was issued. In either case, only the original purchaser of the stock is liable. One who acquires it in good faith from the original stockholder has no additional liability.

Sec. 86. No par stock.—The statutes of some states provide that a corporation may issue stock with no par value, the value of the stock being determined by its sale value in the open market. Stockholders and the public will not be injured by this type of stock, because there is no holding out that the stock has any particular face value, and all persons dealing in such stock are under a duty to investigate the corporation's assets and its financial conditions. Stock with no par value represents on its face what proportionate part it is of the total assets of the corporation, but does not indicate the monetary value of the share. The law usually permits the directors to determine what portion of the amount received from the sale shall be credited to the capital stock account and how much, if any, shall be credited to capital surplus.

Sec. 87. Treasury stock.—Treasury stock is that which has been issued by the corporation for value and returned by gift or purchase to the corporation, or to trustees for the corporation to sell. It may be sold below par and the proceeds returned to the treasury of the corporation for working capital. It differs from stock originally issued below par, in that the purchaser is not liable for the difference between par and the sale price. It may be sold at any price the company sees fit.

Transfer of Stock

Sec. 88. Method of transfer.—A share of stock is personal property and the owner has a right to transfer his stock, just as he may transfer any other personal property. It is a marketable commodity and is bought and sold daily on the market. A share of stock is generally transferred by an indorsement and delivery of the certificate of stock. In the absence of statute a share may be transferred or assigned by a bill of sale or by any other method that will pass title to a chose in action or other intangible property. Whenever a share of stock is sold and a stock certificate issued, the name of the owner is entered on the stock book of the corporation. In a small corporation the secretary of the corporation is capable of handling all transfers of stock and the canceling and reissuing of new certificates. This method, however, is inadequate in large corporations where the business of transferring stock has become enormous and complicated. For the purpose of meeting this situation transfer agents are now established and employed by corporations. The transfer agents transfer stock, cancel old certificates, issue new

ones, prepare and keep up to date the names of the stockholders of the corporation, distribute dividends, mail out stockholders' notices, and perform many of the functions normally performed by a corporation secretary. The New York Stock Exchange rules provide that corporations listing stock for sale must maintain a transfer agency and registry, operated and maintained under the rules of the Stock Exchange; similar rules are necessary for stock listed on the New York Curb Market. The registrar of stock is an agent of the corporation whose duty is to see that no stock certificates are issued in excess of the authorized capitalization of the corporation. For every share of stock transferred the old certificate must be canceled and a new certificate issued.

The transfer of stock is an assignment, and in order to make a complete transfer a novation is necessary. A novation is executed when the old stock certificate is surrendered and canceled and a new certificate issued to the transferee and his name entered on the corporate stock book by the corporation through the transfer agent. Consequently, there are two distinct steps necessary to make a perfect transfer of the stock.

First, the certificate is assigned by the transferor to the transferee by the transferor's signing his name in a blank provided on the back of the certificate, and delivering it to the transferee. Second, the transferred certificate is delivered to the corporation or transfer agent and the corporation enters upon the corporate stock transfer book that the transferee has acquired the stock, after which recording the corporation issues a new certificate of stock, certifying that the newly recorded stockholder owns the specified amount of stock. The corporation then cancels the old certificate of stock.

As between the transferor and the transferee, the registration of the transfer is not necessary. As between the stockholder and the corporation, a registration is necessary, in order that the corporation may know who is entitled to the rights of a stockholder. Between the transferor and the transferee, an assignment of stock may be made by a simple delivery of the certificate without writing, by a formal assignment on a separate sheet of paper, or by a formal assignment accompanied by power of attorney authorizing a person to sign the corporation transfer book and record the transfer. Stock may be transferred by the transferor as collateral security, and under such circumstances an assignment on a separate sheet of paper is the usual method.

Many states have adopted what is known as the Uniform Stock Transfer Act. In the main, it provides for the method of transfer

indicated above, the transfer of a certificate from the transferor to the transferee constituting a valid and complete transfer of the shares of stock between the parties without a register of the transfer upon the books of the corporation.

Sec. 89. Limitation upon the right of transfer.—The right to transfer freely one's share in the ownership of the business is inherent in corporate organization. It is one of those features of corporate life which distinguishes it from a partnership. Unmindful of this principle, "closed" corporations often attempt by agreement or by-law to limit the group of potential purchasers. In this effort they are only moderately successful. A corporate by-law which provides that the shares of stock can be transferred only to the corporation or to those approved by the board of directors is unenforceable. It places too severe a restraint upon the alienation of property. Society is best protected when property may be transferred freely from hand to hand. However, an agreement or a by-law approved by all stockholders, to the effect that no transfer of stock shall be made until it has first been offered to the other members of the corporation, is generally enforced. Notice of the by-law or agreement should be set forth in the stock certificate, since an innocent purchaser without notice of the restriction on alienation takes free from it.

Occasionally an officer of a corporation is appointed upon the condition that he will purchase a certain amount of corporate stock. The agreement usually stipulates that, upon the termination of his official relationship, he will resell the stock at a stipulated price to the corporation. Such an agreement has generally been enforced, although, if it is clear that the corporation promises to purchase the stock, some courts suggest that the agreement is illegal. Since a corporation may acquire treasury stock only out of surplus, an agreement to purchase when no surplus exists could scarcely be enforced.

Sec. 90. Improper transfer.—A certificate of stock to which the shareholder's name has been forged is not negotiable. One who purchases such a certificate gains no title to the shares represented by it.[6] An interesting question arises in this connection when the corporation issues a new certificate in reliance upon the forged indorsement. An innocent purchaser of the new certificate clearly has a claim against the corporation. Likewise, the stockholder whose name was forged, not having lost title by the forgery, has an action against the corporation to compel the restoration of his name as a shareholder. The corporation finds its relief in recovery from

[6] Continental Trust Co. v. Stump, 1926, 15 Fed.(2) 464; p. 708.

the person who presented the stock for transfer. One who presents a certificate for transfer warrants that all necessary indorsements are genuine.

Under the Uniform Stock Transfer Act, a stock certificate which has been indorsed in blank is substantially bearer paper. One in possession of it may sell to an innocent purchaser and divest the owner of title. A thief, a finder, or an agent in possession may cause the owner to lose his title by an unauthorized sale. In those states which have not adopted the Act, the weight of authority is probably contra. They hold that a certificate of stock is nonnegotiable, thus giving the purchaser no better title than was held by the person selling it to him.

Sec. 91. Transferor's liability.—Stock which is being paid for at the call of the board of directors may be sold before all of the calls have been made. In such cases the purchaser is deemed to have assumed responsibility for all future calls, and the transferor is relieved of liability. In other words, as soon as the transfer is recorded on corporate records, a novation has been consummated. This is not true when the transfer is made to a financially irresponsible person for the express purpose of eliminating the liability for stock of doubtful value.

As to the calls made previous to the transfer, but which remain unpaid at that time, the transferor remains liable. The liability of the transferee in such a case doubtless depends upon his knowledge or lack of knowledge of the unpaid calls. If the corporation issues a certificate prior to the time when all calls are made, it should not be marked "fully paid and nonassessable." An innocent purchaser of stock thus erroneously marked takes it free from any liability to the corporation for unpaid calls.

Sec. 92. Right of transferee to dividends.—Dividends on stock belong to the person who is owner of the stock at the time the dividends are declared. As to the corporation, the ownership of the stock is determined by the stock register, and the dividends will be paid to the person whose name appears upon the stock book. In the absence of an agreement to the contrary, dividends declared before a transfer of stock, although not payable until a future time, belong to the transferor.[7] But dividends declared after the transfer of the stock, although earned before the transfer, belong to the transferee. However, by agreement between the transferor and the transferee, upon notice to the corporation, the corporation must pay the dividends in compliance with the agreement.

Dividends are often declared as of a certain date and payable to stockholders of record as of a later date. In such cases, a transfer

[7] Hyatt v. Allen, 1874, 56 N.Y. 553, 15 Am. Rep. 449; p. 709.

after declaration but before the record date, carries the dividends to the transferee. There is also some authority to the effect that a stock dividend passes to the transferee unless the contract of sale provides otherwise. Dividends normally become a debt as of the time they are declared, but stock dividends may be rescinded, according to many courts, after they have been declared. Consequently, in the case of cash dividends, the debt is owed to the stockholder at the date of declaration, or record date, whereas in reference to stock dividends no debt exists, since the new issue of stock is transferred to the owner at the time it is issued.

Review Questions and Problems

1. What is the capital stock of a corporation? How is it represented? Distinguish between it and the capital of a corporation.

2. What right does a share of stock give to the stockholder? Is it personal or real property? What is the difference between a share of stock and a certificate of stock?

3. *A* is a bondholder in the *D* Company. Under ordinary conditions does he have any right to participate in the control of the business? Has a bondholder any security for his bond?

4. The *X* Company has both preferred and common stock. The preferred stock is 7 per cent stock. The company declares a 7 per cent dividend on the preferred stock and then declares a 10 per cent dividend on the common stock. Under such conditions, have the preferred stockholders a right to demand 10 per cent?

5. *A*, along with a number of others, subscribes for stock in anticipation that a corporation will later be formed. Before incorporation takes place, he notifies the incorporators that he withdraws his subscription. May he legally do so? Suppose the subscription had been made after incorporation?

6. What is meant by cumulative preferred stock? Would you rather own cumulative or noncumulative preferred stock? Is the preferred stockholder, in the absence of an agreement, entitled to a preference at dissolution?

7. The *X* Company purchased an invention from *A* and paid for it by the issuance of $100,000 of common stock. As a matter of fact the invention was worth only $50,000, but the directors honestly believed that it was worth $100,000. May the creditors recover an additional $50,000 from *A*?

8. What is no par stock? At what price may it be sold? What are its advantages?

9. How is stock usually transferred? Suppose the transferee fails to have the transfer recorded until after a dividend is declared; does it affect his right to the dividend? To whom would the company usually pay such a dividend?

10. *A* became a transferee of sixty shares of stock in a corporation

which issued its stock marked fully paid and nonassessable upon the payment of 70 per cent of its par value. Assuming that *A* knew the conditions surrounding its issuance, is he liable to creditors in case of insolvency? Suppose he had been an innocent purchaser?

11. Explain the necessity for stock transfer agents and registrars.

12. *A* held a certificate of stock for twenty shares in *X* Company, which was stolen. His indorsement was forged, and the certificate was transferred to *B*, an innocent purchaser. *B* obtained a new certificate from the company in his name and sold it to *H*, an innocent purchaser. What are the rights of *A*, *H*, and *X* Company?

13. *Y* Company on March 1 declared a cash dividend of 5%, payable on June 1 to all stockholders of record on May 1. On April 10, *A* sold ten shares of stock in *Y* Company to *B*, although the transfer was not recorded on the corporation's books until May 15. To whom will the company pay the dividend? As between *A* and *B*, who is entitled to the dividend?

Chapter X

RIGHTS OF STOCKHOLDERS

Sec. 93. Right to inspect books.—A stockholder of a corporation has the right to inspect the books and papers of the corporation for proper purposes at the proper time and the proper place. The inspection, however, must be made with a justifiable motive and not through idle curiosity or for purposes which in any way interfere with the corporate management. The business hours of the corporation are the reasonable and proper hours in which a stockholder is entitled to inspect the books. The right to inspect the books is sometimes expressly given by the statute, the constitution, the charter, or the by-laws of the corporation. This statutory privilege gives a stockholder an absolute right to inspect the books, but most courts hold that it cannot be exercised where its purpose is improper or unlawful or merely to satisfy one's idle curiosity. Other courts hold that the motive of inspecting the books is immaterial, and that the corporation has no right to question the reason for which the books are being inspected.

Sec. 94. Right to attend meetings and to vote.—By virtue of the ownership of a share of stock, the stockholder has a right to attend meetings and to cast his vote for the election of directors and for the determination of corporate policies. A further treatment of this subject will be given under the chapter on Management of Corporations.

Sec. 95. Right to share in profits and dividends.—A stockholder has a right to share pro rata with the other stockholders in the profits of the corporation when a dividend is declared. Whether or not a dividend is declared is within the discretion of the board of directors. The stockholders of a corporation are not entitled to the payment of a dividend whenever an earned surplus exists. The board of directors, at its discretion, may see fit to continue the profits in the business for the purpose of extension and improvements. A board of directors, however, must act reasonably and in good faith. Where such is not the case and there are profits out of which dividends may be declared, the stockholders may compel the board of directors to declare dividends.[1] It must be clear, however, that the board of directors has, illegally, wantonly, and without justification, refused to declare a dividend before the stockholders have a right to interfere.

[1] Dodge et al. v. Ford Motor Co. et al., 1919, 204 Mich. 459, 170 N.W. 668; p. 710.

When a dividend is declared, it becomes a debt of the corporation and will be paid to the person whose name appears on the corporate stock books as the owner of the share, unless the corporation has received notice of a transfer. A cash dividend, once its declaration has been made public, may not be rescinded, although there is some authority for rescinding a stock dividend.

Sec. 96. When dividends may be declared.—The statutes of the various states governing the declaration of dividends appear to follow two distinct patterns. The first group of states, apparently codifying the common law, provide that dividends can be declared only out of net profits. Under this rule it seems safe to say that dividends may be declared out of current profits even though a deficit has arisen from the operation of previous years. Capital surplus or surplus arising from the appreciation of fixed assets would not appear to be available under the law of these states.

The other group of states, representing perhaps a majority, determine the legality of a dividend by its effect upon the capital stock. A declaration of dividends is proper so long as it does not impair the capital stock. Any declaration, however, which reduces the net assets of the corporation below the outstanding capital stock is illegal. Under this view it would seem that capital surplus and surplus created by an appraisal of fixed assets might be available for dividends. The law in this regard is not at all definite, but the Uniform Business Corporation Act, which has accepted the majority view, makes capital surplus available for dividends. It limits the use of surplus arising from appreciation of fixed assets to stock dividends. Such a surplus is not available for other uses in those states which have adopted the Act.

In general, under either theory, dividends are permissible only after provision has been made for all expenses, including ample allowance for depreciation. In those industries dealing with wasting or depleting assets, such as mines and oil wells, it is not necessary to care for the depletion before declaring dividends.

The directors in many states are personally liable to creditors for dividends improperly declared in case the corporation later becomes insolvent. The stockholders who receive such dividends may be compelled to return them. In a few of the states, statutes make the stockholders liable only if they received them in bad faith and directors liable only if they acted carelessly or in bad faith.

Kinds of Dividends

Sec. 97. Cash dividend.—It is customary to pay dividends in cash. The amount paid is usually a certain percentage of the outstanding stock of the particular class involved. The amount re-

ceived by each stockholder varies with the amount of stock owned by him.

Sec. 98. Scrip dividend.—A scrip dividend is a certificate issued to the stockholder, when the board of directors has declared dividends out of profits which are represented by property other than money. Such a dividend is issued where the directors anticipate the time when the property may be sold for cash, and the cash distributed as a money dividend. The certificate gives the stockholder a right to share according to his stock in the cash derived from the sale of the property set aside as a dividend. These certificates sometimes draw interest, and are occasionally convertible into bonds or stocks of the corporation. Such scrip certificates do not pass title to the property to stockholders, but merely give them the right to receive the proceeds from the sale of the property. They partake of the nature of stock dividends, but do not carry voting power.

Sec. 99. Property dividend.—A property dividend is one made in property rather than in cash. A corporation owning stock in another corporation may issue such stock to its stockholders as property dividends. In some jurisdictions, however, a stockholder may insist upon the payment of his dividend in cash rather than in property. This is particularly true of a preferred stockholder. The dividend on preferred stock must usually be paid in cash if the stockholder demands it.

Sec. 100. Stock dividend.—A stock dividend is an issue of stock to the stockholders, based upon accumulated assets of the corporation over and above the capital stock. Instead of declaring a cash dividend, the stockholders may authorize an issue of additional stock out of the surplus and thus increase the capital stock of the corporation. This type of dividend payment is often resorted to where the corporation has used the earnings and profits for extensions and improvements of the business. In some states, the declaration of stock dividends is limited or prohibited by statute. It is improper in many states to declare a dividend of preferred stock on common stock or of common stock on preferred stock. The stock dividend should be in stock of the class which is to receive it. Generally the purpose of a stock dividend is to capitalize the surplus profits of the corporation. If the stock dividend exceeds the surplus, it is an issue of bonus stock, and the holders will become liable to subsequent creditors for a sum equal to the par value. A stock dividend is not taxable as income of the stockholder. It is merely a subdivision of the property value to which the stockholder is already entitled. Where stock entitled to such a dividend is held by a trustee for the benefit of a life tenant, the remainder to be paid

over to another after the death of the life tenant, a question arises as to who is entitled to the stock dividend.[2] Under the general rule, if the stock dividend has been earned before the life estate was created, it is held to be principal, irrespective of the time when the dividend was declared. It thus belongs to the principal or corpus and is not an income for the benefit of the life tenant. If, however, the fund out of which the stock dividend is declared was earned after the creation of the life estate, it is held that the dividend is income and belongs to the life tenant. If it was earned partly before and partly after the creation of the life tenant, an apportionment of the amount is usually made. Some courts, however, hold that stock dividends are part of the corpus itself, and do not belong to the life tenant, irrespective of when earned.

Sec. 101. Bond dividend.—A corporation may issue dividends of its own bonds, if the capital stock is not impaired or the rights of creditors are not interfered with. Such a dividend, however, cannot be issued until after the corporate debts have been satisfied.

Sec. 102. Right to preference upon the increase of capital stock.—The capital stock of a corporation is fixed by the charter, and it cannot be increased except by express authority from the state creating the corporation. The stockholders and not the directors must authorize an increase in the capital stock. Such an authorization must be made by amendment of the charter in compliance with the statute providing for changes in the corporation.

When an increase in the capital stock has been properly authorized, the existing stockholders have a prior right against third parties to subscribe to the increased capital stock.[3] This right is called the stockholder's *preëmptive* right and is based upon the stockholder's right to protect and maintain his proportionate control and interest in the corporation. Thus, if a class of stock has no voting power and is nonparticipating, it is questionable whether such preëmptive right exists. This right may be limited or waived by contract and by provisions in the charter or by-laws of the corporation. It is not applicable to treasury stock.[4] It is applicable to new authorizations of stock and perhaps to new allotments of stock previously authorized, particularly if the new allotment of an original authorization takes place some time after the original issue. Some states approve the issuance of stock to employees without regard to the preëmptive right. Whether or not a stockholder must pay more than par value for the increased stock varies in the different

[2] Soehnlein v. Soehnlein, 1911, 146 Wis. 330, 131 N.W. 739; p. 712.
[3] Jones v. Morrison, 1883, 31 Minn. 140, 16 N.W. 854; p. 713.
[4] Crosby v. Stratton, 1902, 17 Colo. A. 212, 68 Pac. 130; p. 714.

states. Some states hold that he can be compelled to pay more, and other states hold that he cannot.

Sec. 103. Right to sue for injuries to the corporation.—A stockholder cannot maintain an action at law for injuries to the corporation, because the corporation is a legal entity and by law has a right to bring a suit in its own name. A stockholder cannot bring a suit at law for and in behalf of the other stockholders for injury to the corporation.[5] Neither can a stockholder bring a suit in law against the directors or other officers of the corporation for negligence, waste, and mismanagement in the conduct of the corporate business, although such conduct is injurious to the stockholder. The right to sue for injuries to the corporation rests strictly with the corporation itself.

A stockholder may, however, bring a suit in equity to enjoin the officers of a corporation from entering into ultra vires contracts or from doing anything that would impair the stockholders' rights in the corporate assets. Likewise, the stockholder has a right to bring suit in equity for or on behalf of the corporation itself, if the officers are acting outside the scope of their authority, are guilty of negligent conduct, or are engaging or are about to engage in fraudulent transactions with other stockholders in such a way as to be injurious to the corporation itself.

Before a stockholder may enter into a suit in equity for and on behalf of the corporation, he must show that he has done everything possible to secure action by the managing officers and directors and that they have refused to act. Any judgment received in such an action benefits the corporation and only indirectly the stockholder who initiates the action. He is permitted, however, to recover the expenses involved in the suit.

Review Questions and Problems

1. The *X* Company was engaged in the business of manufacturing patent medicines. *A*, who was a stockholder in the company, was engaged in a competitive business. *A* desired to inspect the books of the *X* Company for the purpose of obtaining a list of the customers. Had he a right to do so?

2. What is a stock dividend? What is its effect upon the assets of the corporation?

3. The *X* Company had a surplus of $5,000,000 and had made plans for extensions and improvements which would require the expenditure of $3,000,000. Assuming that the directors could not show a need for further improvements, might *A*, a minority stockholder, by proper action, have forced the directors to declare a dividend?

[5] Ames v. American Telephone & Telegraph Co., 1909, 166 Fed. 820; p. 715.

4. The directors of the *X* Company declared a dividend when there were insufficient profits and surplus to pay it, although, at the time, the remaining assets were more than sufficient to pay liabilities if stock was not regarded as a liability. The corporation soon became insolvent. Could the creditors have recovered the amount of the dividend from the directors?

5. A corporation, by its proper officials, increases its capital stock by 50 per cent. What are the rights of existing stockholders?

6. The directors of a corporation, by reason of misconduct and negligence, have wasted the assets of the corporation. May a stockholder of the corporation recover from them in the name of the corporation for the losses caused by the directors' negligence? What should he do first?

7. What is a scrip dividend? What is a property dividend? When would a property dividend be used?

CHAPTER XI

MANAGEMENT OF CORPORATIONS

Sec. 104. In general.—Regulation and control of a corporation rest in the stockholders. The majority of the stockholders, by vote, has a right to bind the corporation and all its members in any transaction or proceeding within the scope of the corporate powers as authorized by the corporate charter.[1]

The charter may, however, vest control and management of the corporation exclusively within the board of directors. The power of the stockholders is then limited to the extent of securing a new board of directors, if they are not satisfied with the acts of the present board.

The extent of the powers of the corporation is defined by the statute creating the corporation and by its charter. The by-laws regulate the conduct and define the duties of the officers and the members between themselves and the corporation, with respect to carrying out the powers given to the corporation by the state.

Sec. 105. By-laws.—A by-law is a rule of conduct which regulates and defines the duties of the members and the officers of a corporation among themselves. Every corporation has implied power to enact by-laws for the purpose of carrying out the power conferred upon it by the state. These by-laws must not violate any rules of law; they must be general in their nature and must not be directed toward the conduct of any particular individual. The by-laws are binding upon all the stockholders. They must be consistent with the purpose and objects for which the corporation is created and are not binding upon third persons unless third persons have knowledge of such rules.

The stockholders have power to amend, to add to, and to repeal the by-laws to the same extent as they have power to create by-laws in the first instance. They cannot, however, repeal, amend, or add to the by-laws, where such change will affect the vested rights of a stockholder.

The stockholders may delegate to the board of directors the right to adopt new by-laws, or to repeal or to add to them. The board of directors, however, cannot change the by-laws with respect to limitation or power or duty given to them by the stockholders.

The by-laws usually provide for the number of officers and directors, the method of electing them, and the enumeration of their

[1] Hodge et al. v. U.S. Steel Corporation, 1903, 64 N.J. Eq. 807, 54 Atl. 7; p. 717.

duties. They also specify the time and place of the meetings of the directors and the stockholders. If the corporation is a nonstock corporation, the by-laws specify the requirements and the method for membership.

Sec. 106. Stockholders meetings.—Action by the stockholders normally binds the corporation only when taken in regular or properly called special meeting, after such notice as is required by the by-laws or statute has been given. However, it is generally conceded that action approved informally by all stockholders will bind the corporation. Unless otherwise provided by statute, notice of regular meetings need not be given if the by-laws provide for a definite place and time of meeting. Most by-laws and many state statutes provide that notice must be given of regular as well as special meetings.

Notice of a called meeting must include a statement concerning the matters to be acted upon at the meeting, and any action taken on other matters will be ineffective. If unusual action, such as a sale of corporate assets, is to be taken at a regular meeting, notice of the meeting must call attention to that fact.

Failure to give proper notice of a meeting generally invalidates the action taken at the meeting. A stockholder who, having failed to receive notice, attends and participates in a meeting is said to waive the notice by his presence.

A quorum of stockholders must be present in order to transact business, such quorum being a majority of the voting shares outstanding, unless some statute or the by-laws provide for a smaller percentage. Affirmative action is approved by majority vote of the shares present at a meeting, providing a quorum exists. There are certain unusual matters, such as merger or sale of all corporate assets, which, at common law, required unanimous vote. Today, statutes usually provide that such action can be taken by vote of two-thirds or three-fourths of the stockholders. Many of these statutes also provide that the dissenting shareholders have the right to surrender their shares and receive their fair value in case they disapprove of the action taken.

Sec. 107. Voting.—Every member of a corporation is entitled to vote. In nonstock companies the members are entitled to one vote. In stock companies the members are entitled to as many votes as they own shares of stock.[2] The stockholder whose name appears upon the corporate record is usually designated by the by-laws as the person entitled to vote. Preferred stockholders, by their contract with the corporation, may not be entitled to a vote. All jurisdictions hold, however, that every stockholder, whether

[2] State ex rel. White v. Ferris, 1875, 42 Conn. 560; p. 717.

preferred or not, is entitled to vote unless agreed otherwise. A stockholder cannot be deprived of a right to vote by a by-law. However, unless expressly prohibited by statute, the corporation may issue stock in the future, either common or preferred, and specify that the holder shall not vote.

The statutes of some states provide that a stockholder, in the election of directors by cumulative voting, may cast as many votes for one candidate for a given office as there are offices to be filled, multiplied by the number of his shares of stock; or he may distribute this same number of votes among the candidates as he sees fit.

A stockholder is entitled to vote only by virtue of his ownership in the stock, and, under the common law, this right can only be exercised in person. However, by statute, or the charter, or the bylaws, a stockholder may specifically authorize another to vote his stock. This authorization is made by power of attorney and must specifically state that the agent of the stockholder has power to vote his principal's stock. This method of voting is called voting by proxy. It is a personal relationship, and may be revoked at any time by the stockholder before the authority is exercised. The laws relative to principal and agent control this relationship.

A stockholder, unlike a director, is permitted to vote on a matter in which he has a personal interest. In certain respects he represents the corporation welfare in his voting, whereas in other respects he votes in such a manner as he thinks will best serve his interest. The majority of stockholders may not take action, however, which is clearly detrimental to the corporation and minority interests. This becomes particularly significant when the majority of the shareholders also own most of the stock of an allied or related enterprise and seek to operate the first corporation in such a manner as to profit the second at the expense of the first. If it is clear that the affairs of the first corporation are being mishandled in order to benefit the second, such action may be enjoined by the minority interests.

Sec. 108. Voting pools and trust agreements.—Various devices have been used whereby minority interests or a group of stockholders may effectively control a corporation. The creation of a holding company, the issuance of non-voting shares or the issuance of shares with voting rights but with a small or nominal par value, voting pools and voting trusts, have all been utilized for this purpose, and in general all of them are effective means for obtaining control. A voting pool arises whenever a number of stockholders agree to vote their stock as a unit in accordance with a certain plan. Such an agreement is enforceable unless the purpose to be accomplished is improper.

A voting trust develops from the transfer of title of their shares by various stockholders to a trustee for the purpose of voting the stock. The stock is then registered in his name, he votes at the meetings of shareholders, and receives dividends as they are declared. He issues to each stockholder, whose stock he holds, a certificate of beneficial interest which entitles the owner thereof to have his shares returned at the termination of the trust and to receive dividends within a given time after they are paid. Some courts have held voting trusts unenforceable because they tend to separate ownership from control and management. Many of the courts, including most of those rendering recent decisions, enforce the trust agreement unless its objectives are improper or the period of its continuance unreasonably long.[3] The Uniform Business Corporations Act sets a limit of ten years upon voting trusts.

Directors

Sec. 109. Qualifications and powers.—The directors of a corporation are, with the possible exception of the first board, elected by the stockholders. In a few states, the corporate charter names the first board of directors. In the absence of a provision in the charter, by-laws, or statute, it is not essential that directors hold stock in the corporation. Since they are to supervise the business activities, select key employees, and plan for the future development of the enterprise, they are presumably elected because of their business ability.

The directors have power to take such action as is necessary in the ordinary business activities of enterprises of the type being managed. They may not exceed the power granted to the corporation by its charter, amend the charter, approve a merger, or bring about a consolidation with another corporation. Charter amendments, consolidations, and mergers require the approval of a rather large percentage of the stockholders.

Directors are presumed to be free to exercise their independent judgment upon all matters presented to them. Consequently, their management of the business cannot be interfered with by action on the part of the stockholders.[4] Similarly, any contract made by a director with a stockholder concerning a particular matter before the board is contrary to public policy and unenforceable. Free and independent action by directors is required for the best interests of the corporation itself as distinct from the interests of a few stockholders.

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[3] Clark v. Foster et al., 1917, 98 Wash. 241, 167 Pac. 908; p. 718.

[4] Charlestown Boot and Shoe Co. v. Dunsmore et al., 1880, 60 N.H. 85; p. 719.

Sec. 110. Meetings.—The statute, charter, and by-laws usually provide for the number of directors. In most cases, not less than three directors are required. Since the board of directors must act as a unit, it is necessary that it assemble at board meetings.[5] The by-laws usually provide for the method of calling directors' meetings and for the time and the place of meeting. A record is usually kept of the activities of the board of directors, and the evidence of the exercise of its powers is usually stated in resolutions kept in the corporate record book. A majority of the members of the board of directors is necessary to constitute a quorum. Special meetings are proper only when all directors are notified or are present at the meeting. Directors may not vote by proxy, having been selected as agents because of their personal qualifications.

Sec. 111. Liabilities of directors.—Directors are said to stand in relation to the corporation as trustees, for both the corporation and the stockholders. However, they are not trustees in the strict sense. They are agents with more than the usual authority of an agent.[6] Therefore, a director occupies a position of trust and confidence with respect to the corporation, and cannot, by reason of his position, directly or indirectly derive any personal benefits that are not enjoyed by the corporation or the stockholders. All secret profits obtained by a director in the pursuit of the corporate business must be accounted for to the corporation.

A director may contract with the corporation which he represents, but he is subject to the same limitations that an agent is in dealing with his principal. He is required to disclose his interest in all contracts and, because of his fiduciary relation, to volunteer all pertinent information regarding the subject matter involved. Furthermore, he is forbidden to vote as a director on any matter in which he has a personal interest. Even though his vote is not necessary to carry the proposition considered, most courts consider the action taken to be voidable. Some courts go so far as to hold that, if he is present at the meeting, favorable action will not be binding. Clearly, if his presence is required to make a quorum, no transaction in which he is interested should be acted upon. These rather severe rules are enforced so that directors will not be tempted to use their position to profit at the expense of the corporation.

Directors are personally liable when they willfully misuse their power and misapply the funds of the corporation. They are also personally liable where they issue stock as fully paid when it is not paid in full. They are not liable, however, for accidents and mis-

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[5] Baldwin et al. v. Canfield, 1879, 26 Minn. 43, 1 N.W. 261; p. 720.

[6] Briggs v. Spaulding, 1890, 141 U.S. 132, 35 L. ed. 662; p. 721.

takes of judgment or for losses, if they have acted in good faith and have exercised ordinary care, skill, and diligence.

The directors, although holding a fiduciary relation to the corporation, have no such relationship with the individual stockholders. In a sale of stock by a stockholder to a director, they deal at arm's length. The director who, because of his relation to the corporation, is in a position to know many factors which affect the value of the stock, is not obligated to volunteer such information to the stockholder. There is a strong minority view and a tendency in recent decisions to support a fiduciary relationship.

Sec. 112. Compensation.—In the absence of a stipulation in the charter or by-laws, directors receive no compensation for their services as such. If they do work not recognized as falling within the duties of a director, they may recover for the reasonable value of their services. Directors who are appointed as officers of the corporation should have their salaries fixed at a meeting of the shareholders or in the by-laws. Since directors are not supposed to vote on any matter in which they have a personal interest, it is difficult for director-officers of small corporations to fix their rate of compensation. Any action to determine salaries should be ratified by the stockholders in order to insure the validity of the employment contracts.

Review Questions and Problems

1. A majority of the stockholders of a corporation happen to meet at the corporation offices. While there, they hold a meeting and transact certain corporate business. Are their actions effective?

2. Who usually has power to adopt or to alter by-laws?

3. *A* holds a certificate of stock for five shares in the *X* Company. How many votes is he entitled to cast at a stockholders' meeting? Does a preferred stockholder have a right to vote?

4. May a stockholder vote by proxy? May he terminate the proxy whenever he desires? May a director vote by proxy?

5. With whom does the management of a corporation usually rest? Who usually elects the officers and selects the employees of the corporation?

6. *A*, a stockholder in a corporation, desires to sell certain real estate to the corporation. He is present at the meeting of the stockholders when the matter is considered and votes in favor of the purchase. Assuming that a majority favors the purchase, has a minority stockholder any right to object? Suppose *A* had been a director and the matter had been before a meeting of the board of directors?

7. What is the purpose of a voting pool?

8. Name the various methods used to gain control of corporate management through voting power.

9. *A, B,* and *C* are directors of a small corporation and, as such, appoint themselves as officers of the corporation at fabulous salaries. May they later be made to account to the corporation for any amount received in excess of the reasonable value of their services?

10. *A* was elected director of a certain corporation by the majority interests upon his promise to vote for *B* as the general manager. Was *A*'s promise enforceable?

CHAPTER XII

DISSOLUTION OF A CORPORATION

Sec. 113. Expiration of charter.—Corporate existence may be terminated by the expiration of its charter, through dissolution by the attorney general, by consolidation, or by action of the stockholders.

Where the charter provides that the corporation shall exist for a definite period, it automatically terminates at the expiration of the period. However, upon application, a rule for the continued existence of the corporation may be made.

Sec. 114. Dissolution by attorney general.—The attorney general of the state is the only person authorized to forfeit a charter. The state, having brought the corporation into existence, has a right to forfeit the charter. Neither a stockholder, a corporate creditor, nor any other governmental agency can bring a suit to forfeit a corporation charter. If a corporation misuses its power, or enters into illegal acts, such as combinations in restraint of trade, or ceases to perform its corporate functions for a long period of time, the attorney general may institute a suit for the purpose of forfeiting the corporate charter. A suit by the state to forfeit a corporate charter is called a quo warranto proceeding.

Sec. 115. Consolidation and merger.—Consolidation is the uniting of two or more corporations, by which a new corporation is created and the old entities are dissolved. The new corporation takes title to all the property, rights, powers, and privileges of the old corporations, subject to the liabilities and obligations of the old corporations.[1]

In a merger, however, one of the corporations continues its existence, but absorbs the other corporation, which is merged into it. Whether the creditors of the absorbed corporation become the creditors of the absorbing corporation depends upon the solvency of the absorbed corporation and the inability of its creditors to find attachable assets. The continuing corporation may expressly or impliedly assume and agree to pay the debts and liabilities of the absorbed corporation. If so, such creditors become third party creditor beneficiaries. By statutes in many states the surviving corporation is deemed to have assumed all the liabilities and obligations of the absorbed corporation. The statutes of the various

[1] Pullman's Palace Car Co. v. Missouri Pac. Ry. Co., 1885, 115 U.S. 587, 29 L. ed. 499; p. 722.

states provide the methods for corporate consolidation and merger.

Sec. 116. Dissolution by the stockholders.—A corporation can be dissolved by the consent of all the stockholders, and by less than all of the stockholders if it is insolvent. If the corporation is insolvent, it may be dissolved upon application to the state which created it. Under these circumstances, a court usually appoints a receiver to marshal the assets and to make distribution to the creditors.

Upon dissolution, all the corporate property, both personal and real, is first used to pay corporate debts. After the debts are paid, the remainder is to be distributed among the stockholders in proportion to the capital stock they own. The liability of the stockholders, upon dissolution, ceases as to any further business. Where a receiver has been appointed and it is necessary to carry out contracts not yet completed, the corporation still remains liable for the performance of its executory contracts.

Rights of Creditors

Sec. 117. Right against corporate assets.—The corporation stands in the same position as a natural person, with respect to creditors. A suit may be brought against it and, upon judgment being obtained, an execution may be levied against its property, which may then be sold. Likewise, corporate assets may be attached, and, if the corporation has no property subject to execution, its assets may be traced by a bill in a court of equity.

The creditors have no right, because they are creditors, to interfere with the management of the business.[2] A creditor who has an unsatisfied judgment against a corporation, because there is no corporate property upon which a levy can be made, may bring a bill in equity to set aside conveyances and transfers of corporate property which have been fraudulently transferred for the purpose of delaying and hindering creditors.[3] Creditors may also, under the above circumstances, ask for a receiver to take over the assets of the corporation and to apply them to the payment of debts.

Sec. 118. Right against stockholders.—Stockholders are not liable for the debts of the corporation. This distinction is the essential feature in which a corporation differs from a partnership. Each member of a partnership is liable for the debts of the firm. The members of a corporation, on the other hand, are not liable for the debts of the firm.

If the members of a corporation have not paid their stock in full,

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[2] Hollins et al. v. Brierfield Coal & Iron Co., 1893, 150 U.S. 371, 37 L. ed. 1113; p. 722.

[3] Graham v. La Crosse & M. R. R. Co., 1880, 102 U.S. 148, 26 L. ed. 106; p. 723.

however, the creditors, after exhausting the assets of the firm, may look to the stockholders for their unpaid balance. This is the limit of the liability of the members of a corporation.

But the statutes of many states have increased the liabilities of stockholders to corporate creditors. That is, the statutes provide that the stockholders shall be liable for a sum in addition to the par value of their stock. This additional liability is known as the statutory liability of stockholders. A few states, by statute, attach additional liability to stockholders of manufacturing corporations. Some attach liability equal to the par of the shares in banking and trust companies. The stockholders will be liable to the creditors, if the capital stock has been distributed among the stockholders before the creditors have been paid, and the creditors can reach the assets of the corporation in the hands of the stockholders, on the theory that the assets have been transferred in fraud of creditors.

Review Questions and Problems

1. The majority of the stockholders of a corporation, being interested in a rival concern, vote to dissolve the corporation. Can it be dissolved without the consent of the minority? Suppose the corporation had been insolvent?

2. The *X* Company, for a number of years, has failed to perform any of the duties authorized by its charter. Who is the proper person to dissolve it?

3. May the creditors of an insolvent corporation recover from the stockholders after the corporate assets have been exhausted?

4. The stockholders of a corporation sell some of the corporation property and divide it equally among the stockholders. Later, the corporation becomes insolvent. Can the creditors force the stockholders to return the amount which they received?

PART III
MISCELLANEOUS BUSINESS ORGANIZATIONS

Chapter XIII

Sec. 119. Introduction.—Most of our business is conducted by individual proprietorships, partnerships, and corporations. A few of the other types should, however, be given some consideration. The most important of these are the limited partnership, the joint stock company, and the business trust. In the sections which follow, it is proposed to consider briefly their organization and the extent to which the owners have personal responsibility for obligations which are incurred.

Limited Partnerships

Sec. 120. Definition.—A limited partnership is one which comes into existence by virtue of an agreement. A limited partnership, like a corporation, is authorized by statute. Limited partnerships are so called because the liability of one or more of the partners, but not of all, is limited to the amount of capital contributed at the time of the creation of the partnership. It is similar to a corporation in that its right to exist is accorded by statute, and that the limited partners, like stockholders, are liable only to the extent of their original investment.

Sec. 121. How formed; statutory requirements.—A limited partnership may be formed by two or more persons, having one or more general partners and one or more limited partners. Under the Uniform Limited Partnership Act, which has been adopted by most of the states, with variations, two or more persons, to create a limited partnership, must sign and swear to a certificate containing the following information: the name of the partnership; the character of the business; the location; the name and place of residence of each member; those who are to be the general and those who are to be the limited partners; the term for which the partnership is to exist; the amount of cash or the agreed value of property to be contributed by each partner; the additional contributions, if any, to be made from time to time by each partner; the time that any such contributions are to be returned to the limited partner; the share of profit or compensation which each limited partner shall receive; the right that a limited partner has to substitute an assignee of his interest; the right to admit additional limited part-

ners; the right given to one or more of the limited partners to priority over other limited partners as to contributions, and compensation by way of income; the right of a limited partner to demand property rather than cash in return for his contribution; and the right of the remaining general partners to continue the business on death, retirement, or incapacity of other partners.

Sec. 122. Filing and publication of certificate.—The certificate must be recorded in the county where the partnership has its principal place of business, and a copy must be filed in every community where it conducts business or has a representative office. To determine the requirements of recording, it is necessary to consult the statutes of the various states.

In nearly all the states, it is required that the certificate be published in some newspaper during a specified period of time before the beginning of business. It is also required in some states that proof of publication be made by affidavit of the publisher, and filed with the certificate. If such certificate is not filed and recorded, with the affidavit relative to publication, a limited partnership is not considered as organized.

Upon the expiration of the partnership, a new certificate must be filed in compliance with the statutory requirements for a new organization. Likewise, if there is any alteration in the original certificate, such as a change in the name of the partnership, the capital, or other matters, a new certificate must be filed. If such certificate is not filed and the partnership continues, the limited partners immediately become liable as general partners.

Sec. 123. Name of partnership.—The statutes of most states require the partnership to conduct its business in a firm name which does not include the name of any of the limited partners or the word "Company." Some states specify that the word "Limited" shall be added. In some jurisdictions no liability will attach to the limited partners unless creditors are misled or injured by the failure of the firm to use the word "Limited" or by the use of the word "Company." Some states also provide that the partnership shall post in some conspicuous place the name of the firm, including the names of all the members therein.

Sec. 124. Liability of limited partner.—A limited partner is not liable beyond his contribution to creditors created by the partnership in the pursuit of the partnership business, unless the limited partner participates in the management and control of the business.

Sec. 125. Dissolution.—A limited partnership cannot be dissolved voluntarily before the time for its termination as stated in the certificate, without the filing and publication of the notice of the dissolution. Upon dissolution, the distribution of the assets

of the firm are prescribed in the statute, and priority among partners with respect to their share in the assets is controlled by the statutory requirements in the several states which have adopted the Uniform Limited Partnership Act.

Joint Stock Companies and Business Trusts

Sec. 126. Joint stock companies.—A joint stock company is a business arrangement which provides for the management of the business to be placed in the hands of trustees or directors. Under the constitution or by-laws of the organization, shares represented by certificates are issued to the various members, who are joint owners in the enterprise. These shareholders elect the board of directors or trustees. The shares are transferable, the same as the shares of a corporation, and such transfer does not cause dissolution. Likewise, the death of one of the shareholders does not dissolve the organization. It exists for the period of time designated in the by-laws. Such an association is a partnership, even though the primary purpose of such an arrangement is to secure many of the advantages of a corporation.[1] Unlimited liability continues, but in many other respects the features of a corporation are present.

Sec. 127. Business trusts.—The business trust is an organization formed by trustees under a contract, called a declaration of trust, executed by the trustees. Under the agreement, the trustees issue certificates of beneficial interest, which are sold to investors.

The trustees take the capital in compliance with the agreement and operate the business, whatever it may be, as principals, for the benefit of the shareholders. Such an organization has many of the characteristics of a corporation, in that the trustees elect officers from among themselves, and in some states the shareholders at stated meetings, by virtue of the trust agreement, are permitted to elect the trustees.

Such an organization avoids the statutory regulations of a corporation, in that it is not a creature of the state, and seeks as well to avoid partnership liability on the part of the investors. The courts in most of the states, however, have held that if the investors under the trust agreement have a right to exercise some control over the management of the business, by way of election of trustees or otherwise, such shareholders are liable as partners.[2] It is clear, on the other hand, that if such shareholders have no control over, or no right to interfere in any way with, the management of the business, they are beneficiaries under a trust agreement and are not liable as

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[1] People ex rel. National Express Company v. Coleman et al., Tax Commissioners, 1892, 133 N.Y. 279, 31 N.E. 96; p. 725.

[2] Simson et al. v. Klipstein, 1920, 262 Fed. 823; p. 726.

partners.[3] This business organization has been called different names, such as "Business Trust," "Massachusetts Trust," and "The Common Law Trust." As a substitute for a corporation, it has lost many of its advantages, owing to statutory regulation by the various states; as a method to avoid partnership liability, it is ineffective, in that a shareholder whose money is being risked in a business venture naturally desires to have some control over the policy and conduct of the business, and such reservations carry with them the obligation of partnership.

The trustees are usually held to have unlimited liability for all obligations of the business trust unless the contracts restrict the rights of the creditors to the assets of the trust. It is customary for business trusts to place this limiting clause in all contracts, particularly if there is any possible question about the solvency of the trust.

Sec. 128. Nonprofit organizations.—Nonprofit unincorporated associations arise, like partnerships, out of a contract.[4] Such associations are organized for social, educational, philanthropic, and fraternal purposes. These organizations have many of the characteristics both of the corporation and of the partnership in that they have by-laws, directors or trustees, and the usual officers, namely, president, secretary, and treasurer. In their method of functioning and their form they are much like corporations. To the extent that they are less formally organized, it may be said that such associations resemble partnerships. As a general rule, the liability of the members in such associations does not rest upon the theory of partnership but on the theory of principal and agent, the officers of the association being the agents and the members the principals.[5] Since no entity exists by either a partnership or corporate organization, the officers are not agents of an entity, but those members of the organization who approve of a particular contract are liable as principals.

Sec. 129. Joint adventure.—A joint adventure is quite similar to a partnership but falls short of being one because its activities do not go far enough to be called a business. It is usually limited to one transaction or a series of transactions relating to a particular property. If two people buy a specific piece of real property for the purpose of resale at a profit, they become parties to a joint adventure.

The law controlling their individual relationship is essentially the same as found in the partnership. They have a fiduciary rela-

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[3] Williams et al. v. Inhabitants of Milton, 1913, 15 Mass. 1, 102 N.E. 355; p. 728.

[4] Chicago Grain Trimmers' Assn. v. Murphy, 1945, 389 Ill. 102, 58 N.E.(2) 906; p. 729.

[5] Stone v. Guth, 1937, (Mo. App.) 102 S.W.(2d) 738; p. 730.

tionship and share profits or losses as is done in a partnership. They have much the same relation to third parties as partners have, particularly when the limited nature of the undertaking is considered.

Review Questions and Problems

1. What is a limited partnership? May all of the partners be limited?
2. What part do limited partners take in the management and conduct of the firm's business? Should their names appear in the firm name?
3. What makes possible limited partnerships? Must notice of the same be filed with the county recorder?
4. What features of joint stock associations are like those of a corporation?
5. *A, B,* and *C* invest money in a joint enterprise and place this money in the hands of certain trustees. From time to time they offer suggestions to the trustees and at times they elect new trustees. What are the liabilities of the investors?
6. *A, B, C, D, E, F, G,* and *H* form a reading club. *H,* the secretary, orders twenty books from a certain bookstore and charges them to the club. Under what conditions may the bookstore recover from the members of the club?

Book V

PERSONAL PROPERTY

CHAPTER I

NATURE OF PERSONAL PROPERTY

Sec. 1. Definition.—Property is deemed to be any object, corporeal or incorporeal, capable of being reduced to exclusive possession. Property, for most purposes, is classified as either real or personal. Generally speaking, real property is considered to be land or anything permanently attached thereto. All other property is said to be personal property.

Sec. 2. Types of personal property.—There are three distinct kinds of personal property: chattels real, chattels personal in possession, and chattels personal in action. Chattels real are those interests in land which at one's death do not pass directly to the heirs, but pass first to the administrator or executor for administration, as provided for by law. Usually, leases of land for a period of years are considered chattels real.

Chattels personal in possession are those tangible and movable objects which may be transferred from hand to hand. This class of personal property is the kind with which most of us are quite familiar.

Chattels personal in action, often called "choses in action," include those things to which one has a right to possession, but concerning which it may be necessary to bring some legal action in order eventually to enjoy possession. Any contract action may be said to be a chose in action. The most common form of a chose in action is a negotiable instrument. It evidences a right to the money provided for therein, but it is possible that an action may have to be maintained to reduce the money to possession.

Sec. 3. Methods of acquiring title.—Title to personal property may be acquired through any of the following ways: original possession, transfer, or accession.

Sec. 4. Original possession.—Personal property which is in its native state and over which no one as yet has taken full and complete control belongs to the first person reducing such property to his exclusive possession. Although most property today may be said to belong definitely to someone, there are still some kinds of property, especially wild animals, fish, and other property of like kind, which are still available for appropriation by any individual. Property once reduced to ownership, but later discarded, belongs to the first party taking possession.[1]

[1] Huggins v. Reynolds, 1908, 51 Tex. Civ. App. 504, 112 S.W. 116; p. 735.

In addition to the above, it might be said that property which one creates through mental or physical labor belongs to the creator unless he has agreed to create it for someone else, being induced to do so because of some compensation which has been agreed to by the interested parties. Under this heading might be included such items as books, inventions, and trade-marks. This kind of property is usually protected by the government through means of copyright, patents, and trade-marks.

Sec. 5. Transfer.—Property may be transferred through sale, gift, will, or operation of law. The law relating to a transfer by sale will be taken up more in detail in a subsequent chapter, as it forms as important branch of our law today. A transfer by gift may be made effective, with the consent of the owner, by an actual physical change in possession of the property. Normally, the gift is not complete until the change in possession has been effected. In the case of choses in action, the transfer of possession usually takes place by means of an assignment, the exception being negotiable instruments, which may be transferred either by assignment or negotiation.

At a person's death, all his property, either real or personal, may be disposed of by will. The person taking personal property under the terms of a will is called a legatee, and the property is spoken of as a legacy.

Where the deceased leaves no will, the property descends as provided by the laws of descent in the particular state involved. The laws of the different states vary greatly in this particular, but operate to transfer intestate property to those persons stipulated in the law as being entitled to it. Foreclosure sale offers another illustration of transfer of title by operation of law.

In all cases of transfer of property, the transferee takes no better title than that possessed by the transferor. An innocent third party who purchases property from one having no title can obtain no title by such a transfer.

Sec. 6. Accession.—Accession, taken literally, means "adding to." Property permanently added to other property and forming a minor portion of the finished product becomes part and parcel of the larger unit.[2] In such cases title automatically passes to the party holding title to the larger mass. This rule applies where the minor unit is stolen as well as where it is purchased. If stolen, the original owner may recover from the party who first converted it to his own use. The increase in value of personal property caused by the expenditure of skill or material thereon passes to the one who retains title to the raw material.

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[2] Eaton v. Munroe, 1862, 52 Me. 63; p. 735.

Sec. 7. Accession to stolen property.—An important problem arises where property wrongfully taken is greatly increased in value, after the taking, by the expenditure of labor and materials. In accordance with the law of the previous section, the benefit of such increase in value would pass to the one having title to the raw material. Such is not always the result arrived at by the courts. An increase in value by an intentional wrongdoer through the expenditure of labor and materials always passes to the true owner of the property, and he may successfully bring suit to reduce it to his possession, although the raw material has been enhanced in value many times.[3] A sale of the property in its improved state by the wrongdoer does not affect the right of the true owner. He may recover his property from the bona fide purchaser. The person who has wrongfully taken possession of personal property may never receive or pass title to it, regardless of how much he has increased its value.

Property purchased from a wrongdoer and increased in value by the bona fide purchaser follows a different rule. An innocent purchaser of stolen goods, who greatly increases the property in value by the expenditure of skill and materials, becomes liable to the true owner for the value of the goods in their original state only. In effect, title passes to the bona fide purchaser, provided he pays to the original owner the former value of the property. Unless the property has been greatly increased in value—at least two or three times its original value—an action of replevin to recover the property may be maintained by the original owner.

An unintentional wrongdoer, who greatly improves in value the property wrongfully taken, if sued for the value of the property, is always liable for the original value of the property. If he has improved to a great extent the value of the property by the expenditure of skill and labor, the original owner may not replevin the article from him. There are a few courts, however, which seem to permit the original owner to recover the improved article.

Sec. 8. Confusion.—Property of such a character that one unit may not be distinguished from another unit, and which is usually sold by weight or measure, is known as fungible property. Grain, hay, logs, wine, and other articles of like nature afford illustrations of property of this nature. Such property, belonging to various parties, often is mixed by intention of the parties, by accident, or by the misconduct of some wrongdoer. Confusion of fungible property belonging to various owners, assuming that no misconduct is involved, results in an undivided ownership of the total mass.

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[3] Sligo Furnace Co. v. Hobart-Lee Tie Co., 1911, 153 Mo. App. 442, 134 S.W. 585; p. 736.

To illustrate: grain is stored in a public warehouse by many parties. Each owner holds an undivided interest in the total mass, his particular interest being dependent upon the amount stored by him. Should there be a partial destruction of the total mass, the loss would be divided proportionately.

Confusion of goods which results from the fraudulent conduct of one of the parties causes the title to the total mass to pass temporarily to the innocent party. If the wrongdoer is unable to show that the resultant mass is equal in value per unit to that of the innocent party, he loses his interest in the resulting mass. Where the new mixture is worth no less per unit than that formerly belonging to the innocent party, the wrongdoer may claim his portion of the new mass by presenting convincing evidence of the amount added by him.

Sec. 9. Abandoned and lost property.—Property is said to be abandoned whenever it is discarded by the true owner, who, at that time, has no intention of reclaiming it. Such property belongs to the first individual again reducing it to possession.

Property is lost whenever, as a result of negligence, accident, or some other cause, it is found at some place other than that chosen by the owner. Title to lost property continues to rest with the true owner. Until the true owner has been ascertained, the finder may keep it, and his title is good as against everyone except the true owner.[4] The rights of the finder are superior to those of the person in charge of the property upon which the lost article is found. Occasionally, state statutes provide for newspaper publicity concerning articles which have been found. Under these statutes, if the owner cannot be located, the found property reverts to the state if its value exceeds an established minimum.

Mislaid or misplaced property is such as is intentionally placed by the owner at a certain spot in such a manner as to indicate that he merely forgot to pick it up. In such a case the presumption is that he will later remember where he left it and return for it. The owner of the premises upon which it is found is entitled to hold such property until the true owner is located.

Sec. 10. Extent of ownership.—Title to personal property may be held in common with others. Normally, in such a case, the owners are entitled to an equal use of the property or to their portion of the income derived from its use. In the event of the death of one of the co-owners, his share in the property passes to the executor or administrator of his estate.

Under the laws of many states, personal property, as well as real estate, may be held in joint tenancy. The interest of a deceased

[4] Hamaker v. Blanchard, 1879, 90 Pa. St. 377, 35 Am. Rep. 664; p. 737.

owner passes automatically to his joint owner without the necessity of probate. Because of this fact, husband and wife in many cases are holding personal property jointly in order to avoid the expense of administration of an estate in the event of the death of either. Joint tenancy of personal property does not arise unless a contract between the co-owners states clearly that such is the case and that the right of survivorship is to apply.

Review Questions and Problems

1. What are the two kinds of property? How many kinds of personal property are there? What is meant by choses in action?
2. How may personal property be acquired?
3. *A*, a farmer, learns that another party killed a number of rabbits which were running at large upon his farm. To whom do the rabbits belong?
4. *A* desires to present an automobile to his son, and, on January 1, he purchases and delivers a Buick car to the son, telling him that it is a belated Christmas gift. Shortly thereafter, the father demands the car. Is the father entitled to it?
5. What happens to personal property not disposed of by will?
6. *A* intentionally took corn belonging to *B* and distilled it into whisky. *B* had the sheriff seize the whisky, but *A* contends that the whisky belongs to him because of the great increase in its value. Is *A* correct?
7. *A*, the driver of a garbage wagon owned by *B*, found a diamond ring in the garbage. The owner cannot be found. Which party is entitled to possession of the ring?
8. What is fungible property? *A* owns some lumber which he fraudulently mixes with lumber owned by *B*. The quality of the two piles of lumber was entirely different, but the content of the two amounts cannot now be distinguished. May *B* retain title to both amounts?
9. What is meant by joint ownership? When is it used? Why?

Chapter II

SALES

Transfer of Title

Sec. 11. Introduction.—Many of the legal difficulties of the average businessman revolve around the sale and purchase of merchandise. In either event, the legal relations involved are controlled by the law of sales. The law of sales consists of a body of legal rules concerned with agreements entered into for the purpose of effecting a transfer of title to personal property. This body of rules forms a specialized branch of the law of contracts. The contract of sale follows the ordinary rules of contracts, but, because of the nature of the relation, certain additional rules have been adopted. Peculiar conditions surrounding sales of property make it necessary to imply many terms which are usually not expressed. It is primarily with these implied terms that the law of sales deals. The Uniform Sales Act, which has attempted to codify most of these rules, has been adopted in a number of the states, and the rules set forth in this chapter are those adopted by the Uniform Act.

Sec. 12. Distinction between contracts "to sell" and contracts "of sale."—The legal relations effected by a contract to sell differ materially from those arising from a contract of sale. An agreement to sell discloses an intention to transfer title to personal property at some subsequent date. A contract of sale has for its purpose the present transfer of title to the property in question. Only property which is in existence and title to which rests with the seller may be the subject of present sale. In order that a transfer of ownership may be made, there must exist property capable of being transferred. On the other hand, a contract to sell may relate to property not yet in existence or to property to which title is possessed by some third party. The undertaking in such a case is that of bringing the property into existence or of obtaining title before the date set for delivery. Any attempt to transfer present title to such property is at best an agreement to sell rather than a sale. Property not yet possessed or not yet in existence is known as "future goods."

Sec. 13. Risk of loss.—Normally, the risk of loss resulting from the theft or destruction of property rests with the one holding title. Because of this fact, it becomes quite important to determine whether a particular agreement is a contract of sale or a contract to

sell; and, if the latter, whether title has passed at the time a particular loss occurs. Title is the determining factor in ascertaining where the loss shall fall. The vendor must bear any loss caused by the destruction of goods before title passes.[1] Any loss which takes place after title has passed rests with the vendee. These are the general rules, but they may be varied by express provisions to the contrary in the contract. The contract may provide that the risk shall be borne by the vendor until delivery, or that it shall reside with the vendee, despite the fact that title is not to pass until later.

Where goods which form the basis of a sale are only partially destroyed before title passes, the vendee has the option of either accepting the balance or rescinding the agreement. If he elects to accept the portion of the goods which remain in deliverable condition, he must pay the full contract price, unless they are sold by weight or measure. In the latter event he pays only for the goods received at the unit price established in the agreement. Total destruction of specific goods which form the subject matter of the agreement releases the vendor from any duty to deliver. Destruction of goods out of which he expects to make delivery, or destruction of the source from which his supply is normally received, does not release him from his duty to perform. Inasmuch as it is still possible for him to deliver, although the performance becomes more burdensome, he is liable in damages for a failure to deliver the goods bargained for.

To illustrate: *A* contracts to sell *B* a certain horse for $100. The horse dies before the date set for delivery and the passing of title. The loss falls upon *A*, but he is excused for his failure to deliver the horse. Let us assume that, instead of a horse, *A* agrees to deliver to *B* five hundred bushels of wheat at $1 per bushel. Just before delivery is to take place, all the wheat owned by *A* is destroyed. The loss must be borne by *A*, and, if *B* is compelled to pay more than a dollar a bushel elsewhere for the grain, *A* must make up the difference. In either contract, had the agreement been one of sale instead of an agreement to sell, the loss would have fallen upon *B*, although delivery had not as yet taken place.

Sec. 14. Title passes according to intention of parties.—Title to personal property which forms the basis of sale passes at the time intended by the parties. If the agreement indicates in any manner when title is to pass, the terms of the agreement govern. It is seldom, however, that the parties to a sales agreement think of inserting any provision relative to the passing of title. Because of this fact, various rules for determining the intention of the parties

[1] Miller v. Seaman et al., 1896, 176 Pa. St. 291, 35 Atl. 134; p. 739.

have been formulated by the courts. In the absence of any stipulation in the agreement to the contrary, or of any conduct which indicates a contrary intention by the parties, title passes in accordance with the rules set forth in the sections which follow.

Sec. 15. Sale on trial.—When goods are delivered to the buyer on approval, trial, or other similar terms, title remains in the seller until the buyer evidences in some manner an intention to adopt the transaction.[2] This intention may be evidenced by express notice to the seller, or by any conduct which indicates an acceptance of the goods. Retention of the goods beyond a reasonable time, or beyond the time established by the agreement, indicates an intention to keep the property. If the vendee is under no duty to return the goods, which situation is seldom true, he should notify the vendor within a reasonable time that he is not accepting the goods.

A sale on trial must be carefully distinguished from a transaction in which goods are delivered "on sale and return." Whenever the agreement indicates an intention to make a present sale, but also gives the buyer an option to return the goods, title passes with a right on the part of the buyer to revest title in the seller by returning or tendering the goods. Such return or tender must take place within a reasonable time, provided no limit has been prescribed in the contract. An agreement, therefore, which gives to the buyer a right to return the goods, if they prove unsatisfactory, has the effect of transferring title to him, with its corresponding risk of loss. On the other hand, a sale on trial throws no risk upon the buyer until he adopts the transaction in some manner and thereby assumes title. He is a mere bailee of the property until he elects to become its owner and, as such, rests under a duty to exercise reasonable care for its protection.

Contracts for the sale of merchandise which has been bottled or which is delivered in containers often provide that the buyer may return the containers and receive credit for them. In these cases title to the containers passes to the buyer and risk of loss rests with him until they have been returned to the seller. However, if the buyer is not charged with the container but agrees to return it, a bailment takes place. In such a bailment, the bailee is liable for loss only when he fails or is unable to return the container because of his wilful or negligent act.

Sec. 16. Ascertained goods.—An unconditional contract to sell specific goods in a deliverable state passes title to the property at the time of the agreement. In other words, where the specific articles to be delivered are identified, the goods are said to be ascertained. In such a case, articles of like kind cannot be substituted;

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[2] Hunt v. Wyman, 1868, 100 Mass. 198; p. 740.

the particular goods upon which the minds of the parties met are to be delivered. Under such circumstances, title passes at the time the contract is formed. The fact that the date of delivery or payment is postponed beyond the time of the agreement does not delay the passing of title. Inasmuch as the buyer is usually free to assume possession, the risk passes at the date of the agreement.

Where ascertained goods form the basis of a sale and the seller is to do something to them for the purpose of putting them in a deliverable condition, title does not pass until such thing is done.[3] Thus, if he is to repair, measure, or weigh the property, title passes only after he has completed his task. Under such circumstances, it is only fair that the seller assume the risk until delivery can be made, as it is his failure to act which prevents the buyer from taking possession.

Sec. 17. Fungible goods.—As said before, fungible goods are goods that are not sold by the individual unit, but by weight or measure—goods in which one unit is like any other unit. A sale of a certain quantity of fungible goods passes title at the time of the agreement to an undivided interest in the total mass, if the particular mass out of which it is to be delivered has been agreed upon.[4] However, if the seller is to weigh, sack, or do something to the goods to place them in a deliverable condition, title passes only after he has completed his work.

Sec. 18. Unascertained goods.—A contract to sell unascertained or future goods by description or sample causes title to pass only when goods corresponding to the description or sample have been unconditionally appropriated to the contract by one of the parties with the assent of the other. Title passes whenever the seller appropriates specific property with the assent of the buyer, or when the buyer appropriates it with the assent of the seller. The assent may be either express or implied and may be given either before or after the appropriation. Both the appropriation and the assent must combine, however, to pass title.

To illustrate, let us assume that a buyer has seen the supply, such as a number of cars, from which the selection is to be made, all of the articles being of the kind and quality to be purchased. If, after the contract is made, the seller selects one and marks it with the buyer's name, title passes at that time. Even though it has not been paid for, any loss arising from its destruction would fall upon the buyer. Similarly, a buyer who supplies the seller with containers in which to pack or ship the merchandise is said to accept title as of the time the containers are filled. These and similar acts

[3] Hamilton et al. v. Gordon, 1892, 22 Or. 557, 30 Pac. 495; p. 740.

[4] O'Keefe v. Leistikow, 1905, 14 N.D. 355, 105 N.W. 515; p. 741.

on the part of a buyer act as assent in advance of appropriation, and the seller's act of appropriating the goods causes title to pass.

Sec. 19. Delivery to carrier.—One method of appropriation quite often used by the seller is that of delivering the goods to a carrier. Delivery of goods to a carrier for the purpose of transmission to the buyer or to some bailee of the buyer constitutes an appropriation of the goods by the seller. If the contract to sell requires the seller to deliver the goods to a certain destination, or to pay the delivery charges, the title does not pass until the goods have been delivered. If the buyer is to pay delivery charges, title passes as soon as the goods are delivered to the carrier. The carrier is said to act as an agent of the buyer to accept goods appropriated by the seller, provided the goods delivered correspond to the description or sample. Thus, any loss or injury suffered by goods in transit falls upon the vendee if he is to pay transportation charges. Where the seller is to deliver the goods to the buyer's destination, the risk rests with the seller until the goods are unloaded and ready to be carried away.

Title does not pass unless the goods shipped correspond in both quality and quantity to those ordered. If those delivered to the carrier are not the kind or the amount ordered, the buyer is not required to accept them. Therefore, any loss arising during their carriage must be borne by the vendor. Likewise, failure to follow shipping instructions given by the buyer or, in the absence of any, to make the customary contract for the protection of the buyer, shifts the risk of loss during transit to the seller.

A "c.i.f." contract is one in which the purchase price of the goods is presumed to include the cost of the goods, customary insurance, and freight to destination. Since the shipper procures insurance in such cases and forwards the policy to the purchaser, it is usually held that title passes at the point of shipment.[5]

Sec. 20. C. O. D. shipments.—The mere fact that goods are shipped C. O. D., which, taken literally, means cash on delivery, does not affect passing of title. Such a provision in the bill of lading merely indicates that the shipper is retaining the right to possession of the goods until payment is made. Title passes to the buyer, if he is to pay transportation charges, at the time the goods are received by the carrier; but the seller reserves a lien, evidenced by his right to possession, until the price is paid by the buyer.

When goods are shipped under a bill of lading denoting that the goods are to be delivered to the seller or his order, the seller retains title. But if, except for the form of the bill of lading, title would have passed to the buyer, it is presumed that title is retained for

[5] Smith Co. v. Moscahlades. 1920. 183 N.Y.S. 500: p. 742.

security only and the risk of loss is carried by the buyer from the moment the goods are delivered to the carrier. Since title is reserved for security only, it passes to the buyer when he obtains the order bill of lading properly indorsed. The bill of lading is usually delivered to the buyer by some bank only after the buyer pays the accompanying draft or bill of exchange. When the order bill of lading, properly indorsed, is sent by the seller directly to the buyer along with a bill of exchange for his acceptance or payment, he obtains no right or title to the goods until acceptance or payment. However, a third party who purchases, in good faith, the bill of lading or goods from the buyer obtains good title, although the latter's title was defective.

To illustrate these rules, let us assume that *A* ships *B* goods on an order bill of lading which designates *A* as consignee. *A* mails the bill of lading, indorsed in blank, to *B*'s bank, accompanied by a bill of exchange for $500, payable at sight. The agreement calls for payment of the freight by *B*. If the goods are damaged in shipment by some act of God, the loss must be borne by *B*, as title is retained as security only.

Sec. 21. **Voidable title.**—Where the seller has a title which may be voided by some third party, the buyer acquires a good title to the goods, provided he purchases them in good faith without knowledge of the right of the third party. Thus, a party who has a right to rescind an agreement because of fraud has no right to do so after his vendee has resold the property to an innocent purchaser.

In addition, a vendor who sells property but retains possession of it, and then resells to, delivers to, and receives payment therefor from an innocent third party who does not know of the previous sale, passes good title to the third person. The vendee who obtains title to property, but leaves it in the possession of the vendor, makes it possible for the vendor to perpetrate a fraud. In the event of such misconduct, any loss must be suffered by the original vendee, unless he can recover from the vendor.

Warranties

Sec. 22. **Express warranty.**—A warranty is an affirmation of fact or a promise by the seller, relating to the goods, which acts as an inducement for the buyer to purchase. Warranties are of two kinds: express and implied. An express warranty is one which becomes part of the sale agreement because of a direct statement made by the seller; an implied warranty attaches itself to the contract by reason of the nature of the agreement. A purchaser who desires a particular kind of warranty relative to the property should demand an express stipulation to that effect in the agreement.

Two distinct factors combine to bring about an express warranty. First, the vendor must make a statement of fact or a promise of future conduct concerning the property sold. Second, the statement or promise must be such as to induce, in some measure, the buyer to act. Statements of fact should be clearly distinguished from statements of opinion.[6] Any representation qualified by "I think" or "I believe" clearly expresses merely an opinion and does not form any part of a warranty. Furthermore, statements referring to the value of an article are usually considered matters of opinion. Ideas concerning the value of property must necessarily vary with the individual. Any reference to the quality of the article, however, is usually considered a statement of fact.

Any conduct on the part of the vendee which indicates that he is relying on his own judgment or investigation rather than on the statement of the vendor negatives the idea of a warranty. In order for a warranty to arise, the statement made by the vendor must act as an inducement to the vendee to enter into the agreement. Furthermore, any general statement made by the seller, where the property is available and is being inspected by the parties, does not cover obvious defects. Thus, *A* sold *B* a horse, which was present and subject to inspection at the time of the sale. *A* made a statement that the horse was sound "in every particular." It was held that the statement did not operate as a warranty against blindness, which was apparent to anyone upon casual inspection.

Sec. 23. Implied warranty of title.—The vendor of personal property warrants, as an implied term of his contract, that he has title and that no one having a paramount title will interfere with the quiet enjoyment of the property by the vendee. In addition, he warrants that the property is free from all liens. If the agreement be one to sell rather than one of sale, he warrants that he will have title to the specified property before the time it is to be transferred.

To illustrate: *A* sells *B* a used automobile, honestly believing that he has title to it. *C*, having a better title to it, demands possession. Good faith on *A*'s part does not relieve him; he becomes liable to *B* for the purchase price and for any other damages suffered as a result of the breach of warranty.

Sec. 24. Warranty of fitness for a particular purpose.—Although goods are most often sold by description or catalogue number, occasionally a buyer desires an article to fulfill a particular purpose. Where the buyer expressly or impliedly indicates to the seller the particular purpose for which he desires the goods and relies upon the skill or judgment of the seller, there arises an im-

[6] Saunders v. Cowl et al., 1938, 201 Minn. 574, 277 N.W. 12; p. 743.

plied warranty that the goods will prove fit for the purpose. In such instances it is presumed that the vendor is more familiar than the vendee with the results to be obtained from the use of particular property. In addition, an implied warranty of fitness may be annexed by the usages and customs of trade. Because of the nature of the business, it may be implied in certain cases that the buyer desires an article for a special purpose. In ordinary cases, however, it must appear that the purchaser relies upon the skill of the vendor, and that he does not order the property by description or by its trade name.[7] Property sold under its trade or patent name carries with it no implied warranty of fitness for a particular purpose.

Sec. 25. Warranty that goods are merchantable.—A sale of goods by sample or description raises an implied warranty that they shall be merchantable. Goods are merchantable whenever they are free from hidden defects and are fit for the use to which they are ordinarily placed.[8] When goods are inspected by the buyer, there is no implied warranty against defects which the examination should have revealed. Where goods are the subject of inspection, the vendee should be in as good a position as the vendor to know whether the goods are merchantable. However, a warranty arises against defects which do not appear upon an examination of the goods.

In some respects a sale at retail, when the article of merchandise is displayed for the purpose of enabling the buyer to select the article desired, is not a sale by description. This is particularly true if the buyer takes the article from an open counter. Several courts have held that no implied warranty of merchantability applies in such a case but the better view seems otherwise. The purchaser who selects a can of beans from a shelf is as effectively saying, "I want a can of beans," as the person who orders them over the telephone.

At one time, only the grower, packer, or manufacturer warranted goods to be merchantable. The Uniform Act has broadened the rule so that it includes anyone regularly engaged in selling such goods. Thus, the warranty of merchantability forms an implied part of all sales, except casual sales made by people not regularly engaged in selling the articles involved. Implied warranties, as well as express warranties, may be provided against in the contract of sale. Waiver of implied warranties must be clearly expressed to be effective. A statement that only those warranties written into

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[7] McNabb et al. v. Kentucky Natural Gas Co. et al., 1938, 272 Ky. 112, 113 S.W.(2) 470; p. 744.

[8] Ryan v. Progressive Grocery Stores, Inc., 1931, 255 N.Y. 388, 175 N.E. 105; p. 745.

the contract shall attach to a sale does not have the effect of eliminating the implied warranties, more definite language being required to attain that end.

In addition to being merchantable, goods ordered by sample must conform to the sample. Where ordered by both sample and description, the goods must correspond to the description as well as to the sample. It is not enough for the bulk of them to be like the sample; the description must also be complied with.

Sec. 26. Extent of implied warranties.—Warranties associated with a contract of sale are applicable only between the vendor and the vendee.[9] The terms of their agreement do not extend to purchasers from the vendee. Thus, a hidden defect which appears after the article has reached the hands of the ultimate consumer gives the consumer no right against the manufacturer or the grower. The warranty of the manufacturer extends only to the jobber or the retailer. The only recourse of a consumer in case of defective merchandise is to look to the retailer upon express or implied warranties.

To this general rule there is one exception. An article which, if defective, normally would prove dangerous to human life carries with it an implied warranty of the manufacturer or the grower to the ultimate consumer. It is because of this exception that the packer of canned goods is liable in many states to the ultimate consumer for damages resulting from improper or defective canning. The real basis for such an extension of the warranty is that the damages are attributable to the negligence of the canning company, some courts permitting recovery in tort based upon evidence of carelessness in packing, and a few extending the doctrine of warranty in such cases to the length necessary for recovery against the packer. These latter courts in reality partially adopt the theory that the warranty runs with the goods. Other theories have at times been resorted to in order that an action may be sustained against the manufacturer or packer.[10]

Remedies

Sec. 27. Remedies of seller where buyer refuses delivery.— Whenever the seller properly performs by tendering delivery of the quality and quantity of goods ordered by sample or description, he is entitled to have the purchaser accept the goods and make payment. Delivery and payment are presumed to take place contemporaneously unless a different time for payment has been provided in the agreement. A refusal by the buyer to accept the goods and

[9] Prinsen v. Russos, 1927, 194 Wis. 142, 215 N.W. 905; p. 746.

[10] Baxter v. Ford Motor Co. et al., 1932, 168 Wash. 456, 12 Pac.(2d) 409; p. 747.

to pay for them gives the seller a right to recover damages only. His damages are dependent upon the current market price of the goods at the time of the buyer's refusal. In case the agreement relates to goods for which there is no available market, a tender of delivery gives to the vendor a right to recover the full contract price. This rule applies particularly to goods manufactured especially for the buyer.

Where title has passed to the buyer before delivery, as in the case of ascertained goods, and he refuses to pay, action may be maintained for the full purchase price. The same remedy is also available where the buyer, regardless of delivery or the passing of title, is to make payment at a certain time.

Sec. 28. Unpaid seller's lien.—The unpaid seller of goods, who is in possession of them, although title may have passed to the vendee, is entitled to retain possession until payment of the purchase price, where the goods are to be paid for when delivered, where the period of credit has expired, or where the buyer has become insolvent. In other words, the unpaid vendor has a lien upon the goods until such time as they are delivered or paid for, unless the period of credit previously agreed upon has not expired.[11] Thus, goods in the possession of the vendor, unless paid for or purchased on credit, may not be levied upon by creditors of the vendee, although title has passed. Even though credit was bargained for, the levy may not be made without payment for the goods, if the buyer has become insolvent or the credit period has expired.

Insolvency as used in the law of sales means the failure of the buyer to meet his current demands as they fall due. Failure of the debtor to satisfy his obligations as they mature makes him insolvent and gives a seller the right to invoke an unpaid seller's lien or to stop goods in transit.

Sec. 29. Stoppage in transitu.—An unpaid seller who has parted with possession of the goods to some transportation agency may, in the event of the insolvency of the buyer, stop the goods in transit, even though title may have passed to the buyer. The unpaid seller, for the purpose of maintaining his lien, is considered as being in possession of the goods until they are delivered by the carrier to the buyer. The insolvency of the purchaser gives to the seller a right to demand a return of the goods so long as they have not been delivered to the buyer. He must, however, pay the necessary transportation charges to the carrier. The right of stoppage in transitu is terminated by delivery of the goods to the buyer, whether the buyer has obtained them during transit or after arrival at their destination. However, so long as the carrier is still in pos-

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[11] Perrine v. Barnard et al., 1896, 142 Ind. 448, 41 N.E. 820; p. 748.

session, unless it has wrongfully refused delivery, or unless it holds the goods in storage under a subsequent agreement with the purchaser, this right of the seller to demand a return of the goods continues.

Notice must be given to the carrier in ample time so that it may communicate, by the use of reasonable diligence, with its agent in charge of the goods. Delivery of the goods to the buyer, before notice can reach the agent in charge, terminates the lien of the seller.

Sec. 30. Right of resale.—The unpaid seller who has a lien upon the goods is entitled to resell them within a reasonable time after the buyer has been in default in payment of the purchase price. If the goods are of a perishable nature, the right to resell arises immediately upon the default of the buyer. The seller is under no duty to notify the purchaser of his intention to resell and may recover from him any deficit arising from the sale.

If the seller desires, he may, instead of reselling the property, merely rescind and look to the buyer for any damages suffered. Rescission will not be considered as having taken place unless he has given notice to the buyer or has in some other way definitely indicated his intention to rescind.

Once delivery of the goods to the buyer has been made, the only remedy of the unpaid seller is to bring suit for the purchase price. He may not rescind and demand the return of the property. Known insolvency on the part of the buyer does not amount to fraud and gives to the seller no right to rescind. Rescission may take place where title has been retained as security, but this situation forms a conditional sale and is considered in detail elsewhere.

Sec. 31. Remedies of the buyer.—Where title to the goods has passed to the buyer and the seller wrongfully neglects or refuses to deliver the goods, the buyer may bring suit to recover either the damages resulting from conversion or possession of the property by replevin.[12] If the agreement consists of a mere contract to sell unascertained goods and the seller defaults, the purchaser may bring suit for damages. In the absence of extenuating circumstances showing special damages, he is limited in his recovery to the difference between the current market price and the price which he has agreed to pay.

Sec. 32. Remedies for breach of warranty.—Any warranty made by the vendor which proves to be false gives to the buyer a choice of four remedies. He may accept or keep the goods and set up the breach of warranty as a partial extinction of the purchase price, or, if payment has been made, he may keep the goods and re-

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[12] Abraham v. Karger, 1898, 100 Wis. 387, 76 N.W. 330; p. 749.

cover for the damages sustained. He may refuse to accept the goods where title has not passed and maintain an action against the seller for damages arising from the breach of warranty; or he may rescind the agreement, and, if the goods have been delivered, return them and recover any part of the purchase price which has been paid.

Sec. 33. Inspection of goods.—Upon receipt of goods the buyer always has the right to inspect them before acceptance. If the inspection discloses that they do not conform to the description, sample, or warranties, or that the quantity is greater or less than ordered, the buyer may reject the property. An acceptance of the goods by the purchaser, after an inspection has revealed a defect of some character, constitutes a waiver of the right to rescind and limits the buyer to his remedy for damages. Thus, if *A* orders from *B* a gross of cut-glass tumblers which are described as having certain markings, and those received have entirely different markings, the buyer may either return them or keep them and deduct from the purchase price the damages occasioned by the breach.

The buyer has no right to inspect goods which are shipped C. O. D. until after he has paid the purchase price. If defects are revealed by a later inspection, however, he may return the goods and demand his purchase price.

Negotiable Documents of Title

Sec. 34. Duties of bailee.—A negotiable document of title is a written instrument which indicates that certain goods are in the possession of a given bailee and will be delivered to the order of the person named therein—or to bearer, if so worded. Negotiable warehouse receipts and bills of lading are the best-known documents of this character. A public warehouse which issues a negotiable receipt is not at liberty to surrender the goods to the original bailor unless he surrenders the receipt for cancellation. The receipt is a symbol of the goods described therein and must be presented in order that the goods may be obtained. The warehouse that surrenders goods without the return of the receipt may be called upon for the goods by someone who has purchased the document. The goods should be delivered only to the person in possession of the receipt and then only in case it has been properly indorsed, if such was required. Much the same can be said of a common carrier or any other organization which issues a negotiable document of title.

If the instrument is originally drawn to bearer, title to it can be transferred without indorsement. Where it is drawn to a certain person or order, however, his indorsement must appear on the instrument before anyone can obtain title thereto. A forged in-

dorsement is ineffective and does not pass title. An instrument properly indorsed in blank becomes bearer paper and may thereafter be transferred by delivery, whereas a special indorsement—to a certain person—requires that it again be indorsed in order to effectuate a transfer.

Sec. 35. Rights of purchaser.—A bona fide purchaser of a negotiable document of title takes it free of certain equities of ownership. The Uniform Bills of Lading Act provides that a bona fide purchaser of a bearer bill of lading, or of one that is indorsed in blank, takes good title thereto. Thus, a thief or a finder of such an instrument could sell it to an innocent party and pass good title. The Uniform Sales Act does not extend such freedom to the circulation of other negotiable documents of title. It provides that the holder of a bearer document, or of one which has been indorsed to him, may transfer good title to an innocent third party, although the holder violates a trust in so doing. Thus, it is only where one has been entrusted with the document that he can transfer good title. If he holds it as an agent for a certain purpose and wrongfully disposes of it, the purchaser obtains good title to it.[13]

One who is persuaded to dispose of a negotiable document of title by reason of fraud, mistake, or duress cannot recover it from a bona fide purchaser. To illustrate, let us assume that *A*, upon delivery of goods to a public warehouse, receives a negotiable warehouse receipt. *B*, by misrepresenting his financial standing, induces *A* to sell the goods to him on credit. The warehouse receipt is indorsed to *B*, who indorses it and sells it to *C*, an innocent purchaser. It is clear that *C*'s claim to the goods is superior to *A*'s—*A*'s only recourse being to recover from *B* for his fraud.

It should be borne in mind that if the original bailor of the goods—one who delivered them to the carrier or warehouse—had no title to them, a subsequent purchaser of the document of title could get no title to the goods. A negotiable document of title is valuable only where its first possessor had title to the goods represented thereby. A thief cannot pass title to stolen property by delivering it to a public warehouse and then selling the negotiable warehouse receipt which he receives therefor.

The Uniform Bills of Lading Act makes a carrier responsible for bills of lading which are issued when no goods are delivered. Thus, an agent, who fraudulently issues a negotiable bill of lading without receiving any goods, makes it possible for an innocent purchaser thereof to recover from the carrier. Before the Uniform Bills of Lading Act was adopted, the courts were in serious conflict as to the rights of the parties, but, where the Act has been adopted, responsi-

[13] Baker Co. v. Brown, 1913, 214 Mass. 196, 100 N.E. 1025; p. 750.

bility for the agent's misconduct clearly rests upon his principal.

Sec. 36. Liability of indorsers.—The indorser or transferor of a negotiable document of title makes three distinct warranties:

1. He warrants that the instrument is genuine. One who purchases a forged document of title may, upon discovery of the forgery, recover from the indorser. In case it is bearer paper and unindorsed, he recovers from the person who sold it to him.

2. He warrants that he has a legal right to negotiate or transfer it. This assertion is in effect a warranty that his title to the document is good.

3. He warrants that he has a right to transfer title to the goods and that the goods are merchantable or fit for a particular purpose, if the sales agreement implies such. In this case he makes the usual implied warranties which accompany any sale of goods: namely, title, merchantability, and, possibly, fitness for a particular purpose.

It should be noted that he does not warrant performance by the bailee. His warranties are satisfied when the purchaser obtains a good right against the warehouseman or carrier. If the bailee has misappropriated the goods or refuses to surrender them, the holder of the document has, as his only recourse, an action against the bailee who issued the document.

Review Questions and Problems

1. *A* owned two piles of wheat in a warehouse, which totaled 6,700 bushels. He sold 6,000 bushels to *B*, who paid for them and took a bill of sale and a warehouse receipt. Later *A* sold the same wheat to *C*. *C* contends that *B* did not obtain title because the wheat was not set apart. Assuming that *B* saw the two piles of wheat, did title pass to him at the time the agreement was made?

2. *A* contracted to sell and deliver to *B* 2,000 cords of wood, at $5.50 a cord, from a certain timber plot. A fire destroyed all the timber except 500 cords. *B* refused to accept the 500 cords and *A* sued for damages. Did *A* have a right to recover?

3. *A* sells *B* a certain used automobile. Before the car is delivered, it is destroyed by fire. Who must bear the loss? Does the fact that it is not paid for have any bearing on the result?

4. What is the difference between a contract "of sale" and a contract "to sell"?

5. *A* advertises a certain kind of bicycle for sale on thirty days' trial. *B* orders one of the bicycles and it is sent to him by express. Before the trial period expires, the bicycle is stolen. Who must bear the loss?

6. When does title pass in a sale on trial? How does it differ from a sale and return?

7. *A* sold *B* a horse and warranted it to be sound. The horse proved

to be unsound and *B* desires to rescind. *A* desires to introduce evidence which indicates that he made the statement in good faith. Is such evidence pertinent?

8. *A* ordered some No. 1 and No. 2 Poughkeepsie foundry pig iron from *B*. He intended to use the iron in the manufacture of stoves. Some of it proved unfit for such a purpose. May *A* recover from B for breach of an implied warranty of fitness for a certain purpose?

9. *A* ships to *B* certain goods on credit. Under what conditions may *A* demand that the carrier redeliver the goods to him instead of delivering them to the consignee?

10. *A* ships goods to *B* under an order bill of lading. It is agreed that *B* is to pay the freight, the bill of lading with draft attached being sent to *B*'s bank. The goods were destroyed in shipment by an act of God before *B* had taken up the draft and obtained possession of the bill of lading. Upon whom must the loss fall?

11. Normally the purchaser receives no better title than the vendor possesses. Is this fact true of a title which is voidable by reason of fraud on the part of the vendee in the first sale?

12. What are the two elements of an express warranty? What is meant by an implied warranty of title?

13. When is there an implied warranty of fitness for a particular purpose?

14. *A* contracts to sell certain Kentucky tobacco like the sample. He ships to the buyer tobacco in every respect like the sample, but grown in Wisconsin. Is the buyer bound to accept the tobacco?

15. Does a warranty made by the manufacturer to the retailer extend to the consumer?

16. Name three remedies possessed by the unpaid seller of goods under varying conditions. If title has passed and the goods have been delivered, may the vendor demand a return of the goods sold, in the event of nonpayment? Is the vendee liable for any deficit if the goods are resold by the vendor at a loss, assuming that the goods are resold under a vendor's lien?

17. What are the remedies of the purchaser where the seller refuses to make delivery?

18. *A* shipped, C. O. D., $500 worth of groceries to *B* in accordance with an order from the latter. The goods arrived at their destination, but *B* refused to accept or pay for them without first inspecting them. The carrier refused to permit the inspection, and before the groceries could be sold elsewhere some of the fresh vegetables were badly damaged. Was *B* entitled to inspect the goods before payment? Who bore the loss?

19. *A* Company issued to *B* a negotiable warehouse receipt for 500 barrels of flour. *B* indorsed the receipt to *C*, and *C* to *H*. It was later discovered that *B* had stolen the flour, and *A* Company was compelled to deliver it to the true owner. Has *H* a cause of action against *A* Company? Has *H* a cause of action against *C*, who was innocent of any misconduct?

20. *A* Company gave *B* a negotiable warehouse receipt for the storage of certain furniture. A short time thereafter *B* returned for the furniture, insisting that he had lost the receipt. The furniture was delivered to *B;* a week later, *C*, an innocent purchaser of the receipt, presented it to *A* Company and demanded the furniture. May *C* recover from *A* Company?

21. When does the purchaser of a negotiable warehouse receipt take better title to it than the transferor had?

22. *W*'s husband bought a can of pork and beans at a neighborhood grocery. The food had been improperly packed, and *W* became seriously ill as a result. Can she sue and recover damages from the packer? From the grocer?

23. *O* owned two mules which were in the possession of *T*. He sold the mules to a bank and gave the bank a bill of sale, but failed to notify *T* of the change of title. *O* later sold the mules to *P*, an innocent purchaser, who paid for them and obtained possession from *T*. As between the bank and *P*, who has the best claim?

CHAPTER III

BAILMENTS OF PERSONAL PROPERTY

General Rules

Sec. 37. Definition of bailments.—Possession of property is often temporarily surrendered by the owner. In such cases the person taking possession may perform some service pertaining to the goods, after which he returns them to the owner. Upon many occasions one person borrows or rents an article which belongs to another. A contract whereby possession of personal property is surrendered by the owner with provision for its return at a later time forms a bailment. The owner of the goods is known as the bailor, while the one receiving possession is called the bailee. From the foregoing definition it appears that three distinct requisites of a bailment exist. If these essentials are thoroughly understood, the student should encounter no difficulty in distinguishing a bailment from other contractual relationships. The three requisites are: (1) retention of title by bailor; (2) possession and temporary control of the property by the bailee; (3) ultimate possession to revert to the bailor unless he orders it transferred to some designated third person.

Sec. 38. Distinguished from a sale.—It often becomes important to determine whether a particular transaction is a bailment or a sale. To illustrate: *A* surrenders possession of fifty sheep to *B*, who, by the terms of the agreement, is to return to *A*, at the end of a three-year period, fifty sheep of like kind, age, and weight. Is this transaction a sale of a certain fifty sheep for fifty other sheep? Or is it a bailment? If it is a sale and one half of the sheep die, the loss falls upon *B* rather than upon *A*. Furthermore, creditors of *B* may levy upon the sheep, provided it is a sale; whereas, if a bailment has been created, only the creditors of *A* may assert an interest in the sheep. A purchaser may pass title to goods purchased to a third party, whereas a bailee has no right to pass title to goods of the bailor unless he also happens to be acting as the bailor's agent. The test used in the foregoing illustration to determine the nature of the transaction is the application of the third requisite of a bailment. Are the identical articles delivered to be returned to the bailor? A close analysis of the terms of the particular agreement shows that a delivery of fifty other sheep of like kind and character would satisfy all requirements. Thus, a sale of fifty sheep for fifty

sheep to be delivered later has taken place; and *B* is a purchaser rather than a bailee.

A mere change in the form of the property while in the hands of the bailee does not affect the relationship. Thus, *A* floats logs downstream to *B*, to be sawed into lumber by the latter. *B* is as much a bailee of the lumber as he was of the logs.

Sec. 39. Types of bailment.—Bailments group naturally into three classes: bailments for the benefit of the bailor; bailments for the benefit of the bailee; and bailments for the mutual benefit of the bailor and the bailee. Typical illustrations of the first group are found in those cases in which the bailor leaves goods in the safe-keeping of the bailee under circumstances which negative the idea of compensation. Inasmuch as the bailee is not to be paid in any manner, the bailment is for the exclusive benefit of the bailor. A bailment for the benefit of the bailee is best exemplified by a loan of some article. Thus, *A* borrows *B*'s watch to carry for the day. The bailment is one for the sole benefit of *A*.

The most important type of bailment is the one in which both parties are to benefit. Contracts for repair, carriage, storage, or pledge of property fall within this class. The bailor receives the benefit of some service; the bailee benefits by the receipt of certain agreed compensation; thus both parties profit as a result of the bailment.

Sec. 40. Degree of care required.—Provided proper care has been exercised by the bailee, any loss or damage to the property bailed follows title and consequently falls upon the bailor. Each type of bailment requires a different degree of care. In a bailment for the benefit of the bailor, the bailee is required to exercise only slight care, while, in one for the benefit of the bailee, extraordinary care is essential. A bailment for the mutual benefit of the parties demands only ordinary care on the part of the bailee. Ordinary care is defined as that care which the average individual usually exercises over his own property.[1] Slight care and extraordinary care vary from ordinary care in that the one is a lower, and the other a higher, degree of care than ordinary care.

Furthermore, the amount of care demanded varies with the nature and value of the article bailed. The care found to be sufficient in the case of a carpenter's tool chest would probably not be ample for a diamond ring worth $10,000. A higher standard of protection is required for valuable articles than for those less valuable.

Property leased by the bailor to the bailee must be reasonably fit for the service desired. For this reason it is the duty of the bailor to notify the bailee of all defects in the property leased, of which he

[1] Bowen v. Isenberg Bros. Co., 1907, 22 Del. 230, 67 Atl. 152; p. 752.

might reasonably have been aware. The bailor is responsible for any damage suffered by the bailee as the result of such defects, unless he notifies the bailee of them. This rule holds true, even though the bailor is not aware of the defect if, by the exercise of reasonable diligence, he could have discovered it. If, on the other hand, the article is merely loaned to the bailee—a bailment for the benefit of the bailee—the bailor is in duty bound to notify the bailee only of known defects.[2] A bailor who fails to give the required notice of a defect is liable to any person who he might anticipate would be using the defective article as a result of the bailment. Employees of the bailee and members of the bailee's family might well recover of the bailor for injuries received as a consequence of the defect.

Sec. 41. Contracts against required care.—Certain classes of bailees have found it desirable to provide in the bailment agreement against any liability resulting from their negligence or that of their employees. Such a provision found in the contract of a quasi-public bailee, such as a railway or a hotel, is illegal and, therefore, ineffective. The ordinary private bailee, however, may insert in the contract any provision which he desires, so long as the bailor is willing to enter into the agreement under the particular terms. If the latter is unwilling to accept the particular terms, he is at liberty to contract elsewhere. Where the provision is such as to defeat the real purpose of the contract and to shock the sense of justice of the court, the provision will not be enforced. Thus, *A* stored apples in *B*'s private warehouse to protect them against the winter weather. The agreement provided that they were left at the owner's risk. *B* failed to heat the building and the apples were frozen. It was held that such a provision did not relieve *B* from liability.

Sec. 42. Effect of exceeding the bailment contract. — The bailment agreement governs the duties and rights of the bailee. Should he treat the property in a different manner, or use it for some purpose other than that contemplated by the contract, he becomes liable for any loss or damage to the property in the interim.[3] This result appears to be true, although the damage can in no sense be attributed to the conduct of the bailee. To illustrate: Let us assume that *A* stores his car in *B*'s public garage for the winter. *B*, because of a crowded condition, has the car temporarily moved to another garage without the consent of *A*. As the result of a cyclone the car is destroyed while at the second location. The loss falls upon *B*, as he has exceeded the terms of the bailment contract. In a restricted sense, the bailee is guilty of conversion of the bailor's

[2] Gagnon v. Dana et al., 1898, 69 N.H. 264, 39 Atl. 892; p. 753.

[3] McCurdy v. Wallblom Co., 1905, 94 Minn. 326, 102 N.W. 873; p. 754.

property during the period in which the contract terms are being violated.

Sec. 43. No right to deny title of bailor.—The bailee has no right to deny the title of the bailor unless he has yielded possession to one having paramount title. In other words, the bailee has no right to retain possession of the property merely because he is able to prove that the bailor does not have title. In order to defeat the bailor's right to possession, he must show that he has returned the property to someone having better title, or is holding the property under an agreement with the true owner.

Common Carriers

Sec. 44. Definition.—A common carrier of freight is defined as one who holds himself out as being ready and willing to carry goods for anyone who presents them. A common, or public, carrier is distinguished from a private carrier in that the former stands ready to serve anyone desiring the service, while the latter operates under a contact only. A common carrier usually operates between definite termini or over a definite route. A private carrier transports freight from point to point, as demanded by his contract with the shipper. A private carrier becomes a public one as soon as it begins to cover definite territory at somewhat regular intervals and carries goods for anyone desiring to ship them. An ordinary drayman is a private carrier, but the operator of a truck between two cities on a regular schedule would, under most circumstances, be a common carrier.

A common carrier rests under a duty to accept goods for transportation whenever they are presented. It may, however, limit its business to a particular kind of property. The mere fact that a truck owner limits his business to the transportation of milk does not render him a private carrier if he stands ready to carry milk for anyone. An express company is not bound to accept any or all personal property presented. Its business is limited to somewhat small and valuable articles.

Sec. 45. Care required of the common carrier.—The contract for carriage of goods constitutes a mutual benefit bailment, but the care required of the carrier greatly exceeds that of the ordinary bailee. A common carrier is an absolute insurer of the safe delivery of the goods to their destination. This rule is subject to only five exceptions. Any loss or damage which results from (1) an act of God, (2) action of an alien enemy, (3) order of public authority, (4) inherent nature of the goods, or (5) misconduct of the shipper must fall upon the one possessing title. Thus, any loss which results from an accident or the wilful misconduct of some third party

must be borne by the carrier. For example, *A*, in order to injure a certain railway company, sets fire to several boxcars loaded with freight. Any damage to the goods falls upon the carrier. On the other hand, if lightning, an act of God, had set fire to the cars, the loss would have fallen upon the shipper.

Any damage to goods in shipment which results from the very nature of the goods or from the failure properly to crate or protect the property must be suffered by the shipper. Thus, the damage to a shipment of fresh strawberries, caused by excessive heat during the period of shipment, must be borne by the shipper, provided the carrier has offered proper refrigeration.

Goods may be damaged while in the possession of either the receiving or a connecting carrier. Damages arising while goods are being transported by a connecting carrier may be recovered by the shipper from either of the two carriers. If the shipper files his claim against the original carrier, it, in turn, demands restitution from the connecting carrier.

Sec. 46. Contract against liability of carrier.—A common carrier may not contract away its liability for goods damaged in shipment by the negligence of its employees. Such a provision in a bill of lading is illegal. It may, however, where lower rates are granted, relieve itself from the consequences of causes or of conduct over which it has no control. Thus, a provision which relieves a carrier from damage caused by fire is effective, where the fire is not caused by any misconduct on the part of employees.

Furthermore, the company may limit its liability to an agreed valuation. The shipper is limited in his recovery to the value asserted in the bill of lading. The rate charged for transportation may vary with the value of the property shipped. It is for this reason that the agreed valuation is binding.[4]

Sec. 47. Beginning of the relation.—The liability of the carrier attaches as soon as the goods are delivered to it. The receipt of the goods is usually acknowledged by a bill of lading, which sets forth the terms and conditions of shipment. The carrier becomes responsible for a carload shipment as soon as the car has been delivered to it. If the car is loaded while located upon railroad property, the carrier becomes liable at the moment the car is fully loaded.

Sec. 48. Termination of the relation.—The extreme degree of care required of the carrier may be terminated before the goods are actually delivered to the consignee. Three views prevail in this country as to when the relationship of carrier ceases. Some states

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[4] Carpenter v. B. & O. R. R. Co., 1906, 22 Del. 15, 64 Atl. 252; p. 754.

hold that the duties of a carrier end, and those of a warehouseman begin, as soon as the local shipment is unloaded from the car into the freight house. Others hold the carrier to strict liability until the consignee has had a reasonable time in which to inspect and remove the shipment. Still other states hold that the consignee is entitled to notice and that he has a reasonable time after notice in which to remove the goods before the liability of the carrier as a carrier is terminated.[5] To illustrate: Let us assume that goods arrive at their destination and are unloaded in the freight house. Before the consignee has had time to take them away, the goods are destroyed by fire, although the carrier has exercised ordinary care. Under the first of these views, the loss would fall upon the shipper, as at the time of the fire the railway was no longer a carrier but a warehouseman. Under the other two views, the loss would fall on the carrier, as the extreme liability had not yet terminated, inasmuch as no time had been given for delivery.

The carload shipment is delivered as soon as it is placed on the private switch of the consignee or "spotted" at the unloading platform. Any subsequent loss, unless it results from the negligence of the carrier, must fall upon the owner of the goods.

Sec. 49. Rates.—Rates charged by common carriers must be reasonable. Carriers engaged in interstate business are subject to the regulation of the Interstate Commerce Commission and all tariffs or rate schedules must be filed with it. Almost all the states have railroad commissions for the purpose of establishing rates for intrastate business. These commissions also require tariffs to be filed with them. Any rate either higher or lower than that shown in the tariff is illegal. Discriminatory rates by the use of rebates are also forbidden, and the giving or receiving of rebates constitutes a crime.

A railway may insist upon the payment of the charges at the time it accepts the delivery. Since it has a lien upon the goods as security for the charges, however, it customarily waits until the goods are delivered, before collecting. The carrier usually refuses to surrender the goods unless the freight is paid, and, if the freight remains unpaid for a certain period of time, it may advertise the property for sale. Any surplus, above the charges, realized from the sale reverts to the owner of the goods.

An undue delay on the part of the consignee in removing the goods from the warehouse or the tracks of the railway permits the carrier to add a small additional charge known as demurrage.

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[5] Walters et al. v. Detroit United Ry. Co., 1905, 139 Mich. 303, 102 N.W. 745; p. 755.

Review Questions and Problems

1. A bill of lading of a common carrier contains a clause relieving it of liability for all loss to property in transit caused by fire. A fire, caused by the negligence of the carrier's agent, destroyed goods in shipment belonging to *B*. Has *B* an action against the carrier?
2. *A*, a customer of *B* Company, laid aside an old coat while trying on a new one. After trying on the new coat, *A* discovered that the old one had been stolen from the counter where it was laid. Is *B* Company liable for the loss?
3. *A* brought *B* some ore to be assayed and returned to *A*. *B* learned that the ore did not belong to *A* and refused to return it. *A* brought an action of replevin to recover the ore. Should he succeed?
4. *A* takes to *B*'s mill certain wheat to be ground into flour. After the wheat is ground into flour, but before the flour is returned to *A*, creditors of *B* levy upon the flour. Are their rights superior to those of *A*?
5. What degree of care must be used by a bailee in a mutual benefit bailment? *A* rents his car to *B*. What type of bailment is this? Is the bailor ever under a duty to notify the bailee of unknown defects in the article bailed?
6. What is meant by an act of God? Is a carrier an absolute insurer of the safe delivery of goods shipped?
7. *A* uses the property bailed to him for purposes other than those stipulated in the agreement. While it is being so used, it is accidentally destroyed. Assuming that the bailee was exercising due care at the time, is he liable for the loss?
8. Goods shipped over the *B* Railway are damaged by fire after they reach their destination and are placed in the warehouse. Under what conditions may the carrier be held liable?
9. Who establishes the rate charged by carriers?

Book VI

SECURITY FOR CREDIT TRANSACTIONS

Chapter I

BAILMENTS AS SECURITY

Sec. 1. Introduction.—Today, much of the business of the world is done on credit. It is natural that the person extending credit should take some means to protect himself against credit losses, particularly where the debtor is in a position to offer protection. Quite often the security accorded the creditor consists of a lien on property—usually in the nature of a pledge or mortgage. A pledge merely forms one of several bailments which may be used to protect the person extending credit. Consignments, common-law liens, and trust receipts are all forms of the bailment relationship, and will, along with pledges, be treated in this chapter.

Sec. 2. Consignments.—A consignment consists of a shipment of goods by the owner, called the consignor, to an agent, called the consignee, for the purpose of having them sold by the agent. A manufacturer who considers a retailer a poor financial risk often ships goods on consignment. In such a case the consignee, in disposing of the goods, acts as an agent of the consignor and receives a certain commission for his services. He holds, in trust for the consignor, all funds received from the sale of the goods. If goods are sold on credit, the consignor assumes the risk of collection, unless the consignee by agreement has guaranteed the collection of all accounts. The consignee has implied authority to sell on credit unless there is a clear custom to the contrary or unless the contract forbids it. Should he be careless in the selection of credit risks, he would, according to the rules of agency, be liable for any resulting loss.

All consignments are bailments. The consignor retains title, and possession will ultimately revert to him, unless he, acting through his agent, transfers title and possession to some third party. Thus the ordinary rules of bailment govern the relationship. The risk of loss, assuming the consignee exercises reasonable care, rests upon the consignor unless the agreement between the parties imposes upon the consignee the duty of carrying adequate insurance. The consignor must pay the taxes on the goods, and his creditors alone can levy on them, the creditors of the consignee having no interest therein.[1] In this connection, attention should be called to the fact that the consignee is entitled to assert a lien against goods in his

[1] Harris v. Coe et al., 1898, 71 Conn. 157, 41 Atl. 552; p. 759.

possession for any amount owed to him by the consignor under the consignment contract. Thus, the consignee might maintain a lien for advances to the consignor, for freight or for insurance, where these items have been paid for the benefit of the consignor. The claims of the consignor's creditors in the consigned goods are subject to the contract rights of the consignee. Such liens as existed for freight, insurance, and advances are superior to the claims of judgment creditors of the consignor.

It is often quite difficult to distinguish between a consignment and some form of sale. However, whenever the contract is so worded as to make it possible for the consignor to call upon the consignee for payment for the unsold goods, the transaction partakes of the nature of a sale and is no longer a consignment. In a consignment, the consignee rests under a duty to account only for the goods which have been sold. The consignor then repossesses those goods which are unsold at the termination of the relationship. It is also customary for the consignor to establish the retail price of the goods to be sold, although this conduct is not necessarily an incident of the relationship.

Sec. 3. Artisan's lien.—From a very early date the common law permitted one who expended labor or material upon the property of another to retain possession of such property as security for his compensation. This right was a personal one and, therefore, not assignable. Furthermore, it did not arise where the bailor had contracted for a period of credit. The lien arose only in case the bailee was entitled to his compensation upon completion of the task assigned.

The common-law lien also existed in favor of public warehousemen and common carriers.[2] Since the law required them to supply storage or carriage upon request, they were protected by a lien on the goods entrusted to their care. By statute, this lien has been extended in many states to include all cases of storage.

It should be noted that the lienholder has no right to charge storage for property in his possession, if he is retaining it merely for the purpose of maintaining his lien. Thus, if the owner is willing to take possession of his goods, although he is unable to pay the charges against them, the right to charge storage ceases. Neither does the lienholder have the right to use goods which he is retaining as security for an indebtedness.

The artisan's lien is inferior to a prior lien of record or a conditional vendor's claim but is superior to a later lien. The owner of mortgaged property, who takes it to an artisan for repairs, creates a

[2] Lewis v. Gray, 1912, 109 Me. 128, 83 Atl. 1; p. 760.

lien thereon which is inferior to the equity of the mortgagee, since the latter's claim arose first in point of time.

Sec. 4. Possession.—The artisan's lien has been somewhat modified by statute in the various states. Under the early law, continued possession of the property was required. A surrender of possession had the effect of canceling the lien, and a later return of the property would not cause the lien to revive. Likewise, if the property was later returned for additional repairs or for storage, it was impossible to "tack" the two accounts. A new lien arose to secure only the later bill. In general, it may be said that this common-law lien, with these same limitations, still exists. By statute, however, many states now permit the lienholder to surrender possession and still retain his lien for a limited time, provided a notice of lien is filed.

Sec. 5. Foreclosure.—At common law the only right of the lienholder was to retain possession of the property. If he desired to collect his charges, he was compelled to obtain a judgment and levy against the property, just as any other creditor was required to do. Because he retained possession of the property, his rights as a creditor were superior to those of other creditors. Here, again, legislation has generally changed the common-law rule and the lienholder is permitted to have the property sold for his benefit, any surplus reverting to the owner of the property.

Pledges

Sec. 6. Nature.—A pledge consists of a bailment of property by the owner to another as security for a debt. Attention should be focused upon the fact that the lien does not arise until the pledgee —one who receives the property—has actually taken the property into his possession.[3] If the property is of such a nature that actual physical possession is practically impossible, the pledgee may acquire constructive possession of it by taking steps of some kind to make it possible for third parties to learn of his interest in the property. Thus, crude oil or gasoline contained in a huge tank could not well be physically transferred from the pledgor to the pledgee, but constructive possession could be obtained if the pledgee placed an agent in charge of it, or if he leased the tank and posted on it notices of his lease or lien.

Any surrender of possession by the pledgee, even temporary, effects a release of the security during the period in which the owner is entrusted with the property. Any sale by the owner to an in-

[3] Abraham Heilbron et al. v. Guarantee Loan & Trust Co., 1896, 13 Wash. 645, 43 Pac. 932; p. 761.

nocent purchaser during such a period passes good title to the purchaser and thus defeats the security of the pledgee.

Although any kind of personal property may be pledged, usually a lien on tangible property is created by a mortgage. Therefore, notes, bonds, certificates of stock, and other evidences of property right, usually designated as collateral security, form the basis of most pledges. Mere delivery of such property is sufficient to create the lien, without any necessity for indorsement. Whenever negotiable instruments are concerned, the security of the pledgee is increased by an indorsement, as he then becomes a holder in due course, thus holding the paper free from personal defenses. The position of the pledgor is compromised, somewhat by indorsement, in that he thus places it within the power of the pledgee to pass title to third parties prior to default, although the right to do so does not exist.

Ordinarily, the pledgee gets no better title to, or equity in, the pledged property than the pledgor had when the pledge was created. However, where negotiable or seminegotiable paper is bearer in form or has been indorsed in blank by the owner, the one in possession has power to pass better title than he possesses. Thus, an agent in charge of an order bill of lading which has been indorsed in blank may effectively pledge it to an innocent creditor.

Sec. 7. Increase in pledged property.—Any natural increase in the property pledged becomes part of the pledge and may be retained by the pledgee as security. Thus, the pledgee becomes entitled to temporary possession of any natural increase in livestock, interest on indebtedness, or dividends on stock. This increase must be accounted for by the pledgee at the termination of the pledge. Thus, a pledgee who holds negotiable notes as security is entitled to collect interest as it falls due, but must account for it at the final settlement.

Sec. 8. Debts secured.—Unless provided otherwise, it is clear that pledged property secures only the debt for which the pledge is created. The pledgee is not entitled to hold the property as security for another debt unless there is an agreement to that effect. It is customary business practice, however, for the collateral agreement to provide that the collateral shall secure first the particular debt and then other obligations due, to become due, thereafter created in favor of, or acquired by, the payee. Where such terms exist, the pledgee may, after the original debt is paid, retain the collateral to secure other obligations running in his favor. Occasionally the agreement reads that the security is to protect the original debt and other obligations in favor of the holder thereof. In this case any person who holds the original indebtedness at its ma-

turity may use the pledge to secure other obligations due him as they mature.[4] In this connection, there is a distinct difference between holder and payee. If the right to hold the collateral as security for other debts rests in the payee, only the original payee can so use it.

A pledgee who transfers the pledge to an indorsee of the principal debt is not responsible for the misconduct of the indorsee with reference to the collateral. If the indorsee wrongfully disposes of pledged property, the loss cannot be attributed to the original pledgee. This is particularly true where the primary debt is negotiable in form, thus implying the right to negotiate it and transfer the collateral to the new holder of the indebtedness.

Neither does the original pledgee guarantee the genuineness of the collateral security to the indorsee of the principal debt. One obtaining unenforceable collateral from the original pledgee has no action against the latter because of that fact.

Sec. 9. Sale of pledged property.—The pledgee has no right to sell the pledged property until after maturity of the debt which the property secures. Neither has he any right to repledge the property as security for an obligation of his own, except as he pledges the obligation which the property secures in the first instance. Some notes provide that property pledged may be sold at any time the pledgee deems himself insecure. In such a case, the pledgee may sell the property at any time, provided he feels insecure.

The pledgee should not be permitted to profit by an improper sale and repurchase of the property pledged. Should the pledgee wrongfully sell the pledged property or repledge it without authority, he is guilty of conversion. In such a case the pledgor has an option of recovering the value of the property at the time of the conversion, or its value at the time he first demands it, or he may recover the property from the innocent purchaser unless negotiable paper is involved. Thus, assuming a sale by the pledgee without proper notice, the pledgor may recover the value of the property at the time of the sale or at the time he learns of the sale and makes demand for the property, whichever proves most profitable to him. If he does not care to do either, he may bring suit to recover the property from the purchaser at the sale, leaving the latter to bring an action against the pledgee.

Unless notice and public sale are waived by the pledge agreement, the pledgee, after default by the pledgor, must give both notice to the pledgor and public notice, and must sell the property at a public sale if he desires to realize upon the pledge. It is customary, however, to provide in the pledge agreement that the property

[4] Foster v. Abrahams, 1925, (Cal. District Court of Appeal) 241 Pac. 274; p. 761.

may be sold with or without notice, and at public or private sale. Under such conditions the pledgor may find that his property has been sold following default without his having received any notice.

Although the pledgee generally has the implied right, upon the pledgor's default, to dispose of pledged property, he does not have such right in the case of a pledge consisting of short-term notes. The pledgee may realize his pledge only by collection of the collateral notes as they fall due, unless the agreement provides otherwise. The loss that is likely to arise from a public sale of short-term notes is so great that the right to sell them arises only where it is expressly conferred.

The pledgee is under no duty to dispose of the property pledged as security with him, even though he is requested to do so by the pledgor.[5] He may sit idly by and watch the security decline in value without putting forth any effort to dispose of it, and still recover from the pledgor on the debt. If the pledgor desires to avoid such a loss, he should redeem the property or bring a buyer who is willing to pay enough for the pledged property to extinguish the debt which the property secures. The right of the pledgor to redeem arises at the maturity of the debt and continues until the pledged property has been properly sold by the pledgee. The pledgor cannot avoid a loss which results from a decline in the value of the pledge before the principal obligation matures. The pledgee may always hold his security until the debt falls due, unless the debt is payable "on or before" a certain date. In this case the debtor may pay it whenever he desires and demand the pledge.

The pledgee should take care not to alter the rights of the pledgor in the pledged property. He has no right to extend time on pledged notes, deposit bonds with a reorganization committee, or release security for pledged collateral without the consent of the pledgor. The latter is the owner, and his interest can be divested only by a sale of the property after default has taken place or by such other procedure as the pledge agreement makes provision for.

Sec. 10. Surplus after sale.—The pledgor may recover from the pledgee any surplus arising from the sale of the property, over and above the amount required to pay the debt. Any deficit which arises from a sale of the property may be recovered by the pledgee from the pledgor.

In case the pledgee sells the property before the debt matures, any profit from the sale belongs to the pledgor. Thus, a pledgee of stock in a corporation, who sells it when prices are high and repurchases it when they are lower but before the debt matures, makes a profit which the pledgor may recover.

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[5] Minneapolis & N. Elevator Co. v. Betcher, 1889, 42 Minn. 210, 44 N.W. 5; p. 762.

Trust Receipts

Sec. 11. Nature.—A relatively new device, which is finding general favor as an instrument for financing purchases by the retailer, is the trust receipt transaction. The trust receipt indicates that the entruster has advanced money to the trustee for the purchase of goods, the goods being held in trust for the entruster until the indebtedness is satisfied. It is made use of primarily where some agency, usually not related to the manufacturer, is financing purchases of rather expensive items of stock in trade and where the chattel mortgage is an unsatisfactory instrument. The finance company advances a large portion of the purchase price and accepts the trust receipt as its security. The retailer, known as the trustee, is generally authorized to sell the articles in the ordinary course of trade, but at the time of sale an accounting of the proceeds, to the extent of the loan, must be rendered to the finance company. The lien of the entruster—finance company—extends to contract claims and negotiable instruments received by the retailer in settlement of credit sales. Thus, if a retailer sells an automobile to a consumer and receives a negotiable note in settlement, the finance company has a claim on the note. The note in such a case is substituted as security in place of the automobile.

The trust receipt has not been used to protect old obligations, and under the Uniform Trust Receipts Act, recently enacted by a substantial number of the states, it can be used only to protect some third party who has advanced money with which to buy new stock or has advanced it to pay for stock previously purchased but remaining on the floor. It is not essential under the uniform law for the lender ever to have had the goods in his possession, the lien arising as soon as the loan is made against the particular property.

The trust receipt, in many respects, is like a chattel mortgage, and in some states has been held to be such under the recording laws, thus making the security ineffective unless the trust receipt conforms to the law relating to mortgages and is properly recorded. In some particulars it partakes of the characteristics of a consignment, and in others it is similar to a conditional sale, but it resembles the pledge most. It differs from a pledge mainly in that possession is not required to protect the lender.

Sec. 12. Rights of purchaser.—Since the entruster authorizes the trustee to sell the goods held in trust as a means of obtaining funds with which to liquidate the loan, a purchaser in the ordinary course of business obtains good title. The entruster loses his claim to the property but has a claim to any unpaid balance, provided that the claim is made before the consumer pays the retailer. In

such cases the consumer may assert any setoff or defense against the entruster that he possesses against the trustee.

One who purchases other than in the usual course of business, or who obtains a judgment against the trustee and seeks to levy against the property, takes the goods subject to the equity of the lender.[6] One who takes the goods in satisfaction of an old debt, giving a release of the obligation, receives a defective title in that he may have to surrender them to the entruster. To the extent that he gives new consideration, in addition to the cancellation of the old debt, his claim is superior.

The Uniform Act provides for filing a copy of a general contract, under which the parties expect to operate, with the Secretary of State.[7] If this is not done within thirty days after the loan is made, the lien of the entruster is inferior to that of an intervening creditor or purchaser not in the usual course of business. Once the agreement is filed, the entruster is protected on all transactions occurring during the following year, a new filing being required annually. Most of the states do not require recording in order for the entruster to protect himself.

Storage, processing, or transportation liens are superior to the claim of the finance company. Since such liens are customarily incurred in the regular course of business, the lender assumes these risks at the time the loan is made.

Sec. 13. Rights of the entruster.—In case the entruster fails to obtain payment of the debt at maturity or finds the borrower in default on any other term of the contract, he may possess the goods. The contract may legitimately provide many causes for possession by the lender, such as insolvency of the borrower, a judgment against him by some third party, or a feeling of insecurity on the part of the lender. After possession of the goods is taken by the entruster, he may, under the Uniform Act, sell them at public auction and apply the proceeds on the indebtedness, any deficit remaining a claim against the borrower. Any expense of selling or possessing the goods is added to the indebtedness. Where the Uniform Act has not been adopted, the contract makes provision for the right to possess and resell the goods.

If the retailer has sold the goods and has failed to account for the proceeds, the lender may recover any identifiable proceeds or other property acquired therewith, provided the proceeds are still in the trustee's possession.[8] This is true, however, only if action is taken

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[6] General Motors Acceptance Corporation v. Hupfer, 1925, 113 Neb. 228, 202 N.W. 627; p. 763.

[7] Donn v. Auto Dealers Inv. Co., 1944, 385 Ill. 211; 52 N.E.(2) 695; p. 764.

[8] Commercial Credit Co. v. Barney Motor Co., 1938, 10 Cal.(2) 718, 76 Pac.(2) 1181; p. 766.

promptly, thus avoiding injury to innocent third parties.[9] The Uniform Act goes beyond and provides for a preference in liquidation in case the lender can show that the assets of the borrower have been increased by the proceeds received from the sale, it being unnecessary to identify particular proceeds.

Review Questions and Problems

1. *A* shipped *B* goods on consignment. They were to be sold at prices established by *A*, and the consignee, *B*, was to account at the end of each week for the goods sold, less a certain amount for his commission. While the goods were in *B*'s possession, they were destroyed by fire. Who must bear the loss, assuming that *B* exercised proper care?

2. *A* takes his car into *B*'s garage for repairs. At that time there was a properly recorded chattel mortgage on the car. *A* failed to pay either the mortgage or the repair bill. Whose lien is superior?

3. What steps must the pledgee take before disposing of pledged property? How may he avoid this procedure?

4. Is the pledgor or the pledgee entitled to the surplus arising from a sale of pledged property? May the pledgor demand that the pledgee sell the pledged goods after default?

5. *A* pledged ten bales of cotton as security for an indebtedness of $200 and any other obligations due, to become due, created, or hereafter to be created, in favor of the payee. The payee of the obligation negotiated it to *H* and transferred the collateral to him. At the time of *A*'s bankruptcy, *H* held an additional claim of $300 against *A*. Are both claims secured by the cotton?

6. One who has a lien upon an automobile for repairs surrenders possession of it to the owner. What happens to the lien under the common law? Has the result been changed by statute?

7. If *A* consigns to *B* goods for resale, may *B*'s creditors levy upon the goods?

8. *A* loaned money to *B*, a retailer, with which to purchase automobiles for resale. As security for the loan, *A* accepted a note from *B* and a trust receipt for the cars. *B* sold one of the cars in the regular course of business on a conditional sale contract, the conditional sale contract and accompanying note being sold to a local bank. As between *A* and the bank, whose claim to the note is superior?

9. *P* placed a diamond necklace in the hands of a jeweler in order that the latter might show it to a prospective purchaser. Instead of selling it, the jeweler pledged the necklace to the defendant as security for a loan of $1,000. Can *P* successfully replevin the necklace?

[9] Universal Credit Co. v. Citizens State Bank, 1945, (Ind.) 64 N.E.(2) 28; p. 768.

Chapter II

CHATTEL MORTGAGE

Sec. 14. Nature of mortgage.—A chattel mortgage is a transfer of a defeasible title to personal property as security for a debt. The title is defeasible in that the mortgage agreement provides that the property may be redeemed by payment of the debt at any time before foreclosure. The person giving the mortgage is known as the mortgagor, while the one accepting it as security is called the mortgagee.

A chattel mortgage differs from a pledge in that it usually provides for the retention of possession by the mortgagor, while a pledge is good only when the pledgee remains in possession. Furthermore, the pledgee obtains an inherent right to dispose of the property upon default of the debtor, whereas the mortgagee must foreclose in accordance with the statutes of the particular state, in order to secure his money. The mortgage agreement may grant to the mortgagee a right to possess, sell, and dispose of the property in case of default; but in many states this right is encumbered, by statute, with requirements for giving notice, for public sale, and for an accounting, which requirements render a sale by the mortgagee only slightly less cumbersome than foreclosure.

Sec. 15. Property subject to a mortgage.—Property cannot be the subject of a mortgage until such time as it has either actual or potential existence. Thus, bricks not yet formed, or furniture as yet unprocessed, cannot be effectively mortgaged as bricks or furniture. Since no such product to which title may be transferred as yet exists, it can be neither sold nor mortgaged.[1]

Property has potential existence when it will normally come into being without the aid of man: that is, when the property out of which the increase naturally springs is present. The states are somewhat in conflict concerning the time when crops to be grown on certain land have potential existence. A bare majority of the states permit a chattel mortgage on grain crops to be registered, although the crops have not been planted. A strong minority, however, insist that the crops must be planted before they may be effectively mortgaged. The majority of the states thus make it possible to create a mortgage on crops that are to be grown during a number of years in the future. So long as the mortgagor has an interest in

[1] Townsend Brick & Contracting Co. v. Allen et al., 1900, 62 Kan. 311, 62 Pac. 1008, 52 L.R.A. 323; p. 771.

the land equal to the period covered by the mortgage, the crops are said to have potential existence.

If no crops are grown by the mortgagor, or if the mortgagor's right in the land is disposed of before the crops mature, the holder of the chattel mortgage has no security for his debt. A mortgage on future crops is good only in case the crops mature and are harvested by the mortgagor before his interest in the land expires or is terminated.[2]

Property to which the mortgagor has no title may not be effectively mortgaged. Such an attempt amounts in equity to a promise to mortgage, and will be enforced between the immediate parties as soon as title is acquired by the mortgagor. A mortgage on property to be acquired in the future, however, is not valid as against an innocent third party, even after title has been acquired, unless the mortgagee immediately takes possession of the property or obtains and files a new mortgage. One who is interested in determining the status of title to personal property seldom searches the records beyond the date upon which the owner purchased the property. He concludes that no mortgage would be created before the property was purchased. Therefore, a mortgage given before title is acquired is not effective against good-faith purchasers of the property. An "after acquired" clause is subject to the same objection. A mortgage on presently owned property which attempts to cover other property obtained by purchase or gift during the life of the mortgage is effective only on the presently owned property as against innocent third parties. If the newly acquired goods are sold to innocent purchasers, the purchasers obtain good title. In several of the states a judgment creditor's lien is superior to the mortgagee's "after acquired" clause.

In a number of the states an exception to this rule exists in the case of a stock of merchandise. In these states a mortgage upon stock in trade which covers subsequently acquired goods, purchased with the proceeds from the sale of the mortgaged stock, is effective. Perhaps a slight majority of the states follow the general rule and refuse to uphold the validity of the mortgage on subsequently acquired stock in trade.

Sec. 16. Recording mortgage.—A chattel mortgage which permits the mortgagor to remain in possession of the mortgaged property becomes effective against bona fide purchasers and judgment creditors only when it is properly executed and recorded or filed.[3] The statutes of most states require that the mortgage be recorded or filed—some require recording, while others provide for filing—

[2] McMaster v. Emmerson et al., 1899, 109 Iowa 284, 80 N.W. 389; p. 772.
[3] Seacoast Finance Corp. v. Cornell et al., 1927, 104 N.J.L. 24, 138 Atl. 695; p. 773.

with the recorder of the county in which the mortgagor resides. In a few states it is recorded in the county offices of the county in which the property is located. Removal of the mortgagor from one county or state to another, with the consent or knowledge of the mortgagee, imposes a duty upon the latter to record his mortgage in the new location.[4]

A bona fide purchaser is one who gives value for the property without knowledge that it has been mortgaged. Even though the mortgage is not recorded, a purchaser with knowledge of its existence takes subject to the mortgage. He cannot, by purchasing the property, cut off a superior equity of which he is aware. In most states a mortgage is not effective until it is placed on record or until third persons have knowledge of it. Any rights of third parties in the property, which intervene between the giving and the recording of the mortgage in these states, are superior to the mortgage. In a few states the statute provides that a mortgage must be recorded within ten days after it is given, or else it is void as to all creditors.[5] Prompt recording of a chattel mortgage is desirable, since secret liens are not favored by the courts.

Attention should be called to the fact that recording or filing is unnecessary where the mortgagee takes possession of the property.

In order for a purchaser of personal property to be certain that no lien exists against it, he should search the records of the county in which the mortgagor resides, and he should also inquire of any third party who happens to be in possession of the property of what the latter's interest consists.

A chattel mortgage may not be filed or recorded unless it has been properly executed. The laws of the various states determine the form of the mortgage and require that it be sworn to before some public officer. The particular public officers who may perform this duty differ in various states.

Sec. 17. Description of goods.—Extreme care should be exercised by the mortgagee in the description of the property mortgaged. It must be described with sufficient clearness to enable interested third parties to identify the property.[6] As between the immediate parties, however, whenever a description proves ambiguous, evidence may be introduced to prove their intention.

A mortgage on growing crops is effective only when the real estate

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[4] First National Bank of Ellsworth v. Ripley, Sheriff, 1927, 204 Ia. 590, 215 N.W. 647; p. 773.

[5] Illinois Nat. Bank & Trust Co. v. Holmes, 1941, 311 Ill. App. 286, 35 N.E.(2) 823; p. 774.

[6] Baldwin v. Boyce, 1898, 152 Ind. 46, 51 N.E. 334; p. 776.

upon which the crops are to be grown is specifically designated. Such a mortgage is not defeated by the fact that the crops are later harvested and confused with other goods.

A mere change in the form of the property does not affect the validity of the mortgage. Thus, it has been held that a mortgage on leather is good also on shoes manufactured from the leather. So long as the mortgaged property can be traced into the new article, and forms the major portion of it, the mortgage is good.

Some question exists as to whether the natural increase of livestock is covered by a mortgage, where the matter is not specifically mentioned. Although there are very few cases on the subject, the prevailing view seems to be that the increase follows the property mortgaged and is subject to the lien. However, to be safe in such cases, it is best to provide definitely that the increase of the livestock shall be subject to the terms of the mortgage.

Sec. 18. Loans secured.—The purpose of a mortgage is to secure the payment of a debt. It may secure only one obligation, or various ones, depending upon the mortgage agreement. If the mortgage is correctly drawn, it may secure advances to be made in the future, as well as existing loans. Where the agreement includes a stipulation covering future advances, any advances made thereunder carry security superior to a second mortgage on the same property in favor of some third party, although the second mortgage is given and recorded before the advances are made. To illustrate: *A* gives *B* a chattel mortgage to secure a present loan of $500 and other sums as advanced, not exceeding an additional $1,000. Shortly thereafter, *A*, to secure a loan of $400, gives *C* a second mortgage on the same property. Still later, *B* advances *A* an additional $500. Clearly, in such a case *B* is protected under his mortgage to the extent of $1,000, before *C* can expect any security. However, a second mortgagee may limit the advances which are possible under a first mortgage by giving the first mortgagee actual notice of the former's interest. Mere recording of the second mortgage does not have this effect, although actual knowledge of the inferior equity will have, regardless of how the knowledge is obtained. Thus, in the illustration, if *C* had informed *B* of the second mortgage before the advance was made, *C*'s lien would have been superior to that which protected the later advance. However, the mere recording of *A*'s mortgage to *C* did not have the effect of giving notice, as *B* was under no duty to inspect the records after he recorded his mortgage.

When the mortgagee has contracted to make certain future advances, the better view is that he is not limited, in making the

advances, by knowledge of inferior liens. It is only where the advances are optional that knowledge of an inferior lien precludes the right to make additional advances.

A mortgage should accurately describe the obligations which it secures. It is only by such a description that the purchaser of mortgaged property can ascertain the indebtedness which he must pay in order to clear the property of the mortgage. The courts will, at the instance of an interested party, avoid a mortgage in which the amount has been fraudulently overstated. If the overstatement is the result of an error or mistake, the mortgage is usually held to be good security for the actual amount of the indebtedness.

Sec. 19. Waiver.—Most states provide for certain penalties in case the mortgagor sells or moves the mortgaged property without the consent of the mortgagee. If the mortgagee consents to a sale of such property, he thereby waives his lien, and the purchaser obtains good title.[7] A general authority to sell, granted by the mortgagee, constitutes a waiver of all interest in the property or the proceeds of sale. In order adequately to protect his interest, where a sale appears desirable, the mortgagee should either sell the property himself, after securing the consent of the mortgagor, or make the latter an agent to sell for the benefit of the former. If the mortgagee pursues the latter course, he maintains his lien upon the proceeds resulting from the sale.

Sec. 20. Foreclosure.—Whenever the mortgagor defaults or fails to meet the obligation which the mortgage secures, the mortgagee is entitled to foreclose. A foreclosure is effected by a court order giving authority to some court officer, usually the sheriff, to sell the property. The debt is then paid out of the return from the sale. Inasmuch as a mortgage is given merely for security, any surplus arising from foreclosure must be paid to the mortgagor. Any deficit existing after the sale price has been applied to the debt may be recovered from the mortgagor, along with any court costs attached to the proceedings.

In order to avoid the time and expense involved in a foreclosure suit, the majority of mortgage agreements provide that the mortgagee may, upon default, take possession of the property and sell as best he can. As mentioned before, many states, by statute, have modified this right in various ways. For example, Illinois demands in such a case that the sale be public, after requisite notice has been given, and that an accounting be rendered to the mortgagor within a certain period after the sale has taken place.

[7] Van Sant v. Austin-Hamill-Hoover Commission Co., 1927, 221 Mo. App. 1096, 295 S.W. 506; p. 777.

The duration of a mortgage and the time within which it must be foreclosed are often prescribed by statute in the various states. Thus, in Illinois a chattel mortgage may not exceed five years in duration and must always be foreclosed within ninety days after maturity.

Review Questions and Problems

1. Who usually retains possession of property secured by a chattel mortgage? What kind of property is subject to a chattel mortgage?
2. *A*, desiring to purchase two trucks, gave to a bank a mortgage on the trucks to obtain the money with which to purchase them. He then purchased the trucks. He later sold one of these trucks to *C*, an innocent purchaser. Assuming the mortgage to be properly recorded, whose claim to the truck is superior?
3. Is recording always essential to the validity of the mortgage?
4. *A* gave *B* a chattel mortgage upon certain leather. This leather, unknown to *B*, was converted into shoes and sold to *C*. Does *C* take the shoes subject to the mortgage?
5. May future loans be secured by a chattel mortgage and be effective against intervening mortgages?
6. *A* held a mortgage on *B*'s wheat crop. He told *B* to sell the crop and to pay him the amount of the debt. *B* sold the wheat, but used the money for other purposes. Did *A* lose his lien on the wheat?
7. May the mortgagee take possession and sell the mortgaged property in case the mortgagor has defaulted in payment of the debt?
8. *A* borrowed $5,000 of *M* and gave him a chattel mortgage on certain cattle as security for the loan. The mortgage was properly recorded, but *A*, prior to the maturity of the debt, sold some of the cattle and increase therefrom to *X*, a packer who resided in another state. *A* failed to pay *M* and the latter desires to recover of *X*. Is *X* liable and, if so, to what extent?

CHAPTER III

CONDITIONAL SALES

Nature

Sec. 21. Requisites of a conditional sale.—An increasingly important device used for the protection of the businessman who sells on credit is the conditional sale. There was a time when the use of the conditional sale was confined largely to installment sales; but, because of its simplicity and its adaptability to the protection of the vendor, its use has become widespread in all sales which involve a period of credit.[1]

A conditional sale is one in which title to the property under sale does not pass to the vendee until some specified condition has been satisfied. The contracting parties are at liberty to establish any condition precedent to the passing of title which they see fit to stipulate. In business, however, the conditional sale is considered one in which the title is to pass only after full payment of the purchase price. In other words, in a conditional sale, title is retained by the vendor as security for the purchase price, although possession is surrendered to the vendee.

The only formal requisite required by the law of most states for the validity of a conditional sale is a stipulation in the agreement which indicates that title is retained by the vendor.[2] By statute, in a slight majority of the states, the agreement must be signed by the purchaser, and must be recorded or a copy must be filed in the recorder's office. The common law required no record; but, for the protection of innocent third parties, who often are led to purchase the property because of the apparent ownership of the vendee, a slight majority of the states have enacted legislation which requires either recording or filing. In those states which have no such legislation, the innocent purchaser from a conditional vendee takes subject to the title of the vendor. The conditional vendee has no title and is, therefore, incapable of transferring it.[3]

The conditional sale is not available as a general security device. It grows out of a sale of personal property and cannot be used effectively after title has passed to the buyer. Similarly, an attempt to secure a loan or a past due indebtedness by the execution of a note which states that the creditor is retaining title to certain goods un-

[1] See form #8.

[2] Adams v. Askins, 1927, 215 Ala. 632, 112 So. 199; p. 779.

[3] Fairbanks-Morse & Co. v. Parker et al., 1925, 167 Ark. 654, 269 S.W. 42; p. 779.

til the debt is paid, is meaningless. In such a case, title to goods belonging to the debtor cannot be retained by the creditor since the latter never at any time held title to them.

Sec. 22. Other conditions.—A recent tendency has been observed to provide that title shall not pass until the purchase price and all bills for repairs on the article sold, arising during the life of the contract, have been paid. Thus, the retailer of automobiles or tractors often provides that title shall not pass until bills for repairs supplied or services rendered are satisfied. From this point, it is only a short step to a more inclusive clause which calls for retention of title until all debts owing the seller, for this or other items, shall have been liquidated. Thus, certain retail concerns engaged in installment selling now make the transfer of title dependent upon final payment of all credit transactions arising during the life of the contract. Theoretically, since the transfer of title is a matter of contract, it seems that such agreements should be enforceable. At present there is no well-defined law on the subject, but, considering the fact that many states do not have recording laws for conditional sales and that in a few states all security transactions of this character are treated as mortgages, it is questionable if these provisions will be enforced against third parties.

Sec. 23. Fixtures.—Retention of title to articles which the conditional vendor knows or has reason to believe will be attached to larger items gives the vendor a right to repossess as against the vendee or any one having an equity in the larger item, which equity arose prior to the conditional sale. This is true only if the article can be repossessed without serious injury to the larger unit. Thus, the conditional vendor of automobile tires may repossess them as against the conditional vendor of the car, but is compelled to account for the old tires in case he traded for them.

One who acquires a later equity in or title to the larger unit has a superior claim to the conditional vendor of the fixture. A manufacturer of refrigerators, having sold some to the owner of an apartment house for installation therein, cannot repossess them, upon default, as against a later mortgagee of the premises. The later lien claimant has extended credit on the strength of the larger unit in its improved condition and ought to have full protection accorded to him.

Sec. 24. Sale for the purpose of resale.—Where goods are sold under a conditional sale agreement to a vendee whose business it is to resell them, the retention of title clause is not effective as against those who purchase in the ordinary course of business. Thus, a manufacturer who sells his product on credit to a retailer and protects himself with the use of the retention of title clause, cannot ex-

pect to assert his right to the property as against one who purchases from the retailer in the ordinary course of business. This rule applies, despite the fact that the retailer has failed to pay for the goods. In the majority of states, however, such a retention of title is good against attaching creditors and against those who take the goods other than as purchasers in the ordinary course of business. Thus, goods sold by the manufacturer under such an agreement cannot be levied on and sold by creditors of the retailer unless the goods have been paid for by the latter. The only reason the ordinary purchaser obtains good title is that the manufacturer who sells to a retailer impliedly assents to the resale of, and transfer of title to, such goods. It is only through a resale of the property that the manufacturer expects to receive his money. Therefore, he impliedly waives his title to the goods whenever they are sold by the retailer, whether they are sold for cash or on credit.

A manufacturer or wholesaler who sells to a retailer and uses the conditional sale as security for the credit extended, has no equity or interest in the proceeds realized by the retailer at the time the goods are sold. The proceeds belong to the retailer, and the manufacturer or jobber becomes an ordinary creditor in the event the retailer fails to pay his obligation. The latter's agreement with the producer is usually so worded as to require him to pay promptly after the goods have been sold.

Sec. 25. Rights of the vendor.—The conditional vendor has a choice of two remedies in the event of default in payment by the vendee. He may elect to rescind the agreement, or he may institute suit to recover the amount due under the sale agreement. If he decides to rescind, he informs the vendee, and, if payment is not made, he demands possession of the property. Rescission entitles the vendor to possession of the property and to the right to retain all payments previously made, but it gives him no right to recover any possible deficit. Thus, in the absence of an agreement to the contrary, when property is repossessed by the vendor and resold for less than the balance due, the loss must be borne by the vendor. On the other hand, if the property sells for more than the balance due, the vendor is entitled to keep the surplus. Even though the property sells for enough to create a surplus after all the costs of resale are paid, the vendee has no right to it. Because of these rules, it is customary to include in conditional sale agreements a provision which calls for payment to the vendor of any deficit after all expenses of repossessing and resale are cared for. Such a provision adequately protects the vendor, but accords the vendee no right to recover in case a surplus exists. A provision giving this right to the vendee may be, but seldom is, included. A few of the states have

adopted the Uniform Conditional Sales Act, which definitely provides for the recovery of any deficit by the vendor and of any surplus by the vendee.[4]

Sec. 26. Foreclosure.—No formal procedure has been established for the foreclosure of the conditional sale. It is entirely a matter of rescission by the vendor.[5] The vendee having defaulted in payment of the purchase price, the vendor is entitled to possession of the property after making a demand, unless the payments due are paid. If possession is not voluntarily surrendered, the vendor may use any peaceable means at his disposal to obtain possession. Some state courts have held that the vendor may exercise reasonable force in reducing the property to possession.[6]

After the property has been repossessed, no formal court order is essential before it may be resold. The vendor is at liberty to sell it or not, as he sees fit. All interest of the vendee in the property or the proceeds of sale have been cut off by the rescission, except in those rare instances in which the agreement or special legislation has increased his common-law rights.

Many conditional sale agreements provide that the vendor shall have the right to enter and take the goods whenever the vendee attempts to sell, mortgage, or move them, or whenever creditors of the vendee levy on the goods or the vendor deems himself insecure. In the event the vendor elects to retake the property because of a breach of any of the above provisions, he has no right to sell or to dispose of the property unless that right has been expressly conferred by the agreement. The right to rescind and to sell the property arises only upon default in payment, unless the agreement stipulates otherwise.

Sec. 27. Rights of the vendee.—The conditional vendee has a right to the possession and beneficial use of the property until such time as the vendor elects to rescind upon proper cause. He may sue and recover damages for any wrongful interference with his possession or use of the property. He is entitled to the benefits conferred by any of the warranties, either express or implied, just as though he had title. A breach of any warranty gives him the same right that it would give to any other purchaser.

In addition to these rights, the vendee may assign his conditional sale agreement to third parties and thus dispose of his interest in the property, subject only to the rights of the vendor. This right to assign the agreement may be barred by a provision in the con-

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[4] Hare & Chase, Inc. v. Hutchison et al., 1927, 3 W.W. Harr. 384, 138 Atl. 611; p. 780.

[5] C. I. T. Corporation v. Corey, Sheriff, 1938, 58 Ida. 763, 79 Pac.(2) 542; p. 781

[6] Lambert v. Robinson et al., 1894, 162 Mass. 34, 37 N.E. 753; p. 782.

tract of sale forbidding it. In any event, an assignment of the agreement does not relieve the vendee of liability for the balance of the contract price. In effect, he becomes a surety for the faithful performance of the contract by the assignee.

Transfer of Title

Sec. 28. Title passes at time of payment.—Title to goods sold under a conditional sale agreement automatically passes to the vendee upon payment of the purchase price, unless other conditions are prescribed in the contract.[7] A valid tender of payment has the same effect, although the tender is refused by the vendor.

Some little conflict exists where notes are received in settlement for goods sold under such an agreement. The mere taking of a note does not, by the law of most states, constitute payment; the note represents only the agreement for an extension of credit. Therefore, receipt of a note in settlement for goods sold does not cause title to pass.[8] Furthermore, it has become customary in many localities to use what is known as a "title retaining note." Such a note definitely stipulates that title to the goods for which it is given is to be retained by the holder of the note until the goods are paid for. Such a note clearly indicates that title is being retained until the indebtedness is paid.

The conflict becomes more pronounced, however, where security is accepted in addition to the note itself. What effect upon title has the giving of a note by the vendee, if the note is secured by a pledge, surety, or chattel mortgage upon other goods? The cases are fairly evenly divided on this question, but the slight weight of authority, as well as the better view, seems to be that such a note does not represent payment and that title does not pass until final payment is made, unless an agreement is reached that the note is to constitute payment.

Whenever the payee of a conditional sale note sells or discounts it, the retention of title clause acts as security for the benefit of the new holder of the note. In case the buyer defaults in payment, the holder of the note has all the rights which were formerly attached to the conditional vendor. If the note is not a title-retaining one, the purchaser of it is better protected by having the contract of sale assigned to him at the time the note is acquired. Even where this precaution has not been taken, it has been held in a few

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[7] Automobile Service Corporation v. Community Motors, Inc., 1941, 312 Ill. App. 263, 38 N.E.(2) 512; p. 783.

[8] McMullen Machinery Co. v. Grand Rapids Trust Co., 1927, 239 Mich. 295, 214 N.W. 110; p. 785.

cases that title follows the note and rests in the purchaser until the purchase price is paid.

A borrower who pledges conditional sale contracts as security for his indebtedness does not, by the act of pledging, give to the pledgee the right to repossess the goods upon default in payment. The power to repossess rests in the real creditor, but, if exercised, will benefit the pledgee. The pledgee may legally exercise the right to repossess only when the pledge agreement expressly grants him that right.

Sec. 29. Election by the vendor.—The conditional vendor becomes possessed of an option in the event of default by the vendee. He may rescind the agreement and repossess the property, or he may bring suit and obtain a judgment for the purchase price. Should he elect one of these remedies, his election operates as a bar to the use of the other. Thus, after the vendor has sued for the purchase price and obtained judgment, he may not later elect to rescind and demand possession of the goods.[9] Title passes as soon as judgment for the full purchase price is obtained, even though the judgment remains unpaid. The right to a judgment exists only on the theory that title quite definitely rests with the purchaser.

Where goods are to be paid for in installments, suit for any particular installment, with the exception of the last one, does not operate to pass title. The vendor is entitled to all installments, except the last, without the transfer of title. It is only where the last installment is due, and suit is brought for the entire balance due, that title passes to the vendee.

Sec. 30. Risk of loss.—As a general rule, it may be said that risk of loss follows title. This fact was found to be true of ordinary sales; whether the vendor or the vendee had to bear the loss depended upon which had title at the time the loss occurred. In a conditional sale, however, title is retained by the vendor merely as security for the purchase price; possession and the beneficial use of the property reside with the vendee. For these reasons, any loss occasioned by destruction of, or damage to, the property must be suffered by the vendee, provided title would have passed in an ordinary sale. Thus, in all cases where the goods have been delivered, the vendee assumes the risk. To illustrate: *A* sells *B* an automobile for $500 on credit and retains title as security. The car is destroyed by fire while $300 of the purchase price remains unpaid. *B* still owes *A* a duty to complete his payments, although the car is destroyed without any fault on his part.

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[9] Loden v. Paris Auto Co., 1927, 174 Ark. 720, 296 S.W. 78; p. 787.

Review Questions and Problems

1. What is the purpose of a conditional sale? How is it effected? In the absence of statute is it necessary to record or to file a conditional sale?

2. *A* sold the *B* Company some machines under a conditional sale contract. The *B* Company paid one third of the purchase price and gave notes for the balance. *B* Company defaulted in payment and *A* repossessed the goods. May the receiver of the *B* Company recover the payment made to *A*? Has he the right to one third of the goods?

3. *A*, a manufacturer of wagons, sold a number of them to *B*, a retail implement dealer, under a conditional sale agreement. *B*, not having paid *A* for the wagons, sold two of them to *C* and received payment for them. *A* later demands the wagons from *C*. May he recover them? Are the funds received by *B* to be held in trust for *A*?

4. A conditional vendor obtains a judgment for the unpaid purchase price of certain goods. The judgment not being paid, he desires to take possession of the goods. Is he free to do so?

5. Under what conditions is the vendor entitled to recover a deficit at time of resale? May the vendee recover any surplus?

6. What effect upon the passing of title does the taking of a secured note by the vendor have?

7. Under a conditional sale, upon whom does the risk of loss fall?

8. *S* sold a furnace to *B* under a conditional sale contract, the purchase price to be paid in installments. The furnace was installed in a residence upon which there was a mortgage in favor of *M*. *B* failed to pay the mortgage or to pay for the furnace. *M* seeks to enjoin *S* from removing the furnace. Should he be successful?

9. *D* owed *C* $500 for money previously borrowed. He gave *C* a new note for that amount, which stated that *C* was retaining title to certain property, owned by *D*, until the note was paid. This property, which had at all times been in the possession of *D*, was later sold by *D* to an innocent purchaser. Did the innocent purchaser obtain good title?

CHAPTER IV

SURETYSHIP

Nature

Sec. 31. Introduction.—Although security often takes the form of a lien on property, credit may be extended upon the combined financial standing of the debtor and some third person. The agreement whereby the third party extends his financial standing as security for the debtor is known as a contract of suretyship.

Since much of the business carried on today is conducted by agents, it becomes necessary for the principal to exact the utmost honesty and good faith of his agent in the performance of his duties. Whenever the principal is unwilling to repose such confidence in the agent alone, he usually obtains what is known as a bond for faithful performance, which is signed by the agent and some third party. This bond also amounts to a contract of suretyship. A contract of suretyship, therefore, appears to have for its objective, security either for the payment of money or for the faithful performance of some other duty, in the latter case often being known as fidelity insurance.

The person primarily bound to perform is known as the principal or principal debtor; the party secondarily liable is called the surety or guarantor; while the party entitled to performance is customarily spoken of as the creditor.

Sec. 32. Nature of relation.—Whenever, as between two parties, one of them is primarily liable and the other secondarily liable for the faithful performance of an obligation, a suretyship relation exists. As soon as interested third parties learn of this status, they become bound to treat it as such. To illustrate: Let us assume that *A* and *B* are partners in the mercantile business. *A* disposes of his interest in the firm to *B*, who assumes all outstanding obligations. A suretyship relation immediately comes into existence; *B* is primarily liable and *A* is secondarily liable. As soon as the creditors are notified of the new relation, they are called upon to treat *A* as any other surety.

The same general situation arises where a mortgagor of property disposes of his equity to one who is willing to assume the mortgage debt. The mortgagor becomes in effect a surety for the faithful performance of the purchaser.

Sec. 33. Results from contract.—The suretyship relation results from a contract. This contract, like any other, must be sup-

ported by some consideration. In addition, the Statute of Frauds requires an agreement whereby one is to become responsible for the debt, default, or miscarriage of someone else, to be in writing.

The duties assumed by the surety are largely determined by the contract terms. In the absence of a stipulation to the contrary, the surety is responsible only for the future conduct of the principal. The contract does not relate to past transactions or conduct of the principal, unless there is a definite stipulation to that effect, because, in the interpretation of ambiguous language, the courts tend to favor the voluntary—unpaid—surety at the expense of the third party. The courts incline to give words their normal meaning, even though it works a hardship upon the surety because of language unhappily employed, but, if the meaning is uncertain, they construe it most strongly against the user. In the case of unpaid sureties, the language is usually framed by the creditor, and so is construed against him.

It should be noted that defenses of a personal nature which the surety may have against the principal debtor are not available against the creditor. A surety who is persuaded to become such because of misrepresentations made by the principal is nevertheless liable to the creditor. Similarly, an understanding between the surety and the principal that the obligation will not be effective until signed by some third party cannot affect the rights of the creditor.[1] Even the failure of the principal to pay the premium required by the surety does not relieve the latter of his duties to the creditor.

Sec. 34. Fiduciary relationship.—The suretyship relation is one of trust and confidence. In ordinary contracts one party in possession of vital information is under no duty to disclose it to the party with whom he is contracting. The rule governing the formation of a contract of suretyship is different, however. A creditor in possession of unusual and important facts must impart those facts to the surety at the time the agreement is made. Failure to do so justifies rescission by the surety and permits him to evade liability. The courts deem it unfair to permit a creditor to take advantage of a suretyship contract when he knows that the surety is unwittingly assuming an unusual risk. An employer who is aware of past defalcations or embezzlements of an employee must make such fact known to anyone who assumes the suretyship relation in his favor. Likewise, a surety is released if the creditor is aware that the surety is relying upon misinformation and he fails to warn the surety of his error.

An employer who discovers that an employee has been guilty

[1] Watkins Co. v. Brund et al., 1931, 160 Wash. 183, 294 Pac. 1024; p. 788.

of misappropriation of funds should immediately discharge him. Failure to do so releases a surety from liability for future defaults. An employer who desires to give such an employee his "second chance" can safely do so only with the consent of the surety.

Sec. 35. Duration of relation.—A surety who becomes responsible for the faithful performance of a particular contract continues as such so long as the principal and creditor operate under the original agreement. The liability terminates with the complete performance of the contract.

Some question arises where a surety agrees to be responsible for goods of a certain kind sold to the principal. Thus, *A* signs the following writing: "Let bearer have what leather he needs. Charge it to him and I will see you paid." In this and similar cases special attention is given to the specific language used, in an attempt to determine the intention of the parties. However, in many instances it is not clear whether *A* becomes surety for only one transaction or many. The general rule is that a guaranty unlimited as to amount or time covers one transaction only.[2] If it is limited as to amount, but not as to time, it is considered a continuing guaranty; that is, it covers all goods sold from time to time, but the amount of the unpaid balance for which the surety continues liable may not be in excess of the amount stated in the agreement. A guaranty of general credit which carries a limit on its duration but none as to amount is impliedly limited to a reasonable amount. The existence of a surety does not authorize the creditor to extend credit in excess of the reasonable needs of the debtor. Difficulty in such cases might be avoided by a more elaborate agreement setting forth the terms somewhat in detail.

A continuing guaranty can be terminated at any time the guarantor desires. As soon as his notice of revocation is brought to the attention of the creditor, his liability for future obligations ceases. He remains responsible, however, for all obligations created prior to the receipt of his notice by the creditor. Death or insanity of the guarantor automatically revokes a continuing guaranty. The majority of the courts do not require the giving of notice to the creditor in such cases.

Sec. 36. Surety and guarantor.—Thus far, mention has been made of both surety and guarantor. In certain respects there is a difference in the two relations, although the vast majority of the rules are applicable to both relations. Therefore, unless a distinction is made in the subsequent sections, it may be assumed that the laws of suretyship apply also to guaranty.

Technically speaking, a surety is liable jointly with his principal

[2] Joseph Gard v. James E. Stevens, 1864, 12 Mich. 292; p. 789.

and may be sued with him on the contract. A guarantor's liability arises from an independent agreement.[3] A guaranty may be either absolute or conditional. An absolute guarantor warrants performance by the principal and becomes liable as soon as the principal fails to perform. His liability is almost identical with that of the surety.

A conditional guarantor usually warrants that the creditor will be able to force performance by the principal. A guaranty of collectibility is conditional, the condition being the creditor's inability to collect. In such cases the guarantor is entitled to notice within a reasonable period after default; the surety and absolute guarantor are not entitled to such notice, unless required by the terms of the contract.

Rights of Creditor

Sec. 37. Immediate recourse to surety.—The surety becomes liable to the creditor as soon as the principal defaults in the performance of his duties; the creditor need not exhaust his remedies against the principal before looking to the surety. This rule seems to be true, although the creditor has in his possession securities placed with him by the principal. He may immediately resort to the surety without disposing of the securities.

Where several sureties are jointly liable, the creditor may join all of them in one action and, after obtaining judgment, recover the entire amount from any one of them. The claim, unless the creditor has agreed otherwise, is entire and need not be divided for the convenience of the sureties.

Sec. 38. Subrogation.—Subrogation is the substitution of one party for another with respect to certain rights which the latter has against a third party. Securities placed with the surety by the principal for the protection of the former in case the latter defaults may be made available to the creditor.[4] To the extent of his claim, the creditor may substitute his position for that of the surety, with reference to the securities. Thus, it has been held that, in the event of the return of securities by the surety to the principal, the creditor is entitled to follow them into the hands of the debtor and subject them to a lien in his favor. This rule applies only where the rights of innocent third parties have not intervened. He may also secure an injunction against their return to the principal, thus having the securities impounded by the court until the principal debt falls due, at which time they may be sold for the benefit of the creditor.

The right of subrogation does not exist where the securities are

[3] See form #9.

[4] First National Bank v. Davis et al., 1901, 87 Mo. App. 242; p. 789.

left with the surety by some third party. The theory is that securities placed with the surety form a trust of that portion of the estate of the principal which he sets aside for the payment of his debt. Securities belonging to third parties do not form part of the principal's estate, and, therefore, are not subject to subrogation.

Rights of Sureties

Sec. 39. Extension of time.—The creditor should be careful not to extend the time for performance without the consent of the surety. An agreement between the principal and the creditor, which definitely extends the time within which performance may be demanded, releases the surety. The reason for this rule is that the financial status of the principal may become less sound during the period of the extension. Such a change in his financial condition would work to the disadvantage of the surety. The court does not consider in each case whether the position of the surety has been injured by the extension, but merely applies the general rule that an extension of time releases the surety.

Mere indulgence upon the part of the creditor, or passively permitting the debtor to take more time than the contract calls for, does not release the surety. The latter is in no sense injured by such conduct, because he is free at any time to perform on his part and immediately start suit against the principal. The surety is not discharged unless there is a binding agreement between the principal and the creditor for a definite period of extension.

The consent of the surety may be obtained either before or after the extension has been granted. Consent given after the extension amounts to a waiver of the right to rescind and is valid, although it is not based upon any new consideration. Notice to the surety that an extension has been granted, or a failure on the part of the surety to reply to a request seeking permission to extend, is not equivalent to consent. In the latter case, silence should act as a warning not to grant the extension, since the surety is apparently unwilling to extend the risk.

Sec. 40. Extension with rights reserved.—An extension of time by the creditor, in which the extension agreement stipulates for reservation of rights against the surety, does not release the surety. Such an extension is conditional and does not bind the surety. He is free at any time to complete performance for the principal and immediately sue him for damages suffered. To illustrate: *S* becomes surety for *P* on a note in favor of *C*. The note falls due on a certain date, and *P* requests from *C* an extension of ninety days. The extension is granted with the express stipulation that *C* reserves all rights against *S*. *S* is not released, although he

receives no notice of the transaction. He is still entitled to pay the debt at any time he desires and to turn to *P* for reimbursement.

An extension of time in which the surety is amply protected by securities placed with him by the principal, does not effect a discharge. In such a case it is impossible for the surety to be damaged by the extension.

A third exception to the rule concerning an extension seems to be in the process of development by the courts. In several cases it has been held that a paid surety—one who has received some compensation for the risk which he assumes—is not released unless he is damaged as a result of the extension of time granted to the principal.[5] In such a case the surety is released only when he can show that the ability of the principal to perform has perceptibly weakened during the period of extension.

An extension of time on an obligation arising out of a continuous guaranty does not release the guarantor except where the maximum liability is thereby exceeded. To illustrate, let us assume that *G* guaranteed payment of goods sold to *P* by *C* up to a maximum of $10,000. If a claim for $3,000 falls due, an extension of time by *C* will not release *G* as long as other claims in addition to the $3,000 do not exceed $10,000.

Sec. 41. Change in contract terms.—Any material change in the terms of the contract between the principal and the creditor, without the consent of the surety, discharges him.[6] Inasmuch as the principal contract governs the surety's liability, any change in its terms must be assented to by him.

A discharge of the principal debtor, or of any one of them if there are two or more, unless assented to, releases the surety. This rule is subject to those exceptions existing in the case of an extension of time; that is, the surety is not released if the principal debtor is discharged with reservation of rights against the surety, or if the surety is protected by securities.

Sec. 42. Payment.—The surety is discharged by payment, or tender of payment, by the principal. Whenever a payment is made by a debtor who owes several obligations, he has the right to designate which item shall be credited with the payment. In the absence of any instructions, however, the creditor is at liberty to apply it where he desires. A creditor who holds both secured and unsecured claims, in the absence of instructions to the contrary, would naturally credit all payments against the unsecured items. The surety is not in a position to object to this practice. His protection

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[5] Murray City v. Banks et al., 1923, 62 Utah 296, 219 Pac. 246; p. 790.

[6] Magazine Digest Pub. Co., Limited v. Shade et al., 1938, 330 Pa. 487, 199 Atl. 190; p. 791.

lies in his persuading the debtor to stipulate that the payments shall be applied upon the claim which is secured by the surety. In the absence of instructions by the debtor or of a particular application by the creditor, the court applies the credits against the obligations in the order of their maturity.

The mere receipt of a note or check of the principal debtor by the creditor does not release the surety, as the debt is not paid until the note or check is honored. If a new note is given in settlement of an old one, the old one being canceled and returned, an extension of time has taken place, which releases the surety. Where both notes are retained by the creditor, the courts hold that the second is merely collateral to the first and the surety is not released.

Sec. 43. Defenses of principal.—Defenses available to the principal may be asserted by the surety against the creditor. Such defenses as mistake, fraud, undue influence, and lack of consideration may be taken advantage of by the surety. The defenses of infancy and bankruptcy form exceptions to this rule. In these instances the surety is required primarily to avoid any loss resulting from such situations.

Similarly, the surety may set off against the creditor any claim which the creditor owes him. If the creditor calls upon the surety to pay the principal's obligation of $500, the surety may deduct any amount which is due him from the creditor. Thus, it may be said that the surety can interpose either his own or his principal's defenses against the creditor.

Sec. 44. Subrogation.—The surety who fully performs the obligation of his principal is subrogated to the creditor's rights against the principal. The surety who pays his principal's debt becomes entitled to any securities which the principal has placed with the creditor. Likewise, if the creditor has obtained a judgment against the principal, the surety receives the benefit of the judgment when he satisfies the principal's debt. Where the creditor has collateral as general security for a number of obligations, the surety's right of subrogation does not arise unless all of the obligations are satisfied. It should be noted that subrogation applies only to rights of the creditor against the principal. If some third person, to secure the principal's debt, also pledges collateral to the creditor, the surety has no equity in the security, although the creditor calls upon him to satisfy the debt.

A creditor in possession of collateral given to him by the principal is not at liberty to return it without the consent of the surety. Any surrender of securities releases the surety to the extent of their value, his loss of subrogation damaging him to that extent. Failure of the creditor to make use of the securities, however, does not re-

lieve the surety, since the latter is free to pay the indebtedness and to obtain the securities for his own protection.

Sec. 45. Recovery from principal.—Every contract of suretyship carries an implied term that the principal will reimburse the surety for any loss caused by the principal's default. Normally, the surety is not permitted to add any attorney's fees which he has been compelled to pay on his own behalf by way of defense, or fees paid to the creditor's attorney. All attorney's fees can be avoided by performance of contract terms; when the principal fails to perform, it becomes the immediate duty of the surety to act. Attorney's fees incurred in a bona fide attempt to reduce the amount of the recovery form an exception to this general rule.

The surety may recover only the amount paid by him. Thus, if he settles a claim for less than the full amount owing the creditor, his right to recover is limited to the sum paid under the settlement. Furthermore, bankruptcy on the part of the principal, although it takes place before the surety is called upon to perform, releases him from further liability to the surety.

Any securities falling into the possession of the surety at the time he settles his principal's obligation may be disposed of so far as is necessary to extinguish the surety's claim for indemnity.

Sec. 46. Cosureties' liability.—Cosureties exist whenever two or more parties become liable for the faithful performance of the principal. The creditor may compel one surety to pay the entire claim, it not being necessary for him to distribute the loss among the various sureties. This leaves the burden of recovery from the other sureties upon the surety first paying the claim.

An extension of time to one of the cosureties or the release of one of them does not necessarily discharge the rest of the sureties. It merely releases the remaining sureties of the share which the favored one should have paid, they remaining liable for their portion of the obligation.

Sec. 47. Right against cosurety.—There is an implied contract among cosureties that each shall assume the same risk, unless they have fixed different amounts for their maximum liability. In this event, they agree to share the loss in proportion to their maximum liabilities. Because of the implied contract, any surety who settles the claim of the creditor may recover from his cosureties their proportionate share.[7] Should certain of the sureties prove to be insolvent or residents of another state, the loss is first divided among the solvent sureties within the state.[8] Each contributing surety then possesses an independent action against the insolvent or nonresi-

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[7] Acres v. Curtis, 1887, 68 Tex. 423, 4 S.W. 551; p. 792.

[8] Smith et al. v. State of Maryland, 1877, 46 Md. 617; p. 794.

dent surety for the amount which he paid on behalf of that incapable cosurety.

A surety has no right to contribution until he has paid more than his share of the outstanding claim. As soon, however, as he pays more, he may recover the excess from any of the cosureties, provided the cosurety is not compelled thereby to pay more than his share.

No surety has a right to profit at the expense of a cosurety. Neither has he a right to reduce his personal risk by secretly procuring collateral from the principal debtor. Any such collateral, obtained either before or after he became a surety, must be held for the benefit of all the sureties.[9] It is possible, of course, for all the sureties at the time they become such to agree that one of them may be favored by receiving collateral for his protection, but, in the absence of such an arrangement, all have a right to share in the collateral held by one.

Review Questions and Problems

1. What are the purposes of a contract of suretyship? What are the three parties to a suretyship transaction usually called?

2. Suppose *S* signs a statement to the effect that he will be secondarily liable for groceries, not exceeding $300, furnished to *X*. How long will such a guaranty continue?

3. Must the creditor first sue the principal before he attempts to recover from the surety?

4. *S* became surety for his brother *P* and for protection was given certain bonds owned by *P*. Both *S* and *P* became insolvent and *S* was considering the possibility of returning the bonds to *P* when *C*, the creditor, brought a bill to have the bonds impounded for his protection. Was he entitled to do so?

5. What is the effect of an extension of time allowed to the principal by the creditor? Is the surety bound if he assents to the extension after it takes place? How would you extend the time for performance and still expect to be able to look to the surety?

6. *C* held an obligation of *P*'s upon which *S* was surety. *C* permitted the obligation to run several years past its maturity date, although the interest was always paid. No definite extension period was ever agreed upon between *P* and *C*. After a number of years, although within the period required by the Statute of Limitations, *C* attempted to recover from *S*. Should he have been allowed to recover?

7. What is meant by subrogation? Is the surety entitled to subrogation after he has only partially performed his principal's obligation? What effect upon the liability of the surety has the surrender of securities by the creditor to the principal?

8. *A* and *B* are sureties upon an obligation of *P*. At the time *A* became a surety he obtained a mortgage from *P* upon certain personal

[9] Hoover, Appellee v. Mowrer et al., 1891, 84 Iowa 43, 50 N.W. 62; p. 795.

property, to protect himself in case *P* defaulted. *P* failed to perform and *A* and *B* were compelled to carry out the agreement. Did *A* hold the mortgage for his own protection alone or for the mutual protection of the sureties? If you were *A*, how would you arrange the matter to protect yourself only?

9. What is the effect of insolvency of one of the sureties upon the liability of the other sureties? May one of the sureties recover from the others if he has paid no more than his share, although the others have as yet paid nothing? What is the result of a discharge of one of the sureties by the creditor?

10. If you hold various obligations of *P*, some secured by sureties and some unsecured, and a payment is received, have you a right to apply it on the unsecured claims, although the secured claims are due first?

11. *A* and *S* signed a mortgage note in favor of *P* for $15,000, it being known to *P* that *S* was merely a surety. Some time later, *A* became insolvent and *P* accepted $7,000, discharging *A* from further liability. May *P* recover the $8,000 balance from *S*?

CHAPTER V
INSURANCE

Sec. 48. Introduction.—Insurance is playing an increasingly important role in our national economy. Greater security appears to be desired in a significant degree, and, in many areas of life, insurance readily lends itself to the satisfaction of this desire. It offers a method whereby possible losses may be borne by numerous individuals, rather than by the particular person upon whom the loss chances to fall in the first instance. The insurance company acts as a sort of collecting agency or clearing house for the purpose of distributing the risk, and charges a fee for its services in this connection.

The subject of insurance is treated under security relations because it is often used as a security device or is closely associated with other security which is given. Buyers who purchase on credit are often required to keep the property insured against fire loss. A borrower who gives a mortgage on real property as security for an indebtedness is generally compelled to keep the property insured, in favor of the mortgagee, against loss from windstorm and fire. A person to whom credit has been extended often protects his creditor by procuring a policy of life insurance equal to the indebtedness, naming the creditor as the beneficiary. Insurance is thus used to protect both the creditor and the debtor against loss resulting from unusual causes or premature death.

Sec. 49. Types of insurance.—Numerous types of insurance have been originated in an attempt to meet as many of the risks which are faced by businessmen and their employees as is possible. Protection can be procured for almost any risk if the one subject to the risk is able and willing to pay the required premium. Many forms of insurance are familiar to all of us, among them life, health and accident, fire, theft, windstorm, workman's compensation, and public liability insurance. In addition there is available plate glass, fidelity, marine and hospital insurance. Unemployment compensation and old-age benefits paid by state or federal governments are closely akin to insurance.

Since insurance is treated at this point primarily as a protective device for creditors, further mention will be made only of those legal principles which relate to fire and life insurance. It can be said in general, however, that the law governing health and accident insurance follows closely that which controls life insurance. The other

types of insurance—often spoken of as indemnity insurance—are in large measure subject to the same rules of law which govern fire insurance.

Sec. 50. Formation of the agreement.—There is nothing in the nature of a contract of insurance which requires it to be in writing, but such contracts are written in most instances. The insurer's application, containing many queries, is signed by the insured. It is this application which usually constitutes an offer on the part of the insured, although in fire insurance it often happens that the insured merely requests the agent of the company to give him certain protection. In either of these cases, the company customarily signifies its acceptance by delivery of the policy. Therefore, the only terms of the agreement are embodied in the application and the policy. The insured may reject a policy which includes terms different from those requested in the application. An acceptance of such a policy amounts to a substitution of the terms of the policy for those of the application, and the terms of the former control. The rights of the parties are usually determined by reference to the provisions of the policy, unless a waiver of policy provisions was effected at the time of delivery.

In fire insurance it is customary to authorize the local agent to accept the application. Because of this fact, the insurance may become effective before the policy is delivered, provided the agent indicates, by action or conduct, his willingness to accept the risk for his principal. At this point a distinction should be made between the local agent and an insurance broker. An insurance broker is one whose business it is to procure insurance for those desiring it. He has no authority to represent the insurance company, but is the agent of the insured for the purpose of obtaining the insurance, after which the agency terminates.

One standard type of life insurance contract provides that the contract shall be in force from the date of the physical examination, provided the insured is an acceptable risk at that time and the premium is paid prior to the time the application is forwarded to the company. In other words, if the insured's health, family history, and other risk factors conform to the standards of the insurer, the policy dates from the time of the examination. Delivery of the policy in such a case merely indicates that the company has finally approved the particular risk. Thus, the death of an applicant before the risk has been finally acted upon will not bar recovery by the beneficiary, provided the insured was in good health when he submitted to the physical examination. This is particularly true where the company approves the risk before, or even after, death without delivery of the policy. If the company refuses to approve

the application and has any reason for so doing, the applicant has no insurance.

Sec. 51. Delivery of the policy.—A second type of contract used by insurance companies, primarily for industrial, fraternal, or other insurance in which there is no physical examination or in which the payment of the premium is deferred until some time after the application is signed, customarily provides that it is not to be effective until the policy is delivered to the insured in good health and the first premium has been paid. Such an agreement presents two questions: When has delivery been completed and when is the applicant in good health? Under normal circumstances, the courts have held the policy to be delivered as soon as it is deposited in the mail.[1] This appears to be true even though the company mails the policy to its representative rather than directly to the insured. The act of mailing from the home office signifies acceptance of the risk.

Some uncertainty exists where the policy is mailed to the agent of the company with instructions to check on the health of the applicant before handing the policy to the insured. Two distinct views may be observed in the various states. The first, which is the minority view, holds that since the local agent is entrusted with discretion concerning delivery—being obligated to ascertain the state of health of the insured before delivery—the policy is not effective until placed in the possession of the insured. In these states the judgment of the representative appears to be final, and after delivery the question of good health cannot be raised. On the other hand, the majority of the states take the view that delivery is effective at the time the policy is mailed from the home office whether mailed directly to the insured or to an agent of the insurer, but that it is operative only if, at that time, the insured is actually in good health. Any serious ailment with which the applicant is afflicted, even though he is unaware of the disease, prohibits insurance protection under the policy. This is true even though the insured has been in possession of the policy for a considerable period of time, unless the incontestable period has been reached. A minor illness, which later becomes serious, does not affect the validity of the policy.

Although the insurer has a reasonable time in which to determine whether to accept or to reject the application, unreasonable delay followed by the death of the insured gives rise to a cause of action against the company. Unless the company acts with reasonable dispatch, the insured is delayed in obtaining other insurance, and thus remains uninsured because of the negligence of the insurer.

[1] New York Life Ins. Co. v. Babcock, 1898, 104 Ga. 67, 30 S.E. 273; p. 796.

It is this negligence which forms the basis for an action against the company.

It is customary in life insurance contracts, although not in fire insurance, to provide that the insurance shall not be effective until after the payment of the premium. Execution of a note for the first premium cannot be substituted for cash unless it is accepted by the home office. Occasionally the local agent is willing to accept the note of the applicant and to advance the money for the first premium from his personal funds. In such cases the insurance is in force only if the agent pays the premium.

Sec. 52. Representations and warranties.—A representation is a statement made by the insured to the insurer at the time the contract is in the process of formation. Because of the nature of the contract of insurance—the insured having full and complete information, the insurer possessing little knowledge, relating to the risk—it becomes the duty of the insured to inform the insurer fully concerning the nature of the risk. For this reason a misrepresentation of any fact which materially affects the risk affords a basis for rescission by the insurer.[2]

The insurer is permitted to avoid his contract whenever any material statement found in the application is proved to be incorrect. This rule appears to hold even though the party responsible for the false statement actually thought it to be true, and despite the fact that the condition misrepresented was in no sense responsible for any loss involved.

In order to avoid the necessity of determining in any particular instance whether representations affect material matters, many companies have adopted a provision in their policy which declares that all representations shall be deemed warranties. A breach of any warranty, regardless of how trivial it is, justifies rescission. To obviate the harshness of this rule, some states, such as New York, have by legislation converted all warranties into representations, and some, by judicial decision, have provided that breach of warranty, unless it concerns a material matter or is intentionally misstated, does not afford ground for rescission. The courts are prone to consider intentional misrepresentations as material even though they relate to rather insignificant matters, whereas, if the misstatements are unintentionally made, the materiality of the statement must be shown by ample evidence.

Sec. 53. Fraud of the agent.—Representations or warranties stated correctly to the agent of the company, but recorded incorrectly by him in the application, furnish the company no ground for relief, unless the insured knew that the agent acted fraudulently.

[2] Mutual Life Ins. Co. v. Denton, 1927, 93 Fla. 276, 112 So. 53; p. 797.

The mere fact that the insured signs the application does not make him responsible for all statements contained therein, as he has a right to assume that the agent of the company acts honestly. Any loss resulting from the misconduct of the agent must be suffered by the company rather than by the insured.

Lately, most insurance policies are made to include the application as a part thereof, and the applications are made to read that the applicant has read all answers given to questions propounded and has found them to be correct. In the construction of contracts of this character, many courts have held that the insured is bound to read his policy within a reasonable time and to report any errors promptly to the company. Failure to do so makes the applicant responsible for all statements made. Perhaps, however, the weight of authority holds the insurance company liable even in cases of this character.

Sec. 54. Information vitally affecting risk.—Information possessed by the insured, which vitally affects the risk, should be communicated to the insurer, although no questions are asked concerning the matter. Failure to transmit such information, where failure to do so would practically constitute fraud, acts as an excuse for nonperformance on the part of the company. Thus *A*, knowing of the existence of a widespread fire near certain property belonging to him, hastens to an insurance company's agent and procures a policy of fire insurance on the goods in question. Because he fails voluntarily to give the information relating to the fire, he is not allowed to recover for the loss which results from the destruction of his property.

Sec. 55. Binder.—A binder is temporary insurance, usually procured to cover a period during which the insurer is considering an application for a regular policy. A binder does not state all the terms of the agreement, but carries with it the ordinary and normal provisions found in a regular policy. The premium and the duration of the binder often are not stated. In such cases a reasonable amount must be paid, and the policy may be terminated at any time by either party if he gives the notice required in the ordinary policy —usually five days.

Sec. 56. Insurable interest.—Insurance partakes of the nature of a gambling contract. To avoid the evil effects of ordinary wagering contracts, the courts require the insured to have an insurable interest in the life or property insured. Thus, a person who secures a policy of fire insurance upon property cannot recover for the damages resulting from fire unless he holds some legal or equitable interest in it, in which case a destruction of the property might mean a pecuniary loss. This is the best test of an insurable interest. If

the destruction of the property or person insured might result in a pecuniary loss to the one procuring the insurance, an insurable interest exists.[3] Thus, an owner, lessee, mortgagee, or purchaser has an insurable interest in property, while an employer, employee, business associate, creditor, or a dependent relative may legally insure the life of a person.

In fire insurance the insurable interest must exist at the time the policy is issued and continue down to the time of the loss. Thus, *A*, having taken out fire insurance upon an automobile while he owned it, could not recover its value, although the property was destroyed by fire, after the car had been sold. The new owner would also be denied recovery unless the policy was assigned to him with the consent of the insurer. In life insurance it is sufficient if the insurable interest exists at the date the policy is issued. A subsequent change in the relation of the party securing the insurance and the one whose life is insured does not terminate the insurance.

In this connection, it should be pointed out that a person who procures insurance upon his own life may make anyone he desires his beneficiary if a company is willing to issue such a policy. Inasmuch as the insured has an interest in his own life, the beneficiary is not required to have such an interest. It is only where one takes out insurance upon the life of another that an insurable interest must be present.

Risks Assumed by Insurer

Sec. 57. Life insurance.—As stated before, the policy of insurance contains many provisions inserted for the benefit of the various parties. Its terms, considered in the light of the application, govern largely the rights of the parties. There are, therefore, many types and variations of life insurance policies, but they may be divided generally into three classes: term, whole life, and endowment. Upon the death of the one whose life is insured under any of these policies, the insurance company becomes liable for the face of the policy.

A term policy calls for the payment of premiums for a relatively short period with the company carrying the risk only for that period unless the insured reaches a later agreement with the insurer to substitute another type of policy within the term or to renew the term. The rate on term insurance is lower than on other types since the protection is to run only for a limited period of time and results in a lower probability of death.

The whole life insurance policy calls for payment of premiums as long as the insured lives, unless it is modified by a paid-up provi-

[3] Creed v. The Sun Fire Office, 1893, 101 Ala. 522, 14 S. 323; p. 798.

sion, which requires the payment of premiums only for a certain specified number of years. Thus, a twenty-year paid-up policy would require the payment of premiums for only twenty years, although the amount of the premium would be somewhat larger than the premium on a general life policy. The insurance, in either case, would be paid at the death of the insured.

An endowment policy provides for the payment of the face of the policy upon the death of the insured or at the end of a certain specified number of years. Thus, a twenty-year endowment policy calls for payment of the policy at the end of twenty years, unless the insured dies sooner. Such an insurance policy serves the double purpose of insurance and investment, and requires an annual premium still larger than either of the other types of policies.

A few companies, for a slight addition to the premium, insert a clause which provides for a monthly payment to the insured in case he becomes permanently disabled. Another provision often included calls for double indemnity if the insured dies as the result of an accident. In addition to the policies enumerated, there are various combinations and variations which take care of unusual situations, but those mentioned constitute by far the largest portion of the total insurance written.

Sec. 58. Fire insurance.—The object of fire insurance is to protect the insured against any loss to particular property which results directly or proximately from an unfriendly fire. An unfriendly fire is one that is not confined to its proper container. In other words, as soon as a fire leaves the place where it is expected to burn, it ceases to be friendly and at once assumes an unfriendly attitude.[4] To illustrate: *A* has his furniture insured against fire. By accident, a valuable piece of furniture is placed so near an open fireplace as to be materially damaged, although it never actually catches fire. The insurer is not liable for the resulting damage. However, if the furniture takes fire and burns, the company is liable, for at that time the fire is said to become unfriendly; it has ceased to burn in its customary receptacle.

The insurance company is liable for any loss caused directly or proximately by the fire. Thus, any loss from smoke, water, theft, removal damage, or falling walls is covered, as well as any direct loss from the fire itself, assuming an unfriendly fire. The fact that the unfriendly fire is confined to another building does not preclude one whose property has been damaged by smoke, water, or falling walls from recovering on his policy of fire insurance. It is not necessary that the fire enter his premises in order to permit recovery.

The majority of fire insurance policies relieve the company from

[4] Ellis v. Norwich Union Fire Ins. Soc., 1927, 259 Mass. 540, 156 N.E. 696; p. 798.

liability for any loss resulting from explosions. The courts, however, have construed this provision to mean that the company is liable if the explosion results from an unfriendly fire. It is only where the explosion is caused by a friendly fire that liability is excluded. Thus, an explosion caused by an ordinary fire in a furnace would not be covered, but an explosion caused by an unfriendly fire in the building where the explosion occurred would impose a liability upon the insurer to pay for both the fire and explosion loss. In any event, and regardless of how the explosion is caused, the insurance company is liable for the actual fire loss which follows the explosion if an unfriendly fire ensues. In some states, a provision in the policy reads that if any portion of a building falls except as the result of an unfriendly fire, the policy is automatically terminated. Where such is the case, should an explosion set in motion by a friendly fire cause a wall to fall, the policy would be terminated, and the company would thus be relieved of any responsibility for the fire loss which might follow.

Much the same is true of windstorm loss. The insurer is liable for fire damage which follows, unless liability is eliminated by some policy provision. Loss by lightning is generally covered by the policy, although the policy often eliminates responsibility for damage to electrical equipment caused by electrical disturbances. Some policies also deny recovery in case goods are stolen when they are removed to avoid a fire loss.

To obtain protection against many risks not covered by the ordinary fire insurance policy, "extended coverage" clauses are made available. Under them the company assumes responsibility for losses resulting from explosions, windstorms,[5] damage from airplanes, and numerous other causes.

The fact that a fire originates through the carelessness of the insured, his agent, or a member of his family does not affect the right to recover. One of the chief purposes of insurance is to protect against loss resulting from such causes. At the time of a fire, however, it is the duty of the insured to remove goods, where possible, from the path of a fire in order to keep the loss of the insurance company to a minimum.

Sec. 59. Property insured.—Only property which is definitely described in the policy is protected. Furthermore, the policy limits its application to property owned by the insured, unless the applicant clearly states his desire to have other property in his care protected by the insurance. Thus, a policy which covers the goods of

[5] Gerhard v. Travelers Fire Insurance Co., 1945, 246 Wis. 625, 18 N.W.(2) 336; p. 799.

the insured located at a certain place does not cover goods held on consignment, unless the agreement is expressly so drawn.

Insured property located at a certain place is not covered when it is moved to a new location, unless the insurer consents to the change, the reason being that the particular location of the property has a material bearing on the risk.

Sec. 60. Mortgage clause.—The destruction of mortgaged property by fire gives the mortgagee no interest in the proceeds recovered under a fire insurance policy unless the mortgage required the mortgagor to insure the property for the benefit of both parties. Since the vast majority of mortgages require insurance, fire insurance companies have formulated a standard mortgage clause for insertion when insurance is issued on mortgaged property.[6] The clause provides that any fire loss shall be paid to the mortgagee to the extent of his interest, and, in case a balance remains, that it shall be paid to the owner. Thus, if property mortgaged for $7,000 is fully insured, and a $9,000 loss occurs, $7,000 is payable to the mortgagee and $2,000 to the mortgagor. The amount paid to the mortgagee effectively reduces the amount owed by the mortgagor. In this manner both parties are adequately protected by a single policy.

The insurance contract, by its terms, is avoided by certain forms of misconduct on the part of the insured, but such misconduct does not affect the right of the mortgagee to collect in the case of a fire loss. As to him, the policy cannot be rescinded without first giving ten days' written notice. Because of this fact the policy may be in force as to the mortgagee but not as to the mortgagor, in which case subrogation is available to the insurer against the owner.

Sec. 61. Coinsurance.—Coinsurance is a term applied to that type of fire insurance which requires the insured to bear a certain portion of the loss where he fails to carry rather full protection. Thus, many policies on downtown city property provide that, unless the insured carries insurance which totals 80 per cent of the value of the property, the insurer shall be liable for only that portion of the loss which the total insurance carried bears to 80 per cent of the value of the property. In such cases the insured who insures for less than the required amount assumes part of any possible loss. This clause is not part of the regular fire insurance policy and, where the company permits the clause, its insertion makes possible a much lower premium than otherwise called for.

Sec. 62. Termination of policy.—Fire insurance companies have incorporated a provision in their policies which gives the in-

[6] See form #10.

surance company a right to terminate the risk by giving five days' written notice, which notice states that the unearned premium is available upon request. The notice does not become effective until it has been received by the insured or his authorized agent.[7] Such a cancellation entitles the insured to the unearned portion of the premium.

The insured likewise has a right to terminate the policy, his notice taking effect as soon as it is received by the company. Termination by the insured entitles him to somewhat less than the amount represented by the unexpired period of the policy.

Sec. 63. Lapsed policies.—In other than industrial insurance, the statutes of the states and policy provisions require the company to extend life insurance for thirty days after the regular premium falls due. Industrial life policies may, and often do, contain a grace period, but the time allowed for late payment is not uniform, the period varying from state to state. Payment made during this grace period continues the policy in force until the next premium falls due, but, if payment is not made during this period, the policy is said to lapse and can be reinstated only with the consent of the company. The mere mailing of a check in payment of the premium is sufficient and, if the check is lost or delayed in the mail, the policy does not lapse provided the check was supported by an adequate bank balance. A few courts have held that a check is good payment, where the company issues its receipt, even though the check is dishonored. This is true only when the insured immediately offers to make good the dishonored check.

Lapsed policies of life insurance give to the insured the right to do one of three things. He may demand the cash surrender value of the policy—all or a portion of the amount set aside as a reserve to protect the life of the insured; he may obtain a paid-up policy for such an amount as the reserve will purchase, the amount being dependent upon the age of the insured; or he may obtain a term policy for the original amount, the length of the term being determined by the amount of the reserve. When the insured fails to exercise his choice within the time provided in the policy, it is customary for the policy to provide that the provision for the term policy—known as extended insurance—shall be effective. A lapsed policy, against which the insured has borrowed the maximum amount, gives no rights to the insured, but the courts are very careful, in figuring the reserve down to the date it lapses, to be sure that the reserve has been exhausted by loans or extended insurance.

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[7] Kinney v. Rochester German Ins. Co., 1908, 141 Ill. App. 543; p. 801.

Sec. 64. Provisions which benefit the insurer.—A fire insurance policy contains numerous provisions, which, if not adhered to by the insured, may excuse the company from performing.

Since insurance companies are regarded by the courts much like public utilities—in that many features of their business can be regulated by the state—it is possible for the state to prescribe a standard policy for use in the state or merely to stipulate that any policy used must include certain provisions and exclude others. Because of this, the number and content of clauses contained in a policy vary materially from state to state and careful reading of the terms of the policy used in a particular state is imperative. Some of the more usual provisions are discussed below.

It is customary to include a clause that the policy shall be suspended if the property is vacant or unoccupied beyond a stated time and the company has not waived the provision by a rider attached to the policy.[8] The policy is automatically reinstated when the property again becomes occupied, assuming the policy has not expired. Another common clause provides that the insurance shall be suspended while the risk is materially increased by any act within the control or knowledge of the insured. This usually refers to matters on the property of the insured over which he has control, not including factors of risk arising out of the use made of adjoining property. Other clauses have at one time or another been included, relating to the keeping of explosives on the premises,[9] the title to and the liens against the property, and, in the case of merchandise, the owner's keeping an iron safe in which books of account may be kept.

The policy always provides that the insured shall give immediate notice of loss to the insurer. Furthermore, unless the loss is settled in the interim, within sixty days he must make a sworn statement of loss to the company, detailing the extent of the fire loss.

Provisions placed in policies for the protection of the company may be waived by any general agent of the insurer; therefore, whenever it becomes necessary or desirable to violate such provisions, a rider signed by the agent and temporarily waiving the clause in question should be attached to the policy.

Sec. 65. Subrogation.—The purpose of fire insurance is to indemnify the insured in the event of a loss which results from fire. If the insured suffers no loss as a result of fire, the insurance company should suffer none. For this reason, any right of action pos-

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[8] Aldridge v. Piedmont Fire Ins. Co., 1945, 183 Va. 830, 33 S.E.(2) 634; p. 802.

[9] Rabinowitz v. National Fire Ins., Co., 1927, 258 Mass. 508, 155 N.E. 435; p. 803.

sessed by the insured against some third party, which would compensate the former for the loss, automatically passes to the insurer upon settlement in full for the loss suffered. This right of substitution of the insurer to the position of the insured is known as subrogation. Thus, a mortgagee who takes out insurance to protect only his interest, if allowed to recover insurance in case the mortgaged property is destroyed, must assign his mortgage debt to the insurer. The latter then has a cause of action against the mortgagor, just as the mortgagee would have had. Insurance taken to protect only the mortgagee affords the mortgagor no protection. In case of a fire loss the liability of the mortgagor for the debt merely runs to the insurance company to the extent it has paid the mortgagee for the fire loss.

The right of subrogation does not apply to life or accident insurance, inasmuch as it is not directly the purpose of such insurance to compensate for the actual loss sustained.

Sec. 66. Division of loss.—At one time fire insurance policies provided that, in case other insurance was obtained on the same property without the consent of the insurer, the policy would be void. Today most policies expressly provide that additional insurance may be carried. Since the purpose of fire insurance is to indemnify the owner against loss, it should be emphasized that, regardless of how much insurance one carries or how many policies he holds, he is entitled to recover no more than his actual loss. If the insured carries policies in several companies, the loss is apportioned among them according to the amount of insurance each company has issued. To illustrate: Jones carries on certain property a $10,000 fire insurance policy in the Beech Fire Insurance Company and a $5,000 policy in the Fidelity Insurance Company. His property, which is worth only $6,000, is totally destroyed. He can recover only $4,000 of the Beech Company and $2,000 of the Fidelity Company.

Rights of Beneficiary in Life Insurance

Sec. 67. Rights vest at the time policy is issued.—Such rights as are given the beneficiary named in a life insurance policy vest at the time the policy is issued. The insured possesses no power to alter or amend effectively the terms of the contract, without the consent of the beneficiary. Unless the right has been specifically reserved in the policy, the insured may not designate a new beneficiary. However, the policy is customarily drawn so as to permit the insured to borrow of the insurer on the strength of the policy or to surrender it and obtain the cash surrender value.

The insured in many cases expressly reserves in the policy the right to change beneficiaries. Practically all policies provide that, in case the beneficiary dies before the insured, and no substitute beneficiary is named, the proceeds are payable to the estate of the insured. Where the right to change the beneficiary is expressly reserved in the policy, it may be changed without the consent of the existing beneficiary. The change dates from the time it is indorsed on the policy, but in cases where the insured has done all possible on his part to effect the change, and dies before the indorsement is made, the new beneficiary is protected. Delay on the part of the mail, or in the conduct of the company employees after receiving the request for a change, will not injuriously affect the rights of the newly named beneficiary.

Sec. 68. Rights of creditors.—The creditors of the insured have practically no rights in the proceeds of his life insurance. Upon the death of the insured, the money is paid directly to the designated beneficiary, who is in no sense responsible for the debts of the insured. Should the insurance be payable to the estate of the insured, then, like any asset, the amount may be used to satisfy the debts of the deceased.

If the insured has not reserved the right to change the beneficiary, the rights of the beneficiary are not affected by the insolvency or bankruptcy of the insured. Since the rights under such a policy are vested in the beneficiary at the time the policy is issued, the cash surrender value of the policy cannot be touched by the creditors or by the trustee in bankruptcy. Where the right to change beneficiaries has been reserved, the bankruptcy of the insured permits the trustee in bankruptcy to claim the cash surrender value for the benefit of creditors. In order to protect the families of those carrying insurance, several states have enacted legislation exempting the cash surrender value from claims of creditors or exempting a portion of insurance payable to the estate of the insured. Reference must be made to the statutes of a particular state to determine the extent of this protection.

An insured person who borrows money and pledges to his creditor, as collateral, a policy of life insurance gives security of doubtful value where some person other than the creditor has been designated as the beneficiary in the policy. If no right to change the beneficiary has been reserved, the creditor secures no interest in the policy unless the beneficiary joins in the assignment. Where the insured has reserved the right to change the beneficiary, the majority of the courts protect the creditor to whom the policy is pledged.[10] Many

[10] Antley v. St. Mathews National Bank, 1927, 139 S.C. 23, 137 S.E. 199; p. 804.

of the courts take the contrary view, however. The creditor's position is always strengthened if both the beneficiary and the insured join in the assignment.

A policy of insurance, taken out upon the life of a debtor by his creditor, is enforceable for the face amount despite the fact that the debt is reduced below the face of the policy. In such cases the courts compel the creditor to turn the excess above the indebtedness over to the estate of the debtor. Similarly, where the debtor carries the insurance and has named the creditor as beneficiary, the claim of the creditor extends only to the amount of the indebtedness.

Sec. 69. Incontestable clause.—Many states, by statute, and most companies, by provision in the policy, provide that a life insurance policy may not be contested after a certain period of time, except for nonpayment of premiums or violation of the military or airplane clauses found in the policy. Thus, fraud on the part of the insured at the inception of the policy may not be raised by the company after the policy has been outstanding for two years; two years represent the usual period provided in which the company is given a right to rescind.[11] To illustrate: An applicant for life insurance materially misrepresents to the insurer the condition of his health at the time his application is filed. Three years later he dies from tuberculosis, with which he was afflicted at the time he made the application. His beneficiary is entitled to recover on the policy, because the incontestable clause bars the insured's fraud as a defense. Misstatement of the applicant's age gives no right of rescission to the company, but the face of the policy is correspondingly reduced.[12]

The clauses of a life insurance policy calling for double indemnity in case of accidental death or for payments in case of disability may be contested after the contestable period has expired. The courts have felt that these clauses are not essentially a part of life insurance, and, consequently, are not subject to the provision or statute concerning incontestability. Of course, the contract can be so drawn as to make the policy incontestable on these points, if the company desires.

Sec. 70. Assignment.—A life insurance policy in which the insured is also the beneficiary may be sold and assigned to a third party, although the assignee is a stranger and has no insurable interest in the life of the insured. The assignment binds the company as soon as it receives notice thereof. If the assignee continues to pay the premium, he is entitled to the face of the policy upon the

[11] Powell v. Mutual Ins. Co., 1924, 313 Ill. 161, 144 N.E. 825; p. 804.

[12] New York Life Ins. Co., v. Veit et al., 1945, 294 N.Y. 222, 62 N.E.(2) 45; p. 805.

death of the insured,[13] unless he receives the assignment merely as security for an indebtedness. Certain fraternal insurance provides that the policy of life insurance may be made payable only to certain members of the family. In such cases the policy may not be assigned, being payable only to the estate of the insured or to the members of his family indicated in the policy.

A fire insurance policy may not be assigned without the consent of the insurer. Such a policy gives a personal right, and, as the risk varies in many cases with the person protected, the right may not be assigned. If the insured no longer needs protection, he may assign the policy, provided the company consents; or, if the company refuses, the insured may cancel the policy and demand a return of a portion of the premium previously paid.

After a fire loss has occurred, the right to the proceeds may be assigned and the assignment becomes effective as soon as the insurance company receives notice of it. Only where an attempt is made to assign the policy protection is the assignment ineffective unless it is assented to by the insurer.

Review Questions and Problems

1. Where are the terms of a contract of insurance embodied? When does the contract of fire insurance become effective? Of life insurance?

2. An applicant for fire insurance is asked if the property is encumbered. He replies that it is not, although there is a mortgage of $4,000 against the property. May the company avoid the policy? Would the same result obtain if the applicant were unaware of the mortgage?

3. *A*, a stockholder in *X* Steamship Company, procured insurance upon the company's steamer *X*. The steamer was destroyed, but the company refused to pay, contending that *A* possessed no insurable interest. Was the company correct in its contention?

4. *A*, an applicant for life insurance, was asked whether he used intoxicating liquor. He informed the agent that he did, but the agent, without the applicant's knowledge, inserted in the application the word "no." May the company avoid the policy?

5. Several buildings were insured against fire, the policy providing that no gasoline was to be kept on the premises. Gasoline had been kept on the premises, but none was there at the time the fire occurred. May the insured recover?

6. What is meant by an unfriendly fire? May a friendly fire become unfriendly? Is the insured in a fire insurance contract protected against loss from an explosion, assuming that the explosion was caused by fire?

7. A fire caused the wall of a building owned by *A* to fall and damage a building owned by *B*. May *B* recover on a policy of fire insurance covering his building? Suppose that *B*'s furnishings had been damaged

[13] Prudential Ins. Co. v. Deyerberg et al., 1927, 101 N.J. Eq. 90, 137 Atl. 785; p. 807.

by the smoke from the fire in the adjoining building, what would be the result?

8. What is meant by the term "coinsurance"? What is its purpose?

9. *M* owned certain buildings which were insured by the *X* Company. As a result of the negligence of the *Y* Railway Company, a fire takes place, damaging the buildings. The *X* Company paid *M* the amount of the damage. May the *X* Company recover from the Railway Company?

10. May a fire insurance contract be assigned without the consent of the company? May a life insurance policy be assigned?

11. *A* took out insurance in the name of his wife, without reserving the right to change beneficiaries. He later asked the company to change the beneficiary and to substitute his son's name for that of his wife. Has the company a right to change the beneficiary?

12. What is the purpose of an incontestable clause? When is a policy of life insurance contested, within the meaning of the clause?

13. Assume that a policy contains a two-year incontestable clause. *A* in his application states that he does not use intoxicating liquors. Three years after the policy is issued, he dies from excessive use of such liquors. The evidence clearly shows that he was a user of intoxicants at the time he filed his application. May his beneficiary recover?

14. What is a standard mortgage clause? To whom is a fire loss paid when a policy includes a standard mortgage clause? If the insured violates the terms of the policy, does this fact relieve the insurer of its duty to the mortgagee?

15. *A* carried a $10,000 life insurance policy in which *B*, his wife, was named the beneficiary. If *A* dies while he is insolvent, must *B* use the proceeds of the insurance to pay *A*'s obligations?

16. The insured desired to change the beneficiary in a policy of life insurance from his wife to his mother. The policy provided that he might do so by making the request, surrendering the policy, and having the change indorsed thereon. He made the request for change but failed to return the policy for indorsement. At the time of his death, was his wife or mother entitled to the insurance? Suppose his wife had possession of the policy and refused to surrender it?

17. *A* obtained a policy of life insurance for $500 in which *W*, his wife, was named as beneficiary. The policy provided that it was to be effective when the policy was delivered to the insured in good health. At the time the policy was delivered to the insured he was afflicted with pneumonia, as a result of which he died a few days later. Was *W* entitled to recover from the insurer?

18. *A* carried a policy of life insurance for $5,000, which was payable to his estate. Shortly before his death, he mailed the policy to his fiancée, telling her that he wanted her to have it in case anything happened to him. At his death, will the money be paid to his estate or to his fiancée?

19. *A* carried a policy of insurance for $10,000 on his life, the premium falling due on August 1, 1939. He mailed a check on August 29 in payment and immediately received an official receipt of payment. The check was dishonored because of insufficient funds and the company refused to

accept a money order on September 5 in settlement. The insurance company refused to reinstate the policy because of the poor health of the insured. Had the policy lapsed, if the insured had tendered the money order as soon as he learned the check had been dishonored? If the insured had carried no bank account, but had paid a neighbor the amount of the premium for the latter's check—which was indorsed and mailed to the company—and this check had been dishonored, would your answer be the same?

20. *A* borrowed $15,000 of *B* and as security procured a policy of life insurance for that amount and named *B* as the beneficiary. *A* died at a time when the debt had been reduced to $7,000. Determine the rights of *A*, and *B*. Would the result be the same if *B* had taken out the insurance on *A*'s life?

Book VII

REAL PROPERTY

CHAPTER I

PRINCIPLES OF REAL PROPERTY

Sec. 1. Nature of.—The term "real property" refers to land or anything permanently attached thereto. For example, houses, fences, and permanent improvements are real property. Upon severance, however, such improvements become personal property. Things such as trees, shrubbery, and perennials, which grow upon the land and continue thereon from year to year, are regarded as real property, and, so long as they remain attached to the land, are considered part of the realty. However, upon severance, such as cutting down trees, quarrying stone, removing gravel, and so forth, such property is said to be personalty.[1]

On the other hand, growing crops, such as wheat, corn, and other fruits of labor, are said to be personal property, and a tenant, upon leaving the real estate, has a right to such crops as he himself has planted. However, until severed, growing crops remain part of the realty and pass with it at time of sale.

Sec. 2. Fixtures.—Fixtures—personal property which has been attached to realty—may become a part of the real property or be of such a character that they continue to be treated as personalty. In reaching their decisions as to whether fixtures are real property or personal property, the courts have considered four distinct factors: (1) the mode of annexation; (2) the intention of the person who attaches the fixture; (3) the relationship between the fixture and the use to be made of the real property; and (4) the relationship existing between the parties engaged in the controversy.

The first of these factors throws very little light upon the problem except as it reflects the intention of the person who added the fixture. It is the intention which becomes material. The intention of a tenant may be, and usually is, quite different from that of the owner. The courts have been quite liberal in permitting tenants to remove trade fixtures. The use to be made of a fixture also becomes quite significant, particularly where the controversy is between buyer and seller. In the case of a residence, storm windows or screens may well be treated as real property even though they are not attached to the residence at the time of sale. They were built in most instances especially for the particular building upon which they are used. However, if a tenant has storm windows or screens installed, the problem becomes entirely different.

[1] Cook v. Whiting, 1855, 16 Ill. 480; p. 811.

The court must of necessity consider the relationship of the parties involved in the legal controversy.

Sec. 3. How title to real property is acquired.—Title to real property may be acquired in several different ways: (1) by original entry, called title by occupancy; (2) by transfer through and with the consent of the owner; (3) by transfer upon sale by a sheriff; (4) by possession of a party under claim of title for the period of the Statute of Limitations, usually twenty years, called adverse possession, or title by prescription,[2] (5) by will; (6) by descent, regulated by statute; and (7) by accretion, as when a river or a lake creates new land.

Sec. 4. Original entry, or title by occupancy.—Except in those portions of the United States where the original title to the land was derived from grants which were issued by the King of England and other sovereigns, who took possession of the land by conquest, title to all the land in the United States was derived from the United States government. Private individuals occupied such land for the period of time prescribed by federal statute and met such other conditions as were established by law, thus acquiring title by patent from the federal government.

Sec. 5. Transfer with the consent of the owner.—The title to real property is most commonly transferred by the owner's executing a deed to his transferee. Deeds are formal instruments under seal and may be "warranty deeds," "special warranty deeds," or "quitclaim deeds." A warranty deed conveys the fee simple title to the grantee, his heirs or assigns, and is so called because of the covenants on the part of the grantor by which he warrants: (1) that, at the time of the making of the deed, he has fee simple title therein and right and power to convey the same; (2) that the property is free from all encumbrances; (3) that his grantees, heirs, or assigns will have the quiet and peaceful enjoyment thereof, and that he will defend the title to the property against all persons who may lawfully claim it. In most states it is not necessary that the above warranties be written in the deed. Such a deed is substantially as in the form shown on page 397.

The grantor, by his deed, may make warranties, other than those enumerated above, with respect to the property transferred. Such a deed is called a "special warranty deed."

There may be circumstances under which the grantor would not wish to make warranties with respect to the title, and under such conditions he may execute a quitclaim deed. Such a deed merely transfers his existing legal and equitable rights in the premises de-

[2] Pierce et al. v. Cherry Valley Farms, Inc., 1945, (Ohio App.) 63 N.E.(2) 46; p. 811.

No. . . . .
Entry Book. . . . . Page. . . . .

WARRANTY DEED

GEORGE WILSON AND WIFE
TO
JOHN MOORE

STATE OF ILLINOIS, } SS.:
. . . . .County }

I, ... ,
Clerk of the Circuit Court and Ex-officio Recorder within and for the County and State aforesaid, do hereby certify that the within and foregoing instrument of writing was filed for record on the . . . . day of. . . . . ,
A. D. 19. . ., at . . . . o'clock. . . . . M,
and duly recorded in volume. . . . . of
Deeds, on page. . . . . and examined.

. . . .
Clerk.

WARRANTY DEED

THE GRANTORS, *George Wilson and Grace Wilson, his wife,* of the City of *Danville,* in the County of *Vermilion,* and State of *Illinois,* for and in consideration of *one dollar and other good and valuable consideration* in hand paid, CONVEY AND WARRANT to *John Moore,* of the City of *Urbana,* County of *Champaign,* and State of *Illinois,* the following described Real Estate, to wit:

Lot Five (5) of Block Six (6) of J. R. Jones' second addition to the City of Danville, situated in the County of *Vermilion,* in the State of *Illinois,* hereby releasing and waiving all rights under and by virtue of the Homestead Exemption laws of this State.

Dated this *3rd* day of *July,* A.D. 19. . .

Signed, Sealed, and Delivered in Presence of

Andrew Smith
Marie Smith

George Wilson (Seal)
Grace Wilson (Seal)
. . . . (Seal)

State of *Illinois* }
Vermilion County } ss.:

I, *Laura Black, a notary public,* in and for said County, in the State aforesaid, do hereby certify that *George Wilson and Grace Wilson, his wife,* personally known to me to be the same persons whose names *are* subscribed to the foregoing instrument, as having executed the same, appeared before me this day in person and acknowledged that *they* signed, sealed, and delivered the said instrument as *their* free and voluntary act, for the uses and purposes therein set forth, including the release and waiver of the right of homestead.

Given under my hand and *notarial* seal this *3rd* day of *July,* A. D. 19. .

Laura Black,
Notary Public.

scribed in the deed to the grantee. A quitclaim deed would be used under circumstances where an heir, owning an undivided interest in real property, wished to make a conveyance of his rights in the land, or where the interest of a person in land is questionable, and, to clear the title, he gives a quitclaim deed. In the latter case, if he had title he has parted with it, and if he had none no injury has been done to him by the execution of the deed. The following is the usual form of a quitclaim deed:

QUITCLAIM DEED

Statutory Form

THE GRANTOR, *George Wilson* of the City of *Urbana,* in the County of *Champaign,* and State of *Illinois,* for and in consideration of *One and no*/100 Dollars CONVEYS AND QUITCLAIMS TO *John Moore,* of the City of *Urbana,* County of *Champaign,* and State of *Illinois,* all interest in the following described Real Estate, to wit:

Lot Five (*5*) *of Block Six* (*6*) *of J. R. Jones' Second Addition to the City of Urbana,* situated in the County of *Champaign,* in the State of *Illinois,* hereby releasing and waiving all rights under and by virtue of the Homestead Exemption laws of this State.

Dated this *3rd* day of *July,* A. D. 19. . .

Signed, Sealed, and Delivered in Presence of

. . . .

. . . . *George Wilson* (Seal)

. . . . (Seal)

. . . . (Seal)

. . . . (Seal)

State of *Illinois* }
Champaign County } ss.:

I, *Charles Walker, a notary public,* in and for said County, in the State aforesaid, do hereby certify that *George Wilson,* personally known to me

to be the same person whose name *is* subscribed to the foregoing instrument, as having executed the same, appeared before me this day in person and acknowledged that *he* signed, sealed, and delivered the said instrument as *his* free and voluntary act, for the uses and purposes therein set forth, including the release and waiver of the right of homestead.

Given under my hand and *notarial* seal this *3rd* day of *July*, A. D. 19...

Charles Walker,
Notary Public.

Sec. 6. Covenants and conditions.—Quite often the grantor places restrictions upon the use which may be made of the land conveyed. He may, for instance, provide that it shall be used exclusively for residential purposes and that the style and cost of the residence meet certain specifications. These restrictions are so inserted in the deed as to act as covenants or promises on the part of the grantee to observe them, and are said to run with the land. Even though the grantee fails to include them in a subsequent deed made by him, the new owner is nevertheless subject to them. They remain indefinitely as restrictions against the use of the land.

Most of these covenants are inserted for the benefit of surrounding property and may be enforced by the owners of such property. This is particularly true where the owner of land which is being divided into a subdivision inserts similar restrictions in each deed. The owner of any lot which is subject to the restrictions is permitted to enforce the restrictions against the other lot owners located in the same subdivision. Only occasionally is a covenant inserted for the personal benefit of the grantor.

Deeds containing a condition subsequent are sometimes given to the grantee. Such deeds provide that the title reverts to the grantor in case the condition occurs. A deed to a church, by way of gift, often provides that the property must continue to be used for church purposes or title will revert to the original owner. If the provision for reversion is not included, it becomes difficult to distinguish between a covenant and a condition. In case of doubt, the courts tend to treat these provisions as covenants rather than as conditions.

Sec. 7. Execution of deeds.—The statutes of the various states provide the necessary formal requirements for the execution and delivery of deeds. A deed must be signed, sealed, acknowledged, and delivered. A deed is not effective until it is delivered to the grantee: that is, placed entirely out of the control of the grantor. This delivery usually occurs by the handing of the instrument to the grantee or his agents. Where property is purchased on installment contract, and occasionally in other cases, the deed is placed in

the hands of a third party, to be delivered by him to the grantee upon the happening of some event, usually the final payment by the grantee. Such delivery to a third party is called delivery in escrow and takes control over the deed entirely out of the hands of the grantor. Only if the conditions are not satisfied is the escrow agent at liberty to return the deed to the grantor.

Sec. 8. Recording of deeds.—In order that the owner of real estate may notify all persons that he has title to the property, the statutes of the various states provide that deeds shall be recorded in the recording office of the county in which the land is located. Failure of a new owner to record the deed makes it possible for the former owner to convey and pass good title to the property to an innocent third party, although he has no right to do so and would be liable to his first grantee in such a case.

Sec. 9. Abstracts of title.—Every deed, mortgage, judgment, lien, or estate proceeding which affects the title to real estate, is required by statute to be filed and recorded in the recording office of the county within which the real estate lies. In order for an owner to know the history and nature of the title to be obtained by him, title companies examine such records and prepare abstracts of the record. A purchaser of real estate should demand such abstract of title and have it examined in order to determine whether there are any existing claims against the property, or any outstanding interests that might in any way affect his title. The abstract of title must be supplemented from time to time, in order to show the chain, so that all court proceedings, such as foreclosures, partitions, transfers by deed, and probate proceedings, may be shown. Title companies are organized for the purpose of preparing such abstracts, and, after their preparation, examination of them should be made by a competent attorney before a purchaser accepts the title from the grantor.

Sec. 10. Title by descent or will.—Each state provides by statute for the disposition to be made of the property of a deceased person who leaves no will. It is customary to allow the surviving spouse and children to share in the estate in proportion of one third and two thirds respectively, this being true whether there is one or several children. For the details of the statute of descent, reference must be made to the law of the particular state involved. Personal property usually descends in accordance with the law of the state in which the deceased resided at the time of his death, whereas real property normally descends according to the law of the state in which it is situated.

With two exceptions, the deceased may, by will, distribute his property as he desires. He may leave all of it to one child at the ex-

pense of the others or he may leave it all to some charitable institution and make no provision for his children or relatives. In such cases, exactly what the testator had in mind must be clear from the provisions of the will. Naturally, a person may not make disposition of his property until provision has been made for the payment of his debts, and, second, the law of many states provides that the deceased must make some provision for the surviving spouse. The law generally stipulates that the survivor must be left with at least one third of the net estate.

A will is effective only when it has been drawn by one of sufficient mental capacity to realize fully the nature and effect of his act. The law requires that the signature to the will be witnessed by at least two, and in some states three, persons who are not interested in the estate. In a few states, a will written entirely in the handwriting of the deceased is probated even if it has not been witnessed. It should be understood that a will has no effect on the right of the owner to dispose of property during his lifetime. A will takes effect only at death and only then if it has not been revoked by the testator prior to his death.

Estate in Real Property

Sec. 11. Estates in fee simple.—A person who owns the entire estate in real property is said to be an owner in fee simple. The title to real property may be divided—that is, a person may possess the right to own it for his life or for that of another. Such an estate is called an estate for life. A person, by lease, may have the right to the possession of real property for a term of years, but such property is regarded as personal property, although in effect the lease constitutes an interest in real property.

Sec. 12. Life estates.—An owner of land may create, either by will or by deed, a life estate therein. Such a life estate may be for the life of the grantee or it may be created for the duration of the life of some other designated person. Unless the instrument which creates the life estate places limitations upon it, the interest can be sold or mortgaged like any other interest in real estate. The buyer or mortgagee takes into consideration the fact that he receives only a life estate and that it may be terminated at any time by the death of the person for whose life it was created. For full protection, the mortgagee should carry insurance upon the life of the life tenant.

The life tenant is obligated to use reasonable care to maintain the property in the condition in which it was received, ordinary wear and tear excepted. It is his duty to repair, to pay taxes, and to pay interest on any mortgage which may have been outstanding at the time the life estate was created, out of the income received. The

life tenant has no right to make an unusual use of the property if such a use tends to deplete the value of the property unless the property was so used at the time the estate was created. For instance, a life tenant would have no right to mine coal or to cut and mill timber from land in which he held only a life estate unless those operations were being conducted or contemplated at the time the life estate was created.

Sec. 13. Remainders and reversions.—After the termination of a life estate, the remaining estate may be given to someone else, or it may revert to the original owner or his heirs. If the estate is to be given to someone else upon the termination of a life estate, it is called an estate in remainder. If it is to revert back to the original owner, it is called a reversion. If the original owner of the estate is dead, the reversion comes back to his heirs. A remainder or a reversionary interest may be sold, mortgaged, or otherwise disposed of in the same manner as any other interest in real property.

Sec. 14. Dower and curtesy.—At common law, a wife is entitled, upon the death of her husband, to a life estate in one-third of any real property which her husband owned at the time of his death. The common law provided that, if there was a child born alive, upon the death of the wife the husband was entitled to a life estate in the whole of the wife's property. This was known as curtesy.

Curtesy has quite generally been abolished by statute, although in some of the states the husband is given the right of dower in its stead. Some of the states have also abolished dower, making some other provision for the surviving wife or husband. A few of the states are in the midst of a change. New York, for example, makes dower available to a surviving wife in case the marriage took place before 1930 but is limited to the real property which was acquired by her husband prior to 1930. In those states where dower is provided for, the husband cannot defeat the dower by conveying his property prior to his death. A purchaser acquires good title only if the wife joins in the deed, unless the statute makes some other provision. Dower is now quite generally controlled by statute in those states where it is in use.

Sec. 15. Easements.—An easement is a right, granted by the grantor to the grantee, to use real property. For example, the grantor may convey to the grantee a right of way over his land, the right to erect a building which may shut off light or air, the right to lay drain tile under the land, or the right to extend wires over the land. If these rights of easement are reserved in the deed conveying the property, they pass along with the property to the next grantee and are burdens upon the land. Such easements may be

made separate and distinct, by contract, and are binding only to the immediate parties to the agreement. If such right to use another's land is given orally, it is not an easement but a license, and the owner of the land may revoke it at any time; whereas an easement given by grant cannot be revoked or taken away except by deed, as such a right of way is considered a right in real property. An easement, like title to property, may be acquired by adverse possession.

Sec. 16. Tenancies—joint tenancy, and tenancy in common.—An estate in land may be owned by several persons. Such persons may hold the real estate, either as tenants in common or as joint tenants, according to the nature of the granting clause in the deed by which the title is transferred. In a joint tenancy each person owns an undivided interest in the real property. Upon the death of any one of the owners, the remaining owners take the property, and, upon the death of all the owners except one, the entire property passes to such survivor, if the joint tenancy has not been terminated by some act of the parties.[3] In tenancies in common, however, upon the death of one of the several owners, the title to his share passes to his heirs, and the heirs, therefore, become tenants in common with the surviving tenants in common. A joint tenancy can be created only by a specific statement in the granting clause of the deed, which usually states that the grantees shall hold title to said premises as joint tenants with the right of survivorship, and not as tenants in common. In the absence of such clause, grantees are tenants in common.

Sec. 17. Tenancy by entirety and community property.—Some states have provided by statute for tenancy by entirety, which is essentially like joint tenancy, except that it cannot be terminated without the consent of both parties and is available only between husband and wife. Under joint tenancy, either co-owner can destroy the joint tenancy by a sale and transfer of his interest, the purchaser becoming a tenant in common with the other owner or owners. Such is not possible if the ownership is one by entirety.

Several of the southwestern and western states have what is known as community property, having inherited it in part from their French and Spanish ancestors. In these states, all property acquired after marriage other than by devise, bequest, or from the proceeds of noncommunity property, becomes the joint property of husband and wife. Control of the property is vested primarily in the husband and he is authorized, in most states, to sell or mortgage it. The proceeds of the sale or mortgage in turn become community property. Upon the death of one of the parties, title to at least half of the community property passes to the survivor. In most

[3] Van Antwerp v. Horan, et al., 1945, 390 Ill. 449, 61 N.E.(2) 358; p. 812.

of the states, the disposition of the remainder may be by will or under the rules of descent.

Review Questions and Problems

1. How does real property differ from personal property? What is the nature of growing crops?
2. Name five methods of acquiring title to real property.
3. What is the difference between a warranty and a quitclaim deed? Name the three warranties implied from a warranty deed.
4. *A* plotted a certain ten acres of land into city lots. In the deed to each lot he inserted a provision that no house should be constructed upon the lot at a cost of less than $5,000. One of the grantees now proposes to build a $4,000 house. May the other grantees enforce the restriction?
5. What is the meaning of delivery in escrow? When is it used?
6. If you desired to purchase some real estate, where would you go to determine the state of the grantor's title?
7. *A* lives in Illinois and owns property in South Dakota. Unknown to *A*, *B* enters and takes possession of the property, pays taxes, and farms it for a period of twenty-five years. Do these acts affect *A*'s title?
8. *A* and *B* hold title to real estate as joint tenants. May *A* sell and convey his one-half interest to *C* without obtaining *B*'s consent? *A* dies and his heirs contend they own his share. Is their contention correct?
9. *A*, the owner in fee simple of certain property, deeds a life estate therein to his mother. What is the balance of the estate called? To whom does it belong?
10. What is the difference between dower and curtesy?
11. Distinguish between an easement and a license.
12. *A* willed certain land to *W* for life with the remainder to *W's* minor children. *A* died and sometime thereafter *W* leased the property to *X* Coal Company, which stripped the land of coal and destroyed it for other useful purposes. Have the children a good cause of action against the coal company?

Chapter II

REAL ESTATE MORTGAGES

Sec. 18. Nature of, and essential requirements under the early common law.—A real estate mortgage is now generally considered a lien on land, created by contract, for the purpose of securing the performance of an obligation, usually the payment of money. The party who makes the mortgage is the mortgagor; the party to whom it is made—the one who lends the money—is the mortgagee. Under the common law, the early form of a mortgage on land consisted of an absolute conveyance of the title of the land by the owner to the mortgagee, upon a condition that the title would revert to the mortgagor when the obligation was performed or the money was repaid. The mortgagee secured the absolute right to the land and could take possession and collect the rents and profits. If the mortgagor failed to pay the money on or before the day set, the property was forfeited to the mortgagee.

Sec. 19. Growth of equitable theory.—Under the common-law theory, the owner often lost his land if he was unable to repay a small loan on the due date, as required under his contract. In order to avoid the harshness of this rule, courts of equity began to allow the mortgagor to redeem his land after he had made a default. This right of the mortgagor, first recognized by a court of equity, is called his equity of redemption. Upon default, the mortgagee, by a process called a bill to foreclose the mortgage, asked the court to fix a date within which time the mortgagor must exercise his right to redeem his land. On the mortgagor's failure to redeem within the fixed time, the property became the absolute property of the mortgagee. During the time that the land was encumbered by the mortgage, the mortgagee had the absolute right to take possession of the property and to secure the income from it. On account of these unjust advantages, courts of equity have taken the view that, since the transaction is intended by the parties only as a security transaction, such intention should be carried out. Under modern statutes regulating mortgages, the mortgagor is now regarded as the real owner of the land. He has the right to exercise all the powers of an owner, subject, however, to the limitations contained in the mortgage. The mortgagee is regarded as having merely a lien on the land to secure his debt.

Sec. 20. Legal and equitable theories of mortgages.—Many of the states still hold to the old legal theory and regard the title and

the right of possession as passing to the mortgagee. This theory is called the title theory of mortgages, since title passes to the mortgagee. In the states where the title theory prevails, courts of equity permit the mortgagor to have a right of accounting against the mortgagee for any income obtained from the property while it is in his possession. In the law courts in the title theory states, the mortgagor today is regarded as the real owner as to everyone except the mortgagee.

In a majority of the states the equitable theory prevails; in these states the title remains in the mortgagor, and the mortgagee has only a lien against the property as a security for his loan. Such view is called the lien theory of mortgages.

Sec. 21. Property capable of being mortgaged.—In general, any interest in land, an equitable as well as a legal interest, can be mortgaged. The common interests subject to mortgage are fee simple estates, estates for life, estates for years, dower interests of widows, a mortgagee's interest, and a mortgagor's interest. Land may be mortgaged separately from its improvements, or the improvements may be mortgaged separately from the land, or both land and improvements may be mortgaged. Growing crops and various other interests in real estate may be mortgaged for the purpose of securing a loan.

Property which one does not own cannot be mortgaged, but a mortgage may be so drawn as to cover property to be acquired in the future. Although no mortgage exists at the time, equity will recognize a lien against the property as soon as it is acquired. This lien is good as to all persons who acquire rights in the property, except bona fide purchasers for value without notice.

Sec. 22. Form of mortgage.—The form of mortgage in common use still represents the title theory, and, as in a deed, states that it conveys the property to the mortgagee, subject to the conditions set forth in the mortgage. Such a conveyance of real property must be in writing, under seal, and executed with all the formalities of a deed. The contract between the parties with respect to the loan need not be included in the deed of conveyance, but may be set forth on a separate sheet of paper. In the title theory states, a mortgage is a very formal instrument. In the lien theory states, short forms of mortgages are usually authorized by statute and are not of such a technical nature.

Sec. 23. Recording mortgages.—In order that the mortgagee may give notice to third parties that he has an interest in the real estate covered by the mortgage, it is necessary that the mortgage be recorded in the recording office of the county where the real estate is situated. This recording protects the mortgagee against subse-

quent bona fide purchasers of the land from taking the real estate free from the mortgage. The statutes of the various states specify the requirements necessary for recording mortgages.

Sec. 24. An absolute conveyance may be a mortgage.—An absolute deed made by a landowner to a person may be shown by parol evidence to be a mortgage, if such evidence indicates that the intention of the parties was to make the transfer a security for a loan.[1] The landowner must prove, however, by clear, precise, and positive evidence that it was the intention of the parties to draw up the deed for the purpose of securing a loan.

Likewise, a landowner may sell his land and give an absolute deed, with an agreement that he retain the right to repurchase for a certain price within a specified time. Parol evidence may be introduced in such a case to establish that the deed was given for the purpose of securing a loan. If the evidence is convincing, a court of equity will declare such a deed to be a mortgage. For example, a man may convey his farm worth $30,000 for a consideration of $10,000. The so-called buyer then gives the seller an option to repurchase at a figure approximating $10,000 and interest. If the evidence is clear that the parties intended to make a loan, even though the option period has expired, it is not too late for the grantor to redeem his property, because the court will treat the deed as if it had been a mortgage.

Sec. 25. Deed of trust in the nature of a mortgage.—A deed of trust is often used as a substitute for a mortgage, for the purpose of securing debts. The property is conveyed to a trustee to hold in trust for the benefit of the creditor. If the mortgage is paid at the time required by the contract, the trustee reconveys the property to the grantor. If there is a default in the payment, the trustee sells the property and applies the proceeds to the payment of the debt secured. Deeds of trust are used where numerous notes are secured by the same property and are used to secure bondholders. For example, where it is desired to issue bonds secured by railroad or other corporate property, a trust deed may be executed to secure the entire bond issue. This method is necessary, because it would be impractical to execute a separate mortgage to secure each bond.

Sec. 26. Purchase money mortgages. — A purchase money mortgage is given for a part or the whole of the purchase price of land. For example, *A* wishes to purchase real estate worth $30,000. He has $10,000 in cash. Upon securing title from the vendor, he can complete his purchase by giving back to the vendor a mortgage on the real estate to secure the remaining purchase price of $20,000. This type of mortgage is normally used in the buying and selling of

[1] McGill v. National Bank of Topeka, 1938, 77 Pac.(2) 944, 147 Kan. 605; p. 814.

real estate. It is not necessary that the wife join the husband in executing such a mortgage, for the purpose of cutting off her right of dower. The mortgage is attached to the property before it becomes the property of her husband and she is entitled to dower only in what may remain to her husband after the mortgage on the property is paid, or in his equity of redemption, which is his share of the purchase price of the land on a foreclosure sale. There are other types of mortgages, such as building and loan mortgages, which are prescribed by the statutes of the various states governing and controlling building and loan associations.

Sec. 27. Rights of mortgagor.—The mortgagor is personally liable for the mortgage debt, not by reason of the mortgage, but because he makes a note, a bond, or other contract which evidences the debt secured by the mortgage. A mortgage may be made to secure the performance of an obligation other than the payment of money. The mortgagor under the lien theory of modern statutes is regarded as the owner of the land. He has the same right to control the property as he had before making the mortgage, and he may sell the land, or lease it, or make other mortgages, subject, however, to the agreement creating the already existing mortgage. Upon his death, interest in the real estate passes to his heirs, or, if he leaves a will, to his devisees under the will. His interest may be sold by a judgment creditor under an execution, subject to the prior right of the mortgagee. The mortgagor is entitled to retain possession of the property, cultivate the land, and secure the income therefrom. Being the owner of the mortgaged property, the mortgagor has an insurable interest in the property and can insure it for full value, regardless of the amount for which it is mortgaged. By the terms of the mortgage, the mortgagor is usually required to keep up the insurance for the benefit of the interest represented by the mortgage for and on behalf of the mortgagee. Upon a loss the insurance company pays the mortgagor and the mortgagee, as their interests may appear.

Sec. 28. Rights and liabilities of the mortgagee.—In the title theory states, the mortgagee has legal title and a right to possess the mortgaged property during the period of the mortgage, unless the contract grants to the mortgagor the right to remain in possession. In the lien theory states, the mortgagor is entitled to possession unless a different arrangement is provided for in the mortgage. In both the lien and title theory states, the mortgagee is protected against any person who commits waste or impairs the security. Even the mortgagor may not use the property in such a manner as to reduce materially its value. Mining ore, pumping oil, or cutting timber are operations which must be provided for in the

mortgage agreement. Perhaps, if they were being conducted at the time the mortgage was created, the mortgagor might continue without authorization in the mortgage. Under either title or lien theory, the mortgagee who takes possession of the property is obligated to derive a revenue from its use and to account for the amount received.

A mortgagee has a right to pay off or to redeem from any superior mortgage, in order to protect his security, and he can charge the amount so paid to the mortgagor. Likewise, he may pay taxes or special assessments which are a lien on the land, and defend suits which threaten the title of the mortgagor and recover the sum so expended. The mortgagor is under a duty to protect the security, but, should he fail to do so, the mortgagee has the right to make any reasonable expenditures necessary to protect the security for a debt.

Sec. 29. Transfer of mortgaged property. — The mortgagor may sell or will or give away the mortgaged property, subject, however, to the rights of the mortgagee. A transferee from a mortgagor occupies the position of a grantee; he stands in the same position as the mortgagor and has no greater rights. Such grantee of the mortgagor's interest may redeem the land and require the mortgagee, if the latter is in possession, to account for rents and profits. A grantee of mortgaged property is not personally liable for the mortgage debt, unless he impliedly or expressly assumes and agrees to pay the mortgage.[2] If he merely purchases "subject to" the mortgage, he pays the mortgage debt only when he deems the real estate to have a value greater than the amount of the mortgage, and he is not personally liable on the obligation. If he assumes the mortgage, he becomes personally liable for the debt, although the land is worth less than the mortgage. For example, if *A* purchases real estate worth $8,000 which is subject to a mortgage of $5,000 and assumes and agrees to pay the mortgage, he pays the former owner $3,000 and assumes responsibility for the ultimate payment of the mortgage. If he merely purchases the real estate subject to the mortgage, he again pays the owner $3,000, but pays the $5,000 mortgage only if the land is worth that much when the mortgage matures. Otherwise, he permits the land to be foreclosed without any personal liability on his part for the deficit; whereas, if he had assumed the deficit, he would have been liable for it.

Sec. 30. Liability of mortgagor after transfer.—If the grantee of the mortgaged property assumes and agrees to pay the indebtedness, he thereby becomes the person primarily liable for the debt; as between himself and the mortgagor, by virtue of his promise to

[2] Thomas et al. v. Home Mutual Building Loan Assn., 1910, 243 Ill. 550, 90 N.E. 1081; p. 815.

the mortgagor to pay the debt, he is the principal debtor and the mortgagor is the surety. This assumption by the grantee, however, does not relieve the mortgagor of his obligation to the mortgagee, and such mortgagor continues liable unless he is released from his indebtedness by the mortgagee. Such a release must comply with all the requirements for a novation. In those states which recognize the relationship of principal and surety between the mortgagor and his grantee, an agreement made by the mortgagee with the grantee, to extend the time of payment, will release the mortgagor from liability. If the grantee takes "subject to" the mortgage, the original debtor is not released, since suretyship is not involved directly. Many states, however, release the mortgagor of responsibility for any loss resulting from a decline in value of the mortgaged property during the period of extension.

Transfer of Debt and Mortgage

Sec. 31. Transfer of debt.—A debt which is secured by the mortgage is a chose in action, usually evidenced by notes or bonds. If the notes or bonds are nonnegotiable, the assignee of such notes or bonds takes title subject to all defenses that are available against the assignor. If, however, the notes or bonds are negotiable instruments and are transferred by indorsement, as required under the Law of Negotiable Instruments, the holder takes title free of personal defenses which would have been available against the transferor. The holder of the negotiable instrument secured by the mortgage has the right, upon default, to enforce the mortgage for the purpose of securing payment of the debt, as evidenced by the notes or bonds. A transfer of the mortgage without the debt gives to the transferee only a bare legal title or lien, which he holds in trust for the owner of the mortgage debt, although as between mortgagee and the purchaser of the mortgage, it is implied that the debt follows the mortgage. However, if the debt is transferred to one person and the mortgage is assigned to another, the holder of the indebtedness is in the best position.

If an assignment of the mortgage is made, it should be recorded in order to give notice of the rights of the assignee to all subsequent purchasers. However, failure to record the assignment will not aid a purchaser or later mortgagee who has notice of the assignment.[3] Actual notice should also be given to the mortgagor; otherwise payment by the mortgagor to the mortgagee may discharge the mortgage.

Sec. 32. Payment before default.—Payment of the mortgage debt at or before the time it is due terminates the mortgage. Upon

[3] Kalen v. Gelderman et al., 1938, 66 S.D. 53, 278 N.W. 165; p. 816.

payment by the mortgagor a release or satisfaction is secured from the mortgagee, and this release should be recorded in order to clear the title to the land. Otherwise, the unreleased mortgage will remain a cloud on the title. If the mortgagee refuses voluntarily to give a release, he can be compelled to do so in a court of equity by a bill to remove a cloud on the title, or by other proceeding provided for by statute.

A tender of money by the mortgagor before the due date does not terminate the lien evidenced by the mortgage, because the mortgagee cannot be forced to lose his investment before maturity. However, a tender upon the due day terminates the lien, although such a tender does not discharge the debt, and the mortgagee may still enforce it personally against the mortgagor until absolute payment. Under the common-law title theory, a tender on the due day satisfies the condition, extinguishes the lien, and reinvests the title in the mortgagor, but a tender after the due day does not have such an effect. The condition not having been performed, a reconveyance by the mortgagee is necessary. Thus, in the title theory states, a tender after maturity does not terminate the lien, although in the lien theory states, a tender at or after maturity terminates the lien. The mortgagor's only remedy in title theory states is that of placing his money in court and bringing a suit in equity for redemption. Such tender does, however, forestall recovery for interest and court costs.

Sec. 33. Right to redeem.—At any time after default, but before sale of the land on foreclosure, a mortgagor may exercise his right to redeem from the mortgage, unless this right has been barred by a period of time specified by the statute. Any person who has an interest in the mortgaged land is entitled to redeem from the mortgage; but, in order to do so, he must pay the entire mortgage debt, with interest, and all other sums, including costs, to which the mortgagee may be entitled by reason of the mortgage. If the mortgagee is in possession of the mortgaged property and refuses to consent to a redemption, the mortgagor or any party entitled to redeem may file a bill in equity for the purpose of redeeming the mortgaged property. Such person, however, must be ready and willing to pay whatever the court finds due, or tender to the court all moneys due on said mortgage. By statute in most states, any person interested in the premises, through or under the mortgagor, may, within a specified period of time from the sale of said property, redeem the real estate so sold. To do so, he must pay to the purchaser thereof, to the sheriff, or to the court officer who sold the property for the benefit of the purchaser, the sum of money, with interest and costs, for which the premises were sold or bid off.

The period of time allowed for redemption varies greatly from state to state.

Mortgage Foreclosures

Sec. 34. Right to foreclose.—If the mortgagor fails to perform his obligation—that is, to pay the debt when it falls due, or to perform any of the covenants set forth in the mortgage, such as the payment of principal by installment, of interest, insurance, or taxes—or if he defaults in other obligations, the mortgagee may declare the whole debt due and payable and foreclose for the purpose of collecting the indebtedness.

Sec. 35. Types of foreclosure.—The statutes of the various states specify the procedure by which mortgages are foreclosed. There are four types of foreclosure proceedings for the purpose of using the mortgaged property to pay the mortgage debt: strict foreclosure, foreclosure by suit in equity or in law, foreclosure by exercise of the power of sale, and foreclosure by entry and writ of entry. Strict foreclosure is one by which the mortgagee gets the land free from the right of redemption; that is, the decree provides that, if the debt is not paid by a certain date, the mortgagor loses such right and the mortgagee takes it free from the rights of junior mortgagees and lienholders. This is a harsh rule and is used only where it is clear that the mortgaged property is not worth the mortgage indebtedness, the mortgagor is insolvent, and the mortgagee accepts the property in full satisfaction of the indebtedness.

The usual method of foreclosing a mortgage is a proceeding in equity, such proceeding being provided for by statute. A bill for foreclosure is filed in a court of equity; this bill sets up the mortgagee's rights, as provided for in the mortgage, and shows such breaches of the covenants in the mortgage as will give a right of foreclosure. The court will issue a certificate of sale authorizing the master in chancery or some other officer of the court to sell the land at public auction. Following the sale, he gives the purchaser a deed to the land and accounts for the funds realized as a result of the sale. To the extent that funds are available, they are used to pay court costs, the mortgage indebtedness, and inferior liens in the order of their priority. If any surplus remains, it is paid to the former owner of the property. Foreclosure by a second mortgagee is made subject to all superior liens. The buyer at the foreclosure sale takes title, and the first mortgage remains a lien on the property. All inferior liens are cut off by foreclosure except as the holders thereof have an equity in a surplus if such exists. As stated in Section 32, the statutes in many states provide a short period of time after the sale within which the mortgagor or other persons in

interest are entitled to redeem the property. Where such statutes are in force, the purchaser is not entitled to his deed until after the expiration of the period within which redemption may be made.

Sec. 36. Foreclosure by exercise of power of sale.—The mortgage often provides that, upon default by the mortgagor, the mortgagee may sell the land without judicial process. This method of foreclosure can only be made in strict conformity with the terms of the mortgage, and there is no redemption from such sale unless given by statute. The power of sale makes the mortgagee the agent of the mortgagor to sell the land. In some states, however, a power of sale in the mortgage is expressly forbidden by statute and foreclosures must be effected by judicial proceeding. A power of sale granted in a mortgage or a deed of trust is not revocable, since the agency is coupled with an interest; therefore, the death or insanity of the mortgagor will not revoke the power. In those states where the exercise of power is regulated by statute, the sale must be public after the prescribed notice is given. In the absence of statute or mortgage agreement, however, the sale may be private. Since a mortgagee, in selling the land under a power of sale, is acting as an agent for the mortgagor, he is not allowed to purchase at the sale, because an agent cannot himself purchase that which he has been given authority by his principal to sell. The purchaser at such a sale secures only such title as the mortgagor had when he made the mortgage.

When a deed of trust, in which the trustee is empowered to sell the land and to apply the proceeds to the mortgage debt, is given to secure the payment of a debt, the same rules apply as are set forth above.

Sec. 37. Foreclosure by entry and by writ of entry.—In some states, the mortgagee may foreclose by entry upon the land, after default, after publication of notice and advertisement, and in the presence of witnesses; or by the possession of the premises for a period of time. If, after a limited period, the mortgagor does not redeem, the foreclosure is said to be completed and the title to rest in the mortgagee.

Sec. 38. Deficiency decree.—Since the mortgage debt is usually represented by a bond or a note, the mortgagor is personally liable for such debt, and the mortgagee may sue the mortgagor for it. If the land which is the security for the debt does not sell for a sum sufficient to pay the mortgage indebtedness, by statute in most states the court may enter a deficiency decree for that part of the unsatisfied debt. This decree will stand as a judgment against the mortgagor, and his other property may be levied on to satisfy such judgment. For example: *A*. the mortgagee, owns a mortgage which

is security for an indebtedness of $10,000 against *B*'s land. If, on foreclosure and sale of the land, the sum of only $7,000 is secured, *A* may obtain a deficiency judgment against *B* for $3,000, which will be a lien against any other property that *B* may own. Such other property may then be levied on and sold to satisfy the $3,000 deficiency judgment.

Review Questions and Problems

1. How have courts of equity altered the early common law of mortgages?
2. *A* mortgages to *B* certain land which *A* now owns and certain land which he shall acquire later. The latter land is subsequently purchased, but is sold to *C*, who has no knowledge of the mortgage. Determine the rights of *B* and *C*.
3. What is the purpose of recording mortgages? Where should they be recorded?
4. *A*, desiring to borrow $15,000, gives *B* an absolute deed as security for a loan of this amount. *B* executes an agreement to reconvey the property upon the payment of the debt and interest three years later. Is this a sale or a mortgage?
5. How does a trust deed differ from a mortgage? What is its purpose? What is a purchase money mortgage? When does such a mortgage attach to the property?
6. *A* sells *B* property which has a $10,000 mortgage on it in favor of *C*. *B* purchases the property subject to the mortgage. The property declines in value and, at the maturity of the mortgage debt, is foreclosed and sells for $8,000. May *C* recover the deficit from *B*? May he recover from *A*, assuming that *A* is the mortgagor?
7. In the previous case, how would the result differ if *B* had assumed the mortgage debt?
8. *B*, the holder of a note secured by a mortgage, assigns the mortgage to *A* and negotiates the note to *C*. Whose claim is superior? Should an assignment of a mortgage be recorded? Does the assignee of the mortgage ever obtain a better right than the original mortgagee?
9. What is meant by strict foreclosure? When is it used? What is the usual method of foreclosure?
10. Has the mortgagor any right to redeem the land after foreclosure sale?
11. What is the legal effect of tender before and after maturity? At common law? In lien theory states?
12. *A* holds a first mortgage on land of $15,000 and *B* has a second mortgage of $6,000. *A* forecloses, and the land sells for $18,000. What are the rights of the parties?

CHAPTER III

LANDLORD AND TENANT

Sec. 39. Relation created by lease.—The relationship of landlord and tenant is created as a consequence of a lease, either express or implied, oral or written, and arises only when the tenant takes possession of the premises leased. No particular form of words is necessary to create the lease or the relation of landlord and tenant. The language used must be sufficient to indicate an intent to divest the landlord of possession and to vest possession in the tenant. The person giving up possession under the lease is called the landlord, or lessor, and the one coming into possession by virtue of the conveyance is called the tenant, or lessee. The instrument which creates the relation is called a lease. It need not be in writing unless the period of time is such that it comes under the Statute of Frauds. The landlord, or lessor, grants possession of land or tenements in return for rent or other income on the part of the tenant, or lessee.

The particular classes of tenancy are terms for years, tenancy at will, tenancy from year to year, tenancy at sufferance, and tenancy for life.

Types of Tenancy

Sec. 40. Tenancy for years.—A lease for years is a conveyance between the lessor and the lessee by which the lessor grants the possession and enjoyment of property for a definite period of time and by which the lessee agrees to pay rent in money or other consideration, at the end of stated periods, during the term of the lease. The period of time must be certain and definite, or no estate for years is created. A lease for a period of time, depending upon a contingency which is not certain to happen, is not definite. Except when regulated by statute, a lease may be made for any period of time the parties may agree upon: it may be made for 99 years, for 999 years, or for one day.

Sec. 41. Termination of lease.—A lease for years terminates at the expiration of the period. Such lease does not terminate at the death of the lessee before the expiration of the term. A leasehold estate is personal property and passes to the personal representative of the lessee upon his death, and his estate is liable, as in any other contract, on the covenants in the lease for the payment of rent. If the property leased consists of rooms or apartments in a

building, the destruction of the building by fire or otherwise terminates the lease and the liability of the tenant to pay rent. This is an exception to the general rule that a tenant remains liable for the rent on the premises, irrespective of injury or destruction by fire or other casualties. Where the tenant leases the land as well as the building, destruction of the building does not destroy all the premises; whereas, in a lease of rooms or of an apartment, the whole of the premises leased is destroyed and the enjoyment of the premises contracted for becomes impossible, because nothing remains upon which the lease can operate. It is customary in the ordinary lease of property to insert a clause which effects a termination of the lease in case an important building is destroyed or materially damaged.

Sec. 42. Rights of tenant after term.—In the case of a tenancy for a term of years, the interest of the lessee ceases at the end of the period, the landlord being under no duty to give him notice. During the term, the tenant has a right to remove those movable fixtures which he has installed, and, if they are not moved before the expiration of the term, such fixtures become a part of the realty and the property of the landlord. If, during the term, the tenant has sown crops which mature after the term, the right to such crops passes to the landlord with the reversion.

Sec. 43. Tenancy at will.—Where the lease is for no definite period, but at the will of the lessor, it is said to be a tenancy at will.[1] A tenancy at will may be either express or implied, and, if the landowner permits a person to occupy his premises an indefinite period of time, without demanding rent, a tenancy at will is said to be created by implication. Such a tenancy may be terminated at any time by either the lessor or the lessee, and the death of either terminates such tenancy. Under some jurisdictions, it is necessary to give reasonable notice of such termination; whereas, under others, the landlord may terminate the tenancy at any time. Where the landlord terminates a tenancy at will, the tenant is entitled to the unmatured crops and may enter upon the property for the purpose of harvesting them at maturity.

Sec. 44. Tenancy from period to period.—When a tenant holds over after the termination of a lease for a definite period and remains in possession, and the landlord accepts rent, a tenancy from period to period is created. Also, if a lease is invalid for failure to comply with the Statute of Frauds and if entry has been made and rent paid, a tenancy from period to period arises if annual rental has been paid. If the original lease calls for a monthly rental, rather than an annual rental, or if the period of the original lease

[1] Thompson v. Baxter, 1909, 107 Minn. 122, 119 N.W. 797; p. 818.

was for one month, a holding over creates only a month-to-month tenancy. If the original lease called for an annual rental, the tenancy becomes one from year to year. The two leases differ in regard to the notice that is required to terminate them. At common law, a lease from year to year could be terminated by either party only if notice of the desire to terminate was given at least six months before the year expired. Failure on the part of the landlord to give such notice made it possible for the tenant to remain another year. A month-to-month tenancy was terminable by giving at least thirty days' notice before the close of the particular month in which it was to be terminated. The customary written notice now provided for in state statutes is sixty days for a year-to-year tenancy and thirty days for a period-to-period lease of less than a year.

A tenant of farm land who holds it under a lease from year to year has the right to return and harvest those crops which have been planted prior to the time that notice of termination is received. Leases from period to period, like leases for years, are not terminated by the death of the tenant or landlord.

A lease from period to period may also result from an agreement at the time of letting. If the contract provides for a periodical payment of rental without any fixed duration, a tenancy from period to period arises.

Sec. 45. Tenancy at sufferance.—Where a tenant holds over after the expiration of a definite period, the landlord may treat him as a tenant at sufferance. Likewise, a tenant at sufferance is created if the original entry by the tenant was otherwise than by lease, and such person continues in possession at the option of the landlord. If the owner accepts the payment of rent due after the expiration of a term, the acceptance is evidence of his intention to treat the party in possession as a tenant, and such act creates a new tenancy from month to month or for a period for which the rent was received. A tenancy at sufferance may be terminated at any time by the landlord.

Sec. 46. Tenancy for life.—An estate for life is usually created by deed. However, a lease may be made to hold for the term of the grantee's life or for the life of another, with an agreement to pay rent or other consideration. In the absence of a definite agreement with respect to rents and services to bind the grantee to the grantor, a conveyance will be made, in which an estate for life is created. Under such circumstances, the grantor is not a landlord and the grantee is not a tenant.

Sec. 47. Difference between a lease and a license.—A license is a mere privilege granted by one person to another to use his land

for some particular purpose, without the licensor's passing to the licensee any interest or estate in the land. A license merely gives one the privilege of coming on another's land, without committing a trespass. A license is personal and can only be enjoyed by the party to whom the privilege is given, and may be revoked at any time by the person granting the license. A license is not assignable, and, even though given for consideration, it cannot be exercised by any person other than such licensee. A demise or lease, however, is more than a license, in that it carries a present interest or estate in the land for a definite period, and gives the right to the possession of the land and the exclusive occupation and enjoyment of it for all purposes set out in the lease. The granting of permission to place advertising signs and billboards upon land or buildings is an illustration of a license.

Rights and Duties of the Landlord

Sec. 48. Right of landlord to enter upon premises.—The estate of the landlord during the term of the lease is called a reversion. The lessee is the absolute owner of the premises for the purposes for which the lease is created. The tenant is in possession of the premises and the landlord has no right to interfere with the lessee's enjoyment and use of the land, except as provided by the lease. In the absence of an agreement, the lessee has the sole and exclusive right to the occupancy and control of the premises and may prevent the landlord from entering upon the premises or interfering in any way with the lessee's possession.

Most leases provide, however, that the landlord may enter on the premises and place "to let" and "for rent" signs thereon. The landlord has the right to enter the premises to levy for distress or to demand payment for rent. If the tenant abandons the premises, the landlord may enter for the purpose of taking care of them, without incurring any liability to the tenant as a trespasser. Care must be exercised in such cases to make it plain that the landlord is not consenting to the abandonment of the premises by the tenant. If the landlord accepts the surrender of the premises without protest, the lease is terminated by the mutual agreement of the parties, and the tenant is relieved of responsibility for loss in case the landlord is unable to find a new tenant.

Sec. 49. Right to recover for injuries to the premises.—The landlord may recover for any injuries to his reversionary interest, that is, such injuries as would affect the premises after the expiration of the lease—for example, the destruction of the premises or uses likely to ripen into easements, such as the laying of water pipes across the premises, removal of part of the property, construction

of party walls, and so forth. The landlord has no right to recover for injuries to growing crops, as such an injury is an injury to the possession rather than to the reversion. However, an injury to trees or to standing timber, or the removal of line fences, would be an injury to the reversion, for which the landlord may recover.

Sec. 50. Warranty of landlord as to condition of premises.—In general, there is no implied warranty that the premises are suitable for the use for which they are leased by the tenant. The duty of the lessee is to examine the premises for defects, and, if he neglects to do so, or if he fails to provide against such conditions in his lease, he takes the premises at his peril.[2] The landlord is under a duty to notify the lessee of unhealthful conditions of the premises, which may arise from latent defects; failure of the landlord to do so constitutes fraud and gives a right to the tenant to abandon the premises.

Sec. 51. Duties and liabilities of landlord as to repairs of premises.—In the absence of an agreement, the landlord is under no obligation to repair the lease premises.[3] Nor is there any implied covenant to rebuild or to repair property damaged by fire or other causes. The lessee takes the premises as they are and cannot bind the landlord for repairs without the latter's consent. A promise to repair on the part of the landlord after the lease has been executed is without consideration and cannot be enforced. However, in some states, if the premises are defective, a promise to repair is binding if the tenant notifies the landlord that unless such repairs are made, he will vacate the premises. In a few states it is provided, by statute, that the landlord, in renting houses for habitation, shall keep them in repair fit for occupancy by human beings. Otherwise, the tenant may vacate after notice, without incurring liability for future rent. If a building is rented to two or more tenants, the landlord is obligated to keep in repair the portion of the building used in common by the various tenants.[4] The roof, common hallways, and the foundation must be cared for by him.

Sec. 52. Recovery of owner for injuries occasioned by defects.—In general, it may be said that the landlord is not liable to the tenant, his family, or guests for defects existing in the rented property. Since the landlord makes no warranty as to its condition, the tenant and his guests use the property at their peril. Even in those cases where the landlord is obligated by contract to repair, or where common property is involved, the landlord's liability is generally

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[2] Walsh v. Schmidt, 1910, 206 Mass. 405, 92 N.E. 496; p. 819.

[3] Petz v. Voigt Brewing Co., 1898, 16 Mich. 418, 74 N.W. 651; p. 819.

[4] Whellkin Coat Co. v. Long Branch Trust Co., 1938, 121 N.J.L. 106, 1 A.(2) 394; p. 820.

based on carelessness. Unless he has been notified of the defect or has been negligent in failing to discover it, his failure to correct it will ordinarily result in no liability.

The owner of business property, knowing that business invitees will be constantly entering it to transact business, has an increased responsibility. He is liable for injuries sustained by business guests as a result of defects existing at the time the lease was created or of defects arising from the ordinary use of the property. To this extent, the owner of business property is obligated to keep it in good repair in order to avoid liability for injuries sustained.

A similar duty attaching to all owners of property concerns passers-by. An injury occasioned to a person merely passing by the property, and which results from either original or use defects, must be compensated for by the landlord.

Remedies for Recovery of Rent

Sec. 53. Landlord's lien.—At common law a landlord has no lien for rent upon the property of a tenant.[5] However, if the landlord is receiving his rent as part of the crop or produce of a farm, by usage in some states he is given a lien on the crops for rent. The landlord and the tenant may, by express provision in any lease, provide that the landlord be given a lien upon personal property of the tenant, which is present upon the leased premises. In many jurisdictions statutes have been enacted expressly giving a landlord a lien for rent. Such statutes specify the property subject to the lien. The statutes of the various states should be examined to determine the nature and extent of the lien. In some cases a lease which gives the landlord a lien on the personal property of the tenant, for rent, is in the nature of a chattel mortgage, and, to be effective, the lease must be recorded, in order to protect bona fide purchasers and creditors.

Sec. 54. Suit on the lease.—The landlord may recover for rent in an action at law, where the lease contains an express covenant to pay rent. The usual procedure for the recovery of rent is called distress for rent.

Sec. 55. Distress for rent.—This is a common-law remedy by which the landlord may, by obtaining a distress warrant, seize the personal property of the tenant to force payment of rent. In some states, it has been abolished by statute, and in other states, it has been adopted or changed by statute. Where a tenancy from year to year is ended by the landlord's giving notice to quit and the tenant holds over, no action for distress will lie—the only remedy being damages for the holding over. In order for the landlord to distrain for rent, the tenant must owe him a certain definite sum of rent,

[5] Hadden v. Knickerbocker, 1873, 70 Ill. 677, 22 Am. Rep. 80; p. 821.

payable in money or produce or other services, which is in arrears. The tenant has all the day on which the rent falls due in which to make payment, and suit cannot be brought until the morning after the day the rent is due. All the personal chattels of the defendant, which are not perishable, are subject to be distrained for rent. Usually book accounts of merchants and implements of trades or professions cannot be taken on distress; they are also exempt under the statutes. If the rent is paid prior to an authorized sale, it is the duty of the landlord to return the property in the same condition as it was when it was distrained.

Sec. 56. Place of distraining.—Only property which is on the premises can be distrained or taken for rent. If, however, the tenant fraudulently removes his property from the premises, either before or after the rent becomes due, the landlord may follow and seize such property, provided it was removed by the tenant after the landlord had actually come to distrain. By statute, the landlord is permitted to follow property removed from the premises, and to levy distress after the termination of the tenancy; and in some jurisdictions he has the right to distrain the tenant's property, even though it has not been on the demised premises.

Sec. 57. Procedure for distress.—Under the statutes of some of the states, the landlord must make an affidavit setting forth his right to distrain and to secure a warrant to be levied by the proper court officers. The statutes provide for the time when notice of sale must be given both to the tenant and to the public, and, if the distress has been wrongfully made, a purchaser at such sale will acquire no title. The purchaser will be liable for damages for trespass.

Rights and Liabilities of the Tenant

Sec. 58. Estoppel to deny landlord's title.—A tenant, by virtue of his possession, is estopped from denying his landlord's title. The actual possession of the premises gives an advantage to the lessee, and, by reason of this advantage, he has no right to question the title of the lessor. The lessee must surrender his possession before he may assert whatever title he has. He is then at liberty to recover the land if he can prove his right. Neither can the lessee claim title to the premises by reason of defects in the lease or by admissions on the part of the lessor.

Sec. 59. Duty of lessee to redeliver at expiration of term.—There is an implied covenant in every lease that the lessee will redeliver the premises to the lessor at the end of the term, and, if the lessee wrongfully withholds possession, the lessor may sue and recover damages. The lessee is also under duty, at the expiration of the lease, to remove his personal property and to return the prem-

ises in the same condition as they were when he received them at the beginning of the term. This provision does not bind the lessee, however, to make payment for ordinary wear and tear from reasonable use of the premises or for actual destruction beyond his control.

Sec. 60. Duty of tenant as to care and repair of premises.—In the absence of any agreement, the tenant is under duty to keep the premises in repair, such as replacing doors and broken windows, repairing fences, and making ordinary repairs which are not permanent in nature but which are necessary to keep the premises from deteriorating and unduly depreciating. The tenant usually is under no obligation to make substantial and lasting repairs, such as putting on new roofs, rebuilding walls, and other permanent improvements. The landlord and tenant may make agreements as to the nature and character of repairs during the term; but, in the absence of such agreement, there is no implied liability on the part of the tenant to make such lasting repairs or to make repairs that were needed at the time he entered.

Sec. 61. Improvements by lessee in the absence of an agreement.—There is no implied covenant on the part of the lessor to pay the lessee for improvements placed on the premises during the term of the lease, although such improvements become part of the real estate and, upon the expiration of the term, revert to the lessor. If, however, the lessee makes improvements upon the land and wrongfully is denied the use and benefit of them by the landlord, he is entitled to recover for the reasonable value of such improvements. In general, such improvements are usually for the benefit of the lessee, and under such circumstances, he is not entitled to recover from the lessor for improvements made by him during the term. Neither can the lessee, upon the expiration of the term, remove permanent improvements, placed by him upon the premises, which have become a part of the realty.

Sec. 62. Duty to pay rent.—Where one party has the use, enjoyment, and possession of another's land, the law will imply an agreement on the part of such person to pay a reasonable rent for the premises, in the absence of an agreement to the contrary. In order to raise an implied promise to pay rent, it is necessary to show that the relation of landlord and tenant exists. Rent may be payable either in money, or any other consideration agreed upon between the parties. The right to collect rent is a chose in action and may be assigned by the landlord, separate and distinct from his reversionary interest in the premises. In the absence of an agreement, the duty to pay rent arises at the end of a period, rather than at the beginning.

Sec. 63. Defenses to liability for rent.—A tenant may have a right to set up counterclaims against any action on the part of the landlord to recover rent, if the landlord has violated any of the covenants in the lease. That is, if the lessor has interfered with the possession of the lessee to the damage of the latter, the tenant may set off such damage against rent due. If the landlord has evicted the tenant of the whole of the premises, the tenant will be relieved of his duty of paying further rents. Eviction may be actual or constructive. If the landlord, through failure to perform substantially the terms of his lease, causes the premises to become untenable, so that the tenant is forced to give up possession, the latter is said to be constructively evicted. If the tenant remains in possession of the premises, however, he waives his defense of constructive eviction and is bound for the payment of the rent. Where the landlord is under duty to furnish heat and fails to do so, and the premises become uninhabitable, the tenant may surrender possession and escape liability for future rents.

Subletting and Assigning

Sec. 64. Nature.—A subletting is a leasing by a tenant of the whole or a portion of the leased premises for a term less than the original lease. An assignment of a lease is not a subletting, because it is a transfer of the lessee's entire right in the premises. In general, the lessee may sublet the premises for a term of years less than his lease, unless there is a covenant against subletting or a statute prohibiting such subleases. A subletting does not relieve the original lessee of his duty to his lessor for the payment of rent or for the performance of any of the covenants in the lease. Similarly, a tenant may assign his lease unless there is some stipulation against it, and the assignment will not release the assignor of responsibility for the terms of the lease. Unless the assignee expressly assumes responsibility for the terms of the lease, he is bound only so long as he cares to remain in possession. Any lessee who assigns a lease should extract a promise from the assignee to assume all the burdens and promises contained in it. Even though the assignee assumes the lease and the landlord consents to the assignment, the tenant is not released unless a novation takes place.

Sec. 65. Consent of lessor to subletting.—If the lease provides that the lessee cannot sublet without the consent of the lessor, the lessor may refuse to give his consent. The lessee should obtain such consent before the subleasing of the premises, although it may be given at any time, either at the time of subletting or after. The relation of the sublessor and the sublessee is that of landlord and

tenant, and failure on the part of the sublessee to pay rent does not release the original lessee of his duty to the landlord.

Sec. 66. Rights and liabilities of sublessee.—The sublessee acquires no greater rights against the original lessor in the use and enjoyment of the premises than was held by the original lessee, and such sublessee has no right to enforce any of the covenants which may exist in the original lease between the lessor and the lessee. The lessor may maintain an action for damages against the said sublessee for any breach of express provisions contained in the original lease, or may enjoin the sublessee from using the premises for any purpose other than that expressly provided for in the original lease.

Review Questions and Problems

1. How is the relation of landlord and tenant created? Are any formalities required?

2. *A*, who holds a 99-year lease upon a certain building, dies. Does the lease descend to *A*'s personal representative or to his heirs?

3. *A* is a tenant at will on *B*'s farm. *B* terminates the tenancy after *A* has planted certain crops. May *A* return and harvest the crops? Suppose the lease had been for a definite period? Suppose it had been a tenancy at sufferance?

4. The lessor desires to enter upon the premises and place a "for sale" sign. Has he a right to do so?

5. *A* leased certain property for ten years. The property is destroyed by fire. Must *A* continue to pay the rent?

6. *A* leased to *B* certain premises for dwelling purposes. Unknown to *B*, there was a buried cesspool under the basement. The pool was not properly covered and the house became uninhabitable. Had *B* a right to terminate the lease?

7. *A* has rented a house from *B*. The roof is badly in need of repairs. Is *B* under a duty to repair?

8. *A* rents from *B* a farm at $10 an acre. Has *B* any lien upon crops grown by *A*?

9. *A* leases certain land from *B*. He later denies the title of *B* and refuses to pay the rent. Assuming that *B* has no title to the premises, may *A* deny *B*'s title?

10. *O* leased certain business property to *T* for ten years at an annual rental of $18,000, payable in monthly installments of $1,500. At the end of three years *T* assigned the lease to *A*, who remained in possession for only two of the remaining seven years. Is *A* liable in damages to either *O* or *T*? Is *T* liable to *O*, assuming *O* assented to the assignment?

11. *O* leased property to *T* for one year at $1,500 a year, payable in monthly installments of $125 a month. After the termination of the lease, *T* remained in possession for twenty-three months and paid $125 a month to *O*. On the closing day of the twenty-third month, *O* gave *T* notice to vacate the property. What are the rights, if any, of *T*?

Chapter IV

MECHANICS' LIEN LAWS

Sec. 67. Nature.—Mechanics' lien laws are the result of legislation which make possible liens upon real estate, where such real estate has been improved. The purpose of such legislation is to protect the laborer and materialman in the event of the insolvency of the owner or the contractor. The laws of the states vary slightly in the protection accorded and the procedure required to obtain it. For these reasons, the laws of the individual state should be consulted in a particular instance. The sections which follow relate to provisions which are generally found in the various state laws.

Sec. 68. Persons entitled to lien.—Those persons are entitled to a lien, who, by either express or implied contract with the owner of real property agree: (1) to deliver material, fixtures, apparatus, machinery, forms, or form work to be used in repairing, altering, or constructing a building upon the premises; (2) to fill, sod, or do landscape work in connection with the same; (3) to act as architect, engineer, or superintendent during the construction of a building; or (4) to furnish labor for repairing, altering, or constructing a building.

Those parties who contract with the owner, whether they furnish labor or material, or agree to construct the building, are known as contractors. Thus, practically any contract between the owner and another, which has for its purpose the improvement of real estate, gives rise to a lien on the premises in favor of those responsible for the improvement. To illustrate: A contract to attach a permanent fixture to a building or one to beautify a lawn would create a lien in favor of the contractor.

In addition to contractors, anyone who furnishes labor, materials, or apparatus to contractors, or anyone to whom a distinct part of the contract has been sublet, has a right to a lien. These parties are customarily referred to as subcontractors. Their rights differ slightly from those of contractors, and some of these differences will be considered in later sections.

In order that a lien for materials may be maintained, the material must be furnished directly to the contractor or subcontractor.[1] In addition, a record of the material furnished on each job is usually required. This procedure is necessary for two reasons: first, the record is essential to accuracy in the determination of the amount

[1] Hightower v. Bailey et al., 1900, 108 Ky. 198, 56 S.W. 147; p. 823.

of the lien; and, second, it is evidence that the contractor is not his own materialman. If the material is sold on the general credit of the contractor and no record of the deliveries is kept, title passes to the contractor and he becomes his own materialman.

The lien of a party furnishing building material arises as soon as the material is delivered to the premises.[2] On the other hand, one who supplies equipment or machinery receives a lien only if he can show that the goods delivered have become a part of the completed structure.

Sec. 69. Against whom does the lien arise.—Any interest in real estate may be subjected to a lien. A fee simple, a life estate, or a lease for years may have a lien against it, depending on the nature of the contract. If the owner of the fee simple contracts for the construction, or authorizes or knowingly permits the improvement to be made, the lien is good against his interest as well as against the improvement. If a lessee, without the consent or knowledge of the owner, contracts for the construction or improvement of property, the lien arises only upon the interest of the lessee. To illustrate: *A* leases a vacant lot from *B*, with the understanding that *A* is to construct a building on the premises. Any lien created will affect the interests of both *A* and *B*. If *A* had not obtained *B*'s consent to erect the building, the lien would have been created against the interest of *A* only.

The improvement of real property should not give to the lien holder a right to disturb or destroy a prior mortgage. At the same time, there is no occasion to increase the protection of the mortgagee at the expense of the lien holder. Consequently, an existing mortgage is always given a superior lien on the value of the property in its unimproved state. In many states, however, if the improvement, or its value, can be segregated, the mechanic's lien will be superior on the improvement. Where separation is not feasible, a method of appraisal is usually provided for, to determine what portion of the proceeds, at time of sale, are derived from the improvement.

Sec. 70. Formalities required to perpetuate lien.—Under the law of most states the contractor's lien arises as soon as the contract is entered into. In order to protect the contractor against claims of innocent third parties who might purchase the property or obtain a mortgage thereon, the law provides that the lien must be made a matter of record within a certain time, usually four months after all work is completed. As between the owner and the contractor, how-

[2] Moorhead Lumber Co. v. Remington, 1925, 165 Minn. 411, 206 N.W. 653; p. 823.

ever, the time limit may be extended somewhat beyond this period. During the four month's period, the lien is good against innocent third parties even though it is not recorded.

To establish their liens, the subcontractors—materialmen, laborers, and others—must, within a relatively short period of time after they have furnished the last of their materials or labor, either make the liens a matter of record, or serve written notice thereof on the owner, according to the particular state statute. The period most frequently mentioned by the various states is sixty days.

Sec. 71. Protection accorded the owner.—The mechanics' lien law usually states that the owner shall not be liable for more than the contract price, provided he follows certain procedure outlined in the law. The law further provides that it shall be the duty of the owner, before making any payments to the contractor, to obtain from the latter a sworn statement setting forth all the creditors and the amounts due, or to become due, to them. It is then the duty of the owner to retain sufficient funds at all times to pay the amounts indicated by the sworn statements, provided they do not exceed the contract price. In addition, if any liens have been filed by the subcontractors, it is the owner's duty to retain sufficient money to pay them. He is at liberty to pay any balance to the contractor. If the amount retained is insufficient to pay all the creditors, they share proportionately in the balance, except that most of the states prefer claims of laborers. The owner has a right to rely upon the truthfulness of the sworn statement.[3] If the contractor misstates the facts and obtains a sum greater than that to which he is entitled, the loss falls upon the subcontractors rather than upon the owner. Under such circumstances, the subcontractors may look only to the contractor to make good their deficit. Payments made by the owner, without first obtaining a sworn statement, may not be used to defeat the claims of subcontractors, materialmen, and laborers. Before making any payment, it is the duty of the owner to require the sworn statement and to withhold the amount necessary to pay the claims indicated.

Where the contractor is willing, the owner may also protect himself by stipulating in the construction contract a waiver of the contractor's lien. A waiver of lien by the contractor also waives the lien of the subcontractors, as they derive their rights through those of the contractor. Certain states require the owner to record such a contract before subcontractors begin work, in order that the agreement may bar their right to a lien.

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[3] Knickerbocker Ice Co. v. Halsey Bros. Co., 1913, 178 Ill. App. 629; p. 824.

Review Questions and Problems

1. What is the purpose of the mechanics' lien law? Who may take advantage of it?

2. *A* agreed to furnish material and to install a heating plant for *B* at a cost of $300. *B* advanced to *A* $200 with which to buy the material. The material was purchased on credit and *A* used the money for other purposes. *A* failed to complete the work, and *B* was compelled to pay *C* $150 for completing the job. May the materialman maintain his lien?

3. *A* rented a plot of ground from *B*, with the understanding that *A* might have buildings constructed thereon, such as were necessary to the operation of an amusement park. The buildings were constructed under contract with *A*, but the various contractors were not paid. May they maintain a lien against *B*?

4. *A* agreed with *C* to have the latter build a house at a cost of $4,000. The house was completed on January 15. On February 1 the property was sold to *B*, who had been informed by *A* that all contractors' bills had been paid. As a matter of fact *C* had received no money. May *C* file his lien as against *B*?

5. How may the owner protect himself against paying more than the contract price?

6. *A* contracted to place an asbestos curtain in *B*'s theater. Is *A* entitled to a lien?

Book VIII

TRADE REGULATIONS

Chapter I

GOVERNMENT AND BUSINESS FREEDOM

Sec. 1. Introduction.—During the Middle Ages and up until the middle of the eighteenth century, the business and economic life of the people was regulated by the church, by guilds, by customs, and by legislation against forestalling, regrating, and engrossing. These regulations applied to corners on commodities and the creation of monopolies. An early English statute defined forestallers as: ". . . those that buy anything before the due hour, or that pass out of town to meet such things as come to the market, to the intent they may sell the same in the town to regraters (resellers)." Punishment for the violation of the statute was the pillory, forfeiture of the goods, or, if the violation was repeated, banishment. Old statutes regulated prices, wages, weights and measures, and quantity and quality of commodities. Legislation regulated meat markets, wool buyers, corn merchants, clothiers, and butter and cheese merchants. The church punished by excommunication for unreasonable profits and usury. The American colonies followed the English idea of governmental economic control. Early Massachusetts and New York statutes fixed prices for commodities, regulated wages and hours of carpenters, bricklayers, and laborers, and set limits upon the percentage of profits. Standards of quality were laid down for bread and beer by weight and measure, and many rules and regulations pertaining to adulterations and methods of marketing were prescribed. From these illustrations, it can be seen that in our economic life during the Colonial period controls and restraints were imposed upon business.

In the United States, beginning with the middle of the nineteenth century, business and industrial expansion, under the impetus of the competitive system, brought into play a broader idea of the terms "liberty" and "due process." Early state regulatory legislation met constitutional barriers, because freedom of contract by judicial interpretation was read into the phrase "life, liberty, or property without due process of law." Hence, many early legislative attempts at government regulation were declared unconstitutional. Under this view, the duties of government are limited to the smallest possible activity and confined to the maintenance of order, enforcement of contract rights, and the preservation and protection of private property.

Unfettered free competition and extended "business liberty,"

however, led to abuses and predatory practices which tended to become destructive of competition itself. Hence, courts and legislative bodies over the past few decades have been modifying their concept of the extent to which business should be free of governmental control. It is those limitations which are at present imposed upon business with which we are to be concerned in the sections which follow.

Sec. 2. Police power.—Police power is that power which inherently resides in any governmental body to protect by legislation the property, health,[1] life, and well-being of its citizens. State laws or city ordinances which provide against the adulteration of food products or the care to be taken of food displayed for sale, or which provide for the abatement of nuisances or building restrictions, are illustrations of state regulations justified as a proper exercise of the police power.

Under this police power, certain businesses and professions are licensed, and only those persons obtaining licenses are authorized to practice such professions. Lawyers, doctors, barbers, real estate brokers, and others fall within this group.

It is this same police power which makes it possible, by proper legislation, for the state to protect the position of labor or to protect the public against monopolistic tendencies and their effects. However, the extent of state regulation may become so broad as to infringe upon those personal liberties and freedoms protected by the Fourteenth Amendment to the United States Constitution and the state constitutions. A point is finally reached at which it is both unwise and unconstitutional to proceed further to restrict business activities as an aid to society as a whole.

The power of the Congress of the United States to pass legislation regulating and controlling business activities is found in the Constitution, wherein is enumerated the grant of powers to the federal government and those powers implied therefrom. The power of Congress to pass federal regulatory legislation is not a police power; it is a granted power from the several states. Under the Constitution of the United States, Congress has power "to regulate commerce with foreign nations and among the several states and with Indian tribes." Under this power, federal legislation regulating combinations and monopolies in restraint of trade or commerce among the several states was enacted. Such legislation as the Sherman Act, the Clayton Act, the Robinson-Patman Price Discrimination Act, the Federal Trade Commission Act, and other acts regulating and controlling the production and sale of commodities, are illustrations. Likewise, the National Labor Relations Act, pro-

[1] State ex rel. v. Farmers Union Creamery, 1938, 160 Or. 205, 84 P.(2d) 471; p. 829.

viding for collective bargaining between employers and employees, was enacted under an extension of the power of the commerce clause to prevent the disruption of interstate and foreign commerce, because labor disputes "are likely to substantially impair or disrupt the marketing of goods from, to, or into the channels of commerce." Also the Fair Labor Standards Act was enacted, under the power of Congress to regulate interstate commerce, to exclude from interstate commerce goods produced, in industries engaged in commerce or in production of goods for commerce, under labor conditions detrimental to the maintenance of the minimum of standards of living necessary for the health, efficiency, and general well-being of workers.

Also under the power of Congress "to borrow money on the credit of the United States, to coin money and regulate the value thereof," Congress has passed legislation regulating banks, banking, and currency. Under its power to establish post offices and post roads, Congress has enacted the Federal Communications Act regulating radios and broadcasting.

As police power of the states to pass regulatory legislation is limited by state constitutions and the Fourteenth Amendment to the United States Constitution, likewise the power of the federal Congress to pass regulatory legislation is limited by the Fifth Amendment to the Constitution, which provides that such regulation shall not go so far as to deprive persons "of life, liberty or property without due process of law, nor shall private property be taken for public purposes without just compensation."

Monopolistic Practices

Sec. 3. Contracts in restraint of trade.—Competition, usually relied upon to encourage maximum production and to maintain reasonably low prices, can produce that result only if it is permitted to operate. It is because of this fact that the courts hold contracts which provide for the restraint of trade or the limitation of competition to be illegal. A person who has agreed not to compete with another is free to disregard his contract, or a retailer who has agreed with others to maintain a certain retail price for a specific article of merchandise is not bound, because such agreement is illegal and void.

Such contracts, which have as their primary purpose the restraint of free competition, may take many forms. Agreements not to compete, to divide the market,[2] to maintain prices,[3] to limit production, to pool the business, to divide the profits, for exclusive deal-

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[2] Clark et al. v. Needham et al., 1900, 125 Mich. 84, 83 N.W. 1027; p. 831.

[3] United States v. General Electric Co., 1926, 272 U.S. 476, 47 Sup. Ct. 192; p. 832.

ing, or for tie-in sales are all of this character. Unless they fall within the exceptions noted later they are considered contrary to public policy and are unenforceable.

Sec. 4. Exceptions.—Contracts in partial restraint of trade are valid if such restraint has reference to and is ancillary to the sale of property, a business, a profession, or to the discontinuance of employment, and if such restraint is reasonably necessary for the protection of the purchaser. For example, a contract in which *A* sells his grocery business to *B* and as part of the consideration *A* promises not to go into the grocery business in the same locality for a period of five years is a legal contract even though there is a partial restraint of trade. Since the purchaser of good will has very limited protection as such, it has become customary to insert certain restrictions by contract upon the seller. Any restriction upon the future conduct of the seller which is essential to protect fully the buyer in the fruits of his purchase is legal. The restriction should be no greater in time or territory than is required to protect the buyer.[4] If the restriction exceeds what is reasonably necessary, the entire limiting clause becomes illegal, thus leaving the buyer without much protection. In the absence of an effective restrictive agreement, one who sells his good will limits his future business conduct only slightly. He must not thereafter directly or by circular solicit business from his old customers, although he may advertise generally.

An employee in his contract of employment may agree that at the termination of his employment, he will not enter into business for himself or with a competitor in the territory where he has built up his acquaintance in the service of the principal. Such a contract forbids him to carry away from his principal that good will which he builds up in his principal's service.

Similar restrictions are often imposed in leases and sales of real estate.[5] So long as the vendor or lessor does not desire to have competition on property which he controls, he may avoid such competition by contract. Since other property in the community may be used for competitive purposes, the agreement is binding. If a lease is made, however, for the express purpose of taking an industry out of competition, the lease is unenforceable in that it limits competition.

Sec. 5. Federal and state laws.—Since at common law the only penalty attaching to contracts in restraint of trade was their unenforceability between the parties, they continued to be made and carried out at the expense of the public. Their creation and per-

[4] Brecher v. Brown, 1945, 235 Iowa 627, 17 N.W.(2) 377; p. 833.
[5] Wittenberg v. Mollyneaux, 1900, 60 Neb. 583, 83 N.W. 842; p. 835.

formance were not criminal and they violated no statute. The increasing growth of combinations, trusts, and monopolies hampered severely the functioning of our competitive system and the protection which it was expected to afford society. Consequently, federal and state legislation have been enacted to correct the evils growing out of agreements to restrain trade and to limit competition. The Sherman Act, passed in 1890, was the first significant attempt to control the matter so far as interstate trade is concerned. It provides that those who enter into contracts, combinations, or conspiracies in restraint of trade or who create monopolies, are subject to fine or imprisonment. It further provides that any person who is injured as a consequence of such action shall be permitted to recover three times the amount of the damages sustained.

The Sherman Act has for its purpose the preservation and maintenance of free competition in interstate commerce by thwarting monopolistic control of large corporations. Since the Act does not apply until monopolies in fact exist, it cannot effectively reach unfair trade conduct which produces combinations and monopolies in restraint of trade. In order to define more definitely what unfair competitive acts are in restraint of trade and to regulate unfair trade practices, particularly price discrimination, Congress passed the Clayton Act in 1914. Section 2 of the Clayton Act was amended in 1937 by Section 1(2) of the Robinson-Patman Act, which amendment more specifically defines what commodities are subject to lawful and unlawful price discrimination. In 1914, Congress also passed the Federal Trade Commission Act, which Act creates the Federal Trade Commission and authorizes it to issue complaints when it has reason to believe that "unfair methods of competition in commerce and unfair and deceptive acts in practice in commerce" are being carried on to the detriment of the public and competition. This legislation permits regulation and control of unfair competitive conduct at its inception, before monopolistic power has developed. Unfair and deceptive practices in commerce include price cutting; misbranding; secret rebates; interference with competitors; boycotting; espionage; bribery; disparagement of goods; patent infringement; palming off goods with trade names; use of misleading names, false advertising of food, drugs, devices, or cosmetics; and other predatory practices. The Commission, upon the issuance of a complaint, may order a hearing directing the one complained of to appear and show cause why such person or firm should not cease and desist from engaging in such unfair trade practice. Violations of the act and noncompliance with orders of the Commission are punished by fine and imprisonment. Appeals from orders of the Commission may be made to the federal courts.

Statutes have been enacted in many of the states which follow the pattern established by federal legislation. In this manner, intrastate trade is protected as well as interstate commerce against the evil effects of monopolistic practices.

Sec. 6. Exclusive dealing contracts.—Exclusive dealing contracts are of two types. Under one form of arrangement, the producer contracts to sell his products exclusively through a particular dealer in a certain community, binding himself not to sell to other retailers in that area.[6] Such an agreement may enhance or curtail competition, depending on the circumstances. An agreement to give a dealer the exclusive sale of a new commodity, or of an item which, like automobiles, is large enough to sustain an independent retail outlet, may promote competition rather than destroy it. The dealer is encouraged thereby to work the market diligently, knowing that he will receive the full reward of his efforts. The new article comes into definite competition with previously existing items and the public benefits. In such cases the agreement is not unreasonable and may be enforced by the parties. However, if the article is one which has little or no competition in its field, an exclusive dealing arrangement gives the particular retailer a monopoly in his area. Such an agreement may prove detrimental to the public and is illegal.[7]

The second type of contract is one in which the retailer agrees not to sell a competitive article. Such an agreement is legal provided the commodity or line is of sufficient importance to sustain an independent retail establishment, as in the case of gasoline products. An agreement by a filling station to sell a certain brand of gasoline exclusively would be quite proper.[8] On the other hand, if the commodity in question is one which is sold by retailers along with numerous other items, quite a different problem is involved. If the article is one which dominates a field, the producer thereof may preëmpt all retail outlets in a community by getting them to agree not to handle any item made by a competitor. Such an agreement may have the effect of driving the competitive article off the market because retail outlets are closed to it. Agreements of this character are illegal and are in violation of federal and state legislation.

Sec. 7. Price discrimination.—Price discrimination which has for its purpose the elimination of competition may take either of two forms. It may be such as to eliminate competition on the level at which the seller is doing business, or it may be such as to aid the buyer to eliminate competition in his field. Price discrimina-

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[6] Newell v. Meyerdorff, 1890, 9 Mont. 254, 23 Pac. 333; p. 837.

[7] Standard Fashion Co. v. Magrane Houston Co., 1922, 258 U.S. 346; p. 838.

[8] Federal Trade Commission v. Sinclair Refining Co., 1923, 261 U.S. 463; p. 840.

tion in either area which tends to restrict competition is illegal and subject to such penalties as the law provides. Illustrative of the first type is the producer who sells his product at a certain price in one area but cuts that price materially in another locality in an attempt to drive out competitors. It is permissible to discriminate in price to meet competition or to care for difference in transportation costs, but it is no longer proper to use price reductions to destroy a competitor.

It is likewise improper for a producer to offer attractive prices to one buyer in a given area and not to make those prices available to other dealers in the same territory. To give one retailer a material advantage over his competitors, thus making it possible for him to undersell them, tends to force the competitors off the market. Here, again, the manufacturer or producer is allowed to make price concessions in certain instances. He may make different prices to different classes of customers. A jobber may obtain a lower price than a retailer, although the latter is willing to buy as much as the former. It is also proper to make quantity concessions to the large user, provided those concessions are also available to other customers who are willing to purchase in similar quantities. The producer must be in a position to justify the discrimination in price because of the difference in the cost of servicing the quantity user over the occasional buyer. The question remains pertinent in all price discrimination cases: has the reduced price a tendency to eliminate competition?

Sec. 8. **Tie-in sales.**—In a broad sense, a tie-in sale takes place whenever the purchaser of a certain article is compelled to purchase other articles of the seller in order to buy the particular item he desires. It usually takes the form of an agreement to use only a seller's supplies with a machine purchased from the seller, or not to use the machine in the same plant in which competitive machines are in use, thus making it necessary for the purchaser to use nothing but the seller's machines in his plant. Through contracts of this character, the seller attempts to eliminate competition in his field by denying a market for competitive products. Monopoly with its evils tends to be the result. Contracts of the tie-in type have been made illegal and now legislation makes it illegal also to lease property with tie-in provisions made a part of the lease, if the effect is to restrict competition.[9]

Sec. 9. **Patents.**—At common law, a person who first developed a new article or process, possessed a monopoly on it only as long as he was able to keep secret the mechanical device or process used.

[9] International Business Machines Corp. v. United States, 1936, 298 U.S. 131; p. 841.

As soon as a competitor learned to duplicate the product, a competitive article could be placed on the market. To encourage new inventions, processes, and materials, the federal government was authorized to grant patents. A person who perfects a new machine or improvement thereof, a new process or some new material, may make application and obtain a patent therefor, if the idea has not been known to, or used by, another person before it became known to the person making the application. The patent gives to the holder the exclusive right to produce the new article for the period provided by statute, at present seventeen years. Anyone who is found guilty of making use of the patent without the owner's consent is guilty of infringement and may be compelled to pay damages. Injunction is also a proper remedy in such cases.

The person to whom the patent is granted may, if he desires, sell and assign the patent to such buyer as he can find. The assignee in such a case, has all the rights possessed by the former holder of the patent. It is also possible for the holder of the patent to license its use by others and exact a license or royalty fee for such use.

Sec. 10. Retail price control.—Attempts have often been made by producers to control the price at which their article is sold at the retail level. A contract between the producer and retailer to the effect that the article will not be sold for less than a certain price is illegal under our common law. Such an agreement was thought to be contrary to public policy because it eliminated price as a factor in competition between the retailers selling identical products and, hence, robbed society of potentially lower prices. It was also inconsistent to say that title to the article sold passed to the retailer and at the same time to permit the seller to have control of the article sold.

Although a contract containing a retail price-maintenance clause was illegal, manufacturers were able to control prices by selling only to those who maintained the advertised price, since the sellers were at liberty to select their own buyers. If a retailer was discovered cutting the retail price, the manufacturer, by refusing him the privilege of making further purchases, cut off his supply of commodities, thus exercising power to control the resale price. If, however, manufacturers by organization provided for a scheme that caused all price cutters to be reported to a central office and maintained a list of such retailers, such organization was an illegal combination and subject to criminal prosecution.

However, since price cutting often has an injurious effect upon the public as well as upon the good will of the manufacturer's product, the states have passed what are generally called fair trade or price-maintenance statutes, which protect the distributors and the public against the unfair trade practice of price cutting in the dis-

tribution of articles of standard quality having a trade-mark, patent, or name. The acts have for their purpose the regulation of such unfair competition as price cutting and the elimination of price wars by prohibiting "Willfully and knowingly advertising, offering for sale or selling any commodity at less than the prices stipulated in any contract entered into pursuant to the provisions of the Act whether the person so advertising, offering for sale, or selling is or is not a party to such contract." [10] Such conduct is unfair competition and is actionable at the suit of any person damaged. Such act has no application, however, to contracts or agreements which attempt to control prices between groups of wholesalers or between groups of retailers. These contracts are still illegal.

These fair trade laws usually provide as follows:

No contract relating to the sale or resale of a commodity which bears, or the label or content of which bears, the trade-mark, brand, or name of the producer or owner of such commodity, and which is in fair and open competition with commodities of the same general class produced by others shall be deemed in violation of any law of the state by reason of any of the following provisions which may be contained in such contract:

1. That the buyer will not resell such commodity except at the price stipulated by the vendor.

2. That the producer or vendee of a commodity require upon the sale of such commodity to another, that such purchaser agree that he will not, in turn, resell except at the price stipulated by such producer or vendee. Such provisions in any contract shall be deemed to contain or imply conditions that such commodity may be resold without reference to such agreement in the following cases:

a. In closing out the owner's stock for the purpose of discontinuing delivery of any such commodity: provided, however, that such stock is first offered to the manufacturer of such stock at the original invoice price, at least ten (10) days before such stock shall be offered for sale to the public.

b. When the goods are damaged or deteriorated in quality, and notice is given to the public thereof.

c. By an officer acting under the orders of any court.

To remove such contracts from illegality at common law and the Sherman Act, the Sherman Act was amended in 1937 by the Miller-Tydings Act.

Sec. 11. Public utilities.—Public utilities are those business enterprises which have been granted by law the right to operate as monopolies in their field. They include railroads, bus lines, gas and

[10] Revlon Nail Enamel Corp. v. Charmley Drug Shop, 1938, 123 N.J. Eq. 301, 197 Atl. 661; p. 843.

electric companies, and other enterprises which society feels can function best where direct competition does not exist. The Interstate Commerce Commission has been established to regulate railroads and related interstate activities, whereas for other public utilities state commerce or utility commissions have been created.

No new business unit may enter the public utility field or extend its business into a new territory without first obtaining a certificate of convenience and necessity from the proper regulating body. In order to obtain such a certificate, it is necessary to show that service of the particular kind involved is not being rendered in the territory sought to be served, that such service should be offered, and that the applicant is the proper one to furnish it. If there are several applicants, the one who is best equipped and whose record for past service is good and who can serve more efficiently than the others, is in a better position than the applicant who merely filed his application first.

The regulatory body has the right to order extensions of service and to establish the standards of service to be rendered. Complaints of customers because of inadequate service are properly filed with the state or federal regulatory body.

The rates charged by a public utility are fixed by the state commission after a hearing at which all interested parties are represented. Once fixed, the utility has no right to discriminate in rates between customers who receive the same service. The rates established must be reasonable and high enough to permit the operating company to earn a fair return upon the value of the property devoted to the service of the public. They are adjusted from time to time in order to make certain that the utility does not earn an unreasonable return or, in the event costs increase, to avoid the possibility that property is being confiscated.

Sec. 12. Enforcement of legislative regulations.—In order to administer and enforce regulatory laws, federal and state administrative boards or commissions have been created. Most federal regulatory statutes create commissions or boards to carry out the purpose of the legislation. For example, the National Labor Relations Board administers and enforces the National Labor Relations Act. The Federal Trade Commission administers and enforces the Clayton Act and the Robinson-Patman Act. The Interstate Commerce Commission administers and enforces the Railroad Reorganization Act, the Railroad Retirement Act, and the Motor Carriers Act. The Social Security Board administers and enforces the Social Security Act. State Public Utility Commissions administer and enforce public utility acts; State Milk Control Boards administer and enforce legislative regulations of the milk industry. These

boards and commissions have power to receive complaints by any injured person, to order hearings, to take evidence, and, upon a finding that regulatory legislation has been violated, to issue cease and desist orders forbidding the unlawful conduct. If such orders are not complied with, the board or commission may appeal to the courts—to the federal courts if it is a federal board or to the state courts if it is a state board—for the enforcement of its orders and decrees. Likewise, the person against whom the order is issued has the right to appeal to the federal or state courts, as the case may be, for a review and adjudication of the order issued.

Most of the state and federal regulatory statutes provide additional penalties for violations. Statutory tort actions permitting a recovery of triple damages are given to the person injured because of violation of the statute. Actions for a breach of contract and equitable injunction proceedings are also permitted to the injured party. Violations of regulatory statutes are made criminal acts, and the attorney of a state is authorized to prosecute for such violations by enforcing penalties of fines and imprisonment.

The orders and decrees of these administrative boards are effective as rules of law in controlling business. Therefore, a businessman must not only satisfy the law of contracts, negotiable instruments, corporations, partnerships, and so forth, in carrying out his business, but he must operate his business in compliance with the orders and decrees of both federal and state administrative boards.

Review Questions and Problems

1. State broadly how business was regulated during the Middle Ages and down to about the middle of the eighteenth century.
2. What is meant by the police power of the state?
3. Jones has a good retail grocery business in a small community, but Smith is planning to open a competitive store. Will a contract whereby the latter agrees to refrain from entering competition upon the payment of $1,500 be enforceable?
4. Enumerate three situations in which contracts in restraint of trade are legal.
5. Name several devices which have been used to restrain trade improperly.
6. *A*, *B*, and *C* each operated a coal mine in a certain territory. *C* agreed with *A* and *B* to close his mine for five years, the latter parties to pay to *C* one-fourth of the net profits realized from the operation of their mines each year. If *C* opens his mine before the expiration of the fifth year, may *A* and *B* recover damages for breach of the contract?
7. *A* sold his retail hardware store in a certain community and agreed with *B*, the buyer, not to re-enter the hardware business in that community for the next five years. Is the agreement enforceable?

8. The *R* Company manufactures tabulation machines and distributes them under a lease which provides that the lessee shall use therein only tabulating cards manufactured by *R* Company. The federal government sought to enjoin the use of such a lease. Has it the right to do so?

9. Did the illegality and unenforceability of contracts in restraint of trade at common law effectively control unfair trade practices? What laws were enacted to aid the functioning of the competitive system?

10. *X* Company began the manufacture of a new cigar and agreed that *R*, a jobber, might have the exclusive sale of the article in a certain territory. *X* Company later violated the agreement and sold through other jobbers. *R* brought suit for damages. Should he have recovered?

11. *X* Company, a manufacturer of blankets, advertised them as being 100% wool, whereas they were only 30% wool. Competitors enlisted the aid of the Federal Trade Commission in an attempt to obtain a cease and desist order against *X* Company. Should they have been successful?

12. *B* Company operates a bus line in a certain community and the state utility commission established a 5¢ fare. At the end of the first year, *B* Company received revenues sufficient to meet expenses and to earn 2% on its investment. The company requested an increase in fare to 6¢. Was it entitled to an increase?

13. *G & R* Company, a large tire manufacturer, contracted to furnish a large mail order house with all of its requirements for automobile tires at cost of manufacture, plus 6% profit. The *G & R* Company also distributed its tires through independent dealers who purchased in small quantities at a much higher price. Over a period of seven years the tire manufacturing company realized a net profit of seven million dollars on its contract with the mail order house. During the same period, on an equal volume of sales to the independent dealers, the tire manufacturing company made a net profit of twenty million dollars. Is the price discrimination practiced by *G & R* Company improper?

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CHAPTER II

BUSINESS TORTS

Sec. 13. Introduction.—The businessman, in his competitive practices, is curbed by three distinct forces: first, by his own moral concepts, as influenced by the reactions of his business associates; second, by his liability to the injured parties for the damages occasioned them; and third, by some positive law, legislative or otherwise, making particular conduct a crime and imposing certain penalties. With the first of these controls we are not concerned, since there is no assurance that the force will operate in any particular case. The second control has been fairly well established, and for the most part is found in the law of torts. Whenever a business practice is indulged in which injures materially a competitor, the latter has a right to recover damages unless the first party can justify his conduct.

Competition

Sec. 14. Right to compete.—In general, the right to enter into a business as a competitor of others in the same field is not denied by our economic or political order. Even though the opening of a new enterprise will do serious harm to existing and established businesses, freedom of competition has not been denied. If insufficient demand exists to insure the economic life of all, the law sanctions the economic death of those unable to survive. The fact that old customers are enticed to a new business, that prospective sales dwindle, or that similar wares are offered at lower prices gives no cause of action to the old entrepreneur against the new.[1] Even though one has a sale almost consummated, a competitor, with knowledge of that fact, is at liberty to tempt the customer with a lower price on similar goods.

To this general principle the courts have laid down one well-defined exception. If a person enters into a competing business for the express purpose of driving his competitor out of business and, having accomplished his purpose, intends to withdraw from the enterprise, he commits an actionable wrong.[2] It is also true that, if one conducts his business in such a manner as to embarrass or harass unduly a competitor without correspondingly promoting his own

[1] Von Bremen et al. v. MacMonnies et al., 1910, 200 N.Y. 41, 93 N.E. 186; p. 845.
[2] Tuttle v. Buck, 1909, 107 Minn. 145, 119 N.W. 946; p. 847.

interests, he may be enjoined from indulging in such tactics.[3] One who injures a competitor commits a wrong unless he can justify it as the lawful exercise of a right.

To these general principles the legislatures have from time to time added further exceptions in the case of public utilities. Those industries in which the public has a peculiar interest, and which competition most seriously hampers by duplication of facilities and increased costs, have been relieved of competition.

Sec. 15. Threats or intimidation.—Injury to one's business resulting from threats to customers or intimidation of prospective purchasers is recoverable in damages. If the threats are made by one in good faith who thinks that they are legally sound, no tort has been committed, but an injunction will be issued restraining such conduct in the future. Thus, if the owner of a patent honestly believes that another is infringing on his patent, he may threaten potential purchasers with a lawsuit in case they purchase. Should a court later determine that no infringement existed, the party who threatened the buyers is not liable for damages. His threat was made in good faith for the purpose of protecting his own interest.

Sec. 16. Disparagement.—One who disparages or belittles the goods of another may be enjoined from future misconduct, and in certain instances may be compelled to pay damages to the injured party. There are four distinct elements of disparagement:

1. An express or implied misstatement of fact—as distinguished from words of comparison which indicate merely an opinion. Such expressions as "good" or "bad," "better" or "best" are in effect opinions.

2. The statement must concern the injured party's goods. Merely misrepresenting favorably one's own goods never constitutes disparagement. Some misstatement must be made about goods offered for sale by another.

3. The motive which prompts the statement must be bad. In other words, the statements must be intentionally made for the deliberate purpose of injuring the other party.

4. The injured party must allege and show special—as distinct from general—damages. That is, he must be able to prove loss of specific sales as a result of the statements. A general allegation and showing that business had declined a certain amount would not be enough.[4]

All four elements must be present in order to recover damages.

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[3] American Bank and Trust Co. v. Federal Reserve Bank, 1921, 256 U.S. 350, 41 S.Ct. 499, 65 L. ed. 983; p. 848.

[4] Hopkins Chemical Co. v. Read Drug and Chemical Co., 1914, 124 Md. 210, 92 A. 478; p. 850.

A showing of the first two elements, however, will entitle one to an injunction against a repetition of such statements.

Sec. 17. Inducing breach of contract.—To induce one person to breach his contract with another is to commit a tort. The effect is the same even though the one who induced the breach did so in order to sell his own goods or services.

Mere passive presentation of the merits of one's products which has the net result of causing one to breach a contract and to purchase the goods of another is not actionable. It is only where one is active in persuading another to violate one agreement in order to be free to make another that a tort is committed.

Closely akin to inducing breach of contract are those cases involving boycotts. In general it can be said that an agreement to boycott a certain individual or group of individuals is legal only so long as it is in furtherance of some justifiable objective. Thus, an agreement by retail coal dealers whereby no purchaser may purchase on credit so long as he owes another dealer is legal, because of the protection such an agreement accords all parties to it.

Appropriation of Competitor's Trade Values

Sec. 18. Trade dress or wrapper.—One who devises a distinctive[5] wrapper, container, or shape for a product and who builds up a good will around it is entitled to protection. He may enjoin others from copying his device if it is distinctive or unique. If the particular wrapper or shape serves a useful purpose or adds to the value of the product by extending its life or usefulness, it can be protected only by patent or by copyright.

Sec. 19. Trade-mark or name.—Technically a trade-mark is supposed to be some mark or stamp imprinted upon the product, whereas a name does not have to be attached to the product. So far as the legal rights of the owner are involved, there is practically no difference between the two.

The first user of a trade-mark or name has a right to its exclusive use. The second user of such a mark or name, or of one which is deceptively similar, may be enjoined from its further use. Just how similar the mark, name, or trade dress must appear before relief will be granted presents an interesting problem. In general, it can be said that, whenever the casual observer, as distinct from the careful buyer, tends to be misled into purchasing the wrong article, an injunction is available to the injured party.[6]

Sec. 20. Descriptive, geographical, and proper names.—A name or mark which is descriptive of the nature of the article sold

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[5] George G. Fox Co. v. Hathaway, 1908, 199 Mass. 99, 85 N.E. 417; p. 851.

[6] Standard Oil Co. v. Mitchie, 1929, 34 Fed.(2) 802; p. 852.

may not be exclusively appropriated by any one concern. Such terms as "Always Closed" for revolving doors and "Rubberoid" for roofing fall in the descriptive class and may be used by anyone.

The use of a geographical name is somewhat similar. Every manufacturer or producer has a right to indicate upon his product or produce where it is produced. The same is true in the case of proper names. Every individual has a right to make use of his name in connection with his business. Any good will or favorable reputation that attaches to it should not be denied to him. Consequently, one generally cannot exclusively appropriate a proper name.

The three rules indicated above are subject to one well-recognized exception. If a descriptive, geographical, or proper name has been used so long as to become identified with a certain product, thus having a secondary meaning, the first user will be protected in its use.[7] Newcomers in the field who desire to use the descriptive term, the geographical location of their plant, or their names in identifying their products will have to qualify the use in such a manner as to avoid possible injury to the first user's good will. The latest cases indicate that such names cannot be identified as the name of the product by the second user, but that the maker's name or location may be placed on the product in some inconspicuous manner. Thus, it is clear that no one by the name of Ford could manufacture an automobile and call it Ford, although the name Ford could undoubtedly be used by the manufacturer in his business.

Sec. 21. Limited protection only.—An important question in the use of trade-marks and names is: In what territory will the first user be protected in their use? In reply to this question, two rules can definitely be indicated, while a third has aroused considerable conflict in those states which have passed on the problem.

1. If two parties in different localities and at different times innocently create and use the same name or mark, each user will be protected in that territory which he first penetrated with the name or mark. The first user cannot deny the second user the benefit of the good will which the latter has innocently built up. Each will be protected in the territory which he has preempted by prior use.[8]

2. A second user, although innocent, will not be protected in territory where the first user has conducted any business, regardless of how slight or trifling those business transactions are.

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[7] American Waltham Watch Co. v. United States Watch Co., 1899, 173 Mass. 85, 53 N.E. 141; p. 853.

[8] Hanover Star Milling Co. v. Metcalf, 1915, 240 U.S. 403, 36 S.Ct. Rep. 357; p. 855.

3. If the first user's good will has penetrated into new territory, but no business has been transacted there, a second user may adopt the name or mark and intentionally profit by the good will which the first user has built up.[9] This appears to be the holding of the majority of the courts, including the Supreme Court of the United States, although there is a vigorous minority. Sound reasoning and fairness would both lead toward a different result. The view of the majority prohibits expansion by the first user, defeats national advertising, submits the reputation and good will of the first user to the hands of the second user, and destroys the uniqueness of the name or mark. Despite this line of reasoning the Supreme Court of the United States declared that no protection was needed until the first user had entered a given territory. The fact that the mark was registered with the federal government was given no weight in the decision. The only merit in registering a trade-mark or name is that a presumption immediately arises that the party registering the mark or name is the first user. This presumption can be rebutted by another's proof of prior use. The first user is always protected regardless of registration.

A trade-mark or name is protected only against infringement on articles of the same class. A first user cannot enjoin a second user from use of a mark or name on an article of an entirely different character. Three tests have been applied by the courts in determining whether articles are of the same class.

1. Are the articles so similar that one can be substituted for the other, as cocoa or chocolate?

2. Are the articles allied products, or are they used together, such as automobiles and automobile tires?

3. An association of ideas test:[10] does one article call the other to mind? Are they usually associated together in retail establishments? Hats and shoes offer an illustration of this group.

Through the adoption of these tests the courts attempt to prevent the confusion of goods by consumers, to make possible the expansion of a line to include new articles similar in nature, and to protect the good will of a business concern from the assault of a predatory competitor or one attempting to profit from the efforts of another.

Sec. 22. Effect of wrongful use of name or mark.—A second user who makes an improper use of a trade-mark, name, or wrapper can always be enjoined from using it in the future. In addition, if the user is an intentional wrongdoer—if he intentionally profits from the use of another's good will—the injured party may recover damages or the profits of the wrongdoer. In some courts, including

[9] Yellow Cab Co. v. Sachs, 1923, 191 Cal. 238, 216 Pac. 33; p. 856.

[10] Wall v. Rolls-Royce, 1925, 4 Fed.(2) 333; p. 857.

the federal courts, the first user may recover both profits and damages. It should be borne in mind, however, that damages or profits can be recovered only in case of intentional wrongdoing. If the second user copies the mark or name exactly or so nearly as to indicate bad faith, damages or profits are recoverable. If the second user has no knowledge of the first user's name or mark, an injunction is the only remedy available in most of the states.

Sec. 23. Trade information and advertising. — Information about one's trade, customers, processes, or manufacture is confidential in nature. If a competitor can discover this information fairly through research, study, or observation, he may use it freely in the absence of a patent or a copyright. However, if he obtains such information by bribery of an employee of the first concern or by engaging an employee of the first concern with the understanding that he will use this information, the second party may be enjoined from making use of it.

In this connection it should be emphasized that an idea once exposed to the public may thereafter be used by anyone. The forward march of civilization is dependent upon the freedom with which new ideas are adopted. A book or magazine article containing new ideas may be copyrighted, but the ideas set forth therein may be used by anyone so long as the language used is not published by another. One who unfolds to an interested party a plan for financing his product or for merging several industries may discover later that the interested party has made use of these ideas without compensating the originator of them. To forestall such a possibility, the originator of the idea should, before explaining his idea, obtain a promise of payment in case his plan is adopted.

Review Questions and Problems

1. Name three forces which may be relied upon to curb unfair competition.

2. Hanson was just about to complete the sale of a used car to Miller when Sanson happened along. The latter offered a similar car to Miller at a lower price, finally consummating the sale. If Hanson sues Sanson for interference with his sale, should he be permitted to recover?

3. *A* was the only grocer in Centerville, and *B*, who had quarrelled with *A*, rented a building and made plans to enter the grocery business in the same community. Under what conditions, if any, will *A* be able to enjoin *B*?

4. *X* Co. was engaged in selling farm wagons in a certain state when *Y* Co. entered the state with a competitive make. *X* Co. instructed a representative to follow the sales agent of *Y* Co. and to harass or threaten until the sales agent left the territory. What recourse, if any, has *Y* Co.?

5. *A*, the owner of a certain make of car, is asked by *F*, a friend, how he likes the car. *A* replies that it has a very weak transmission. Assuming that the statement is untrue, will the manufacturer or retailer of the car have an action against *A*?

6. A certain distribution company called its gasoline "Silver Flash." A competitor named its brand "Silver Streak." Will the first user be able to enjoin the second?

7. W. Parker desires to manufacture fountain pens and to give the pens of his manufacture his name. Assuming there is at present a pen by that name, has he a right to do so?

8. Elgin Watch Co., located at Elgin, Illinois, manufactures watches, giving them the name of Elgin. Will a competitor be able to apply that name to its watches if they are made in Elgin?

9. *X* Co., selling dresses under the trade name of "Sweet Sixteen," has been engaged in business for many years in the eastern and middle western states. *Y* Co., with knowledge of the good will attached, proposes to sell dresses under the same name in Washington, Oregon, and California. May *Y* Co. be enjoined at the request of *X* Co.?

10. Yale Lock Co. manufactures locks of all kinds under the name "Yale." *X* Co. desires to manufacture bricks and sell them under the same name. Should it be able to do so?

11. *X* Co. manufactures Stetson hats, and *Y* Co. desires to manufacture and sell Stetson shoes. Should it be permitted to do so?

Chapter III
LABOR AND THE LAW*

Sec. 24. Introduction. — Wage-earners and employers, like others, are subject to the basic laws of the land. The laws of contracts, agency, and torts are as applicable to those who work or employ as they are to society generally. However, through the years there has been developed by legislation and court decisions a body of law dealing directly with industrial relations. For a long period of time the law expanded slowly, but recently, under the impetus of federal and state legislation, rapid development in this area has taken place. At the present time, labor law has not fully crystallized, but some of the legislation and certain of the broad legal concepts appear to be lasting enough to merit consideration by students of business. In a book of this character, it is impossible to give detailed consideration to all legislation which has been enacted for the benefit of labor. However, such federal protective legislation as the Fair Labor Standards Act, the Social Security Act, the Employers' Liability Act, the Workmen's Compensation Act, the National Labor Relations Act, and the Norris-LaGuardia Act (anti-injunction act) are considered in some detail.

Miscellaneous Legislation

Sec. 25. Fair Labor Standards Act.—Wages and hours laws have been enacted by the federal government and by some states for the maintenance of fair standards of living, requiring a minimum wage to be paid for services, and establishing the maximum number of hours of work to be performed within a week at base pay. The federal act is called the Fair Labor Standards Act. The reasons and purposes of the Act are set out in its declaration of policy. It states that industries, engaged in commerce or in the production of goods for commerce, by paying inadequate wages and demanding long hours of service cause commerce, and the channels and instrumentalities of commerce to be used to spread and perpetuate sub-

* The Labor Management Relations Act, 1947, commonly called the Taft-Hartley Act became law while this revision of the text was in process. At the time of printing, its constitutionality had not been established and its provisions had not been construed by the courts. As a consequence, the matter dealing with the National Labor Relations Act emphasizes primarily the rights and duties of the employer under the previous law. However, where these rights have been clearly altered, the text cares for some of the changes. The new law, insofar as it imposes new duties and responsibilities upon labor organizations, has been outlined only and no attempt has been made to construe or explain the provisions.

standard labor conditions among workers of the several states. Such conditions burden commerce and the free flow of goods in commerce, constitute unfair methods of competition, lead to labor disputes, obstruct commerce, and interfere with orderly and fair marketing.[1]

Those employees exempt from the Act are: Any employee employed in a bona fide executive, administrative, professional, or local retailing capacity or in the capacity of outside salesman; any employee engaged in any retail or service establishment, the greater part of whose selling or services are in intrastate commerce;[2] any employee employed as a seaman; any employee of a carrier by air; any employee employed in the catching, taking, or harvesting of any kind of fish, shell fish, etc.; any employee engaged in agriculture; any employee employed in connection with the publication of weekly or semi-weekly newspapers with circulations of less than 3,000, the major part of which circulation is within the county where printed and published; any employee of a suburban railway or motor bus carrier; any employee, working in the area of production, employed in the handling, packing, or canning of agricultural commodities or dairy products; a switchboard operator employed in a public telephone exchange which has less than 500 stations; employees of railroads; agricultural workers not legally required to attend school; and any children employed in the motion picture or theatrical industry.

The Act specifically forbids "oppressive child labor." This means the employment of any child under sixteen years of age other than by parents or guardian or in some activities specified by the Secretory of Labor, or the employment of any person between the ages of sixteen and eighteen years in any occupation declared by the Secretary of Labor to be particularly hazardous to health and well-being.

The constitutionality of this Act rests upon the powers of Congress to regulate commerce among the several states. The Act applies in all industries engaged in interstate commerce or in the "production of goods for commerce." The term "production of goods for commerce" includes production of goods which, at the time of production, the employer, according to the normal course of his business, intends or expects to move in interstate commerce, even if all such goods do not thereafter actually enter interstate commerce.[3] In determining whether the Act applies to an industry

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[1] United States v. Darby, 1941, 312 U.S. 100, 61 Sup. Ct. 451; p. 859.

[2] J. L. Brandeis & Sons v. National Labor Relations Board, 1944, 142 F.(2d) 977; p. 860.

[3] United States v. Darby, 1941, 312 U.S. 100, 61 Sup. Ct. 451; p. 859.

and its employees, it is unnecessary to show that any particular percentage of manufactured goods should reach interstate commerce or to show the amount of volume shipped in interstate commerce; it is sufficient if any amount reaches interstate commerce.[4]

The Act provides for minimum wages, including one and one-half times the regular rate for all hours in excess of the prescribed time. The Act is administered by the Administrator of the Wages and Hours Division of the Department of Labor.

Proceedings before the Administrator of the Wages and Hours Division, based upon the report of an Industry Committee, are "judicial" in character, and before any orders may be issued, proper notice and full hearings are required. Any person dissatisfied by an order of the Administrator may obtain a review of such order in the Circuit Court of Appeals of the United States for the circuit wherein such person resides.

A person who violates any provision of the Act shall, upon conviction, be subject to a fine of not more than $10,000 or to imprisonment for not more than six months, or both. Also, any employer who violates the provision as to minimum wages and maximum hours shall be liable to the employee or employees affected to the amount of their unpaid minimum wages or unpaid over-time, plus an equal sum as damages. Such action may be maintained in any court of competent jurisdiction.

Sec. 26. Social Security Act.—A comprehensive social security program has been adopted by the federal government in cooperation with the states. It consists of unemployment insurance, federal-state relief and public welfare, a general national pension plan, and special systems of pensions and unemployment insurance for railroad employees.

There was created by the Social Security Act of 1935, a system of unemployment insurance. States were encouraged to adopt their own unemployment insurance laws in conformity with the federal unemployment insurance plan. These laws provide that employers and, in a few states, employees shall contribute in the nature of a tax to a fund, the amount of the contribution being a percentage of the wages earned and paid. This fund is deposited partially in the federal Treasury and partially with the particular state, to be distributed later to unemployed former employees who are unable to secure employment of a similar character. The details concerning waiting period and length of time for which payments are to be made have been worked out by the various states. The administrative expenses of each cooperating state are paid by the federal government. At the present time unemployment insurance sys-

[4] Wagner v. American Service Co., 1944, 58 F. Supp. 32; p. 861.

tems have been enacted in each of the forty-eight states, the District of Columbia, and the territories of Hawaii and Alaska. The Unemployment Insurance System is under the Federal Security Agency.

The Social Security Act authorizes a federal-state plan by which the federal government provides grants in aid for cash allowances to the aged, the blind, and dependent children. Upon the formation of a plan submitted by a state to the Social Security Board and its acceptance by the Board, the federal government makes a grant of one dollar for every dollar provided by the state.

The Social Security Act also authorizes a national pension system. This system is supported by a tax determined by a fixed percentage of the payroll, paid both by the employee and employer. It provides for a life income payable in monthly installments to qualified individuals who have attained the age of 65 years and who are no longer in regular employment. Upon the death of an employee, monthly benefits are paid to properly qualified beneficiaries such as his widow, children, or parents.

A complete social security legislative policy has not yet been formulated and it is probable that many amendments and changes will be made with reference to including more employees within the Social Security program, and to the methods of procedure and administration.

Sec. 27. **Employers' liability acts.**—At common law the responsibility of the employer for an injury occurring to an employee is recognized, but because of the common law defenses available to the employer, the remedy of an employee for such injuries has been of little value. The common law defenses available to the employer before the adoption of employers' liability acts were: (1) the fellow servant rule, (2) assumption of risk, and (3) contributory negligence. Under the fellow servant rule, the employer was not liable for injuries caused to the employee by a fellow servant. The master owed certain duties to his servant with respect to a reasonably safe place in which to work, safe tools and appliances, and the exercise of ordinary care and diligence in keeping the plant and appliances in repair and in safe condition. Injuries which arose because of unsafe conditions of appliances or tools were not chargeable to the employer in absence of the employer's negligence. Hence, if an injury occurred, the employer was excused because the employee assumed the risk under the unsafe conditions. Also, if the employee was in any degree guilty of negligence himself, he was without remedy because his contributory negligence was the proximate cause of the injury.

This situation led to statutory remedies. One of the first reme-

dial statutes was the Federal Employers' Liability Act passed by Congress in 1909. It established rules and regulations which operate uniformly in all states with respect to interstate commerce. The effect of the Act, in cases to which it is applicable, is to abolish, in whole or in part, the above mentioned common law defenses of the employer—namely, the fellow servant rule, assumption of risk, and contributory negligence of the employee. The employee does not assume any risks of his employment in any case when the employer, a common carrier, has violated any statute enacted for the safety of employees, or in any case where injury or death results from the negligence of officers or agents of the employer. Beginning about 1880, many states enacted various types of employers' liability acts applicable to various classes of employment. Some modified the defense of contributory negligence, others abrogated the fellow servant rule. Such statutes also gave a cause of action for the death of an employee to the widow, the father or mother, or children, without any limit as to the amount of damages. These statutes were limited and were applicable only to workers in the following industries: railroads, mining, building, and other hazardous types of employment.

These state and federal employers' liability acts, although making some changes for the better protection of the employee, mainly reduced the defenses of the employer. The issue of the employer's negligence was still a matter of proof for the employee. In order for the employee to recover compensation for injuries, court action was still necessary. Expensive litigations, delays, and problems of statutory construction left the employee practically without compensation for injuries.

Workmen's Compensation Laws

Sec. 28. Workmen's compensation acts.—The failure of employers' liability acts to give adequate protection and compensation to injured employees in hazardous employment brought about the enactment by the states of workmen's compensation legislation.

Workmen's compensation acts are based upon the principle of liability without fault. Compensation for injuries to employees under the acts becomes a charge on industry. Once the employer-employee relationship is established, the only issues to be determined are: (1) Did the injury arise out of and in course of the employment? (2) What is the extent of the injury? (3) What amount of compensation should be paid?

Workmen's compensation acts in the United States are based upon the English Workmen's Compensation Act of 1897. Because of the various types of industry in different parts of the country, no two acts are alike. Each is different as to employments and

injuries covered, benefits paid, and methods of insurance coverage.

In order to give security for the payment of compensation, various insurance systems have been developed. There are two general plans. The first, which sets up a compulsory or exclusive state insurance system, has been adopted in a few states. All employers engaged in the hazardous industries specifically designated by the act are required to pay a percentage of the payroll into a fund which is administered and distributed by the state. The percentage of the payroll paid by the employer is fixed by statute. However, the amount of this percentage may change according to the "experience rating" of a particular industry. Most statutes provide that industries that have operated over a period of time and have experienced a small number of accidents, may contribute a smaller sum to the state fund, the sum being determined by the "experience rating" provided in the statute. The second plan, adopted in most states, permits employers to carry their own risk upon filing a statement, with the Workmen's Compensation Commission, of their financial ability and depositing securities with the state as protection for injured employees. Possible recovery by an employee for an injury sustained in the course of his employment can be determined only by careful scrutiny of the law in the state where the employer operates.

Sec. 29. Industries included.—The industries included within compensation acts vary greatly among the several states. No state act includes all industries. All state acts include hazardous occupations but enumerate certain occupations to which the act does not apply. Agricultural and casual laborers, domestics, and office employees are often not included within the act. However, in some jurisdictions, even though the occupation is not hazardous or specifically included, employers may elect to come under the act.

The injuries to be compensated are those "arising by accident out of and in course of the employment," or "sustained while in the performance of duty," or "accidental injuries in the course of employment but not out of the occupation." Much of the litigation involving workmen's compensation acts concerns whether the injury was accidental and arose out of and in course of the employment.[5]

Some state courts have construed the present acts to include occupational disease as an injury within the act. Other states have passed legislation enumerating certain occupational diseases and providing for compensation for such diseases. States in which mining, smelting, or metal refining and heavy industries are predominant provide compensation for diseases peculiar to such industries.

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[5] Larsen v. State Industrial Accident Commission, 1932, 125 Cal. App. 13, 13 P.(2) 850; p. 862.

Sec. 30. Compensation benefits.—Benefits provided for under workmen's compensation acts are of two kinds—money payments and medical care. The majority of statutes enumerate fixed sums to be paid dependents in case of death. Disabilities are classified as permanent total disability, such as the loss of both feet, both hands, or eyesight with specific sums designated; temporary total disability; temporary partial disability; and permanent partial disability. Degrees of disability are indicated for different injuries and a certain sum provided for each degree of injury. No two statutes are alike as to amount of benefits, and amendments are made almost every year. Medical benefits and hospitalization are provided for by most of the statutes. The employer or insurer, either state or private, is charged with this service. This service is limited as to amount and time, depending upon the character of the injury and the time required for treatment and rehabilitation.

Sec. 31. Administration of workmen's compensation acts.—The removal of the so-called employers' defenses—the fellow servant rule, assumption of risk, and contributory negligence of the employee—by the employers' liability acts, left only the questions of the negligence of the employer and the amount of compensation to be determined. Even though an injured employee recovered damages for his injury in a court of law, such judgment gave inadequate protection because the judgment of a case in common law is a final determination of the issue, thus making it impossible for any readjustment in case of a change in the condition of the injured employee. Therefore, the workmen's compensation acts provide for readjustment and changes in benefits and payments over a long period of time, and permanent commissions have been created to handle the many continuous problems within the field of administrative law. In the case of contested claims, however, the statutes provide for appeals to the courts. In a few states the compensation laws are administered by the courts; special commissions are appointed by the courts and, assisted by the state labor officers, they carry out the continuous supervision required by the act. Most states, however, administer workmen's compensation acts by boards called Workmen's Compensation Commissions.

Competitive Conduct of Organized Labor

Sec. 32. Objectives of organized labor, and means used.—It is often said that workmen organize to obtain higher wages, shorter hours, and better working conditions. It might be more accurate to say that their organized efforts within the competitive system are directed to gaining for the laboring class a greater share of the joint product of labor and capital.

To accomplish this result, labor relies in large measure upon the rights to bargain collectively, to strike, to picket, and to boycott. Early common law denied employees the right to organize in an attempt to improve their condition. Concerted effort to improve their position as to wages, hours, or working conditions was held to be a conspiracy.

National Labor Relations Act

Sec. 33. In general.—Under the common law, laborers finally gained the right to organize, but the employer was free to deal with union representatives or not as he thought best served his interest. He was free to discharge employees who became active in union organizations or to extract a promise from his employees not to join a union. The employer could make individual contracts with his employees, or he might, if he thought it wise, promote and dominate a company union, contracting with its representatives and settling grievances through its committees.

In 1935, the federal government, under the power given it to regulate interstate commerce, passed the National Labor Relations Act with the expressed purpose of diminishing the number of labor disputes which burdened or obstructed the free flow of commerce. This objective was to be accomplished by assuring to the employees the right to organize without the threat of losing their jobs and by requiring employers to bargain with the selected representatives of the organized group. In other words, the government undertook to foster and to protect unions as bargaining agents for employees, hoping thereby to reduce the number of interruptions in production.

The federal government can control only interstate trade, but some of the states have enacted similar legislation for intrastate business. The Supreme Court of the United States has also been quite liberal in its interpretation of interstate trade. If a business sells any part of its product in interstate trade or if it buys a substantial portion of its raw material from a producer in another state, it is subject to the National Labor Relations Act.[6]

Sec. 34. Employee protection.—The Act expressly gives employees the right to organize, to form or to join a labor organization, to bargain collectively, and to engage in concerted activities for the purpose of collective bargaining. To insure this freedom, it is made an unfair labor practice for an employer to do any of the following:

1. To interfere with, restrain, or coerce employees in the exercise of the rights mentioned above;
2. To dominate or interfere with the formation or administration

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[6] Santa Cruz Fruit Packing Co. v. National Labor Relations Board, 1938, 303 U.S. 453, 58 Sup. Ct. 282; p. 864.

of any labor organization, or to contribute financial or other support to it;

3. By discrimination in regard to hire or tenure of employment, to encourage or discourage membership in any labor organization, except that it shall be legal for the employer to enter into a union shop agreement;

4. To discharge or otherwise discriminate against an employee because he has filed charges or given testimony under the Act; or

5. To refuse to bargain collectively with selected representatives of his employees.

The administration of the National Labor Relations Act has been placed in the hands of the National Labor Relations Board and any employee, or group of employees, who feels aggrieved under the Act, is free to file a complaint with the Board or its agents. If the matter cannot be settled amicably, a hearing is held and, if the Board finds an unfair labor practice has been indulged in, it issues a cease and desist order which may be enforced in the Circuit Court of Appeals if such order is properly issued.

Sec. 35. Employer protection.—The Act as amended in 1947 accords the employer certain rights and imposes certain duties upon labor unions and their agents. It specifically makes it an unfair labor practice for any organized labor organization to do any of the following:

1. To restrain or coerce employees in the exercise of their right to organize, form, or join unions and to bargain collectively;

2. To cause or attempt to cause an employer to discriminate against any employee because of his particular union activities, except that in a union shop he may be compelled to be a member of a union;

3. To refuse to bargain collectively if it is the representative of the employees;

4. To engage in or encourage a strike or a concerted refusal to handle certain materials, if the object is to:

(a) Force an employer or self-employed person to join a union or employer group or to cease doing business with or refrain from using the products of any other producer;

(b) Require an employer to bargain with a union unless it has been certified as the bargaining agent;

(c) Compel the employer to assign particular work to a particular union or class of employees unless the employer has been so ordered by the Board;

5. To require the employee to pay an initiation fee which is excessive or discriminatory;

6. To cause an employer to pay money, in the nature of an exaction, for services which are not to be rendered.

These provisions have not been construed by the courts, but they seem to outlaw the secondary boycott and the jurisdictional strike.

Sec. 36. Interference, restraint, or coercion.—Improper interference with union organization and activity by an employer usually takes one of two forms. The employer either intimidates his employees or he uses measures to rid himself of union organizers. Congress in passing the law and the courts in construing it, have expressed the view that collective bargaining can function smoothly only when employees feel free to join the union of their choice, uninfluenced by the likes or dislikes of their employers, and when union organizers are given the utmost freedom in making contacts with employees. To use or threaten force against organizers is an improper labor practice, and the courts have gone so far as to give organizers the right to enter on their own time the property of the employer and pass out union literature to employees off duty.

Espionage—spying openly or secretly upon union activities—has been held to be an unfair labor practice on the part of an employer.[7] Employees will not risk their jobs and participate fully in union activities if they think their actions are being reported to their employer. It is improper for an employer to call employees into his office and advise them against membership in a union. However, the constitutional provision which guarantees freedom of speech apparently does give to the employer the right to express frankly his views on organized labor or about a particular union and to transmit those views to his employees, provided he makes it clear that they are at liberty to exercise their choice. He is not free to make derogatory remarks about union organizations or untrue statements, but is allowed to state in a general way his views on them as related to his plant, so long as the message contains no threat or language tending to intimidate the employees.[8] However, the 1947 amendment permits freedom of speech, unless the statement contains a threat of reprisal or a promise of some benefit.

Individual contracts of employment, which offer profit sharing arrangements to the employee who contracts individually as distinct from those who contract through union representatives, are improper. To destroy the good will of the union by offering a bonus to those who disregard it is clearly an interference with the freedom of organization.

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[7] Montgomery Ward & Co. v. National Labor Relations Board, 1939, 103 F.(2) 147; p. 865.

[8] Big Lake Oil Co. v. National Labor Relations Board, 1945, 146 F.(2d) 967; p. 867.

Sec. 37. Employer support of union.—Prior to the National Labor Relations Act there were many company or independent unions which were unaffiliated with national organizations. These unions were often sponsored by the management, held meetings on company property, and were influenced by supervisory employees. Upon the passage of the Act, such a union immediately became an improper bargaining agent, even though it held a membership of more than a majority of the employees. The union had to be disestablished and reestablished without any aid from the company, and became a proper bargaining agent only when it had entirely divorced itself from its former associations. On the whole, the National Labor Relations Board has looked with disfavor upon company or independent unions as bargaining agents.

Sec. 38. Discrimination.—An employer or a union is forbidden to discriminate in regard to hire, tenure, or other conditions of employment because an employee is or becomes a member of a union. To encourage or to discourage membership is equally improper, except that a union-shop agreement made in good faith is legal. A union-shop agreement, however, which has been entered into for the express purpose of frustrating an attempt by a rival union to organize the employees, has been held improper.

Because of the general principles suggested above, it is improper to discharge an employee who has been active in union affairs or who has been urging the employees to strike or who has been on a strike. Even though the conduct of an employee has been such as to justify dismissal, if the employer is at all influenced by the employee's union activities, the discharge is improper.[9] Similarly, it has been held that an applicant for work may not be rejected merely because of his affiliation with a union or because of his activities in its behalf. In one case, an employer was compelled to accept a new employee where it appeared that the only reason for rejecting his application was his union connection.

Sec. 39. Reinstatement.—At common law a contract of employment is not specifically enforceable against either the employer or the employee, but under the National Labor Relations Act the courts have held that the Board has power to order an employer to reinstate an employee who has been discharged because of his union activities. The employer is also obligated to pay wages which would have been earned during the period of unemployment, unless the employee has had employment elsewhere or could have obtained such employment. Two rather important questions intrude at this point: (1) must an employer reinstate an employee who has been

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[9] National Labor Relations Board v. Arcade-Sunshine Co., 1940, 118 F.(2d) 49; p. 868.

on strike, particularly where non-strikers have been employed during the strike; and (2) must the employer reinstate employees who have been guilty of criminal conduct during the course of the strike? [10]

At the conclusion of a strike, the employer in giving employment to the strikers must make no discrimination between those who have been active in support of the strike and those who have not. However, if the strike is not the result of an unfair labor practice, the employer is not obligated to discharge new employees to make room for those who have been out on strike. The reverse is true in the case of a strike which has been called because of a refusal to bargain collectively or because of wrongful discharge of certain employees. A strike called because of unfair labor practices gives the employer no right to replace striking employees with permanent new personnel. When the strike is settled, old employees have first claim to the jobs which are available.

Those employees who during the course of the strike have been guilty of serious offenses, such as wanton destruction of property, taking over control of the employer's property, or injuring employees who continued to work, may properly be denied reemployment. Minor misdemeanors, such as assault and battery without serious consequences, have, in the past, been held to be insufficient reasons for denying reinstatement.

Sec. 40. Refusal to bargain collectively.—The National Labor Relations Act requires employers to bargain with the representatives of organized labor, provided the latter have been selected properly. This does not mean that the employer must comply with all the requests made of him, but he must in good faith meet with the representatives in a bona fide attempt to reach an agreement.[11] He may not use dilatory tactics in order to place the union in a bad light with its members, nor has he a right summarily to reject all proposals made, without some proposal on his part. However, an employer, without being guilty of bad faith, may state his position succinctly and emphatically. So long as he gives the representatives of labor a fair and courteous hearing, he is not guilty of an unfair labor practice merely because he refuses to grant them the particular contract terms they desire. Under the 1947 amendment, labor organizations must also exercise good faith in collective bargaining, if they are the chosen representatives of the laborers involved in the controversy.

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[10] National Labor Relations Board v. Fansteel Metallurgical Corporation, 1939, 306 U.S. 240, 59 Sup. Ct. 490; p. 870.

[11] National Labor Relations Board v. P. Lorillard Co., 1942, 314 U.S. 512, 62 Sup. Ct. 397; p. 873.

Sec. 41. Selection of bargaining agent.—An employer is entitled to evidence that bargaining agents represent the majority of employees. In some cases the management is supplied with a membership list which clearly indicates that a majority of the employees are members of the union. In case of doubt as to union membership and as to who shall represent the employees as bargaining agents, it is necessary for the employees to hold an election, supervised by the Board. A majority of those voting determine the result. The fact that fewer than a majority of the employees vote does not invalidate the election. Employees on strike have the same right to vote as employees who remain on the job, unless they have been permanently replaced. The Act of 1947 provides that employees on strike who are not entitled to reinstatement shall not be eligible to vote.

The Board is given power to determine the employee unit which is to bargain, as well as to determine the employer unit.[12] To illustrate, if it thinks the employees will be better protected thereby, the Board may determine that they are to bargain as an industry rather than as a craft. It may determine whether the proper employer unit consist of all the employers in a given area or whether the employer of a particular plant is the unit for bargaining.

A question has arisen as to the right of the Board to call an election and certify a new bargaining agent during the existence of a contract made with properly selected agents. The problem becomes acute when a majority of the employees change their allegiance from one union to another at the beginning or during the middle of a contract period. Usually the Board refuses to call an election until near the close of a contract period. In cases in which the contract is one of long duration, and particularly where there is evidence that it was made to block selection of new representatives later, it is possible that the contract is illegal and a new election is proper.

Enforcement of Union Agreements

Sec. 42. By the union.—Labor law has developed slowly, and now generally recognizes as contracts, most agreements between labor unions and employers. At first, the courts found no consideration given by the union which supported promises made by the employer. Now, however, on equitable theories, the union is given such relief as the situation merits. An injunction to compel the employer to respect the terms of the agreement is the most customary relief obtained.

Occasionally the union, as distinct from its members, sustains

[12] National Labor Relations Board v. Griswold Mfg. Co., 1939, 106 F.(2) 713; p. 875.

damages because of the failure of the employer to carry out the agreement. In such a case, money damages may be recovered. In a few instances the union has attempted to recover in a single suit such damages as have been suffered by its members because of a violation of the wage provisions of the union contract. The right to recover in such a case has generally been denied because the right to recover resides in the individual employee.[13]

Sec. 43. **By individual employees.**—The terms of a union agreement which relate to wages, hours, and operating conditions may be enforced by individual employees. One theory suggests that the union representative acts as the agent of the employees in arranging the contract terms; another suggests that by usage or custom, the union terms become a part of the individual contracts of employment; and a third theory is that the union has made a contract for the benefit of third parties, namely, the employees. Unless an employee has compromised his position by accepting less than the union scale in full satisfaction of his claim for wages, he can recover the union rate for work performed. This is true although the employee is not a member of the union. This is particularly true under legislation which makes the bargaining agent of the majority the representative of all employees.

The right of an individual employee to make a contract with his employer which differs from the union agreement is questionable, especially if the individual contract is less favorable to the employee. An individual agreement which provides better terms than the union agreement is enforceable unless the purpose of such agreements is to discredit the union by discouraging membership therein.

Sec. 44. **By the employer.**—Although most unions are unincorporated, it is now generally held that a suit against them will prevail. In the federal courts, suits may be instituted against them in the union name, while in most of the state courts class suits are necessary, the suit being initiated against some of the members as representatives of all of them. If union officials are active in persuading the employees to breach their contract, an injunction may be had against them. If they call a strike in violation of their agreement with the employer, money damages can be recovered, although the judgment can be collected only from the union funds.

The union is liable for damages resulting from the torts committed by its officers or members in the course of their duties, such duties having been approved or ratified by the union. Unless individual acts of terrorism committed by members are authorized or

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[13] Milk Wagon Drivers Union v. Associated Milk Dealers, 1941, 39 F. Supp. 671; p. 876.

ratified by the union, it is not liable. The union is liable for injuries sustained by an employer through illegal use of the secondary boycott or the jurisdictional strike.

Sec. 45. Closed shop agreements.—A closed shop agreement—one whereby the employer agrees to employ only members of the union—is made illegal by statute in some of the states and by the federal government. The union shop, however, is legalized by the federal government, it being one in which any person may be employed but must, within a short time, become a member of the union.

Picketing and Boycotts

Sec. 46. The right to picket.—In most labor disputes the strike is not very effective unless the employees are permitted to picket the employer's place of business. Through picketing, the union endeavors to persuade non-striking employees to cease work, and to gain the support of the public in inducing the employer to meet the union demands. Picketing, properly engaged in, is available to labor as a pressure device in labor disputes. Although conduct which injures a person's business is normally a tort, if the benefits to the union group outweigh the injury done to the proprietor's business, no tort is committed. Although picketing tends to injure the business of the employer, the net gains to labor are such that the courts sanction it. Labor, in such a case, is competing with capital. Even though there may be no dispute between management and its employees, it has been held proper to picket an employer's business by outside organizers and non-employees for the purpose of unionizing the management's employees. The right to picket in such a case derives its chief support from the Constitutional guarantee of freedom of speech.[14]

Picketing becomes illegal as soon as the pickets threaten violence, make insulting remarks to employees, make untrue assertions about the employer, force themselves on people who do not care to listen, or congregate in such large numbers as to intimidate those who desire to work or do business with the employer. Picketing likewise becomes improper when the pickets damage the property being picketed, or attempt to take control of it.

Sec. 47. Use of injunction.—The effect of the Norris-LaGuardia Act and similar state laws is to deny to courts the right to issue injunctions in labor disputes, unless the following conditions are present:

1. Unlawful acts must have been threatened and will be committed unless restrained, or have been committed and will continue.

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[14] American Federation of Labor v. Swing, 1941, 312 U.S. 321, 61 Sup. Ct. 568; p. 877.

(The injunction issues only against the guilty parties or associations participating in or ratifying the illegal conduct.)

2. Substantial and irreparable damage to complainant's property will follow.

3. The injury on complainant will be greater than that inflicted upon defendants by the issuance of the injunction.

4. Complainant has no adequate remedy at law.

5. Public officers are unable or unwilling to supply adequate protection.

Although the injunction is not entirely denied to employers, its use has been greatly curtailed. Where the injunction is issued, there is some question as to whether picketing, as well as the illegal conduct, should be enjoined. The tendency seems to be to restrain only the illegal acts.

Some states have attempted by legislation to outlaw picketing on the theory that it leads to strife and violence, but such legislation has been held unconstitutional as abridging freedom of speech.

Sec. 48. Boycott.—A boycott is a concerted effort to persuade people not to deal with a particular person or to buy a certain product. As related to labor disputes, it usually consists of representatives of organized labor picketing an employer's place of business in an attempt to persuade the public not to transact business with the employer. Such action has been approved by the courts as a proper device to be used by labor in promoting its interests. A boycott becomes illegal whenever it ceases to be peaceful in character or when intimidation of customers is resorted to.

A secondary boycott develops when labor fights a business against which it has no grievance, in an attempt to force the business concern not to deal with another employer against which grievances are held.[15] An example is the boycott of a retailer who distributes the product of a manufacturer whose employees are on strike. Such a boycott not only affects his sales of the commodity purchased from the "unfair" producer, but also affects the entire business of the retailer. The legality of the secondary boycott has not been fully determined, although its use has been sanctioned in some cases as a legitimate means for advancing the interest of the laboring group.

The secondary boycott is legal in those cases in which there is a community of interest between the retailer and the producer against whom the grievance is held. This community of interest exists if the retailer tends to profit by a lower price made possible by the producer's use of unorganized labor. If the thing against which

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[15] Mlle Reif, Inc. v. Randau, 1937, 166 Misc. 247, N.Y.S.(2) 515; p. 879.

organized labor is fighting tends to benefit the boycotted party, the boycott is proper. On the other hand, to picket a professional man because he has made one purchase of the non-union product or to picket the seller of raw materials to a manufacturer against whom a grievance is held, is a questionable right. A peaceful secondary boycott appears legal only when the person boycotted tends to profit from the non-union activities of the primary enterprise, and under the 1947 amendment to the federal law, secondary boycotts for most purposes appear to be made illegal where interstate commerce is involved.

Review Questions and Problems

1. What is the purpose of the Fair Labor Standards Act?

2. What employees are exempt from the application of the present Fair Labor Standards Act?

3. The Star Publishing Company publishes *The Polk County Star*, a semi-weekly newspaper with a circulation of 3,800, the major part of which is within Polk County where the paper is printed. At the present time, three rural carriers are receiving 38¢ an hour. Are these employees entitled to an increase in wages under the Fair Labor Standards Act?

4. The Baker Drug Co. owns and operates a drug store in a town near a state line. Ninety-five per cent of its merchandise is purchased and shipped to it from outside the state. Sales to out of state customers do not exceed .003 per cent of its total sales. During the year 1945-46, an employee worked an average of twelve hours per day for six days per week. The employee brings an action in the local circuit court to recover back wages at one and one-half times the regular rate for all hours in excess of forty hours per week. Should he recover?

5. Enumerate what benefits are given to employees under the Social Security Act.

6. At common law what defenses were available to employers in suits brought by employees for injuries received during employment?

7. Why are employers' liability acts inadequate protection for injured employees?

8. Under workmen's compensation acts, what are the only issues to be determined?

9. Name the different types of insurance plans used to protect injured workmen under compensation acts.

10. Would a laundry, doing a purely local business but located in a city on a state line and buying its supplies from out of state and engaged in collecting and delivering garments across state lines, be subject to the jurisdiction of the National Labor Relations Board?

11. A manufacturing company employs several hundred employees. The company has established a pension plan, recreational clubs, and vacation plans for its employees. Company representatives known as per-

sonnel officers aid and supervise the employees in these activities. In performing their duties, these personnel officers keep files in which they record information concerning the various activities of different employees and make periodic reports to the management. Later, a union was organized and investigation disclosed that during the period of organizing, those individuals most active in labor organization did not receive promotions or were discharged for the slightest infractions of the rules of employment. The union filed charges of unfair labor practices with the National Labor Relations Board. After notice, hearing, and proof, for what unfair labor practice may the Board issue a cease and desist order?

12. The *A* Corporation refused to bargain with an elected representative of its employees; the representative was not an employee. The employees went out on a strike. During the strike, the president called into his office several employees and informed them that they were a committee representing the employees and that he would deal with them. The president prepared a letter with a heading, "Collective Bargaining Representatives of *A* Corporation Employees." Upon this letter was typed a contract of employment. Each member of the committee signed the letter and was instructed to secure the signatures of the other employees. A majority of the employees signed the contract set forth in the letter.

Does the above procedure constitute proper collective bargaining under the National Labor Relations Act?

13. *A* worked for the *X* Corporation as a boiler operator in the same plant for sixteen years. His work was efficient, and he had a record for being punctual. He had been active in organizing the employees of the plant and was warned by the vice-president that "he had better watch his step; he might get into trouble." *A* became an officer in the union. Immediately he was transferred to a small plant owned by the firm. Here he had little opportunity to contact the employees at the large plant and was denied the opportunity for overtime.

Is the above conduct by the *X* Corporation discrimination in regard to time and tenure under the National Labor Relations Act?

14. *T* is employed as a truck driver by defendant company. A collective bargaining agreement had been entered into between the company and the Truck Drivers Union, providing for hours, wages, and conditions of employment. *T* was employed at a wage less than that provided for in the union contract. When *T* joined the union he learned about the higher wages. May *T* recover from the employer defendant company as back wages the difference between what he received and the amount provided for by the union contract? May the union sue on the contract in *T*'s behalf?

15. The Del Ray Café had entered into a closed shop agreement with its employees through the C.I.O. union. The A.F.L. union picketed the café claiming in its placards that the café was unfair to organized labor. The café had no dispute with its C.I.O. union employees. The café brings an equity action to enjoin the picketing. The A.F.L. union de-

fends that to enjoin such picketing would be an interference with free speech. Does the right of free speech, as a basis for picketing, go this far?

16. The defendant Dairy Union workers picketed a retail store which sold dairy products. The union, at the time, was out on strike against the Dairy Products Corporation which sold to the retail store. The retail store had no dispute with its own employees. The pickets carried placards stating "Buy Union Dairy Products Only," "This store sells non-union goods." Should the union be enjoined from picketing the retail store?

Suppose the retail store was a drug store which purchased only small quantities of dairy products for its fountain from the Dairy Products Corporation. What result?

Book I

CONTRACTS

CHAPTER II[1]

OFFER AND ACCEPTANCE

BROADNAX v. LEDBETTER

1907, 100 Tex. 375, 99 S.W. 1111.

Plaintiff sued for a reward offered by defendant, alleging that defendant was a sheriff and as such had in his custody one Vann, convicted of murder and condemned to death; that Vann, pending his appeal to the higher court, had broken jail and escaped; that defendant offered a public reward for his recapture; and that the plaintiff made the recapture and thereby earned the reward. Defendant objected that the plaintiff did not state that he had knowledge of the offer of reward when he made the capture. The court gave plaintiff leave to amend, but the plaintiff declined to do so and, upon losing the case in the lower court, appealed, standing upon the sufficiency of his claim without such averment.

WILLIAMS, J. . . . The liability for a reward of this kind must be created, if at all, by contract. There is no rule of law which imposes it except that which enforces contracts voluntarily entered into. A mere offer or promise to pay does not give rise to a contract. That required the assent or the meeting of two minds, and therefore is not complete until the offer is accepted. Such an offer as that alleged may be accepted by any one who performs the services called for when the acceptor knows that it has been made and acts in performance of it, but not otherwise. He may do such things as are specified in the offer, but, in so doing, does not act in performance of it, and therefore does not accept it, when he is ignorant of its having been made. . . .

Judgment for defendant.

MONTGOMERY WARD AND CO. v. JOHNSON

1911, 209 Mass. 89, 95 N.E. 290.

The defendant manufactured and sold firearms to jobbers. She issued a printed letter to all jobbers, indicating that she would sell only those who maintained certain uniform resale prices. Enclosed with the letter was a document which set forth the prices, terms, and conditions under which revolvers would be sold. The letter said:

[1] No cases accompanying text of Chapter I.

No order will be filled except upon the terms set forth in the enclosed document.

The plaintiff, who received the letter, ordered a number of revolvers according to the terms of the document. The defendant refused to ship and the plaintiff brought a bill for specific performance.

Bradley, J. . . . An invitation to prospective buyers to . . . trade with the defendant, even when confined to a definite class, imposes no obligation on the sender of accepting any offer which thereafter might be received. The order of the prospective buyer does not ripen into a contract until the defendant's acceptance takes place and then only as to the goods specifically ordered. . . .

We are of the opinion that a fair interpretation of the letter, and document, very plainly shows that it was not a general offer to sell to those addressed, but an announcement, or invitation, that the defendant would receive proposals for sales on the terms and conditions stated, which she might accept or reject at her option.

Relief denied.

McPHERSON BROTHERS CO. v. OKANOGAN COUNTY

1907, 45 Wash. 285, 88 Pac. 299.

A bill to compel the defendant to accept a bid and to convey certain real estate was dismissed by the lower court.

Fullerton, J. In substance the complaint of the appellant alleged that the county of Okanogan, being the owner in fee simple of certain real property, advertised the same for sale at public auction to the highest and best bidder for cash; that, at the time and place appointed for the sale, the appellant appeared, and when the property was offered for sale, bid therefor the sum of one hundred dollars, which sum was the highest and best bid for such property; that the county, through its officers, refused to accept the bid, or knock down the property to it for said bid.

The appellant contends that, since it bid for the property when it was offered for sale and since its bid was the highest and best bid offered therefor, it was the duty of the officer conducting the sale to strike off the property to it, and that the failure of the officer so to do cannot affect its right to have the sale completed, and that it is now entitled to a deed to the property.

On the question whether an auction sale is so far complete as to enable the seller to enforce the payment of the sum bid for property offered for sale, or the bidder to enforce a delivery or conveyance of such property, where the sale has proceeded no farther than an offer on the one side and a bid on the other, the leading case is

Blossom v. Railroad Co., 3 Wall. 196, 18 L. ed. 43. It was there held that a bidder at a judicial sale at public auction, whose bid had not been accepted, could not, even though he was the highest and best bidder, enforce an acceptance of his bid and a conveyance of the property to him, on tender to the proper person of such bid. Arguendo the court said:

"Biddings at an auction, says Mr. Addison, are mere offers, which may be retracted at any time before the hammer is down and the offer has been accepted. The leading case upon that subject is that of Paine v. Cave, where it was expressly held that every bidding at an auction is nothing more than an offer on one side until it has received the assent of the auctioneer as the agent of the owner."

Measured by the test thought sufficient in these cases, the offer to sell the property and a bid therefor by the appellant did not create a contract of sale between the county and the appellant, since the property was not struck off to the appellant, nor his bid accepted.

The judgment is affirmed.

MINNESOTA LINSEED OIL CO. v. COLLIER WHITE LEAD CO.

1876, Fed. Cas. No. 9,635, 4 Dill. 431.

Plaintiff brought an action to recover $2,150, a balance admittedly due for oil sold to the defendant. Defendant seeks to reduce plaintiff's claim, based upon the following circumstances. On July 31, plaintiff by telegram offered to sell a certain amount of linseed oil to defendant at a certain price. Although this telegram was transmitted late in the evening of July 31, it was not delivered to defendant until the morning of August 2. On August 3 defendant accepted plaintiff's offer by depositing a telegram with the telegraph office in his city and shortly thereafter upon the same day defendant received a telegram from the plaintiff revoking plaintiff's offer. The market price on linseed oil was very unstable.

Nelson, District Judge. . . . In the case at bar the delivery of the message at the telegraph office signified the acceptance of the offer. If any contract was entered into the meeting of minds was at 8:53 of the clock, on Tuesday morning, August 3rd and the subsequent dispatches are out of the case. . . . Conceding this, there remains only one question to decide, which will determine the issues: Was the acceptance of defendant deposited in the telegraph office Tuesday, August 3rd, within a reasonable time so as to consummate a contract binding upon the plaintiff?

The better opinion is, that what is, or is not, a reasonable time, must depend upon the circumstances attending the negotiation,

and the character of the subject matter of the contract, and in no better way can the intention of the parties be determined. If the negotiation is in respect to an article stable in price, there is not so much reason for an immediate acceptance of the offer, and the same rule would not apply as in a case where the negotiation related to an article subject to sudden and great fluctuations in the market. ". . . If no definite time is stated, then the inquiry as to a reasonable time resolves itself into an inquiry as to what time it is rational to suppose the parties contemplated; and the law will decide this to be that time which as rational men they ought to have understood each other to have had in mind." Applying this rule, it seems clear that the intention of the plaintiff, in making the offer by telegram, to sell an article which fluctuates so much in price, must have been upon the understanding that the acceptance, if at all, should be immediate, and as soon after the receipt of the offer as would give a fair opportunity for consideration. The delay, here, was too long and manifestly unjust to the plaintiff, for it afforded the defendant an opportunity to take advantage of a change in the market and to accept or refuse the offer as would best subserve its interests.

Judgment will be entered in favor of the plaintiff for the amount claimed. The counterclaim is denied. Judgment accordingly.

BOSSHARDT & WILSON CO. v. CRESCENT OIL CO., Limited

1895. 171 Pa.St. 109.

Assumpsit to recover damages for breach of contract. Judgment for defendant. After stating by letter under date of July 31, 1893, the terms of an offer to supply crude oil to the plaintiff, the defendant concluded:

> We extend to you a refusal of making the contract on the above basis for the term of sixty days from this date. Should it not be accepted in writing on or before that time the above is to become null and void, and without effect between us.

On September 25, 1893, the defendant wrote plaintiff:

> We wish to advise you that we withdraw our offer of July 31. . . . You will therefore consider the same canceled.

Two days later, however, the plaintiff replied as follows:

> Dear Sirs: We hereby notify you that we accept and will fully carry out the option and contract given to us by your . . . letter dated Pittsburgh, Pa., July 31, 1893. . . . We hereby repudiate your attempted

withdrawal of said option and contract as expressed in your letter to us, dated Pittsburgh, Pa., September 25, 1893.

McCollum, J. A careful study of the evidence in the case has convinced us that there was no contractual relation between the litigants. . . . There is nothing in the offer which indicates that there was a consideration for the option it gave nor anything in the oral evidence which stamps the latter as irrevocable during the time allowed by the letter for the exercise of it. . . . There being no consideration for the offer in this case the defendant had a clear right to withdraw it at any time before there was an acceptance of it. The counsel for the plaintiff . . . conceded that, if there was neither a consideration for nor acceptance of it, the right of the defendant to withdraw it is plain and indisputable.

Judgment for defendant.

MORRISON et al. v. PARKS

1913, 164 N.C. 197, 80 S.E. 85.

This is an action to recover damages for failure to deliver lumber. The offer follows:

> Gentlemen: I have about 80,000 feet of oak left yet, for which I will take $16 per M delivered on cars at Bridgewater 'log run.' I will take $8 per M for the mill culls I have at Bridgewater, as that is what it cost me, cut and deliver the same.

The plaintiff replied as follows:

> Dear Sir: Your letter of the 20th received and would say we will take your 4/4 oak at $16, mill culls out, delivered on cars at Bridgewater. We will handle all your mill culls, but not at the price you are asking. We are buying from A. L. & Co. for $4.50 on board the cars. We should be glad to handle yours at this price. How soon will you have some 4/4 ready to load? We will take the 80,000 feet and will depend on this, and will load it out as soon as you can put it on the railroad. Please write us at once how soon you will have some of this stock ready to load.

Clark, C. J. The alleged contract being in writing, the construction of this written evidence was a matter for the court. In order to make the offer and reply a contract, the acceptance must be "(a) absolute and unconditional; (b) identical with the terms of the offer; (c) in the mode, at the place, and within the time expressly or impliedly required by the offeror." The plaintiff Morrison testified that "4/4" means lumber "an inch thick, of any length or width," and that "log run" means "any thickness, with culls out."

He further testified that the market price of 4/4 lumber of that character, at that place and time, was $18.50.

It is apparent that the reply was not an acceptance of the terms of the offer of the defendant. (1) The defendant offered to take $8 per M for mill culls. The plaintiff replied, offering $4.50. (2) The defendant offered 80,000 feet of oak, "log run," at $16. The plaintiff replied, offering $16 per M for 4/4 oak—an entirely different article and which he himself testified was then worth in the market $18.50 at the same place.

There was no contract. The offer of the defendant was not accepted, but a counter offer of an entirely different nature was made. The minds of the parties never met.

Judgment of nonsuit affirmed.

DIEBEL v. KAUFMAN

1945, (Ohio App.) 62 N.E.(2) 770.

MILLER, J. This is an appeal on questions of law and fact from the Common Pleas Court of Franklin County, Ohio.

The action is one for specific performance of a contract for the purchase and sale of 30 shares of stock in The Modern Tool, Die and Machine Company, which is being held by the defendant as executor of the estate of Mary E. Cain, and which, under the terms of her will, he is authorized to sell. The regulations of the company contain the provision that a stockholder desiring to sell must first offer the stock at the market price to the company which shall have an option of purchase for thirty days.

On May 18, 1943, the defendant made an offer in writing to The Modern Tool, Die and Machine Company to sell the 30 shares involved herein at a price of $175 per share. On May 28, 1943, a special directors' meeting was called and a resolution was duly passed authorizing the acceptance of the offer by the company. A special stockholders' meeting was held on June 4th and a motion to approve the purchase was lost for the want of a two-thirds majority. The defendant then sought to sell the stock and announced through his attorney that sealed bids would be accepted up to 12:00 o'clock noon, June 7th, at which time the highest bid would be accepted. At ten minutes to 12:00 M., June 7th, the plaintiff and his attorney called at the office of Henry S. Ballard, attorney for the executor, and who had made the offer to sell, and attempted to deliver to Mr. Ballard a sealed bid for the purchase of this stock. Mr. Ballard refused to accept the bid, stating that he had just been served with a copy of pleadings being filed in a suit in the Common Pleas Court in which this stock was involved. The offer was one of

$180 per share, making a total of $5,400.00 for the same. A cash tender was made several days later and the same was refused.

We are of the opinion that the defendant was justified in refusing to sell this stock to the plaintiff for two reasons: First, an offer unless given for a valuable consideration can be withdrawn at any time before acceptance, which was done in the instant case; second, according to the conditions as contained in the company regulations, when an offer was made to the company by the stockholder to sell stock, the company had an option for thirty days in which to accept. During this period of time the holder of the stock could not legally sell to a third person, for although the stockholders at one meeting might refuse to accept the offer, they might well reconsider their action within the thirty day period and decide to purchase the stock. It will be noted that the company at no time notified the defendant that the offer had been rejected by the company. Had this been done, it would seem that the defendant, having given notice to the company, with an offer to sell at a definite price, and this offer being rejected by the company, would then be at liberty to dispose of the same. Since the defendant had no right to offer the stock for sale as he did on June 7th, the plaintiff acquired no right to purchase it. The plaintiff was secretary of the company and was fully informed as to its bylaws and regulations.

Judgment for the defendant.

BUTCHERS' ADVOCATE CO. v. BERKOF et al.

1916, 158 N.Y. Supp. 160, 94 Misc. 299.

Action by the Butchers' Advocate Company against Jacob W. Berkof and another. From a judgment for plaintiff, and an order denying defendants' motion for a new trial, defendants appeal.

LEHMAN, J. The defendants, on or about August 1, 1914, signed a paper which reads as follows:

Brooklyn, N.Y., August 1, 1914.

Undersigned hereby authorizes the publishers of the Butchers' Advocate to insert our ad. to occupy ¼ page in Butchers' Advocate for one year and thereafter until publishers have order to discontinue the ad., for which we agree to pay $8 (eight dollars) per insertion.

Safety Auto Trolley,
J. W. Berkof.

The plaintiff proceeded under this authorization to publish advertisements for the defendant. Some time in September the defendants notified the plaintiff to discontinue the advertisement, but the plaintiff continued to insert same in each issue, and has recov-

ered a judgment for the sum of $416, the price named for insertion of advertisement for one year. . . .

. . . In this case the defendant in the written agreement merely authorizes the plaintiff to publish his advertisement for one year. The defendant at that time did not expressly or impliedly in any form agree to do anything. It was evidently a mere offer or unilateral promise on the part of the defendant, which could ripen into a mutual contract only when the offer was accepted . . . by performance. . . .

In this case . . . the offer was merely to pay a certain sum per insertion, which was authorized for one year, and in such cases the past performance implied only an acceptance of the offer to pay according to the insertions. It follows that the plaintiff is entitled to no recovery for insertions made after the defendants had notified it to cease publication.

Judgment should therefore be reversed. . . .

HENDRICKSON v. INTERNATIONAL HARVESTER CO. OF AMERICA

1927, 100 Vt. 161, 135 Atl. 702.

Action by Peter Hendrickson against the International Harvester Company of America to recover damages on account of the defendant's failure to deliver to him a broadcast seeder. The defendant's agent took the order for the machine, which order was retained by the defendant an unreasonable time and, until this controversy arose, without indicating that it either accepted or rejected the offer of the plaintiff to buy the seeder mentioned.

Powers, J. . . . The order was subject to approval. . . . The fact that the defendant kept the order without approving it or notifying the plaintiff of its disapproval would amount to an acceptance.

True it is that it takes two to make a bargain, and that silence gives consent . . . only when there is a duty to speak. And true it is that it is frequently said that one is ordinarily under no obligation to do or say anything concerning a proposition which he does not choose to accept; yet we think that, when one sends out an agent to solicit orders for his goods, authorizing such agents to take such orders subject to his (the principal's) approval, fair dealing and the exigencies of modern business require us to hold that he shall signify to the customer within a reasonable time from the receipt of the order his rejection of it, or suffer the consequences of having his silence operate as an approval.

Judgment for plaintiff.

BOSTON ICE CO. v. POTTER

1877, 123 Mass. 28.

The defendant purchased ice of plaintiff in 1873 but because of a misunderstanding, he discontinued their services and ordered his ice from the Citizens' Ice Co. The plaintiff purchased the business of the Citizens' Ice Co. and delivered ice to the defendant for over a year. The defendant was not notified of the change until a year after the delivery was started and the defendant refused to pay for the ice delivered.

ENDICOTT, J. . . . There was no privity of contract established between the plaintiff and defendant and without such privity the possession and use of the property will not support an implied assumpsit, Hills v. Snell, 104 Mass. 173, 177. And no presumption of assent can be implied from the reception and use of the ice, because the defendant had no knowledge that it was furnished by the plaintiff, but supposed that he received it under the contract made with the Citizens' Ice Company. Of this change he was entitled to be informed.

A party has a right to select and determine with whom he will contract and cannot have another person thrust upon him without his consent. It may be of importance to him who performs the contract, as when he contracts with another to paint a picture, or write a book, or furnish articles of a particular kind, or when he relies upon the character or qualities of an individual, or has, as in this case, reasons why he does not wish to deal with a particular party. In all these cases, as he may contract with whom he pleases, the sufficiency of his reasons for so doing cannot be inquired into. If the defendant, before receiving the ice, or during its delivery, had received notice of the change, and that the Citizens' Ice Co. could no longer perform its contract with him, it would then have been his undoubted right to have rescinded the contract and to decline to have it executed by the plaintiff. But this he was unable to do, because the plaintiff failed to inform him of that which he had a right to know.

The case of Boulton v. Jones, 2 H. & N. 564, was cited by both parties at the argument. There the defendant, who had been in the habit of dealing with one Brocklehurst, sent a written order to him for goods. The plaintiff, who had on the same day bought out the business of Brocklehurst, executed the order without giving the defendant notice that the goods were supplied by him and not by Brocklehurst. And it was held that the plaintiff could not maintain an action for the price of the goods against the defendant.

Judgment for defendant affirmed.

LUCAS v. WESTERN UNION TELEGRAPH COMPANY

1906, 131 Iowa 669, 109 N.W. 191.

Action for damages accruing to plaintiff as a result of defendant company's delay in transmitting plaintiff's message of acceptance until the offer of a third party, one Sas, had terminated through lapse of time. By way of defense the defendant company asserted that there was no loss occasioned by their delay in transmitting the telegram since the contract was completed upon the delivery of the message of acceptance to the telegraph company. The lower court gave judgment for the plaintiff.

Ladd, J. . . . Having sent the proposition by mail he impliedly authorized its acceptance through the same agency. Such implication arises (1) when the post is used to make the offer and no other mode is suggested, and (2) when the circumstances are such that it must have been within the contemplation of the parties that the post would be used in making the answer. . . . The contract is complete in such a case when the letter containing the acceptance is properly addressed and deposited in the United States mails. . . . This is on the ground that the offeror, by depositing his letter in the post office, selects a common agency through which to conduct the negotiations, and the delivery of the letter to it is in effect a delivery to the offeror. . . . But plaintiff did not adopt this course. On the contrary he chose to indicate his acceptance by transmitting a telegram to Sas by the defendant company. Sas had done nothing to indicate his willingness to adopt such agency and the defendant in undertaking to transmit the message was acting solely as the agent of the plaintiff. The latter might have withdrawn the message or stopped its delivery at any time before it actually reached Sas. It is manifest that handing the message to his own agent was not notice to the sendee of the telegram. The most formal declaration of an intention of acceptance of an offer to a third person will not constitute a contract. A written letter or telegram, like an oral acceptance, must be communicated to the party who has made the offer or to someone expressly or impliedly authorized to receive it, and this rule is not complied with by delivering it to the writer's own agent or messenger even with direction to deliver it to the offeror. . . . The plaintiff then did not accept the offer of Sas until the telegram was received by the latter.

The case was sent back for retrial with the instructions to ascertain whether the acceptance was delivered to the offeror within a reasonable time.

CHAPTER III

CONSIDERATION

SANDELLI v. DUFFY

1944, 131 Conn. 155, 38 A.(2) 437.

BROWN, J. In this action brought on the common counts to recover an indebtedness of $777.89, the plaintiff by his bill of particulars and more specific statement alleged that he sold and delivered flowers, plants, etc. to "defendant . . . and her husband, Frank P. Duffy (deceased) doing business as Frank P. Duffy" in response to orders in connection with their undertaking business, that the above was the balance due on the running account, and that on April 8, 1942, the defendant expressly agreed in writing to "pay the full amount as soon as I sell the house," having reference to her homestead in New Britain. The defendant's answer was a general denial. The court rendered judgment for the plaintiff for the above amount and the defendant has appealed.

In this court the plaintiff has urged that the court's finding of liability on the part of the defendant can be sustained on any or all of these grounds: (1) She is a surviving partner or member of a joint venture; (2) the articles went "for the joint benefit" of herself and her husband within § 5155 of the General Statutes; and (3) she expressly promised on April 8, 1942 to pay the debt. The court's conclusions make clear that its judgment was predicated on the last ground. The facts found are insufficient to support a conclusion of liability on the first ground. The same is true of the second ground. . . . The judgment for the plaintiff cannot be sustained on the third ground. This is so because there was no consideration for the defendant's promise. Something given before a promise is made, and therefore without reference to it, particularly given to another than the promisor, does not constitute legal consideration.

Judgment for defendant.

HAMER v. SIDWAY

1891, 124 N.Y. 538, 27 N.E. 256.

PARKER, J. The question which . . . lies as the foundation of plaintiff's asserted right of recovery, is whether, by virtue of a contract, defendant's testator, William E. Story, became indebted to his nephew, William E. Story 2d, on his twenty-first birthday, in the sum of $5,000.

The trial court found as a fact that "on the 20th day of March, 1869, William E. Story agreed to and with William E. Story 2d, that if he would refrain from drinking liquor, using tobacco, swearing, and playing cards or billiards for money until he should become twenty-one years of age then he, the said William E. Story, would at that time pay him, the said William E. Story 2d, the sum of $5,000 for such refraining, to which the said William E. Story 2d, agreed," and that he "in all things fully performed his part of said agreement."

The defendant contends that the contract was without consideration to support it, and therefore invalid. He asserts that the promisee by refraining from the use of liquor and tobacco was not harmed but benefited; that which he did was best for him to do, independently of his uncle's promise, and insists that it follows that, unless the promisor was benefited, the contract was without consideration, a contention which, if well founded, would seem to leave open for controversy in many cases whether that which the promisee did or omitted to do was in fact of such benefit to him as to leave no consideration to support the enforcement of the promisor's agreement. Such a rule could not be tolerated, and is without foundation in the law.

The exchequer chamber in 1875 defined "consideration" as follows: "A valuable consideration, in the sense of the law, may consist either in some right, interest, profit, or benefit accruing to the one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other." Courts "will not ask whether the thing which forms the consideration does in fact benefit the promisee or a third party or is of any substantial value to any one. It is enough that something is promised, done, forborne, suffered by the party to whom the promise is made as consideration for the promise made to him." Anton, Cont. 63. . . . Pollock in his work on contracts says: ". . . Consideration means not so much that one party is profiting as that the other abandons some legal right in the present, or limits his legal freedom of action in the future, as an inducement for the promise of the first."

Now applying this rule to the facts before us, the promisee used tobacco, occasionally drank liquor and had a legal right to do so. That right he abandoned for a period of years upon the strength of the promise of the testator that for such forbearance he would give him $5,000. We need not speculate on the effort which may have been required to give up the use of those stimulants. It is sufficient that he restricted his lawful freedom of action within certain prescribed limits upon the faith of his uncle's agreement, and now,

having fully performed the conditions imposed, it is of no moment whether such performance actually proved a benefit to the promisor, and the court will not inquire into it; but, were it a proper subject of inquiry, we see nothing in this record that would permit the determination that the uncle was not benefited in a legal sense.

Judgment for plaintiff.

NARDINE v. KRAFT CHEESE CO.

1944. (Ind. App.) 52 N.E.(2) 634.

FLANAGAN, J. For several years prior to August 24, 1941, the appellant, Lattie Nardine, a resident of Vincennes, Indiana, had operated a grocery in Lexington, Kentucky, under the name of Standard Market. During that time she had been an open account customer of appellee. In July 1941 she purchased from apellee 515¾ pounds of longhorn cheese. After a short time a dispute developed as to this cheese. Appellant said it was spoiled when received and that appellee should take it back. Apellee said that appellant spoiled it trying to force cure it and therefore it could not be returned. This dispute continued until after appellant closed her business on August 24, 1941.

Thereafter letters were exchanged between the parties concerning settlement of appellant's account, whereby it developed that there were other differences as to items in the account. About October 1, 1941, appellee's Lexington manager went to Vincennes to discuss the account with appellant but they were unable to agree as to the amount appellant owed. The dispute concerning the shipment of longhorn cheese above referred to was continued at that conference.

On October 30, 1941, appellant wrote appellee the following letter:

"Enclosed please find check in the amount of One Hundred Forty Six Dollars and one cent ($146.01) which according to our records pays my account in full.

"You will notice that I have taken a 10¢ per lb. deduction on the 515¾ lb. bad longhorn cheese, that I received from you. We are still at quite a loss on this cheese, as we really had to sacrifice it to get rid of it.

"In regard to the balance on your statement of overcharges and deductions, I wish to advise that I find it impossible to check up on this as they are so old. I feel that if the deductions were not in order, that I should have been notified at the time they were taken from the checks. As you told me, these were left over from before the time you took over this account.

"We are sorry to have had to make the above deductions, but I really feel that it is a just one. It has been a pleasure to do business with the

Kraft Cheese Company at Lexington, and I want to thank you for all past favors.

"With best regards to you, I remain,"

Enclosed with the letter was a check for $146.01 marked, "This pays my account in full to date." After receiving the letter and check appellee mailed the check to the Vincennes bank on which it was drawn for certification. The bank certified the check and returned it to appellee who still retains it.

Thereafter appellee brought this action against appellant seeking to recover on account for the balance it claimed due after deducting the sum of $146.01. Appellant answered among other things that there had been an accord and satisfaction. Trial resulted in judgment for appellee in the sum of $87.88 and this appeal followed. The sufficiency of the evidence is properly challenged.

When the holder of a check has it certified by the bank on which it is drawn the drawer is discharged and the debt becomes that of the bank. . . . If it was tendered in full payment of a claim which was unliquidated or concerning which a bona fide dispute existed, the acceptance of the check discharged the debt. . . .

Appellee says that there was no dispute because the trial court found that the longhorn cheese which appellant claims was spoiled when it arrived was in fact spoiled by appellant in trying to force cure it. The trial court could, and undoubtedly did, find that appellant spoiled the cheese. But in determining whether there was an accord and satisfaction we are not concerned with the question as to who was right and who was wrong in an existing dispute. We are concerned only with the question as to whether a good faith dispute existed at the time the check was tendered in full payment. Neubacher v. Perry, supra. The evidence on this question by both parties was all to the effect that such a dispute did exist.

It is true as appellee contends that the question of accord and satisfaction is ordinarily a question of fact, but where the controlling facts requisite to show accord and satisfaction are undisputed the question becomes one of law. . . .

Our conclusion is that the facts in this case show an accord and satisfaction of the claim sued upon.

Judgment for defendant.

FURMAN UNIVERSITY v. WALLER et al.

1923, 124 S.C. 68, 117 S.E. 357.

MARION, J. This is an action to enforce a subscription for $10,000, made by the late C. A. C. Waller, of Greenwood, S.C., to the "Baptist 75 Million Campaign." Upon the trial of the cause

in the circuit court, Hon. Jno. S. Wilson, President Judge . . . granted a motion for the direction of a verdict in favor of the plaintiff. From judgment thereon, defendants appeal.

The appellants . . . say that the subscription of Mr. Waller was a nudum pactum, a mere naked promise to give something in the future, unsupported by a valuable consideration and unenforceable in law or equity; and that such conclusion of law is not affected and cannot be impeached by the facts, or any legitimate inference therefrom, adduced in evidence.

Subscriptions other than this . . . were actually received and one of them, in the sum of $25,000, was paid in cash. In reliance on these subscriptions "all over the state," money was borrowed by Furman University, and many improvements made. A dormitory and other buildings were erected and land purchased for that and other purposes of enlargement. The faculty and students were doubled in number. All of this was done on the strength of the subscriptions secured. . . .

In 1 Parsons on Contracts (8th ed. 1453) it is said: "On the important question, how far voluntary subscriptions for charitable purposes, as for alms, education, religion or other public uses, are binding, the law has in this country passed through some fluctuations, and cannot now be regarded as on all points settled. Where advances have been made or expenses or liabilities incurred by others in consequence of such subscriptions before any notice of withdrawal, this should, on general principles, be deemed sufficient to make them obligatory, provided the advances were authorized by a fair and reasonable dependence on the subscriptions; and this rule seems to be well established."

[Likewise] where the promisee has, before withdrawal, [formally] accepted the subscription, and has expressly or by clear implication, agreed to apply the promised contribution to the purpose for which it was subscribed, and has thereby assumed the discharge of an obligation, which may be enforced in law or in equity, the element of valuable consideration to support the promisor's agreement is supplied by the enforceable covenant of the promisee; there is then promise for promise; and therefrom springs a valid and enforceable contract.

Judgment affirmed.

LINZ v. SCHUCK

1907, 106 Md. 220, 67 Atl. 286.

Action on a contract. From a judgment for plaintiff, defendant appeals.

The appellant owned a house under which appellee agreed to

build a 7 foot basement, walls to be underpinned with good hard brick laid in cement, at a contract price of $1,500. Upon commencing the excavation the appellee encountered very unusual conditions, which he described as follows: "The house stood on a hard crust about three feet thick, and the foundation of that house didn't extend through that hard crust. It was built on that crust and the more we got through that the more we got into a swamp like—the bottom of an old creek, black muddy stuff and soft and they tried to dig and it all ran into this place . . . and a big lump would cave off and fall in every now and then. . . ."

The excavation was stopped but later it was agreed that plaintiff was to build the cellar, employing whatever means necessary, the defendant to stand the extra costs and consequences. In putting in the cellar plaintiff drove "lagging" in to hold the ground and after excavating to a depth of eight feet drove poles down eight feet and formed a concrete footing on these poles. When the job was finally finished defendant refused to pay the additional costs and plaintiff sued.

BOYD, J. . . . In King v. Duluth, 61 Minn. 487, . . . it is stated that a promise by one party to a subsisting contract to the opposite party to prevent a breach of the contract on his part is without consideration. . . . [However] it is entirely competent for the parties to a contract to modify or waive their rights under it and ingraft new terms upon it, and in such a case the promise of one party is the consideration for that of the other; but where the promise to the one is simply a repetition of a subsisting legal promise, there can be no consideration for the promise of the other party, and there is no warrant for inferring that the parties have voluntarily rescinded or modified their contract. But where the party refusing to complete his contract does so by reason of some unforeseen and substantial difficulties in the performance of the contract, which were not known or anticipated by the parties when the contract was entered into, and which cast upon him an additional burden not contemplated by the parties, and the opposite party promises him extra pay or benefits if he will complete his contract, and he so promises, the promise to pay is supported by a valid consideration. In such a case the natural inference arising from the transaction, if unmodified by any equitable considerations, is rebutted, and the presumption arises that by the voluntary and mutual promises of the parties their respective rights and obligations under the original contract are waived, and those of the new or modified contract substituted for them. Cases of this character form an exception to the general rule. We are . . . of the opinion that this [action] . . .

can be sustained on the ground stated in King v. Duluth, etc., Ry. Co.

Judgment affirmed.

BAILEY et al v. AUSTRIAN

1873, 19 Minn. 465.

BERRY, J. If the testimony, which plaintiffs contend was erroneously rejected, had been received, it would, together with the evidence introduced, have tended to establish a state of facts substantially as follows, viz.: That on the second day of September, 1871, plaintiffs engaged in a general foundry business in St. Paul, defendant promised to supply them with all the Lake Superior pig iron wanted by them in their said business, from said date until December thirty-first next ensuing, at specified prices, and that plaintiffs simultaneously promised to purchase of defendant all of said iron, which they might want in their said business, during the time above mentioned, at said prices. If this state of facts establishes any contract, it is a contract of mutual promises. That is to say, the sole consideration for defendant's promise to supply, is plaintiffs' promise to purchase and vice versa.

The general rule is, "that a promise is not a good consideration for a promise, unless there is an absolute mutuality of engagement, so that each party has the right at once to hold the other to a positive agreement." 1 Parson's Contracts, 449 and note z.

Upon the foregoing facts, the engagement of plaintiffs was to purchase all of said pig iron, which they might want in their said business during the time specified; but they do not engage to want and quantity whatever. They do not even engage to continue their business. If they see fit to discontinue it on the very day on which the supposed agreement is entered into, they are at liberty to do so at their own option, and, whatever might have been defendant's expectations, he is without remedy. In other words, there is no absolute engagement on plaintiffs' part to "want" and, of course, no absolute engagement to purchase any iron of the defendant.

Without such absolute engagement on plaintiffs' part, there is no "absolute mutuality of engagement," so that the defendant "has the right at once to hold" plaintiffs "to a positive agreement."

Upon these grounds we are of the opinion that the testimony excluded was properly excluded, since it did not tend to establish a valid contract on the part of the defendant, and was therefore immaterial.

This case may be looked at from another point of view with like results. Plaintiffs' promise was the sole consideration for defend-

ant's promise. To be a sufficient consideration it is necessary that plaintiffs' promise be a benefit to defendant or an injury to plaintiffs. But so long as, for the reasons before given, plaintiffs are not bound to do anything by virtue of their promise, the promise cannot be such benefit or injury.

Judgment affirmed.

A. F. SAVAGE et al., Appellants v. MARKEY MACHINERY CO., Respondent

1924, 128 Wash. 433, 223 Pac. 2.

The purpose of this action was to recover for the breach of an alleged express warranty in the sale of a second hand donkey engine. The trial resulted in a judgment dismissing the action, from which the plaintiffs appeal.

It appears that the engine was sold to the plaintiffs without express warranty, after inspection by their agent, who was an expert in steam and gasoline engines. A bill of sale made a week later and after the machine had been delivered and paid for recited that it was in first class condition, which was untrue.

MAIN, C. J. To support this bill of sale no new consideration passed. As to the reason for its being given, the testimony is in dispute. It was taken in the name of Mrs. A. F. Savage, who apparently had advanced money to the paying (purchasing) company. The fact that it is recited in the bill of sale that the rig was in first class condition does not therefore furnish a basis of liability.

Judgment affirmed.

PITTMAN v. ELDER

1886, 76 Ga. 371.

In 1864 Richard Pittman gave Asenath Pittman a note for $4,200 for money borrowed. In 1881, the note being unpaid, Richard Pittman indorsed on it, "I hereby renew within note with interest." In 1885 the holder of the note sued Richard Pittman.

HALL, J. The question made is whether a debt coming within the limitation act of March 16, 1869, which not only bars the right of action, but extinguishes the debt, can be revived by a new promise in writing made after the lapse of the period in which the act prescribes for the bringing of the suit, without an additional consideration for the promise. The court held indebtedness, which had never been paid to the owner of the claim, was a sufficient consideration to support the promise and to entitle the plaintiff to her action; and such have been the rulings of this court in cases strictly analogous, as where the party making the promise has

been discharged from liability by a final certificate in bankruptcy. Weatherly v. Hardman, 68 Ga. 592.

. . . The liability . . . on promises of this class . . . is now based exclusively on the right of a party to waive the protection of a statute relieving him from indebtedness. "Where the consideration was originally beneficial to the party promising yet if he be protected from liability by some provision of the statute or common law meant for his advantage, he may renounce the benefit of that law; and if he promises to pay the debt, which is only what an honest man ought to do, he is then bound by the law to perform it," was said by the entire court in Earle v. Oliver, 2 Ex. R. 90.

Judgment for plaintiff.

NILSSON et al. v. KIELMAN et al.

1945, (S.D.) 17 N.W.(2) 918.

Action against Ethel E. Kielman and L. T. Nilsson on a note. The note matured in 1926 and the statute of limitations had run against it unless certain payments indorsed thereon had extended the life of the note. One payment resulted from the sale of certain property pledged as security and a second payment was the result of the collection of a note which had been assigned as collateral. Ethel E. Kielman made no payments and the security for the note had been given plaintiff many years before the money was realized and the credit given on the note.

ROBERTS, J. . . . It appears from the provisions of SDC33.0213 that an acknowledgment or promise to be effectual to interrupt the running of the statute of limitations must be in writing and signed by the party to be charged, but this requirement does not alter or take away the effect of a part payment. It is the settled law of this state that a part payment to be effectual to interrupt the running of the statute must have been made voluntarily and must have been made and accepted under circumstances consistent with an intent to pay the balance. . . . Payments made by a joint debtor bind only the person making the payments and do not operate to interrupt the running of the statute as to the other debtors not participating or acquiescing in the payments. . . . The principle on which part payment operates to take a debt without the statute is that the debtor by the payment intends to acknowledge the continued existence of the debt.

The agreement with reference to the amount of credit on January 19, 1940, constitutes neither a new promise in writing nor a part payment as of that date. It is the fact of voluntary payment made by the debtor and not entry of credit that interrupts the running of

the statute. Nor did the collection of the account amounting to $74.40 give new life to the debt. Plaintiffs were authorized to collect the accounts and apply the proceeds to payment of the debt, but this did not have the same effect as if made personally by the defendants. There is no vital distinction between such a case and one where money received by the payee of a note from collateral security such as notes and mortgages of third parties pledged by the maker is credited on the principal note. Such payment does not interrupt the running of the statute. . . . The underlying reason for the doctrine is that a creditor is not an agent of the debtor to such an extent as to make an act done by him in the name of the debtor operate as a new promise to himself without which element the payment cannot operate to interrupt the statute.

Judgment for defendant affirmed.

Chapter IV

VOID AND VOIDABLE CONTRACTS

McGUCKIAN v. CARPENTER
CARPENTER v. McGUCKIAN

1920, 49 R.I. 94, 110 Atl. 402.

McGuckian sold to Carpenter—a minor—a horse, wagon, and harness and received part payment in cash, with notes for the balance. Carpenter sold the wagon and harness, but because of the condition of the horse it became necessary to kill it. McGuckian desires to recover on the notes, while Carpenter is attempting to recover the money paid, although he is unable to return any of the property purchased. McGuckian contends that the contract may not be disaffirmed without a return of the consideration.

SWEETLAND, C. J. . . . In support of these exceptions before us counsel for McGuckian has called to our attention the opinion of courts in some jurisdictions that in all cases an infant, on his avoidance of an executed contract, must return the property or consideration received before he can maintain his action for the money or property which he gave in the transaction, and, if he has disposed of the money or goods or has so misused them that he cannot restore them, then he cannot be permitted to disaffirm the contract. These cases are based on the consideration that minors should not be permitted to use the shield of infancy as a cover for dishonesty and the doing of injury to others dealing with them in good faith. We do not find that this court has passed upon the exact question involved in this exception. We are of the opinion that, when an executed contract is not one for necessaries, an infant should be permitted to disaffirm it and recover the consideration moving from him, and should be required on his part to return the consideration that remains in his hands; but, if he has dissipated the consideration or lost it, or for any reason he is unable to restore it to the other party, he none the less should be permitted to disaffirm the contract and recover back the consideration moving from him. The law gives to a minor the right to disaffirm his contracts on the ground of the disability of infancy. This has been provided as a protection to him from the consequences of his own improvidence and folly. . . .

Not infrequently, even in cases where the infant still has the consideration and returns it to the other party to the contract, such other party is far from being placed in statu quo. It has been said

that the right of an infant to avoid his contract is absolute and paramount to all equities.

The view which we have taken appears to us to have the support of the weight of authority. . . .

Judgment for Carpenter.

JOSIAH BOYDEN v. WILLIAM BOYDEN and Another

1845, 9 Metc. (Mass.) 519.

Assumpsit for goods sold and delivered. The plaintiff received a note for $44 in payment of a horse and plow sold to the defendants. The defendants at the time were minors. The horse was traded for another one after one of the minors became of age. The plow was retained without any attempt to return it for three years after both minors had become of age.

SHAW, C. J. . . . Some points seem to be well settled. If a minor gives a written promise for the purchase money for goods sold to him by an adult person, the contract is voidable and not void, and may be ratified by the infant, after coming of age. . . . It is also well settled that it is the privilege of the minor only to disaffirm the contract, and, until he does so, the other party is bound by it. The minor, when of age, may regard it as beneficial, and choose to affirm it. . . . If the minor refuses to pay the price, as he may, the contract of sale is annulled, and the goods revest in the vendor. . . . But until some notice given by the purchaser after becoming of age, of his purpose to annul the contract, or some significant act done, the vendor cannot reclaim his property, and his taking it would be a trespass. If, therefore, the minor purchaser, after coming of age, retains the specific property, treating it as his own, when it is in a condition to be restored and it is of any value, and if, for an unreasonable time, he neglects to restore it, or to tender it, or give notice of his readiness to restore it, according to the circumstances of the property and of the parties, it manifests his determination to keep the property and affirm the contract. And further; if, after coming of age, he retains the property for his own use, or sells or otherwise disposes of it, such detention, use or disposition—which can be conscientiously done only on the assumption that the contract of sale was a valid one, and by it the property became his own—is evidence of an intention to affirm the contract, from which a ratification may be inferred.

Judgment for plaintiff affirmed.

MARY E. GREGORY v. FRANK LEE

1894, 64 Conn. 407, 30 A. 53.

TORRENCE, J. . . . It thus appears that the defendant, a minor (a student at Yale College), agreed to hire the plaintiff's room for forty weeks at ten dollars per week, and that he entered into possession and occupied it for a part of said period; that he gave up and quit possession of the room and refused to fulfill said agreement on the 20th of December, 1892, paying in full for all the time he had occupied it. . . .

Under the facts stated, it must be conceded that this room at the time the defendant hired it and during the time he occupied it, came within the class called "necessaries," and also that to him during said period it was an actual necessary; for lodging comes clearly within the class of necessaries, and the room in question was a suitable and proper one, and during the period he occupied it, was his only lodging room. "Things necessary are those without which an individual cannot reasonably exist. In the first place, food, raiment, lodging and the like. About these there can be no doubt. . . ."

The question now is whether he is bound to pay for the room after December 20, 1892. The obligation of an infant to pay for necessaries actually furnished to him does not seem to arise out of a contract in the legal sense of that term, but out of a transaction of a quasi-contractual nature; for it may be imposed on an infant too young to understand the nature of a contract at all. . . . And where an infant agrees to pay a stipulated price for such necessaries, the party furnishing them recovers not necessarily that price but only the fair and reasonable value of the necessaries. . . . This being so no binding obligation to pay for necessaries can arise until they have been supplied to the infant; and he cannot make a binding executory agreement to purchase necessaries. . . .

Judgment for defendant.

JOHN DAVIS v. LEWIS H. CALDWELL

1853, 12 Cush. (Mass.) 512.

Action on an account for family groceries amounting to $41.31. The defense was infancy. Although the defendant was married, it appears that he was under guardianship, with his property under the guardian's control. In the agreed statement of facts it did not appear that the guardian had failed or refused to provide the essentials of life.

SHAW, C. J. . . . But it is also conceded, on the other side, that the defendant was under guardianship, and had property in the

hands of his guardian, and that known to the plaintiff; but of what nature, to what amount, whether the guardian consented or declined to apply the property of the ward to his necessary support, does not appear, but these are all important in determining the question, whether the articles were necessaries or not. The term "necessaries," in this rule of law, is not used in its strictest sense, nor limited to that which is required to sustain life. That which is proper and suitable to each individual, according to his circumstances and condition in life, are necessaries, if not supplied from some other source. But when suitable provision is made, by a parent or guardian, or where, from any source, the wants of a minor are supplied, articles furnished by a trader to the minor, on his own credit, are not necessaries, and of this the trader must take notice and inform himself.

From this view it necessarily follows, that in most cases, the question, whether articles furnished are necessaries or not, is a question of fact for the jury, depending on the circumstances; and the two principal circumstances are, whether the articles are suitable to the minor's estate and condition, and whether he is, or not, without other means of support. . . .

Retrial ordered.

RICE v. BOYER

1886, 108 Ind. 472, 9 N.E. 420.

Action to recover the value of a buggy and set of harness sold to the defendant while he was yet a minor. The defendant gave a note and mortgage in payment, but later repudiated the mortgage by selling the property. In order that he might purchase the property, the defendant represented that he was twenty-one years of age.

ELLIOTT, C. J. . . . The material and controlling question in this case is this: Will an action to recover the actual loss sustained by a plaintiff lie against an infant who has obtained property on the faith of a false and fraudulent representation that he is of full age?

Infants are, in many cases, liable for torts committed by them, but they are not liable where the wrong is connected with a contract, and the result of the judgment is to indirectly enforce the contract. . . . It is evident, from this brief reference to the authorities, that it is not easy to extract a principle that will supply satisfactory reasons for the solution of the difficulty here presented. It is to be expected that we should find, as we do, stubborn conflict in the authorities as to the question here directly presented, namely, whether an action will lie against an infant for falsely representing himself to be of full age. . . .

Our judgment, however, is that, where the infant does fraudulently and falsely represent that he is of full age, he is liable in an action ex delicto for the injury resulting from his tort. This result does not involve a violation of the principle that an infant is not liable where the consequence would be an indirect enforcement of his contract; for the recovery is not upon the contract, as that is treated as of no effect, nor is he made to pay the contract price of the article purchased by him, as he is only held to answer for the actual loss caused by his fraud. In holding him responsible for the consequences of his wrong, an equitable conclusion is reached, and one which strictly harmonizes with the general doctrine that an infant is liable for his torts.

Judgment for plaintiff.

GEORGE R. NEWELL v. A. E. RANDALL

1884, 32 Minn. 171, 19 N.W. 792.

Action of replevin to recover certain property. Defendant denies plaintiff's ownership and asserts that he took the goods on an attachment from one Bauman. The plaintiff alleges that he was induced to sell the goods to Bauman on credit by reason of false and fraudulent representations concerning the latter's credit. Bauman desired to purchase of plaintiff's agent, and was told he must first indicate "how he stood." Bauman stated in response that he "had three thousand dollars in his business, consisting of merchandise and book-accounts, and that he had three hundred dollars in cash." He neglected, however, to state that he was indebted in his business to the extent of $2,100. Goods were sold on credit as a result of the statement.

MITCHELL, J. . . . It is earnestly contended that this evidence is insufficient to establish plaintiff's allegation that Bauman obtained the goods by fraud, that he was not inquired of as to his debts; and that no duty was imposed upon him to make a voluntary statement in regard to them. It is doubtless the general rule that a purchaser, when buying on credit, is not bound to disclose the facts of his financial condition. If he makes no actual misrepresentations, if he is not asked any questions, and does not give any untrue, evasive, or partial answers, his mere silence as to his general bad pecuniary condition, or his indebtedness, will not constitute a fraudulent concealment. . . . But this was not a case of mere passive nondisclosure. The object of De Laittre's (the agent's) inquiry clearly was to ascertain Bauman's financial condition and ability to pay. Bauman's statement was in response to that inquiry and when he undertook to answer he was bound to tell the whole truth,

and was not at liberty to give an evasive or misleading answer which, although literally true, was partial, containing only half the truth and calculated to convey a false impression. . . . To tell half a truth is only to conceal the other half. Concealment of this kind, under the circumstances, amounts to a false representation.

Judgment for plaintiff.

GUARANTY SAFE DEPOSIT & TRUST CO. v. LIEBOLD

1904, 207 Pa.St. 399, 56 Atl. 951.

This was an action of ejectment. It appears that Liebold gave to the plaintiff an option to purchase a portion of his hotel for $15,000. The plaintiff exercised the option and tendered the proper sum to defendant, who refused it. It further appears that at the time the agreement was made a rumor was prevalent that a large factory was to be located in the city of Butter, where the property was located. The defendant contends, although the evidence indicated otherwise, that plaintiff had full knowledge that the Standard Steel Car Co. expected to locate there, while his knowledge was indistinct and indefinite.

Brown, J. . . . Suppose Reiber (acting for the plaintiff) had known definitely that the plant was to be established in Butter and Liebold had been ignorant of this, was it the duty of the former to disclose such information to the latter, and can it be that, without such disclosure, his contract with Liebold is not enforceable in equity? In this commercial age options are daily procured by those in possession of information from which they expect to profit, simply because those from whom the options are sought are ignorant of it. When the prospective seller knows as much as the prospective buyer, options can rarely, if ever, be procured, and the rule that counsel for appellant would have us apply would practically abolish them. . . . If the appellee concealed anything it was his duty to disclose, or said anything to mislead or deceive the appellant, this rule, of course, would not apply, but they dealt at arms' length, as men always do under such circumstances, each trying to make what was supposed to be the best bargain for himself at the time. This was the right of each of the parties, and on this point the appellant cannot be heard to complain. . . .

Judgment for plaintiff.

KUELLING v. RODERICK LEAN MFG. CO.

1905, 183 N.Y. 78, 75 N.E. 1098.

The plaintiff purchased from a retail implement dealer a horse-drawn road roller for use on his farm. A defective tongue was in-

serted in the machine, the defects consisting of cross-grained material, a large knot in the wood, and a knothole which had been plugged with other wood. These defects were concealed by covering the knotholes with putty, painting the tongue, and installing it with the defective side down.

As a result of the defects, the tongue broke and the team ran away, seriously injuring the plaintiff. He alleges that the manufacturer fraudulently inserted the tongue, and he seeks recovery from the factory rather than from the retail dealer. The lower court ordered a nonsuit in favor of the defendant.

BARTLETT, J. . . . In the case at bar we have, not only fraudulent deceit and concealment, but what amounts to an affirmative representation that the tongue of the roller was sound, as the manufacturer, by filling the defect with putty and painting the entire surface, so that the eye could not detect any weakness by reason of the knot, knot-hole filled up, the kind of wood employed, and the fact that it was cross-grained, must be held to have represented that the roller as offered for sale was in a perfectly marketable condition.

Reversed and remanded for new trial.

CASH REGISTER CO. v. TOWNSEND

1905, 135 N.C. 652.

This is an action to recover the balance of $480 due under a contract for the purchase of a cash register. It was delivered, but the defendant alleged that the purchase was induced by fraudulent representations of the plaintiff's agent. The statements charged against the agent were that the use of the cash register would save the expense of a bookkeeper; that the books could be kept on the machine; and that it would not take half the time to keep the defendant's books as was required without a machine; and that it would save half of one clerk's time.

BROWN, J. . . . The material elements of fraud, as laid down by the text writers, are, first, misrepresentation or concealment; second, an intention to deceive, or negligence in uttering falsehoods with intent to influence the action of the other party. To constitute legal fraud, which will warrant the rescission of a contract there must be a false representation of a material fact. . . . No particular rule can be laid down, as this must necessarily depend upon the facts of each case, the relative situation of the parties, and their means of information. But all the authorities are to the effect that where the false representation is an expression of commendation or is simply a matter of opinion, the courts will not interfere

to correct errors of judgment. . . . The law will not give relief unless the misrepresentation be of a subsisting fact. . . .

What has been called "promissory representation," looking to the future as to what the vendee can do with the property, how much he can make on it, and in this case, how much he can save by the use of it, are on a par with false affirmations and opinions as to the value of the property, and do not generally constitute legal fraud. . . .

Mr. Clark in his work on Contracts states in substance that commendatory expressions or exaggerated statements as to value or prospects, or the like, as where a seller puffs up the value and quality of his goods, or holds out flattering prospects of gain, are not regarded as fraudulent in law. It is the duty of the purchaser to investigate the value of such expressions of commendation. He cannot safely rely upon them. . . .

Judgment for plaintiff.

DONALDSON, Assignee v. FARWELL et al.

1876, 93 U.S. 631.

Action by plaintiff to recover value of certain goods taken by the defendant. The defendant sold goods to one May in April, 1872. At the time, unknown to the defendant, May was hopelessly insolvent. The goods were purchased by the son of May, who testified that his father had been insolvent for three years and that he did not expect his father to pay for them. May expected to sell the goods and pay other creditors. The defendant later discovered the insolvency and recovered possession of some of the goods the day before May was adjudicated a bankrupt. The assignee in bankruptcy claims the property, but the defendant insists that it had a right to rescind because of fraud and that its possession of the property was proper.

DAVIS, J. The doctrine is now established by a preponderance of authority, that a party not intending to pay, who, as in this instance, induces the owner to sell him goods on credit by fraudulently concealing his insolvency and his intent not to pay for them, is guilty of a fraud which entitles the vendor, if no innocent third party has acquired an interest in them, to disaffirm the contract and recover the goods. . . . Here the vendors exercised the right of rescission shortly after the sale in question, and as soon as they obtained knowledge of the fraud.

The court held that the assignee appointed in bankruptcy proceeding was in no better position than May and affirmed a judgment in favor of the defendant.

STATE STREET TRUST CO. v. ERNST et al.

1938, 278 N.Y. 104, 15 N.E.(2) 416.

This was an action to recover damages sustained through reliance upon an alleged misrepresentation made by defendants in a certified balance sheet. The defendant conducted an audit of Pelz-Greenstein Company with full knowledge of the fact that it was to be used as a basis of credit. The audited concern was engaged in financing purchases of merchandise and raw materials for manufacturers, and accepted inventories and accounts receivable as security. It is thus made clear that the financial position of Pelz-Greenstein Company was entirely dependent upon the ability of its debtors to sell their products and to collect their accounts. The accountants issued ten copies of a certified balance sheet unaccompanied by any letter of explanation, and the plaintiff extended credit to Pelz-Greenstein as a result. The plaintiff was unable to recover the money loaned, bankruptcy having intervened, and insisted that several items in the balance sheet were improperly stated. The lower courts gave judgment for the defendant.

FINCH, J. . . . With the certified balance sheet defendants issued the following certificate:

> We hereby certify that we examined the books of account and record pertaining to the assets and liabilities of Pelz-Greenstein Co., Inc., New York City, as of the close of business December 31, 1928, and, based on the records examined, information submitted to us, and subject to the foregoing notes (not here material), it is our opinion that the above condensed statement shows the financial condition of the company at the date stated and that the related income and surplus account is correct.

To what extent may accountants be held liable for their failure to reveal this condition? We have held that in the absence of a contractual relationship or its equivalent, accountants cannot be held liable for ordinary negligence in preparation of a certified balance sheet even though they are aware that the balance sheet will be used to obtain credit. Ultramares Corporation v. Touche, 255 N.Y. 170, 174 N.E. 441, 74 A.L.R. 1139. Accountants, however, may be held liable to third parties, even where there is lacking deliberate or active fraud. A representation certified as true to the knowledge of the accountants when knowledge there is none, a reckless misstatement, or an opinion based on grounds so flimsy as to lead to the conclusion that there was no genuine belief in its truth, are all sufficient on which to base liability. A refusal to see the obvious, a failure to investigate the doubtful, if sufficiently gross, may furnish evidence leading to an inference of fraud so as to im-

pose liability for losses suffered by those who rely on the balance sheet. In other words, heedlessness and reckless disregard of consequence may take the place of deliberate intention. . . .

The defendants, however, contend that they may escape all liability by insisting that the balance sheet merely purported to reflect the condition of the books and that it did this correctly. The balance sheet, however, did not correctly reflect the condition of the company even as shown by the books, as will later appear. Nor is the duty of an accountant in preparing a balance sheet confined to a mere setting up of the items from the books. . . .

The record is, indeed, replete with evidence, both oral and documentary, to make a prima facie case against the defendant. In the first place, we have these accountants guilty of an act which is the equivalent of active misrepresentation. On April 2, 1929, they sent to Pelz-Greenstein the certified balance sheet, with ten additional copies, knowing that it was to be used to obtain credit. . . . Not until thirty days later did the accountants send Pelz-Greenstein a letter of explanation of this balance sheet, and then apparently only one copy. . . . The above act of the accountants, in placing in circulation a certified balance sheet which they practically conceded should not be used without knowing the scope of the examination set forth in the covering letter, and then only one copy, whereas there had been ten copies of the certified balance sheet issued, was itself gross negligence and an important piece of evidence raising an inference of fraud. The certified balance sheet, outside of capital, showed a small surplus of $83,000. According to the evidence and the reasonable inferences deductible therefrom, a jury might have found that instead of a surplus of $83,000 the balance sheet should have shown a deficit and an impairment of capital of over half a million. A jury could also have found that in addition over $768,000 of its commission accounts were in a condition indicating the likelihood of substantial losses. . . .

Upon all the evidence it cannot be said as a matter of law that plaintiff has failed to make out a prima facie case against defendants.

The judgments should be reserved and a new trial granted, with costs in all courts to abide the event.

FRASER v. GLASS

1941, 311 Ill. App. 336, 35 N.E.(2) 953.

Dove, J. . . . From the pleadings and evidence, it appears that appellee was injured in an automobile accident on Saturday, November 24, 1934, while riding in a car driven by her husband.

There was a collision between it and a car driven by Algernon Glass (referred to in the record as Al Glass), who was insured in the Inter-Insurance Exchange of the Chicago Motor Club. Her injuries consisted of bruises about the lower extremities, scratches on the leg, a large bruise on the right hip, and a cut to the bone on the knee about an inch and a half long, requiring sutures. Whether Dr. Williams, who treated appellee for her injuries, was called by the implied authority of Glass is in dispute, but we regard that question as not being determinative of any issue presented. The complaint charges misrepresentation of appellants, or mutual mistake, as to the extent of her injuries. The proofs show a mutual mistake.

Two days after the accident a claim adjuster of the Inter-Insurance Exchange called at the Fraser home to determine its liability and the feasibility of a settlement, but nothing was accomplished. He testified that Mr. and Mrs. Fraser said they would not be ready to settle until near the end of the week. On the following Friday, six days after the accident, a Mr. Glenn (since deceased), another adjuster for the Inter-Insurance Exchange, called at the Fraser home. Appellee and her husband testified he said he had a lot of business and was in a hurry. Mr. Fraser told him his car repairs would cost $102. At Glenn's suggestion, Fraser called Dr. Williams by telephone, and they both talked with the doctor about the extent of appellee's injuries and the amount of his bill. Appellee's leg began to swell immediately after the accident and gradually grew worse. At the time the release was signed, the cut on the knee had not healed, and appellee was experiencing pain. The leg was swollen to the ankle. In walking around the house she used a rope looped around her foot and held in her hand to prevent pulling on the cut. She had to be helped up and down stairs. Dr. Williams had treated her four or five times, and on or before the time of the settlement, told her her disabilities would be of a minor character. Dr. Williams testified that the adjuster informed him in the telephone conversation of the pending settlement and that they would like to know the amount of his bill. Dr. Williams told Fraser his wife was getting along all right; that he expected she would be around in a few days, and he did not think he would have to call again. Glenn then talked with the doctor, and thereafter told appellee and her husband the injuries would be superficial and would not trouble her very much, indicating he got the information from the doctor. The doctor fixed his fees at $15. A settlement of $150 was then agreed upon. Appellee and her husband testified it was agreed that $102 was allocated for car repairs; $15 for doctor bill, and $33 to appellee for loss of time from her business of soliciting hosiery orders. . . .

After the settlement appellee's condition became worse. On the following Tuesday, Dr. Williams was again called, and came two or three times after that. An infra-red light was used two or three times each day. Appellee's condition continued to grow worse and Dr. Shreffler was called about the latter part of December or the first part of January. The knee cut had healed, but he found an extensive blood clot in the superficial vein of the right leg, which was quite swollen. The clot could be easily felt along the vein. The treatment prescribed was the elevation of the leg and ice packs along the area involved. This was continued about ten weeks, during which time appellee remained in bed. Dr. Shreffler testified the presence of an infection accounted for the clot; that the symptoms are the presence of the clot itself and the swelling of the leg he found at that time; that the clot or swelling could cause pain and suffering. Apellee testified there was another clot in her other leg and Dr. Shreffler testified it came from the accident. Dr. Williams testified he was honestly mistaken in his judgment as to the extent of her injuries on the date of the settlement, and corroborated appellee's testimony that after the settlement he told her he had made a mistake in her case. . . .

It has been held that the statement that the releasor "would be all right in 30 days," Atchison, Topeka & Santa Fe R. Co. v. Peterson, 34 Ariz. 292, 271 P. 406, 407, and the statement that the releasor was "pretty well along toward being cured," Granger v. Chicago, M. & St. P. R. Co., 194 Wis. 51, 215 N.W. 576, 577, were statements of a past or present fact. Under the facts shown in this record the mistake was clearly as to an existing fact, i.e., appellee's condition at the time of the settlement. The mistake was not as to whether blood clots would develop, but was as to the seriousness of the infection then present. Appellee relied upon the statements of the doctor, and there is nothing to indicate she was not justified in so doing, or was negligent in not calling another doctor less than a week after the accident. She was in no better position to know the pathology connected with her condition than appellants. It is not enough to prevent relief in case of mutual mistake that the party might, had he done all within his power, have ascertained the truth but only reasonable diligence is required. Winkelman v. Erwin, 333 Ill. 636, 165 N.E. 205; Hoops v. Fitzgerald, 204 Ill. 325, 68 N.E. 430; Barker v. Fitzgerald, 105 Ill. App. 536.

A court of equity may grant cancellation where the party requesting it has entered into a contract without negligence, through a material mistake of fact, when it can do so without injustice to the other party. The fact concerning which the mistake was made

must be material to the transaction and effect its substance, and must not result from the want of such care and diligence as would be exercised by persons of reasonable prudence under the same circumstances, and to warrant cancellation the evidence must be clear and positive. Smuk v. Hryniewiecki, 369 Ill. 546, 17 N.E.2d 223, and cases there cited. The rule puts the burden upon the person seeking cancellation to show the mistake by clear and positive evidence, but no more than that is required. Winkelman v. Erwin, supra; Munnis v. Northern Hotel Co., 237 Ill. App. 50.

The mutual mistake in the instant case is not only proved by clear and convincing evidence, but it is not questioned by appellants except by the untenable assertion that it was a mistake as to the future. As the suit is based upon a mistake as to appellee's condition at the time the settlement was made, and not upon whether blood clots were then present, it makes no difference whether they were then present, either in an initial or an advanced stage.

Judgment for plaintiff.

SLADE v. SLADE et al.

1941, 310 Ill. App. 77, 33 N.E.(2) 951.

This was a tort action to recover damages growing out of alleged business duress. The plaintiff's husband and his brother, the defendant, were owners of the stock of a certain corporation. They had entered into an agreement whereby the survivor was entitled to purchase the stock of the deceased according to certain terms. It was alleged that the plaintiff, after her husband's death, had very little income and that he owned only stock in this corporation and certain other stock which was pledged to secure a debt of this particular corporation. The defendant being desirous of purchasing said stock as cheaply as possible refused to have the corporation pay the debt and effect a release of the other stock. It was also alleged that he made numerous bookkeeping entries to show the plaintiff's interest was worth much less than it appeared to be and that he failed to purchase the stock in accordance with provisions of the contract entered into between the brothers but offered a sum much less than the stock was worth. He did all of these things, so it was stated, knowing that the plaintiff would soon be without funds upon which to subsist. She was thus finally persuaded to sell the stock for much less than its value. She also lost money on the stock which was pledged as collateral. She brought suit to recover damages suffered because of the defendant's conduct on the theory that

it constituted duress. The lower court dismissed the plaintiff's complaint and she appeals.

HEBEL, J. . . . The plaintiff, in considering the law as applied to the facts, urges that the rule of duress and coercion applies, and we quite agree with the suggestion of plaintiff that the law is, as stated in 13 C.J. 402, 17 C.J.S., Contracts, § 175, that: ". . . the question of duress is one of fact in the particular case, to be determined on consideration of the surrounding circumstances, such as age, sex, capacity, situation and relation of the parties; and that duress may exist, whether or not the threat is sufficient to overcome the mind of a man of ordinary courage, it being sufficient to constitute duress that one party to the transaction is prevented from exercising his free will by reason of threats made by the other, and that the contract is obtained by reason of such fact." In the same citation, page 403 (17 C.J.S., Contracts, § 177), it is further said: "Where the parties are not at arm's length, but one of them is in a position to dictate, the courts will treat agreements which are influenced by threats of injury to, or the withholding of, property as made under duress, as where a banker refuses to honor a customer's check unless he accedes to a false and fraudulent claim; where one with the necessary power threatens to prevent the clearance of a vessel; where a gas or water company refuses to furnish gas until a promise which it has no right to exact is made; where a state institution refuses to admit a student unless a payment of an illegal fee is made by him; and other like cases." . . .

Under the provisions of the will of Samuel Slade, plaintiff succeeded to the ownership of such high grade and valuable stockholdings as 375 shares of Union Carbide & Carbon Corporation stock, 32 shares of Westinghouse Electric Company stock, 65 shares of Wm. Wrigley, Jr., Corporation stock, 50 shares of Chicago Corporation stock, and 40 shares of Electric Household Utilities Corporation stock, which stocks were pledged to Continental Illinois National Bank & Trust Company as collateral to secure an indebtedness of Slade, Hipp & Meloy, Inc., the stock of which corporation is now in question. Plaintiff urges that, having elected to exercise the stock option, Dana Slade was obliged to post other collateral for the company's indebtedness, and thus enable plaintiff to dispose of her stock which was pledged as collateral for said indebtedness. Plaintiff urges that by the allegations in the complaint Dana Slade's purpose would have been hindered, and not served, had plaintiff been given free access to the pledged collateral, and that he, therefore, failed to free the collateral, with the result that she was unable to reduce the stock to her possession until after she sold the Slade,

Hipp & Meloy, Inc., stock to the defendant, Dana Slade; and that the only purpose for said defendant's wilful failure to release the pledged stock was to oppress the plaintiff; and that, after considering all of the facts alleged in the amended complaint, plaintiff was obliged because of her impoverished condition to accept Dana Slade's terms for the sale of the stock, whether reasonable or not....

It further appears as alleged that Dana Slade prevented plaintiff from exercising her rights of stock ownership, that he voted her shares in his own name, and it is urged by plaintiff that this with his other actions must all be recognized as means of harassing and coercing plaintiff into action which would otherwise have been unacceptable to her. The contract of February 2, 1932, must be deemed to have been executed primarily for the benefit of the surviving brother, and was essentially a recognition that the business, although in corporate form, was actually a joint enterprise of the two brothers, the purpose of the contract being to give the surviving brother an absolute continuing option to determine whether the business should become his alone or one in which others might have a part. The stock was not susceptible to valuation by the ordinary market influences of supply and demand, and the continuing option provision of the contract made the stock virtually unsalable to anyone except a party to the agreement.

On February 2, 1932, Samuel Slade, Dana Slade, Ida Slade, wife of Dana, and plaintiff were the owners of all the shares of stock of this corporation, and subsequent to the death of Samuel Slade, on February 16, 1936, the defendant, Dana Slade, notified plaintiff on December 18, 1936, of his election to purchase her stock for the price and upon the terms set forth in the contract. During the time between the death of her husband and the time when she sold her stock to defendant, Dana Slade, excepting the receipt of dividends of $1,264 in 1937, $950 in 1938, and $395 from the sale of certain stocks, plaintiff had no income after the lapse of one year after her husband's death.

It appears that the plaintiff requested defendant, Dana Slade, to effect a release of the stock that was pledged for the liability of the Slade, Hipp and Meloy, Inc., that he neglected to meet with this request, and that plaintiff was unable to reduce the pledged stock to her possession until late in the month of December, 1938, being two years from the date of the notice of Dana Slade that he would purchase the stock in question. During this period, the stock depreciated in value approximately to the amount of $9,000 at the date when the stock was in fact released to the plaintiff. Plaintiff is seeking to recover this amount. It would appear from the facts al-

leged in the pleadings that the delay in the settlement of the matter that existed between the plaintiff and defendants was caused by the acts of the defendant, Dana Slade, in order—as alleged—to decrease the value of the holdings of Samuel Slade. Under the allegations made, the matter was proper to submit to a jury.

Reversed and remanded for new trial.

CHAPTER V

UNENFORCEABLE CONTRACTS

TOOKER v. INTER-COUNTY TITLE GUARANTY AND MORTGAGE CO.

1946, 295 N.Y. 386, 68 N.E.(2) 179.

Section 116 of the Banking Laws of New York requires that every director of a bank shall own at least ten shares of its stock having a par value of not less than $1,000. In order to qualify as a director of the Flora Park Bank, Tooker purchased ten shares of stock from the defendant at a price of $5,000, the latter agreeing to repurchase the stock at a price not less than that amount at any time the plaintiff ceased to be a director. The bank failed and the plaintiff resigned as a director and sought to recover the purchase price of his stock. The defendant contends that the contract is illegal, being contrary to public policy.

LOUGHRAN, C. J. . . . The plan that underlies this text of section 116—and every other provision of the Banking Law—has long been well known. "The prime object is to protect the public, including depositors, and after that to enable the stockholders to secure a fair return from their investment. Banking institutions are not created for the benefit of the directors." Vann, J., in People v. Knapp, 206 N.Y. 373, 383, 99 N.E. 841, 845, Ann.Cas. 1914B, 243. To that end, section 116 requires every director of a banking institution to share its business risks to the extent of undiluted ownership of the prescribed amount of its stock. . . . It is material, then, to inquire whether that policy was unduly transgressed by the contract in suit.

Manifestly, the transaction was designed to qualify the plaintiff for election as a director of the bank. Transfer of bank stock for the purpose of so qualifying the transferee is not obnoxious to the statute. Cf. Matter of Ringler & Co., 204 N.Y. 30, 37, 97 N.E. 593, 595, Ann.Cas. 1913C, 1036. But this case does not stop there. The contract in suit inevitably supplied to the plaintiff a means whereby at any time during his directorship he was equipped to free himself in a substantial degree from the chance of financial loss incident to record ownership of his qualifying shares, with the result that his sense of the character of his duty as a director may well have been reduced in like measure. Such an arrangement inher-

ently tended to thwart the public purpose declared by section 116 and, therefore, no cause of action can be founded thereon.

Judgment for defendant.

POPE v. HANKE

1895, 155 Ill. 617.

This is an action upon three notes amounting in the aggregate to $8,881.53. By way of defense it was asserted that they were based upon an illegal consideration.

MacGruder, J. The transaction between the D. P. Grier Grain Company and the appellee were mere speculations upon the future prices of grain. The contracts for the delivery and sale of the grain in the future were not made with the intention that any grain should be received or delivered but with the understanding that each transaction should be settled by the payment of the difference between the contract price and the market price at the time fixed. It is well settled, that all such contracts are mere wagers or gambling contracts, and are void. . . . In Crawford v. Spencer, 92 Mo. 498, the Supreme Court of Missouri said, "The law is now settled that a sale of goods to be delivered in the future is valid, such a contract is valid though there is an option as to the time of delivery, and though the seller has no other means of getting them than to go into the market and buy them; but if, under the guise of such a contract, valid on its face, the real purpose and intention of the parties is merely to speculate on the rise or fall of prices, and the goods are not to be delivered, but the difference between the contract and market price only paid, then the transaction is a wager and the contract is void."

Judgment for defendant.

SANFORD et al. v. KANE

1890, 133 Ill. 199, 24 N.E. 414.

Kane filed a bill to redeem his property from a mortgage. A question was then presented concerning the amount required to pay the mortgage debt, usury being involved.

Shope, C. J. . . . It is conceded that Kane received only $475 of the $500 for which the note and mortgage were given. Sanford contends that the $25 retained by him out of the loan was not usury, but was commission paid him by Kane for procuring the loan. Undoubtedly, a broker, negotiating loans in good faith for others, may charge the borrower commission without rendering the loan, at full rate of legal interest, usurious. . . .

The question here made is one of fact. Was the loan made by

Sanford or by Whittlesey? Looking at the papers executed by the Kanes, and the acts of the parties, the conclusion that it was in fact made by Sanford seems irresistible. He took the note and mortgage to himself, and furnished the money by his draft, long before the assignment to Whittlesey. The transaction was evidently one not infrequent, where a loan is taken at a high rate of interest, and subsequently sold to investors of money. If Sanford in fact made the loan, he could not divest the transaction of the taint of usury by afterwards selling the note and mortgage to Whittlesey.

INLAND COMPRESS CO. v. SIMMONS

1916, 59 Okla. 287, 159 Pac. 262.

Action by Simmons to recover from Inland Compress Co. for damages to cotton, which resulted from the negligence of the defendant's agents.

HOOKER, C. J. . . . About the only question presented by this appeal is whether the cotton ticket executed by the company and delivered to the plaintiff at the time the cotton was delivered by him to the company . . . is a legal contract and enforceable in the courts of this state, it being contended by the plaintiff in error that the cotton ticket did constitute a contract, and that under the terms of the contract it is not liable for loss by damage, fire, flood, or other agencies unless by the wilful act or gross negligence. . . .

It is universally agreed and acceded to in this state that common carriers, on account of the relation that they occupy towards the public and the duty they owe the public generally, are prohibited by law from contracting against their own negligence. The reason for this requirement is apparent, and it would seem that the same cause which prohibits contracts of this character from being made by a common carrier would likewise prohibit contracts of like nature from being made by other enterprises which serve the public and which conduct and carry on a large and important part of the public business, which business is essential to the commercial life of the people of the state. . . .

In this state cotton occupies such an important relation to the business life of the people of the state, and cotton compresses perform such an important duty to the general public, that it may be said that courts take judicial knowledge of the fact that compresses are in their nature, or rather, in a sense, quasi public institutions. In fact the business of compressing cotton by reason of its nature, the extent and the necessity therefor, is such that the public must use it, and it is of such public consequence, and affects the community at large to such an extent, that it is a public business, and

as such should not be permitted to relieve itself from liability by contracts of the kind involved here.

Judgment for plaintiff affirmed.

BRILSON v. MOFFATT et al.

1916, 173 Cal. 685, 161 Pac. 259.

Suit by Brilson to quiet title. The court found plaintiff and his predecessors had had exclusive possession of the property and paid all taxes assessed against it for over 20 years. The only interest claimed by Moffatt was under a mortgage and note dated March 5, 1887. The mortgage was not paid or released. In 1890 Moffatt had attempted to foreclose, but had been denied this right because the court found the note to be based upon an illegal contract. The lower court adjudged that under the circumstances the plaintiff was not entitled to have his title quieted.

MELVIN, J. . . . The fact that the consideration was illegal does not take this case from under the operation of the rule. The parties to the foreclosure suit were both violators of a statute, and each was equally at fault. This action should leave them, as did the foreclosure suit, exactly where their mutual violation of the statute placed them. The judgment is affirmed.

BAILEY v. MARSHALL

1896, 174 Pa.St. 602, 34 Atl. 326.

DEAN, J. Whether the debt in controversy be that of him who has assumed to pay it, or of another, is in most cases a question of fact. There can be no precise legal definition of liability under the act which will determine all cases. . . . It is clearly meant to relieve an alleged guarantor or surety. It was never intended to relieve him who had a personal beneficial interest in the assumption. There can be no better construction of this statute than in Nugent v. Wolfe, 111 Pa.St. 480, 4 Atl. 15, where we held that: "It is difficult, if not impossible, to formulate a rule by which to determine in every case whether a promise relating to the debtor liability of a third person is or is not within the statute; but as a general rule, when the leading object of the promise or agreement is to become guarantor or surety of the promisee for a debt for which a third party is and continues to be primarily liable, the agreement, whether made before or after or at the time with the promise of the principal, is within the statute, and not binding unless evidenced by writing. On the other hand, when the leading object of the promisor is to subserve some interest or purpose of his own not-

withstanding the effect is to pay or discharge the debt of another, his promise is not within the statute."

Applying these principles to the facts before us, to what conclusion do they impel us? In September, 1892, Mary E. Bailey held a note against Davis Pennock, in the sum of $1,000 with power of attorney to confess judgment. At this time Marshall, the defendant, entered a judgment against Pennock for $5,000, issued execution, and levied on all the real and personal property of Pennock. The amount actually due and payable on his $5,000 judgment did not exceed as appeared afterwards from his own statement, $200. . . . Just at this juncture, Marshall, knowing her (Bailey's) rights, sent for her, and said, "I will stand by thee, and see thee is paid every cent, if thee says nothing and does nothing." She accepted his proposition, neither entered her judgment, nor took any steps to collect it. . . .

What was the leading object of Marshall in making the promise by which he lured her to inaction? Clearly it was not to pay Pennock's debt, nor Mrs. Bailey's claim. . . . His leading object was to subserve his own interest. In fact, he had no other object. Having accomplished it, he is now called upon to answer not for Pennock's debt, but for his own. . . .

Judgment for plaintiff.

VEEDER, Rec. v. HORSTMANN et al.

1903, 85 N.Y. App. Div. 154.

This was a bill for specific performance of a long-term oral lease on certain real estate.

CHASE, J. . . . The real estate in question was swampy land; it had to be filled in, and the company entered into the possession thereof and proceeded to do the necessary filling at a cost to it of $5,500. About the first of July it commenced the erection of the buildings thereon and subsequently the machinery was placed therein. The buildings so erected were built in a substantial manner upon concrete foundations. They were completed between the 1st and 6th of October, 1901. The expenditure by the company on said real property amounted to about $47,000. From the time said company commenced to fill said land it was in open and notorious possession thereof. . . .

The appellants insist that the contract cannot be enforced for the reason that a lease of real property for a longer period than one year is void, unless the contract or some note or memorandum thereof expressing the consideration is in writing and subscribed by the lessor. . . .

The company not only entered into the possession of the real property under said agreement and remained in the exclusive possession thereof, but expended large sums of money in permanent and substantial improvements. Where improvements are substantial and permanent in character and are such as would not have been made except in reliance on the contract, specific performance will be decreed. Where the circumstances are peculiar and exceptional and where in case the contract is not carried out it will result in a fraud upon some of the parties to the contract, equity should and will lend its aid to defeat the fraud.

Judgment for plaintiff.

WEEKS v. CRIE et al.

1900, 94 Me. 458, 48 Atl. 107.

Assumpsit to recover damages for nondelivery of a quantity of fish. The evidence indicated that the defendant orally agreed to sell to the plaintiff ten barrels of split herring at $4.25 a barrel and at the same interview agreed to sell and deliver three to five hundred drums of hake at $1.65 per kentle when called for. The herring were delivered and paid for, but delivery of the hake was refused. The statute of frauds was interposed to avoid liability, and the lower court ruled that if the two transactions took place at the same interview, only one contract was involved.

SAVAGE, J. . . . The case shows that no memorandum was made, and nothing was given in earnest to bind the bargain; and the defendants claim that no part of the goods sold were accepted and received by the purchaser, so as to bind the defendants to deliver the hake. This last proposition is controverted by the plaintiff, and hereon, as will be seen, the case hinges. . . .

Now, if there were two separate contracts of sale, one for the herring and one for the hake, it is clear that the acceptance and receipt of the herring did not take the contract for the hake out of the statute. . . . The application of the statute of frauds in case of the purchase of a number of articles at the same transaction may depend upon whether there is one contract or more. The mere fact that a separate price is agreed upon for each article, or even that each article is laid aside as purchased, makes no difference so long as the different purchases are so connected in time or place, or in the conduct of the parties, that the whole may fairly be considered as one transaction. Such is the common case of a number of articles purchased at private sale of a shopman, for instance, at the same time, though at separate prices. . . . But whether such negotiations for separate articles result in one entire contract for the

whole, or whether the contract for each remains separate and distinct, may depend upon many circumstances. It raises a question of fact properly to be passed upon by the jury. Were the transactions near in time or place or similar in circumstances? What was the conduct of the parties? . . . What was the language used? What are the proper inferences to be drawn as to the intention of the parties? The answers to these and other like questions solve the problem. . . . We think this [lower court] ruling was erroneous. . . . Whether the negotiations constituted one contract or more was a question of fact, and should have been submitted to the jury.

New trial ordered.

GODDARD v. BINNEY

1874, 115 Mass. 450.

This was an action to recover the contract price of a buggy. The buggy was made according to the peculiar specifications of the defendant and marked with his initials. It was destroyed by fire after completion but before delivery, although notice of its completion had been given the defendant. The contract being oral, and for an amount larger than the statute required, a question arose as to whether the contract fell within the statute of frauds.

AMES, J. Whether an agreement like that described in this report should be considered as a contract for the sale of goods, within the meaning of the statute of frauds, or a contract for labor, services and materials, and therefore not within the statute, is a question upon which there is conflict of authority. According to a long course of decisions in New York, and in some other states of the Union, an agreement for the sale of any commodity not in existence at the time, but which the vendor is to manufacture or put in a condition to be delivered, . . . is not a contract of sale within the meaning of the statute. . . . In England, on the other hand, the tendency of the recent decisions is to treat all contracts of such a kind intended to result in a sale, as substantially contracts for the sale of chattels. . . .

In this commonwealth, a rule avoiding both of these extremes was established in Mixer v. Howard, 21 Pick. 205, 32 Am. Dec. 256, and has been recognized and affirmed in repeated decision of more recent date. The effect of these decisions we understand to be this, namely, that a contract for the sale of articles then existing or such as the vendor in the ordinary course of his business manufactures or procures for the general market, whether on hand at the time or not, is a contract for the sale of goods to which the statute applies.

But, on the other hand, if the goods are to be manufactured especially for the purchaser, and upon his special order, and not for the general market, the case is not within the statute. . . .

Judgment for plaintiff.

COHEN v. ARTHUR WALKER AND COMPANY, Inc.

1922, 192 N.Y. S. 228.

Plaintiff sues to recover damages suffered because defendant failed to ship certain merchandise. A judgment was awarded to defendant on the theory that no proper evidence of the contract was available. The only signature of the defendant on the written memorandum consisted of its printed name in the body of the order for goods, said order having been filled in by the defendant's agent. The lower court gave judgment for the defendant.

LYDON, J. . . . These orders are not signed by the plaintiff, but are on the printed blanks of the defendant, and contain the details of the orders and the printed name of the defendant. The proof shows that these orders were filled out by the defendant and sent to the plaintiff by mail, that thereafter, and during February and March following the receipt of the written orders, the plaintiff spoke to the defendant's vice president several times, and demanded delivery of the goods called for in the orders. . . .

The defendant's answer in setting up the defense of the statute of frauds states that there was no memorandum in writing "subscribed by the defendant in this action, the party to be charged therewith." This misstatement of the requirement of the statute may have led to some confusion on the trial. The present statute of frauds does not require the memorandum to be subscribed by the party to be charged. It is sufficient if that party or his authorized agent signs the same. . . .

It is now well settled that under the present statute of frauds the printed name of the party sought to be charged, at the top or in the body of the memorandum, is sufficient compliance with the statute. . . . The defendant having filled out these orders by its duly authorized officer, Mr. Smith, the vice president, that constituted an appropriation of the printed name of the defendant as its signature for these transactions.

Judgment reversed.

CHAPTER VI

PERFORMANCE OF CONTRACTS

TICHNOR BROS. v. EVANS

1918, 93 Vt. 278, 102 Atl. 1031.

Assumpsit by Tichnor Bros. to recover the amount due for certain post card sets. As part of the consideration the plaintiff agreed not to sell any of them to competitors. Later some were sold to a competitor on the same street. Defendant contends that he is thereby relieved from performing. The lower court deducted $1 as damages and allowed recovery.

POWERS, J. . . . The defense is predicated upon the doctrine, frequently approved by this court, that a breach that goes to the essence of the contract operates as a discharge of it. This rule will not avail the defendant. It is not every breach that goes to the essence. It gives rise to an action for damages, but it does not necessarily justify a refusal to perform. Where, as here, the stipulation goes only to a part of the consideration, and may be compensated for in damages, its breach does not relieve the other party of performance. . . . In order to operate as a discharge or give rise to a right of rescission, the partial failure to perform must go to the very root of the contract. . . .

Judgment affirmed.

BETTINI v. GYE

1876, 1 Q.B. Div. 183.

Plaintiff, a professional singer, agreed to be in London "without fail" six days before the commencement of his engagement to sing in theatres, halls, and drawing rooms. He failed to arrive on scheduled time and the defendant refused to employ him. This is an action to recover damages sustained.

BLACKBURN, J. . . . In the absence of an express declaration, we think that we are to look to the whole contract, and applying the rule stated by Parke, B., to be acknowledged, see whether the particular stipulation goes to the root of the matter, so that a failure to perform it would render the performance of the rest of the contract by the plaintiff a thing different in substance from what the defendant has stipulated for; or whether it merely partially affects it and may be compensated for in damages. Accordingly, as

it is one or the other, we think it must be taken to be or not to be intended to be a condition precedent.

If the plaintiff's engagement had been only to sing in operas at the theatre, it might very well be that previous attendance at rehearsals with the actors in the company with whom he was to perform was essential. . . . But we find, on looking to the agreement, that the plaintiff was to sing in theatres, halls, and drawing rooms, both public and private. . . .

And, as far as we can see, the failure to attend at rehearsals during the six days immediately before the 30th of March could only affect the theatrical performance, and perhaps, the singing of duets or concerted pieces during the first week or fortnight of his engagement, which is to sing in theatres, halls, and drawing rooms, and concerts for fifteen weeks.

We think it does not go to the root of the matter so as to require us to consider it a condition precedent.

Judgment for plaintiff.

SUNSHINE CLOAK & SUIT CO. v. ROQUETTE et al.

1915, 30 N.D. 143, 152 N.W. 359.

The plaintiff brought an action to recover $173.25 alleged to be due for certain ladies' cloaks and coats. The evidence indicated that defendant ordered the goods with the understanding that they were to be shipped by August 15, they being fall goods. They were shipped on September 28 and arrived October 12. They were immediately returned to the plaintiff. Lower court gave judgment for the plaintiff.

CHRISTIANSON, J. It is doubtless true, as appellant contends, that time is never considered as the essence of a contract, unless by its terms it is expressly so provided. . . . But, although it is true that time is never considered as the essence of the contract, unless it is so provided by the terms thereof, still it is not necessary to declare in so many words "that time is of the essence of the contract," but it is sufficient if it appears that it was the intention of the parties thereto that time should be of the essence thereof.

The supreme court of Iowa, in considering this question in Bamberger Bros. v. Burrows, 145 Ia. 441, 450, said: "In the law of sales it is a settled rule that time may be of the essence of the contract; and, when a time for delivery is fixed it is generally so regarded. Therefore, if the seller fails to make delivery on the date so fixed, the buyer may rescind or recover damages for the seller's breach of contract." . . .

In Cleveland Rolling Mill Co. v. Rhodes, 121 U.S. 255, that court

said: ". . . In the contracts of merchants time is of the essence. The time of shipment is the usual and convenient means of fixing the probable time of arrival, with a view of providing funds to pay for the goods, or of fulfilling contracts with third parties." . . . We are satisfied that the agreement to ship on August 15th was a condition precedent.

Judgment reversed.

PRODUCERS' COKE CO. v. HILLMAN et al.

1914, 243 Pa.St. 313, 90 Atl. 144.

This was an action to recover for certain coke sold and delivered. In order to be relieved of a previous contract, under which plaintiff was to deliver its output of coke and by reason of which defendant had contracted to sell a considerable amount, the plaintiff agreed to deliver during the month of July 3,680 tons at $2.379 per ton and 2,124 tons in August, September, October, November, and December each, at the price of $2.345 per ton. The plaintiff fell short 844½ tons in July and delivered none at all in September. This suit was brought to recover for the July delivery. Defendants contend that the contract was entire and no recovery could be had for part performance.

STEWART, J. . . . Where a question of this kind arises, it is the intention of the parties that controls, and not the divisibility of the subject, . . . and this intention is to be collected from the words employed, where the intention can be clearly derived therefrom. When, as understood in their ordinary sense, the words do not disclose the manner and intent to which the parties intended to be bound, resort must be had to rules of construction as aids. . . .

The distinguishing mark of a divisible contract is that it admits of apportionment of the consideration on either side so as to correspond to the unascertained consideration on the other side. Where such a purpose appears in the contract, or is clearly deducible therefrom, it is allowed great significance, when ascertaining the intention of the parties. It is a mistake, however, to suppose that in every case it is conclusive in itself. It is determining only when there are no opposing signs or marks. Where these latter are present it becomes a question of preponderance. . . .

The present is a case in which the manifest purpose of the agreement would be defeated were it held to be a divisible contract, thereby allowing the plaintiff not simply to disappoint the defendants in what it was intended they should receive for a specific and express purpose, but requiring from the defendants payment for so

much performance as met the pleasure, convenience, and advantage of the plaintiff. . . .

Judgment for defendant.

AMBERG GRANITE CO. v. MARINETTE COUNTY et al.

1945, 247 Wisc. 36, 18 N.W.(2) 496.

Plaintiff persuaded the defendant to use granite in surfacing a new courthouse instead of Bedford stone and agreed to supply and complete delivery of the granite within six and a half months after certain W.P.A. labor had been made available to them, the contract price being $17,950. The contract anticipated delivery from time to time with final delivery to be made within the time indicated. About two months after work had started, the plaintiff by letter of February 25 stated that he would be unable to complete the work unless he was paid an additional sum, was given additional for W.P.A. labor, and was granted additional time within which to complete his contract. Later the defendant notified the plaintiff that a material breach had taken place and notice of termination was being given in accordance with contract terms. The agreement did not provide that time was of the essence but it was generally known that numerous other contracts on the same building were involved and their performance had to be tied in with the performance of the plaintiff's contract. The plaintiff rejected the termination and said it stood ready to perform. Defendant completed the job with Bedford stone and plaintiff sues for damages. Defendant filed a counterclaim for damages.

Fairchild, J. The plaintiff, December 1940, assumed a burden by the terms of its contract with the defendant which eventually proved to be beyond its ability to carry. Under the facts established, a finding that plaintiff was, on March 24, 1941, so circumstanced that it could not deliver according to the terms of its contract, is amply sustained. Although there is a claim by plaintiff of being able of living up to its agreement, the evidence shows an inability which amounts to an absolute and unconditional disclosure of intention to default unless it could induce concessions of consequence from defendant. . . .

Since defendant was not in default at the time of termination, we become concerned as to whether there was a breach or default by plaintiff justifying the defendant in ending the contract and asking damages. From an examination of the testimony as to the conduct of the plaintiff prior to notice of termination, it appears that the amount of work necessary to be done together with the letter of February 25, evidences an effective breach by the plaintiff, justify-

ing rescission by the defendant. Although it has been held that the right to rescind for an anticipatory breach is exceptional and to be permitted only where future breach is conclusively established, . . . nevertheless where a party disables himself from performing, the other party may treat the contract as rescinded and sue at once. Although a mere anticipation that a contractor will not be able to perform may not be sufficient to justify treating the delay as a total default, still when the contractor who is months behind a schedule agreed upon demands more time and the circumstances of the case show that time is material and is of the essence of the contract, a termination of the contract is justified.

The plaintiff indicated in its letter of February 25, that it would be unable to go on unless it received more compensation and even then, would have to have an extension of time. The jury so found and there is no reason to upset that finding. An extension of time asked by the contractor who was already behind would have had the result indicated of preventing other contractors completing their contracts timely.

Judgment for defendant with counterclaim allowed.

JACOB TRINLEY & SONS v. GOLTER et al.

1945, 93 N.H. 268, 41 A.(2) 243.

The defendant owed Yeaton and Son an unascertained amount but was persuaded to give them his notes for a total of $3,278.50 with the understanding that the exact amount owing would be determined at a later time. These notes were indorsed to the plaintiff for value but with knowledge that the defendant was not to pay unless the amount was owing. Two notes for $500 each were paid and one for $800 was extended for eight months, and another for the same amount was extended indefinitely, whereas the final note was never extended. The jury found there was no consideration for the three unpaid notes and gave its verdict for the defendant. The judge nevertheless gave a judgment for the plaintiff on the first note on the theory of waiver predicated upon the following letter:

Mr. J. A. Trinley
Columbia Hotel
Portland, Maine

Dear Sir:

In regard to our conversation of yesterday, as the matter now stands regarding notes given to H. A. Yeaton & Son and which he turned over to you in good faith as far as you were concerned, it would seem best for

me to take my medicine and try and get something from them if there is anything to get. Therefore, if satisfactory to you, the two notes that are past due will be paid as follows: one is to be paid on January 15, 1942, and the other shortly after, perhaps thirty days later, but this one I would rather give you the date when paying the other.

This letter was signed by the defendant and assented to by the plaintiff but the former later refused to pay.

BRANCH, J. Viewing the evidence in the light most favorable to the defendant, the plaintiffs occupied the position of indorsee for value but with knowledge of infirmity of the notes. The issue of lack of consideration was fully tried and submitted to the jury, who must be assumed to have found in favor of the defendant upon it. The principal question of the case arises in regard to the legal effect of the defendant's conduct, subsequent to the discovery of the errors in his account.

It is the contention of the plaintiffs that the defendant's agreement evidenced by the correspondence set forth above, "constituted a waiver of his defenses to all the notes," and they rely upon the rule of law which has been stated as follows: "The rule is that if one, with full knowledge of facts constituting a defense on his note, secures an extension thereof on the faith of his promise to pay it upon a new maturing date, he ratifies the instrument and so waives his defense. . . ."

Apparently applying this principle, the trial Court ruled, "that the defendant, for valuable considerations, waived any defense he may have had on the note for $800 maturing May 1, 1941, and entered into a binding and valid extension agreement with the plaintiffs for the payment of said note at a definite, certain, ascertainable time, i.e., on or before January 15, 1942." This conclusion of the Presiding Justice regarding the first note in suit appears to be inescapable. Defendant's express declaration of intention to take his medicine and his express promise to pay the note on January 15, 1942, leave no room for argument on this point.

We think the same conclusion follows in regard to the second note. The defendant himself proposed that this note be paid "shortly after January 15, 1942 . . ." This proposal was accepted by the plaintiffs. . . . If this arrangement was satisfactory to the parties, there is no reason why the court should find fault with it. With respect to the third note, no waiver could be spelled out of the correspondence since no extension of time was requested or granted. That note apparently came due according to its terms on April 1, 1942, and as to it, the defendant was free to assert any defense which he possessed. Having established the defense of lack of con-

sideration, the defendant is entitled to judgment with respect to the third note.

Judgment for the plaintiff for $1,600 and interest.

SEGGEBRUCH v. STOSOR

1941, 309 Ill. App. 385, 33 N.E.(2) 159.

March 6, 1940, plaintiff filed a "Separate Action in Chancery" in which, among other things, she alleged that a short time prior to May 1, 1939, defendant, intending to cheat and defraud plaintiff, acquired adjoining real estate and erected a gasoline station thereon; that since May 1, 1939, defendant had refused to have an attendant at the gasoline station located on plaintiff's premises, except that he sold about 200 gallons of gasoline a month from that station while prior to May 1, he had sold approximately 12,000 gallons a month; that defendant was financially insolvent and plaintiff was without an adequate remedy at law; that she was entitled to recover the reasonable rental of the premises which was $150 a month; that the lease be canceled and plaintiff be given a decree for the amount found due.

Defendant filed his answer in which he alleged he kept an attendant who operated the gasoline station on plaintiff's premises every day, substantially as alleged in his answer to the forcible detainer suit; admitted he sold approximately 12,000 gallons of gasoline per month prior to May 1, 1939; alleged he had asked plaintiff to "enclose the grease and oil rack so that he could more completely service his customers," which plaintiff refused to do, and thereupon he was compelled to erect a gasoline station on the adjoining premises; denied he was insolvent; denied that the reasonable rental value of the premises was $150 per month, and denied that plaintiff was entitled to recover damages.

April 23, 1940, the case was heard before the court without a jury and a decree entered which found the equities in favor of plaintiff; that defendant had maliciously failed and refused to operate the gasoline station on plaintiff's premises for the purpose of defrauding her; that there was due and owing plaintiff $147.50 a month from May 1, 1939, to the date of the entry of the decree. The decree further found the court had theretofore entered judgment at law in the forcible detainer case in plaintiff's favor and against defendant that she recover possession of the premises and it was decreed that plaintiff recover from defendant $1,696.25. Defendant appeals from that part of the decree awarding plaintiff $1,696.25. No appeal was taken from the judgment entered in the forcible detainer case.

Defendant contends he had a right to construct and conduct a station on the adjoining premises because, as stated by counsel, "No minimum rental is fixed and there is no agreement that the defendant will not conduct the same business at any other address"—that since the lease contained no provision on this question defendant was at liberty to conduct the gasoline station on the adjoining premises.

In deciding the case the chancellor said: "The parties hereto entered into a written lease for the premises and as a rental it is provided" that defendant would pay plaintiff 1¼ cents for each gallon of gasoline "sold from the premises each month during the term * * * During the term created by the lease the defendant built another station immediately adjoining this particular station and began to operate the new place.

"The pleadings admit that prior to his occupation of the new station there was sold an average of 12,000 gallons of gas at the station operated under the lease and that immediately after the new station began to be operated the sale of gas in the old place dropped to some 200 gallons a month. The Defendant on the witness stand admits there was no change in the volume of sale at the place so that since the operation of the new station the sales in the two places have reached about the same as the sales in the old place when it was operated alone.

"In an undertaking such as we have here the lessee undertakes to operate the premises in such a way as to reasonably produce the rental contemplated by the parties at the time the contract was entered into, and that he will not by his own act deprive the plaintiff of her share of the bargain to which she would be reasonably entitled if the premises continued in the condition in which it was rented without hindrance on the part of the defendant.

"Here the defendant willfully and deliberately and purely with the intention of injuring the plaintiff built himself a station right next door and transferred to the new place. Now he stands before the Court and says there is nothing in my contract that I will not cheat the plaintiff by building my own station next door thereby depriving her income under the lease. Of course, there is not. Certainly the plaintiff could not foresee such a possibility and the law will not stand by and allow such an evident wrong to be committed without finding some remedy. The law will treat the income from the new place as belonging to the old, especially since the evidence clearly shows there was no change in the volume."

We agree with the statement of the chancellor and while there was no express covenant in the lease, it was clearly implied that de-

fendant would use reasonable diligence in operating the gas station on plaintiff's premises.

Judgment for plaintiff.

CITY OF MINNEAPOLIS v. REPUBLIC CREOSOTING CO. et al.

1924, 161 Minn. 178, 201 N.W. 414.

The defendant had agreed to deliver certain wood paving blocks, and this is an action to recover damages for failure to make delivery. The lower court directed a verdict in favor of the plaintiff.

STONE, J. . . . Defendant's next contention is that there was a legal excuse for failure of compliance. The argument is predicated upon the general car shortage. There is no doubt that it existed and imposed an insurmountable obstacle to defendant's performance, unless to begin with it had on hand enough material, raw and manufactured, to enable it to begin and maintain deliveries as required. On this phase of the case defendant resorts to the rule of impossibility of performance, urging that the car shortage created one that was insurmountable.

The weakness of that argument, and it is a fatal one, is that this is not the kind of a situation to which the rule of impossibility of performance is applicable. There was no clause in the contract or specifications which expressly, or by implication, excused performance in case of car shortage or labor trouble. It was competent for the parties so to have conditioned the contract. They did not do so. Defendant's obligation to perform was absolute. We appreciate fully that the manufacture of creosoted wood paving blocks is not a rapid process; that freshly cut, long leaf, southern pine is required; that it takes time to procure and assemble it before the process of manufacture begins: and that manufacture and shipment to consumer takes still further time. However, defendant's business was to manufacture and deliver where and as required the commodity in question. Plaintiff was not its only customer. Supposedly, it was manufacturing and selling paving blocks in large quantities. It had a plant in Minneapolis. It might have conditioned performance upon continued and normal railroad freight service. It did not take that precaution. It must take the consequences, for performance was normally possible and the thing which prevented was a foreseeable contingency against which it might have protected itself, and, notwithstanding which, it undertook punctual performance.

Judgment affirmed.

BOOTH v. SPUYTEN DUYVIL ROLLING MILL CO.

1875, 60 N.Y. 487.

Action for failure to deliver on or before April 1, 1868, one hundred tons of steel caps for rails. The defense consisted of the fact that defendant's rolling mill was destroyed by fire on March 10, 1868.

CHURCH, C. J. The point made, that the destruction of the mill by fire was an excuse for nonperformance of the contract by the defendant, is not tenable.

In the first place it does not appear nor is it found as a fact, that the burning of the mill prevented such performance. The contract was made December 27, and the steel caps were to be delivered on the first of April thereafter. The mill was burned on the 10th of March. . . . A party cannot postpone the performance of such a contract to the last moment and then interpose an accident to excuse it. . . .

There was no physical or natural impossibility, inherent in the nature of the thing to be performed, upon which a condition that the mill should continue can be predicated. The article was to be manufactured and delivered, and whether by that particular machinery or in that mill would not be deemed material. True, the contract specifies the mill as the place, but it necessarily has no importance, except as designating the place of delivery. For aught that appears, other machinery could have been substituted.

The defendant agreed to furnish a certain manufactured article by a certain specified day, and it cannot be excused by an accident, even if it prevented performance. If it sought protection against such a contingency it should have been provided for in the contract. . . .

Judgment for plaintiff.

CARROL v. BOWERSOCK

1917, 100 Kan. 270, 164 Pac. 143.

This action was brought to recover for the part performance of a contract to construct a reinforced concrete floor in a warehouse. It appears that a fire destroyed the warehouse after the old floor had been cut away and some forms built and a few concrete footings poured. Certain floor rods were also in place but not permanently attached.

BURCH, J. . . . The contractor cannot give and the owner cannot obtain that which they have contracted about. Neither one can complain of the other on that account, and the law must deal

with the new situation of the parties created by the fire. The owner cannot be called upon to reimburse the contractor merely because the contractor has been to expense in taking steps tending to performance. . . . The owner must be benefited. He should not be enriched at the expense of the contractor. That would be unjust, and to the extent that the owner has been benefited, the law may properly consider him as resting under a duty to pay. The benefit which the owner has received may or may not be equivalent to the detriment which the contractor has suffered. . . .

The test of benefit received has been variously stated. Sometimes it is said that benefit accrues whenever the contractor's material and labor, furnished and performed according to the contract, have become attached to the owner's realty. . . . "In whatever way the principle may be stated, it would seem that the liability of the owner in a case like this should be measured by the amount of the contract work done which, at the time of the destruction of the structure, had become so far identified with it as that but for the destruction it would have inured to him as contemplated by the contract." 186 Mass. 520.

. . . The test is whether or not the work would have inured to his benefit as contemplated by the contract if the fire had not occurred. . . .

[Recovery was allowed for cutting away old floor and concrete footings.]

JOHNSON et al. v. FEHSEFELDT

1908, 106 Minn. 202, 118 N.W. 797.

Plaintiffs were owners of a threshing outfit and entered into an agreement to thresh the defendant's grain. They abandoned the work after completing only part of it. They now seek to recover for the portion completed. The lower court directed a verdict for the plaintiffs for the work they had done at the agreed price per bushel. Defendant appeals.

JAGGARD, J. . . . The essential question is whether the contract was entire and indivisible, in the sense that the plaintiffs could not recover upon a quantum meruit or upon the contract to the extent to which it had been performed. On principle we are of the opinion that plaintiffs could not recover. When they found that they were operating at a loss, they had the option to complete the contract, recover the contract price, and submit to the loss, or to abandon the contract, lose the work they had done, and be subject to whatever damages might be recoverable for the breach of the contract. The fact that plaintiffs had rendered services. the value of

which the defendant retained, did not entitle plaintiffs to recover on quantum meruit because of the contract and of the inability of the defendants to return the services. . . .

It would be obviously inconsistent with common justice that plaintiffs should recover pro tanto on the contract which they had substantially violated. They were in the wrong. They were not in a position to say to the defendant: "We will perform the contract we have agreed to if it proves profitable. If we find it unprofitable, we will abandon it." That would be to contradict the contract.

Judgment reversed.

RIGS v. SOKOL et ux.

1945, 318 Mass. 337 61 N.E.(2) 538.

Suit to compel specific performance of a contract.

SPAULDING, J. . . . By its (the contract's) terms the plaintiff agreed to manage the restaurant from November 11 to December 31, 1944, and to pay Sokol the sum of $26 a week, retaining whatever balance remained, after payment of expenses, as compensation for his services. The plaintiff had the right to purchase the fixtures and equipment of the restaurant, including the good will, for the sum of $4,000 at any time between November 11 and December 31. The $300 paid under the earlier contract was to be retained by the defendants as a payment on account and $1,700 was to be paid upon the delivery of a bill of sale from the defendants to the plaintiff. The balance of $2,000 was to be paid by a note payable in instalments and secured by a mortgage of personal property. The $1,700 and bill of sale were to be retained in escrow by an attorney of the defendants until the plaintiff obtained a beer and wine license. The contract gave to the plaintiff an option for a lease of the premises for a period of five years. It also contained a provision "that if either party * * * shall refuse to perform any of the conditions herein * * * or to perform * * * the said agreement, then the party refusing to do so shall pay to the other the sum of $500."

Upon the signing of the contract Sokol turned over the keys of the restaurant to the plaintiff who then commenced to operate it. On November 18, 1944, Sokol under the name of Sokol & Co. filed an application with the Lowell license board for the renewal of his victualler's and beer and wine licenses at the White Eagle Cafe, and these licenses were granted by the board on December 14, 1944, and approved by the alcoholic beverages control commission two days later. Prior to this, on October 31, 1944, the plaintiff had filed an application for a beer and wine license but this was not acted upon

because, as the board informed the plaintiff, it was bound to renew Sokol's license unless good reason could be shown why it should not do so. Upon learning that Sokol was endeavoring to renew his license, the plaintiff, prior to December 31, 1944, went to him and protested and told him that he was ready to go through with the contract. Sokol, having unsuccessfully tried to persuade the plaintiff to take back the $300 deposit and to call off the contract, then said that he would not sell and ordered the plaintiff out of the restaurant. "No reasonable cause was ever given * * * [by Sokol to the plaintiff] for ordering him out of the * * * [restaurant] or in refusing to go forward with the completion of the agreement."

The master found that damages would not adequately compensate the plaintiff for the refusal of the defendants to perform the contract; and that although it was not possible to determine accurately "the amount of money and effort spent and devoted * * * [by the plaintiff to the restaurant] it far exceeds $500."

The final decree ordered the defendants to execute a lease of the premises and a bill of sale transferring the good will, fixtures and personal property to the plaintiff, in return for which the plaintiff was to pay the cash then due ($1,700) and to deliver a note and mortgage for the balance, all of which were to be held in escrow until the plaintiff was granted or denied a beer and wine license for the premises from the licensing authorities of the city of Lowell; it further ordered that the defendants during the term of the lease "sign * * * any and all forms, applications * * * assets and assignments necessary to enable * * * [the plaintiff] to be granted licenses * * * by the license board of the city of Lowell," and the defendants were enjoined from accepting any license for the year 1945 and from interfering directly or indirectly with the granting of one to the plaintiff by the licensing board; it contained the further provision that, if the plaintiff were not granted a license within a reasonable time, the instruments and deposits held in escrow were to be returned and the injunction was to become inoperative.

The decree was right.

The defendants contend that, since the contract provided for the payment of $500 in the event that either party refused to perform, the plaintiff had an adequate remedy at law; they also argue in effect that this provision gave the parties the privilege of either performing the contract or paying $500. These contentions cannot be sustained. In view of the finding of the master that damages would not adequately compensate the plaintiff and of the nature of the contract, it is one that may be specifically enforced. "It may be taken to be settled in this commonwealth that the question whether a contract will or will not be specifically enforced depends

upon the question whether the thing contracted for can be purchased by the plaintiff, and whether damages are an adequate compensation for a breach." Butterick Publishing Co. v. Fisher, 203 Mass. 122, 130, 89 N. E. 189, 190, 133 Am. St. Rep. 283. Furthermore, the plaintiff among other things is seeking specific performance of a covenant to give a lease. That such covenants may be specifically enforced is well settled.

Nor is the provision in the contract for the payment of $500 in the event either party fails to perform a bar to specific performance. It is settled by our decisions and by the great weight of authority that the right to specific performance either affirmatively or by way of injunction is not lost because the contract contains a provision for the payment of a penalty or liquidated damages in the event of a breach. This result is reached on the assumption that the parties ordinarily contemplate that the contract be performed and that the provision for a penalty or liquidated damages in the event of a breach is intended as security for performance and not as a price for the privilege of nonperformance.

Contract, of course, may provide for the payment of a fixed sum as an alternative to performance. In such a case the promisor's election to pay the sum agreed upon will prevent specific performance of the other alternative. But whether such a provision is merely security for the performance of the contract or an alternative to its performance depends upon the intention of the parties to be deduced from the whole instrument and the circumstances. We are of opinion that the contract under consideration contemplated that it was to be performed and that the provision for the payment of $500 was intended as security for its performance and not as a price for the privilege of nonperformance.

Judgment for plaintiff.

CLARK v. MARSIGLIA

1845, 1 Den. (N.Y.) 317.

Assumpsit for work, labor, and material. The defendant delivered to the plaintiff a number of paintings to be cleaned and repaired at an agreed price. After the work was begun, the defendant directed the plaintiff to stop, but the latter persisted and is now attempting to recover the full contract price. The lower court charged the jury that, as the plaintiff had begun work, he had a right to finish and that the defendant could not revoke the order.

Per Curiam. The question does not arise as to the right of the defendant below to take away these pictures, upon which the plaintiff had performed some labor, without payment for what he had

done, and his damages for the violation of the contract, and upon that point we express no opinion. The plaintiff was allowed to recover as though there had been no countermand of the order; and in this the court erred. The defendant, by requiring the plaintiff to stop work upon the paintings, violated his contract and thereby incurred a liability to pay such damages as the plaintiff should sustain. Such damages would include a recompense for the labor done and materials used, and such further sum in damages as might, upon legal principles, be assessed for the breach of the contract; but the plaintiff had no right by obstinately persisting in the work to make the penalty upon the defendant greater than it would otherwise have been.

To hold that one who employs another to do a piece of work is bound to suffer it to be done at all events would sometimes lead to great injustice. . . . In all such cases the just claims of the party employed are satisfied when he is fully recompensed for his part performance and indemnified for his loss, in respect to the part left unexecuted; and to persist in accumulating a larger demand is not consistent with good faith toward the employer.

Judgment reversed.

KEEBLE v. KEEBLE

1888, 85 Ala. 552, 5 So. 149.

The plaintiff was employed by defendant's testator as business manager. His agreement called upon him to abstain from the use of intoxicating liquors, and in case he became intoxicated he was to pay as liquidated damages the sum of $1,000. This was offered as a set-off to plaintiff's demand.

SOMERVILLE, J. . . . The plaintiff violated his promise by becoming intoxicated, and remained so for a long time, and acted rudely and insultingly towards the customers and employees of the testator. . . . The contention seems to be that, in as much as it was possible for a breach to occur with no actual damages other than nominal, the amount agreed to be paid should be construed to be a penalty. . . . There are but few agreements of this kind where the stipulation is to do or not to do a particular act, in which the damages may not, according to circumstances, vary, on a sliding scale, from nominal damages to a considerable sum. . . .

In all such cases, as often decided, it is competent for the parties to stipulate for the payment of a gross sum by way of liquidated damages for the violation of the agreement, and for the very reason that such damages are uncertain, fluctuating, and incapable of easy ascertainment. . . . But the law will not enter upon an inves-

tigation of the quantum of damages in such cases. This is the very matter settled by the agreement of the parties. If the act agreed not to be done is one from which, in the ordinary course of events, damages, incapable of ascertainment save by conjecture, are liable naturally to follow, sometimes more and sometimes less, according to the aggravation of the act, the court will not stop to investigate the extent of the grievance complained of as a total breach, but will accept the sum agreed upon as a proper and just measurement by way of liquidated damages, unless the real intention of the parties . . . designed it as a penalty.

Judgment for defendant.

CHAPTER VII

RIGHTS OF THIRD PARTIES

MARCELLE, Inc. v. MARCUS COMPANY

1931, 274 Mass. 469, 175 N.E. 83.

This is a bill for a decree interpreting a written "Agreement and Lease" between the parties. The defendant conducts a large department store in Worcester. It leased to the plaintiff a portion of its space to carry on a millinery business, the business to be operated in such a way as to appear to the public as a department of the defendant's business, although in fact it was the business of the plaintiff. A question arose as to the right of the plaintiff to sublet the space leased to him.

RUGG, C. J. The agreement and lease signed by the parties manifestly is much more than a lease in the ordinary significance of that word. It is an instrument designed to regulate, so far as reasonably might be foreseen, the manifold relations and points of possible friction arising out of the inevitably close physical situation between the business of the plaintiff and the business of the defendant. The intent of the parties as gathered from the document as a whole forbids the idea that anybody could be permitted to take the place of the plaintiff in whole or part in its relations to the defendant without the consent of the latter.

The court denied the right to sublease the space.

RODIJKEIT v. ANDREWS

1906, 74 Oh. St. 104, 77 N.E. 747.

Action by Rodijkeit against the Lake Shore and Michigan Southern Railroad for wages, in which others intervened. Some time prior to this suit Rodijkeit has assigned wages due or to become due as a switchman of said railroad to an extent not exceeding $75. There still remains due $45.60 of this sum. Andrews claims this amount.

SUMMERS, J. . . . The question presented is the right of a person in the employ of another, in the absence of a contract for a definite time of employment, to assign future earnings of such employment. It is well settled that a mere expectancy or possibility is not assignable at law, consequently wages to be earned in the future not under an existing engagement but under engagements subsequently to be made, are not assignable. If there is an existing

employment, under which it may reasonably be expected that the wages assigned will be earned, then the possibility is coupled with an interest and the wages may be assigned. . . .

Some of the early cases were to the effect that the engagement must be for the time covering the wages assigned. . . . And later cases held that the assignment was valid, although the engagement was subject to be terminated at any time. . . .

"When a party has entered into a contract or arrangement, by the ordinary and legitimate and natural operation of which he will acquire property, his existing right thereunder is not a mere naked hope; it is a possibility of acquiring property coupled with a legal interest in the contract." Pom. Eq. Jur. Sec. 1286.

Judgment for defendant.

MARTIN v. ORNDORFF

1867, 22 Iowa 504.

This is an action to recover the balance due for some 96 cattle sold and delivered to the defendant. The latter contends that the contract was assigned to one McPherson, and that the steers were shipped to him.

WRIGHT, J. While the defendant had the right to assign the contract to McPherson, and while such assignment might carry to the assignee the rights of the assignor, it would by no means follow therefrom that plaintiff was thereby bound to "look to said assignee in all respects, and upon precisely the same terms and conditions as he would have done to the assignor if the contract had not been assigned." One party to a contract cannot thus shift or throw off his liability, nor make the other the involuntary creditor of a third person.

If plaintiff delivered the cattle to McPherson, or his agent, at defendant's request, then this was a delivery to defendant, and he would be liable. If plaintiff released defendant and accepted McPherson as his debtor, or agreed to look to him for his pay, then he cannot recover. If, however, he was to deliver the cattle to McPherson, and nothing was said as to payment, then, in the absence of fraud or collusion, plaintiff might so deliver without payment, and look to defendant for his money; or, in other words, if the defendant assigned the contract to McPherson, and directed plaintiff to deliver the cattle to such assignee, the plaintiff was not bound to hold them until paid for, but, in the absence of instructions to hold until payment, plaintiff might deliver to the assignee and hold defendant liable. . . .

Judgment for plaintiff.

ADAMSON v. PAONESSA et al.

1919, 180 Cal. 157, 179 Pac. 880.

Interpleader suit by John Z. Adamson against Geo. C. Paonessa, Charles W. Lloyd, and the National Surety Company. It appears that Paonessa was to do certain street work for the city and as such secured a bond for faithful performance with the National Surety Company as surety. In order to obtain the surety, Paonessa agreed that all payments were to be withheld until completion and then paid to the surety company. It was to turn the amount over to Paonessa after relieved of all liability. Later because of loans made to him, Paonessa made an assignment of his claim to one Lloyd, who immediately served notice on the city clerk of the assignment. The city had no notice of the prior assignment. The treasurer was just ready to make the payment in bonds to Lloyd when the surety company intervened, as they had been compelled to pay materialmen some $10,000.

LAWLOR, J. . . . The surety company neglected to give immediate notice of the assignment to it, and before it gave such notice Lloyd had taken an assignment for a valuable consideration without notice or knowledge of the prior assignment, and had given notice of his own assignment. The rule is well established in such a case. It is thus stated in Widenmann v. Weiniger, 164 Cal. 667: ". . . As between successive assignees of a chose in action, he will have a preference who first gives notice to the debtor, even if he be a subsequent assignee, providing at the time of taking it he had no notice of a prior assignment."

The judgment of the lower court, therefore, in directing the delivery of the bonds to Lloyd, was correct and to that extent is affirmed. . . .

AMERICAN BRIDGE CO. et al. v. CITY OF BOSTON

1909, 202 Mass. 374, 88 N.E. 1089.

The plaintiffs had received an assignment of all money due or to become due one Coburn under two contracts. The amount of two architect's certificates are in question. Shortly after they were issued Coburn defaulted and the city desires to recoup the damages resulting from the breach and deduct it from the amount of the two certificates. The default took place, however, after the city had received notice of the assignment. This is an action by the assignee to recover.

HAMMOND, J. . . . The assignment of a chose in action conveys, as between assignor and assignee, merely the right which the as-

signor then possesses to that thing; but as between the assignee and the debtor it does not become operative until the time of notice to the latter, and does not change the rights of the debtors against the assignor as they exist at the time of the notice.

It becomes necessary to consider the exact relation between the defendant and Coburn, the assignor, at the time of notice. The auditor has found that written notice of the assignments were given to the defendant on November 14, 1902, before the service of any trustee process. At that time there does not seem to have been any default on the part of Coburn. At the time of the notice what were the rights between him and the defendant, so far as respects this contract? He was entitled to receive these sums, but he was also under an obligation to complete his contract. This right of the defendant to claim damages for the nonperformance of the contract existed at the making of the contract and at the time of assignment and of notice, and the assignees knew it, and they also knew that it would become available to the defendant the moment the assignor should commit a breach. Under these circumstances it must be held that the assignees took subject to that right. . . . Even if the sums were due and payable in November, 1902, at the time of notice, still if this action had been brought by the assignor after the default, there can be no doubt but that the defendant would have had the right to recoup the damages suffered by his default. And the assignees who seek to enforce this claim can stand in no better position in this respect than the assignor.

Judgment for defendant.

BASSETT et al. v. HUGHES

1877, 43 Wis. 319.

Action for the balance of an indebtedness due originally from Hugh W. Hughes (defendant's father) to the plaintiffs.

In April, 1870, Hugh W. Hughes conveyed to the defendant certain real estate and all of his personal property, and the defendant agreed to pay all debts of his father. Plaintiff held a note against the father at that time. The lower court refused to allow the defendant to show that he and his father had rescinded the agreement in 1873.

Lyon, J. 1. It is settled in this state that when one person, for a valuable consideration, engages with another to do some act for the benefit of a third person, the latter may maintain an action against the former for a breach of such engagement. This rule applies as well to covenants under seal, as to simple contracts. . . . In the present case, the defendant, for a valuable consideration, en-

gaged with his father to pay the debt which the latter owed the plaintiffs, and, within the above rule, the plaintiffs may maintain this action to recover the unpaid balance of such debt.

2. It is quite immaterial, if the defendant's covenant to pay his father's debts was afterwards rescinded by mutual agreement between the parties to it. Before that was done, the plaintiffs had been informed of the covenant, and made no objection thereto; indeed the fair inference from the testimony is, that the plaintiffs fully assented thereto. Whether it was or was not competent for the parties to the covenant to rescind it before such notice to and assent by the plaintiffs, we need not here determine. Certainly after such notice and assent, the covenant could not be rescinded to the prejudice of the plaintiffs, without their consent.

Judgment for plaintiff.

CHAPTER VIII
DISCHARGE OF CONTRACTS

LOWE v. BLUM et al.

1896, 4 Okla. 260, 43 Pac. 1063.

This was an action brought by Blum to recover upon certain promissory notes aggregating the sum of $5,475.46. It appeared from the evidence that defendant was insolvent when the notes fell due and that Mungesheimer, Klein, and Marx, who were his sureties, entered into an agreement whereby the latter agreed to pay all outstanding claims, if the defendant turned over to them his entire stock in trade. The assets of the business were delivered to the sureties. A short time thereafter the defendant in a conversation with Leon Blum, one of the members of plaintiff firm, informed him of the situation. Leon Blum stated that it was all right, that he knew the parties, and that they were good and that he was well satisfied with the arrangement. The notes were not paid and this suit was instituted. The lower court concluded that no novation existed as "before said contract could be binding upon said parties, they must have agreed to have released the defendant from any obligation which the defendant was under to have paid such sum of money as indicated by the notes."

MCATEE, J. . . . When the defendant in error, Leon Blum, was subsequently informed of the arrangement, he stated to the plaintiff in error that "that was all right, that he knew the parties and that they were good and that he was well satisfied with the arrangement made." But there are no words here . . . by which it can be shown that the defendants in error ever agreed to release the plaintiff in error upon the notes sued upon, or that the possession of the notes ever changed, or was sought to be changed, from the defendants in error, or that Mungesheimer and Klein and J. Marx ever met the defendants in error and agreed, with them, to pay off the notes sued upon, provided the defendants in error would release the plaintiff in error from any further obligation thereon, all of which would have been necessary in order to constitute a new contract, a contract of novation, in which the liability of the plaintiff in error upon the notes sued on to the defendant in error was obliterated, and Mungesheimer and Klein and J. Marx accepted, in his lieu and stead in such a manner, as that suit might be brought against them upon the notes sued upon in this case.

Judgment for plaintiff.

SHAPIRO v. FRIEDMAN

1945, 132 N.J.L. 456, 41 A.(2) 10.

Brogan, C. J. The question presented by this appeal calls for the construction of R. S. 2:24-7, N. J. S. A. [a section of the statute of limitations] under which in the computation of time from accrual of an action until it is barred by the passage of time, allowance is made in appropriate instances for such periods as a debtor shall be absent from the state. . . .

These are the facts of the case: The plaintiff, Dora Shapiro, a resident of New York, was the owner of Harry Friedman's obligation. It may be called a promissory note since it is an unconditional written promise to pay a certain sum—$16,394.18—with 6% interest to Mrs. Shapiro three years from date, which was February 1, 1932. On its accrual the obligation was not met. Plaintiff, who continuously resided in New York and never became a resident of New Jersey, caused a summons and complaint to be delivered to the Sheriff of Monmouth County on January 30, 1941, which was one day prior to the expiry of the six year period after the accrual date, February 1, 1935. The process remained with the Sheriff—whether on plaintiff's instructions or not does not appear—until June 5, 1941, when the summons and complaint were served on the defendant personally in Monmouth County. It seems that defendant's wife owned a summer home in Long Branch, N.J., and each year from May or June until October this place had been used as a summer residence by the defendant's wife, mother-in-law, children, and grandchildren. The defendant himself went there during the summer on week-ends, as a rule, and occasionally oftener. When process was served on him in June, 1941, he had not been at the summer residence since the fall season of 1940. The house had been closed in the interim. Each year telephone service for the summer months was made available for the family. The listing in the telephone book was in the name of the defendant personally. The plaintiff considered that her suit, started by serving the defendant in June, 1941, about four months after the six year period, which began to run on February 1, 1935, had expired, was none the less timely because of the saving features of the statute, supra. The learned trial judge, considering that the statute was inapplicable in these circumstances, ordered a judgment for the defendant, and the plaintiff appeals. The main contention of the appellant is that the defendant was a resident of this state during the summer months of each year since 1935 or that he was a resident here for a sufficient number of months which, if credited against the limita-

tion statute, saves the action. In our opinion, this construction of the statute, supra, is erroneous.

In this case it is clear that the obligation originated and the cause of action thereon accrued outside the state. The creditor, i.e., plaintiff was and always has been a nonresident. The debtor, under the proofs, had his domicile in the city of New York during all this period. Does the statute, supra, stop the running of the time fixed for the bringing of suit in the case of a defendant who is not domiciled here (and never was) but whose family occupies a summer home in this state which the defendant regularly visits? We do not think so. As a matter of fact our construction of the statute, supra, has been averse from the contention of the plaintiff for more than a hundred years. Rather does the statute contain the plain implication that the party to be charged, if the statute may be invoked, was living in this state when the obligation was incurred and moved out before its accrual, or that he moved away after its accrual but before the statute of limitations had run its course. . . .

In this case the defendant was not a resident when the cause of action accrued but the plaintiff is not advantaged thereby because the cause did not accrue in this state. Nor can it be said that the debtor after accrual, "removes from this state" in the statutory sense because his presence here was never permanent in that he could be considered as having moved from this jurisdiction. As a matter of fact he never moved from New York City.

Judgment for defendant affirmed.

RICE v. BORDNER

1905, 140 Fed. 566.

ARCHIBALD, J. . . . But, passing that by, the proofs that have been submitted lead to the same result. They show that in a small way the respondent may be said to have had several occupations. He had a store; was agent for the sale of fertilizers, and he ran a farm. The question is: In which business was he chiefly engaged? This is to be determined by which was of paramount importance to him, or on which he depended for a living . . . about which there can be no serious question. No doubt at one time he had a store of considerable local importance; the election district being named after it. But that was many years ago, and the business had been so eaten into by other stores which have started up about him at no great distance that what he was doing in that line at the time these proceedings were instituted was insignificant. . . . From this, as he swears, his income was about $60 or $70 a year; and it is difficult to see how it could be more. In addition he sold $200

or $300 worth of fertilizers as agent for a phosphate company. . . . In contrast to this is shown that the respondent had two farms, aggregating 240 acres, which he managed himself, employing but one man regularly besides his son; others being called in as occasion required. From this land he raised wheat, oats, corn and hay, besides having a number of cows and selling milk; the total farm products being valued at from $1,000 to $1,200, out of which he realized about $600, and the sales of milk alone amounting to some $200 to $250. That it was upon the farm that he depended for a livelihood is evident; what is called his store being the merest excuse for one, and yielding him but a pittance. . . . The petition is therefore dismissed at the cost of the petitioning creditor.

In re STOVALL GROCERY CO.

1908, 161 Fed. 882.

NEWMAN, J. . . . The bankrupt firm is alleged to have been composed of M. E. and C. C. Stovall, which firm, according to the petition, did business at different times under the name of Stovall Grocery Company. . . . The first ground of bankruptcy is that on the 25th day of January, 1908 [this petition having been filed on February 1, 1908], the firm committed an act of bankruptcy by paying to one H. L. Singer a note for $3 in full of Singer's claims, and that this was a preference, and intended to be a preference. I do not think that the payment of $3 to a creditor a week before the bankruptcy proceeding was instituted could be classed as a preference. It is not such a substantial transaction as would, of itself, justify the institution of a proceeding in bankruptcy. . . . It would be difficult to draw a line and say what amount would be sufficient, and what would not, made in payment of a debt, to make a substantial preference. This would depend more or less on the character of the business, whether large or small.

The other ground of bankruptcy relied upon is this: "That on the 24th day of December, 1907, said C. C. Stovall, a member of said firm, conveyed and transferred his undivided half interest in and to a certain lot . . . in the city of Atlanta, to Mattie E. Stovall, his wife, without consideration, with intent to hinder, delay, and defraud his creditors and the creditors of said firm. . . ."

It will be perceived that the act of bankruptcy alleged here is the transfer by an individual member of a firm of property with intent to defraud individual creditors and firm creditors. That is not an act of bankruptcy on the part of the firm. The partnership entity must act, and what is relied upon must be its act.

As neither of the grounds of bankruptcy contained in the petition are sufficient, the demurrer to the petition is sustained.

BATCHELDER v. HOME NAT. BANK

1914, 210 Mass. 420, 105 N.E. 1052.

Action to recover an alleged preference. It appears that the bankrupt O'Neill had long been a friend of the cashier of defendant bank, and had been a borrower for many years. Shortly before bankruptcy his stock in trade was totally destroyed by fire. Shortly thereafter he met the cashier, and the latter suggested that the insurance money be paid to the bank. The notes were not yet due, but the insurance money was paid to the bank, leaving a small balance in cash, which was given to O'Neill, the bankrupt. The question arose as to whether the jury was justified in finding knowledge of insolvency on the part of the bank, where actual insolvency was present.

SHELDON, J. It was a closer question whether the defendant had reasonable cause to believe that he (O'Neill) then was insolvent and intended to prefer it to other creditors. To hold the defendant there must have been a reasonable cause of belief, not a mere ground of suspicion. . . . On the other hand, it is equally true that this is a question of fact; that the inference of the fact may be drawn from circumstances; and that the same circumstances which to some minds would merely give ground for suspicion may afford also evidence which to other minds would carry conviction that they not only showed cause of belief, but actually had created a real belief. . . . The jury were warranted in finding that the defendant had reasonable cause to believe. . . .

Judgment for plaintiff.

FRANK v. MERCANTILE NAT. BANK

1905, 182 N.Y. 264, 74 N.E. 841.

This was an action by the trustee in bankruptcy to recover a certain deposit in National Broadway Bank, which the defendant had assumed as part of the liabilities of said bank. The defendant desired to set off certain notes signed by the bankrupt which were taken from the National Broadway Bank, at the time its obligations were assumed. The plaintiff contended the right of set-off did not arise as most of the notes had not matured.

CULLEN, C. J. . . . Section 68 of that law (bankruptcy act) provides that "in all cases of mutual debts or mutual credits between the estate of the bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the

balance only shall be allowed or paid. . . ." The argument is that, as unmatured claims against the bankrupt are provable against his estate they necessarily are the subject of set-off under the provisions of section 68. We think that this position is well taken, but we shall refrain from entering into any discussion of the question, as the proposition seemed to be settled by decisions of the federal courts. The uniform current of authority in the District and Circuit Courts of the United States, is to that effect, and the law is so stated in the textbooks on bankruptcy.

Judgment for defendant.

ROSENBERG v. BLOOM et al.

1938, 99 Fed.(2) 249.

This is an appeal from an order denying Rosenberg a discharge in bankruptcy. It appeared that one D. C. Bloom had made loans to Rosenberg which totaled between $140,000 and $160,000 during the years 1919 to 1926. The borrower used the money to invest in real estate and real estate loans, but no settlement was made until 1930, when a note was given in settlement. The bankrupt had few transactions after 1930, and the amount remained unpaid. In 1936 he filed his petition in bankruptcy and requested his discharge. He destroyed or lost all memoranda of his business transactions, except that, about the time his petition in bankruptcy was filed, he made a very brief copy of his transactions following 1930. At that time, he apparently destroyed the original records.

STEVENS, J. . . . His testimony as to such records was that he kept a record of the transactions with D. C. Bloom prior to 1930, but that after May 1, 1930, there was no use for them, and that he kept some and destroyed others; that he now has no record of such period. Bankrupt also testified that he kept a record of the transaction in two "memo books," but that he does not know what happened to them. Again, the bankrupt testified that in moving from hotel to hotel he gradually disposed of his records, which were kept in a suitcase, in order not to have to walk around with the suitcase in his hand.

In this state of the record, we believe that the finding of the Court "that the bankrupt destroyed or failed to keep books of account or records from which his financial condition and business transactions might be ascertained, and such failure or acts are not justified under the circumstances of the case" is fully supported by the evidence. . . .

Each case stands on its own facts with respect to whether or not the bankrupt has sustained the burden of justification which the

statute places upon him for failure to keep or destruction of adequate records. . . . It being obvious that the bankrupt's financial condition and business transactions could not be ascertained from the single record book he did produce, and he having failed to justify his failure to produce adequate records, the judgment of the District Court denying the discharge must be affirmed.

In re SAVARESE, Appeals of State Bank

1913, 209 Fed. 830.

This is an appeal of an objecting creditor from an order granting the bankrupt a discharge. It appears that a partnership existed between Savarese Bros. The partner involved in this case was principally engaged in outside work. A son of the other brother was responsible for the office work. Money was borrowed from a bank upon the basis of a financial statement and with certain warehouse receipts as security. On the balance sheet two pieces of real estate were listed, they being individual property, but mortgages against them were not indicated. In addition notes and accounts payable were not included to the extent of some $40,000. The bankrupt contends that he knew nothing of the books and had no intent to defraud. The lower court found for the bankrupt.

WARD, Circuit Judge. . . . Giving great weight, as we should, to these conclusions we are still unable to believe that Ferdinando Savarese was without knowledge in the premises. He had been 40 years in the business and was entirely familiar with the amount and value of goods on hand. He could hardly have overlooked the fact that his First Place premises were included in the statement as firm assets, and were grossly overvalued. At the least, he was recklessly negligent. If such accounts as his are to be adopted it will be made very easy for embarrassed merchants to close their eyes to the fraudulent acts of their servants by which they profit, and then, if bankruptcy ensues, obtain the discharge which is intended to enable the merely unfortunate debtors to start life anew.

Judgment reversed.

PEERLESS MFG. CO. v. GOEHRING et ux.

1944, 131 Conn. 93, 38 A.(2) 5.

DICKENSON, J. The plaintiff brought this action to recover a debt owed to it by the named defendant and to set aside as fraudulent a conveyance of real estate made by him to his wife, the other defendant. . . . The defendant William had a running account with the plaintiff for material purchased. His credit was stopped when he failed to pay $466.76 due on his December, 1939 account.

In February, 1940 he conveyed title to the only real estate he owned to his wife. The transfer arose out of the following circumstances: William was threatened with litigation for patent infringements and believed his property would be attached. He informed his wife of this and she suggested that he transfer the real estate to her to which he agreed. She had a deed of the property drawn and he executed it, conveying the title to her with no return consideration. By making the transfer his assets were reduced to a small amount of personal property. The transfer was made with the intent, entertained by both parties, to avoid attachment of the property. Olive (the wife) had originally owned the property but had deeded it to William as a gift in 1937. . . .

The complaint in the action is framed to rely on General Statutes § 5984. This provides that, "all fraudulent conveyances . . . made or contrived with intent to avoid any debt . . . shall, notwithstanding any pretended consideration therefor, be void as against those persons only . . . to whom such debt belongs." The defendant Olive does not contend that there was a valuable consideration for the conveyance but only a good consideration arising out of the original purchase of the property by her, its transfer to the defendant and subsequent relations between them. . . .

In the instant case it appears that Olive neither gave a valuable consideration for the property nor purchased it innocently (from her husband). The transfer was voidable at the instance of the proper party. . . . The plaintiff was such a party. That the conveyance was not made with the specific intent of placing it beyond the reach of the plaintiff does not prevent it from being held fraudulent. We early held in interpreting the statute that since every person is conclusively presumed to intend the natural and necessary consequences of his acts, if he makes a fraudulent conveyance with specific intent to avoid the debt of one with the necessary effect of avoiding it as to another, the conveyance is within the statute as to the latter debt as well. . . .

Judgment for the plaintiff affirmed.

Book II

AGENCY

CHAPTER I
CREATION OF THE AGENCY

MORELAND et al. v. MASON, Sheriff, et al.

1927, 45 Idaho 143, 260 Pac. 1035.

The respondents brought an action against the defendants for the value of 16 head of cattle. It was maintained that the defendant was guilty of conversion when he sold the cattle under an attachment against G. H., W. H., and Gladys McWilliams. The respondents were engaged in buying and shipping live stock, and agreed with G. H. and W. H. McWilliams that the latter would purchase from time to time at certain prices. The McWilliamses gave their own check for the cattle, but the same was always taken care of at the bank by respondent. The cattle were brought to the shipping lot of Moreland and Madden, and there fed and cared for till shipped. The value of the stock was determined just before shipping, and, if the stock was purchased at a certain price and at less than the market price, the difference was paid to the McWilliamses. If more than the market price was paid, the loss was borne by the respondents.

Moreland and Madden contend that the McWilliamses were their agents, while the defendant asserts that they acted as independent contractors.

BABCOCK, C. . . . An independent contractor is defined as one who renders services in the course of an occupation, representing the will of the employer only as to the results of the work, and not as to the means by which it is accomplished. An agent is defined as one who acts for another by authority from him; one who undertakes to transact some business or manage some affair for another by authority and on account of the latter.

The distinction between an independent contractor and an agent is not always easy to determine, and there is no uniform criterion by which they can be differentiated. But it would seem that where the agent's functions are concerned, either entirely or mainly with the execution of contracts on behalf of the principal, although not subject to the control of the principal with respect to the details of the work, he is an agent, and not an independent contractor.

By some authorities the distinction is made on the footing that the normal function of an agent is that of representing his principal in transactions arising out of business, trade, or commerce; while the normal function of an independent contractor is that of per-

forming work which is predominantly physical in its nature. . . .

Considering the testimony in the case in the light of these definitions, the McWilliamses were the agents of the respondents and were not independent contractors. They were controlled by respondents as to the price they were to pay for the cattle, in that they should not pay more than the market price, and if they did, the respondents bore the loss. . . .

It follows, therefore, that the McWilliamses, being the agents of the respondents in the purchase of the cattle in question, and not independent contractors, the title to the cattle, at the time of the levy of the attachment and execution in the case of D. P. Snyder v. McWilliams, was not in the defendants, the McWilliamses, but in respondents.

Judgment for respondents.

PETTINGER v. ALPENA CEDAR CO.

1913, 175 Mich. 162, 141 N.W. 535.

One James H. Wade purchased from plaintiff numerous camp supplies for his lumbering outfit. After considerable credit had been extended the plaintiff demanded a settlement and Wade appealed to one Gannon for assistance. Gannon approved the account and told the plaintiff to send it to the defendant. This procedure was followed and the bill was paid. Gannon also told the plaintiff to continue to furnish supplies and the bills would be paid by the defendant. The defendant refused to pay subsequent bills and denied that Gannon possessed any authority, but offered evidence indicating that he was in charge of the lumbering interests of one Gustin, who happened to be the president of the defendant company. Wade carried blank labor orders which he used to pay laborers, and which were drawn on the defendant. The plaintiff often cashed these and they were always honored by the defendant.

Bird, J. . . . In as much as there was no proof that Gannon had any actual authority to act for the defendant, the question here raised is one of agency by estoppel. . . . In Clark v. Dillman, 108 Mich. 625, 66 N.W. 570, it was said:

"It is undoubtedly the law that a person may be bound by the representations and acts of another, as agent, where there has been such a holding out as reasonably to lead one dealing with him to believe in the existence of such agency. But all the elements of estoppel must be present. There must be conduct calculated to mislead and it must be under circumstances which justify the claim that the alleged principal should have expected that the representations would be relied and acted upon; and, further, it must ap-

pear that they were relied and acted upon, in good faith, to the injury of innocent party."

The plaintiff claims to have parted with his merchandise in the belief that the defendant was interested in the lumbering which Wade was carrying on, and that Gannon was acting for it, and that it would pay for such supplies as he furnished the camp. This belief was induced by the fact that Gannon had approved of an account which he held against Wade, and the defendant had paid it as he was advised by Gannon it would do. . . . A check for $100, drawn by the Alpena Cedar Company to the order of Gannon and indorsed by him to Wade, was accepted by plaintiff as a payment on Wade's account, and this check was honored by the defendant. This incident, in connection with other evidence, helped to confirm the belief of plaintiff that Gannon was acting for the defendant.

Judgment for the plaintiff affirmed.

GROSCUP v. DOUNEY

1907, 105 Md. 273, 65 Atl. 930.

This was a suit brought by Douney to recover a commission alleged to have been earned through the sale of real estate. It appeared that the defendant had placed her husband in charge of the erection of three houses upon certain property and had also made him an agent to sell the property. He, without any authority from the defendant, listed the property with the plaintiff, and one of the lots was sold as a result of the plaintiff's efforts, all of which was unknown to the defendant.

SCHUMUCKER, J. . . . The law is firmly settled that ordinarily an agent has no power to delegate his authority to another, or to employ a subagent in the absence of an express or implied authority to do so from his principal. This is especially true where the execution of the power conferred upon the agent involves the exercise of judgment or skill. . . . The power to an agent to delegate his authority may be implied from a variety of circumstances, as where it is shown that the principal contemplated or knew that the agent intended to delegate his authority or where such delegation is authorized by custom, usage, the course of trade or by necessity or where the acts to be performed are merely mechanical or ministerial. . . .

In the case before us there is no evidence that Mr. Groscup's agency to manage and sell the property was created by a written instrument or that any express authority was conferred on him to employ a subagent to make the sale.

Judgment for defendant.

CASADY v. MANCHESTER FIRE INS. CO.

1899, 109 Iowa 539.

Action for money had and received. The plaintiff's father was an agent for the defendant. He defaulted and disappeared. The defendant asked one Palmer to investigate and report immediately. Palmer accepted payment of the shortage from the plaintiff, but agreed to see that the plaintiff was appointed agent in the place of his father. The company cashed the check but appointed someone else as agent. They contended that Palmer had no authority to make the contract.

LADD, J. It may be conceded that Palmer did not have authority to make such a contract. Neither was he empowered by the telegram to adjust the father's accounts and receive the plaintiff's check in settlement. But he did so, and the company approved his course by retaining the money. It cannot be permitted to ratify a part of this transaction without being held to have confirmed the whole. It could not retain the money without approving the method resorted to by its agent, Palmer, in procuring it. . . . These [the facts] were learned shortly afterwards and then, at least, it was bound to either return the check, or to carry out Palmer's contract, purporting to have been made in its behalf. Having refused to ratify the making of the contract by Palmer for plaintiff's appointment as agent to succeed his father, the consideration failed, and the plaintiff became entitled to recover for money had and received.

KESSLER et ux. v. TROAST et ux.

1927, 101 N.J.Eq. 536, 138 Atl. 371.

This was a bill to set aside a deed and mortgage. The plaintiff agreed to purchase certain land from the defendants providing they were able to secure municipal permission to construct a clothing store on the premises. The defendants' agent represented that the permission had been granted and caused a deed to be executed and received $1,000 and a purchase money mortgage for the balance. The municipality refused to permit the construction of the store, the representation of the defendants' agent having been fraudulent.

BENTLEY, Vice Chancellor. . . . It is difficult to determine whether or not it is intended to be urged that the defendant Troast is not responsible for the fraudulent representation of his agent, who was his father. Pom. Eq. Jur. Sec. 909 says:

"An express ratification, however, is not necessary. If the principal received and retains the proceeds of the agent's fraud—the

property, money and the like obtained through an executed transaction—or claims the benefit of or attempts to enforce an executory obligation thus procured, he renders himself liable for the fraudulent acts of his agent."

Rescission allowed.

CHAPTER II

PRINCIPAL AND THIRD PARTY

BOWMAN v. PRESS PUB. CO.

1934, 316 Pa. 531, 175 Atl. 483.

Plaintiff owned a newspaper distributing agency, and along with other publications sold defendant's paper to various retail vendors and individual subscribers. He desired to dispose of his business but the defendant refused to transfer the agency to the potential purchaser. Plaintiff found another person, a certain Kenneth George, who was willing to purchase the business for $6,750. The buyer paid $2,000 in cash and was to pay the balance in monthly installments. The plaintiff secured the defendant's approval of the transfer and the defendant's circulation manager agreed at the time the agency was transferred to return the agency to the plaintiff if the buyer of the business failed to pay his installments. The buyer failed to meet his installments, but the defendant refused to reappoint the plaintiff as its agent.

PATTERSON, J. . . . Defendant's motion for judgment raises two questions of law. The first is that the defendant's circulation manager had no real or apparent authority to make the oral agreement here in suit. The second is that the agreement was without consideration. We can accord merit to neither.

We consider first the question of consideration. It appears in the evidence on behalf of the plaintiff that in July, 1928, plaintiff had a purchaser, but the defendant's manager imposed conditions that could not be met. The circulation manager agreed to get plaintiff a buyer. In 1929, plaintiff found a purchaser who would meet the conditions imposed and, when the parties consulted with the defendant's circulation manager, the latter signified his willingness to accept the buyer because the Press wanted separate distribution. Thereupon, plaintiff agreed to turn over his route list and everything pertaining to the agency. . . .

As to the apparent scope of the circulation manager's authority to bind defendant, it was a question of fact under the particular circumstances of this case and was submitted to the jury in the plainest possible terms. The fact and the scope of the agency are for the jury, where they are to be established by parole evidence and surrounding circumstances and the burden is on the plaintiff in such a case.

Admittedly, Test was defendant's circulation manager. Plaintiff had dealt with him as such for several years. He had supervision over distributing agencies; he selected the mediums and the distributors; the collection and circulation supervisors were under his direction and he could appoint and revoke the appointment of distributors; he met with other circulation managers as to their co-operation; and he could, and in this case did, impose conditions upon which distributors might transfer their business to a successor. Certainly the authority to do these things must, of necessity, endow him with the correlative authority to say that upon a certain contingency he would revoke George's agency and return it to the plaintiff. . . . Where a corporation entrusts a manager with general supervision of a particular branch of its business, it invests him with the power of a general agent coextensive with business entrusted to his care and is bound by his contracts on its behalf made within the apparent scope of his authority, and the scope of the agency is for the jury.

The language of Judge Patterson of the Superior Court used above was approved by the Supreme Court and the judgment of $5,295.54 for the plaintiff was affirmed.

WESTURN v. PAGE

1896, 94 Wis. 251, 68 N.W. 1003.

Action for damages for an alleged breach of an express warranty of the soundness of a horse. Mr. Hall as agent for the defendant made such an express warranty, but his authority to do so was denied by the defendant. The judge in the trial court gave the following instruction to the jury: "If Mr. Hall, the defendant's agent, made an agreement of warranty respecting the soundness of the horse, the defendant is bound by it, because he gave Hall full authority to sell or exchange the horse." The lower court assumed that the power to sell carried power to warrant.

MARSHALL, J. . . . In Pickert v. Marston, 68 Wis. 465, the subject was discussed at length, and the general rule, laid down by standard text writers and supported by the great weight of authority, was there stated with approval as follows: "The general rule is as to all contracts, including sales, that the agent is to do whatever is usual to carry out the object of his agency, and it is a question for the jury to determine what is usual. If, in a sale of goods confided to him, it is usual in the market to give a warranty, the agent may give that warranty in order to effect the sale." The subject was again before the court in Larson v. Aultman & Taylor Co., 86 Wis. 281. In the opinion of the court by Mr. Justice Cassoday, it is

there said: "The rule is well settled that the agent employed to sell has no implied power to warrant, unless the sale is one which is usually attended with a warranty." So, it comes to this; that, in order to make out a cause of action for breach of an express warranty of an article sold by an agent, it is incumbent upon the party seeking to enforce such warranty to prove express authority from the principal to make it, or that such sales are usually attended with such warranties. . . .

In the light of the foregoing, the instruction under consideration is clearly erroneous, which must work a reversal of the judgment appealed from.

HICHHORN MACK & CO. v. BRADLEY

1902, 117 Iowa 130, 90 N.W. 592.

Action on account for cigars sold and delivered at an agreed price. Defendant interposed a counterclaim for damages because an exclusive right to sell a certain brand of cigars had been wrongfully terminated. The defendant contended that he was to have the exclusive agency so long as he rendered his best services in pushing the sale. The plaintiff desired to introduce evidence indicating that he had told the sales agent not to enter into such an agreement. The lower court refused to admit the evidence and the jury returned a verdict for the defendant.

McClaim, J. . . . There was some evidence of a custom in the trade by which it was generally understood that agents negotiating with jobbers for the introduction of brands of cigars had authority to give the exclusive privilege for an unlimited time. The court excluded testimony of a witness as to what was said by a member of plaintiff firm to Glaspell at Rockford, Ill., where the two had been negotiating for the release of another agent of the territory which was to be given to defendant, as to the terms of the contract which Glaspell should make with defendant; but we think there was no error in this ruling, for, as against a contract made by a general agent within the scope of his authority, it is not competent to show private instructions given to the agent by the principal. It may be that in some cases the authority given to the agent may be proven, although the person with whom the agent subsequently deals is not bound to know the extent of such authority. But what the witness in the case before us was asked to testify to was not the authority of the agent, but a conversation between the agent and the principal. Clearly, this was immaterial under the issues.

Judgment affirmed.

THE TERRE HAUTE & INDIANAPOLIS R. R. CO. v. McMURRAY

1884, 98 Ind. 358.

ELLIOTT, J. Frankfort is a way station on the line of appellant's road, distant many miles from the principal offices of the company and from the residences of its chief officers. At this station, at one o'clock of the morning of July 2nd, 1881, Thomas Coon, a brakeman in the service of the appellant, had his foot crushed between a wheel of a car of the train on which he was employed as a brakeman, and a rail of the track. The injury was such as demanded immediate surgical attention. The conductor of the train requested the appellee, who was a surgeon, residing in the town of Frankfort, to render the injured man professional aid, and informed the appellee that the company would pay him for such services; at the time the accident happened, and at the time the surgeon was employed, there was no officer superior to the conductor at the town of Frankfort. . . .

The authority of an agent is to be determined from the facts of a particular case. Facts may exist which will greatly broaden or greatly lessen an agent's authority. A conductor's authority in the presence of a superior agent may dwindle into insignificance; while, in the absence of a superior, it may become broad and comprehensive. An emergency may arise which will require the corporation to act instantly, and if the conductor is the only agent present, and the emergency is urgent, he must act for the corporation, and if he acts at all, his acts are of just as much force as that of the highest officer of the corporation. In this instance, the conductor was the highest officer on the ground; he was the sole representative of the corporation; he it was upon whom devolved the duty of representing the corporation in matters connected within the general line of his duty in the sudden emergency which arose out of the injury to the fellow-servant immediately under his control. . . .

There are cases, where the train is distant from the supervision of superior officers, where the conductor must act, and act for the company. . . . Simple examples will prove this to be true. Suppose, for illustration, that a train is brought to a halt by the breaking of a bolt, and that near by is a mechanic who can repair the broken bolt, and enable the train to proceed on its way, may not the conductor employ the mechanic? Again, suppose a bridge is discovered unsafe and that there are timbers at a neighboring mill which will make it safe, may not the conductor in behalf of his prin-

cipal, employ men to haul the timbers to the bridge? In these examples, we mean to include, as a silent factor, the fact that there is an emergency, allowing no time for communication with superior officers, and requiring immediate attention.

Judgment for surgeon.

PEOPLE ex rel. CARR v. GULLBORG

1927, 324 Ill. 538, 155 N.E. 324.

THOMPSON, J. This appeal is from a judgment of the county court of Cook county overruling objections to taxes extended against an apartment building at 1549 Fargo Avenue, Chicago, and ordering a sale of the property. . . .

In 1925 the board of assessors continued the valuation of $80,250 but the board of review raised it to $110,250. Appellant paid the taxes based on a full valuation of $80,250 and filed objections to the balance on the ground that he had not received notice of the hearing before the board of review and that it was without jurisdiction to increase the valuation. The records of the board of review show that notice of the hearing was sent to George P. Adams. Appellant testified that he is a manufacturer and that Adams is employed in his office; and that in 1925 Adams occupied one of the apartments in his building at 1549 Fargo Avenue and was authorized to receive the rent from the other tenants; that Adams was not a leasing agent nor an agent having general supervision of the property; and that this authority was limited to receiving the rent and delivering it to him at his office. . . .

The law is well settled that, when notice to an agent is relied upon to bind a principal, the nature of the agency must be such that the law will presume that the agent carried the notice to his principal, or it must be established as a fact that he did communicate to his principal such notice. Notice to or knowledge of an agent while acting within the scope of his authority and in reference to a matter over which his authority extends is notice to or knowledge of the principal, but, in order to be binding upon the principal, the knowledge must be acquired while his agent is acting within the scope of his authority and in reference to a matter over which his authority extends. . . . Conceding that Adams received the notice of the hearing before the board of review, it was not binding upon appellant because it was not a matter over which Adams' authority extended. . . .

Judgment for defendant.

ZAZZARO v. UNIVERSAL MOTORS

1938, 197 Atl. 884.

This was an action by plaintiff to recover possession of an automobile. The defendant had given one Horwitz special authority to sell it for $400 net. The plaintiff signed a contract to purchase, and gave his check for $100 and note for $300 in settlement. Horwitz, to induce the sale, promised personally to hold the note for a few days until the plaintiff could borrow $300 on his insurance. The note, however, was immediately turned over to the defendant. When the check arrived from the insurance company, the plaintiff indorsed and delivered it to Horwitz, who failed to surrender it to the defendant. The defendant, under the conditional sale contract, repossessed the car and plaintiff now seeks to recover it on the theory that he had paid for it in full.

BROWN, J. . . . This court has stated the implied powers incident to the agency relationship in these words: "The creation of an agency carries with it the usual and appropriate means of accomplishing its object and clothes the agent with such authority as is proper to effectuate its purpose." Kearns v. Nickse, 80 Conn. 23, 25. . . . The American Law Institute, in dealing with the question as to the circumstances under which incidental authority is inferred, says: "Unless otherwise agreed, authority to conduct a transaction includes authority to do acts which are incidental to it, or are reasonably necessary to accomplish it." Restatement Agency, p. 89, sec. 35. And under Comment a, it is further stated that "conversely to the rule . . . prima facie, an agent is not authorized to do acts not incidental to the transaction, nor usually done in connection therewith, nor reasonably necessary." The application of this principle to the undisputed facts in this case make evident that the court was warranted in concluding that Horwitz had no authority to accept payment of the note. As the defendant's agent for this isolated transaction only and pursuant to express instructions, he sold this car known by the plaintiff to belong to the defendant for $100 cash plus his note to its order for $300 due thirteen days later and secured by the conditional bill of sale, both of which instruments were forthwith turned over to the defendant, which kept them. Horwitz collected the note before maturity. Under these circumstances, authority in Horwitz to accept payment of the note was neither proper nor reasonably necessary to do the act directed or to accomplishing the result specified by the defendant. Nor was the acceptance of the payment either a usual or an

appropriate means to that end. It cannot be said to be incidental thereto.

Judgment for defendant affirmed.

AMERICUS OIL CO. v. GURR

1902, 114 Ga. 624, 40 S.E. 780.

LUMPKIN, P. J. An action was brought in the superior court of Sumter county, by W. H. Gurr against the Americus Oil Company for the price of certain cottonseed. There was a verdict for the plaintiff, and the defendant complains here of the court's refusal to grant it a new trial. The theory of the plaintiff was, that he sold the seed to one Ward, as agent of the defendant; that it received the seed, and was therefore liable to him for the price thereof. . . .

We reverse the judgment rendered in this case, because it was contrary to law. The plaintiff failed entirely to show that Ward was the general agent of the defendant company, or that he had authority to buy the seed upon credit. It clearly and distinctly appears from the evidence as a whole, and there is no testimony to the contrary that the arrangement between the company and Ward was for him to buy seed and ship the same to the company, he in each instance to pay for the seed purchased with cash furnished him for this purpose by the company. His agency was thus limited, and Gurr in dealing with him was bound, at his peril, to know exactly what authority Ward had in the premises. . . . There is not one line of testimony in the record before us which would warrant a finding that the oil company contemplated or intended that Ward should have any other authority, except to buy for it, with cash supplied to him, the cottonseed which the company needed in its business. The fact that it actually received the seed which was delivered by Gurr to Ward did not make it liable to the former under the doctrine of ratification. It did not know of or sanction Ward's purchase on credit and had in point of fact furnished him with more than enough cash to pay for the seed he obtained from Gurr.

Judgment for defendant.

GOODENOUGH v. THAYER

1882, 132 Mass. 152.

This was an action to recover damages for breach of contract. The plaintiff entered into a contract for space in the steamer Atrato for shipment from Boston to London of certain live stock. The steamer was to put on board a condenser capable of supplying suf-

ficient water. The agreement stated that it was between Thayer and Lincoln, agents of the steamer Atrato, and H. B. Goodenough. It was signed merely Thayer and Lincoln, Agents. Several sheep and hogs died en route because of a shortage of water. The defendants contend that the contract was with the owner of the steamer and they are not personally liable.

ENDICOTT, J. . . . The defendants in the body of the agreement disclose their principal, for they describe themselves as agents of the steamship Atrato, and they do not sign the instrument personally, but as agents. The case does not fall, therefore, within that class of cases, cited by the plaintiff, where the instrument does not disclose the name of the principal; nor within the other class of cases cited, where, although in the body of the instrument it appears, or is to be inferred that the party signing is agent, or is acting in behalf of other persons, the instrument is signed by his name only. In these cases it was held that there was a personal undertaking by the defendant.

Nor can it be said that the recitals in the body of the instrument, that the defendants were agents of the steamship Atrato, and their signatures thereto, describing themselves as agents were mere descriptio personarum. . . . The agreement contains express stipulations on the part of the steamship Atrato, and express provisions touching the liability of her owners, as where it recites, "steamer agreeing to put on board a condenser capable of supplying the stock with water in sufficient quantities," etc. . . .

Taking all of the provisions of the special agreement together, it appears that it was not the intention of the parties that the defendants should be bound personally, but that it was the intention to bind the shipowners. And the intention is so plainly apparent that it is not to be controlled by the words, "agents of the steamer Atrato," instead of for the steamer Atrato.

Judgment for defendant.

KAYTON v. BARNETT

1889, 116 N.Y. 625, 23 N.E. 24.

This action was brought to recover a balance of the purchase price for certain property. On the 17th day of March, 1881, the plaintiffs sold and delivered to William B. Bishop several machines. All but $1,500 was paid and before payment Bishop died in an insolvent condition. Plaintiffs, having learned that he acted for the defendants, instituted this action.

FOLLETT, Ch. J. When goods are sold on credit to a person whom the vendor believes to be the purchaser and he afterwards discov-

ers that the person credited bought as agent for another, the vendor has a cause of action against the principal for the purchase price. The defendants concede the existence of this general rule, but assert that it is not applicable to this case, because, while Bishop and the plaintiffs were negotiating, they stated they would not sell the property to the defendants, and Bishop assured them he was buying for himself and not for them. It appears by evidence, which is wholly uncontradicted, that the defendants directed every step taken by Bishop in his negotiations with plaintiffs; that the property was purchased for and delivered to the defendants, who ever since retained it. . . . Notwithstanding the assertion of the plaintiffs that they would not sell to the defendants, they, through the circumvention of Bishop and the defendants, did sell the property to the defendants, who have had the benefit of it, and have never paid the remainder of the purchase price pursuant to their agreement. Bishop was the defendant's mind, and so the minds of the parties met, and the defendants having, through their own and their agent's deception, acquired the plaintiffs' property by purchase, cannot successfully assert that they are not liable for the remainder of the purchase price because they, through their agent, succeeded in inducing the plaintiffs to do that which they did not intend to do, and, perhaps would not have done had the defendants not dealt disingenuously.

Judgment for plaintiffs.

LINDQUIST v. DICKSON

1906, 98 Minn. 369, 107 N.W. 958.

Action to recover from the defendant, as an undisclosed principal, for labor and material performed and furnished by the plaintiff in decorating and repairing her house. It appeared that the plaintiff entered into the contract with defendant's husband, assuming at the time that he was the owner; that later the plaintiff obtained a judgment against the husband on this claim, ignorant of the fact that the property was owned by defendant. The defendant contends that such an unsatisfied judgment is a bar to this action.

Start, C. J. . . . The general rule is that where a simple contract, by parol or writing, is made by an authorized agent without disclosing his principal, and the other contracting party subsequently discovers the real party, he may abandon his right to look to the agent personally and resort to the principal. . . .

Election implies full knowledge of the facts necessary to enable a party to make an intelligent and deliberate choice. . . . We,

therefore, hold upon principle what seems to be the weight of judicial opinion, that, if a person contracts with another, who is in fact an agent of an undisclosed principal, and, after learning all the facts, brings an action on the contract and recovers judgment against the agent, such judgment will be a bar to an action against the principal. But an unsatisfied judgment against the agent is not a bar to an action against an undiscovered principal when discovered, if the plaintiff was ignorant of the facts as to the agency when he prosecuted his action against the agent.

Judgment for plaintiff.

JONES v. COOK

1922, 90 W.Va. 710, 111 S.E. 823.

An action to recover damages resulting from a collision with defendant's automobile, which was negligently driven by defendant's stepdaughter. The stepdaughter, Ivol Hickman, was returning from a football game with numerous friends, but no other member of defendant's family was in the car. Defendant introduced no evidence but asked a directed verdict. It was granted and plaintiff appeals.

MEREDITH, J. . . . But there arises a more serious question on the record. It can fairly be inferred from the evidence that defendant's automobile was a "big closed" Hudson "family car"; that it was acquired by him for the use and pleasure of his family, including his stepdaughter; that she was accustomed to drive it with his knowledge and consent, not only generally, but also with his permission on this particular occasion. . . . Therefore, the question for decision is whether the defendant is liable for an accident occurring by reason of the proved negligence of his stepdaughter, while driving his automobile acquired for the purposes mentioned. . . .

It necessarily follows that, unless the driver of defendant's car at the time of the injury was in his service, the defendant is not liable. The authorities cannot be reconciled. In the leading case of Doran v. Thompsen (76 N.J.L. 754), a case very similar to the case at bar, the court held the owner not liable. In that case the daughter, who was the driver, was the only member of defendant's family in the automobile. In the later case of Missell v. Hayes (86 N.J.L. 348), a son of the defendant was driving the automobile, and with him at the time of the accident were the defendant's wife and daughter, and two guests. The court differentiates that case from the case of Doran v. Thompsen, in that in the Missell case there were members of the defendant's family in the automobile, other than the driver, and held that it was a question for the jury to determine

whether the son, while driving the automobile, was the father's servant on the father's business; and affirmed a judgment in favor of the plaintiff.

We see no possible ground of difference concerning the owner's liability, whether there be but one member of the family or all members of the family in the automobile at the time of the negligent injury. . . . The doctrine of agency is not confined to merely commercial business transactions, but extends to cases where the father maintains an automobile for family use, with a general authority, expressed or implied, that it may be used for the comfort, convenience, pleasure, and entertainment or outdoor recreation of members of the owner's family. This view accords with the great weight of authority.

Judgment reversed.

COSGROVE v. OGDEN

1872, 49 N.Y. 255, 10 Am. Dec. 361.

This action was brought to recover damages for injuries to plaintiff, a small boy, resulting from falling lumber. The lumber had been piled upon a sidewalk in front of the home of the plaintiff's parents. While he was walking by on the sidewalk, some of it fell upon him and greatly injured him. The defendants' agent was in charge of their lumber yard and responsible for the unloading of lumber, selling and delivering it to the customers. On this occasion he had it unloaded on the sidewalk because it was more convenient than in the yard. The defendants had expressly instructed him not to pile it there, but he disregarded the instructions.

Grover, J. . . . The defendants were responsible for this act of Brown. It was an act done by him in the prosecution of their business, and they are not relieved from responsibility therefor by his departure from their instructions in the manner of doing it. The test of the master's responsibility for the act of his servant is not whether such act was done according to the instructions of the master to the servant, but whether it was done in the prosecution of the business that the servant was employed by the master to do. If the owner of a building employs a servant to remove the roof from his house and directs him to throw the materials upon his lot, where no one would be endangered, and the servant, disregarding this direction, should carelessly throw them into the street causing an injury to a passenger, the master would be responsible therefor, although done in violation of his instructions, because it was done in the business of the master. But should the servant, for some purpose of his own, intentionally throw material upon a passenger, the

master would not be responsible for the injury, because it would not be an act done in his business, but a departure therefrom by the servant to effect some purpose of his own.

Judgment for plaintiff.

MEEKER v. MANNIA

1896, 162 Ill. 203, 44 N.E. 397.

A bill for specific performance of a contract involving the purchase of real estate. The defense was that the full purchase price had not been paid. It appeared that the plaintiff paid some $200 to one Liebner, who was apparently acting for Frey & Schlund, who were in turn the agents of the defendant. Frey & Schlund made Liebner their agent to aid in disposing of real estate in this particular section of Chicago because he could speak the Polish language. Various neighbors of Mannia, the plaintiff, testified to having paid various sums to Liebner, and later receiving deeds for the property, all of which plaintiff was well aware. Liebner failed to account for this particular $200 and the defendant contends that the agency was terminated about a month before the transaction took place.

Craig, J. But it is said in the argument that Liebner was discharged as agent before he collected the money. There is some evidence in the record that Frey & Schlund discharged him between the 1st and 10th of September, 1891. . . . Moreover, if they had terminated the agency, it was their duty to give these Polish people, with whom he had been dealing and doing business as their agent, notice that the agency was terminated. But this was not done or attempted to be done until October 26, 1891, after the money in question had been paid, when a notice was published in a newspaper.

Mechem on Agency (sec. 229), in speaking on this subject, says: "Where a general authority is once shown to have existed, it may be presumed to continue until it is shown to have been revoked, and persons who have dealt with the agent as such, or who have had notice of his authority, may very properly expect that if the authority be withdrawn, they will be given reasonable and timely notice of that fact, and that they may therefore lawfully presume, in the absence of such notice, that the authority still continues."

Specific performance decreed.

F. T. BANKING CORP. v. GERSETA CORP.

1923, 237 N.Y. 265, 142 N.E. 607, 31 A.L.R. 732.

The plaintiff is a banking corporation. The defendant is a manufacturer of silk. Plaintiff alleges it sold to defendant raw silk

valued at $18,453.34. The facts indicate that the defendant purchased the goods through the Raw Silk Trading Co., importers, and treated them as owners, and that at the time of purchase the importers owed them more than the sale price of the silk. The defendant desires to set off this against the sale price. The plaintiff in fact furnished money to the importer to purchase the silk in China and took title to it as security. It later surrendered the property, by means of trust receipts to the importer, to be sold by the importer for the bank. It was sold in the importer's name and the defendant dealt with him as principal. The bank by instituting the suit for the contract price has ratified the agency.

POUND, J. . . . The rule is elementary that an undisclosed principal cannot assert his rights against a third party, without leaving to the third party the same rights that it would possess if the agent had in fact been the principal. If the agent sells goods in his own name, having possession of the goods, the right of set-off which might be asserted against the agent, may be asserted against the undisclosed principal. The state of accounts between the agent and the third party at the time the principal seeks to assert his rights against the third party becomes a matter of defense. If the purchaser, acting innocently and in good faith, with no notice or knowledge, sufficient to put it on inquiry, of the agreement between the bank and importer, dealt with the importer in reliance on its contract to purchase the silk from it and the possession of the goods, the rights of the purchaser are not to be affected by the subsequent disclosure of an unknown principal and the limitations on authority of the agent.

Judgment for defendant.

CHAPTER III

PRINCIPAL AND AGENT

RICH v. BLACK & BAIRD

1895, 173 Pa. St. 92, 33 A. 880.

Bill in equity to compel an accounting and a reconveyance of real estate. The defendants, through their agent Moore, were appointed agents for the sale of certain real estate at $3,000 an acre. Later they sent Moore back to see if the price could not be reduced to $2,500 an acre. The plaintiff refused, and the defendants finally informed him that they had obtained a purchaser at $3,000 and the deed was made to Barr, an employee of the defendants. The land was laid out into lots and many of them were sold, the deeds given by Barr. The evidence indicated that in all the transactions Barr merely acted as agent of the defendants. Black & Baird received for their service as brokers, the sum of $416.64 from the plaintiff. Shortly after the plaintiff learned the true facts, this action was instituted.

STERRETT, C. J. The rule of public policy which avoids, at the instance of the cestui que trust, purchases made by agents for sale is practically absolute in its character. . . . And the reasons are obvious. On the one hand, the relation which such agents bear is confidential, and disarms the vigilance of their principals; it affords peculiar facilities for obtaining exclusive information in respect of the property entrusted to them for sale; their employment implies that they have superior advantages for making sales, and that they will use every effort and means to obtain the highest price for the benefit of their principal. On the other hand, their individual interest is to purchase at the lowest price, and places them in a position which is inconsistent with the faithful and proper discharge of the duties of trust. . . . The cestui que trust is not bound to prove nor is the court bound to judge, that the trustee has made a bargain advantageous to himself.

The appellants misapprehend the rationale of this rule. They insist that because, as they claim, the sale was satisfactory to Mrs. Rich, the rule has no application. Conceding that in the first instance it was satisfactory, that fact would not take away her option to rescind. . . . If they could realize profits for themselves, they could and should have done so for their cestui que trust; that was their employment and that their undertaking; and equity will treat that as done which ought to have been done. To sustain the pur-

chase made in these circumstances would work "actual injury" to Mrs. Rich, tend to encourage breaches of trust, and violate a wise rule of public policy.

Decree for plaintiff.

PATTERSON v. MISSOURI GLASS CO.

1897, 72 Mo. App. 492.

This suit is to recover of defendant certain premiums for the insurance of a building leased by plaintiff to defendant. The defendant by the terms of the lease agreed to pay the insurance premiums. It appears that plaintiff's property was managed through agents, who procured the insurance through an agent of the company. The plaintiff's agent received from the insurance agent a 10 per cent rebate on the premium for placing the insurance with the particular insurance agent. The defendant contends that this 10 per cent in reality belongs to the plaintiff and should therefore be deducted from the amount due the plaintiff. The lower court gave judgment accordingly, although the plaintiff's agents obtained the rebate because they were members of the underwriter's board and could not possibly have obtained such a low rate otherwise.

Bond, J. . . . The relative rights of the two parties in this case depended upon the law governing the duty and liability of agents to their principals. On this subject the rule is elementary that all profits made or advantage gained by the agent in the execution of the agency, beyond his ordinary compensation, belong to his principal. It matters not how fair the conduct of the agent may have been in the particular matter, "nor that the principal was not in fact injured by the intervention of the agent for his own benefit, the result is the same." Applying these rules of law to the facts in this record, the conclusion cannot be avoided that the money paid to plaintiff's agents by the agent of the insurance companies for taking out policies in such companies on plaintiff's property, was a personal gain or advantage derived by plaintiff's agents from the execution of the agency beyond the compensation allowed to them by the plaintiff. This being so the money in question belonged to her.

Defendant was allowed the deduction.

WHITNEY v. MARTINE

1882, 88 N.Y. 535.

This action was brought to recover a sum of money which the defendant's testator, acting as an agent for the plaintiff, had invested in certain real estate bonds. The agent was given complete control over the investment. It is insisted that he failed to

exercise reasonable care, as the loan was made to a person of doubtful financial ability and was secured only by a second mortgage.

MILLER, J. . . . The responsibility of an agent or attorney under such circumstances is beyond dispute, and the rule is well settled that the agent is not only bound to act in good faith, but to exercise reasonable diligence and such care and skill as is ordinarily possessed by persons of common capacity engaged in the same business. . . . The proof shows that the value of the property at the highest estimate placed upon it by the defendant's witness was but a few thousand dollars over the amount of the first mortgages and the plaintiff's loan, and a very inadequate security in case of a change or fluctuation in value or the depreciation of real estate in the locality, from any cause. It also appears that the loan upon the first mortgages was made at an unusually large discount for a good investment, and that a large amount was retained for fees, for examining title and other expenses; that the mortgagors were, or became afterward, insolvent and the property was sold at far less than the amount of the first mortgages. These circumstances all tend to show that the loan was improvidently and improperly made, and unsafe and insecure at the start.

. . . And as a general rule it may be properly laid down that it is not prudent or safe to advance moneys on second mortgages when there are large prior encumbrances, and especially where the personal security of the mortgagor is in any way precarious.

Judgment for plaintiff.

WALSH v. ISGRO

1938, 121 N.J.L. 165, 1 Atl.(2) 391.

Action to recover broker's commission for the sale of a farm. The plaintiff was authorized in writing to find a purchaser for the farm at a price of $14,000 at a 7% commission. He had shown the farm on several occasions to one Grover and had received an offer from the latter of $10,000. Later Grover went directly to the defendant and purchased the farm for $10,000, and plaintiff sued to recover his commission, although he did not have an exclusive agency.

WELLS, J. . . . It is a settled rule of law in this state that a real estate broker, duly employed in writing, earns his commission when he finds a purchaser able and willing to comply with the terms specified in the authority thus given or when he finds a purchaser who agrees to purchase on terms satisfactory to the owner. Ganley v. Kalikman, 105 N.J.L. 311, 145 A. 108, affirmed 106 N.J.L. 237, 148 A. 917.

It is not disputed in the present case that the plaintiff, Walsh, had secured an offer of $10,000 from Grover, and that the defendant later sold the property to Grover's wife for that amount. Nor is it disputed that Grover was his wife's agent in the negotiations with Walsh. However, the defendant contends that Walsh was entitled to commissions only on a sale made for $14,000, the amount specified in the authorization of September 9, 1936. . . .

Under the terms of the contract in the case at bar, the plaintiff was entitled to commissions if he was the procuring or efficient cause of the sale to Grover. Since the evidence was conflicting, so as to raise a doubt on this point, it was properly submitted as a question of fact to be determined by the jury. [It found in favor of the plaintiff.]

The defendant urges a further ground of appeal based on the refusal of the trial court to make a certain requested charge. The substance of the charge was that the plaintiff would not be entitled to commissions if the jury found (1) that the defendant believed he was selling to a purchaser other than one who had been shown the farm by Walsh; (2) that there were no circumstances which would put defendant on notice that the purchaser was originally interested by Walsh.

The plaintiff's right to recover is not dependent upon the knowledge of the defendant that the purchaser was procured by the activity of the plaintiff. McLaughlin v. Campbell, 78 N.J.L. 541, 74 A. 530. Furthermore, we think that both of the propositions were necessarily considered by the jury in their determination of the procuring or efficient cause of the sale.

The judgment of the court below [in favor of the plaintiff] is affirmed.

KNOWLES v. HENDERSON

1945, 156 Fla. 31, 22 S.(2) 384.

Henderson brought suit against Knowles to recover a commission for locating a buyer for certain real estate. The evidence indicated that Knowles authorized Henderson to sell the property for a price of $42,000, the commission to be $4,000. Henderson found a buyer who was ready, willing, and able to purchase, but Knowles was unable to transfer the property because it developed that he only owned a one-half interest in it. Judgment was given for the plaintiff and Knowles appealed.

SERBING, J. . . . The appellant next submits that, even assuming the plaintiff's testimony to be true, the judgment may not stand for the reason that inasmuch as the plaintiff has elected to sue upon

the theory that he was employed as a broker to sell the property, he cannot legally sustain his right to a real estate commission upon proof merely that he produced a purchaser ready, able and willing to buy but must go further and prove either that he actually negotiated and effected a sale of the property, or procured from his customer a binding contract of purchase for the property within the terms of his authority, leaving nothing for the principal to do on his part but to execute at the proper time the necessary transfer of title.

The rule contended for by appellant is sound where applicable. But we do not think the rule controls the case at bar. The law makes a distinction between a real estate broker to find or produce a purchaser for the property of another and the employment of a broker to effect a sale of such property. Under the first type of employment contract the broker to be entitled to his commission is required only to produce a purchaser ready, able and willing to perform upon the terms fixed, leaving to the seller the actual closing of the sale. Under the second type of employment contract the broker is not entitled to the commission until he has not only found a purchaser who is ready, able and willing to buy upon the terms fixed by the seller but has also actually effected the sale, or procured from the prospective purchaser a binding contract of purchase within the terms of his authority. . . . Accordingly, a broker who has been employed to effect or consummate a sale will not ordinarily be entitled to his commissions if he has done nothing more than produce a purchaser ready, willing and able to buy, even upon the terms authorized—for in such case he has not completed his contract.

But the general rule stated is not without its exceptions. The weight of authority is to the effect that where a broker in good faith and in reliance upon his contract procures a purchaser ready, able and willing to buy the property in accordance with the terms fixed by the seller, and before the broker can effect the sale or procure a binding contract of purchase the seller defeats the transaction, not for any fault of the broker or purchaser, but solely because the seller will not or cannot complete the transaction, then and in such case the broker is entitled to his commission, if the customer remains ready, able and willing to purchase although the sale has not been fully completed; the strict terms of the contract between principal and broker as to completing the sale or procuring a binding contract of purchase from the purchaser being deemed waived by the principal. . . . As was said in Walker & McClelland v. Chancey, 96 Fla. 82, 117 So. 243, 247:

"It is a general principle of law that he who himself prevents the

happening or performance of a condition precedent, upon which his liability, by the terms of the contract, is made to depend, cannot avail himself of his own wrong and relieve himself of his responsibility to the obligee, and shall not avail himself, to avoid his liability, of a nonperformance of such condition precedent, which he has himself occasioned, against the consent of the obligee. . . ."

Judgment for plaintiff affirmed.

HOGGAN v. CAHOON

1903, 26 Utah 444, 73 Pac. 512, 99 A.S.R. 837.

This action was commenced to recover the sum of $290.35 and interest, the same being the amount of damages and costs paid by the plaintiff. It appears that the plaintiff was made agent of the defendant to take possession of certain property upon which the latter claimed to have a chattel mortgage. As a result of the taking, one S. S. Johnson obtained judgment against the plaintiff. The lower court gave judgment for defendant, and plaintiff appeals.

BARTCH, J. We will, in the first instance, consider the question whether the complaint states a cause of action. . . . Therefrom [the facts] it appears that the defendant appointed the plaintiff as his agent for the purpose of transacting certain specific business, which was to take into possession certain goods and chattels, and transport them to a particular place named. The agent proceeded to, and did transact the business of the agency at the special instance and under the direction of the principal; and, although the goods and chattels were covered by a mortgage held by the principal, the agent was not aware that the taking and carrying away of them constituted a tort. He, as appears, acted in good faith, and upon the faith of representations and assurances of the principal that such taking was lawful and proper. . . .

If the allegations are in fact true, the plaintiff has a right of recovery. The facts stated are such as to characterize the case as an exception to the rule that tort feasors or wrongdoers cannot have redress against each other. That rule applies to cases where he who seeks redress knew or must be presumed to have known that the transaction which resulted in the damages he was compelled to pay was tortious and unlawful. But where, as appears from the allegations in this case, an agent acts in good faith for his principal, under the principal's direction, and relies upon his representations that the transaction is lawful, and the same is not manifestly unlawful, the law implies indemnity, for damages of third parties, to the agent from the principal. . . .

"The agent has the right to assume that the principal will not call

upon him to perform any duty which would render him liable in damages to third persons. Having no personal interest in the act, other than the performance of his duty, the agent should not be required to suffer loss from the doing of an act apparently lawful in itself, and which he has undertaken to do by the direction and for the benefit and advantage of the principal. . . . Wherever, then, the agent is called upon by his principal to do an act which is not manifestly illegal and which he does not know to be wrong, the law implies a promise on the part of the principal to indemnify the agent for such losses and damages as flow directly and immediately from the execution of the agency. . . ." Mechem on Agency, Sec. 653.

We are of the opinion that the court erred in sustaining the demurrer.

SINES v. SUPERINTENDENTS OF THE POOR

1885, 58 Mich. 503.

This suit is brought by Sines against the superintendents of the poor of Wayne county. It appears that Sines and his wife had been appointed keeper and matron of the county alms-house at $800 a year, the year having terminated Oct. 1, 1882. Nothing was said and they continued to perform the services in like manner until the first day of February, 1883, when they were notified that another keeper had been appointed. This action was instituted to recover unpaid salary for the balance of the year, and the amount paid for rent, which was to be furnished under the original contract.

CHAMPLIN, J. . . . The contract had been previously made for a year's service and under that contract defendant had gone on from year to year, and, in such cases, if nothing is said or done by either party at the end of the year to terminate it, but, on the contrary, the person performing service is allowed to continue on without objection, the facts raise the presumption from which the jury have found that both parties have assented to the contract continuing in force for another year.

FLANAGAN v. BROWN

1886, 70 Cal. 254.

This is an action upon a note for $27,000. The owner, who had purchased it from an insolvent bank for $32, made an agreement with the plaintiff whereby the note was to be placed with the plaintiff to sell, dispose of or collect. The proceeds were to be divided equally between the parties. After this agreement the owner released his claim at the request of the defendant. The plaintiff con-

tends that he has an agency coupled with an interest and the owner had no power to surrender his claim.

SULLIVAN, J. . . . If Flanagan has any standing, it must result from something else than his mere custody of the paper; he is not the owner of it; he is a mere agent entrusted with its custody; was he such an agent that his principal had not the right to revoke his authority? . . . The term "power, coupled with an interest" is well understood, and is discussed and defined in the very cases cited by the code commissioners under the section above referred to. These cases lay down the rule that a power coupled with an interest is where the grantee has an interest in the estate as well as in the exercise of the power. It is determined to exist or not accordingly as the agent is found to have such estate or not before the execution of the power. If his interest is only a right to share the proceeds which result from the execution of his power, the agent has not a power coupled with an interest.

The case of Brown v. Pforr, 38 Cal. 550, recognizes the rule as to power coupled with an interest.

"There the agents had an interest to the extent of $750 in the execution of the power conferred within the time named in their contract of agency, but they had no interest in the real estate which was the subject of the agency. Accordingly, the principal, even within the time limited in the contract, was held to be at liberty to revoke."

. . . Flanagan, in the sense of the rule here laid down, and of the rule laid down by section 2356 of the code, was not a holder of a power coupled with an interest. If not, by the terms of this section his power was revocable, and his principal's release is a good bar to this action.

Judgment for defendant.

Chapter IV

AGENT AND THIRD PARTY

BOELTER v. NATIONAL MFRS. BANK et al.

1927, 194 Wis. 1, 215 N.W. 436.

Action by Paul Boelter against the National Manufacturer's Bank and H. C. Hilton. It appeared from the evidence that plaintiff was seeking for a house which he might rent. He learned that a house belonging to one Verbeck was for rent at $35 a month and that the key was with the defendants. He, through his agent, obtained the key from Hilton, cashier of defendant bank. He desired to rent the house and asked the rental. Hilton informed him that the previous parties paid $35 a month. He asked to deposit $5 and send the balance down the next day. This was done and in each case the defendant gave a duplicate deposit slip in favor of Verbeck. Plaintiff moved in, but was soon ejected by Verbeck, as the defendants had no authority to lease—their only authority being to collect the rent. This is an action to recover the damages.

Rosenberry, J. . . . The question is, Does this amount on the part of Hilton to a representation that he was authorized by Verbeck to rent the premises in question? There is no dispute as to the fact that he had no such actual authority. Oliver v. Morawetz, 97 Wis. 333, 72 N.W. 877, establishes the proposition that a person who represents to another that he has authority to do an act as agent, when in fact he has no such authority, is liable on an implied warranty, or in an action of deceit, according to the facts of the particular case. . . .

The defendant Hilton personally or as cashier of the bank neither did nor said anything that was not in accord with the truth. If he was guilty of a breach of duty to anyone, it was to Verbeck, a depositor, when he handed out the key to the Verbeck property without ascertaining the authority of the party to whom he handed it to receive it. But he owed the plaintiff no duty in that respect. . . . Plaintiff's agents conceded that, when they went to the bank to ask for the key, they were already apprized of all the facts that they ever ascertained, and that was that the premises were for rent, the former tenant had paid $35 per month, that the key was in the custody of the bank, and that the rent would be received by the bank on behalf of Verbeck. There was no inquiry whatever as to the right of the bank or Hilton to make a lease of the premises. . . .

If the defendant Hilton is liable at all, it must be upon an implied warranty. All of the cases which we have been able to find are cases in which the agent expressly represented himself as having authority from his principal to act. We find no case where an agent has been held liable under circumstances such as are presented here, either upon deceit or assumpsit. It is apparent here that every word which Hilton said and every act which he did was consistent with the performance of his duty as cashier of the bank. . . . We search in vain for any circumstance in this which warrants a finding that Hilton held himself out as the agent of Verbeck.

Judgment for defendant.

CODDING v. MUNSON

1897, 52 Nebr. 580, 66 A.S.R. 524.

Munson sued Codding, alleging that he had sold and conveyed land for the price of $10,000 but had only received the sum of $9,750, and prayed a judgment for the remaining $250. The plaintiff, having been promised $10,000 for the property, transferred it to the defendant as trustee. The contract of sale was signed for the Mothers' Jewels Home by the defendant. Since the Home was an unincorporated institution, the plaintiff contends that the defendant is individually liable for the unpaid balance.

The evidence discloses that meetings were held in New York by some of its citizens for the purpose of securing a location there for an institution for orphans under the patronage of the Woman's Home Missionary Society of the Methodist Episcopal Church. Both plaintiff and defendant attended the meetings and it was agreed that $10,000 was essential. Donations in the form of negotiable notes were to be taken and defendant was made trustee. This land was transferred to defendant upon the receipt of $9,750 in notes properly indorsed. The plaintiff contends that defendant is individually liable for the balance. The lower court gave the following instruction: "If you find from the evidence that Codding was in this transaction only agent and trustee for the Mothers' Jewels Home, and that all his transactions as such agent have been performed in good faith, then you should find for the defendant." Judgment was thereupon rendered for the defendant.

Irvine, C. . . . It is the general rule that one who assumes to act as agent for a principal who has no legal status or existence renders himself individually liable on contracts so made. . . . This doctrine receives its most frequent application in cases like the present, where a person or committee incurs obligations as the result of instructions given by a body gathered together informally for a

special purpose, and possessing no definite membership or continued power of existence. The rule is founded upon a presumption of fact, and is not the expression of any positive or rigid legal principle. The presumption referred to is that the parties to a contract contemplate the creation of a legal obligation capable of enforcement, and that, therefore, it is understood that the obligation shall rest on the individuals who actively participate in the making of the contract, because of the difficulty in all cases, the impossibility in many, of fixing it upon the persons taking part in or submitting to the action of the evanescent assemblage. If, however, the person with whom the contract is made expressly agrees to look to another source for the performance of its obligations, or if the circumstances be such as to disclose an intention not to charge the agent, as where the other agrees to accept the proceeds of a particular fund, there is no longer reason to indulge the presumption, and it may be rebutted by proof of such facts.

Applying these principles to the case at bar, the evidence would raise prima facie the presumption upon which the general rule is based. On the other hand, it was sufficient to justify the inference that the plaintiff did not look to the defendant personally, but was to receive merely the subscription notes or their proceeds. The instructions should have stated the law as we have indicated it and submitted to the jury the issues bearing thereon. Instead . . . the instruction was erroneous, because it made Codding's release from liability depend upon his action as agent for the Home. . . .

CABOT v. SHAW and Others

1889, 148 Mass. 459.

Contract to recover money paid for freight. The defendants acting only as agents of a steamship company accepted payment of freight on goods to be shipped. The steamship was lost before reaching its destination and this action was instituted to recover for freight paid. This action was based on money had and received to plaintiff's use.

Morton, C. J. . . . The liability of an agent who has acted on good faith, to repay money paid to him for his principal, arises only when the party paying it proves that he has the right to recall it, and that he has notified the agent and made a demand on him before the money was paid over to the principal. After such demand, if the money is still held by the agent, and no change has taken place in his situation the law regards it as held for the use of the party entitled to it, who may maintain an action for it. . . .

In the case before us, it is agreed that "before February 16, 1886,

when said money was paid by plaintiff, and between that date and the time when the plaintiff demanded of the defendants the return of the same, on March 27, 1886, the defendants received other moneys on account of the said company, and before said demand on March 27, 1886, paid out for and on account of said company more than all the moneys which they received on account of said company, including the money received of the plaintiff." . . .

It thus appears that before the demand was made upon them by the plaintiff, the defendants had paid over to their principal the money paid them by the plaintiff. . . . The test of liability is whether the agents have, in good faith, paid over the money received by them. It appears in this case they have. . . .

Judgment for defendants.

LOUGHERY et al. v. HUXFORD et al.

1910, 206 Mass. 324, 92 N.E. 328.

Plaintiffs claimed that on or about March 24, 1904, plaintiffs orally contracted with the Lange Canning Co. of Eau Claire, Wis., and with the Reedsburg Canning Co. of Reedsburg, Wis., by which the plaintiffs were to be their general agents for the year 1904 for the sale on commission in New England of their goods. The defendants with knowledge of such contracts persuaded the canning companies to rescind and break the agreements. The result was that defendants obtained the agency while the plaintiffs were denied it. The plaintiffs, for loss of commissions and other damages, obtained a judgment of $1,549.20. The defendants filed objections.

HAMMOND, J. The rulings requested were rightly refused. While the evidence as to sales made by the plaintiffs or defendants before the year 1904, and by the defendants in 1904, was not admissible as showing the rule of damages, or even as conclusively showing the damages, still it was admissible as having some bearing upon the value to the plaintiffs of the contract and the amount of the damages suffered by the breach.

Exceptions overruled.

Book III

NEGOTIABLE INSTRUMENTS

CHAPTER I

INTRODUCTION TO THE LAW OF NEGOTIABLE INSTRUMENTS

MANHATTAN CO. v. MORGAN

1926, 242 N.Y. 38, 150 N.E. 594.

CARDOZO, J. . . . Testimony is in the record that interim certificates for government and corporate bonds pass freely from hand to hand without other evidence of title than the possession of the instrument. Testimony is also in the record that the particular form of certificate adopted by the bankers did not come into general use till 1920, the year of the transaction out of which this controversy arises. The trial judge refused to find the existence of a general custom whereby instruments of like tenor are treated as negotiable.

The holding was, upon these facts, that title to the certificates stolen from the owner was not divested by the later purchase for value without notice.

We do not say that authority was lacking to issue certificates in some other form that would have imposed a different obligation. Very likely the bankers might have put forth participation certificates or trust receipts whereby the temporary or provisional bonds would have been charged with a trust or subjected to an equitable assignment for the benefit of subscribers. There would be a question even then whether such instruments, if issued, would have had the effect of a negotiation of a part interest in the bonds. The statute provides that negotiation may be effected only by delivery or by indorsement (neg. Inst. Law, § 60), and that indorsement to be effective must be an indorsement of the entire instrument, and not merely a transfer or attempted transfer of a part interest therein (§ 62). There is no occasion to determine the application of those sections, for the instruments issued were not participation receipts giving a present equitable interest in the existing temporary bonds. They were executory promises. The underwriters of the issue, holding the temporary or provisional bonds as security for the underwriting, became bound to the subscribers for the delivery of definitive bonds "when, as and if" received from the government of Belgium.

This analysis of the contract impels us to the conclusion that the law denies negotiability to instruments so phrased. Negotiable instruments may fall within one or other of two classes. They may

represent interest in property, in which event they will give rise to rights *in rem,* or they may be promissory and executory, creating rights *in personam.* Negotiability was one determined by the rules of the law merchant. In this state, a statute, the Negotiable Instruments Law, has codified those rules either wholly or in part. We assume, though there is no occasion to determine, that negotiable instruments of the first class, i.e., those representing interests in property, are not within the purview of the statute, however broad its title. Other acts, more restricted in scope, deal with bills of lading, warehouse receipts, and certificates of stock, instruments *quasi* negotiable, if not negotiable altogether. Our concern at the moment is with instruments of the second class, where the words, in effect at least, are those of promise merely. We do not now decide that even as to instruments of this order, the creative force of the law merchant has been extinguished altogether. Opportunities for growth may exist along lines and in directions which can hardly be charted in advance. We are satisfied, however, that the law merchant is without capacity to make instruments negotiable against the express prohibition of a statute which says that they are not negotiable.

So far as the Negotiable Instruments Law is concerned, the remedy for the evil, if it be one, is an amendment of the statute that will add to the negotiable instruments there enumerated or described such other classes as the law merchant or the custom of the market may from time to time establish. Until such an amendment shall be adopted, the courts in their decisions must take for granted that the Legislature is content with the law as it is written.

NOTE—Interim certificates were made negotiable by statute in New York in 1926, Chapter 704.

CHAPTER III[1]

CREATION OF NEGOTIABLE INSTRUMENTS

In re DONOHOE'S ESTATE

1922, 271 Pa. St. 554, 115 Atl. 878.

The claimant, Richard Donohoe, presented the following note as a claim against his mother's (Cecelia W. Donohoe's) estate:

I Cecelia W. Donohoe . . . promise to pay to the order of *Richard Donohoe, thirteen thousand and seventy* dollars and *86/100 dollars* . . . *with interest at* 6%. . . .

Witness *my* hand and seal.

[Seal] *Hester Johnson,*
Notary Public.

The note was on a printed form and the words italicized above were in the handwriting of Mrs. Donohoe. From the evidence it appears that the notary had Mrs. Donohoe sign in the wrong place and he signed where ordinarily she should have signed. The lower court allowed the note to go in as a valid claim against the estate. On appeal it is objected that the note is invalid because it is not signed. The upper court also held the note valid.

WALLING, J. . . . That Mrs. Donohoe's signature appears in the body of the note and not at the end is unimportant, so long as she intended thereby to obligate herself for its payment. There is no law requiring a note to be signed at the end thereof, as in the case of a will; hence, whenever it can be found that the signature, wherever it appears, was intended as an execution of the note, it is sufficient. For example, to write, "On demand, I, *John Smith,* promise to pay Thomas Brown one hundred dollars," is, in form, a good obligation and that is essentially this case.

PLANTERS' CHEMICAL & OIL CO. v. MORRIS

1924, 19 Ala. App. 670, 100 So. 200.

Plaintiff holder of note sued defendant Morris, maker on a note signed Z $\underset{\text{mark}}{\overset{\text{his}}{\times}}$ T, Morris. There was no attesting witness. Evidence was introduced by plaintiff that defendant, not being able to sign his name, requested another person to sign the defendant's name and the defendant then made his mark.

[1] There are no cases relating to Chapter II of the text.

SAMFORD, J. . . . Under the common law the execution of an instrument by mark is sufficient, and we know of no statute changing the rule.

SHEMONIA v. VERDA

1927, 24 Ohio App. 246, 157 N.E. 717.

The plaintiff, Petros Shemonia, sued the defendant, Vassili Malik Verda, upon the following written instrument, signed by the defendant:

Cleveland, Ohio, January 2, 1924.

I borrowed money from Petros Shemonia, the sum of five hundred dollars ($500.00) with 4 per cent interest. The borrowed money ought to be paid within four months from the above date.

[Signed] Vassili Malik Verda.

Witness: Piroske Verda

The defendant claimed that the instrument was not a promissory note because it contained no promise or agreement to pay.

WASHBURN, P. J. . . . It is true that some courts hold that to be a promissory note the instrument must contain an express promise to pay, and that a promise to pay which is implied in law is not sufficient to constitute the instrument a promissory note. But by the great weight of authority, if the language of the instrument is such that there may be deduced from it a direct undertaking to pay, that is sufficient; in other words, if the promise is not one implied by law from an acknowledgment of indebtedness, but is implied from the language of the instrument itself, from the language used by the maker, the instrument is then a promissory note. . . .

. . . the acknowledgment by the defendant that he borrowed the money from the plaintiff, and ought to repay it imports and amounts in law to a promise to pay it, when considered in connection with the whole writing that was signed by the defendant which specified the amount, due date, and rate of interest. . . . (The language of the instrument satisfied the requirements for a promise, but the instrument was non-negotiable in that it did not contain the words "order" or "bearer.")

SIEGEL et al. v. CHICAGO TRUST & SAVINGS BANK

1890, 131 Ill. 569, 23 N.E. 417.

Siegel, Cooper & Co. contracted with D. Dalziel, an advertising agency, for street car advertising and gave in consideration, the following instrument:

$300.00 Chicago, March 5, 1887.

On July 1, 1887, we promise to pay D. Dalziel, or order, the sum of three hundred dollars for the privilege of one framed advertising sign, size ——— x ——— inches, in one end of each of one hundred and fifty-nine street cars of the North Chicago City Railway Company for the term of three months, from May 15, 1887.

Siegel, Cooper & Co.

The maker claimed that the instrument was not negotiable because of the statement of the transaction on the face of the instrument which gave rise to the instrument itself, and that, therefore, he had the right to set up against the bank his defense of Dalziel's failure to perform.

SHOPE, C. J. . . . It is a promise to pay a certain sum at a day certain, for consideration thereafter to be rendered, and depends for its validity upon the imprint promise of the payee to furnish the consideration at the time and in the manner specified—that is, it is a promise to pay a sum certain on a particular day in consideration of a promise to do and perform on his part. A promise is a valuable consideration for a promise.

But the question remains, whether the statement or the recital of the consideration on the face of the instrument impairs its negotiability and in this instance amounts to a condition precedent. The mere fact that the consideration for which a note is given is recited in it, although it may presume thereby that it is given for and in consideration of an executory contract or promise on the part of the payee, will not destroy its negotiability, unless it appears through the recital that it qualifies the promise to pay and renders it conditional or uncertain, either as to time of payment or the sum to be paid. . . . The presumption of law would be that the contract would be carried out in good faith and the consideration performed as specified. The makers had put their promissory note into the hands of Dalziel upon an express consideration which they were thereafter to receive, and for the performance of which they had set forth to realize upon the undertaking of Dalziel, and we are aware of no rule by which they can hold this endorsee for value before due or before the time of performance must begin, chargeable with notice that the promise upon which the makers realized would not be kept and performed.

Judgment for plaintiff.

GLENDORA BANK v. DAVIS et al.

1928, 204 Cal. 220, 267 Pac. 311.

The plaintiff Bank sued the defendant Davis on a promissory note signed by the defendant Davis. The note appeared to be ne-

gotiable in form, except that immediately preceding the signature of the maker Davis, was the following provision:

> This note is given in payment of merchandise and is to be liquidated by payments received on account of sale of such merchandise.

The trial court concluded that the note was nonnegotiable. One of the questions on appeal was whether the trial court's conclusion was correct.

SHENK, J. We think that the trial court was correct. Section 3082 of the Civil Code requires, among other things, that an instrument to be negotiable, must contain an unconditional promise to pay a sum certain in money. Section 3084 provides that a promise to pay out of a particular fund is not unconditional, and section 3085 provides that "an instrument payable on a contingency is not negotiable, and the happening of the contingency does not cure the defect." It is clear that the last clause of the note, above quoted, is susceptible of no other reasonable interpretation than that payment of the note or any part thereof was to be made out of receipts from the sale of the merchandise for which the note was given, and that this provision is "a promise to pay out of a particular fund," the existence of which depended on the contingency of the sale of the merchandise which might not take place at all or might take place to some, but to an uncertain extent. These factors were fatal to the negotiability of the note under the Code sections referred to.

WELCH v. OWENBY

1918 (Okl.) 175 Pac. 746.

C. A. Owenby et al., indorsees, sued Welch et al., on a promissory note which upon its face contained the following statement:

> It [meaning the note] being given for Percheron Stallion . . . with the understanding and agreement between the maker of this note and the Arkansas Valley Breeding Company that the above described property is and shall remain in said Arkansas Valley Breeding Company's possession with full power of disposition without notice in such manner as he may see fit until paid for. This note is the first of a series of three and if default is made in the payment of one, then all shall be due and payable at once.

Welch claims the note is nonnegotiable and sets up the defense that it was procured by fraud and deceit. Welch rests his claim of nonnegotiability upon the expression that the promise to pay is con-

ditional upon the passing of title to the horse from the payee to the purchaser.

PRYOR, C. . . . It will be observed that this note is certain as to amount, date of maturity, and the promise to pay is unconditional . . . unless the subjoined statement that the note is given for a stallion which is delivered to the maker of the note with the understanding that the stallion shall remain the property of the payee with full power to dispose of the same until the note is paid renders it nonnegotiable. There is nothing in this subjoined statement that makes any of the provisions of the note conditional or qualifies them; it is just a mere statement of what the note is given for and the security for the payment of the note. There is nothing in the statement which accelerates or retards the maturity of the note. This note was executed after tne taking effect of the negotiable instrument statute . . . which statute provides that the promise to pay is unconditional, although coupled with the statement of the transaction which gives rise to the instrument. . . . In the case of the Chicago Railway Equipment Co. v. The Merchants Bank, 136 U.S. 268, 10 Sup. Ct. 999, 34 L. ed. 349, the Supreme Court of the United States, in holding that a subjoined statement in a promissory note, similar to the one in the note under consideration, would not affect its negotiability, used the following language: ". . . The agreement by which the vendor retains the title and by which the notes are secured on the cars is collateral to the notes and does not affect their negotiability. It does not qualify the promise to pay at the time fixed any more than would be done by an agreement of the same kind embodied in a separate instrument, in the form of a mortgage. . . ." In the light of the statute and the foregoing authorities, the subjoined statement in said note did not render said note conditional or uncertain as to any of the essentials of a negotiable instrument. . . .

Judgment for plaintiff.

PAGE v. FORD

1913, 65 Or. 450, 131 Pac. 1013.

Page, indorsee, brought an action to recover an amount due on a promissory note executed by Ford and others. The note was regular in form, but contained upon its face, the following language:

> This note is secured by a mortgage of even date given to secure the balance of the purchase price of the property described in said mortgage.

Ford claims that the holders of the note are limited to the mortgaged property, while Page as holder of said note contends that he

may ignore the mortgage and recover a personal judgment on the note, and that the reference to the mortgage on the face of the note does not make the promise to pay conditional and limited to the covenants within the mortgage.

McBride, J. Quoting from Thorp v. Mimdeman, 123 Wis. 149, 101 Northwestern 114, wherein the court said: "If all the agreements contained in every mortgage are as a matter of law imported into the note . . . the most simple real estate mortgage would deprive the note which it secures of its negotiable character, because it would import into the note one or more collateral agreements which are not for the payment of money. Fortunately it is not necessary to give so violent a shock to the well understood principles of law governing the negotiability of notes and mortgages." The note is given as evidence of the debt and to fix the terms and time of payment. It is usually complete in itself—a single absolute obligation. The purpose of the mortgage is simply to pledge certain property as security for the payment of the note. . . . The promise to pay is one distinct agreement and if couched in proper terms is negotiable. The pledge of real estate to secure that promise is another distinct agreement which ordinarily is not intended to affect in the least the promise to pay, only to give a remedy for failure to carry out the promise to pay. The holder of the note may discard the mortgage entirely and sue and recover on his note; and the fact that a mortgage has been given with the note containing any manner of agreements, relating simply to the presentation of the security, would cut no figure. . . . In view of our holding that the note was negotiable and placed by indorsement free from latent assumptions between the parties, the testimony was immaterial in any event. In this view of the case the following instructions given by the Court below was error: "The note being non-negotiable, the defendants, Ford & Williams, are entitled to show all defenses thereon, which it had against the Oregon & Idaho Company at the time the notice of the settlement of the note was given to them."

HULL v. ANGUS

1911, 60 Or. 95, 119 Pac. 284.

Plaintiff executed a note which, among other things, contained this provision:

This note is given as a part of the purchase price of real property and is secured by mortgage of even date herewith, and *subject to all the terms and conditions of said mortgage.*

The question was whether the note was negotiable, so as to prevent plaintiff's urging the cancellation of the note against the holder.

BURNETT, J. . . . An instrument to be negotiable must contain, among other things, an unconditional promise or order to pay a sum certain in money.

It would be doing violence to the language to say that the note is unconditional, when it expressly says upon its face that it is subject to conditions. The reference to the mortgage by the terms of the note is in effect making the note and mortgage one instrument, with the conditions rendering the note nonnegotiable.

Judgment for defendant.

ENOCH v. BRANDON

1928, 249 N.Y. 263, 164 N.E. 45.

This is an action by the plaintiff to recover certain bonds that had been stolen from him and later negotiated to the defendant, an innocent purchaser. The bonds were secured by a certain trust deed and certain references to it were contained in the bonds which are said by the plaintiff to make the bonds nonnegotiable. If the bonds are negotiable the defendant has the right to retain them. The bonds provided that they might be registered in the usual way, and, except where registered, "they were to be treated as negotiable, and all persons are invited by the company to act accordingly."

ANDREW, J. . . . At times this last provision might aid in the construction of doubtful clauses contained in the instrument before the court. It at least shows that the parties intended to omit anything that might impair negotiability. But no such statement will make negotiable a bond not in the form provided by our statute. . . . At times contract rights may be enforced, or some theory of estoppel adopted, but no intention, no agreement may make negotiable an instrument which the statute declares to be nonnegotiable. We turn, therefore, to the more serious question. The statute deals with the form of the instrument—with what a mere inspection of its face should disclose. It must contain an unconditional promise to pay a fixed sum on demand, or at a fixed or determinable future time, to order or to bearer. Only if it fills these requirements is it negotiable. If it does, no collateral agreement affects its character.

If in the bond or note anything appears requiring reference to another document to determine whether in fact the unconditional promise to pay a fixed sum at a future date is modified or subject to some contingency, then the promise is no longer unconditional.

What that document may provide is immaterial. Reference to the paper itself said to be negotiable determines its character. . . .

The bonds are part of an issue of $7,500,000, "all equally secured by and entitled to the benefits and subject to the provisions" of the trust mortgage. Then, speaking of possible redemption, of acceleration of payment, of a sinking fund, and of notice, it continues: "All as provided" in the trust mortgage, "to which reference is hereby made for a description of the property mortgaged and pledged, the nature and extent of the security, the rights of the holders of the bonds with respect thereto, the manner in which notice may be given to such holders, and the terms and conditions under which said notes are issued and secured."

We hold that here there is no modification of the promise to pay, made in explicit terms. The provisions all have to do with the trust mortgage. They refer to the rights conferred by it upon the bondholders and limit and explain those rights. They are so linked together as to indicate that the obligor was speaking solely of the security. A purchaser, scanning the bonds, would have the same thought. It would never occur to him that, when November 1, 1941, arrived, because of something contained in the mortgage he might be unable to collect the amount due him. He would interpret the statement that the bonds were secured by, and entitled to the benefits and subject to the provisions of, the mortgage, as meaning that a foreclosure or other relief might be had thereunder only subject to its provisions. He would see that reference to it is also made to determine the terms and conditions under which the bonds are issued and secured. Again, it would mean to him, as it means to us, that only by turning to the mortgage might he discover the precise nature of the lien he is to obtain. He would see that the bonds were to be issued, not only upon the general credit of the corporation, but upon the faith of some collateral mortgage. To it he must go, if further knowledge as to his security be desired. . . .

Judgment in favor of the defendant affirmed, the court finding the bonds to be negotiable.

HUSTON v. RANKIN

1922, 36 Ida. 169, 213 Pac. 345.

Plaintiff brought suit on a promissory note which, among other provisions, contained this one:

> In case this note is collected by an attorney, either with or without suit, the makers agree to pay a reasonable attorney's fee.

The defendant contended that this statement on the note, among other provisions, made the note nonnegotiable.

BUDGE, J. . . . It is first contended that the note is not negotiable for the reason that it provides that, "In case this note is collected by an attorney, either with or without suit, the makers agree to pay a reasonable attorney's fee." Appellant concedes the general proposition that the negotiability of a note is not destroyed by reason of a provision for the payment of a reasonable attorney's fee after maturity, but urges that a note may not provide for an attorney's fee without suit and before, or at the time of, maturity, inasmuch as such a provision destroys the certainty of the amount agreed to be paid. C.S. sec. 5868, provides that:

"An instrument to be negotiated . . . 2. Must contain an unconditional promise or order to pay a sum certain in money."

And C.S. sec. 5869 provides:

"The sum payable is a sum certain . . . although it is to be paid: . . . 5. With costs of collection or an attorney's fee, in case payment shall not be made at maturity."

In those states which have adopted the provision of the Negotiable Instruments Law that the sum payable is a sum certain within the meaning of the act, although it is to be paid with costs of collection or an attorney's fee in case payment is not made at maturity, the contention that such a provision in a note destroys its negotiability is untenable (note, L.R.A. 1916B, 675, 684, 685), and although there is a conflict in the authorities, the weight of authority and the better reasoning appear to support the same rule prior to the adoption of the Negotiable Instruments Law. The rule is based upon the view that so long as the amount payable is certain up to the time of maturity, it is not essential that after that time, when the instrument has become nonnegotiable for other reasons, the certainty as to the amount should continue. . . .

The burden of appellant's contention seems to be that the provision in the note here sued upon contemplates that the note may be placed in an attorney's hands for collection at any time before, as well as at the time of or after maturity; that the amount due at maturity would depend to a certain extent on whether it had been placed in the hands of an attorney for collection, and for that reason, the amount due at maturity being uncertain, the note is nonnegotiable. . . .

. . . As is said in Daniel, Neg. Inst. sections 61–62:

". . . the stipulation is valid because it is an indemnification, assured by the maker against the consequences of his own act, for, unless in default, he will not have to pay the additional amount; that it is consonant with public policy, because it adds to the value

of the paper, and has a tendency to lower the rate of discount, . . . and that it does not impair the negotiability of the instrument, for the reasons that the sum to be paid at maturity is certain; that commercial paper is expected to be paid promptly; that, if so paid, no element of uncertainty enters into the contract."

It is clear, therefore, that if a note is paid promptly at maturity no attorney fee or other costs of collection could accrue, and if the cause here under consideration is to be given its natural and ordinary construction, it means that if the note is collected by an attorney after maturity, the maker agrees to pay a reasonable attorney fee.

We are not called upon to decide in this action the validity of a provision for payment of an attorney fee, where collection is made without suit, inasmuch as this clause can only become operative after maturity and can in no way affect the negotiability of the note. . . .

[The note was held to be negotiable.]

UNION NATIONAL BANK OF MASSILLON, OHIO v. MAYFIELD et al.

1918, 71 Okl. 22, 174 Pac. 1034.

Plaintiffs are holders of a promissory note executed by the defendants. The provision in the note with respect to the payment of interest is as follows:

> With interest at the rate 9 per cent. per annum, payable annually, from date until paid: Provided, however, if note is paid on or before maturity, interest shall be only 7 per cent.

The defendants claim that this provision made the note non-negotiable.

SHARP, C. J. . . . The provision with respect to interest means nothing more or less than that interest was payable from date until maturity at 7 per cent. per annum, but, if not paid when due, it should bear interest at the rate of 9 per cent. per annum from date. The note could have been discharged on or before maturity by the payment of interest from date at the rate of 7 per cent. per annum; if not paid then, it could have been paid at any time thereafter upon the payment of interest at 9 per cent. per annum, payable annually. As stated by that eminent jurist, Justice Brewer, in Parker v. Plymell, 23 Kan. 402, in a case involving a somewhat similar provision: "Clearly these words do not destroy the negotiability of the paper. They do not leave uncertain either the fact, the time, or the amount of payment. Indeed, up to and including the maturity of the notes,

they are entirely without force. They become operative only after the notes are dishonored and have ceased to be negotiable, and then there is no uncertainty in the manner and extent of their operation. They create, as it were, a penalty for non-payment at maturity, and a penalty the amount of which is definite, certain and fixed."

McCORMICK & CO., BANKERS v. GEM STATE OIL & PRODUCTS CO.

1923, 38 Ida. 470, 222 Pac. 286.

Plaintiff holder brought suit on three trade acceptances which were ordinary bills of exchange, properly drawn and accepted. There was no question as to the negotiability of the bills except for the following printed matter which appeared on the margin of each of the three instruments:

> The obligation of the acceptor of this bill arises out of the purchase of goods from the drawer. Upon the acceptor hereof suspending payment, giving a chattel mortgage, suffering a fire loss, disposing of his business or failing to meet at maturity any prior acceptance, this trade acceptance, at the option of the holder, shall immediately become due and payable.

The question is whether this printed matter rendered the bill nonnegotiable.

ADAIR, D. J. . . . In the modern commercial world, trade acceptances are fast becoming an important form of contract, ranking with notes, checks and drafts, and other medium of trade. The matter contained therein, aside from the direct order to pay money, is often valuable and intended to facilitate its transfer, and an option similar to that inserted in the margin of the instrument in question might tend to assist the holder in its transfer or sale to another. . . . Does this clause (the second sentence in the marginal note) render the time of payment undeterminable or indefinite? . . . The principle to be deduced from the authorities is this: "To constitute a negotiable promissory note, the time, or the event, for its ultimate payment, must be fixed and certain, yet it may be made subject to contingencies upon the happening of which, prior to the time of its absolute payment, it shall become due. The contingency depends upon some act done or omitted to be done by the maker, or upon the occurrence of some event indicated in the note; and not upon any act of the payee or holder, whereby the note may become due at an earlier day."

We think this general rule should be and the same is adopted in this state, and applying it to the paper here in question, we hold

that the same is negotiable. None of the conditions in the acceleration clause depend upon any act of the holder, nor are they within his control, but all of such contingencies depend either upon some act or omission of the maker, or upon an event indicated in the paper not within the control of either party.

[Court found them negotiable.]

FIRST STATE BANK OF CHEYENNE v. BARTON

1928, 129 Okl. 67, 263 Pac. 142.

Plaintiff brought suit to recover a balance on a time promissory note executed by the defendant. The defendant contended that the note was nonnegotiable because of the following clause:

> If at any time the holders of this note feel insecure regarding payment of this note said holders are authorized to take any or all funds I may have on deposit at the First National Bank, Cheyenne, Okl., to my credit, and place as a credit to this note.

One of the questions presented to the court was whether the above-quoted accelerating clause destroyed the negotiability of the note.

HALL, C. . . . Courts have always placed a liberal construction on commercial paper in the form of promissory notes, with the end in view that such instruments should be held negotiable, if such construction by any fair means is permissible. . . . In regard to the accelerating clause in the present case, if the borrower or maker of the note is a customer of the bank making the note (which generally is the case) the holder at any time, with no other reason than his feeling insecure, can appropriate without the knowledge of the maker any and all funds to the credit of the maker on deposit in said bank, and apply same as partial payment on the note or full discharge of the obligation. Then through no fault of the maker a note which had been paid would be left where it might under certain circumstances, creep into circulation. In case the note were transferred, if the instrument is negotiable, the holder in due course could force payment a second time.

. . . ". . . In no reported case has a clause, accelerating maturity if the holder deems himself insecure, been held negotiable, though a few states have gone as far as to hold negotiable notes with clauses accelerating maturity upon insolvency of the maker or attachment of the property securing the note." (citing numerous cases)

We find no authority which would justify the conclusion that the note in the present case is negotiable. . . .

WETTLAUFER v. BAXTER

1910, 137 Ky. 362, 157 S.W. 741.

Wettlaufer sues Baxter as indorser on the following instrument:

Jan. 15, 1906.

After date we promise to pay Newton J. Baxter two hundred and fifty dollars at 58 Carroll Street, Buffalo, New York.

(Signed) Buffalo Carriage Top Co.

Baxter indorsed the note before maturity to Wettlaufer. The Carriage Company refused to pay and Wettlaufer sued Baxter as an indorser of negotiable paper. Baxter claimed the instrument to be nonnegotiable, because it did not contain the words "or order," or "or bearer."

CARROLL, J. . . . For the purpose then of ascertaining what bills and notes it was intended should be negotiable within the meaning of this act [quoting N. I. L.], we may with propriety inquire what words were generally considered necessary to make a note or bill negotiable. . . . The usual form of negotiable paper is a provision for payment to order or bearer. . . . Without words of negotiability, purchasers take the bill or note subject to all defenses which were available between the original parties, and if it was originally nonnegotiable as against the original parties, it will not be rendered negotiable by subsequent transfer in negotiable form.

Thus it will be seen [from the Act] that it was uniformly held that in order to make a note or bill negotiable, the words "or order," "or bearer," or equivalent words must be used in the body of the note. . . .

Their only effect is to make the instrument negotiable and thereby cut off defenses that the maker or either of the parties to the paper might have and make against the holder in due course, if the note was nonnegotiable. . . . If it is a negotiable instrument, within the meaning of the Act, then the rights and liabilities of the parties to it are fixed and determined by the provisions of the Act alone. This note in our opinion was payable to Baxter alone and did not contain the words "or order," "or bearer" and was not a negotiable instrument.

Judgment for defendant.

UNITED CIGAR STORES CO. v. AMERICAN RAW SILK CO., Inc.

1918, 171 N.Y. Supp. 480.

A man representing himself as Lieutenant Peterson of the United States Navy applied to the defendant for money for a navy tuberculosis camp. He stated that he represented Lieutenant R. L. Parks, Q.M., United States Navy. The defendant drew a check for $100 to the order of Lieutenant R. L. Parks, Q.M., United States Navy, and delivered the check to Peterson with specific instructions to deliver it to Parks as a donation to the fund. It developed that there was no such person as Lieutenant R. L. Parks; that there was no tuberculosis camp fund; that Peterson was an impostor. The plaintiff, the United Cigar Stores Company, cashed the check for Peterson, who claimed to be a representative of Parks and indorsed Parks' name thereupon. Defendant, having discovered the fraud, stopped payment at the bank, and the plaintiff brought this action to recover as a holder of the check. The plaintiff urged that it had good title to the check.

SMITH, J. . . . It appears in the case at bar that there was no actual person calling himself R. L. Parks. One thing is clear, and that is that it was never intended that this check should be paid to this man fraudulently representing himself as Lieutenant Peterson. This check intended to be paid to Lieutenant R. L. Parks, in charge of a Tuberculosis fund for the Navy, has never been indorsed by Parks, or any one assuming to be Parks, in any of these negotiations. . . . The case as I read it, comes squarely within the Shipman Case, wherein the checks were made to fictitious nonexistent persons, and no title has ever passed to this plaintiff upon which it can recover. . . .

Judgment for defendant.

AUTHOR'S NOTE.—If the defendant drawer in the above case had known that Parks was a fictitious person, the paper would have been bearer paper and title to the check would have passed to the plaintiff by delivery; that is, it would not have been necessary to go through the forged indorsement to prove the holder's title.

MECHANICS BANK OF THE CITY OF NEW YORK v. STRAITON

1867, 423 Keyes (N.Y.) 365.

The bank sued the defendant, Straiton, as drawer of a check made payable to "bills payable or order." The defendant claims that the instrument is nonnegotiable for want of a payee, and that it is neither order nor bearer paper.

SCRUGHAM, J. . . . The words "or order," "or bearer," "and

bearer," in notes or bills, are words of negotiability, without which, or other equivalent words, the instrument will not possess that quality, and, therefore, the use of either of these expressions by the drawer of a bill or maker of a note must be regarded as indicating his intention that the paper shall be negotiable.

By naming the person to whose order the instrument is payable the maker manifests his intention to limit its negotiability by imposing the condition of endorsement upon its transfer. But no such intention is indicated by the designation of a fictitious or impersonal payee, for endorsement under such circumstances is manifestly impossible; and the words of negotiability when used in connection with such designation are capable of no reasonable interpretation, except as expressive of an intention that the bill shall be negotiable without endorsement, i. e., in the same manner as if it had been made payable to bearer.

CLARK v. TALLMADGE

1920, 171 Wis. 133, 176 N.W. 906.

The note in question contained this provision:

> . . . and to secure the payment of said amount, I hereby authorize irrevocably, any attorney of any court of record to appear for me in such court . . . . *at any time hereafter,* and confess a judgment, without process, in favor of the holder of this note, for such an amount as may be due, and also for any amount to become due thereon. . . ."

ESCHWEILER, J. . . . We think the reasonable construction under these statutes (provision of the N. I. L.) to be given to this language above quoted, and all of it, omitting no part thereof unless there be cogent reasons for so doing, and none so appears here, necessarily implies that the holder of such note is authorized at any moment after its execution and delivery, to cause judgment to be entered against the maker for any amount still unpaid at such time on the note. We are not justified in construing the clause "at any time hereafter" to mean merely at any time after maturity, nor can we reject as surplusage the phrase, "for any amount to become due thereon." The first phrase speaks of the time of the execution of the instrument, and not as of its maturity. The last phrase relates to a sum not exceeding the face of the note, which is not yet due by the terms of the note itself, but is, according to its terms, to become due thereafter. The right so given to the holder of the note to so enter judgment at any moment after receiving such note is absolutely within his control and beyond the power of the maker to prevent, and therefore it is not payable at a fixed deter-

minable future time within the meaning of section 1675-1, supra (N. I. L.). The power of attorney involved here therefore renders such note nonnegotiable . . .

AUTHOR'S NOTE.—This instrument would be negotiable in Illinois. The negotiable instruments law of that state permits judgment to be taken upon such instruments any time after the date thereof.

PRATT v. HIGGENSON et al.

1918, 238 Mass. 256, 119 N.E. 661.

Plaintiff is suing to recover 4 per cent coupon bonds of the United States for par value of $1,000, payable to bearer, and 4 per cent convertible gold bonds of the American Telegraph and Telephone Company, payable to bearer. Plaintiff claims the right to recover possession of bonds on the theory that the word "convertible," by giving the holder an option to take something in lieu of money as payment, renders the instrument nonnegotiable and, therefore, their title was not divested by a sale from a thief to the defendants who purchased in good faith.

BRALEY, J. . . . If the property had consisted of chattels or nonnegotiable documents of which certificates of stock are an example, the plaintiff's title would not have been divested by a sale even to a purchaser for value and in good faith. . . . But to this rule there is a well-recognized exception where the property consists of negotiable securities. . . . It is settled by Spooner v. Holmes that an action for conversion of interest coupons of United States payable to bearer cannot be maintained by the owner from whom they were stolen when the defendant in good faith received them as an agent in exchange, and without gross negligence from a party to the theft, and paid the proceeds to his employer, receiving no benefit himself, and without any notice from the plaintiff. The grounds of the decision are that being negotiable promises for the payment of money, issued by the government, payable to bearer, the title passed by delivery and the coupons were "subject to the same rules as bank bills or other negotiable instruments payable in money to bearer." . . .

The provision shown by the word "convertible" that the holder at maturity will receive the whole in money or at his option an equivalent in stock of the corporation does not destroy the negotiability. It is a negotiable instrument within the meaning of [quoting N. I. L.] and possesses the essential attributes of commercial paper for the conversion of which the defendants on record cannot be charged.

Judgment for defendant.

TRIPHONOFF v. SWEENEY

1913, 65 Or. 299, 130 Pac. 979.

On March 25, 1911, the defendant gave a check to Malcheff dated April 15, 1911, which payee negotiated to the plaintiff before maturity. The defendant stopped payment on the check as it was given in payment of forged estimates of work done. The defendant claims the right to set up defenses in that the instrument was postdated and therefore nonnegotiable.

BEAN, J. . . . It makes no difference whether a check be postdated or antedated, it is still payable according to its express terms. The drawing of a postdated check is an everyday occurrence in the commercial world, and the uniform understanding of the parties is that when a check is postdated it is payable on the day it purports to be drawn, even though it be negotiated beforehand. . . . An antedated or postdated instrument may be negotiated after or before the date given, and anyone to whom such an instrument is given acquires title thereto as of the date of delivery.

Judgment for plaintiff.

JUMP v. SPARLING

1914, 218 Mass. 324, 105 N.E. 878.

Jump, the holder, sued Sparling individually upon an instrument signed in the following manner: "J. H. Sparling, Treas. Stratton Engine Co." Sparling intended to sign merely in a representative capacity. Oral evidence was introduced to show representative capacity.

RUGG, C. J. . . . Under the law previous to the enactment of the Negotiable Instruments Act the defendant corporation would not have been held on this note. It would have been not the note of the corporation, but simply the individual note of the individual who signed. . . . A change in the law in this respect has been wrought by the Act [quoting sec. 20, U. N. I. L.].

These words apparently imply that if the person signing a promissory note adds to his signature words describing himself as an agent or as occupying some representative position which at the same time discloses the name of the principal, he shall be exempted from personal liability. While, if he omits the name of the principal, although adding words of agency, he will be held liable personally, and the words of agency will be treated simply as descriptio personae. In this respect the common law of this commonwealth whereby agents bind themselves by a form of signing a note such as the one at bar, even though acting with authority . . . is abro-

gated. The agent now relieves himself from liability by a form of signing whereby he describes himself as agent of a disclosed principal.

Though the law on this point in other jurisdictions before the passage of the Negotiable Instruments Act may have differed from that of this commonwealth, the result here reached appears to be in harmony with the rule now generally prevailing under that Act.

Judgment for defendant.

MURRAY v. THOMPSON

1916, 136 Tenn. 118, 188 S.W. 578.

Murray, an infant, sustained injuries while working for a brick company, and in settlement of claim for damages accepted a promissory note payable to his order. This note was indorsed by the infant, Murray, to Thompson and the proceeds invested in a business which failed. Murray, the infant, now seeks to disaffirm the indorsement and to recover possession of the instrument from Thompson.

WILLIAMS, J. One of the questions on which judicial decisions were in conflict was whether an infant's indorsement of a negotiable instrument was void or only voidable [Court, quoting Sec. 22, U. N. I. L.]. In stipulating that the indorsement of the instrument by an infant "passes property therein" it was meant to provide that the contract of indorsement is not void, and that his indorsee has the right to enforce payment from all parties prior to the infant indorser. The incapacity of the minor cannot be availed of by prior parties.

It was not intended to provide that the indorsee should become the owner of the instrument by title indefeasible as against the infant, or to make the act of indorsement an irrevocable one.

The Act does not concern the right of such indorser to disaffirm under the rules of the law of infancy.

The words "passes the property therein," if given a meaning that would deny that right in respect of a contract of indorsement, would deprive the infant of the right to reinvest in himself the title to the instrument against a holder who had knowledge of the indorser's infancy. . . . The common law rule is that the purchaser and indorsee of a note is not a bona fide holder as against an infant indorser and that the latter may disaffirm and recover the note from the possession of the former, who takes with constructive notice of the incapacity.

Judgment for plaintiff.

CHAPTER IV
NEGOTIATION

FARNSWORTH v. BURDICK

1915, 94 Kan. 749, 147 Pac. 863.

William S. Burdick and A. M. Ewing made a promissory note to one Mr. J. A. Wheeler. Mr. Wheeler negotiated the note to the plaintiff, Farnsworth, by writing on the back the following words:

> I, hereby, assine this note over to E. H. Farnsworth, this Nov. 1, 1910.
> J. A. Wheeler

The defendant, Burdick, claims that Farnsworth did not get the note by indorsement but by assignment and seeks to set up a defense of failure of consideration.

MARSHALL, J. (quoting Sec. 63, of the U. N. I. L.). . . . "A person placing his signature upon an instrument, otherwise than as maker, drawer, or acceptor, is deemed to be an indorser unless he clearly indicates by appropriate words his intention to be bound in some other capacity."

When Wheeler placed his name on this note and did not do it as a maker, drawer, or acceptor, he is therefore deemed to be an indorser unless the word "assine" used by him indicates his intention to be bound in some other capacity. The authorities seem to be in utter and hopeless confusion concerning the effect of the transfer of a negotiable instrument by words like those used here. This confusion existed prior to the passage of the Negotiable Instruments Law and still exists. The weight of authority was and is that this is a commercial indorsement. We are of the opinion that the assignment of this note is an indorsement thereof under the Negotiable Instruments Law; that Farnsworth is a holder in due course; that the makers of the note cannot set up the defense against the note that could have been set up against it in the hands of Wheeler.

Judgment for plaintiff.

FAY v. WITTE

1933, 262 N.Y. 215, 186 N.E. 678.

Fay, holder of promissory note, brings an action against Witte as an unqualified indorser, the note having been protested for nonpayment and due notice thereof having been given to the defendant as indorser.

CRANE, J.

The payee for good and valuable consideration indorsed the note in the following language:

> I hereby assign all my right and interest in this note to Richard Fay in full,
>
> Harry C. Witte.

The court in the Appellate Division below held that the indorser by the assignment by the note had rendered himself an indorser without recourse and he was, therefore, not liable as an unqualified indorser. The reason assigned for this conclusion in the opinion of the Appellate Division was that indorsement implies two things: one, a transfer of the note; two, a promise to pay if the maker fails to do so. Witte, it was said, by having assigned the note transferring title, impliedly excluded the second condition or implication—the promise to pay upon default. We can find no justification in the Negotiable Instruments Law (Consol. Laws, c. 38) for an implied qualified indorsement. Either the words, "without recourse," must be used, or other words of similar import. The exclusion of the liability must be expressed by appropriate words, and not implied from the transaction. "A person placing his signature upon an instrument otherwise than as maker, drawer or acceptor is deemed to be an indorser, unless he clearly indicates by appropriate words his intention to be bound in some other capacity." (Negotiable Instruments Law, § 113.)

The placing of this assignment and his name upon the note constituted Witte an indorser unless the words indicate a different intention. The signing on the back of the note has a different effect than would such signing under the same words on a separate paper not attached to the note. This would not be an indorsement at all. It would be a mere assignment transferring title. It is the writing on the back of the instrument itself which constitutes the indorsement with the effect given to it by the Negotiable Instruments Law. . . .

We find no words in this indorsement which state expressly that the payee or indorser assigns or transfers the note, but is not to be held liable over in case of default. We have a clear expression of an assignment and transfer. This is what the words used mean. The note and title to the note were passed to Richard Fay, the plaintiff. However, we find nothing else. The words, "without recourse," are not used, nor any other words of "similar import." We may imply by the use of the word "assign," as did the Appellate Division, that the payee considered himself no longer liable, but im-

plication is not permitted by the statute. The denial of recourse to a prior indorser must be found in the express words, "without recourse," or words of similar import. This indorsement contains no such words. Witte, the defendant, became an unqualified indorser liable as such upon nonpayment and notice of protest. This is the law as stated in most of the authorities, text-books, and treatises.

The judgment of the Appellate Division should be reversed and that of the County Court affirmed, with costs in this court and in the Appellate Division.

Judgment accordingly.

KARSNER v. COOPER

1922, 195 Ky. 8, 241 S.W. 346.

One Cooper, Jr., son of the defendant, Cooper, Sr., executed his note to A. Riley and C. Riley, jointly, for $1,350, due twelve months later. About three weeks after the execution and delivery of the note, A. Riley, one of the payees, indorsed in writing his name on the back thereof and delivered it to A. Karsner in payment for an automobile to the extent of $835, there having been paid on the note $515. The indorsement was in blank. Immediately after A. Riley had indorsed and delivered the note to A. Karsner, A. Riley induced the defendant, Cooper, Sr., to sign his name to the note as a joint maker. There was abundant proof that the defendant was induced to sign by fraud. Later A. Karsner negotiated the note, by delivery, to his brother, C. Karsner, the plaintiff, who paid value therefor. The payee, C. Riley, did not indorse the note until long after it was due. In a suit by the plaintiff, the defendant seeks to set up the defenses of fraud and lack of consideration. The question was whether the plaintiff was a holder in due course and hence free from the defenses.

Thomas, J. . . . Our Negotiable Instruments Act, sec. 49, . . . says: "Where the holder of an instrument payable to his order transfers it for value, without indorsing it, the transfer vests in the transferee such title as the transferrer had therein, and the transferee acquires in addition, the right to have the indorsement of the transferrer. But for the purpose of determining whether the transferee is a holder in due course, the negotiation takes effect as of the time when the indorsement is actually made."

And section 3720 b 41 of the same Statutes says: "Where an instrument is payable to the order of two or more payees or indorsees who are not partners, all must indorse unless the one indorsing has authority to indorse for the others."

The note involved here was made payable to the order of two persons, and there is no pretense, or, at any rate, nothing on the face of the note to show, that they were partners; nor is there anything to show or evidence to prove, that A. Riley had authority to indorse the name of his wife and joint payee on the note, nor did he pretend to do so. When, therefore, plaintiff accepted the note in the face of and directly contrary to the requirements of section 41 (as to indorsement of both joint payees cited above) of our Negotiable Instruments Act, it would seem to require no lengthy discussion to demonstrate that, inasmuch as one of the payees had not in any manner indorsed it, all the rights which plaintiff obtained were those set forth in section 49 of the act (cited above), which were the rights in it that A. Riley, the only indorser, had therein, and that, because it was not then indorsed by C. Riley, the wife, which she did not do till long after it was due, the complete negotiation did not take effect until after its maturity, and that plaintiff is not, therefore, a holder in due course. . . .

. . . Since, therefore, the evidence shows beyond question that the name of defendant to the note was wholly without consideration and was obtained by fraud, and that under the proven circumstances plaintiff was never a holder of it in due course, the court properly rendered judgment dismissing his petition, and it is therefore affirmed.

Chapter V

HOLDERS AND HOLDERS IN DUE COURSE

HAM v. MERRITT

1912, 150 Ky. 11, 149 S.W. 1131.

Action by Ham against Merritt to recover on a note which was given by the defendant to the Southern Hospital Association, the giving of the note being induced by fraud. It was transferred to one Brunson and he sold and indorsed the $300 note to the plaintiff for $100. The defendant contends this fact makes the plaintiff a taker in bad faith.

Hobson, J. . . . Ham and Brunson both testified, in substance, that Brunson had to have $100, and that he finally sold the note to Ham for $100 in order to get this amount of money. The evidence is clear and conclusive that Ham, in fact, paid Brunson $100 for the note, and there is an entire want of any other evidence to show that he had notice of any infirmity in the note, except the fact Brunson sold it for $100. Brunson and Ham both lived in Tennessee, and neither knew Mrs. Merritt. While the fact that the note sold for so small an amount might, with some other evidence, be of great weight, standing alone, it is not sufficient to show that Ham is not a *bona fide* purchaser.

Section 56 of the Negotiable Instrument Act (Laws 1904, c. 102) is as follows: "To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith." Under this statute, the mere fact that the purchaser takes the note at a large discount is not sufficient, standing alone, to deprive him of its protection.

Judgment for plaintiff.

PEOPLE'S STATE BANK v. MILLER

1915, 185 Mich. 565, 152 N.W. 257.

Miller gave his check to a brokerage firm for stock. The brokerage firm deposited the check in the plaintiff bank. The stock was not delivered and, the brokerage firm having failed, Miller stopped payment on the check. The plaintiff bank had not yet collected the check from the drawee bank, but had merely credited the brok-

er's account with the amount of the check. Miller contends that the bank was not a purchaser for value and, therefore, subject to his defense of nondelivery of the stock.

KUHN, J. It seems to be a general rule that when checks or other commercial paper are deposited in a bank indorsed, "for collection," or where there is a definite understanding that such is the purpose of the parties at the time of deposit, the title to the paper remains in the depositor, and the mere fact that the depositor is allowed to check against the credit does not change the import of the transaction. . . . The bank may as a matter of favor and convenience permit checks to be drawn against it before payment. . . . If a paper is delivered by a customer to a bank for collection or "for collection and credit," a credit of the amount to the customer before and in anticipation of collection will be deemed merely provisional, and the privilege of drawing against it merely gratuitous. . . . The right of banks to do this in case of deposits of checks on other banks without any special contract is generally exercised and recognized. This is inconsistent with the idea that title to the check appears absolutely in the bank and is only consistent with the theory that the bank is agent for the customer for collection, notwithstanding the credit of the latter. . . . Under the contract here entered into between the bank and the brokerage concern, it is clear that the bank became the latter's agent for the collection of the check and could not, it is needless to suggest, be the owner of the paper at the same time.

Judgment for defendant.

JOHN DAVIS & CO. v. BEDGESOFF et al.

1930, 155 Wash. 127, 283 Pac. 665.

Defendants executed to one *B* their negotiable promissory note in the sum of $2,700. Before maturity of the note, *B* indorsed and delivered it to the plaintiff corporation as collateral security for the payment of certain money loaned to him by the corporation. Thereafter and before maturity, consideration for the note completely failed, so that the makers, defendants, would have had a complete defense to an action brought by *B* on the note. Plaintiff brought suit on the note, but on the trial failed to show how much was due it from *B* on the loan it made to *B,* for which loan the note was given as security. The court dismissed the action for this reason. The plaintiff appealed urging that, on taking the note as security, it became vested with full legal title to the note with the right to collect the full amount, whether the amount owed the plaintiff was more or less than the face value of the note and irre-

spective of any defense that the defendants might have against *B*.

MITCHELL, C. J. . . . "In this state . . . an indorsee of a note taken as collateral security is a holder in due course to the extent of his interests, if the note is taken before maturity and without notice of any existing equities between the maker and the original payee. . . . But the rights of such holder are restricted to his interests. The rule being that, when the maker of a negotiable instrument indorsed as collateral security has a defense against the original payee of the instrument, the indorsee can in no event enforce payment in excess of the amount which the note is pledged to secure."

. . . It being established by the pleadings and the proof that the defendants had a complete defense to any suit that A. Bridge (*B*, the payee) might have brought on the note . . . , it was incumbent upon the appellant (plaintiff) to prove the amount of Bridge's indebtedness to the appellant on the loan in question for which the instrument was given as collateral. This the appellant did not do and therefore a judgment dismissing the action was proper.

STATE AND CITY BANK AND TRUST CO. v. HEDRICK et al.

1930, 198 N.C. 374, 151 S.E. 723.

On September 23, 1919, each of the two defendants, tobacco warehousemen, executed his demand note for $5,000, payable to the *V* Bank and *due on demand*. It was contemplated that this amount would take care of any overdrafts of the defendants in their account with the *V* Bank, during the tobacco-selling season. The accounts were settled between the defendants and the *V* Bank, but the bank failed to return the notes to the defendants and fraudulently indorsed and negotiated to the plaintiff on June 10, 1920, both of the said notes, as collateral security for a loan made by the plaintiff to the *V* Bank. The *V* Bank became insolvent and there is still due the plaintiff $2,904.91 on the original debt, which sum the plaintiff is attempting to recover from the defendants on the notes which the plaintiff is holding as security.

The question is whether the plaintiff is a holder in due course and therefore not subject to the defense of no consideration which the defendants would have had in a suit brought by the *V* Bank.

CONNOR, J. . . . It is generally held, without regard to statutory provisions, that a negotiable instrument due and payable on demand is not overdue for the purpose of negotiation, until after the lapse of a reasonable time, and that what is a reasonable time depends upon the facts and circumstances of the particular case.

8 C.J. p. 408, sec. 603. These principles have been recognized as the law and are included in the Uniform Negotiable Instruments Act, which has been enacted as the law in this state. . . . Where a negotiable instrument, payable on demand, is negotiated an unreasonable length of time after its issue, the holder is not deemed a holder in due course. Upon the facts found by the referee, in the instant case, and approved by the court, we are of opinion that, as a matter of law, the negotiation of the notes dated September 23, 1919, and due, on demand, to the plaintiff on June 10, 1920, was after the lapse of a reasonable time, and that therefore it was error to hold that the plaintiff became and was the holder in due course of said notes. Even if it should be held that, upon the facts of the instant case, the notes were not overdue until after December 20, 1919, nearly six months had elapsed from said date before the notes were negotiated to the plaintiff on June 10, 1920. This is an unreasonable time, and plaintiff cannot be held a purchaser of the notes before maturity, which is essential to make it a holder in due course. . . .

ANDERSON v. ELEM

1922, 111 Kan. 713, 208 Pac. 573.

The defendant drawer gave a check after the conclusion of a business transaction at night. He stopped payment on the check before banking hours the next day, because the consideration for the check failed. The payee did not present the check for payment but remained in the same town for several days and was accessible to the maker, who knew where he was, but took no steps to obtain possession of the check. The check was dated October 20, 1919, and was cashed in another town in the same state on November 14, 1919, by the plaintiff, who had no knowledge of the failure of consideration. When the check was presented for payment, payment was refused. Plaintiff brings suit on the check. The defendant contends plaintiff is not a holder in due course because he took the check an unreasonable time after its issue.

Burch, J. . . . one who acquires an unpresented check a considerable time after it was issued may nevertheless be a holder in due course. . . . The Negotiable Instruments Act requires that the time shall not be unreasonable. What is a reasonable time depends on a variety of facts and circumstances. . . .

Did the lapse of twenty-four days from the date the check was issued, without more, necessarily give it, in the eyes of the plaintiff, or in the law, the same appearance as that of a dishonored draft, or of an overdue and unpaid promissory note?

. . . It is perfectly true that a check is ordinarily to be regarded as an instrument for present use; but the Negotiable Instruments Act did not declare that a check is due at once, or that it must be presented or put in the course of collection, by the close of business on the next business day after issue. A check is not overdue, for the purpose of negotiation, unless there has been an unreasonable delay in presenting it, and unreasonable delay must be interpreted to mean such delay as to make the check obviously stale.

The facts are before the court. It is essential to uniformity that the court itself should determine questions of this character, and the court holds that the time elapsing between the issuing of the check and its negotiation did not deprive the plaintiff of the rights of a holder in due course.

Judgment for plaintiff.

In re ESTATE PHILPOTT

1915, 169 Iowa 555, 151 N.W. 825.

Philpott entered into a contract to purchase land, and gave his notes to a land company as part payment. Later the contract was canceled with the understanding that the notes be returned. The notes were not returned but indorsed to the plaintiff. One of the notes had blank spaces upon its face as follows: "on or before four .... after date." The defendant contends that the note was not complete and regular upon its face and that the plaintiff was not a holder in due course.

EVANS, J. . . . This note was not complete and regular upon its face. It indicated upon its face that some word had been omitted in an attempted specification of the time of payment.

If it were made to appear that the real contract between the parties was that the note was to be payable in four months or four years, the instrument was reformable in equity. (Quoting U. N. I. L.): "Where the instrument is wanting in any material particular the person in possession thereof has a prima facie authority to complete it by filling up blanks therein." . . . Such an instrument is thereby rendered negotiable, but it becomes so after the blanks are filled and not before. If the real intent of the parties interested was to make this instrument payable in four years, it may be that the payee could have lawfully corrected the oversight by inserting the word "years" and it may be also, that this would have rendered the note negotiable to the holder in due course. . . . The question put in that form is not now before us and we need not play upon it. We think it quite clear that this irregularity upon the

face of the note prevented its taker from becoming its holder in due course.

Judgment for defendant.

LIBERTY TRUST CO. v. TILTON

1914, 217 Mass. 462, 105 N.E. 605.

Perley G. Tilton signed a note to the order of the plaintiff and presented it complete in every respect except the amount, which was blank, to the defendant, Frank B. Tilton. Frank B. Tilton signed his name on the back for the accommodation of Perley G. Tilton with the express understanding that the instrument would not be negotiated until one Leonard Grant also signed on the back, and that the amount should be filled in for two hundred dollars and no more. Grant did not sign the paper and Perley G. Tilton filled in the amount for four hundred dollars and sold the note complete in form to the plaintiff, the payee, who took it without knowledge of the agreement between Perley G. Tilton and Frank B. Tilton. The bank sues Frank B. Tilton. Frank B. Tilton contends that the bank as payee is not a holder in due course.

RUGG, C. J. The effect of that decision (77 N.E. 45) was to hold that the words "immediate parties" as used in section 33, viz., "As between immediate parties and as regards a remote party other than a holder in due course, the delivery, in order to be effectual, must be made either by or under the authority of the parties making, drawing, accepting, or indorsing, as the case may be; and in such cases the delivery may be shown to have been conditional or for a special purpose only and not for the purpose of transferring the property to the instrument," does not necessarily include the payee. Hence, "immediate parties" placed in that connection excludes a party who is a holder in due course. In such cases these words must be confined to parties who are immediate to the conditions or limitations placed upon the delivery in the sense of knowing or being chargeable with notice of them. A payee who is a holder in due course is not an immediate party in the sense of that section. . . . The conclusion follows that the payee named in a promissory note, who purchases it complete in form for value before maturity, in good faith and without notice of any infirmity in title or otherwise, is a person to whom it has been negotiated as a holder in due course, notwithstanding it was signed in blank by the parties to be charged, whose instructions as to filling of the blanks and the delivery has not been followed by the one to whom it was intrusted by him in its incomplete state.

Judgment for plaintiff.

MILES v. DODSON

1912, 102 Ark. 422, 144 S.W. 908.

Dodson, the holder, sued Miles, the maker, upon a note payable to the order of E. H. Smith, dated August 20, 1903, and due January 1, 1905. The plaintiff purchased the note from a bank in February, 1905, which bank had previously purchased it from a holder in due course. The defendant claims the right to set up defense of payment against the plaintiff, on the ground that the plaintiff acquired the instrument after its maturity, and therefore was not a holder in due course.

FRAUENTHAL, J. . . . But under the facts of this case we do not think that the makers can resist the payment of this note by any defense which they might interpose to it in the hands of the original payee even if it should be held that the plaintiff obtained the note from the bank after its maturity. The note was transferred by the payee, Smith, to Dodson & Son in August, 1903, prior to its maturity. If Dodson & Son were at the time holders thereof for value in due course of business then any subsequent purchaser thereof from them, even though he obtained it after maturity, would be protected against any defense which the makers might have or be entitled to assert against the original payee, as is said in one Daniel on Negotiable Instruments, page 801: "As soon as the paper comes into the hands of a holder unaffected by any defect its character as a negotiable security is established; and the power of transferring it to others with the same immunity which attaches in his own hands is inimical to his legal rights and necessary to sustain the character and value of the instrument and to protect the bona fide holder in its enjoyment," and the author further says: "If the holder acquired the paper after maturity from one who became a bona fide holder for value and without notice before maturity, he is then protected by the strength of his transferor's title." . . .

Judgment for plaintiff.

CHAPTER VI

RIGHTS AND LIABILITIES OF PARTIES

LAWLESS v. TEMPLE

1926, 254 Mass. 395, 150 N.E. 176.

PIERCE, J. This is an action by the payee against the drawee. The bill is as follows:

Natick, Sept. 24, 1923

Maurice E. Temple, Please pay to the order of Hazel Lawless $351.50, three hundred fifty one dollars and 50/100.

Norris J. Temple
Maurice E. Temple

The answer raised the sufficiency of the acceptance. . . . The specific contention of the defendant is that the mere signature of the name of the drawee on the bill cannot fulfill the requirements of the statute that the signification of the assent of the drawee must be in writing and must also be signed. Before the adoption of the Negotiable Instruments Act, an oral acceptance of an existing bill of exchange was generally held valid in this country. . . .

The common practice before the act was to write the word "accepted" on the face of the bill, followed by the signature of the acceptor. . . . But such was not necessary, as Sewall, J., said in Storer v. Logan, 9 Mass. 55, at page 59:

"An acceptance entered upon a bill generally, or the blank indorsement of the name of the drawee, holds him absolutely as an acceptor; and no conditions or stipulations, which he may have connected with his acceptance, unless expressed upon the bill, will avail against an indorsee or payee, to whom the bill has been negotiated, and who had received the bill as accepted, without notice of the conditions." . . .

We are of the opinion that under G. L. c. 107, section 155, a drawee may be charged as an acceptor although he writes merely his name upon the bill, and that anyone taking the bill has the right to fill up a blank acceptance on the same principle that a holder may fill up a blank indorsement . . .

Judgment for plaintiff.

FLATHEAD COUNTY STATE BANK v. FIRST NAT. BANK

1922, 282 Fed. 398.

The plaintiff payee of a check, before taking it from the drawer, wired to the drawee bank the following message:

> We hold check of A. O. Myhre (drawer) on your bank for ten thousand dollars. Is it good?

The defendant drawee wired the following reply:

> A. O. Mylhre check for ten thousand dollars is good.

The check was dishonored and the plaintiff is suing defendant, alleging that the defendant's wire constituted an acceptance.

COTTERAL, D. J. . . . The plaintiff necessarily relies on the supposed acceptance of the check in question. Certain statutes of Minnesota are called to our attention as bearing upon the controversy, inasmuch as the place of payment of the check was in that state. The only application of them is that they sanction the acceptance of a check by a separate instrument, and, of course, by a telegram. . . .

In the present case, the inquiry was whether a certain check was good, and the answer was it was good. There was omission of any language expressive of a purpose to honor the check. We are unable to construe the answer to that effect, without other aiding circumstances. Standing alone, it is technically an affirmation that the check of Myhre was worth its face at the time. The meaning ordinarily would be that the deposit account of the maker was then sufficient to meet the check. But this is different from undertaking to pay it, as would have been the significance of the act of formally accepting or certifying it. . . .

Judgment for defendant.

LEEKLEY v. SHORT et al.

1933, 216 Iowa 376, 249 N.W. 363.

I. E. and Erma Short executed a negotiable note for $10,000 in favor of Ella B. Ward and secured it with a mortgage on certain real estate. Ward sold the note and mortgage to the plaintiff and indorsed each of them "without recourse." The plaintiff alleges that the note is due and that the maker is insolvent and was insolvent when the note was executed and that such insolvency was known to the defendant Ward at the time the note was negotiated to the plaintiff. It is also stated that the mortgaged property has a value

not in excess of $6,500 and that no more than said amount can be realized by foreclosure of the mortgage. The plaintiff seeks to recover on the implied warranty of the indorser to the effect that the indorser Ward knew the instrument was invalid or valueless.

ANDERSON, J. . . . The warranties implied by the statute, accompanying an indorsement without recourse, do not include the solvency of the maker, but are restricted to matters affecting the legal enforceability of the paper; and, without an allegation of fraud or deceit, there can be no recovery thereon based upon the insolvency of the maker or his inability to pay. . . .

We hold that the Iowa statute under consideration creates no implied warranty, under a restricted (qualified) indorsement as to the solvency of the maker of a negotiable instrument, or that the instrument is worth par. An indorsement without recourse impliedly warrants that the instrument is genuine and in all respects what it purports to be; that the transferor has good title to it; that all prior parties had capacity to contract; and that the instrument is legally enforceable. There is the additional implication that the indorser knows of no fact which would impair the validity of the instrument or render it valueless, but this provision or implication can arise only when the indorser has such knowledge and fraudulently conceals or withholds same from the transferee. . . . All of these cases, except the early ones, arose under the Negotiable Instruments Law and hold that the word "valueless" does not refer to the value of the security nor to the solvency of the maker, but simply to some legal insufficiency. . . .

Judgment for defendant Ward affirmed.

ROCKFIELD et al. v. FIRST NATIONAL BANK of SPRINGFIELD

1907, 77 Oh. St. 311, 83 N.E. 392.

This action was brought against Rockfield and others to recover on a promissory note. On the back of the instrument appeared the names of Rockfield, Good, and others, who indorsed it before it was delivered to the plaintiff. Defendants claimed that they were not notified of the nonpayment of the note by the maker at maturity and were therefore not indebted to the plaintiff in any sum.

SPEAR, J. . . . The theory of the defendant's proceeding is that Rockfield and Snyder, by writing their names across the back of the note, became indorsers in a commercial sense, and therefore entitled to notice of demand at maturity of the maker and of nonpayment, and, failing, that no liability attached. The theory of the petition is that these defendants having signed the note before delivery must

be held to have signed with the purpose of giving it credit and adding negotiability and therefore stand as makers, and although their names appear on the back of the instrument and they are in law sureties, yet they are not indorsers in the commercial sense and therefore not entitled to notice of demand and nonpayment. . . . In this state from early times (quoting cases) it is held that where the name of a third party, a stranger to the note, appears in blank on the back of the note at the time it takes effect, his undertaking rests upon the consideration which supports the note and the presumption is he intended to be liable as a surety. . . . The question at issue very largely turns upon what is meant by the terms of section 3173 I, the substance of which we here repeat: "Where a person, not otherwise a party to an instrument, places his signature thereon in blank before delivery, he is liable as an indorser." . . . The contention that the provision to the effect that every indorser undertakes to pay after the instrument is dishonored and he has due notice applies only to general indorsers we think untenable. It is "every indorser who indorses without qualification, etc." The word "every" is a term of inclusion. It embraces every party who by previous provision is classed as an indorser, unless his indorsement has been qualified by appropriate words. . . . It follows from these conclusions that by force of sections (quoting Uniform Negotiable Act) a person who being a stranger to a promissory note places his name on the back by blank indorsement is an indorser of the paper and cannot be held in any other capacity. As such, he is entitled, in order to render him liable, to notice of demand on those who are primarily liable and failing such demand and due notice to him, he is discharged.

Judgment for defendant.

W. M. BARNETT BANK v. CHIATOVICH

1925, 48 Nev. 319, 232 Pac. 206.

DUCKER, C. J. [Facts stated in opinion] . . . The purchase of the note being sued on was made by the plaintiff bank from Thornberry, the payee, in October, 1919, more than a year before maturity. . . . The circumstances surrounding the purchase of the note, as testified to by the president of the plaintiff bank, point to its good faith in the transaction. The testimony was not contradicted in any way. The circumstances in evidence pointed out by counsel for defendants in his brief, and claimed by him to indicate the bad faith of plaintiff in the transaction, were for the jury, and resolved against defendants by the verdict in the case. As there was ample evidence to justify the jury in concluding for plaintiff on

the bona fides of the transaction, the verdict is conclusive in this respect.

Defendants contend that the note is void by reason of fraudulent representations claimed to have been made by Thornberry to J. M. and W. M. Chiatovich, the defendants, respecting the pedigree and breeding of the jacks and jennets sold by him to the Chiatovichs under the contracts mentioned, and as to the number and quality of foal said jacks and jennets would produce if properly handled. The two Chiatovich brothers testified to matters tending to support the allegations of their answer in this regard, and other testimony to the same effect was given.

The effect of Thornberry's fraud in obtaining the note in question, upon plaintiff as its holder, if in fact he committed any fraud, was submitted to the jury by proper instructions. The general rule is that fraud in a contract, or in the consideration out of which a negotiable instrument arose, is no defense in favor of the maker as against a bona fide holder. This rule is elementary in the law merchant, and is embodied in our law concerning negotiable instruments. Before Thornberry's fraud could be held to impeach the note in plaintiff's hands, it must appear that plaintiff had actual knowledge of the fraud or knowledge of such facts in connection therewith that the taking of the note amounted to bad faith. Section 56 of the Negotiable Instruments Act (Rev. Laws, sec. 2603), reads:

"To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith." . . .

Judgment for plaintiff.

LOZANO v. MEYERS

1929, Tex. Com. App., 18 S.W.(2d) 588.

The plaintiffs seek to cancel two promissory notes which were executed by the plaintiffs to Meyers and Mulhausen, as contractors. The plaintiffs gave the notes in consideration for the contractors' promise to construct a building. The contract to build was never carried out and the plaintiffs seek to cancel on account of failure of consideration. However, the contractors had already sold one of the notes to one Thompson, who purchased before maturity and gave value. Thompson sold the note to one Purdy for value, and without notice. The defendant Purdy brought a cross-action and sought and was granted judgment for the amount of the note

held by him. The other note was canceled, but the plaintiff appealed, urging that Purdy's note should also have been canceled.

HARVEY, P. J. . . . The plaintiffs contend that these instruments gave notice to both Thompson and Purdy that the contract was indivisible and wholly executory; and, inasmuch as the Mulhausens and Meyers failed to perform their obligations under the contract, the defense of failure of consideration for the note is available to the plaintiffs in error as against Purdy.

The note is a negotiable instrument, and Purdy is holder in due course. Since the latter had no knowledge or notice, at the time he acquired the note, that the consideration therefor had failed, he does not lose the character of holder in due course, even though the "building contract" and note be taken as imparting notice to him that the contract of the Mulhausens and Meyers was indivisible and wholly executory, as contended by the plaintiffs in error. The note is not subject, in his hands, to the defense of failure of consideration. Rev. St. 1925, art. 5933, secs. 25 and 28; 1 Dan. Neg. Inst., sec. 790; 8 C.J. 748; 3 R.C.L., p. 1067. Besides this, Thompson acquired the note in due course, at a time when no breach of the contract had occurred. Purdy, in acquiring the note from him, succeeded to his rights. . . .

Judgment affirmed.

ANGUS v. DOWNS

1915, 85 Wash. 75, 147 Pac. 630.

The plaintiff, Angus, a holder in due course, sues the defendant, Downs, upon a promissory note. Downs defends on the ground that the instrument was never delivered, in that, after it was completed, but before delivery, it was stolen.

FULLERTON, J. (quoting U. N. I. L.). . . . This section, it will be observed, provides in terms that, where the instrument is in the hands of a holder in due course, a valid delivery thereof by all parties prior to him so as to make them liable to him is conclusively presumed. Language could hardly be made plainer and is as applicable to a holder in due course of commercial paper stolen before delivery as it is to commercial paper stolen subject to delivery or commercial paper the title to which is defective for any other reason.

As a general rule, a negotiable promissory note, like any other written contract, has no legal inception or valid existence as such until it has been delivered in accordance with the purpose and intention of the parties. There accordingly is no doubt that delivery of a negotiable instrument is necessary to create any liability as between the immediate parties. . . . No doubt, where the maker of

a negotiable instrument negligently allows the same to get into circulation, he should be held liable to a bona fide holder upon the ground that he is estopped by his own negligence to deny a valid delivery. The maxim declaring that where one of two innocent persons must suffer by reason of a wrong of a third party, he whose act made the wrong possible should bear the loss justly applies with full force. But it is somewhat shocking to suppose that the maker, having exercised due care, may be deprived of his property without his consent. Nevertheless, this is clearly the intention of the Negotiable Instruments Law. . . . This principle applies only to complete instruments, however, for it is declared also by the Act that, where any incomplete instrument has not been delivered, it will not, if completed and negotiated without authority, be a valid contract in the hands of any holder as against any person whose signature was placed thereon before delivery.

Judgment for plaintiff.

NATIONAL EXCHANGE BANK of ALBANY v. LESTER

1909, 194 N.Y. 461, 87 N.E. 779.

Lester was sued as an accommodation indorser upon a note for $375. The note as originally made and indorsed was for $75 only. The maker, before delivery, but after defendant's indorsement and without defendant's consent and knowledge, inserted in the blank spaces the words "three hundred" immediately in front of the word "seventy-five" and the figure "75," and discounted the note as one for $375 at the plaintiff bank.

WILLARD BARTLETT, J. . . . The learned counsel for the respondent asserts the doctrine that "a party to a note who puts his name to it in any capacity of liability, when it contains blanks uncanceled facilitating an alteration raising the amount, is liable for the face of the note as raised to an innocent holder for value." . . . In considering this proposition, it is important to bear in mind a radical distinction which exists between two classes of notes to which the adjudicated cases relate: (1) those notes in which obvious blanks are left at the time when they are made or indorsed of such a character as manifestly to indicate that the instruments are incomplete until such blanks shall be filled up; and (2) those notes which are apparently complete and which can be regarded as containing blanks only because the written matter does not so fully occupy the entire paper as to preclude the insertion of additional words or figures or both. One who signs or indorses a note of the first class has been held liable . . . on the doctrine of implied authority, while in the other cases, relating to the notes of the second class, the liability

of the maker or indorser for the amount of the note as increased by filling up the unoccupied spaces therein is placed upon the doctrine of negligence or estoppel by negligence. . . .

No one questions the proposition that where a party to commercial paper intrusts it to another with a blank thereon designed to be filled up with the amount, such party is liable to the bona fide holder of the instrument for the amount filled in though it be larger than was stipulated with the person to whom immediate delivery was made. . . . But, where there is no blank for that purpose, when the note is indorsed, the insertion of an obligation to pay interest is a material alteration which invalidates the instrument as against the indorser. . . . Now, however, under the Negotiable Instruments Law, . . . he would be liable on the paper according to its original tenor. . . .

On what theory is the indorser negligent because he places his name on the paper without first seeing to it that these spaces are so occupied by cross lines or otherwise as to render forgery less feasible? It can only be on the theory that he is bound to assume that those to whom he delivers the paper or into whose hands it may come will be likely to commit a crime if it is comparatively easy to do so. I deny that there is any such presumption in the law. . . . On the contrary, the presumption is that men will do right rather than wrong. Judgment for plaintiff reversed.

TRUST CO. of AMERICA v. CONKLIN

1909, 65 Misc. (N.Y.) 7, 119 N.Y. Supp. 367.

The plaintiff, Trust Co., seeks to recover from the defendant for an overdraft of his account. It appears that the overdraft arose from the fact that the defendant left the city, and, upon his departure, gave his bookkeeper a number of checks signed by him in blank in order to provide funds for the use of his business. His bookkeeper locked the checks in a drawer in the safe. One of the defendant's employees knew where the key was hidden, took out a blank check, filled in the blank, so that it apparently became a complete instrument payable to the bearer for the sum of $200.

Lehman, J. . . . In the present case, we have two causes intervening to produce a check for the defendant to pay. The defendant delivered the check, signed it in blank to an agent, upon whose fidelity he was bound to rely, and the blanks were subsequently filled in, not by his own agent, but by one who obtained the check through a crime. I do not think that the defendant can be considered negligent in the care of the instrument. It is true that it was stolen; but he kept it locked up in a drawer under circum-

stances that showed at least reasonable care, and he could not presume that a trusted porter had turned out to be a clever thief. If the defendant is liable at all, it is because he owed the bank a duty which he violated by signing the check in blank.

We may, for the purpose of this appeal, dismiss entirely the question whether the defendant would be liable to a bona fide holder for value. The question before us is entirely one concerning the duties of a depositor to his bank. That a depositor owes a real duty of care to a bank has been frequently decided, and this duty is greater than that which the maker of an instrument owes to a subsequent holder for value. A purchaser of a negotiable instrument can take it or not at his option, and usually, at least to some extent, relies upon the responsibility of the last holder. A bank, however, must, at its peril, pay out the money deposited if the depositor directs him to do so. . . . In this case, a depositor has signed a blank check, and has made it possible for a person obtaining the check, not only to successfully tamper with it, but has facilitated if not invited the forgery, which was actually successfully completed. In one sense, he may not have been negligent. It is possible that even a careful man might be willing to assume the risk of theft; but he owed a duty to the bank to put his signature on a blank check only for the purpose of directing it to pay out the money, and however slight the risk, the depositor is the person who has assumed it, . . . and by a survey of his contract made with the bank, he is now bound to pay back to the bank the money which it has paid out.

STRICKER v. BUNCOMBE COUNTY et al.

1934, 235 N.C. 536, 172 S.E. 188.

The plaintiff purchased for value in due course, from a reputable dealer in municipal bonds, and owned, as above stated, a certain Buncombe county road and bridge bond, of the face value of $1,000, with certain unpaid interest coupons attached. At the time he purchased said bond he had no notice of any defect in title or any other irregularity with respect to said bond, and purchased it for the purpose of using the proceeds thereof in part payment of his own taxes, as authorized by Chapter 280 of the Public Laws of 1933, and for the further purpose of selling and assigning any remainder thereof to other persons who desired to acquire bonds, to be applied in payment of taxes, as authorized by said Chapter 280. The bond is payable to "bearer," is negotiable by delivery, and is not registered.

For the purposes of this action it is agreed that the said bond in question was stolen, together with other securities, from Lillian Van Ostrand, in Hollywood, Cal., a former owner thereof, but that the

plaintiff in this action had no knowledge that said bond had been stolen, and that he paid the full market value of said bond, and purchased the same from a reputable dealer in bonds and securities, who also had no notice that said bond had been stolen. It is further agreed that the principal of said bond will not be due until April 1, 1944.

Upon the foregoing facts the trial court adjudged that the plaintiff may negotiate the bond or apply it in the payment of taxes as if it had not been stolen.

The defendants excepted and appealed.

ADAMS, J. . . . It is elementary law that one who finds a lost chattel, although it has not been abandoned, is entitled to possession against all persons except the true owner. With respect to the loser, the title is unaffected by the mere incident of loss, and he may reclaim his property from the finder.

To this rule there is generally recognized exception if the property consists of negotiable securities. Although the thief or finder of a negotiable instrument can acquire no title against the real owner, still, if the instrument be indorsed in blank or be made payable to bearer, a third party acquiring it from the thief or finder, bona fide, for a valuable consideration, before maturity and without notice of the loss, may retain it as against the true owner upon whom the loss falls. Calvert's Daniel on Negotiable Instruments (7th Ed.) § 1731.

To a large extent negotiable securities take the place of money. "It would be most embarrassing therefore," it is said, "if every taker of such paper was bound, at his peril, to inquire into the title of the holder, and if he was obliged to take it with all the imperfections and subject to all the defenses which attach to it in the hands of the holder. It had, therefore, become the settled rule that a thief or any other person having possession of such paper fair upon its face can give a holder in due course a good title to it against all the parties thereto as well as the true owner. It may be taken to be the well settled rule of law that the transfer of stolen commercial paper, negotiable by delivery, to a bona fide purchaser for value, without notice and before maturity, vests him with a good title against the world." 3 R.C.L. Bills and Notes, § 210.

Judgment affirmed.

SABINE v. PAINE

1918, 223 N.Y. 401, 119 N.E. 849.

COLLIN, J. [Facts stated in opinion.] The action is upon a promissory note in the sum of $2,100, made by the defendant and

owned by the plaintiff. The note was payable, four months after its date, to the order of Eugene F. Vacheron. It was delivered to him as the agent of the defendant for the purpose of having it discounted for her. He, after indorsing it, transferred it to the plaintiff for the sum of $1,850. Under the evidence and the decision of the Appellate Division, this appeal presents the single question, Is a usurious promissory note enforceable by a holder in due course? [Court quotes N. I. L. Sections 52 and 57.]

When the Negotiable Instruments Law was enacted, it was an established rule of law in this state and many other jurisdictions that a holder of a note void by virtue of a statutory declaration because of usury, who became such before the maturity of the note for value and without notice of the usury, could not enforce the note. The rule is an exception to the general principle that a negotiable instrument, in the hands of an innocent holder, who had received it in good faith in the ordinary course of business, for value, and without notice of a defense, is not invalid and is enforceable by the holder. . . .

The rule, constituting an exception to it, rests upon the legislative intention and enactment. An instrument which a statute, expressly or through necessary implication, declares void, strictly speaking, is a simulacrum (image) only. It is without legal efficacy. It cannot obligate a party or support a right. In Claflin v. Boorum, 122 N.Y. 385, 388, 25 N.E. 360, 361, we said: "A note void in its inception for usury continues void forever, whatever its subsequent history may be. It is as void in the hands of an innocent holder for value as it was in the hands of those who made the usurious contract. No vitality can be given to it by sale or exchange, because that which the statute has declared void cannot be made valid by passing through the channels of trade. . . ."

The statutes of this state fix the rate of interest upon the loan or forbearance of money at $6 upon $100 for one year, and at that rate, for a greater or less sum, or for a longer or shorter time, forbid the taking of a greater rate, and provide: "All bonds, bills, notes, . . . whereupon or whereby there shall be reserved or taken, . . . any greater sum, or greater value, for the loan or forbearance of any money, goods or other things in action, than is above prescribed, shall be void. Whenever it shall satisfactorily appear by the admissions of the defendant, or by proof, that any bond, bill, note, assurance, pledge, conveyance, contract, security or any evidence of debt, has been taken or received in violation of the foregoing provisions, the court shall declare the same to be void, and enjoin any prosecution thereon, and order the same to be surrendered and canceled." General Business Law (Cons. Laws, c. 20) sub. secs. 370,

371, 373. The statute is peremptory and unequivocal in enacting that a usurious obligation is absolutely void.

The Legislature did not by enacting Section 96 of the Negotiable Instruments Law intend to abrogate the rule we have stated. The statute declaring the usurious instrument void is not repealed expressly or through implication. The court is, under its command, to declare it void, enjoin prosecution of it, and order it to be surrendered and canceled, whenever satisfactory proof of its usurious character appears. It is a pretense, and ineffectual as a source of obligation or of right. It is insubstantial and within the intendment of the Negotiable Instruments Law is not a negotiable instrument, and cannot be acted upon or affected by it. Section 96 is a declaration of the general principle stated by us, and has not relevancy to the rule which is an exception to it. . . .

Judgment for defendant.

CHAPTER VII

PERFORMANCE OF CONDITIONS PRECEDENT TO CHARGE SECONDARY PARTIES

LEONARD v. UNION TRUST CO.

1922, 140 Md. 192, 117 Atl. 318.

Plaintiff brought suit against the defendant as an indorser of a demand promissory note which was dated August 17, 1917. The plaintiff offered the note in evidence and proved that it was presented for payment on the 6th of February, 1920, and was protested for nonpayment and notices were sent to the defendant the same day; but the plaintiff also showed that the maker, the Amiesite Company, went into receivership and the defendant, president of the company, along with the receivers, were attempting, until a short time before the note was protested, to refinance the company, and that the delay in presentment was due to the plaintiff's desire not to press the defendant and to do all it could to get the company going again. Defendant urges that he is discharged because presentment was not made within a reasonable time after issue.

THOMAS, J. . . . While the evidence shows that the note was not presented for payment, protested, and notice sent to the defendant until February 6, 1920, it also shows that after the receivers took charge of the property of the Amiesite Company the defendant and the officers of the trust company were engaged, until a short time before the note was protested, in efforts to reorganize or refinance the company with the view of paying all the indebtedness of the company, including the note in suit, and that the delay in having the note protested, etc., was due to the desire of the trust company not to press the defendant and to do all it could to get the Amiesite Company "going" again. Under these circumstances we think the note was presented, and notice of dishonor given to the defendant, within a reasonable time. . . .

Judgment for plaintiff.

COLUMBIA BANKING COMPANY v. BOWEN

1908, 134 Wis. 218, 114 N.W. 451.

Action by the Columbia Banking Company as holder of a draft against John Bowen, an indorser thereon. On June 10, 1903, the

Farmers' and Merchants' Bank of Bangor, Wisconsin, sold to Bowen a $400 draft, drawn on the National Bank of North America at Chicago, Illinois. Bowen indorsed the draft to one A. R. Tabbert and sent it by mail to Spokane, Washington, where it was received by Tabbert on June 20. Tabbert, traveling to San Francisco, California, carried the draft with him, and, on July 14, 1903, he indorsed the instrument to the plaintiff bank in San Francisco. On that day the plaintiff sent the draft by mail to the drawee bank in Chicago, which bank received the instrument on July 18. It was on that day presented for payment and dishonored, and due notice given to Bowen. Bowen contends that he is relieved as an indorser because of delay in presentment.

MARSHALL, J. . . . As to whether the incidents of the species of bills of exchange last mentioned are the same as those of bills of exchange it was further provided . . . "A check must be presented for payment within a reasonable time after its issue or the drawer will be discharged from liability thereon to the extent of the loss caused by the delay."

Keeping in mind that the discharge from liability above referred to because of unreasonable delay after the issuance of a check in presenting it for payment is of the drawer only, and that this action is against the payee who indorsed the instrument in question without qualification and put it in circulation, we turn to Section 71 which provides as to a bill of exchange payable on demand, which from the foregoing obviously includes a check or a draft on a bank of the character of the one in question "presentment for payment will be sufficient if made within a reasonable time after the last negotiation thereof." . . . A bill of exchange payable on demand, regardless of its character, put in circulation, so long as its circulating character is preserved, may be outstanding without impairing the liability of indorsers thereof.

Applying the law as aforesaid to the facts of this case, it is readily seen that the delay in presenting the paper for payment between its date and the negotiation to the bank at San Francisco is immaterial. Appellant (Bowen) unqualifiedly indorsed the paper and put it in circulation by sending it to Tabbert at a distant part of the country, probably knowing that he was a traveler. Tabbert received the paper while journeying with the intention of going to San Francisco and held it till he arrived there and then negotiated it. It was promptly presented for payment thereafter and so in time as regards that circumstance to preserve the liability of appellant.

Judgment for plaintiff.

GILPIN v. SAVAGE

1911, 211 N.Y. 167, 94 N.E. 656.

The cashier of the Columbia National Bank called the maker of a note by telephone at his place of residence and requested payment. Payment was refused, and Gilpin, the holder of the instrument, now sues Savage, the indorser of the note, which note was payable at a particular place. Savage defends, claiming the instrument was not properly presented for payment.

CULLEN, C. J. . . . It seems entirely clear that no proper presentment of the note was made. Presentment of a note and demand of payment must be made by actual exhibition of the instrument itself or at least the demand should be accompanied by some clear indication that the instrument is at hand ready to be delivered and such must really be the case. While it may not be necessary to actually produce the note, if the maker refuses to pay it, it must be there at the place for presentment; otherwise, the presentment is insufficient. . . .

The counsel for the respondent seeks to sustain the judgment below on two propositions: first, that a demand over the telephone on the maker, at the place specified in the note, is the same as a demand at that place by ordinary speech; second, that the possession of a note by the cashier was sufficient to make the demand a proper one. The truth of the first proposition, as a general rule, may be conceded; but the argument ignores the fact that a valid presentment, as hitherto pointed out, consists of something more than a mere demand. It requires personal attendance at the place of demand with the note, in readiness to exhibit it if required, and to receive payment and surrender it if the debtor is willing to pay. The counsel cites several cases in which it is said that the possession of the instrument by the person making the demand is sufficient, although it is not actually exhibited. These statements were entirely accurate when made, before the general use of the telephone. When demand is made by ordinary human vocal power, unaided by mechanical device, it is plain that the person making the demand is necessarily present at the place at which the demand is made, and if the instrument is in his possession the presence of the instrument is equally clear. The statement, if now inaccurate, is so by the use of the telephone. If the theory on which the decisions of the courts below have proceeded is to prevail, it is difficult to see why a valid presentment of a note payable in Buffalo might not be made over the telephone from New York; or if that is to be deemed too great a distance, where shall the line between a sufficient and insufficient demand and presentment be drawn?

Judgment for defendant.

NELDON v. GRONDAHL

1904, 13 N.D. 363, 100 N.W. 1093.

This action is brought against the defendant as indorser of a promissory note of which he was the payee. The plaintiff is a holder for value, and the note was duly presented for payment when due, and payment refused. The defendant sets up that the note was not presented for payment in the manner provided by law, in that the note by express terms states that it was payable to Grondahl, the defendant, at his store in Fargo, North Dakota. The certificate of the notary does not state that it was presented for payment at the place specified in the note.

Morgan, J. . . . The Negotiable Instruments Act also provides that presentment for payment is made at the proper place where a place of payment is specified in the note, and it is there presented. The certificate does not state the name of the person to whom it was presented and the notary does not give the name of the person in his testimony. A presentment at the bank where a note is payable is sufficient presentment to the maker, although the name of the person to whom presented is not given. . . . The act of presentment was established by the certificate in a general way but not definitely. Whether the presentment was made at the right place was not stated or established thereby. The certificate showed some kind of presentment, but one not necessarily legal or proper under the statute. The bare allegation that the note was presented for payment is not equivalent to certifying that the note was presented at the place where it should have been done. . . . It remains to be determined whether the evidence of the notary was admissible to supply facts that occurred in reference to the presentment that were omitted from the recitals in the certificate (oral evidence was held admissible to show presentment was made at the proper place).

MYERS v. BIBEE GROCERY COMPANY

1927, 148 Va. 282, 138 S.E. 570.

The plaintiff, Bibee Grocery Co., brought action against Myers, as accommodation indorser. Upon maturity the note sued upon was presented and payment was refused. The plaintiff holder thereupon wrote and mailed to the defendant the following letter:

> A note for $669.08, given us by Yeager & Myers on May 28, 1924, was due today, and, as you are indorser on this note, we are writing to advise you that the same is due and to advise you of your liability for the payment of the same, in lieu of having the same protested.
>
> We will ask that you gentlemen please arrange to let us have payment of this note at once as the same cannot be renewed.

The defendant contends that the notice of dishonor was insufficient.

WEST, J. . . . In order to hold an indorser liable, he must have notice that the note has been dishonored, or reasonable diligence must be used to give him such notice. A negotiable note is dishonored only when it is presented for payment according to its terms and payment is refused.

It appears from the evidence that the note upon which this action is based was presented for payment at the Lynchburg National Bank on the day it was due, and that payment was refused, because makers had no money in the bank with which to pay the note, and that the holder on that day mailed to the indorser the letter hereinabove quoted, informing him that the note had been dishonored.

Virginia Code, § 5658, provides:

"The notice may be in writing or merely oral and may be given in any terms which sufficiently identify the instrument and indicate that it has been dishonored by nonacceptance or nonpayment. It may in all cases be given by delivering it personally or through the mails."

It is contended that the notice was insufficient, but when inspected it meets the requirements of Section 5658, supra, since the language used is sufficient to "identify the instrument and indicate that it has been dishonored by . . . nonpayment." While it does not, in terms, say that the note has been presented and payment refused, it does so state by implication. It describes the note and tells the indorser that the holder will look to him for payment and that plaintiff is writing him this letter "in lieu of having the note protested." The holder could not look to the indorser for payment if the note were not unpaid, and could have the note protested only when it had been presented for payment and payment refused. . . .

Our conclusion is that the notice contained in the letter of July 28, 1924, was sufficient. . . .

PRICE v. WARNER

1911, 60 Or. 7, 118 Pac. 173.

Defendant was the indorser of a promissory note executed by Warner. The instrument was duly presented for payment and dishonored. The note was payable in Salem where the defendant resided. The person giving the notice of dishonor also resided in Salem. The day subsequent to the presentation of the note for payment plaintiff's agent called at defendant's place of business for the purpose of giving him notice of dishonor on the note and found that he was temporarily absent from the city. He repeated his vis-

its for four or five days and on each day found him still absent. Afterwards he saw him and gave him notice. The question was whether the plaintiff had given notice of dishonor within the proper time.

McBride, J. (quoting N. I. L.) . . . "The notice may be in writing or merely oral and may be given in any terms which sufficiently identify the instrument and indicate that it has been dishonored by nonacceptance or nonpayment. Where the person giving and the person to receive notice reside in the same place, notice must be given within the following times: (1) If given at the place of business of the person to receive it, it must be given before the close of business hours on the day following. (2) If given at his residence, it must be given before the usual hours of rest, on the day following. (3) If sent by mail, it must be deposited in the post office in time to reach him in the usual course the day following. "Delay in giving notice of dishonor is excused when the delay is caused by circumstances beyond the control of the holder." . . . Plaintiff was required by section (quoted above) to give notice the day following the dishonor of the note, either by mail or personally, unless the delay was excused by the contingency mentioned in section above. (Delay in giving notice of dishonor is excused when the delay is caused by circumstances beyond the control of the holder and not imputable to his default, misconduct or negligence.) The law does not excuse a delay caused by the impossibility of giving notice in a particular manner, but only excuses the delay by the impracticability of giving notice at all.

In this case a notice sent through the mail would have fulfilled every demand of the statute. The plaintiff asks that the delay be excused, not because circumstances beyond his control rendered it impracticable for him to give notice sooner, but because he was unable to give it sooner in the manner attempted. (Plaintiff was held not to have had an excuse for failure to notify within the time allowed by the N. I. L.)

FIRST NATIONAL BANK of SHAWANO v. MILLER

1909, 139 Wis. 126, 120 N.W. 820.

Action by the plaintiff bank against Miller, an accommodation indorser before delivery. At the time the indorsement was made the payee and the plaintiff bank were informed that the defendant Miller received his mail by rural free delivery and as to the route reaching plaintiff. All mail, with postage prepaid, deposited in the post office before nine twenty-five in the forenoon on any week day on the particular route was delivered on the same day. The note

was dishonored Saturday, February 24, 1906. Notice thereof with one cent postage paid, whereas two cents was required, was deposited in the post office the evening of the following Monday. It was immediately placed with the plaintiff's mail for return because of insufficient postage and was received by the plaintiff in due course the following day. On the fifth day thereafter between six and eight P.M. the notice was again deposited in the post office, properly addressed and postage properly paid. Thereafter, the paper was for value sold and duly indorsed without recourse to the plaintiff. The defendant refused payment because he was not properly notified of the dishonor.

Marshall, J. . . . The law relating to proceedings to fix the liability of an indorser of a promissory note in the case of dishonor by the maker was different in some states than in others and for harmony on that as to time and manner of giving notice of dishonor to the indorser, it was provided by the Negotiable Instruments Act that "where the person giving and the person to receive notice reside in different places, the notice must be given . . . if sent by mail by depositing it in the post office in time to go by mail the day following the day of dishonor, or if there be no mail at a convenient hour on that day by the next mail thereafter." Here notice was not sent until after the first mail on the first secular day after dishonor, though there was ample opportunity to do so. The departure time for the mail was between nine and ten o'clock of such day. That was certainly a convenient time within the meaning of the statute. No excuse is found in the evidence for not depositing the notice with postage fully paid so as to have reached the respondent by such mail. The deposit on the evening of that day after ordinary business hours and long after the closing of the mail for such day, as regards the route by which it must have been known the notice would reach the respondent, if at all, clearly was too late. If that were not so, failure to repay the postage so notice would go out by the next mail and failure to remedy the mistake, after knowledge thereof for several days thereafter, released the indorser beyond any possible question.

H. H. DICKINSON COMPANY v. HICKEY

1926, 235 Mich. 638, 209 N.W. 848.

Wiest, J. [Facts stated in opinion.] May 16, defendants Fred J. and Edwin G. Hickey gave plaintiff company their note, payable in 60 days at the Merchants' National Bank, Detroit. Defendant Anna R. Hickey, their mother, was an accommodation indorser thereon. At maturity the note was dishonored by nonpayment,

protest made by a notary public, and notice of dishonor mailed Anna R. Hickey, addressed to 675 Brainard Street, Detroit. At the time the note was given and at the date of dishonor Mrs. Hickey resided at 2933 Second Boulevard, Detroit. The note gave the address of Fred J. and Edwin G. Hickey as 675 Brainard Street, but contained nothing indicating the address of Mrs. Hickey. The Detroit city directory gave Mrs. Hickey's true address and there was no excuse shown for sending the notice of dishonor to her elsewhere. This suit was brought against the makers and indorser to recover on the note. Mrs. Hickey did not receive notice of dishonor of the note and, upon motion of her counsel, the circuit judge, at the close of the proofs, directed verdict in her favor, with judgment for plaintiff against the makers.

The question presented is whether want of notice of dishonor of the note discharged the indorser. Under the Negotiable Instruments Law (C.L. 1915, § 6107) defendant Anna R. Hickey, as indorser, engaged in case the note was dishonored by nonpayment, to pay the amount thereof if the necessary proceedings on dishonor were duly taken. The same law (Section 6130, C.L. 1915) provides for notice of dishonor occasioned by nonpayment and discharges an indorser to whom such notice is not given. The notice required by statute was not given and failure to give the notice discharged Anna R. Hickey. . . .

Chapter VIII

DISCHARGE

NELEN v. SMITH BROS. AUTO SALES, INC.

1923, 45 R.I. 245, 121 A. 394.

Rathbun, J. . . . The plaintiff loaned the defendant $2,200, and received as evidence of the indebtedness the defendant's promissory note for $2,000 secured by a mortgage on two automobiles. The defendant, without the plaintiff's consent, sold one of the automobiles to Frederick R. Devine, and thereafter paid to the plaintiff $1,700 on account of said note.

This suit was brought to recover the balance due on said note After the suit was commenced, but before it was tried, the plaintiff, learning that one of said automobiles was in the possession of Devine, threatened to replevin it from Devine, who thereupon paid to plaintiff the amount which was due upon said note. Devine did not make the payment for the benefit of the defendant, or for the purpose of paying the note, but solely for the purpose of saving himself from annoyance and expense. The plaintiff and Devine each testified that it was agreed between them that the plaintiff would reimburse Devine after the payment on the note was collected from the defendant and that the plaintiff, in proceeding with this action, was acting for the benefit of Devine.

The defendant is not entitled to the benefit of the payment made by Devine. As the payment was made neither for the benefit of the defendant nor for the purpose of paying the note, the action of Devine in making said payment did not extinguish the defendant's liability on the note. . . .

Judgment for plaintiff.

HUNT v. SECURITY STATE BANK

1919, 91 Or. 362, 179 Pac. 248.

The plaintiff Hunt drew a check directing the defendant bank to pay $90 to the order of E. Burdick and delivered the check to Burdick. On January 27, 1917, about eight-thirty A. M. the defendant bank received the check in a "cash letter" from its corresponding bank. The Burdick check, with other checks, was footed on the adding machine, then examined as to signature, checked with the

account to determine if there was a sufficient fund, stamped "paid" and placed upon a three-cornered spindle that has a three-cornered cutting edge and there mutilated. About nine-fifteen of the same morning, but after the check had been stamped "paid" as illustrated above, Hunt appeared at the bank and asked for his balance. When he saw that the Burdick check was not charged against his account, he ordered the bank to stop payment. The bank refused, on the theory that it had already been paid and that Hunt's stop order was too late.

HARRIS, J. The defendant vigorously contends that it was entitled to a directed verdict. This contention proceeds upon the theory that the act of placing it upon the spindle where all "paid" checks were kept until entries were made upon the books, after having first ascertained that there were sufficient funds to credit the drawer and that the signature was genuine operated as a charge against the drawer and as a credit to the holder of the check and amounted to payment. . . .

If what the bank did prior to Hunt's conversation with Hoff (president of defendant bank) amounted to payment then Hunt had lost the right to countermand payment of the check.

During the investigation we must not lose sight of the fact that payment and acceptance are essentially different. Payment is the natural, expected, and intended end of a check. Acceptance strengthens the vitality of a check, and serves to prolong rather than to terminate the life of it. . . . We must remember too that the case now under consideration is not like those where the holder enters a bank with a check, presents it, and is given credit for the amount as a deposit; nor is this case like those where the holder mails a check to the drawee bank, and the latter, in obedience to instructions, charges the account of the drawer, and credits the account of the holder with the amount of the check, for in all those cases payment is made just as completely as it is when the bank actually pays the money over the counter to the holder and he at once returns it to and deposits it with the bank. . . .

When Hunt ordered the defendant not to pay the check, the bank had done nothing more than to satisfy itself that the check was genuine, and that there were sufficient funds to pay it and to stamp it "paid" and to place it upon the spindle. All this was merely preparing to pay. . . . It was not payment. No entry was made on the books. The drawer was not charged; the holder was not credited.

Hunt countermanded payment of the check before the bank had paid it (therefore the bank erred in paying the check).

Judgment for plaintiff.

COLUMBIA GROCERY CO. v. MARSHALL

1915, 131 Tenn. 270, 174 S.W. 1108.

This case is brought to collect on an open account. The defendant for several years had purchased goods of the grocery company and had a large running account. In payment therefor the defendant gave eleven promissory notes, one note to fall due each two months until all were paid. After the notes had been executed and delivered, the bookkeeper of the grocery company filled in with typewriter on each note the following:

> This is one note of a series of eleven, default in payment of any one of which series causes all notes to become due and payable.

Defendant had no knowledge of this alteration.

FANCHER, J. . . . This suit was brought to recover on the original account. The defendant resists the recovery on the ground: First. That the notes were intended and did extinguish the original indebtedness, being taken in settlement and closing out of the account; and that the notes being void because of alteration no recovery can be had. Second. That the alteration being fraudulently made, no recovery can be had, regardless of whether the original account was extinguished.

From a review of the authorities we are of the opinion that the weight of authority is as follows:

That the taking of a promissory note of a debtor does not extinguish the original debt, nor operate as a payment, unless so intended or agreed between the parties, though it may extend the time of payment and if for any reason without fraud the creditor loses his right to sue on the note he is at liberty to sue on the original indebtedness. . . . But now this early doctrine is nowhere adhered to and is superseded by a more reasonable doctrine, that an immaterial change by whomsoever made, at least when unaccompanied by fraudulent design, will not invalidate the instrument and that a material change by a stranger will not avoid it. . . . If the alteration of a written instrument is made by the holder with a design and intent to defraud the maker it extinguishes the debt. This rule is founded on public policy, and in order to preserve the integrity of valid legal instruments, by providing a punishment for the wrong, and to deter the holder from tampering with it. If, however, the alteration is without fraudulent intent, while it will destroy the instrument, it will not destroy the right to recover on the original consideration of which the instrument is a mere evidence. . . . We think the chancellor very mildly termed this act of the complain-

ants a constructive fraud. It was more than that. It was not made in an innocent effort to conform the instrument to the true intention and agreement of the parties or through ignorance, or any other simple, guileless motive. It was a secret and stealthy attempt to gain an advantage. . . .

Judgment for defendant affirmed.

Chapter IX

CHECKS

NORTHERN TRUST COMPANY v. ROGERS et al.

1895, 60 Minn. 208, 62 N.W. 273.

The Farmers and Merchants State Bank being insolvent closed its doors and stopped payment, and, on June 20, 1893, made an assignment of all of its property to the plaintiff for the benefit of creditors. Among the assets of the bank at the time of its failure was a note for $102.50 against defendant Rogers, as maker, and Paulson, as indorser. The plaintiff brought suit on this note, and the defendants attempted to set off a check which they were holding drawn on the defunct bank. The Farmers Accident and Mutual Life Association was a depositor of the bank and had an account to the extent of $300. On May 13th, the life association, in payment of a debt which it owed defendant Rogers, gave him a check on the bank for $105. This check had not been presented for payment when the bank closed its doors on May 15. The sole question is whether upon these facts the defendants may set off the check in the suit brought on the note by the plaintiff, assignee of the bank.

Mitchell, J. . . . The case has been argued by the respective counsel upon the assumption that the answer to this question depends upon the further question whether a check is an assignment of the funds of the drawer to the amount of the check so that, if the drawee bank improperly refused payment, the holder may sue the bank. . . . It is the settled doctrine of the English and Federal courts and of the great majority of the state courts that a check is not an assignment of the drawer's funds, either as between drawer and payee or as between payee and the drawee; that, if the check is not paid on presentation, the holder's only recourse is against the drawer; . . . that an unaccepted draft or ordinary bill of exchange will not, before acceptance, operate as an assignment to the payee of a debt due from the drawee to the drawer is the settled law everywhere, so far as we know. It has been so held by this court. . . .

Judgment for plaintiff.

MINNOT v. RUSS

1892, 156 Mass. 460, 31 N.E. 489.

The defendant, on October 29, 1891, drew a check on the Maverick National Bank payable to the order of the plaintiff, and be-

ing informed by the plaintiff that the check must be certified by the bank before it would be received, the defendant on the same day presented the check to the bank for certification, and the bank certified it by writing on the face of the check the following:

> Maverick National Bank, pay only through clearing house, J. W. Work, Cashier, A. C. J., paying teller.

The plaintiffs received a second check from the defendants, which check was certified this time at the request of the plaintiff on October 31, 1891. On Monday, November 2, 1891, before the commencement of business hours on said day, the bank closed its doors. The checks were duly presented for payment and the drawer received notice of dishonor. The drawer denies liability on each check on the theory that the certification by the bank caused his discharge.

Field, C. J. . . . The bank owed no duty to the drawer to certify the checks, although it could certify them if it saw fit, at the request of either the drawers or the holders, and if it certified them it became bound directly to the holders or to the persons who should become holders. In either case the bank would charge to the account of a drawer the amount of the check, because by certification it had become absolutely liable to pay the check when presented. When a check payable to another person than the drawer is presented by the drawer to the bank for certification, the bank knows that it has not been negotiated, and that it is not presented for payment, but that the drawer wishes the obligation of the bank to pay it to the holder when it is negotiated, in addition to his own obligation. But when the payee or holder of a check presents it for certification the bank knows that this is done for the convenience or security of the holder. The holder could demand payment if he chooses, and it is only because instead of payment the holder desires certification that the bank certifies the check instead of paying it. In one case, the bank certifies the check, for the use or convenience of the drawer and in the other for the use or convenience of the holder. In the present cases the checks were seasonably presented to the bank for payment, and on the facts stated the defendants would be liable unless the certification discharged them from liability. . . . The weight of authority is that if the drawer, in his own behalf, for his own benefit, gets his check certified and then delivers it to the payee the drawer is not discharged; but that if the payee or holder in his own behalf or for his own benefit gets it certified instead of getting it paid then the drawer is discharged. . . .

Judgment for the plaintiff.

CHAPTER X

BANKS AND BANKING

DOWNING v. LAKE COUNTY STATE AND SAVINGS BANK et al.

1930, 133 Or. 322, 290 Pac. 236.

Plaintiff, through her brother, deposited the sum of $9,000 in defendant bank and authorized Bergman, president and executive manager of the bank, to invest the funds for her. She gave him authority to invest, collect, and reinvest the funds. He invested in business enterprises—largely worthless—in which he and plaintiff's brother were interested.

COSHOW, C. J. . . . It was not within the scope of Bergman's authority as executive officer of the banking corporation, to invest and loan money for the bank's depositors with their consent so as to make the bank liable for the acts of its executive officer. The bank's executive officer represents the bank in transacting its business. The scope of his duties does not include that of acting as broker for others. In investing and reinvesting the funds of plaintiff, Bergman was acting for her and not the bank. There is no pretense that Bergman charged any commission fee or remuneration in favor of the bank for his services. That it is not within the scope of his authority as executive officer to act for the depositors of the bank as a broker is well established. . . (by authorities).

Decree in favor of defendant affirmed.

GAMBLE v. BROWN et al.

1928, C.C.A. 29 F.(2d) 366.

Suit by Gamble, receiver of the First National Bank of Sutton, West Virginia, against the directors of the bank.

The bank closed its doors in 1914 because of insolvency. Its insolvency resulted largely from acts of embezzlement and fraud committed by Homer H. Dean, its cashier and vice president, who was in charge of its management. Through his misconduct losses aggregating $65,619.17 arose.

SOPER, District Judge. . . . The evidence will be later dealt with in detail; but it may be said at this point, that the directors were negligent in the following respects: (1) They failed to hold or attend monthly meetings of the board, as prescribed, by the by-laws of the bank. (2) They failed to cause the affairs of the bank to be

periodically examined and audited by a committee appointed by them under the by-laws. (3) They failed to cause the loans discounted by the bank to be passed upon by a discount committee, as required by the by-laws, and failed to pass upon the loans as a board. (4) They failed to require of H. H. Dean a bond for faithful performance by him of his duties as vice president of the bank. . . .

There were only two meetings of the board between January, 1914, when Dean took charge of the bank, and August, 1914, when his defaults were discovered. They were held in May and June, respectively. At neither was there a report of the loans made or business done by the bank, or an account of its assets and liabilities submitted.

[Because of these facts the directors were held responsible for excessive loans, a shortage of notes—seemingly taken by Dean—for embezzlement. The total loss to the directors was $40,683.86.]

HOLMES v. FIRST NATIONAL BANK

1929, 105 N.J.L. 621, 147 A. 441.

Action by Holmes to recover the value of certain government bonds which he had deposited with the defendant bank for safekeeping. The bonds were stolen by an employee of the defendant bank. The bank had insured itself against loss by such misconduct on its own securities and those held as collateral. Bonds left for safekeeping were not so insured. The plaintiff recovered a judgment for $1520.44 in the lower court upon a finding by the jury that the bank was negligent.

McGlennon, J. . . . The sole question argued on both sides and submitted for determination, is the propriety of the trial court's action in leaving it to the jury to decide, under the above circumstances, whether the defendant was negligent in failing to insure plaintiff's property in the same manner that it insured its own property of similar kind. We hold that this action was correct, and that there was no error, therefore, in refusing the motion for nonsuit as well as the motion for a direction of a verdict based upon this ground.

It was open to the jury to find from the evidence that this transaction with the plaintiff was not a casual one, but that the bank held itself out generally to its customers as a safe depository for such purpose. The acceptance of the securities of others, by the bank, as bailee, cast upon it the duty of exercising reasonable care in such safekeeping. "Reasonable care" has repeatedly been defined as that degree of care which a prudent business man would exercise in

regard to his own property of a similar kind under similar circumstances. . . .

Judgment affirmed.

HARMER v. RENDLEMAN

1933, 64 Fed.(2d) 422.

PARKER, Circuit Judge. . . . Plaintiff's original complaint alleges merely that she placed certain securities with the bank for safekeeping and for the purpose of having the bank collect the interest and dividends from same and deposit them to her credit; that after the failure of the bank she demanded a return of the securities which she was unable to obtain. . . . In some manner not shown by the evidence, the securities were taken from the safety deposit box in which they were kept and were not there when the receiver took charge of the bank. There is nothing to show what became of the securities. . . . [The jury found the bank to be negligent in its care of the securities.]

The modern rule, however, is that where such property or its proceeds has gone to swell the aggregate in the possession of the fraudulent party, it may, under proper proceedings, be segregated in amount from such aggregate sum and made the subject of a trust in order to accomplish the ends of justice. . . . But there is a limitation upon this modern rule as well settled as the rule itself. It is indispensable that clear proof be made that the trust property or its proceeds has gone into a specific fund, or into a specific identified piece of property, or has directly augmented a fund upon which the trust is declared when it is sought to impress funds in the hands of a receiver with a trust on account of the wrongful conversion of trust property by an individual or a corporation to whose rights he has succeeded, it must be shown that the funds in his possession have been directly augmented by the presence of the trust property or its proceeds, so that a court of equity can see with certainty that the trust property is in his hands. . . .

Judge Sanborn follows this with the statement: "Proof that a trustee mingled trust funds with his own and made payment out of the common fund is a sufficient identification of the remainder of that fund coming to the hands of the receiver, not exceeding the smallest amount the fund contained subsequent to the commingling, as trust property, because the legal presumption is that he regarded the law and neither paid out, nor invested in other property the trust fund, but kept it sacred."

There is nothing in the record to justify its [the rule's] application here, for there is no proof that the securities of plaintiff or their

proceeds were ever mingled with any fund that came into the hands of the receivers. . . . The owner must trace the securities or their proceeds into the funds which have come into the hands of the receiver, or show that such funds were directly augmented as a result of the conversion of securities. This the plaintiff has not done.

Judgment for defendant affirmed.

ANDREW, STATE SUPERINTENDENT OF BANKING v. PEOPLES SAVINGS BANK

1930, 209 Ia. 1147, 229 N.W. 907.

Appeal from the allowance of a preferred claim. Mrs. Huhm decided to discontinue farming and engaged the bank to look after her sale. The sale was completed by the bank assistant cashier, acting as clerk. He had in his possession $2,567.76 which he finally deposited in the account of Mrs. Huhm, without an accounting and without her consent. A few days thereafter the bank closed.

ALBERT, J. . . . The term "preference" or "preferred claim," although frequently used, is as heretofore suggested, a misnomer. The real foundation of this proceeding is that Mrs. Huhm is asking a recovery of her own property to wit, the proceeds of this sale. There is no question under the repeated decisions of this court that the relation between Mrs. Huhm and the bank with reference to these proceeds is that of principal and agent, and she is simply calling upon her agent (or its receiver) to return to her property which rightfully belongs to her.

Under the well-recognized rules in this state, of which we have made many pronouncements, when the bank, the agent of Mrs. Huhm, received the proceeds of this sale and held it to be turned over to Mrs. Huhm, a trust was thereby created, and, when it is shown that, when the bank closed, it had cash on hand in more than the amount of this trust fund, the amount of the proceeds due Mrs. Huhm, the presumption is that the proceeds of this sale were included in the "cash on hand," and, when the receiver took the cash on hand, he had included in it, among other things, the proceeds of this sale which was the property of Mrs. Huhm.

Affirmed.

FIRST NATIONAL BANK v. UNITED STATES NATIONAL BANK

1921, 100 Or. 264, 197 Pac. 547.

Some forgers procured checks of a steel works which carried an account with the plaintiff bank. They forged signatures to these checks, and eighteen of them came into the hands of the defendant

bank through deposits of its customers. The defendant bank presented these checks to the plaintiff for collection through the clearing house, and they were paid. Shortly thereafter the steel works, on checking its bank statement, discovered the forgery and called it to the attention of the plaintiff who credited the steel works with the amount of the forged checks and then took them to the defendant bank and demanded repayment of the checks.

HARRIS, J. . . . Where a holder for value in due course presents to the drawee a bill of exchange to which the name of the drawer has been forged, and the drawee pays the instrument, the holder and drawee being alike ignorant that the signature of the ostensible drawer was forged, and it is subsequently discovered that the signature of the drawer was forged, the drawee cannot recover payment made to the holder. If in similar circumstances a drawee accepts a bill of exchange and then permits it to go into circulation, he cannot avoid his obligation to pay, even though the forgery is discovered after the acceptance and before presentment for payment. Such was the rule announced in England in 1762 by Lord Mansfield in Price v. Neal, 3 Burr. 1354; and it was repeatedly recognized and accepted as a part of the law merchant of England (4 Har. Law. Rev. 297).

Although in this country most of the text-writers and some judges have protested strongly against the rule announced in Price v. Neal, the doctrine established by that case has been accepted as a part of our law merchant by the national Supreme Court as well as by most of the state appellate tribunals. (Cases cited.)

Stated broadly and in general language, the drawee named in a bill of exchange is bound to know the signature of the drawer, and hence accepts or pays the instrument at his peril. A check is defined as "a bill of exchange drawn on a bank payable on demand." Section 7977, Or. L. A bank is bound to know the signatures of its depositors, and therefore, if as a drawee a bank pays a check to which is signed the name of one of its depositors, it does so at its peril. . . .

Some judges rest the rule upon grounds of estoppel; others say that it is governed by the principles of negligence; and still others invoke the principle of natural justice, that as between two persons, one of whom must suffer, the legal title shall prevail. Frequently the suggestion is made that the rule arises out of considerations of convenience as well as of commercial necessity; for, it is said, throughout the entire business world bills of exchange and checks in large part serve as currency in each day's business transactions, and it is not only convenient but necessary that there shall be a definite time and a fixed place for final settlement, and that the best

time and most appropriate place for such final settlement is the time and place when and where an instrument is presented to the drawee for payment. . . .

Judgment for defendant.

LOUISA NATIONAL BANK v. KENTUCKY NATIONAL BANK

1931, 239 Ky. 302, 39 S.W.(2d) 497.

Fred Banfield, a stranger, appeared at Louisa National Bank with two checks drawn on Kentucky National Bank—one for $400 and one for $600—and apparently signed by Farnum and Armstrong, respectively. He opened an account with them and received $600 in cash. The checks were sent through, after indorsement by both Banfield and the defendant, and the plaintiff paid the one for $600 but returned the other, since Farnum kept no account there. It was later discovered that the $600 check was a forgery and Kentucky National Bank, the drawee, desired to recover the amount paid to the Louisa National Bank.

RICHARDSON, J. . . . The appellee, on presentation for payment of the $600 check, failed to discover it was a forgery. It was bound to know the signature of its customer, Armstrong, and it was derelict in failing to give his signature to the check sufficient attention and examination to enable it to discover instantly the forgery. The appellant, when the check was presented to it by Banfield, failed to make any inquiry of or about him, and did not cause or have him to be identified. Its act in so paying him the check is a degree of negligence on its part equivalent to positive negligence. It indorsed the check, and, while such indorsement may not be regarded within the meaning of the Negotiable Instruments Law as amounting to a warranty to appellant of that which it indorsed, it at least substantially served as a representation to it that it had exercised ordinary care and had complied with the rules and custom of prudent banking. Its indorsement was calculated, if in fact it did not do so, to lull the drawee bank into indifference as to the drawee's signature to it, when paying the check and charging it to its customer's account and remitting its proceeds to appellant's correspondent.

If in such a transaction between the drawee and the holder of a check both are without fault, no recovery may be had of the money so paid. . . . Or the rule may be more accurately stated that, where the drawee pays the money he cannot recover it back from a holder in good faith for value and without fault. If, on the other hand, the holder acts in bad faith or is guilty of culpable negligence,

a recovery may be had by the drawee of such holder. The negligence of the Bank of Louisa in failing to inquire of and about Banfield, and to cause or have him identified before it parted with its money on the forged check may be regarded as the primary, and proximate cause of the loss. . . . In comparison of the degrees of negligence of the two, it is apparent that the appellant excels in culpability.

Judgment in favor of plaintiff affirmed.

GOODALL REAL ESTATE AND INSURANCE COMPANY v. NORTH BIRMINGHAM AMERICAN BANK

1932, 225 Ala. 507, 144 S. 7.

BROWN, J. . . . This is an action on the common counts for money had and received. The plea was the general issue.

The evidence is without dispute that the Peerless Ice Cream Company, Inc., being indebted to the plaintiff in the sum of $125, drew its check for that amount of the indebtedness on the defendant bank with which the drawer was a depositor.

The check was delivered to A. Paul Goodall, plaintiff's agent, who had authority to receive the check as a collector, but had no authority to indorse plaintiff's name thereon or collect said check.

Goodall placed an indorsement thereon, by using a rubber stamp kept by plaintiff for use in making deposits with another bank with which it did business, by stamping thereon the words "A. Paul Goodall R. E. & Ins. Co.—State Agents—Local Agents, Birmingham, Ala.," using the stamp so as not to place thereon "For Deposit Only Account of" which was a part of the stamp, and indorsed "A. Paul Goodall" on the back of the check and presented the check to the defendant bank, who paid it to Goodall.

The check was subsequently surrendered to the drawer, Peerless Ice Cream Company, Inc., and the evidence affords an inference that defendant credited itself on the drawer's account with the amount of said check. . . .

In the instant case the basis of the plaintiff's cause of action is the wrongful conversion of the check and under the law as settled in this state, he could sue in trover for conversion or waive the tort and sue for money had and received. . . .

If what was placed on the back of the check can be treated as an indorsement of the name of the payee thereon, the evidence clearly tends to show it was a forgery, and, if so, such indorsement and payment was inefficacious to pass the title of the check to the defendant. Treating the indorsement of the check as that of Goodall only, the result is the same. . . .

"A suit for money had and received is in the nature of an equitable action, and is maintainable whenever one person has money which ex aequo et bono belongs to another. And it is not always necessary that actual money shall have been received. If property or anything else be received as the equivalent of money by one who assumes to cancel or dispose of a property right, for which, by contract or liability, legal or equitable it is his duty to account to another, the latter may treat the transaction as a receipt of money, and sue for it as such."

The credit received by the defendant, if in fact it credited itself with said check on the drawer's account, was within the rule above stated, the equivalent of money, and it is liable as for money had and received. . . .

The court therefore erred in excluding the plaintiff's evidence and in directing a verdict for the defendant.

Reversed and remanded.

BERG v. UNION STATE BANK

1932, 186 Minn. 529, 243 N.W. 696.

DIBELL, J. . . . It is uniformly held that, if the bank has notice or knowledge of the true ownership of the fund, or if it has knowledge of facts and circumstances sufficient to require inquiry on its part, which inquiry, if made, would have disclosed the true ownership, it cannot apply the fund to an individual indebtedness owing to it by the agent or trustee depositing the same. . . .

When it comes to the question of whether the bank, where it has no notice or knowledge of the true ownership of the fund and no notice of circumstances calling for inquiry, can apply the fund to an indebtedness owing to it by the trustee or agent individually and thereby escape liability to the true owner, there is a sharp division in the authorities. . . . A substantial number of courts have adopted . . . [a] rule, referred to as the equitable rule. That rule is that a bank, even though it has no express or implied knowledge of the true ownership of the fund deposited in his own name by the trustee or agent, cannot apply such fund to the individual debt of such trustee or agent, where the lack of knowledge has not resulted in any detrimental change in the bank's position and no superior equities have arisen in its favor.

Stevens and Company, a corporation, was a brokerage house in Minneapolis. It had sold to the plaintiff warrants of Richland County, Montana, aggregating $3,772.72. On February 16, 1922, it notified Berg that if he would bring his warrants it would collect them for him. Berg brought them in. He left them with Stevens

and Company for collection. His name was not on them. . . . Stevens and Company attached a draft in its own favor on a local Montana bank and received credit in the defendant bank, with which it had a checking account. . . . The warrants were paid by the Montana county and the proceeds received by the defendant on March 8, 1922. . . . On March 8, the day of payment, the balance of Stevens and Company in red was $5,678.33. It continued in red. On the next day it was $10,000 plus in red; the next $11,000 plus in red; the next $13,000 in red; and from then on throughout the month it was in red in excess of $14,000.

The question first to be determined is whether the bank had such knowledge relative to the transaction between the plaintiff and Stevens and Company as to put it upon notice of the source of the deposit. It knew that Stevens and Company was in a bad financial way. . . . The company was dealing as a broker in stocks, bonds and warrants; and upon the whole a jury could find that fair or prudent investigation or inquiry would have led to a discovery of the beneficial ownership of the warrants and that with the information at hand, it should be charged with notice. . . .

The other question is whether the defendant, though knowledge or notice could not be found by the jury, had changed its position so that detriment resulted or so that superior equities arose in its favor. . . . The doctrine is adopted in this state—the so-called equitable one—and illustrated by the cases cited, that though the bank is without actual or constructive notice it cannot retain the trust money unless it has changed its position or acquired a superior equity. As stated on the former appeal, we adopt the equitable rule.

We are unable to discover evidence requiring the jury to find that the bank changed its position to its detriment after receiving the deposit or that equities arose in its favor. . . .

Judgment for plaintiff affirmed.

BOSTON NOTE BROKERAGE CO. v. PILGRIM TRUST CO.

1945, 318 Mass. 224, 61 N.E.(2), 113.

This is a tort action to recover money paid by the defendant bank to the plaintiff's agent and improperly used by the latter.

LUMMUS, J. . . . One Leventhal, a depositor in the defendant bank, lent $10,000 to the plaintiff corporation upon its note, dated August 20, 1941, payable with interest on December 20, 1941, signed in its behalf by Henry Reimers, its treasurer, who was expressly empowered "to sign the corporate name, cash, sign and in-

dorse checks, negotiate loans and in general, to do and transact any and all business which may be properly done and transacted in the name of the company." The plaintiff corporation had no deposit with the defendant bank. Leventhal made the loan by giving to Reimers his (Levanthal's) check for $10,000 upon the defendant bank, dated August 20, 1941, payable to the order of the plaintiff corporation.

On August 21, 1941, Reimers personally presented the check for payment at the defendant bank, with the indorsement of the plaintiff corporation upon the check signed by him as its treasurer. . . . A paying teller of the defendant bank . . . referred him to vice-president Miley, who had authority on behalf of the defendant bank to decide what to do. . . .

Reimers asked Miley for a check of the defendant bank payable to him personally. Miley refused to give such a check in payment of Leventhal's check, but said that he would give Reimers the cash, and then Reimers could take the cash to another officer of the defendant bank at another window and buy the defendant bank's check for $10,000 payable to himself. Reimers took the $10,000 in cash, went to the other officer at another window, and bought the defendant bank's check for $10,000, dated August 21, 1941, payable to the order of Henry Reimers.

Reimers deposited that check in an account that he opened in his own name in a bank in Medford, and it was collected by that bank from the defendant bank. The proceeds of that check never reached the plaintiff corporation, but were wrongfully used by Reimers for his private purposes.

In the Superior Court, on October 24, 1944, a judge made a finding for the plaintiff in the sum of $11,905, which evidently was composed of the sum of $10,000 with interest thereon from August 21, 1941. The case is here on the exceptions of the defendant bank. . . .

He had authority to receive payment of the check in cash. Doing so was not such a badge of fraud as to impose upon the defendant bank a duty to interfere to prevent an apparently intended embezzlement. An honest treasurer may at times keep substantial sums in the form of cash. Neither did the conversion of the check into a bank or cashier's check payable to Reimers personally constitute such a plain indication of an intended embezzlement that the defendant bank became bound to interfere to prevent such a crime. In some situations an honest treasurer might desire to convert a check payable to his corporation into a bank or cashier's check payable to himself. He might reasonably do so if on behalf of his corporation he should contemplate buying goods for cash in

a distant city where he could be identified but where proof of his authority to indorse a check payable to his corporation would be at least difficult. A bank that is merely the drawee of a check ought not to be made liable to the payee for anything short of participation or assistance in a known or apparent misappropriation of funds.

Judgment for defendant.

In re GOEBEL'S ESTATE

1946, 295 N.Y. 73, 65 N.E.(2) 174.

Miss Goebel opened an account in the Lexington Branch of the Corn Exchange Bank Trust Company. In error, it gave the credit to another Goebel at the Fordham Branch. Miss Goebel drew a check for $5,000 against the deposit in favor of Dr. Snyder as a gift and a question arose as to whether it had been paid eleven days later at the time of her death. The Lexington Branch refused to pay it when presented and suggested that Dr. Snyder change it to read Fordham Branch and send it through regular banking channels by depositing it in his account. He received credit at his bank of deposit and in due course the check was marked paid and charged to the wrong Goebel. The error was later discovered and Miss Goebel's account in the Lexington Branch credited but before the check was charged to her account, she died. Two questions arose: Was the check paid and was the alteration material so as to destroy the check?

DESMOND, J. . . . On the day before the death, the confusion had been all cleared away and the bank had put into motion all the procedures necessary to straighten out the books. Nothing done afterwards by the bank was any more than a detailed carrying out of the bank's procedures for correcting its records. . . .

Actually the $5,000 check of June 27th had been "paid" long before the blunder was discovered, since that check, in due course, had been charged by the Corn Exchange Bank Trust Company itself against the very account into which it had put the $16,000 deposit. The check was issued as an order or draft against that $16,000 owing by the bank to Miss Goebel. When that draft was honored and an appropriate $5,000 debit made against the $16,000 credit, and a corresponding $5,000 credit (never revoked) made to Dr. Snyder's own bank of deposit, the check was in fact and in law "paid," and we so hold.

As to the character and effect of the "alteration" also, we find ourselves in disagreement with the holdings below. We do not think that the substitution of the word "Fordham" for the word

"Lexington" was in any way material. An alteration it was, but the instrument as so altered expressed and effectuated the exact and unquestioned intent of the maker. The purpose of Miss Goebel was to draw a draft on the Corn Exchange Bank Trust Company, her debtor, in favor of Dr. Snyder, for $5,000, to be subtracted from the credit standing in her favor with that bank. The Corn Exchange Bank Trust Company is a single corporation, and was the sole debtor, no matter how many branches it maintained.

WARE v. HOGANSVILLE BANKING COMPANY et al.

1930, 171 Ga. 167, 155 S.E. 4.

Suit by Ware against Hogansville Banking Company and A. B. Moberley, Superintendent of Banks, to recover the sum of $125 and interest. It appears that the plaintiff deposited this check, which was drawn on another bank, shortly before the defendant closed its doors and that the check was thereafter collected by the superintendent of banks. The deposit slip contained the following statement:

> In receiving items for deposit or collection, this bank acts only as depositor's collection agent and assumes no responsibility beyond the exercise of due care. All items are credited subject to final payment in cash or solvent credits.

The lower court held that, since the bank was merely an agent, the depositor was entitled to the proceeds of the check.

RUSSEL, C. J. . . . The court correctly held that the evidence did not show that the plaintiff was a depositor in the bank taken in charge by the superintendent of banks, but that the transaction was one which created the relation of principal and agent, the bank being merely the agent of plaintiff for the purpose of collecting the check. This agency ceased upon the failure of the bank, and just as the check itself was the property of the plaintiff so also the proceeds of the check are his, and not subject to be distributed under the provisions of the Banking Act.

Judgment affirmed.

In re RECEIVERSHIP OF WASHINGTON BANK

BRUSEGARD v. UELAND

1898, 72 Minn. 283, 75 N.W. 228.

In the matter of the receivership of the Washington Bank, and Andreas Ueland, receiver. Petition by Thomas Brusegard for the

allowance of a claim. From an order denying the relief, the petitioner appeals.

CANTY, J. At 12:30 p. m. December 29, 1896, the Washington Bank of Minneapolis, Minn., suspended payment, and closed its doors. It was taken possession of by the state bank examiner that same afternoon, and on the next day a receiver in insolvency was appointed for it by the court. At and prior to these times the petitioner, Brusegard, was doing business as a banker at Brandon, Minn., and kept an account in the Washington Bank, which was his correspondent. He filed a petition in the insolvency proceedings, in which he states that he had for some time prior to December 29th remitted to said bank,

> . . . for collection and credit, the drafts and checks of other banks, received by him from his customers and others . . . that during all of said time it was understood and agreed between your petitioner and said bank that his remittances of checks, drafts, and items should be credited to the account of your petitioner in said bank, and that, if any such check or draft remitted by him for collection and credit to said bank should not be paid upon presentation, that the same should be charged back against his said account; and that all remittances of checks and drafts (other than currency or specie) should be credited to him upon receipt thereof, only conditionally upon being paid.

These allegations of the petitioner are not denied by the answer. On December 26th he remitted to the bank, pursuant to this agreement, three checks, drawn by others, for the aggregate amount of $1,324.84. The bank received the checks on the morning of December 28th, and on that day sent these checks, together with others, amounting in all to $2,390.35 to the Scandinavian Bank of St. Paul, for collection and deposit to the credit of the Washington Bank. All of the checks sent by petitioner were collected on that day, and some of the others. The account of the Scandinavian Bank with the Washington Bank then stood as follows:

Balance to the credit of Washington Bank prior to the remittance of that day	$ 609.51
Checks and drafts of others collected that day	962.84
Proceeds of appellant's checks	1,324.84
Total	$2,897.19
Checks and drafts of the Washington Bank paid by the Scandinavian Bank	560.75
Balance	$2,336.44

This balance was paid by the Scandinavian Bank to the receiver after he had qualified. The facts above recited are not disputed.

The petitioner asks that the court declare a trust in his favor on such balance for the amount of the proceeds of said checks which he had so remitted; and that the receiver be ordered to pay him said amount out of said balance. From the order denying his petition, he appeals.

The matter was submitted to the court for decision on the petition and answer thereto. While such a matter may be tried summarily, it is a final trial, on the merits, of a substantial right. The parties are entitled to have it heard on competent evidence, and have the right of cross-examination, but they may also waive these rights. The petition alleges:

> . . . that, at the time of receiving the said three checks, said Washington Bank was insolvent, as was well known to its officers and agents, but unknown to your petitioner.

The answer denies:

> . . . that any officer of the Washington Bank knew that said bank was insolvent prior to 12:30 o'clock p.m. on the 29th day of December, 1896, which was the time when said bank suspended payment and closed its doors, and alleges that up to that time said bank met and discharged all demands upon it, and that it was not, prior to that time, insolvent, except in so far as the property owned by the bank at that time may be insufficient to pay the debts and liabilities of said bank.

This amounts to an admission that on the morning of December 28th the bank was in fact insolvent, in the sense that it had not sufficient assets to pay its debts, but the answer denies that the officers of the bank knew this fact prior to the time the bank closed its doors. Then the petitioner has failed to establish fraud in the receiving of the checks. Of course, if the bank received his checks, knowing that it was insolvent, it would be guilty of fraud, no title to the checks would pass, and he could recover their proceeds, if he could sufficiently trace such proceeds into the hands of the receiver.

Appellant contends, however, that, by the terms of the agreement under which the checks were sent to the bank, the title to the checks did not pass to it; that it only acquired title to the proceeds of the checks after they were collected. It appears from the part of the petition first above quoted that the checks "should be credited to the account" of the petitioner, and, "if not paid upon presentation, that the same should be charged back against his said account." This condition did not, as appellant contends, prevent the title to the checks from vesting in the bank. The condition was for the benefit of the bank, not for the benefit of appellants; and the title

to the checks vested in the bank at the time it received them, subject to the condition that, if they were not paid on presentation, they should be charged back against his account, and the title of the bank would thereupon be devested. This condition never became operative, and therefore the title acquired by the bank on receipt of the checks has never been devested, even if it appears, as appellant contends, that the bank closed its doors before the checks were actually collected. If the title to the checks once vested in the bank, the closing of its doors would not, in the absence of fraud, devest that title. This disposes of the case, and the order appealed from is affirmed.

FIRST NATIONAL BANK v. COMMERCIAL BANK AND TRUST COMPANY

1926, 137 Wash. 335, 242 Pac. 356.

This is an action to recover the amount of checks sent to the defendant for collection. The defendant sent the checks directly to the bank upon which they were drawn—as it was authorized to—and accepted in payment thereof a draft on a Seattle bank in payment. The draft was dishonored because of the drawer's insolvency prior to presentment. Plaintiff contends the defendant is liable because it accepted a draft in payment rather than currency. The lower court sustained this contention.

FULLERTON, J. . . . But we find in the record nothing to indicate an agreement between the appellant and the respondent as to the manner in which payment of checks or other paper could be made by the Bridgeport bank to the appellant after it had been so forwarded; that is to say, there is nothing to indicate that the appellant had the right to accept as payment anything other than lawful money, or that which is by common consent and usage considered and treated as lawful money. . . .

The general rule is well settled that a collecting agent is without authority to accept for the debt of his principal anything but that which the law declares to be legal tender. This rule seems to be not only sound in principle but is sustained by the almost universal authority. . . .

It is next said that the acceptance of the drawee's draft instead of lawful money was justified by custom. But the sufficient answer to this is that no such custom is shown in the record, and it is not a matter of which the court may take judicial knowledge. Of its own knowledge the court knows that the practice varies with the circumstances. In dealings with banks of good financial standing, well known to each other, it is possibly the general practice to accept

without question drafts in payment of obligations. But the reverse is the rule when the circumstances are not these. There is therefore no such general custom, and the court cannot know without proof the custom of a particular place.

Judgment for plaintiff.

FEDERAL RESERVE BANK OF RICHMOND v. PETERS et al.

1924, 139 Va. 45, 123 S.E. 379.

The Federal Reserve Bank of Richmond accumulated $2,295.10 worth of checks drawn on the Prince Edward-Lunenberg County Bank. These checks were mailed directly to the drawee bank for collection. The accounts of the drawers were debited and the Prince Edward-Lunenberg County Bank issued its draft on Bank of Commerce and Trusts in favor of the Federal Reserve Bank for the sum of $2,295.10. The draft was not paid because of the drawer's insolvency before presentment could be made. The Federal Reserve Bank filed a bill demanding payment as a preferred creditor. The lower court denied it.

West, J. . . . In order to make collection of checks handled by them, banks usually adopt one of two methods—reciprocal accounts or remittance. Under the reciprocal accounts method, the collecting bank upon receipt of payment of the checks, gives credit upon its books to the forwarding bank, and the forwarding bank charges the collecting bank on its books. They settle from time to time according as the balance accumulates, with the one or the other. Under this method as soon as the collection is made the relation of the banks is that of debtor and creditor. Under the remittance method the forwarding bank sends the checks to the collecting bank with instructions to collect them and to remit immediately. The collecting bank is not authorized to retain the proceeds in its hands, and therefore acts only as an agent of the forwarding bank. It is manifest that the remittance method was the one used by the Federal Reserve Bank of Richmond in the instant case.

The two assignments of error involve the question whether the facts disclosed by the record are such as to create a trust relation which gave to the Federal Reserve Bank of Richmond a lien upon the assets of the failed bank, before and after they passed into the hands of the receiver.

When a bank receives from its correspondent a check upon itself, it is an agent for its correspondent bank to make a presentment to itself.

The agreement between the two banks constituted the Prince

Edward-Lunenberg County Bank a special agent to collect and remit immediately the proceeds of the checks enclosed, either in currency or by draft on some other bank. When the checks were cashed the $2,295.10 realized thereby became the property of the Federal Reserve Bank of Richmond in the hands of the Prince Edward-Lunenberg County Bank as its trustee. The trustee had the right to withdraw the money from its bank in currency and ship it to the Federal Reserve Bank of Richmond, in which event no controversy would have arisen. The fact that it retained the actual cash, thus permitting the same to temporarily mingle with its general funds and sent to the Federal Reserve Bank of Richmond a draft upon its deposit in the Bank of Commerce and Trusts, did not, however, cause the relation of debtor and creditor to arise, but the general deposit was thereby impressed with a trust.

The relation of principal and agent, which it is admitted obtained between the parties at the beginning of the transaction, did not change to that of debtor and creditor. . . . Where the relation of trust and cestui que trust is established the mingling of the trust fund with the general fund in the hands of the trustee does not destroy the trust but serves to extend the trust or lien to the whole mass of money. . . .

In determining whether or not the failed bank is a debtor or a trustee, the court may well look to the intention of the parties. If the forwarding bank intends to leave the money in the hands of the collecting bank to be used by it in the usual course of business it intends to become a general depositor, and accepts the bank as a debtor. If, on the other hand, the forwarding bank, as in the instant case, does not intend it to be so used, and demands that the proceeds of the checks be immediately returned to it, it does not become a depositor, but simply intrusts the bank with the money for a special purpose, and the collecting bank becomes a trustee, and a court of equity will impress with a trust the general funds in the hands of the trustee in which the trust fund is included.

Reversed and decree entered in favor of the plaintiff.

ROSSI BROTHERS v. COMMISSIONER OF BANKS

1933, 283 Mass. 114, 186 N.E. 234.

The defendant was liquidating a closed bank which held notes of the plaintiff, carrying the names of two indorsers. The total amount due the bank was $4,438.05, and the plaintiff had $2,064.28 on deposit. This is a bill to compel the defendant to apply the deposit on the indebtedness. The bank had an agreement with the

plaintiff that it might charge his account with short term notes whenever they fell due.

RUGG, C. J. It is plain that there was no contract between the plaintiff and the bank whereby the latter was required to charge the account of the plaintiff with the amount of each of its notes as it became due. The arrangement made was simply one of convenience to accommodate the plaintiff. The plaintiff gave nothing to the bank. The plaintiff did not even agree to maintain a deposit in the bank. The bank received no consideration. It already had the legal right to charge the account of the plaintiff with the amount of each note as it became due. No assent of the depositor to this course was required. . . .

The question is whether the deposit can be set off against the notes. This question has never arisen for adjudication with respect to banks in the hands of the commissioner for liquidation under the present statute. . . .

The general principle was stated in Bachrach v. Commissioner of Banks, 239 Mass. 272, 273, 131 N.E. 857, in these words: "In ordinary commercial banks the legal relation between the bank and a general depositor is that of debtor and creditor; and where the depositor owes the bank he may set off his deposit against the indebtedness, even though the bank has become insolvent." This principle prevails in the Federal courts and widely in other jurisdictions. . . .

Set-off is applicable to the present cause even though the defendant holds notes of which the plaintiff is the maker and on which there are two indorsers. The rights of the holder of the notes against the indorsers have been fixed by demand and protest. Although three persons are liable to the defendant on each note, the plaintiff as the maker is primarily and absolutely liable on them.

Judgment for plaintiff.

JEFFERSON STANDARD LIFE INSURANCE COMPANY v. WISDOM C.C.A.

1932, 58 F.(2d) 565.

This is an action to recover from the receiver of First National Bank of Bookhaven, Mississippi, the sum of $5,000 as a preferred claim. The plaintiff had sent the bank a draft for collection. It was collected, and, although the plaintiff had instructed the bank to remit in N.Y. funds, the bank sent its own cashier's check in payment. The latter failed to clear because of the bank's insolvency. The First National Bank collected the plaintiff's draft by accepting a draft on another bank. This draft was finally collected by the

Federal Reserve Bank, which used this amount, along with a balance in its hands, to pay off certain notes which had been discounted with it by the First National Bank. These notes were returned to the receiver. The receiver contended that no preferred claim should arise for two reasons. (1) The proceeds of collection could not be traced into the receiver's hands or the general funds of the bank, and (2) the acceptance of the cashier's check created a debtor-creditor relationship.

SIBLEY, Circuit Judge. . . . Had the Federal Reserve Bank absorbed the fund by an off-set that resulted in no gain to the receiver, the tracing would have fallen short of reaching the assets in his hands, but the fund was in effect invested in the $16,000 of notes which by its application were released and returned to the receiver. Upon these notes and their proceeds, the receiver has the same lien as it had upon the proceeds which purchased them for the receiver. But it was held by the District Court, and is urged here, that the insurance company waived its ownership of the collection and assented to accept the First National Bank as its debtor by accepting the cashier's check sent it. . . .

A bank holding funds as a collection agent cannot make itself a debtor and acquire title to the funds by unauthorizedly commingling them with its own and sending its principal a bad check; nor is this result produced through ratification or waiver by the principal's fruitlessly presenting the check for payment directly or through other banks. The check is sent with an implied representation that it is good. It is accepted as payment, if paid. By its dishonor the arrangement proposed in sending it wholly fails at the option of the holder.

The cause is reversed and remanded with direction to enter a decree for the insurance company fixing a lien for $5,000 upon the notes or their proceeds above referred to.

TEXAS & P. RY. CO. v. POTTORFF

C.C.A. 1933, 63 F.(2d) 1.

This is a case instituted to recover securities pledged by a bank to protect the plaintiff on its deposit. It had on deposit $54,646.94 at the time of closing. On January 29, 1931, the bank being still a solvent, going concern, the railway was induced by the bank to permit it to substitute for the surety bonds theretofore securing the deposit the Liberty Bonds in question. They were deposited with the trust officer of the bank to be held as security for repayment, upon demand, of the deposits.

HUTCHESON, Circuit Judge. . . . In jurisdictions where the

courts have held that to permit one depositor to thus gain a preference over another is contrary to sound public policy, they have stricken down pledges without regard to whether the funds secured were public or private, while in one or two jurisdictions where no contravention of public policy in thus pledging assets is seen, the courts have, without distinction between them, sustained pledges of private and public deposits. . . .

We, therefore, reject the view that implied authority to pledge assets as security for loans extends to pledging them as security for deposits. We agree also with the view expressed that, generally speaking, a bank's general powers do not authorize it to pledge assets for deposits. We find specifically that this bank had no such power and this, not because the recognition of the power would conflict with our views of public policy, but because no express power to do so has been conferred upon it by statute, and because not only does the record not support the finding necessary to be made, if the power is implied, that the giving of pledges for private deposits is a reasonable incident to the business of receiving deposits, and necessary to the proper conduct of the business of a national bank, but the judicial knowledge of banking practices and customs which we may take establishes the contrary to be true.

It remains to inquire whether, though the contract is ultra vires, the railway can enforce its claim on the pledged bonds on the ground that, though the agreement was beyond its powers, the bank has, by making it, obtained the deposit, and therefore may not keep the bonds without returning the deposit made on the faith of their pledging. . . .

We cannot agree with either of these contentions. It is perfectly clear that, though the railway was induced by the promise of security to deposit its funds, there are two agreements here, not one. One, that the bank should pay back to the railway upon demand the sums deposited with it as other general deposits were. This entirely valid contract the receiver has recognized, and has offered to pay the railway a dividend on account of it. The other is an agreement for security. This we have found to be invalid and without contractual force as beyond the corporate power.

The judgment for defendant is affirmed. [This court drew a distinction between private and public deposits.]

Book IV

BUSINESS ORGANIZATIONS

PART I

PARTNERSHIPS

Chapter I

CHARACTERISTICS AND DISTINCTIONS

WORDEN CO. v. BEALS et al.

1926, 120 Or. 66, 250 Pac. 375.

Beals owned standing timber and sold to Bennett the right to enter and cut it, the latter to pay $4 a thousand for the same. In addition, the purchaser agreed to pay Beals from the sale of the lumber milled therefrom one-third of the sale price in excess of $21 a thousand. The cutting, milling, and selling expenses, as well as the $4 a thousand, were presumably to be covered by the $21 a thousand. Worden & Co. sold supplies to Bennett and seeks to recover for them from Beals and Bennett on the theory that they are partners.

Rand, J. . . . It is obvious that no partnership between Beals and Bennett could result either from the making or the performing of this contract. They were to share only in the gross earnings of the business after deducting a specified sum fixed arbitrarily as the cost to be incurred by Bennett in the purchase of the timber and the manufacture and the sale of the lumber. Under this contract Beals was to have no charge or control over the management of the business. He could not make contracts, incur liabilities, manage the business or dispose of the entire business for any purpose. All that he was to receive under the contract was $4 per thousand feet and one-third of such earnings as should remain after deducting an estimated cost of $21 per thousand feet, which sum was to be allowed Bennett as the cost of operation. And since Beals had no community of interest in the business and no common control thereover, no partnership could be created, for where both of these elements are lacking, the sharing of the profits of the business is not sufficient to constitute a partnership.

A careful reading of this contract will disclose that it was not the purpose of either of these contracting parties to submit the control of his interest under the contract to the other, but that each intended to leave himself free to act as an individual and solely for himself as an individual. Under this contract, the money which

Beals was to receive, was to be paid to him as compensation for property sold. . . .

For these reasons, the judgment against Beals must be reversed and it is so ordered.

WHAYNE SUPPLY CO. v. McGOWAN

1926, 213 Ky. 102, 280 S.W. 491.

SAMPSON, J. . . . The facts in this case seem to warrant the conclusion that Kreiger had more contracts than he could finance and was greatly in need of money to carry on his business, and in order to get it from appellee, McGowan, agreed in writing that he would give to appellee a certain part of the net profits of a named road project for the use of $15,000 with which to carry on the work, and McGowan regarding the prospects of profits upon the work as better than the usual rate of interest, consented to furnish the money on condition that he be given a part of the net profits. This, of course, was no more than a loaning of the money for the return of one-half of the profits in the business and did not amount to a partnership, especially when it is considered that McGowan was not to suffer any part of the losses of the business, if any there were, nor to have any part in the management and control of the business. Indeed, it would seem that McGowan's only connection with the affair was the loaning of the $15,000 for which he was to receive one-half of the profits of the business after certain things were done. Without an intention to form a partnership on the part of Kreiger and McGowan the terms of the writing did not raise such a relation and we are persuaded that the learned chancellor arrived at the proper conclusion in holding that McGowan was not a partner of Kreiger and that the creditors of Kreiger could not look to McGowan for the payment of their debts.

STANDARD OIL COMPANY OF NEW YORK v. HENDERSON

1928, 265 Mass. 322, 163 N.E. 743.

Action on contract by the Standard Oil Company of New York against Thomas Henderson Sr., for goods sold and delivered. From an order of the appellate division of the District Court, dismissing report of the trial court, plaintiff appeals. One Thomas Henderson Jr., opened a gas station and put on the window the words "Henderson & Son." This was the only name which appeared on the premises. On the same day that the station was opened the plaintiff and Thomas Henderson Jr., executed an "equipment loan

agreement" for the installation of a tank, pump, and accessories for the gasoline station. The agreement recites that it is made between the Standard Oil Company of New York and Henderson & Son and was signed by the plaintiff and Henderson & Son, by Thomas Henderson Jr. The business was conducted by Thomas Henderson Jr., the son of the defendant. At the time this action was brought the son was out of the state. All goods sold and delivered were charged to Henderson & Son and the delivery slips were signed by Thomas Henderson Jr.

PIERCE, J. For the purposes of this case we assume the defendant was not a partner of Thomas Henderson, Jr. The record contains no direct evidence that the defendant had knowledge or notice that he was held out as a partner in the business of his son, and no circumstantial evidence to warrant a finding of such knowledge and notice, other than can logically be deduced from the evidence that he "walked past the gasoline station almost every day; . . . that he saw the name 'Henderson & Son' " on a window of the premises, and knew that the business was conducted under that name; that he made no inquiries as to whether any credit was being extended by the plaintiff or any person or concern, relying on the fact that his name was used in connection with the business, and he did not tell any one that he was not connected with the business or ask his son to remove his name.

The trial judge specifically found "that [the defendant] was not asked by the plaintiff concerning his responsibility." He stated that he was "unable to find . . . that the defendant ever visited the place of business of the plaintiff." Other than as above stated, there is no evidence reported to warrant an inference that the defendant consented to the use of the sign "Henderson & Son" on the window of the station, and there in no affirmative evidence reported that the plaintiff gave credit to "Henderson & Son" on the faith that Thomas Henderson, Sr., the defendant, was a partner in the business carried on by the son under the sign name "Henderson & Son." . . .

On the evidence the issues which were presented at the trial were: (1) As a matter of fact did the defendant consent to his being held out as a partner in a public manner? And (2) did the plaintiff give credit to the apparent partnership on the faith that there was a partnership and that the defendant was a member of it?

The first request of the plaintiff was denied rightly. The evidence presented an issue of fact, and did not warrant the requested ruling of law that the defendant was a partner by estoppel in the business carried on under the style of "Henderson & Son." Bartlett v. Raymond, 139 Mass. 275, 30 N.E. 91, relied on by the plain-

tiff, decided merely that the evidence in that case warranted a finding for the plaintiffs.

The third request was also denied rightly. There is no evidence reported to warrant a finding that the plaintiff gave credit to the apparent partnership on the faith that the defendant was a partner in the partnership. . . .

The fifth request of the defendant:

"The plaintiff cannot recover on the ground that the defendant Thomas Henderson, Sr., is liable as a partner for estoppel unless he proves by a fair preponderance of the evidence: (a) That Thomas Henderson, Sr., held himself out as a partner; (b) that such holding out was by Thomas Henderson, Sr., or his authority; (c) that the plaintiff had knowledge of such holding out; (d) that the plaintiff acted on the strength of such holding out to his prejudice,"
—correctly stated the law applicable to the evidence before the court. We find no error. The entry must be:

Order of appellate division dismissing report affirmed.

CHAPTER II

PARTNERSHIP PROPERTY

TABER-PRANG ART CO. v. DURANT

1905, 189 Mass. 173, 75 N.E. 221.

This case involves a controversy between the individual creditors of Frank H. Jones and Henry E. Jones and the firm creditors of C. L. Jones and Company over the right to the proceeds from the sale of certain buildings.

MORTON, J. . . . The land and buildings formerly belonged to Charles L. Jones and Henry E. Jones as tenants in common, and they carried on on the premises the business of manufacturing soap, candles, etc., under the style of C. L. Jones and Company. There is nothing to show that the land and buildings were firm property or were so regarded. Charles L. Jones died in March, 1879, and devised his half of the land and buildings to Frank H. Jones with one-half of the fixtures, machinery and apparatus used in the business, and thereafter Henry E. Jones and Frank H. Jones carried on the business on the premises as equal partners under the same style as that under which it had been carried on formerly. There is nothing to show that there was any conveyance of the land and buildings by them to themselves as a firm or that it was agreed or understood that the land and buildings should be regarded as partnership property, and they were not so entered on the books. It is plain that the use of them for partnership purposes did not of itself convert them into partnership assets, or conclusively show an intention to treat them as such. . . .

No rent was paid; the taxes, insurance, and repairs that were paid by the firm, the new floors that were put in, and the small additions that were made to the buildings well might be regarded as an offset to the use of the premises. The fixtures, including machinery, hangers, belts, pulleys, boilers, and kettles that were put in and paid for out of partnership funds constituted partnership property. And they have been removed and sold by the assignee and the proceeds distributed amongst the partnership creditors. The brick storehouse was built by the partnership apparently for the partnership business and was paid for out of partnership funds. It was properly found to be partnership property. The candle factory was rebuilt out of the proceeds of an insurance policy taken out so far as appears by the partnership in its name and the premiums on which were paid by it. We think, though more doubt-

fully, that this also might be properly regarded as partnership property. No appeal, however, has been taken by the assignee, and the question of whether the decree is right in this respect is not before us. As we understand the case, the buildings, out of which the dwelling houses were constructed, were on the land at the time when the existing partnership was formed, and constituted a part of the real estate. The firm paid the expense of making over the buildings into dwelling houses, which were occupied principally by operatives of the firm, but it has been reimbursed out of the rents which it has collected, and we see no reason why the dwelling houses should be considered as partnership property. The partners being equal owners of the real estate and equally interested in the business, the fact that separate accounts were not kept in regard to matters relating to the real estate would seem to be of little moment. It is no doubt largely a matter of intention whether real estate belonging to persons who are partners and used in the partnership business shall be regarded as partnership property or not. We do not think in the present case it sufficiently appears that the owners intended that the property should be regarded as partnership property to warrant a decree to that effect.

SLATER et al. v. SLATER et al.

1903, 175 N.Y. 173, 67 N.E. 224.

The firm of J. and J. Slater was composed of two brothers and transacted a boot and shoe business under such name for more than forty years. Upon the death of one of the brothers the defendant brother continued the business. The trial court upon application by the widow of the deceased brother directed that the entire assets of the firm be sold, and ruled that the right to continue to use the firm name was not a firm asset and that the estate of the deceased partner had no interest therein, but that it belonged to the survivor, and should not be included in the sale of the firm assets. To this part of the decision the plaintiff excepted.

O'Brien, J. . . . The learned court below, while holding that the firm name was a part of the good will and hence partnership assets placed a restriction or limitation upon its use to the purchaser, and the right to sell it, that may materially affect its value, and go far to impair the property which it is conceded the plaintiff has in the good will as a part of her husband's estate. Conceding that the firm name is a part of the good will and is partnership assets it follows that it should be sold without any restriction or limitation upon its use by the purchaser, and in the same way and with like effect as in the case of all the other assets of the firm. If

the firm name is partnership property in any sense, the estate of a deceased partner is entitled to the benefits in the same sense that it is entitled to share in the distribution of the other property.

Judgment for plaintiff.

HENDREN et al. v. WING et al.

1895, 60 Ark. 561, 31 S.W. 149.

Wing et al., were partners doing business as the Arkansas Machinery and Supply Company. They sold E. H. Miller machinery and took back a chattel mortgage on the same, the mortgage describing the mortgagee as the "Arkansas Machinery and Supply Company." Miller had mortgaged other property to Hendren, but had sold it without Hendren's consent, substituting the new machinery in his place of business bought of the Arkansas Machinery and Supply Company. Hendren obtained possession of some of this new machinery, claiming the right to hold the same under his prior mortgage and also claiming that the mortgage to the partnership was invalid in that it did not name either a natural or an artificial person as mortgagee. The partnership seeks to recover possession of the property.

RIDDICK, J. . . . The question for us to determine is whether a chattel mortgage executed to it as such partnership is valid at law. It was said by Mr. Justice Eakin, in Percifell v. Platt, 36 Ark. 464, that "a partnership as such cannot at law be the grantee in a deed or hold real estate." "The legal title," said he, "must vest in some person and the partnership is not a corporation. If the title be made to all partners by name they hold the legal title as tenants in common. . . . If the deed be to a name adopted as the firm style, which includes the name of no party, it passes nothing at law." . . . He proceeds then to say that in equity the rule is different. . . . The decisions in regard to transfers of real estate to partnerships are based on the old rule stated by Judge Eakin, and that a partnership "as such cannot at law be the grantee in a deed or hold real estate." This rule does not apply to personal property. On the contrary, a partnership as such, can at law be the vendee in a bill of sale or other conveyance of personal property. The custom of the country teaches us that this is so. . . . Vast quantities of personal property of all kinds are contracted for, bought and sold by such firms under their firm names each year, and their right to thus buy and sell goes unchallenged. . . . A mortgage is only a conveyance for the purpose of securing a debt. If a bill of sale conveying personal property to a partnership by its firm name is valid,

we see no reason why a mortgage of personal property to a partnership should not be upheld under like circumstances.

Judgment for plaintiff.

McNAIR v. WILCOX

1888, 121 Pa. St. 437, 15 Atl. 575.

Action by John McNair against defendant to recover possession of property assigned by McNair's partner whereby the partnership business was broken up.

STERRETT, J. . . . Nor was the plaintiff's right to maintain the action affected by the fact that the property was transferred to defendant by plaintiff's partner. Plaintiff's interest in the property was not divested by the unauthorized assignment of his partner, made without his knowledge and in fraud of his rights. Speaking of the power of one partner to dispose of firm property, Mr. Justice Strong, in Sloan v. Moore, 37 Pa. St. 217, 223, says: "Still less can authority be admitted in one partner to sell the entire property of the firm when the object of the firm was not trade, buying and selling, but a business to which the continued ownership of the property was indispensable. An assignment is for the purpose of paying the debts; but a sale principally for division as was this case has not even that apology. Such a power in one of two copartners is asserted by no adjudicated case. It is directly in conflict with the purposes of the partnership. Instead of a presumption of agency to make such a sale, the presumptions are all the other way." The sale to the defendant in this case was not for the purpose of paying firm liabilities, nor for any other legitimate purpose. . . . It is well settled that where one joint owner of personal property sells or converts it to his own use, the other may sue in trover for its value. . . .

Judgment for plaintiff.

R. A. MYLES & CO. v. A. D. DAVIS PACKING CO.

1919, 17 Ala. App. 85, 81 So. 863.

This is an action by Myles & Co., a partnership, to recover the value of ten cows levied upon and sold by the defendant under a judgment against R. A. Myles personally. The plaintiff operated a meat market and M. A. Myles was one of three partners.

SAMFORD, J. . . . It is undoubtedly the law of this state that under a *fieri facias* against the goods of one member of a partnership his interest in the tangible assets of the partnership may be levied on and sold, but only such interest as he has; the right acquired by

such purchase is the right of the partner whose interest was sold and only his right, subject to all the liens, encumbrances, or infirmities affecting it as assets of the partnership. It is not a separate and exclusive right to any part or portion of it, or any right of any kind to any one part rather than to any other part, or any other right or interest than was held by the execution debtor as a member of the partnership. The ownership of each partner is subject to the ownership of all the other partners, and all the partners together hold the property subject to the right of the partnership to apply all of its funds to the payment of the partnership debts. The real ownership of all the chattels is vested in the firm, and the interest of each partner is merely a right to share in the profits of the business during its continuance, or in a division of the property upon dissolution after all the partnership obligations have been satisfied. No one partner has a separate ownership of or right to possess exclusively any part of the partnership assets, and a successor to his interest by purchase at an execution sale can acquire no greater interest than he has . . .

And while the interest of a partner in the partnership may be levied upon and sold, if the sheriff, in total disregard and denial of the rights of the partnership, levies upon and sells the partnership property as the property of one of the individual partners under an execution against such member, the sheriff is a trespasser as to the partnership, and his act is a conversion of the partnership property. . . . And the partnership can maintain an action against him to recover the damages resulting from such conversion. . . .

Such sale being illegal and rendering the officer a trespasser *ab initio,* the action may properly be brought in the names of the partners, and they will be entitled to recover the full value of the goods sold.

Judgment for the plaintiff.

QUINN v. LEIDINGER

1930, 107 N.J. Eq. 188, 152 Atl. 249.

In order to procure loans for carrying on their partnership, Quinn and Leidinger took out insurance on their respective lives. Partnership funds were used to pay the premiums. The partners had expressed a desire to insure their lives for the benefit of the enterprise, but, upon being informed by the agent that the partnership could not be made a beneficiary, they named their respective estates as beneficiaries. Upon Leidinger's death his estate received the proceeds of the policy.

LEWIS, V. C. Complainant contends that it was the intention of

the partners that this policy should inure to the benefit of the partnership.

The premiums on both the policies were paid from the partnership funds. The Partnership Act, Laws of 1919, chapter 212, section 8, subdivision 2 (Uniform Partnership Act, § 8(2)), provides, "Unless the contrary intention appears, property acquired with partnership funds is partnership property." The section is perhaps not controlling, since it is undisputed that these partners were in the habit of indiscriminately paying individual obligations with partnership funds. There is no evidence whatever that it was the intention of the partners in regard to these two insurance policies that they should not be partnership funds, except such conclusion as can be reached from the fact that the policies were taken out payable to the individual estates. It seems perfectly clear, however, that the naming of individual beneficiaries was based wholly on the statement of the broker that no other course could be pursued. The broker Stowe, who wrote the policy on complainant's life, testified that when the partners discussed the form of policy complainant said, "We want this insurance so if anything happens to either one of us, the one of us who is left will have the money to wind up the business, or to carry on as he sees fit." Such an expression could have no meaning if on the death of one of the partners the proceeds of the insurance on his life were to go to his individual estate. It could only have meaning if the proceeds of the policy were to go to the benefit of the partnership.

From the foregoing it seems clear to me that the partners intended to take out insurance on the lives of both of them so as to protect the partnership in case of the death of either of them. The insurance was taken out on the life of each partner, and it is immaterial that the insurance was taken out in the individual names, since the proceeds of each policy would be in trust for the benefit of the partnership. . . .

RUSH v. HOWKINS

1910, 135 Ga. 128, 68 S.E. 1035.

[Syllabus by the Court.] George W. Rush and J. S. Howkins formed a partnership to conduct an apiary. "The business was conducted by the said George W. Rush, as he knew and understood a bee culture enterprise, and was to manage and direct the cultivation of the bees and the maintenance of the apiary at West Savannah, Georgia." Each made application for insurance on his own life, and a policy of $1,000 was issued on the life of each, payable to the other. The premiums on the policies were paid with funds of

the partnership. The policy on the life of Rush was payable to "J. S. Howkins, business partner of insured." Rush died during the existence of the partnership, and at the date of his death the business had made a profit of $104.94. Howkins collected the amount due on the policy on the life of Rush, and appropriated the same to his own personal use, for which amount thus collected the administrator of the estate of Rush sued Howkins. *Held* that, as the continuance of the partnership afforded a reasonable expectancy of advantage and benefit to Howkins, he had an insurable interest in the life of his copartner, and, as the beneficiary named in the policy issued on the life of such copartner, was entitled to receive and retain the entire proceeds thereof.

ROBINSON et al. v. DAUGHTRY

1916, 171 N.C. 200, 88 S.E. 252.

This is an action by R. P. Robinson, one of the plaintiffs, to recover a one-half undivided interest in a tract of land in Sampson county, and by R. H. Stowe, another plaintiff, to recover a one-fourth interest in said land.

R. P. Robinson, R. H. Stowe, and T. L. Lowe were partners doing business under the firm name of R. P. Robinson & Co., and the business of the copartnership was selling patent rights to deal in washing compounds. Evidence was introduced tending to prove that the partnership took horses, mules, buggies, carts, and land in exchange for the patent rights, which items were converted into money; that T. L. Lowe had charge of the business in Sampson county; and that it was within the scope of the business to take land and convert it into cash in exchange for patent rights.

On September 27, 1900, the partnership sold to W. A. Hobbs in Sampson county the right to sell the washing compound in the state of Arkansas, and in payment therefor the said Hobbs and wife conveyed to R. P. Robinson & Co., the partnership being alone named as grantee, the land described in the complaint. On October 17, 1900, the said T. L. Lowe, acting for the partnership, sold said land to the defendant, and executed to him a deed therefor in which R. P. Robinson & Co. alone is the grantor, and which is signed "R. P. Robinson & Co. [Seal.]"

The plaintiffs contend that the deed to Robinson & Co. vested the title to the land in the members of the partnership as tenants in common, that the deed executed by Lowe to the defendant only operated to convey his interest in the land, and that therefore they are entitled to recover their interests therein. The defendant contends that the deed executed by Lowe conveyed the interest of all

the partners, and, if not, that it is valid as a contract to convey, of which specific performance will be enforced. . . .

ALLEN, J. The deed executed to R. P. Robinson & Co. is valid, and it operated to vest the full equitable title to the land described therein to the members of the partnership as tenants in common. . . .

If, then, the title to the land was vested in the members of the firm by the deed executed to R. P. Robinson & Co., has it been divested by the subsequent deed executed by Lowe, one of the partners, and what is the legal effect of the latter instrument? . . .

Ordinarily this authority of one partner to bind the others on the ground of agency does not extend to the conveyance of real property and deeds conveying such property must be executed by all the partners (30 Cyc. 494; Thompson v. Bowman, 73 U.S. [6 Wall.] 316, 18 L. Ed. 736); but it is also true that an instrument in form a deed which has been defectively executed by an agent having authority may operate as a contract to convey (Rogerson v. Leggett, 145 N.C. 10, 58 S.E. 596), and that no seal is necessary in a contract to convey land (Mitchell v. Bridgers, 113 N.C. 71, 18 S.E. 91), and that the authority to make the contract may be shown by parol (Hargrove v. Adcock, 111 N.C. 171, 16 S.E. 16; Wellman v. Horn, 157 N.C. 170, 72 S.E. 1010).

Applying these principles to the facts; it follows that the paper writing executed by the partner Lowe in the name of the partnership is valid as a contract to convey, provided there is evidence of authority in Lowe to make the contract. This authority may be express, or implied from the nature of the business conducted by the partnership, and the plaintiff Stowe testified that Lowe had charge of the business of the partnership in Sampson county, and the plaintiff Robinson that it was entirely in the scope of the business to take land and convert it into cash in exchange for patent rights, and, when the character of the business is considered, this furnishes evidence of authority in Lowe to make a valid contract of sale binding on all the partners. . . .

"One partner cannot convey the whole title to real estate unless the whole title is vested in him. Van Brunt v. Applegate, 44 N.Y. 544. But he can enter into an executory contract to convey which a court of equity will enforce. While a contract for the conveyance of land must be in writing, yet an agent to execute the contract may be appointed by parol. Willard on Real Estate, 376. And hence, when the partnership business is to deal in real estate, one partner has ample power, as general agent of the firm, to enter into an executory contract for the sale of real estate."

Plaintiffs nonsuited.

MAERCKLEIN v. MAERCKLEIN

1934, 64 N.D. 733, 256 N.W. 180.

M and S, partners, borrowed $1000 to purchase a farm. M signed the note, and as security gave a chattel mortgage on "all the ewes I own." In fact the partnership owned the sheep mortgaged. Later M gave another mortgage on the same sheep, and still later the partnership gave the First National Bank of Oakes another mortgage on them. The first mortgagee brought suit in which he claimed that his mortgage was paramount.

Burr, C. J. The record shows plaintiff's mortgage was executed by defendant M, with the advice and consent of his copartner, was given upon partnership property and for partnership purposes. The money obtained was used in the purchase of a farm for the partnership. Under our statute, section 6403 of the Compiled Laws: "Every general partner is agent for the partnership in the transaction of its business and has authority to do whatever is necessary to carry on such business in the ordinary manner and for this purpose may bind his copartners by an agreement in writing." Defendant M was a "general partner." His execution of the mortgage was necessary to carry on the business for which the partnership was formed. His act therefore bound the partnership. . . .

But when the general partner M executed the note and mortgage he did not sign the partnership name. The only signature is "M." . . . Hence it is incumbent upon the plaintiff to show that the defendant bank knew, or had it made the required investigation would have learned, that the mortgage was not what it purports to be—an individual affair—but was in fact the obligation of the partnership and covering partnership property. . . .

Chapter III

RIGHTS AND DUTIES OF PARTNERS AMONG THEMSELVES

GRANT v. SMITH

1902, 70 App. Div. 301, 75 N.Y. Supp. 82.

Action for an accounting. The respective interests of the partners, and the amount that each was to contribute to the capital of the firm, were fixed and certain. Plaintiff claims interest on amounts expended by him for the benefit of the partnership in excess of the amount required by the partnership agreement.

Chase, J. Where the share of the several partners in a partnership venture depends upon the capital furnished by them, respectively, it is very clear that interest should not be allowed on moneys furnished to the partnership as capital, either under the original agreement or as additions thereto; but when the amount to be furnished by each partner is fixed and certain, and the share of the respective partners in the profits of the partnership venture is a fixed proportion thereof, advances by one of the partners in excess of his prescribed proportion, although credited to the special account of such partner, and called "capital" of the firm, are in fact, as between the partners, loans and advancements for the benefit of the partnership; and equity requires that interest should be allowed thereon.

CLARK et al. v. STATE VALLEY RY. CO.

1890, 136 Pa. St. 408, 20 Atl. 562.

This action is brought in the name of the firm which consists of three members, Clark, Smart, and Murray. The plaintiff's claim is on a contract for the construction of the defendant's road. The defendant ruled the plaintiff's attorney to file his warrant of authority to sue. The plaintiff filed his warrant, executed in the name of the firm and signed by two individuals, Clark and Murray. The court ruled that this was insufficient as an authority for the use of the firm's name.

Williams, J. . . . Our question then is not whether the warrant of attorney before us is that of all the individuals who compose the firm of Clark, Smart, and Company, but whether it is that of the firm. This leads us to consider the manner in which the business of a firm must be conducted. The firm must have its origin in the mutual confidence reposed by the persons who comprise it in

each other's skill, integrity, and capacity. . . . Differences of opinion about questions of administration are to be anticipated. It would be unreasonable to expect that all the members of a partnership could see alike on all questions and for that reason a mere difference about the best thing to do or the best way of doing it does not necessarily work a dissolution or send the business and assets of the firm to a receiver. It was the rule of the common law that the contract of partnership must be governed by other agreements, by the principles of natural law and justice. It has accordingly been held that where a firm consists of more than two persons, the majority acting fairly and in good faith may direct the conduct of its affairs as long as they keep within the purpose and scope of the partnership. 1 Bouv. Inst. Par. 1454; Story, Partn. Par. 123. In such case, the minority must yield so long as the majority do not transcend or pervert the powers with which the firm has been invested. If the number of partners should in any given case be an even number, and they should be evenly divided in opinion, with no provision for such contingency in their articles, then it may be that, as to that subject, the power of the firm to act is suspended, so long as the even division continues; and if the subject be one upon which action is essential for the purposes of the partnership, such disagreement might work a dissolution by rendering the further prosecution of the common enterprise impossible.

Judgment of the lower court reversed.

KATZ v. BREWINGTON

1889, 71 Md. 70, 20 Atl. 139.

Katz and Brewington were copartners engaged in business under the name of L. Katz and Company. Brewington complains that Katz was in possession and control of the books and refused to permit him to have access to the same, and that Katz had sole possession and control of the goods of the firm and was disposing of the same in fraud of the complainant. Complainant also claims that Katz excluded him from all control of the business and refused to give him any information in regard to the same. Complainant seeks dissolution and an accounting.

Bryan, J. . . . The agreement of partnership required Katz to furnish all the capital and the profits were to be equally divided after the payment of debts and expenses. It was not alleged by complainant that any profits had been made or that there were any debts due by the partnership. It was, however, alleged that the defendant had excluded him from all control of the business of the firm and had refused to give him any information respecting it, and

had carried away the books from the place of business and had refused to disclose the place in which they were. Each partner has an equal right to take part in the management of the business of the firm, although one of them may have an interest only in the profits and not in the capital, yet his rights are involved in the proper conduct of the affairs of the firm, so that profits may be made, so each partner has an equal right to information about the partnership affairs and to the free access of the books. The complainant had a right to learn from the books whether there were profits and whether there were debts.

KAUFER v. ROTHMAN

1926, 78 N.J. Eq. 467, 131 Atl. 581.

Suit by Kaufer against Rothman for an accounting.

BACKES, V. C. The parties to the suit were partners, retail dealers in furs. The partnership came to an abrupt end when the defendant made away with most of its merchandise on a Sabbath, while his more orthodox and pious partner was at devotions in the synagogue. An accounting was ordered. An inventory taken nine days before showed the merchandise assets of $6,444. The value of the remnant taken over by the receiver in the cause three days after the business was wrecked was $1,140. The defendant admitted selling some of the furs in bulk for $1,600, the market value of which was conceded to be $1,925. The Master charged the defendant only with the goods he had sold and at the price he received, to which the complainant excepts. The Master should have determined the value of the merchandise as of the day of the involuntary dissolution and the value of the remnant in the receiver's hands and after making due allowance for sales from the time the inventory was taken until the closing down of business, charged the defendant with the difference, giving him opportunity to further discharge himself if he could. The inventory should have been taken as prima facie evidence of the stock and value. The burden of discharging himself of the difference was upon the defendant because of his responsibility for the confusion. The defendant is liable for the real value of the assets appropriated by him, not the price at which he sold them.

JONES et al. v. CADE

1922, 94 So. 255, 19 Ala. App. 27.

MERRITT, J. The appellants, together with appellee, were, and are, so far as the record discloses, members of a partnership doing

business under the name of the Eufaula Cash Store. Signing the name of the partnership, and his name as president, the appellee executed and delivered to the Bank of Eufaula a note for $491.56, the amount of the note being for money loaned by the bank to the partnership, and which went into the partnership business. Before the money was loaned these appellants, who were also members of the partnership, signed their names on the back of the note. On nonpayment of the note suit was brought against the Eufaula Cash Store and the appellee, and judgment recovered against both. . . . Execution being afterwards issued the amount of the judgment was paid by appellee, and this is a suit reciting said judgment, its payment by appellee, and claiming by contribution of the appellants their proportionate part of the judgment rendered against appellee, for that the appellants were co-makers and co-obligors of said notes. . . .

As stated above, the beginning, execution, and completion of the whole transaction, whereby the note was given, was for a loan of money to the partnership, which money went into and was used for partnership purposes. This being confessedly so, a suit cannot be maintained, at law, between the partners as such, by reason of the partnership relation. There is no rule forbidding suits at law between partners individually, but prior to a settlement of partnership business one partner cannot maintain an action at law against his copartner with reference to partnership affairs. Bumpass v. Webb, 1 Stew. 19, 18 Am. Rep. 34.

The reason for this rule is that it is ordinarily impossible to determine whether the defendant partner is indebted to the plaintiff partner or not until the partnership accounts are settled and the true standing of the parties ascertained; and the process and remedies afforded by a court of law are not usually adequate or appropriate to the investigation of claims requiring such an accounting. Mechem, Partnership, section 133. Even after dissolution there is no right to sue until there has been a settlement. (Citing authorities.) . . .

Judgment for defendant.

LORD et al. v. HULL

1904, 178 N.Y. 9, 70 N.E. 69, 102 Am. St. Rep. 484.

VANN, J. This action was brought by two copartners against the third for an accounting, without a dissolution, and it is not surprising that a challenge is interposed to the jurisdiction of the court. . . .

The general rule is that a court of equity, in a suit by one part-

ner against another, will not interfere in matters of internal regulation, or except with a view to dissolve the partnership, and by a final decree to adjust all its affairs. . . .

While a forced accounting without a dissolution is not impossible, it is by no means a matter of course, for facts must be alleged and proved showing that it is essential to the continuance of the business, or that some special and unusual reason exists to make it necessary. . . .

There is neither allegation nor evidence that Hull tried to exclude or expel the plaintiffs, or to drive them to a dissolution, or that he did anything in bad faith or with an ulterior purpose. The controversy was confined to one point of difference—the Murchison contract—which was a matter of internal regulation. There was no dispute about anything else. . . .

Exclusion from a small portion of the profits, paid or withheld in good faith on account of that contract, was not exclusion from the affairs of the firm, yet an accounting was sought only as a means of settling the dispute over that particular subject, which related simply to a detail in the management of the business. No discovery was asked for. There was no claim that Hull was insolvent, or that he had suppressed any fact, or had made secret profits, or had been guilty of bad conduct, or that the books had not been properly kept, or that the plaintiffs had been denied access to the books. There was no evidence that any partner had refused to give an account of all moneys received by him, or that there was error or omission of any kind in the accounts of the firm, except as limited to the Murchison agreement. It was easy to test the validity of that contract by simply withholding payment, forcing Murchison to sue, and raising the question by answer. That was not an equitable, but a legal, question. Murchison's claim did not differ from that of any firm creditor, except that the partners were at odds over its validity. "No action can be maintained by one partner against the other in respect to particular items of account pertaining to the partnership business." Thompson v. Lowe, 111 Ind. 274, 12 N. E. 477. . . .

There was no sufficient reason for an appeal to a court of equity in the case under consideration. There was no equity in the bill as filed by the plaintiffs, and none in the case made for them by the evidence.

Accounting denied.

Chapter IV

POWERS AND LIABILITIES OF PARTNERS IN RELATION TO PERSONS DEALING WITH THE PARTNERSHIP

SNIVELY v. MATHESON et al.

1895, 12 Wash. 88, 40 P. 628.

This action was brought against Matheson and Dickson, copartners under the firm name of Matheson and Dickson, to foreclose a chattel mortgage on certain grading outfits, comprised of mules, scrapers, and so forth, given to secure a certain promissory note signed in the partnership name. The defendant Matheson alleges that Dickson had no authority to execute the note and mortgage.

Dunbar, J. . . . The pertinent point to be decided in this case is the extent of the power of one partner to bind the copartners to a contract entered into by him alone. It is contended by the appellant in this case that this was a general or trading partnership as distinguished from nontrading partnership and some few cases are cited which would tend to sustain this contention. But the overwhelming weight of authority places this partnership in the list of nontrading partnerships. . . .

The general rule is that, so far as a general partnership, or in other words a trading or mercantile partnership, is concerned, each partner constitutes the other agent for the purpose of entering into all contracts for him within the scope of the partnership business. This power rests in the usage of the merchants and grew out of the necessities of commercial business. Therefore, the doctrine of implied liability received the sanction of the law and has for a long time been, and now is, enforced by the court. But this implied liability does not extend to partners in nontrading partnerships. . . . Hence, before recovery can be obtained upon a contract entered into by one partner in a nontrading partnership against the other partner, it must be affirmatively shown by the party attempting to bind the noncontracting partners either that authority to bind was conferred by the articles, or that authority had been especially conferred, or that it had been the custom of such partnership to recognize this right to such an extent as would give innocent dealers a right to rely upon the question. The trial court was not in error in holding the mortgage null and void.

Judgment for defendant.

PAGE v. BRANT

1856, 18 Ill. 37.

Brant sued Page and Bacon as partners. The defendants pleaded in abatement the nonjoinder of Brown and Wyman as party defendant. The plaintiff denied the joint liability alleged in the plea.

SKINNER, J. . . . The general rule is that the plaintiff must join as parties defendant all who are jointly liable upon the contract sued on and, if he does not, the nonjoinder being pleaded in abatement he cannot recover against any. And in actions in form ex contractu against partners, although the plaintiff need not join dormant or secret partners not known to him at the time of the contract, he must sue all who are ostensible and public members of the firm at the time of making the contract sued on. . . .

. . . Brown and Wyman were ostensible, open members of the firm of Page and Bacon for some two years prior to the commencement of the suit and during which time, we cannot doubt, the liability accrued; and the plaintiff having notice that they had become such partners, should have joined them in the action.

Judgment for defendant.

BOSTON FOUNDRY COMPANY v. WHITEMAN

1910, 31 R.I. 88, 76 A. 757.

Abe Whiteman, a partner in a business conducted under the name of Harry Whiteman, secured goods from the Boston Foundry Company by means of false representations, for which the plaintiff now sues Harry Whiteman.

JOHNSON, J. By the great weight of authority, it is well settled that all the members of a firm are liable for fraud committed by one of them in the ordinary conduct of the firm's business, although the others do not participate in the fraud and have no knowledge of it. It is well established in the law of agency that a principal is civilly liable for the tortious or fraudulent act, whether criminal or not criminal, of his agent, not only when he has previously authorized or subsequently ratified the act, but even though he may have expressly forbidden it, if it has been committed by the agent in the course and as a part of his employment. Applying these principles of agency, therefore, a firm is liable for any loss or injury caused to any person not a member of the firm, or for any penalty incurred by any wrongful act or omission of a partner, acting in the ordinary course of the business of the firm, or with the authority of his copartner. . . . For torts committed by a partner, or by an agent for whose misconduct the partnership is liable, the injured party

may, at his election, sue all the partners, or any one or more of them. Supposing a tort to be imputable to a firm, an action in respect of it may be brought against all or any of the partners. If some of them only are sued, they cannot insist upon the other partners being joined as defendants, and this rule applies even where the tort in question is committed by an agent or servant of the firm and not otherwise with the firm itself.

Chapter V

DISSOLUTION

LISH v. EARNSHAW

1872, 66 Ill. 402.

This bill was to dissolve a copartnership entered into for the purpose of carrying on a quarrying business and was to continue through the full period of five years. The plaintiff asks a dissolution before the term, because of the wrongful conduct and general mismanagement of one of the partners. The evidence shows that there was an honest dispute as to the payment of certain accounts.

Scott, J. . . . It is not for every act of misconduct on the part of one of the partners that a court of equity at the instance of another will dissolve the partnership and close up the affairs of the company. The court will require a strong case to be made, and it is laid down, as a general principle, that a court has no jurisdiction to make a separation between partners for trifling causes or temporary grievances involving no permanent mischief. 3 Kent 60.

. . . It is hardly necessary to comment separately on the other charges of misconduct. We do not find in all the records any cause of sufficient gravity, proved by clear and satisfactory evidence, that would justify a court of equity to interpose, to put an end to the partnership relations between the parties. It may be that there were slight errors in judgment on the part of the superintendent, but no evidence of willful misconduct appears that would result in the serious injury to plaintiff in error or any member of the firm.

Judgment for defendant.

WHARF v. WHARF

1922, 306 Ill. 79, 137 N.E. 446.

Eugene C. Wharf and James Wharf formed a partnership for the purchase of real estate to be improved and sold for their mutual profit. The title to the land was taken in the name of both partners individually. James Wharf died. After the settlement of all partnership debts, there remained fifty-eight lots. The heirs at law of James Wharf claimed title to said lots by descent. Eugene Wharf, the other partner, claimed title to said lots as a survivor of said partnership.

CARTRIGHT, J. . . . In such cases, in the absence of any different agreement, the real estate is regarded as personal property in order to effectuate the partnership business and the settlement of partnership affairs. The English rule established first by judicial decision and more recently by statute is, that real estate is regarded as converted into personalty for all purposes, including not only the partnership business and the settlement of partnership affairs, but also the succession as between the personal representative of the deceased partner and the heir at law. The rule of nearly all courts in the United States is that real estate is to be regarded as personal property only for the business of the partnership and the settlement of its affairs, and when no longer needed for that purpose the ordinary incidents and quality of real estate revive and the property goes according to the statute of descent. This court has followed those rules. . . .

That being the state of law, the legislature in 1917 passed Uniform Partnership Act. . . . The act made material changes in the law of this state relating to partnerships. . . . Related in some way in the question herein involved it contains the following provisions: . . . in part five, clauses (d) and (e) of paragraph 2 of section 25, and section 26, are as follows:

(d) On the death of a partner, his right in the specific partnership property vests in the surviving partner or partners.

(e) A partner's right in specific partnership property is not subject to dower, curtesy, or allowances to widows, heirs, or next of kin.

Section 26. A partner's interest in the partnership is his share of the profits and surplus and the same is personal property. . . .

The provision that a partner's interest in the partnership is his share of the profits and surplus and the same is personal property and that when dissolution is caused by death, each partner as against his copartner and all persons claiming through them in respect to their interests in the partnership unless otherwise agreed, may have the partnership property apply to the discharge of its liability and the surplus apply to pay in cash the net amount owing to the respective partners is inconsistent with the doctrine heretofore held, that, upon the settlement of the partnership affairs, real estate resumes its original character and descends to heirs. It seems that the legislative intention was to adopt the English rule, that real estate which becomes personal property for the purposes of a partnership remains personal property for the purpose of distribution.

Judgment for defendant.

WORD v. WORD

1890, 90 Ala. 81, 7 So. 412.

STONE, C. J. Word Bros., composed of Samuel P. and Charles P. Word, were merchants, copartners. The firm was dissolved by the death intestate, of Samuel P., in November, 1888. After 40 days, Charles P. Word was appointed administrator of Samuel P.'s estate. Belle Word is the surviving widow of Samuel P., but he left no descendants. . . .

The present bill was filed by Belle Word, March 15, 1889, about four months after the death of her husband, and it makes Charles P. sole defendant, suing him both as an individual and as administrator of Samuel P. It avers that the firm owed no debts, and its purpose, as shown by the prayer, is to obtain a settlement of the partnership accounts between the partners, and to have Charles P. account for and pay over the share of Samuel P., his deceased copartner. . . .

The bill charges the defendant with conduct that cannot be justified. Although the law, on the death of his copartner, clothed him with the legal title to the partnership effects, they did not become his in individual right. He took them in trust, and subject to a lien, for the purpose—First, of paying all debts of the partnership; and, second, of accounting to the estate of his deceased copartner for the share to which it was entitled. Lindl. Partn. (Amer. Ed.) bottom pp. 597, 598, 600, 601, 993, 1007. If the survivor neglected to take an account of stock, and fails to keep an account of sales, he does not properly execute the trust the law has cast upon him. And if he is acting thus negligently or faithlessly, and there is danger that the estate of his deceased copartner will suffer by reason of his inability to make good of his default,—or, rather compelled to make it good—then, upon a proper bill, with proper averments and proper prayer for relief, we will not say the effects should not be placed in the hands of a receiver, or the said Charles P. placed under a bond to faithfully account, as the chancellor may deem expedient and necessary.

Bill prematurely brought because statute permits no action against an executor until six (6) months after appointment.

JOSEPH, GABOURY & CO. v. SOUTHWARK FOUNDRY & MACHINE CO.

1891, 99 Ala. 47.

The present action was brought by the appellee corporation against the appellants to recover for the building of certain cot-

ton presses, and counted on the common counts. The defendants pleaded the general issue, payment, and that the defendants, E. B. Joseph and J. A. Gaboury, as a partnership, never made any contract with the plaintiff; and that if the presses were built by the plaintiff, they were built under a contract entered into between plaintiff and the Simplex Compress Manufacturing Company. . . . The evidence tended to show that in April, 1886, Joseph, Gaboury & Co., contracted with the plaintiff to build for them a trial press. This press was built and completed in June, 1886, and was accepted and paid for by the defendants. The plaintiff's testimony tended to show that in June, 1886, Joseph and Gaboury made another contract with the plaintiff to build three more presses for them. This contract, it is contended by the defendants, was made, not with them as a partnership, but with Gaboury for the Simplex Compress Manufacturing Company, a corporation. . . .

At the request of the plaintiff, the court gave to the jury the following written charges: (1) "A partnership is bound for the acts of each of the partners done in the name, and apparently on account of the firm, while it is supposed to exist; and to relieve themselves from this responsibility, they must give a reasonable notice that they are no longer partners." (2) "If the jury believe from the evidence that the partnership of Joseph, Gaboury & Co., employed the plaintiff to build one press for them, and afterwards said partnership was dissolved, and after such dissolution the defendant Gaboury employed plaintiff to build other presses for said partnership, both of the defendants would be liable on such contract, if the plaintiff had no notice of the dissolution of said partnership, until they had done the work contracted with said Gaboury to be done for the said partnership." (3) "That although the partnership of Joseph, Gaboury & Co., may have been dissolved in May or June in the year 1886, and if the plaintiff had no notice thereof until it did the work sued for, such dissolution would be no defense to this action. The defendants appeal and assign as error the above charges given for the plaintiff. . . ."

There was judgment for the plaintiff in the sum of $7,473.75. . . .

In the case of Mauldin v. Branch Bank at Mobile, 2 Ala. 502, it was held that "a dissolution of a partnership may take place inter partes, and yet the connection continue as it respects the rest of the world. In respect to all persons who have had no previous dealings with the concern, a constructive or implied notice of its dissolution will be sufficient. But as to persons who have had dealings with the firm during its continuance, it is requisite, that actual notice be given, or that such steps have been taken as to warrant the inference that it was received by the creditor." The rule rests upon the

principle that the partnership being once known to exist, its continuance will be presumed in favor of third persons, who have had dealings with it as a partnership, until notice of its dissolution has been brought home to them. . . .

The judgment of the lower court is affirmed.

FREEMAN v. HUTTIG SASH & DOOR CO.

1913, 105 Tex. 560, 153 S.W. 122.

Freeman was held liable as a partner for certain debts of the Independent Lumber Company, a partnership engaged in the lumber business at Dallas, contracted before and after his association with it. Prior to July 29, 1908, the partnership known as The Independent Lumber Company was composed of C. B. Yost, E. H. Campbell, and J. T. Sewell, each owning a one-third interest. On that date Freeman with knowledge of the firm's indebtedness purchased Campbell's interest and the transaction was assented to by Yost and Sewell. He did not intend to enter it as a partner. He intended to form a corporation with Yost and Sewell. However, debts were incurred by the organization after July 29th.

PHILLIPS, J. . . . It is an accepted rule in the law of partnership that one who becomes a member of an existing partnership does not thereby become liable for debts already incurred in the absence of an agreement to that effect expressed or implied. The presumption of law is against the assumption of such liability. . . . He ceased to be a naked coöwner when by a clearly implied agreement he permitted his interest to be put to work as capital in the business. He thereby became a partner under elementary principles of law upon the subject. . . . Holding as we do that Freeman became a partner in the business, he was liable for indebtedness contracted after July 29, 1908.

LIVINGSTON v. BLANCHARD

1881, 130 Mass. 341.

Livingston, the plaintiff's testator, and the defendant entered into a partnership for the purpose of carrying on a drug business. The articles provided that Livingston was to contribute the entire cash capital invested in the business; and that the profits after the payment of expenses and a nine hundred dollar salary a year to defendant were to be divided equally between the partners. The defendant on dissolution claims the right to share in one-half the total assets of the firm.

SOULE, J. It appears from the articles of partnership that Livingston contributed the whole capital, which was invested in the

partnership business, and the profits, after providing for the expenses, including rent of store, interest on the capital, and salary to the defendant, were to be divided equally between the partners. The capital became, therefore, partnership property. The expense of insuring was a part of the expense of the business; and on the dissolution of the firm, Livingston, or the plaintiff as executrix of his will, was entitled to repayment of the capital contributed by him, before the defendant was entitled to receive anything as profits. The amount of profits was ascertainable only by deducting from the assets left, after paying the expenses of the business, the amount of the capital invested. Whitcomb v. Converse, 119 Mass. 38.

Judgment for plaintiff.

EMANUEL v. BIRD

1851, 19 Ala. 596, 54 Am. Dec. 200.

Thomas Casey died and his estate was insolvent. He was a member of the firm of Green, Casey and James and the surviving partners were insolvent. The plaintiff, a partnership creditor, filed his claim against the estate and the Probate Court decreed that the claim be allowed in case the assets of the estate were sufficient to pay in full the individual liabilities of the deceased, but not otherwise. The plaintiff brought error.

Dargan, C. J. . . . But where the surviving partners are insolvent and there is no joint fund against which the joint creditors can proceed all difficulty is removed, and the partnership debt being considered in equity as joint and several, the creditor may at once proceed against the estate of the deceased partner. Having the right thus to proceed against the representative of the deceased partner, the question arises, how shall the assets be distributed between a joint creditor and an individual creditor of the deceased when there is not enough to pay both? The principle is unquestionably settled that in the administration of the copartnership assets, the partnership debts are to be preferred and are entitled to priority over the individual debts of the partners. On account of this preference of partnership debts over individual debts, in the administration of partnership assets, necessarily, in my opinion, results the rule, that the separate creditors are to have priority over the joint creditors in the administration of the separate estates, so long as there is a joint fund to which the joint creditors may resort for payment; for if we were to allow joint creditors to come and take pari passu with the separate creditors unpaid, when all the debts could be paid in full by compelling the joint creditor first to

exhaust his remedy against the joint estate, which is primarily liable to pay the partnership debts. . . . But when there is no joint estate, and the surviving partners are insolvent, then there can be no reason why the separate creditors should be entitled to priority over firm creditors; for the debt, though joint at law, is considered joint and several in equity; it is therefore a debt that the deceased partner separately as well as jointly owed and the only ground on which such debt could be postponed must be that there was another fund bound for its payment. . . . It appears to be the well settled doctrine that in cases of bankruptcy where there is no joint estate and no solvent partner the joint creditors may prove their debts against the bankrupt's estate and receive payment pari passu with his individual creditors. . . .

Applying these general principles to the case before us, . . . we think the Orphans' Court erred; for the testimony shows that the surviving partners, Green and James, are insolvent, and that there is no partnership fund to which the plaintiff can resort.

Judgment for plaintiff.

PART II
CORPORATIONS

Chapter VI
CHARACTERISTICS OF CORPORATIONS

FINNEGAN v. THE KNIGHTS OF LABOR BUILDING ASSOCIATION et al.

1893, 52 Minn. 239, 53 N.W. 1150.

Eight persons signed and acknowledged and caused to be recorded in the proper office articles assuming and purporting to form a corporation. The association received subscriptions to its capital stock and proceeded to do business. The defendant organization purchased from the plaintiff plumbing and building supplies for which he brings suit against the subscribers to the stock as partners. The theory upon which the action is brought is that the association's having failed to become a corporation, its members are liable as partners.

Gilfillan, C. J. . . . It is claimed that the association was not an incorporation because—first, the act under which it was attempted to become incorporated . . . is void because its subject is not properly expressed in the title; second, the act does not authorize the formation of a corporation for the purpose or to transact the business stated in the articles; third, the place where the business was to be carried on was not distinctly stated in the articles, and they had, perhaps, some other minor defects.

It is unnecessary to consider whether this was a de jure corporation, so that it could defend against a quo warranto or an action in the nature of quo warranto in behalf of the state; for, although an association may not be able to justify itself when called on by the state to show by what authority it assumes to act as a corporation, it may be so far a corporation, that, for reasons of public policy, no one but the state would be permitted to call in question the lawfulness of its organization. Such is what is termed a corporation de facto—that is, a corporation from the fact of its acting as such though not in law or of a right a corporation. What is essential to constitute a body of men a de facto corporation is stated . . . in Taylor on Private Corporations . . . "When a body of men are acting as a corporation under color of apparent organization, in pur-

suance of some charter or enabling act, their authority to act as a corporation cannot be questioned collaterally." To give a body of men assuming to act as a corporation, where there has been no attempt to comply with the provisions of any law authorizing them to become such, the status of a *de facto* corporation might open the door to fraud upon the public. . . . That was the condition in Johnson v. Corser, 34 Minn. 255, 25 N.W. 799, in which it was held that what had been done was ineffectual to limit the individual liability of the associates. They had not gone far enough to become a *de facto* corporation. They had merely signed articles. ". . . Color of apparent organization under some charter or enabling act" does not mean that there shall have been a full compliance with what the law requires to be done, nor a substantial compliance. A substantial compliance will make a corporation *de jure*, but there must be an apparent attempt to perfect an organization under the law. There being such apparent attempt to perfect an organization the failure as to some substantial requirement will prevent the body being a corporation *de jure;* but if there be user pursuant to such attempted organization it will not prevent it being a corporation de facto. . . .

The omission to state distinctly in the articles the place within which the business is to be carried on, though that might be essential to make it a *de jure* corporation, would not prevent it becoming one *de facto*. . . .

The foundation for a de facto corporation having been laid by the attempt to organize under the law the user shown was sufficient. Judgment for defendant below affirmed.

BATTELLE v. THE NORTHWEST CEMENT & CONCRETE PAVEMENT COMPANY

1887, 37 Minn. 89, 33 N.W. 327.

The plaintiff was one of the promoters and organizers of the defendant and became an incorporator, stockholder, director, and officer. Prior to the incorporation of the defendant, the plaintiff, with two other persons, entered into an agreement to incorporate the defendant for the purpose of transferring property owned by the plaintiff and others. The defendant was organized and by the agreement assumed and agreed to pay the indebtedness against the property. It failed and the plaintiff upon making payment now sued the company, a corporation.

GILFILLAN, C. J. It is self evident that a corporation is not bound by engagements of its "promoter" (i.e., those who bring about its organization) assuming to contract for it in advance. It

cannot have agents until it has an existence. The promoters are not the corporation and their contracts cannot be its contracts. This is so, though the promoters become at the creation of the corporation its only stockholders, directors, and officers. After it comes into existence and operation, it may, by adopting the engagements thus made for it in advance, make them its contracts, precisely as it might make similar contracts had no previous engagements been entered into. . . . It is not requisite that such a doctrine or acceptance be expressed, but it may be shown from acts or acquiescence of the corporation or its authorized agents as any similar contract may be shown. . . .

After receiving the benefit of the previous engagements and accepting and using the property in its business, knowing that, as part of the price of the property, the corporation was to pay the indebtedness, it can hardly be permitted now to deny its liability to pay it. . . .

Judgment for plaintiff.

KRIDELBAUGH v. ALDREHN THEATRES CO.

1923, 195 Iowa 147, 191 N.W. 803.

This is an action by the plaintiff to recover attorney fees for services rendered in connection with bringing the defendant into existence. The contract was made with J. L. Adams, Mrs. J. W. Adams, and W. D. Jamieson and followed an engagement by them previously to organize another corporation. When the defendant came into existence, the three promoters were named as the only directors. He met with them and they requested him to obtain for them the right to sell stock in the state of Iowa, the state in which the corporation was to operate, and told him he would be paid as soon as some of the stock was sold. He attended to the matter but has not been paid for any of his services.

DEGRAFF, J. . . . It is undisputed that the services were performed and the expenses were incurred at the instance and request of the promoters of the defendant corporation, and that the promoters promised to pay the plaintiff $1,500 for his services. Under these facts, the initial question is whether the promoters and incorporators could legally bind the defendant corporation as agents. The doctrine of agency is bottomed on the fiction of identity of principal and agent. There was no principal at the time that the contract in suit was made and consequently there was no agency. Principal and agent are correlative and coexistent terms. Promoters are individually liable on their contracts, and this is true

whether or not their efforts and initiative result in a corporation being called into existence. . . .

In logical sequence, the next question to be answered is whether the user *per se* of the charter and by-laws by the defendant is an adoption or ratification of the promoters' contract.

. . . We again answer in the negative. This is not a case in which the corporation can accept or refuse the benefits of the contract. Under the instant record it had no choice.

We now pass to the pertinent and vital question in the case. Did the corporation subsequently to the date of its creation adopt or ratify, expressly or impliedly, the contract of its promoters in the relation of the payment of the plaintiff for the services rendered by him? . . .

The adoption or ratification of a contract by a corporation is nothing more nor less than the making of an original contract. The theory of corporate ratification is predicated on the right of a corporation to contract and any ratification or adoption is equivalent to a grant of prior authority. . . .

The adoption or ratification of a contract by a corporation need not be shown by express acts, but it may be established by implication, as any other contract. . . .

It is not necessary that a board of directors employ an attorney by formal act or resolution. Furthermore the ratification or adoption of a contract by a corporation through its board of directors may be implied. It must be borne in mind under the facts in this case that the services which had been performed by the plaintiff were fully known by the directors of the company when the question of the prior contract and the securing of a permit to sell stock was under consideration. The board at that time was proceeding to do business under the charter secured through the services of the plaintiff. Not only did its acts constitute a recognition of past services, but in further consideration of the payment of money past due accepted an additional benefit for the corporation in enabling it to sell stock in Iowa. . . . This as we understand it was the position taken by the trial court and that the acceptance of the charter and the doing of business thereunder with relation to the services of the plaintiff performed and to be performed raised an implied contract that the defendant is bound to pay. This does not mean that the corporation in the mere acceptance of a charter is obligated by this fact alone to fulfill contracts made by its promoters in effecting its creation. . . .

Judgment of the lower court in favor of the plaintiff is affirmed.

Chapter VII

POWERS OF CORPORATIONS

WILLIAMS v. JOHNSON

1911, 208 Mass. 544, 95 N.E. 90.

The New York, New Haven and Hartford Railroad Company conveyed certain of its lands to trustees for the purpose of improving, selling, and developing real estate. The stockholders of the corporation challenge the right of the company through its trustee to enter into the real estate business on the theory that the corporation has no right under its charter to engage in such a project.

Knowlton, C. J. . . . A corporation has powers to do such business only as it is authorized by its act of incorporation to do and no other. It is not held out by the government nor by the stockholders as authorized to make contracts which are beyond the purposes and scope of its charter. It is not vested with all the capacities of a natural person or of an ordinary partnership, but with such only as its charter confers. When a corporation, created for the purpose of building and operating a railroad, goes into the business of banking or manufacturing and selling goods or dealing and speculating in real estate, because its corporators or board of directors think such adventures may be profitable, or if a bank should go to building and operating a railroad for like reasons, it is easy to see that in each instance the corporation is attempting to transact business which, under its organic act, it has no right or power to do. . . . Its ownership of the land, which came to it legitimately, left it with property on hand, to be sold or disposed of, so that its proceeds could be properly used for the purposes for which the corporation is created. It did not give it the right to hold the land permanently, or for an unreasonable length of time, as an investment for the production of income; much less did it give it the right to carry on, for a long term of years, the business of speculating in land. . . . If the corporation could not do this directly, it could not do it indirectly through the appointment of trustees or agents who should continue the business for its benefit.

BROWN v. CITIZENS' ICE & COLD STORAGE CO. et al.

1907, 17 N.J. Eq. 437, 66 Atl. 181.

The defendant company gave two mortgages, one for $10,000 and the other for $7,235, to Anna Ballingall, which she assigned to the

complainant. By the terms of the charter the corporation had power to "do any other acts or things incidental to grow out of or connected with said business or any part thereof; to issue bonds secured by mortgage," etc. The defendant claims the corporation had no authority to mortgage its property other than for the purposes above stated and as the money secured by said mortgages was applied to the payment of debts due for machinery the mortgages are ultra vires and cannot stand against the land.

BERGEN, V. C. . . . In my opinion the general power given a corporation under our act to mortgage its property is not restricted by the terms of the charter invoked. That clause has reference alone to the issuing of bonds in the usual commercial form, of the negotiable character, to be sold and passed by delivery and was not intended to and does not prevent the corporation from securing to a creditor its debt by way of mortgage in the common form; and the power to do so is fully conferred by the clause in the charter, which authorizes the company "to do any act or thing incidentally to grow out of or in connection with said business," implying the right to borrow money and pledge its property as security. The complainant is entitled to a decree of foreclosure.

WOODS LUMBER COMPANY v. MOORE

1920, 183 Cal. 497, 191 Pac. 905.

The Continental Producing Company was engaged in the manufacturing of films and entered into a contract with the Goldstein Company whereby the Goldstein Company agreed to sell and furnish costumes to the Continental Company. The Continental Company also entered into a contract with the Woods Lumber Company, plaintiff herein, wherein the Woods Lumber Company was to furnish lumber and materials for the Continental Company. The Continental Company defaulted in its payments, whereupon the Goldstein Company guaranteed the payments of the Continental Company, if the Woods Lumber Company would continue to supply materials to the Continental Company. The Goldstein Company was at the time financially interested in the success of a moving picture being made by the Continental Company. If the Continental Company failed to go on with its enterprise, the Goldstein Company would lose its contract to furnish costumes. This is an action by the Woods Lumber Company against the Goldstein Company on the contract of guaranty on behalf of the Continental Producing Company.

SHAW, J. . . . The articles of incorporation of Goldstein Company gave it power to make films for moving picture plays, and to

exhibit them to the public and also to build structures for the purpose of making such films. This fact, however, did not empower it to guarantee the obligations of other persons or corporations engaged in such business. It was not authorized to make contracts of guaranty as an independent business. It had no express power to make such contracts. The guaranty in question can be upheld as binding upon it only upon the theory that under the circumstances existing at the time it was within the implied powers.

A corporation engaged in carrying on a business which it is authorized to do by its articles and the law under which it is organized has implied power to make all contracts which are "essential to the successful prosecution of the business" (Civ. Code, sec. 354, subd. 8; Bates v. Coronado B. Co., 109 Cal. 163, 41 Pac. 855; Mercantile Trust Co. v. Kiser, 91 Ga. 636, 18 S.E. 358) or the making of which is an appropriate means by which it may be "reasonably expected that the business in which the corporation is engaged will be advanced." (Cases cited.)

The question whether or not a contract of guaranty comes within the reasons above mentioned is one which is to be primarily "determined by the corporation, or those to whom the management of its affair is intrusted." Bates v. Coronado B. Co., supra. The court cannot determine that it is beyond the powers of the corporation, unless it clearly appears to be so as a matter of law. With respect to the means which the corporation may adopt to further its objects and promote its business its managers "are not limited in law to the use of such means as are usual or necessary to the objects contemplated by their organization, but, where not restricted by law, may choose such means as are convenient and adapted to the end, though they be neither the usual means, nor absolutely necessary" for the purpose intended. Winterfield v. Cream City Brewing Co., 96 Wis. 239, 71 N.W. 101. . . .

In a business view the guaranty appeared to be essential to enable the Goldstein Company to obtain payments upon its contract with the Continental Company. It was to be reasonably expected that the making of the guaranty would advance the business of the Goldstein Company, and would secure to it the payment of the debt that would be due to it from its customer, the Continental Company. It was a thing helpful to the conduct of its business, and tended directly to promote the same. All of these things are held in the foregoing cases to be sufficient to bring the contract of guaranty within the scope of the implied powers of a corporation. We are of the opinion that the guaranty was a valid contract of the Goldstein Company.

Judgment for plaintiff.

STATE v. MISSOURI PAC. RY. CO.

1911, 237 Mo. 338, 141 S.W. 643.

A suit to oust two coal companies and an elevator company of their charters, and to order the defendant Railway Company to cease operating these companies on the ground that the Railway Company had acquired the capital stock of the three other corporations and is thus engaged in conducting a business for which it was not incorporated.

VALLIANT, C. J. . . . The organizations of the corporations as stated in the information, and the several purposes for which they were respectively organized, are admitted, and it is also admitted that the majority of the stock in the coal companies and in the elevator company is held by a trustee for the railroad company. The language of the answer perhaps justifies the inference, also, that all the stock in those companies except four shares in each is held by a trustee for the railroad company, and that those four shares are held by individuals to enable them to qualify as directors as the law requires. Against those admissions, we have the statements in the answer that the purpose of the railroad company in acquiring the stock in the coal companies was to secure to itself a supply of coal to be used as fuel in running its trains, and the purpose in acquiring the stock in the elevator company was to facilitate the handling and shipping of grain to be carried over its road. . . .

Under the state of facts above mentioned, the only question of law in this case is, may a railroad company own the majority of stock in a coal company adjoining or near its line of road or in an elevator company offering a convenient means to aid it in the handling and shipping of grain? The question is not, can a railroad company be held to account in a proceeding in quo warranto for an abuse of the power which the ownership of a majority of such stock gives, for perhaps no one would doubt that it would be amenable to such an inquiry, but where there has been no abuse of power, where the business of the corporation is being conducted in the usual way of such business concerns, is it unlawful for the railroad company to own the stock? The only written law to which we are referred as sustaining the contention that it is unlawful for a railroad company to own stock under such conditions is section 7 of article 12 of the Constitution, in which is the following: "No corporation shall engage in business other than that expressly authorized in its charter or the law under which it may have been or hereafter may be organized." That clause in the Constitution does not refer to the ownership of stock in another company. The thing forbidden is the engaging in business not authorized by its charter. It

would doubtless be a violation of that clause of the Constitution if a railroad corporation should acquire and use the stock of another corporation in whose business a railroad company could not lawfully engage as a cover behind which to carry on such business—that is, as a mere means of evading the letter of the law—still in such case the offense would be the carrying on of the business, not the owning of the stock. It would perhaps not be contended that a railroad company could not lawfully own a coal mine and operate it if necessary for the sole purpose of obtaining fuel for its own use, or that it could not own and operate an elevator in the handling of grain to be transported over its railroad. The business therefore of mining coal or operating an elevator is not business of such a character as the clause in the Constitution above quoted forbids. If the railroad company could do that business with its own means, why could it not secure itself in the matter of obtaining coal for fuel or a convenience in handling grain by acquiring stock in a coal or elevator company, if it would be more convenient, and if the public was not injured thereby? . . . We therefore conclude that section 7 of article 12 of the Constitution does not forbid a railroad company to own stock in a coal company or an elevator company, and we hold that the mere fact that the railroad company does own a majority or all but a few shares of the stock in those companies does not authorize a judgment of dissolution of the corporations and ouster of their franchises. . . .

FRASER v. RITCHIE

1881, 8 Ill. App. 554.

This is an action by the judgment creditors of the Eagle Works Manufacturing Company, seeking to subject to their judgment certain personal property formerly owned by the corporation, but sold to the appellants in consideration of the sale and surrender to the corporation of $30,000 worth of its own stock. The bill charges that the sale is fraudulent and void as against the creditors. At the time of the sale the corporation was solvent and possessed of large surpluses.

Wilson, J. The principal question arising in this case relates to the power of a corporation to purchase its own capital stock. . . . It is said that when debts are incurred a contract arises with the creditors that the capital stock or property of the company shall not be withdrawn or applied otherwise than to the satisfaction of their demands; that the creditors have a lien upon it in equity, and that, if diverted, they may follow it as far as it can be traced and subject it to the payment of their claims, except as against holders who

have taken it *bona fide* for valuable consideration without notice (quoting cases).

This principle as a general proposition would seem to be founded in reason and justice and may be regarded as settled law, but it remains to be considered whether the principle as stated is one of universal application admitting of no exception, or whether it is limited in its application, depending upon the circumstances of each particular case. . . .

The current of American authorities, on the other hand, seems to be to the effect that, under certain circumstances and for certain purposes, moneyed corporations and corporations possessing banking powers, and in some instances other corporations may invest their funds in the purchase of their own stock, subject to certain restrictions and limitations, one of which is that it shall not be done at such time and in such manner as to take away the security upon which the creditors of the corporation have the right to rely for the payment of their claim, or, in other words, so as not to diminish the fund created for their benefit. Each case must, therefore, depend upon and be determined by its own facts and circumstances and the difficulty sometimes met with grows out of the proper application of the rule of law to the facts of the particular case. . . . Our conclusion is that the weight of authority in this country is in favor of the power of a corporation to purchase its own capital stock, except where the circumstances are such as to show the purchase was fraudulent in fact or that the corporation was insolvent or in process or contemplation of dissolution at the time of the purchase. . . . We are unable to see any valid ground for holding that a corporation for manufacturing purposes may not, as between itself and its creditors, invest its surplus earnings in the purchase of shares of its stock.

Judgment for defendant.

Chapter VIII

ULTRA VIRES ACTS

NATIONAL HOME BUILDING & LOAN ASSOCIATION v. HOME SAVINGS BANK

1889, 181 Ill. 35, 54 N.E. 619.

The Building and Loan Association exchanged lots with one of its stockholders and assumed and agreed to pay a mortgage on the lot which it received. The Home Savings Bank, plaintiff, files its bill to foreclose, asking a decree against the stockholders, and the Building and Loan Association. The Building and Loan Association sets up in defense that the promise to assume and agree to pay the mortgage was ultra vires.

Cartwright, J. . . . No objection is made to the foreclosure of the trust deed, or the sale of the premises; and the only question involved in this appeal is whether the contract inserted in the deed, by which the defendant, the National Home Building & Loan Association, agreed to assume and pay the debt, is binding upon it. This defendant, which denied the binding force of the agreement, is a corporation organized under the provisions of an act entitled "An act to enable associations of persons to become a body corporate to raise funds to be loaned only among the members of such association," in force July 1, 1879. Laws 1879, p. 83. As a corporation it is a creature of the law, having no powers but those which the law has conferred upon it. A corporation has no natural rights or capacities, such as an individual or an ordinary partnership; and, if a power is claimed for it, the words giving the power, or from which it is necessarily implied, must be found in the charter, or it does not exist. . . . The purpose of this corporation is the raising of funds to be loaned to its members upon the security of its stock and unincumbered real estate. Manifestly, the business of trading in real estate or acquiring the same, except as incidental to their legitimate business, is wholly foreign to the purpose for which the state has created such corporations, and conferred upon them corporate powers. They have no power to take and hold real estate, and contracts made for the purchase of it are not enforceable. . . . If a building and loan association were permitted to invest its money in the purchase of real estate, or to traffic or trade in such property, instead of keeping within the powers conferred upon it, by loaning such money and collecting it, it would not only be exercising powers not granted, but it would be carrying on a business

inconsistent with the purpose of its creation, and against the fixed and uniform policy of the state. (Cases cited.) . . .

The powers delegated by the state to the corporation are matters of public law, of which no one can plead ignorance. A party dealing with a corporation having limited and delegated powers conferred by law is chargeable with notice of them and their limitations, and cannot plead ignorance in avoidance of the defense. . . .

Judgment for defendant.

NASSAU BANK v. JONES

1884, 95 N.Y. 115, 47 Am. Rep. 14.

David Jones, as agent for the plaintiff bank, bought $90,000 in railroad bonds accompanied by bonus stock for the bank. Jones never delivered the bonds or stock to the bank and this is a suit by the bank to recover the bonds and stock. Jones defends that the contract was ultra vires.

RUGER, C. J. . . . It is clear that a banking corporation cannot enter into a contract of this character, unless it has authority under its charter to become a subscriber for the stock of railroad corporations and thereby assume the obligation to which such stockholders are subject by statute. . . . The spirit of the law as well as sound public policy forbids these institutions from risking the moneys intrusted to their care in doubtful speculations or enterprises. . . .

The contract between the plaintiff and Jones is wholly executory, and nothing has occurred thereunder preventing the bank from setting up its own want of authority to make such a contract as a defense to any actions brought thereon by Jones.

While executed contracts made by corporations in excess of their legal powers have in some cases been upheld by the courts and parties have been precluded from setting up, as a defense to actions brought by corporations, their want of power to enter into such contracts (citing cases), this doctrine has never been applied to a mere executory contract which is sought to be made the foundation of an action either by or against such corporation. . . .

In Tracy v. Talmadge, 14 N.Y. 179, Judge Comstock says: "It is admitted that the contract of a corporation which it has no legal capacity to make, cannot in its terms be enforced. . . ."

Jones owed no duty to plaintiff except that which sprang out of his engagement to purchase the stock and bonds in question; and, having failed on account of its illegality, left no enforceable obligation resting on him. . . . The bank by the transaction in question secured Jones' promise to do certain things and has relied solely upon that promise. It has done nothing in performance of the con-

tract; so far as it is concerned the contract remains wholly executory. . . .

The law does not raise an implied obligation to effectuate a purpose which is forbidden and which cannot be effectuated by the parties through the agency of an express contract. . . .

We are unable to discover any ground upon which this action can be maintained.

J. P. MORGAN & CO. v. HALL & LYON CO.

1912, 34 R.I. 273, 83 Atl. 113.

VINCENT, J. This is an action at law, brought by J. P. Morgan & Company to recover from the defendant corporation damages for breach of its written guaranty of a letter of credit issued by the plaintiffs to Emily Alpers; the guaranty being signed by the defendant corporation, by its then treasurer, George C. Lyon. . . .

The case was tried in the superior court without a jury, and a decision was rendered for the defendant, whereupon plaintiffs filed their bill of exceptions upon two grounds: (1) That the said decision was against the law; and (2) that said decision was against the evidence and the weight thereof. The defendant contends that, the Hall & Lyon Company being a trading corporation, the act of its treasurer in signing the guaranty was without authority, and so simply an act for the accommodation of a third party to whom the letter of credit was issued, and therefore that it was ultra vires as to the defendant corporation, and also that the plaintiffs took such guaranty with notice of its character. The plaintiffs deny both of these propositions, and claim: (1) That the guaranty was issued by the treasurer of the defendant company under full apparent authority to bind the defendant company; that his act was not ultra vires, there being no evidence that such guaranty was for the accommodation of a third party; (2) that the plaintiffs took the guaranty in good faith without notice, actual or constructive, there being nothing surrounding the transaction to suggest inquiry as to the validity or purpose thereof; and (3) that the defendant knew that the guaranty was accepted in good faith, and in the belief that it would be recognized, and the drafts drawn on the letter of credit would be paid by the defendant, and therefore the defendant became bound to make such payment. There is nothing in the testimony tending to show whether or not Emily Alpers was in any way or manner connected with the defendant company.

It is, no doubt, the general rule that a corporation is not ordinarily bound by a contract of guaranty for the benefit of third parties, but that such guaranty may be given in the accomplishment of

any object for which the corporation was created, or when the particular transaction is reasonably necessary or proper in the conduct of its business. (Citing authorities.)

There is also good authority for the position that whenever an act may, under any circumstances, be reasonably necessary to carry out the purposes of incorporation, the party dealing with the corporation has a right to assume, without notice to the contrary, that the act is binding upon it. Green's Bryce's Ultra Vires, p. 37 et seq., 40a. The defendant corporation might properly guarantee a letter of credit under some circumstances, as, for instance, if it were sending some one abroad to purchase goods; and the plaintiffs would have the right to assume, both from previous dealings with the defendant and from lack of notice, that the guaranty was in furtherance of the defendant's legitimate business. Taking into consideration the well-known fact that drug stores keep on hand and offer for sale a large variety of articles which cannot be classified as drugs, and the further fact that women have been employed, in recent years, in a great variety of occupations, including heads of departments, buyers, and in many other positions connected with mercantile business, we do not think that the issuance of the letter of credit in the name of a woman would be sufficient to put the plaintiffs upon inquiry. . . .

Judgment for plaintiff.

CHAMBERLAIN v. SOUTHERN CALIFORNIA EDISON COMPANY

1914, 167 Cal. 500, 140 Pac. 25.

L, an employee of defendant company, owned an automobile which needed repairing. The defendant's general storekeeper directed the driver of one of its automobile trucks to go to *L*'s residence with the truck and bring *L*'s automobile to the defendant's shop for repairs, and the driver while so doing negligently injured the plaintiff. After *L*'s automobile was repaired, a bill was rendered to him by the defendant and paid. The driver was under the direction of the storekeeper, the president, and the manager. The company defends upon the theory that the driver was outside the scope of his authority and that the act was ultra vires.

MELVIN, J. . . . Upon a like principle the defendant corporation may not escape liability for torts of its servants acting under its orders, upon the theory that it is not authorized to make repairs upon the instrumentality which caused the damage. To hold otherwise would be to give to an artificial person immunity not enjoyed by a natural one. A corporation acts through its officers and

servants. When the plaintiff established the fact that the driver of the motor truck was a servant of the defendant acting under orders of one of its officers, who had authority to direct him in his work, a prima facie case was established in favor of plaintiff. This condition was not changed by reason of the fact that the assistant general manager did not order the work to be done on Lighthipe's automobile. The fact remains that one having apparent authority gave the order and no showing was made that this authority was not real—indeed, all of the circumstances, including the collection of the cost of repairs, point to the existence of an agreement between the corporation and its employee by which the latter's automobile was to be taken to the former's shop and there to be put in proper condition. Whether such a contract was or was not beyond the granted powers of the corporation is immaterial. In either view the corporation would be responsible for torts committed by its servants. The rule is that actions like the one at bar being founded not upon contract, but upon tort, the defense of ultra vires is not available. In an action arising ex delicto like this one, it makes no difference what sort of a contract the party causing the injury may have been performing when the injury was inflicted. . . .

"Under the rule of respondeat superior a corporation is civilly liable for torts committed by its servants or agent while acting within the scope of his employment, although the corporation neither authorized the doing of the particular act nor ratified it after it was done."

NEW YORK CENTRAL & H. R. R. CO. v. U.S.

1909, 212 U.S. 481, 29 Sup. Ct. 304.

The defendant company and assistant traffic manager were convicted for the payment of rebates to the American Sugar Refining Company and others, under the federal statute. The corporation defends upon the theory that it cannot commit a crime and that said act under which the company was indicted was unconstitutional.

DAY, J. . . . It is true that there are some crimes which in their nature cannot be committed by corporations. But there is a large class of offenses, of which rebating under the federal statute is one, wherein the crime consists in purposely doing the things prohibited by statute. In that class of crimes, we see no good reason why a corporation may not be held responsible for and charged with the knowledge and purposes of their agents acting within the authority conferred upon them. 2 Morawetz Priv. Corp. par. 733; Green's Bryce's Ultra Vires 366. If it were not so, many offenses might go

unpunished and acts be committed in violation of law where, as in the present case, the statute requires all persons, corporate or private, to refrain from certain practices, forbidden in the interests of public policy.

It is a part of the public history of the times that statutes against rebate could not be effectively enforced as long as individuals only were subject to punishment for violation of the law, when the giving of rebates or concessions inure to the benefit of corporations of which the individuals were but the instruments; this situation developed in more than one report of the Interstate Commerce Commission was no doubt influential in bringing about the enactment of the Elkins Law, making corporations criminally liable.

This statute does not embrace things impossible to be done by a corporation; its objects are to prevent favoritism, and to secure equal rights to all in interstate transportation and one legal rate to be published and posted and accessible to all alike.

Judgment affirmed.

CHAPTER IX

MEMBERSHIP IN CORPORATIONS

THE AMERICAN LIVE STOCK COMMISSION CO. v. THE CHICAGO LIVE STOCK EXCHANGE

1892, 143 Ill. 210.

This is a suit by the American Live Stock Commission Company, a not-for-profit corporation, seeking to compel the Chicago Live Stock Exchange to permit it to be a member of the live stock exchange, based upon a certificate of membership assigned to it by Rogers, its former manager. The Live Stock Commission Company contends that the possession of this certificate gives it a right to membership. The by-laws provide that any person of good character, etc., after ten days' notice of an application for membership, may be approved by at least 7 affirmative ballot votes of the board of directors.

BAILEY, C. J. . . . We are unable to see by what principle it can be justly claimed that the complainant is a member of the Exchange or entitled to the privileges of membership, or that it is in any position where it can insist upon being admitted to membership as a matter of right. Whatever may have been its right while Rogers, its manager, was a member, those rights no longer exist, as, by its own admission, Rogers is no longer its manager and is no longer a member of the Exchange. . . . The Exchange is a corporation having rules or by-laws determining the qualification for membership, and prescribing the mode in which members may be admitted, and there is no pretense that the complainant has ever brought itself within the terms of said rules or by-laws so as to be entitled to a membership. . . .

Said association had an undoubted right to adopt this rule, and as it prescribes the mode and the only mode in which membership in the Exchange can be obtained, no one can justly claim to be a member who has been admitted in the mode thus prescribed. . . .

A voluntary association whether incorporated or not has, within certain well defined limits, power to make and enforce by-laws for the government of its members. Such by-laws are ordinary matters between the association and its members alone, and with which strangers have no concern.

HUDSON REAL ESTATE CO. v. TOWER et al.

1892, 156 Mass. 82, 30 N.E. 465.

This is an action by a corporation to recover a subscription to capital stock. The defendants subscribed on assurance of the solicitor that the property should not be mortgaged. Later the subscribers voted to mortgage the property to be purchased by the money raised by subscriptions, and the defendants withdrew their subscriptions. The defendants now refuse to pay their subscriptions to the corporation.

ALLEN, J. At the time when the defendant signed the subscription paper declared on, it was not a contract, for want of a contracting party on the other side; but it has now been established that a subscription of this sort becomes a contract with the corporation when the corporation has been organized, and in this way the objection of the want of a proper contracting party is finally avoided, provided everything goes on as contemplated, without an interruption. Until the organization of the corporation, the subscription is a mere proposition or offer, which may be withdrawn like any other unaccepted offer. Unless the signer is bound upon a contract he is not bound at all. It is open to him to withdraw. It is not on the ground that there was no sufficient consideration. The seal would do away with any doubt on that score, but it is on the ground that for the time being and until the corporation is organized the writing does not take effect as a contract, because the contemplated party to the contract on the other side is not yet in existence and for this reason, there being no contract, the whole undertaking is inchoate and incomplete; and, since there is no contract, the party may withdraw. . . . The defendant thus withdrew before the time came when his subscription would have become a contract.

FIDELITY TRUST CO. et al. v. LEHIGH VALLEY R. CO.

1906, 215 Pa. 610, 64 Atl. 829.

POTTER, J. The facts of this case were not in dispute, and are clearly and accurately stated by the learned trial judge, as follows: "The original complainants in this case, and others who have intervened, are owners of shares of preferred stock of the Lehigh Valley Railroad Company, respondent. Under the terms of an act passed by the Legislature of Pennsylvania, approved March 4, 1850 (P.L. 129), the Beaver Meadow Railroad & Coal Company was authorized to issue preferred stock, which was entitled to a preference over all other stock of said company in every future dividend of profits declared, until the holders were paid, from the funds appli-

cable to such dividend 10 per cent. per annum. . . . In 1876, 9 per cent. only was paid to the common stockholders, and during the years from 1877 to 1893 the annual dividend upon the common stock was from 6 to 8 per cent. No dividends were declared on either the preferred or common stock from October 17, 1893, until June 20, 1904, when a dividend of 10 per cent. was declared on the preferred payable August 1, 1904, and a dividend of 1 per cent. on the common stock. A bill in equity was filed by the holders of the preferred stock praying for a decree declaring them entitled to cumulative dividends at the rate of 10 per cent. per annum before the payment of any dividends to the holders of common stock, for an order directing the specific performance of the agreement of merger between the corporations, and for an injunction enjoining the payment of dividends to holders of common stock until the preferred stockholders had been paid at the rate of 10 per cent. per annum from October, 1893."

Under these facts two questions arose which are thus stated by appellant: "Whether the holders of preferred shares were entitled cumulatively to dividends, at the rate of 10 per centum per annum from the time of issuance thereof, before the holders of common shares were entitled to any dividends. Whether, if thus entitled, their right was to an amount in excess of 10 per centum per annum from the date of original issuance of shares; there having been paid to them, in some years, dividends in excess of 10 per centum per annum." The court below decided both these questions adversely to the defendant company, and finally decreed. . . . "That the holders thereof should be entitled to cumulative dividends thereon at the rate of 10 per cent. per annum before the payment of any dividend to the holders of its common stock. The Lehigh Valley Railroad Company is hereby perpetually enjoined from making any payments of dividends to the holders of its common stock until it shall have paid the holders of its preferred stock dividends at the rate of 10 per cent. per annum from October 17, 1893. . . ." From this decree defendant has appealed.

As to the first question, whether or not the dividends upon the preferred stock are under the contract cumulative, we feel that sound reason and the weight of authority, both English and American, are in accordance with the conclusion reached by the court below. . . . There is no provision in the statute bearing directly upon the question of cumulation, and in the absence of any specification to the contrary the general rule would seem to be that the preferred stock is entitled to arrears. While the act specifies that the preferred stockholders are to be paid from the profits 10 per cent. per annum, before the holders of other stock are entitled to

participate at all, we can see in the language no limitation that the rights of the preferred stockholders are conditional upon the earning of sufficient profits each year to discharge their claim. No matter in what form the guaranty of dividends may be made, they can be paid only out of the net profits. An agreement to pay, even though there be no profits, would be void as against public policy, since their payment, then, depends upon profits, it would be postponed during years of business depression which showed no net profits. In the present case there is no guaranty of profits, or of payment of dividends every year, but there is an agreement that, whenever there are the profits to divide, the holders of preferred stock shall receive of them at the rate of 10 per cent. per annum on the amount of their holdings.

. . . In the present case, it is manifest that a great advantage to the other stockholders would accrue, if the preferred stock be considered as noncumulative. No such object was, of course, before the directors in refraining from the payment of annual dividends; but the possible result shows how such a power might be exercised to deprive the preferred stockholders of their contract rights, and a construction that would permit of such a result is to be avoided. We are of the opinion that the dividends upon preferred stock were properly held to be cumulative. . . .

The assignments of error are overruled, the appeal is dismissed, and the decree of the court below is affirmed.

SCOTT v. BALTIMORE & O. R. R. CO. et al.

1901, 93 Md. 475, 49 Atl. 327.

PAGE, J. The main question presented in the two cases contained in these records involves the right of the preferred stockholders of the Baltimore & Ohio Railroad Company to share in the distribution of the net profits of the company that may be remaining after the appropriation of 4 per centum of the net earnings to the preferred stock. It is contended by the appellants that the preferred stockholder has not only the right to receive a dividend of 4 per centum out of the net earnings before any dividend shall be set apart for the common stockholders, but to share pro rata with the common stockholders in the distribution of the residue, or, as an alternative proposition, to share equally with the holders of the common stock in any part of the net earnings that may be distributable after the payment of a dividend of 4 per centum each to the holders of both common and preferred stock. . . . The question as to the relative rights of these two classes of stock cannot be answered by regarding only the characterization of one of them as "preferred,"

because of the fact that this term, standing alone, means only a stock that differs from other stock in having a preference of some sort attached to it, without expressing the special nature of the preference. Ordinarily the term "preferred stock" is understood to designate such stock as is entitled to dividends from the income or earnings of the corporation before any other dividends can be paid. . . . It always, however, represents, pro tanto, the capital of the company, and has about it no elements or rights other than those that are conferred upon it by the statute or contract to the authority of which it owes its existence. In all other respects the preferred stockholder is upon the same footing as the common stockholder. . . . The preferred dividends may be made cumulative or noncumulative. The dividends may be a fixed amount for each year, to be paid out of earnings, or they may be a percentage, not exceeding a certain amount, to be determined by the directors at their discretion; and the preferred stockholder who has received his preferred dividend may still have a share of the net earnings that may remain. These are all matters for the determination of which the statute or contract must be looked to. . . . The solution of the question with which we are now dealing must depend, therefore, upon the construction to be placed upon the agreement of the parties as expressed in the stock certificates, that must be taken as the embodiment of the contract, and the final expression of the entire measure of the dividend rights of the parties. . . .

The certificate states what the preferred stock "will be entitled to receive," and that is "not exceeding four per cent." That is the measure of its rights. And, if so, how is it possible to hold that having received that amount before the common stock received anything, it shall yet receive afterwards an additional sum? According to the fair meaning of these words, it seems to be clear that a proper construction of them, and the only one that will harmonize them all, is that the preferred stock should be noncumulative, and should receive 4 per cent., and no more, out of the net earnings, but should be entitled to receive that before any dividends are set apart for the common stockholders.

HANDLEY v. STUTZ

1891, 139 U.S. 417, 35 L. ed. 227.

This is a suit by creditors of a corporation to compel stockholders who received 800 shares of bonus stock to make payment on such stock.

Brown, J. . . . The stock of a corporation is supposed to stand in the place of actual property of substantial value and as being a

convenient method of representing the interest of each stockholder in such property, and to the extent to which it fails to represent such value it is either a deception and fraud upon the public or evidence that the original value of the corporate property has become depreciated. The market value of such shares rises with an increase in the value of the corporate assets, and falls in case of loss or misfortune, whereby the value of such assets is impaired. And the increase of value of such stock is taken to represent either an appreciation value of the company's property beyond the par value of the original shares, or so much money paid to the corporation as is represented by such shares. If it be once admitted that a corporation may issue stock without receiving a consideration therefor, and where it does not represent actual or substantiated value in corporate assets, there is apparently no limit to the extent to which the original stock may be "watered," except the caprice of the stockholders. While an agreement that the subscribers or holders of stock shall never be called upon to pay for the same, may be good as against the corporation itself, it has been uniformly held by this court not to be binding upon its creditors.

CONTINENTAL TRUST CO. v. STUMP

1926, 15 F.(2) 464.

Robb, J. Appeal from a judgment in the Supreme Court of the District of Columbia for the plaintiff, in an action to recover the value of fifty shares of the capital stock of Durant Motors, Inc., converted by the defendant.

This stock was the property of the plaintiff, and was delivered to the defendant by the plaintiff's husband to secure the payment of his note; the husband having signed his wife's name to the assignment on the back of the stock certificate without her knowledge. There was a default in the payment of the note, and the stock was sold by the defendant; the proceeds being applied to the payment of the note and the balance deposited to the credit of the husband, who checked out the balance. The good faith of the defendant is not questioned.

On the part of the defendant it is contended that, since no title passed by the forged indorsement the defendant, as an innocent purchaser of the stock, did not acquire and the plaintiff did not lose title, and that the plaintiff's remedy is through an action to compel Durant Motors, Inc., to reissue to her 50 shares of stock transferred on the forged indorsement. Doubtless plaintiff might have elected to pursue such a course . . . But where, as here, the stock has been

sold by the pledgee, and there has been a conversion in the strict sense of the term, the owner may elect to sue for its value.

The judgment for plaintiff is affirmed with costs.

HYATT v. ALLEN

1874, 56 N.Y. 553, 15 Am. Rep. 449.

Plaintiff sold to defendant stock in a corporation, reserving "all profits and dividends of and upon such stock up to January next." No dividend was declared until April. This is an action by the plaintiff to recover the dividend declared in April. In fact, part of the dividend had been earned prior to January.

ANDREWS, J. . . . It is conceded that the plaintiffs are not entitled to recover anything by force of the word "dividends" contained in the agreement. This word, when used in reference to the corporate stock, has a technical but well understood meaning, and indicates corporate funds derived from the business and earnings of the corporation, appropriated by a corporate act to the use of and to be divided among the stockholders. . . . The defendant agreed that dividends to the first of January, 1872, should be paid to the plaintiff. As no declaration of dividends was made until April 9, 1872, the defendant incurred no liability under this part of the agreement. . . . There were no profits accruing to the stockholders until they were set apart by the corporation for their use. . . .

The words "profits and dividends" in the contract in question related to profits or dividends realized by the defendant as a stockholder, or declared by the company prior to January 1, 1872, and as no division of profits was made, the plaintiffs are not entitled to recover.

CHAPTER X

RIGHTS OF STOCKHOLDERS

DODGE et al. v. FORD MOTOR CO. et al.

1919, 204 Mich. 459, 170 N.W. 668.

Bill by the plaintiffs, minority stockholders, praying that the defendant be enjoined from carrying out the announced policy of the majority stockholders respecting dividends; that the defendant be required to distribute immediately 75 per cent of the accumulated cash surplus in dividends; that the defendant be required to distribute in the future all net earnings except such as are required for emergencies; that defendant be restrained from exceeding the present amount of its operating capital.

The bill further alleges that the policy of the majority stockholders of the defendant is to restrict future dividends to the regular monthly dividend of 5 per cent and to use the surplus earnings in the expansion of the plant. . . . That in furtherance of such plans the defendant proposes nearly to double the capacity of the plant and further to extend the operations by the erection of a smelting plant, blast furnaces, ore docks, etc. . . .

The Ford Motor Company was organized in 1903 with a capital stock of $150,000. In 1908 the capital stock was increased to $2,000,000. The company has paid up to July, 1916, 5 per cent monthly dividends and special dividends to the amount of $41,-000,000. No special dividends have been declared since 1915, except a 100 per cent dividend declared since the filing of this bill. The surplus above capital stock is $111,960,907.03, including $52,-550,771.92 in cash. The operating capital is now 30 times its authorized capital and 2½ times the authorized capital for corporations under the statute. A temporary injunction was granted, restraining the defendant from using the cash surplus in establishing its projected smelting plant. After a hearing on the merits, a permanent injunction was granted, restraining the company from using the funds for a smelter plant, and from increasing the fixed assets beyond those existing at date of the decree. The defendants were also ordered to distribute in dividends one-half the cash surplus, less the 100 per cent dividend declared since the filing of the bill. The defendants appeal.

OSTRANDER, C. J. . . . When plaintiffs made their complaint and demand for further dividends, the Ford Motor Company had

concluded its most prosperous year of business. The demand for its cars at the price of the preceding year continued. It could make and could market in the year beginning August 1, 1916, more than 500,000 cars. Sales of parts and repairs would necessarily increase. The cost of materials was likely to advance, and perhaps the price of labor; but it reasonably might have expected a profit for the year of upwards of $60,000,000. It had assets of more than $132,000,000, a surplus of almost $112,000,000, and its cash on hand and municipal bonds were nearly $54,000,000. Its total liabilities, including capital stock, was a little over $20,000,000. It had declared no special dividend during the business year except the October, 1915 dividend. It had been the practice, under similar circumstances, to declare larger dividends. Considering only these facts, a refusal to declare and pay further dividends appears to be not an exercise of discretion on the part of the directors, but an arbitrary refusal to do what the circumstances required to be done. These facts and others call upon the directors to justify their action, or failure or refusal to act. In justification, the defendants have offered testimony tending to prove, and which does prove, the following facts: It had been the policy of the corporation for a considerable time to annually reduce the selling price of cars, while keeping up, or improving their quality. As early as in June, 1915, a general plan for the expansion of the productive capacity of the concern by a practical duplication of its plant had been talked over by the executive officers and directors and agreed upon; not all of the details having been settled, and no formal action of directors having been taken. The erection of a smelter was considered, and engineering and other data in connection therewith secured. In consequence, it was determined not to reduce the selling price of cars for the year beginning August 1, 1915, but to maintain the price and to accumulate a large surplus to pay for the proposed expansion of plant and equipment, and perhaps to build a plant for smelting ore. It is hoped, by Mr. Ford, that eventually 1,000,000 cars will be annually produced. . . .

The record, and especially the testimony of Mr. Ford, convinces that he has to some extent the attitude towards shareholders of one who has dispensed and distributed to them large gains and that they should be content to take what he chooses to give. His testimony creates the impression, also, that he thinks the Ford Motor Company has made too much money, has had too large profits, and that, although large profits might be still earned, a sharing of them with the public, by reducing the price of the output of the company, ought to be undertaken. We have no doubt that certain sentiments, philanthropic and altruistic, creditable to Mr. Ford, had

large influence in determining the policy to be pursued by the Ford Motor Company—the policy which has been herein referred to. . . .

A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes. . . .

In reaching this conclusion, we do not ignore, but recognize, the validity of the proposition that plaintiffs have from the beginning profited by, if they have not lately, officially, participated in, the general policy of expansion pursued by this corporation. We do not lose sight of the fact that it had been, upon an occasion, agreeable to the plaintiffs to increase the capital stock to $100,000,000 by a stock dividend of $98,000,000. These things go only to answer other contentions now made by plaintiffs, and do not and cannot operate to estop them to demand proper dividends upon the stock they own. It is obvious that an annual dividend of 60 per cent. upon $2,000,000 or $1,200,000, is the equivalent of a very small dividend upon $100,000,000 or more.

The decree of the court below fixing and determining the specific amount to be distributed to stockholders is affirmed. . . .

SOEHNLEIN v. SOEHNLEIN

1911, 146 Wis. 330, 131 N.W. 739.

This is a suit by remaindermen under a trust in which the remaindermen claim that stock dividends are part of the corpus of the estate, rather than income, and that as remaindermen they are entitled to such stock dividends.

MARSHALL, J. . . . In such circumstances who takes the distributive share, the term tenant or the remainderman? . . .

There is no legal objection in the absence of some statute to the contrary to a corporation declaring a dividend payable in stock out of its net income leaving its ordinary capital unimpaired. That method is common. True, the general conception of dividend incident to corporate stock is payment from time to time out of net income of moderate amounts, somewhat in the nature, as to regularity of payment and amount thereof, of interest on money investments represented by notes and bonds. But for convenience of the corporation and according to the judgment of directors, dividends out of net earnings carried as undivided profits, or surplus, or otherwise, and existing in cash or property, may be made in cash or stock of

any legitimate kind by some method which will operate to actually transfer distributable assets—those not impairing capital—to individual ownership of stockholders, or constructively do so by beneficially giving them additional shares of stock, thus changing the distributable property into permanent capital against new liabilities. . . .

It is well settled that the doctrine that where there is ownership of stock for a term and a remainder over, income accumulated during such term and distributed as dividends regardless of how it is distributed goes to the owner for the term in absence of manifest intention otherwise by the creator of the estate. . . .

In disposing of stock or property dividend as between tenant and remainderman the court may properly inquire as to the time when the fund out of which the extraordinary dividend is to be paid was earned or accumulated, and also as to the method of accumulation. If it is found to have accrued or been earned before the estate arose it may be held to be principal; and, without reference to the time when it is declared or made payable, to belong to the corpus of the estate and not go to the life tenant. But when it is found that the fund, out of which the dividend is paid, accrued, or was earned, not before, but after the life estate arose, then it may be held that the dividend is income and belongs to the tenant for life.

JONES v. MORRISON

1883, 31 Minn. 140, 16 N.W. 854.

The complainant, a stockholder, files his bill objecting to the increase in capital stock against the defendants who were directors and to enjoin the sale of the increased stock in that no opportunity was given to the complainant to purchase.

Gilfillan, C. J. . . . When the proposition that a corporation is trustee for the corporate property for the benefit of stockholders in proportion to the stock held by them is admitted (we find no well considered case which denies it), it covers as well the power to issue new stock as any other franchise or property which may be of value held by the corporation. The value of that power, where it has an actual value, is given to it by the property acquired and the business built up with the money paid in by the subscribing stockholders. It happens not infrequently that corporations, instead of distributing their profits in the way of dividends to stockholders, accumulate them until a large surplus is on hand. No one would deny that in such case each stockholder has an interest in the surplus, which the courts will protect. No one would claim that the officers, directors, or majority of the stockholders without the con-

sent of all could give away the surplus, or devote it to any other than the general purposes of the corporation. But when new stock is issued, each share of it has an interest in the surplus, equal to that pertaining to each share of the original stock. And if the corporation either through the officers, directors, or majority of the stockholders, may dispose of the new stock to whomsoever it will, at whatever price it may fix, then it has the powers to diminish the value of each share of old stock by letting in other parties to an equal interest in the surplus, and in the good will or value of the established business. . . .

The plaintiff was therefore entitled to an opportunity to subscribe for and take new stock in proportion to the old stock held by him. He had no such opportunity.

Judgment for plaintiff.

CROSBY v. STRATTON

1902, 17 Colo. A. 212, 68 Pac. 130.

THOMSON, J. Walter F. Crosby brought this suit against Winfield S. Stratton to recover damages from the latter for the alleged wrongful conversion by him of stock in the Portland Mining Company, to which the former averred himself to be entitled. The complaint set forth as follows: That the entire capital stock of the Portland Mining Company, a corporation, consisting of 3,000,000 shares of the par value of $1 each, was, at the date of the organization of the company, issued, fully paid and nonassessable, in consideration of certain mining property then conveyed to the corporation; that afterwards, and prior to the 17th day of April, 1894, the stockholders of the company of whom the plaintiff was one, transferred to the company 704,000 shares of this stock, to be held for its use and benefit, and to be part of its general assets; . . . that the directors of the company, by resolution, authorized and directed the sale of the 704,000 shares which had been transferred to the company, for the price of 12½ cents per share, for the general purposes of the corporation; that, by virtue of the property of the stockholders in the stock so ordered to be sold, each stockholder, as incident to his ownership of outstanding stock, had the right to subscribe for, and to have allotted and issued to him, shares of the stock so ordered to be sold, in proportion to his then holdings; that of such stock the plaintiff was entitled to 65,000 shares, and the defendant to 117,424; that by reason of his office as director, and of his participation in the offer of the stock for sale, and the sale, the defendant was well acquainted with the rights of the stockholders in the stock to be sold. . . . To the foregoing complaint, a demurrer was

sustained and, the plaintiff declining to amend, judgment was entered against him, and he appealed to this court. . . .

We come now to an examination of the underlying theory of the case. Had the original stockholders of the corporation any right, in law, to a preference over strangers in the purchase of the 704,000 shares they had transferred to the company, or had one stockholder any preference over another in the purchase? Such preference does exist in relation to original stock which remains untaken, and therefore unissued, at the time of the incorporation; and, in case of an increase of the capital stock, each of the first stockholders has the right to subscribe for and purchase his pro rata share of the new stock. One reason on which the rule in either case rests is that the stockholder has the right to preserve the proportionate interest in the corporation first acquired by him. To dispose of the unissued or added stock to strangers, or to other stockholders, without affording him an opportunity to take his pro rata share, would be, without his consent, to impair his interest and influence in the corporation, and diminish the relative value of his holdings; and this the directors, who are trustees for the stockholders, may not lawfully do. (Cases cited.) But because, to prevent impairment of their interests, corporators have a preference in the purchase of unissued or new stock, it does not follow that they have any right over strangers in the purchase of stock which has been paid for and issued, but transferred back to the corporation as part of its general assets. Their right in the one case is founded on reasons which have no existence in the other. The issued stock of a corporation represents its paid-up capital. The holder owns it and disposes of it as he sees fit; and if it finds its way back into the treasury of the corporation it becomes assets in the same sense that the corporation's other property is assets. It is still part of the paid-up capital; and its sale no more affects the value of the other stock or the standing of the stockholders in the corporation, than the sale of the corporation's tools or machinery. The relative value of all the stock is the same whether the particular stock of which we are speaking remains in the hands of the original holders, or has been acquired from them by the corporation, and placed in its treasury. . . .

The demurrer was properly sustained, and the judgment will be affirmed. Affirmed.

AMES v. AMERICAN TELEPHONE & TELEGRAPH CO.

1909, 166 Fed. 820.

The plaintiff, as stockholder in the Telephone, Telegraph & Cable Co., brought an action against the defendant American Telephone

& Telegraph Co. to recover treble damages under the Sherman Anti-Trust Act, claiming that the defendant company secured control of the Telephone, Telegraph & Cable Co., and so managed it as to force it into the hands of the receiver to the loss and injury of the plaintiff, rendering worthless his shares of stock in the Telephone, Telegraph & Cable Co.

BROWN, District Judge. . . . The principal question upon demurrer is whether the declaration sets forth any injury to the plaintiff resulting in a special damage peculiar to himself and distinguishable in kind from that which he shares with all other shareholders as a result of an injury to the corporation in its business or property.

Assuming merely for purposes of decision upon demurrer that the declaration alleges a violation of the Sherman act, and that it properly alleges consequent damage, I am of the opinion that the injury set forth is to the corporation, for which the corporation alone can maintain an action at law under the Sherman act. Section 7 of that act gives a right to recover threefold damages to—"any person who shall be injured in his business or property by any other person or corporation by reason of anything forbidden or declared to be unlawful by this act," etc.

The business which it is alleged was injured was that of the Telephone, Telegraph & Cable Company of America, and not of the plaintiff. Can it be said that the injury which the plaintiff has suffered by the depreciation of the value of his shares constitutes such an injury in his property that it is distinguishable from the injury to the corporation? The right of a stockholder to maintain an action at law for injury suffered by the corporation was carefully considered by Chief Justice Shaw, in Smith v. Hurd et al. 12 Metc. (Mass.) 371, 46 Am. Dec. 690. In this opinion it is recognized that to the extent of his separate and peculiar interest a stockholder may maintain his separate and special action. It is said, however:

"But an injury done to the stock and capital, by negligence or misfeasance, is not an injury to such separate interest, but to the whole body of stockholders in common. It is like the case of a common nuisance, where one who suffered a special damage, peculiar to himself and distinguishable in kind from that which he shares in common injury, may maintain a special action." . . .

The corporation has a right of action, and to so interpret the act as to confer a right of action upon the stockholder also, upon the present declaration, would be in effect to subject the defendant not merely to treble damages, but to sextuple damages, for the same unlawful act. . . .

Demurrer sustained.

CHAPTER XI

MANAGEMENT OF CORPORATIONS

HODGE et al. v. U. S. STEEL CORPORATION

1903, 64 N.J. Eq. 807, 54 Atl. 1.

A bill by J. A. Hodge and others against the U. S. Steel Corporation to enjoin defendant corporation from carrying out certain contracts authorized and ratified by a two-thirds vote of the stockholders, there being within the two-thirds vote, votes cast by directors who were also stockholders.

VAN SYCKEL, J. . . .. In Durfee v. Old Colony R. Co., 5 Allen (Mass.) 230, Chief Justice Bigelow said: "It may be stated as an indisputable proposition that every person who becomes a member of a corporation aggregate by purchasing and holding shares agrees by necessary implication that he will be bound by all acts and proceedings, within the scope of the powers and authority conferred by the charter, which shall be adopted or sanctified by the vote of the majority of the shareholders of the corporation duly taken and ascertained according to law. This is the unavoidable result of the fundamental principle that the majority of the stockholders can regulate and control the lawful exercise of the powers conferred on the corporation by its charter." In the case of the steel corporation the right of the majority does not rest upon implication. In the by-laws adopted by the stockholders, in pursuance of authority given by the act of incorporation, such power is expressly given to the majority.

STATE ex rel. WHITE v. FERRIS

1875, 42 Conn. 560.

This is a suit with regard to the right of Ferris to vote 564 shares of stock of the H. & A. Transportation Company at the annual meeting for directors and other officers. The stock formerly belonged to a copartnership of which Ferris was a member. The said copartnership was insolvent and its assets were in the hands of an assignee. Ferris secured a power of attorney to vote these shares from the assignee in bankruptcy. The stock at the time of the annual meeting stood on the book as belonging to the partnership.

PARK, C. J. . . . It has been repeatedly held by this court that the books and records of a corporation determine who are its stockholders for the time being and who have the right to vote on the

stock, although the same may have been sold or pledged as collateral security. In such cases the party who appears to be the owner by the books of the corporation has the right to be treated as a stockholder and to vote on whatever stock stands in his name (quoting cases).

Besides, in this case it appears that the assignee did not claim the right to vote on this stock at the annual meeting, but on the contrary consented in advance that L. M. Ferris, Jr., might vote on it. What matters it to the other stockholders which of these parties voted on the stock so long as one party or the other manifestly had the right to vote and both were agreed as to who should vote? The stock stood in the name of the copartnership of which Ferris was a member . . . and the assignee the only other party interested assented to his voting on the stock. . . . We think the other stockholders have no right to complain.

CLARK v. FOSTER et al.

1917, 98 Wash. 241, 167 Pac. 908.

CHADWICK, J. The Lewiston-Clarkston Company, a Washington corporation, was in need of new organization and new credit. . . . To further the interests of the corporation as the parties then supposed, the holders of 9,453 shares of the common stock, the plaintiff among them, entered into what is called a "voting trust agreement." . . .

The shares were to be held by the trustees and voted at any and all regular and special meetings of the stockholders of the company, with full power and authority to sign, execute, and deliver, all consents in respect to the stock as in their sole judgment they might deem for the best interests of the company and its stockholders. . . .

At the time the contract was entered into the trustees issued and delivered to the depositors a "voting trust certificate," made assignable, describing the number of shares deposited, and reciting that the holder was entitled to receive all dividends declared by the company. In the fall of 1916 the trustees selected under the voting trust agreement entered into negotiations for the sale of the hydroelectric plant. The negotiations had so far proceeded that terms were agreed upon, but the sale had not been consummated. The plaintiff, disagreeing with the policy of the trustees, brought this action to restrain a meeting of the trustees and the contemplated sale. A preliminary restraining order was issued by the court. It was thereafter dissolved. The case went to a hearing on its merits, and from a decree denying plaintiff the relief sought plaintiff has appealed.

. . . First, whether a voting trust agreement is void as a matter of public policy; and, second, if not void as offensive to public policy, it is violative of the spirit and letter of the statute law of this state, providing for the creation and management of domestic corporations.

Whether a voting trust agreement is void as a matter of public policy is one upon which the courts have drawn many different conclusions. While it is stated broadly in many of the text-books and annotated notes that the courts have held on the one side that such contracts are void as against public policy and other courts have held they are not invalid, we are of the opinion that in most, if not quite all, of the cases to which our attention has been called the courts have, notwithstanding certain broad statements, inclined to look to the facts and equities of the particular case. As, for instance, where the duration of the trust agreement was fixed for a time unreasonably long, or without a definite period, or beyond the life of any of the participators, or where such agreements were made upon condition of an office to be granted, or for the sole benefit of the parties to the agreement and not for the general welfare of the corporation, or in fraud of the rights of the corporation or the other stockholders, the contract has been held void.

On the contrary, it has been held where an agreement is made in good faith and is for the betterment of the corporation and apparent advantage of all of the stockholders, or to protect the security which sustains the corporation, and it does not appear that any illegal advantage is sought and the agreement is freely and voluntarily entered into, such contracts are not, in and of themselves, contrary to public policy. . . .

It may be said finally that voting trust agreements are valid and binding, if based upon a sufficient consideration, if they do not contravene public policy or a positive prohibitory statute, and if they do not sound in fraud or wrong against the stockholders. Wherefore the object and not the form of the agreement furnishes the test, and where the trust is voluntarily created as a condition precedent to a loan to protect those who have furnished the money that has put the life into a corporation, the courts should not seek further for a consideration. . . . The decree is affirmed.

CHARLESTOWN BOOT & SHOE CO. v. DUNSMORE et al.

1880, 60 N.H. 85.

Plaintiff sued directors because of their negligent conduct and refusal to act with a committee chosen by the stockholders to act

with them. The question arose as to who should manage the business.

SMITH, J. The provision of the statute is, that the business of a dividend paying corporation shall be managed by the directors. The statute reads: "The business of every such corporation shall be managed by the directors thereof, subject to the by-laws and votes of the corporation, and under their direction by such officers and agents as shall be duly appointed by the directors or by the corporation." . . . The only limitation upon the judgment or discretion of the directors is such as the corporation by its by-laws and votes shall impose. It may define its business, its nature and extent, prescribe rules and regulations for government of its officers and members and determine whether its business shall be wound up or continued; but when it has thus acted the business thus defined and limited is to be managed by the directors, and by such officers and agents under their direction as the directors or the corporation shall appoint. The statute does not authorize a corporation to join another officer with the directors, nor compel the directors to act with one who is not a director. They are bound to use ordinary care and diligence in the care and management of the business of the corporation and are answerable for ordinary care. . . .

It would be unreasonable to hold them responsible for the management of the affairs of the corporation if compelled to act with one who to a greater or less extent could control their acts.

Judgment for defendants.

BALDWIN et al. v. CANFIELD

1879, 26 Minn. 43, 1 N.W. 261.

This is a suit to determine the validity of a certain deed executed by the officers of the Minneapolis Agricultural and Mechanical Association with the approval of the board of directors acting separately. The deed was attacked by the plaintiffs as void and of no effect against them.

BARRY, J. . . . As we have already seen, the court below found that by its articles of incorporation the government of the Minneapolis Agricultural and Mechanical Association and the management of its affairs was vested in a board of directors.

The legal effect of this was to invest the directors with such government and management *as a board* and not otherwise. This is in accordance with the general rule that the governing body of the corporation as such are agents of the corporation only *as a board,* and not individually. Hence, it follows that they have no authority to act save when assembled at a board meeting. The separate

action, individually, of the persons comprising such governing body, is not the action of the constituted body of men clothed with the corporate powers. . . . The directors took no action as a board with reference to the sale of the premises or the execution of any deed thereof. So far as in any way binding the corporation is concerned their action in executing the deed is a nullity. They could not bind it by their separate and individual action.

BRIGGS v. SPAULDING

1890, 141 U.S. 132, 35 L. ed. 662.

This is a bill by the receiver of the First National Bank of Buffalo against Spaulding and others, directors, to recover for losses sustained by the bank due to the negligence of the directors. The losses were directly due to the misapplication of the bank's funds by one Lee, cashier and director. Lee was permitted actually to conduct the business and for a long period of time the directors signed Lee's reports without investigation. The by-laws provided for monthly meetings. However, the board only met infrequently and at long intervals.

FULLER, C. J. . . . The liability of directors to the corporation for damages caused by unauthorized acts rests upon the common law rule which renders every agent liable who violates his authority to the damage of his principal. . . .

It is perhaps unnecessary to attempt to define with precision the degree of care and prudence which directors must exercise in the performance of their duty. The degree of care required depends upon the subject to which it is to be applied, and each case has to be determined in view of all the circumstances.

They are not insurers of the fidelity of the agents whom they have appointed, who are not their agents, but the agents of the corporation; and they cannot be held responsible for losses resulting from wrongful act or omission of other directors or agents, unless the loss is a consequence of their own neglect of duty, either for failure to supervise the business with attention or in neglecting to use proper care in the appointment of agents. . . .

We are of the opinion that these defendants should not be subject to liability.

CHAPTER XII

DISSOLUTION OF A CORPORATION

PULLMAN'S PALACE CAR CO. v. MISSOURI PAC. RY. CO.

1885, 115 U.S. 587, 29 L. ed. 499.

This is a suit brought by the Pullman Car Company to enjoin the Missouri Pacific Railway Company and others from discontinuing the use of drawing room and sleeping cars of the Pullman Company and from contracting with any other person for supplying like cars. The Missouri Pacific Railway Company entered into a contract to haul the Pullman cars on their passenger trains on its own lines for a specified period. Before the period expired the Missouri Pacific Railway Company consolidated with itself certain other companies and formed a new corporation by the same name.

WAIT, C. J. . . . The main questions involved in the merits of this case are whether the contract between the Missouri Pacific and Pullman Company made before the consolidation binds the consolidated company to haul the Pullman cars (and other questions). The present Missouri Pacific Company is a different corporation from that which contracted with the Pullman Company. The original company owned and operated a railroad between St. Louis and Kansas City. This company owns and operates that road and others besides. It is a new corporation created by the dissolution of several old ones and the establishment of this in their place. It has new powers, new franchises, and new stockholders. . . .

The new company assumed on the consolidation all the obligations of the old Missouri Pacific. This requires it to haul the Pullman cars under the contract on all roads owned or controlled by the old company at the time of the consolidation, but it does not extend the operation of the contract to other roads which the new company may afterwards acquire.

HOLLINS et al. v. BRIERFIELD COAL & IRON CO.

1893, 150 U.S. 371, 37 L. ed. 1113.

This is a suit by Hollins and others, creditors, on contract whose claims have not yet been reduced to judgment, for the appointment of a receiver and the management of the affairs of the company.

BREWER, J. . . . While it is true language has been frequently used to the effect that the assets of the corporation are a trust fund held by a corporation for the benefit of creditors, this has not been

to convey the idea that there is a direct and express trust attached to the property. . . .

All that it decides is, that when a court of equity does take into its possession the assets of an insolvent corporation, it will administer them on the theory that they in equity belong to the creditors and stockholders rather than to the corporation itself. In other words, and that is the idea which underlies all these expressions in reference to "trust" in connection with the property of a corporation, the corporation is an entity distinct from its stockholders as from its creditors. Solvent, it holds its property as any individual holds his, free from the touch of a creditor who has acquired no lien; free also from the touch of a stockholder who, though equitably interested in it, has no legal right to the property. . . .

A party may deal with a corporation in respect to its property in the same manner as with an individual owner and in no greater danger of being held to have received into his possession property burdened with a trust or lien. The officers of a corporation act in a fiduciary capacity in respect to its property in their hands and may be called to an account for fraud or sometimes even mere mismanagement in respect thereto; but as between itself and its creditors the corporation is simply a debtor, and does not hold its property in trust or subject to a lien in their favor, in any other sense than does an individual debtor. . . . Neither the insolvency of the corporation, nor the execution of an illegal trust deed, nor the failure to collect in full all stock subscriptions, nor all together give to these simple contract creditors any lien upon the property of the corporation, nor charge any direct trust thereon. . . .

GRAHAM v. LA CROSSE & M. R.R. CO.

1880, 102 U.S. 148, 26 L. ed. 106.

The defendant railway company sold certain real estate to Charles D. Nash for $25,000. The officers of the defendant company furnished Nash the means for buying the land. The officers of the company then purchased the land from Nash. The railway company confirmed the sale by executing a deed to the directors. Shortly after the sale, judgments were taken against the railroad to the extent of $40,000. This is a bill to set the conveyance aside as fraud upon the creditors. The railway company was solvent at the time of the conveyance.

Bradley, J. . . . The main question is, whether the sale to Nash made before the railroad company became indebted to the appellant and when for all that appears it was perfectly solvent, even though made for the use and benefit of the officers referred to,

can be set aside at the instance of the complainant for the purpose of subjecting the land to sale under their execution. And this question we think must be answered in the negative.

It is a well settled rule of law, that, if an individual, being solvent at the time, without any actual intent to defraud creditors, dispose of property, for an inadequate consideration or even make a voluntary conveyance of it, subsequent creditors cannot question the transaction. . . .

It is contended, however, by the appellant that a corporation debtor does not stand on the same footing as an individual debtor; that, whilst the latter has supreme dominion over his own property, a corporation is a mere trustee, holding its property for the benefit of its stockholders and creditors; and that if it fails to pursue its right against third persons, whether arising out of fraud or otherwise, it is a breach of trust and creditors may come into equity to compel an enforcement of corporate duties. This, as we understand, is the substances of the position taken.

We do not concur in this view. It is at war with the notion which we derived from the English Law, with regard to the nature of corporate bodies. A corporation is a distinct entity. Its affairs are necessarily managed by officers and agents it is true; but, in law, it is as distinct a being as an individual is and is entitled to hold property. . . .

We see no reason why the disposal by a corporation of any of its property should be questioned by subsequent creditors of the corporation, any more than a like disposal by an individual if his property should be sold. The same principles of law apply to each.

PART III
MISCELLANEOUS BUSINESS ORGANIZATIONS

CHAPTER XIII

PEOPLE ex rel. NATIONAL EXPRESS COMPANY v. COLEMAN et al., Tax Commissioners

1892, 133 N.Y. 279, 31 N.E. 96.

This is a proceeding to review the action of the tax commissioners in taxing a joint stock company on its capital stock as a corporation under a statute which said "that all moneyed or stock corporations deriving an income or profit from their capital or otherwise shall be liable to taxation. . . ." Lower court vacated the assessment.

FINCH, J. . . . But I think there was an original and inherent difference between the corporate and joint stock companies known to our law, which legislation has somewhat obscured but has not destroyed, and that difference is the one pointed out by the learned counsel for the respondent and which impresses me as logical, and well supported by authority. It is that the creation of the corporation merges in the artificial body and drowns in it the individual rights and liabilities of the members, while the organization of a joint stock company leaves the individual rights and liabilities unimpaired and in full force. The idea was expressed in Supervisors of Niagara v. People, 7 Hill 512, and in Gifford v. Livingston, 2 Den. (N. Y.) 380, by the statement that the corporators lost their individuality and merged their individual characters into one artificial existence; and upon these authorities a corporation is defined on behalf of the respondents to be "an artificial person created by the sovereign from natural persons and in which artificial persons the natural persons of which it is composed become merged and nonexistent." I am conscious that legal definitions invite and provoke criticism because the instances are rare in which they prove to be perfectly accurate; and yet this one offered to us may be accepted if it succesfully bears some sufficient test. In putting it on trial we may take the nature of individual liability of the corporators on the one hand and of the associates on the other for the debts contracted by their respective organizations, as a sufficient test of the difference between them and contrast their nature and character. . . .

The debt of a corporation is its debt and not that of its members; the debt of a joint stock company is the debt of the associates, how-

ever enforced. The creation of a corporation merges and grounds the liability of its corporators; the creation of a stock company leaves unharmed and unchanged the liability of the associates. The one derives its existence from the contract of individuals; the other from the sovereignty of the state. The two are alike but not the same. More or less they crowd upon and overlap each other, but without losing their identity; and so while we cannot say that the joint stock company is a corporation, we can say . . . that a joint stock company is a partnership with some of the powers of a corporation. . . . The order should be affirmed with costs.

SIMSON et al. v. KLIPSTEIN

1920, 262 Fed. 823.

Action by Leslie N. Simson and George W. Hunter, trustees, against Ernest C. Klipstein. On motion to dismiss the case for want of jurisdiction.

DAVIS, D. J. Defendant in the above-stated cause moved to dismiss the same on the ground that this court is without jurisdiction because one of the necessary parties plaintiff and the defendant are both citizens of the state of New Jersey. . . .

On March 15, 1916, the plaintiffs, Simson and Hunter, by an instrument purporting to be a declaration of trust, called "Articles of Association of Midvale Chemical Works," established a proposed trust and constituted themselves trustees thereof. Their plan contemplated that, as trustees of the Midvale Chemical Works, the name of the proposed trust, persons would give to them money, in return for which they would issue certificates entitling the holders thereof to share in the profits resulting from their management of the enterprise upon which they were to embark with said money. The certificate holders were the beneficial owners of the money contributed by them, in that they were to share in the profits earned and in the final distribution of the assets of the association, in accordance with the terms of the articles of association. According to said terms, however, the legal and equitable title to the property is vested in the said trustees.

The trustees purchased at Elizabeth, N. J., some considerable real estate and established and operated a factory thereon, wherein aniline oil, etc., was manufactured. On May 31, 1917, the "Midvale Chemical Works, by George W. Hunter, Leslie N. Simson, trustees," entered into an agreement with the defendant for the sale to him of said real estate and factory for the sum of $150,000, and also for the personal property, including the raw materials on hand, an inventory of which, the plaintiffs allege, showed it to be worth about

$45,000 in addition. The defendant entered into possession of the property, but it developed that the said trustees could not give a clear title to the real estate and the defendant refused to accept a deed for the same. During the time title to said real estate was being determined by litigation in the Court of Chancery of New Jersey, the defendant continued in possession of the property and operated the factory. For his alleged failure to pay for the personal property and raw materials, for his refusal to remove from the premises at the termination of the litigation in accordance with the terms of an agreement entered into while litigation was going on, and for damages alleged to have been done to the said property while in possession of defendant, plaintiffs brought this action against him to recover the sum of $141,870.78. The defendant is before this court on motions as aforesaid.

Whether or not an association is a trust or partnership depends upon the instrument creating it. Real estate trusts, such as this claims to be, have arisen principally in Massachusetts and Missouri. Upon a careful examination of the articles of association of the Midvale Chemical Works and of the cases bearing upon this question, I am of the opinion that the Midvale Chemical Works is a partnership. The test is the power of control of the management of the association. If the certificate holders have the power of control, the association is a partnership; if they have not, and the power of control is in the trustees, it is a trust. "The distinction," said Judge Morton, in the case of In re Associated Trust (D. C.) 222 Fed. 1012, "between the two turns upon the provisions of the trust agreement or declaration. In cases where by the declaration of trust, the shareholders are given substantial control of the management of the trust property, the trust is held to be a partnership; in cases where shareholders have no such control, the trust is held, for the purposes of taxation, to be of the same sort as the usual testamentary trust, and not to be a partnership." . . .

Power of control in the case at bar is given to the certificate holders in the articles of association. . . .

. . . It is evident that the power of control of the management is in the certificate holders, and may at any time be exercised by them, notwithstanding any opposition the trustees might offer. The certificate holders are associated together by the terms of the creative instrument. The association is therefore a partnership, and not a trust.

Does it thereupon follow, as contended by the defendant, that the names of the certificate holders should be added as parties plaintiff, one of whom, it is alleged, is a citizen of New Jersey, which fact ousts this court of jurisdiction? It should be noted that the asso-

ciation is a partnership, the certificate holders themselves being the partners, and not, as defendant seemed to think, partners with the trustees, who are not certificate holders. There is, therefore, no trust here, and strictly speaking no trustee. The so-called trustees represent the certificate holders. The certificate holders are principals, and the trustees, the plaintiffs, are their mere "managing agents." . . .

I am of the opinion that Simson and Hunter are proper parties plaintiff, and have full power and authority to represent the certificate holders in this proceeding. . . .

WILLIAMS et al. v. INHABITANTS of MILTON

1913, 15 Mass. 1, 102 N.E. 355.

This is a suit for the abatement of taxes which were levied against the trustee and certificate holders of the Boston Personal Property Trust. By terms of the trust agreement the property was contributed by certificate holders or purchased with money and contributed by them to trustees to pay income from said property to the holders, and on the termination of the trust to divide the proceeds among the shareholders. The trustees had the sole right to have the property and control the business. There was no association between the certificate holders and the trustee who managed the business.

LORING, J. . . . In Phillips v. Blatchford, 137 Mass. 510, the money to carry on the business of manufacturing and selling grates was raised by the sale of transferable certificates issued under a somewhat similar declaration of trust which provided that the business should be carried on by a board of managers of whom the trustee was to be one and the other members were to be elected by the shareholders. This also was held to be a partnership. . . . Williams v. Boston, 208 Mass. 497, 94 N. E. 808, was a similar case. The trust agreement in that case provided that the trust was established "for the purchase, development and disposition of" the former site of the Museum of Fine Arts at Boston. The property was held by trustees, but the shareholders had a right to remove the trustees, and meetings of the shareholders were to be held at which the shareholders might authorize or instruct the trustees in any manner. . . . The property of this association was held to be taxable as a partnership. . . .

In the Boston Personal Property Trust, the property is the property of the trustees, to manage for the benefit of the certificate holders, but to be managed by the trustees and not by the certificate holders. There is no association of or among the certificate holders.

The rights of the certificate holders are limited to each receiving his share of the income of the trust investment during the continuance of the trust and his share of the corpus of the trust when the trust comes to an end. It is in every respect an investment trust and nothing more, . . . and was not taxable as partnership property.

CHICAGO GRAIN TRIMMERS ASS'N v. MURPHY, DIRECTOR OF LABOR

1945, 389 Ill. 102, 58 N.E.(2) 906.

This is an action by the State of Illinois to collect an assessment made under the Unemployment Compensation Act against the Chicago Grain Trimmers Association. The Association was made up of several grain trimmers whose work consists of loading and unloading bulk grain in barges and ships, their secretary and treasurer making contracts with those desiring their services and dividing the income on the basis of the number of hours worked during the week by each member. For his services the secretary received a share of the income the same as the other members. The Association denies that the members are employed by them and has refused to pay the assessment.

SMITH, J. In a general sense, an association is a body of persons acting together, without a charter, for the prosecution of a common enterprise. . . . The term does not have, in law, a fixed meaning such as is accorded to partnerships or corporations, but is used to indicate a collection of persons who have joined together for a certain object. Our statute does not contain a definition of an association. It has, however, been defined in Vol. 1 Bouv. Law Dict. (p. 269) as persons uniting together for some purpose. Black's Law Dictionary defines "association" as the act of a number of persons who unite or join together for some special purpose or business; "the union of a company or business for the transaction of designated affairs or the attainment of some common object."

Some associations may be incorporated under applicable statutes, in which event they are legal entities having such attributes as the statute may give them. In the absence of a statute empowering it to do so, an unincorporated association having no legal existence independent of the members who compose it, is ordinarily incapable, as an organization, of taking or holding either real or personal property in its associate name. . . . In the absence of statutory authority, an unincorporated association has no capacity to enter into contracts in its associate name. However, the officer who makes such a contract and the members who assent to it may be personally bound. The dealing with an association as a legal en-

tity may, under certain circumstances, cause it to be estopped from denying its right to contract. . . .

It is argued by appellee that the Chicago Grain Trimmers Association is engaged in a business for profit and must be treated as a legal entity and an employer under the Unemployment Compensation Act.

In the instant case the members of the association have only one source of income, and that is derived from the capacity of its members to labor. The association is not in business for the purpose of acquiring profit upon the use of the capital contributed by its members or upon the labor of its members. The obvious and real purpose of the common enterprise is to provide a practical means of disposing of the services of its members and of dividing the earnings of the working members. It appears grain trimming is an occupation which must be conducted by a group of men in order to satisfactorily handle a job. A shipowner requires the services of such a group only during the comparatively short interval necessary for the loading and unloading of a ship. In all probability it would be expensive or impracticable to continuously employ the number of grain trimmers necessary to load or unload the ship with reasonable dispatch. Thus from the very nature of the occupation it would appear some workable arrangement is necessary for the calling of the proper number of men at the proper times to effectually do the work.

We are of the opinion the association is not the employer of its members, but merely a convenient device for allocating work among its members in groups which can efficiently perform the various loading jobs as they present themselves, and which can in a convenient and practical manner divide the earnings of the members in accordance with their individual efforts.

Judgment for defendant.

STONE v. GUTH

1937, (Mo. App.) 102 S.W.(2d) 738.

The business manager of the Associated Electrical Contractors, Inc., an association formed to combat an electrical workers' union, brought action against a member of the association to recover for services rendered in the publication of a magazine which the association sponsored. Plaintiff's theory of the case was that the members of the association were partners.

SUTTON, C. A voluntary unincorporated association as recognized and defined in the books, strictly speaking, is neither a partnership nor a quasi partnership. The members thereof, whatever

may be their relations and liability to third persons dealing with the association, are not partners inter sese, since the death or withdrawal of a member does not of necessity work a dissolution of the association, and there exists no authority in a single member to bind the others. . . .

It is broadly stated as a general rule that an unincorporated association organized for profit is in legal effect a mere partnership so far as the liability of members to third persons is concerned, and that accordingly each member is individually liable as a partner for all debts contracted by the association within the scope of its object. But an association not engaged in business enterprises and the objects of which do not contemplate profit and loss is not a partnership, and the liability of its members for debts contracted in behalf of the association is governed not by the principles of partnership but by those of agency. Membership as such imposes no personal liability for the debts of the association, but to charge a member therewith it must be shown that he has expressly or impliedly authorized or ratified the contract upon which the liability is predicated. As a rule nonparticipating members are not liable.

The association involved here is not a partnership. There is absolutely no evidence of an agreement among the members to share profits. The objects of the association do not contemplate profits. The sole function and purpose of the association is to regulate certain affairs of its individual members connected with and related to their individual business enterprises as affected by the demands of the electrical workers' union, and its principal purpose appears to have its source in the advisability of united action in opposition to the united action of the electrical workers' union.

Manifestly the plaintiff here failed to make out a submissible case against the Guth Company. It was a mere nonparticipating member of the association. It had nothing to do with the employment of the plaintiff. . . .

Book V

PERSONAL PROPERTY

Chapter I

NATURE OF PERSONAL PROPERTY

HUGGINS v. REYNOLDS

1908, 51 Tex. Civ. App. 504, 112 S.W. 116.

Connor, C. J. Appellee was a tenant of appellant, and instituted suit, in the justice court, upon an account aggregating $96. Among other items specified was one of $40 for three fourths of two bales of cotton less cost of picking. . . . Appellee's lease terminated January 1, 1907, and appellant Huggins testified, in substance, that, on or about the 15th day of January, 1907, he went to see appellee, who had then removed from the witness' place, in order to get the unobstructed use of the rented premises for pasturage, and that appellee then directed him "to go ahead and turn in, that he (appellee) was not going to pick any more cotton"; that it was after this that appellant caused to be picked and sold the cotton, the proceeds of which was sued for in this case.

It seems to be well settled in the authorities that a party may abandon and relinquish his right to property. If the owner sees proper to abandon his property, and evidences his intention by an act legally sufficient to vest or divest ownership, why may he not do so? In McGoon v. Ankeny, 11 Ill. 558, it is said, quoting from the headnote: "A party considering an article entirely worthless casts it away, intending to abandon it; he loses his title to it." And on the same subject, the case of Wyman v. Hurlburt, 12 Ohio 81, 40 Am. Dec. 461, the Supreme Court of Ohio says, again quoting from the headnote: "abandonment of property divests the owner of his title therein, and the finder who reduces the same to possession after such abandonment is not guilty of conversion. . . ." So that it would seem that appellant would not be liable for the "three fourths of two bales of cotton," for which appellee sued, if he in fact, as appellant in substance testified, wholly abandoned it.

Judgment for defendant.

EATON v. MUNROE

1862, 52 Me. 63.

Walton, J. This is an action of replevin. It appears from the evidence that the plaintiff let one Hall have canvas for the foresail of a gondola; that Hall procured the sail to be made at an expense of about ten dollars for labor, and from five to eight dollars for

materials; that the canvas cost $40.63; that it was agreed the plaintiff should own the sail, and that it should remain his property till paid for; that Hall never paid for the sail, but afterwards sold it to one Chase, and that Chase sold it to the defendant.

The defendant contends that the plaintiff acquired no property in the materials furnished by Hall; that, in as much as the plaintiff consented that his canvas should be inseparably connected with Hall's property, and the plaintiff cannot now hold what was his own, without also holding what was the property of Hall, the action cannot be maintained.

But we are of the opinion that the action can be maintained. . . . If this was not sufficient for the purpose, we think the plaintiff became the owner of the materials furnished by Hall, upon the principle of accession. Title by accession applies not only to what is produced by one's own property, as the increase of animals, but also to that which is united to it, either naturally or artificially.

In Pulsifer v. Page, 32 Me. 404, this court held that a right of property, by accession, may occur when materials belonging to several persons are united by labor into a single article; and that the ownership of an article, so formed, is in the party, if such there be, to whom the principal part of the materials belonged. In respect to the sail, it is clear the canvas formed the principal part of it, and the plaintiff being the owner of the canvas, he would, within the authority of this case, be the owner of the sail when it was completed.

Judgment for plaintiff.

SLIGO FURNACE CO. v. HOBART-LEE TIE CO.

1911, 153 Mo. App. 442, 134 S.W. 585.

Action to recover the value of certain railroad ties alleged to have been converted. The evidence was conflicting as to whether defendant was a wilful or an unintentional trespasser. The court finally found that he was a wilful trespasser.

Cox, J. Appellant insists, first, that the measure of damages was the value of the ties regardless of the question of good faith in cutting them from plaintiff's land. . . .

In our judgment the true rule for fixing the measure of damages is that, if the timber was taken by honest mistake, then the value of the timber before being cut is the measure of damages, but if the party taking the timber knew he had no right to it, and thus became a wilful trespasser in the first instance, then in a suit against him the measure of damages is the value of the timber in its im-

proved condition without reduction for labor bestowed, or expense incurred by the wrongdoer. . . .

The law is not only careful to compensate the owner for the loss of his property, but it is also careful to see that a wilful wrongdoer shall not profit by his own wrong, and by requiring him to respond in damages for the value of the property in its improved state both these purposes are accomplished. To fix the measure of damages at the value of the property in its improved condition when the party had taken it by honest mistake would be as harsh as to fix it at the value in the tree when taken by a wilful trespasser would be unjust. In the former case, the owner would be profiting by the labor of an honest man mistakenly bestowed upon his property, and in the latter case, a wilful trespasser would be profiting by his wrong. . . .

It is conceded by all the authorities that in the case of a wilful trespasser the owner may follow and retake the property in his hands notwithstanding it may have been largely increased in value by the labor of the trespasser. . . .

Judgment for plaintiff.

HAMAKER v. BLANCHARD

1879, 90 Pa. St. 377, 35 Am. Rep. 664.

Sophia Blanchard, plaintiff, was a domestic servant in a hotel of which defendant, Hamaker, was the proprietor. She found in the public parlor three twenty-dollar bills. She handed them to defendant upon his assumption that they belonged to a certain transient guest. They did not, but defendant refused to surrender them.

TRUNKEY, J. It seems to be settled law that the finder of lost property has a valid claim to the same against all the world, except the true owner, and generally that the place in which it is found creates no exception to this rule. But property is not lost in the sense of the rule, if it was intentionally laid on a table, counter, or other place, by the owner, who forgot to take it away. . . . Whenever the surroundings evidence that the article was deposited in its place, the finder has no right of possession against the owner of the building. . . .

An article casually dropped is within the (lost property) rule. Where one went into a shop, and as he was leaving picked up a parcel of bank notes, which was lying on the floor, and immediately showed them to the shopman, it was held that the facts did not warrant the supposition that the notes had been deposited there volun-

tarily, they being manifestly lost by some one, and there was no circumstance in the case to take it out of the general rule of law, that the finder of a lost article is entitled to it as against all persons, except the real owner. Bridges v. Hawksworth, 7 Eng. L. & Eq. R. 424. . . .

When money is found in his house, on the floor of a room common to all classes of persons, no presumption of ownership arises; the case is like the finding upon the floor of a shop. . . . If the finder be an honest woman, who immediately informs her employer, and gives him the article on his false pretense that he knows the owner and will restore it, she is entitled to have it back and hold it till the owner comes.

Judgment for plaintiff.

CHAPTER II

SALES

MILLER v. SEAMAN et al.

1896, 176 Pa. St. 291, 35 Atl. 134.

Action by plaintiff to recover for some lumber alleged to have been sold to the defendant, but which had been borne away by a flood before delivery. The lumber had been delivered in part only when the flood occurred.

WILLIAMS, J. . . . The object of this action is to determine whether the plaintiff or the defendant must bear the loss so occasioned, and this must depend on which of them held title at the time the flood came. The provisions of the contract . . . amount to an agreement to sell all the lumber in the eleven piles, not in a lump or for a gross price, but by the 1,000 feet, at the price of $8.25 per 1,000 feet. The quantity is not to be estimated or to be ascertained at once in any other manner, but is to be obtained by actual measurement, when, and as often "as the lumber is loaded, meassured, and inspected by Mr. Sam Aurand, upon the order of the purchaser." The actual delivery is not made when the lumber is loaded in the yard, but the seller delivers it to the purchaser "f.o.b. cars Williamsport." The price is to be paid on the quantity contained in each shipment ordered within thirty days after shipment, and shipments are to be made only as ordered by the purchaser until June 1, 1894. . . .

It is clear that the defendants had no right to take possession of these piles as piles of lumber. If they had attempted it, Miller could have proceeded, either by replevin or trespass, against them. They could not have sold the lumber in a lump, and delivered it to a purchaser. . . . The lumber swept away by the flood had not been ordered by the purchaser; it had not been inspected, measured, or loaded by the seller, and delivered at Williamsport for the buyer. When the time came for ascertaining its quantity, it was not in the yard of the Dent Lumber Co. to be inspected and measured or estimated, and delivery was therefore impossible. The title had left the plaintiff only as orders had been filed and shipped, and, as to all that remained on the yard, it had never left him.

Judgment for defendant.

HUNT v. WYMAN

1868, 100 Mass. 198.

Contract on an account annexed for $250 as the price of a horse. The plaintiff had the horse for sale and the defendant inquired about it. The defendant said that "if he would let him take the horse and try it, if he did not like it he would return it, in as good condition as he got it, the night of the day he took it." The plaintiff consented and, while being taken by defendant's servant, the horse escaped, ran away, and was severely injured. The horse was in a stable incapable of being returned and plaintiff sued for the sale price.

WELLS, J. Upon the facts stated in this case, there was a bailment and not a sale of the horse. The only contract, aside from the obligations implied by law, must be derived from the statement of the defendant, that, if the plaintiff "would let him take the horse and try it, if he did not like it he would return it in as good condition as he got it." This contract, it is true, is silent as to what was to take place if he should like it, or if he should not return it. It may perhaps be fairly inferred that the intent was that if he did like the horse he was to become the purchaser at the price named. But, even if that were expressed, the sale would not take effect until the defendant should determine the question of his liking. An option to purchase if he liked is essentially different from an option to return a purchase if he should not like. In one case the title will not pass until the option is determined, in the other the property passes at once, subject to the right to rescind and return. . . . This action being founded solely upon an alleged sale of the horse for an agreed price cannot be maintained upon the evidence reported.

Judgment for defendant.

HAMILTON et al. v. GORDON

1892, 22 Or. 557, 30 Pac. 495.

This is an action to recover possession of 300 sacks of wheat on the theory that title passed to plaintiffs at the time the contract of purchase was entered into. The defendant signed a written contract whereby he "hereby sells and agrees to deliver to Hamilton and Rourke, . . . all the grain harvested by me on land described below, wheat sacked in good merchantable sacks." Some of the wheat was delivered, but some 234 sacks are still retained by the defendant.

BEAN, J. . . . As between the parties, it (passing of title) is generally considered a question of intention. And it may often

happen that the parties have expressed their intention in a manner that leaves no room for doubt. Where, however, they have not done so in express terms, the intention must be collected from the agreement, and the courts have adopted certain rules for that purpose. As a general rule, where, by the agreement, the vendor is to do anything with the property, for the purpose of putting it in a deliverable condition, or into that state in which the purchaser is bound to accept it, the performance of these things, in the absence of circumstances showing a contrary intention, is taken to be a condition precedent to the vesting of the property in the buyer, and also when the goods are sold by weight or measure, and anything remains to be done for the purpose of ascertaining the quantity, in the absence of anything showing a different intention, the title does not pass until the goods are weighed or measured. . . .

By the terms of the agreement in this case, the grain was to be harvested and sacked "in good merchantable sacks" by the vendor, in order to put it in a deliverable condition, and by him conveyed to the warehouse or platform of plaintiffs. . . . There is nothing in the agreement or the circumstances of the case to indicate that the parties intended the title of the grain to vest in plaintiffs until it was harvested and delivered at the place agreed upon, and the quantity ascertained. In fact, it was evidently the intention of the parties, at the time the agreement was entered into, that the title and risk should remain in the defendant until so delivered. It was in his possession and under his control. He was required to put it in a deliverable condition, and deliver it at a certain specified place. . . . The contract is only a contract for the sale of a certain crop of grain, and if defendant has violated his agreement, by delivering only a part of the grain, and refusing to deliver the remainder, plaintiffs, if damaged, have their remedy, but not by an action to recover possession of the property.

Judgment for defendant.

O'KEEFE v. LEISTIKOW

1905, 14 N.D. 355, 105 N.W. 515.

Action for the purchase price of 70 bushels of flax. The defendant inquired if the plaintiff had any flax for sale. He was informed that such was the case and that he desired $2 a bushel for it. The defendant then said he would take 70 bushels of flax on the Ops farm at $2 a bushel. He failed to take it and in plaintiff's suit for the purchase price insists that title did not pass because the 70 bushels formed part of a larger mass, and no selection had been made.

MORGAN, C. J. . . . The defendant's contention is that title did not pass, for the reason that the 70 bushels of flax were not separated from the mass with which they were mingled. . . . It is an indisputed fact that the flax was all of one quality and grade, and fit for seeding purpose. Was a separation from the mass, or the measuring of 70 bushels, a condition precedent to the passing of the title to the defendant? We agree that it was not. . . . The flax was in bulk, but its separation is not necessarily a condition precedent to the passing of title. Whether the title passes or not under circumstances depends upon the intention of the parties, to be gathered from the terms and conditions of the contract and the circumstances surrounding and attending the sale. . . . It seems to be generally held that, if the property sold is mixed with other property not like in quality or size and a certain grade or quality only is sold, then the separation and selection is presumptively a condition precedent to the passing of title. It is also held in many cases that, if there must be measuring or selection of certain kinds of property from a mass before the price can be ascertained, then no title presumptively passes. These rules are always subject to the intention of the parties. In this case the property was identified and ascertained. The subject-matter of the contract was specified as 70 bushels of flax on the Ops farm. The price was fixed. Delivery was not dependent on the payment of the price, but prepayment waived. Nothing was undetermined, or dependent upon measuring or weighing of the flax. The mere fact that the 70 bushels were mingled with other flax is not of controlling importance. . . . The buyer and seller became tenants in common of the flax, each having a right to take his share therefrom.

Judgment for plaintiff.

SMITH CO. v. MOSCAHLADES

1920, 183 N.Y.S. 500.

The plaintiff contracted to sell to defendant 400 casks of codfish, to be shipped from St. Johns, Newfoundland, "c.i.f. New York." The ship which carried the fish was sunk by a German submarine. The insurance procured did not cover such a loss and no war risk insurance was obtained. The plaintiff sues for $13,040, the unpaid balance of the purchase price.

LAUGHLIN, J. . . . Under such contracts the seller fulfills all of his obligations by putting the cargo on board and forwarding to the purchaser a bill of lading and a policy of insurance of the kind then current and customarily issued in the trade and if the goods had not been paid for in advance it was customary to present a draft for the

purchase price, accompanied by the bill of lading and policy of insurance and a credit slip for the insurance and freight, if not actually paid for by the shipper which documents were to be delivered to the purchaser on his paying the draft, and the insurance is for the protection of the purchaser who assumes all the risks after the goods have been placed on board; and this constitutes a delivery by the seller under such a contract and the title thereupon passes to the buyer, even though it be stated in the contract that delivery was to be made at the point of destination. . . .

The only significance now attached to the claim that this was a New York contract is that counsel for respondents argues therefrom that the custom at New York with respect to the nature of the insurance the shipper was required to procure was controlling. That point was insisted upon by the defendants on the trial, and on their objection the court excluded considerable competent evidence offered by the plaintiff to show that the universal custom at St. Johns and current in the coastwise trade between that port and New York at the time and at all times prior to the sailing of the Stephano was for the seller to procure only marine insurance, and that such insurance only was procured and was customarily accepted by purchasers in New York City. I am of opinion that the contract was made at Newfoundland, for it became binding and effective only by the last telegram sent by the plaintiff from St. Johns. . . .

I do not, however, regard that as material, for it seems to me quite plain that the custom and usage in the light of which the contract is to be construed in determining the nature of the insurance which it was the duty of the shippers to procure were the custom and usage on the part of shippers, on whom the duty of procuring the insurance devolved in this particular coastwise trade; and it would seem, therefore, that it was the general custom and usage then current and followed by shippers of such freight from St. Johns to New York, which necessarily would imply the same custom and usage on the part of the purchasers in New York in accepting such insurance.

Judgment for plaintiff.

SAUNDERS v. COWL et al.

1938, 201 Minn. 574, 277 N.W. 12.

Action to recover the price of a used tent. The defendant asserted breach of warranty as a defense and seeks to recover the partial payment made at the time of purchase. The defendant knew little about tents or canvas and, although he inspected it when it was folded, it seemed clear that he was unwilling to rely upon his

own judgment. The contract included a statement that it was to be "in good condition on delivery." The tent later proved to be valueless and the plaintiff insisted that the statement was not a warranty.

PETERSON, J. . . . The provision in the contract "in good condition" relates to the quality of the goods. . . . Quality of goods includes their state or condition. The word "good" itself, when used in connection with chattels, refers to their condition, that they are sound, reliable, right and not depreciated and the like. . . . In Skoog v. Mayer Bros. Co., 122 Minn. 209, 142 N.W. 193, 194, decided in 1913, it was held that it is not necessary to use the word "warranty or its precise equivalent" but that "It is enough if the vendor definitely undertakes that the thing sold shall be of a certain kind or quality." . . . Where it appears that the word "good" is used to designate the quality, kind, or condition of goods sold, it is an affirmation of fact, or promise, as the case may be, and not a mere expression of opinion. . . .

It is contended that there is no warranty because the defendant did not rely upon any representation or affirmation made to him by plaintiff concerning the tent, and that he inspected the tent and ascertained for himself that it was all right. The buyer may rely upon the affirmation of the seller rather than his own inspection where, as here, the inspection fails to reveal to him defects, either because of their being latent and concealed or because of the buyer's inability to perceive and realize the defects from such inspection. . . . He may rely on the seller's contract of warranty as protection against defects even though he has made some inspection. The question of patent defects in the tent is not in the case. There is no testimony that the defects were patent. Defendant's evidence, which is not contradicted, is that he did not understand canvas. The warranty in this case was a provision of the contract of sale.

McNABB et al. v. CENTRAL KENTUCKY NATURAL GAS CO. et al.

1938, 272 Ky. 112, 113 S.W.(2) 470.

This is a suit to recover the value of certain gas which the defendant refused to accept at a time when it contained a high sulphur content. The sulphur apparently seeped in from adjoining wells which entered levels untouched by the well belonging to the plaintiff. After certain protective measures were adopted, the defendant again accepted the gas from plaintiff's well. Plaintiff appeals from a judgment in favor of the defendant.

STITES, C. J. . . . Appellants argue simply that it was the duty of appellee, under the contract, to accept gas from their well and that there was no implied warranty that the gas so taken would be free of sulphur or even that it would be of marketable quality. This is really the only question in the case.

The appellant McNabb testified that he knew the use which was intended to be made of the gas at the time he entered into the agreement to sell it. He knew that it was to be used for domestic purposes. Appellees introduced witness after witness, who testified that the odor from sulphurous gas was disagreeable, and numerous witnesses stated that they would find some other fuel for lighting or heating their houses rather than continue the use of the obnoxious gas. . . .

The Uniform Sales Act, Ky. Stats. sec. 2651 8-15, provides: "(1) Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, and it appears that he relies on the seller's skill or judgment (whether it be the grower or manufacturer or not (there is an implied warranty that the goods shall be reasonaby fit for such purpose. . . . (5) An implied warranty or condition as to the quality or fitness for a particular purpose may be annexed by the usage of the trade.". . .

It is obvious that this rule applies with peculiar force to the case here presented. The contract here was to buy gas, but it was marketable gas and not simply any vapor that might arise from appellant's well.

Judgment affirmed.

RYAN v. PROGRESSIVE GROCERY STORES, Inc.

1931, 255 N.Y. 388, 175 N.E. 105.

CARDOZO, C. J. The action is for breach of warranty. Plaintiff through his wife, who acted as his agent, bought a loaf of bread at the defendant's grocery. The loaf had concealed in it a pin, which hurt the plaintiff's mouth. There has been a judgment for the damage. . . .

The plaintiff did not rely on the seller's skill or judgment. His wife stated to the salesman that she wished to have a loaf of "Ward's Bread." The salesman gave her what she asked for, wrapped in a sealed package as it had come from the Ward Baking Company, the baker. She made her own choice, and used her own judgment. . . .

The award of damages, if it is to be upheld, must rest upon some other basis than the imputation of reliance.

"Where the goods are bought by description from a seller who

deals in goods of that description (whether he be the grower or manufacturer or not), there is an implied warranty that the goods shall be of merchantable quality." Personal Property Law, sec. 96, subd. 2. . . .

Loaves baked with pins in them are not of merchantable quality. The dealer is thus charged with liability, though the buyer selects the brand, just as he would be liable for concealed defects upon a sale of wool or silk. Assume that the sale had been made by a manufacturer or a grower, and that there had been a request for a special brand. There would then be no warranty of fitness for any "particular" purpose. Would anyone dispute, however, that a defect of this order, destroying value altogether, would be covered by the warranty of merchantable quality? The question carries its own answer. The rule is different, to be sure, upon a sale of specific goods, not purchased by description. Hight v. Bacon, 126 Mass. 10, 30 Am. Rep. 639. It may even be different, though the purchase is by description, if the goods are subject to inspection and the defects are of such a nature that inspection will reveal them. Williston, Sales, sec. 234; Personal Property Law, sec. 96, subd. 3. Here the sale was by description, the defect was wholly latent, and inspection was impossible. In such circumstances the law casts the burden on the seller, who may vouch in the manufacturer, if the latter was to blame. The loss in its final incidence will be borne where it is placed by the initial wrong. . . .

The facts proved without objection make out a breach of warranty under subdivision 2. In such circumstances the plaintiff ought not to lose the benefit of his judgment because he fancied that he had brought himself within subdivision 1. . . .

The judgment should be affirmed, with costs.

PRINSEN v. RUSSOS

1927, 194 Wis. 142, 215 N.W. 905.

The plaintiff became seriously ill for a rather long period as a result of eating a ham sandwich purchased at defendant's lunch room. It appeared that, unknown to the defendant, the ham had become infected with larvae. The sandwich was not purchased by the plaintiff, but by one who accompanied her on a certain trip.

ESCHWEILER, J. . . . To assert a right, however, based upon a breach of warranty, express or implied, it is necessary that the required elements of contract be present. The express language of the statute above cited and here invoked by plaintiff makes the rule there declared applicable as between buyer and seller, and manifestly is not intended to create a liability of the seller towards any

person outside of such so defined and limited contractual relationship. . . . Unless there be privity of contract, the general rule is that there is no liability for breach of the contract to outsiders. . . .

In Pelletier v. Dupont, 124 Me. 269, 128 Atl. 186, 39 A. L. R. 972, a sale of bread in which was found a pin, the holding being that there can be no liability of a manufacturer to the remote consumer in such a situation, that there can be no implied warranty without privity of contract, and that warranties as to such personal property do not run with the article sold. . . .

Under the testimony here there was no sale to the plaintiff by defendant of the food in question. There could therefore no liability arise on the doctrine of implied warranty in such a transaction, if that doctrine were to be held the law here.

The case was properly submitted to the jury on the theory of negligence and in line with such negligence as that involving the sale of diseased sausage in Haley v. Swift Co., 152 Wis. 570, 140 N.W. 292, where privity of contract need not exist. The jury having found against the plaintiff, no contention is made here that such finding can properly be overthrown.

BAXTER v. FORD MOTOR CO. et al.

1932, 168 Wash. 456, 12 Pac.(2d) 409.

The plaintiff purchased a Ford Sedan from St. Johns Motors, a Ford dealer. The Ford Motor Co. had issued circulars and pamphlets representing that the windshield was made of nonshatterable glass. While the plaintiff was driving the car, a pebble thrown by a passing car struck the windshield, causing small pieces of glass to fly into plaintiff's left eye, resulting in the loss thereof. Plaintiff brought action for damages, and the lower court, after hearing the evidence, took the case from the jury and directed a judgment for the defendant.

HERMAN, J. . . . The principal question in this case is whether the trial court erred in refusing to admit in evidence, as against respondent Ford Motor Company, the catalogues and printed matter furnished by that respondent to St. Johns Motors to be distributed for sales assistance. Contained in such printed matter were statements which appellant maintains constituted representations or warranties with reference to the nature of the glass used in the windshield of the car purchased by appellant. A typical statement (is here set forth):

"Triplex Shatter-proof Glass Windshield. All of the new Ford cars have a Triplex shatter-proof glass windshield—so made that it will not fly or shatter under the hardest impact." . . .

Respondent Ford Motor Company contends that there can be no implied or express warranty without privity of contract. . . . In Mazetti v. Armour and Company, 75 Wash., 622, 135 P. 633 (the Court said): "It has been accepted as a general rule that a manufacturer is not liable to any person other than his immediate vendee; that the action is necessarily one upon an implied or express warranty; that each purchaser must resort to his immediate vendor. To this rule certain exceptions have been recognized: (1) Where the thing causing the injury is of a noxious or dangerous kind. (2) Where the defendant has been guilty of fraud or deceit in passing off the articles. (3) Where the defendant has been negligent in some respect with reference to the sale or construction of a thing not eminently dangerous. . . .

Since the rule of *caveat emptor* was first formulated, vast changes have taken place in the economic structures of the English speaking peoples. Methods of doing business have undergone a great transition. Radio, billboards, and the products of the printing press have become the means of creating a large part of the demand that causes goods to depart from the factories to the ultimate consumer. It would be unjust to recognize a rule that would permit manufacturers of goods to create a demand for their products by representing that they possess certain qualities which they in fact do not possess, and then because there is no privity of contract existing between the consumer and the manufacturer deny the consumer the right to recover damages resulting from the absence of those qualities, when such absence is not readily noticeable. . . .

The court erred in taking the case from the jury and entering judgment for respondent Ford Motor Company.

Reversed and remanded for new trial.

PERRINE v. BARNARD et al.

1896, 142 Ind. 448, 41 N.E. 820.

This action was instituted to recover money and to enforce a seller's lien on certain property. Barnard & Son had sold some lumber to Herbert V. Root, which the latter in turn sold to Perrine. The lumber was set aside in plaintiff's yard and was to be paid for when delivered. The defendant paid Root, and claims title to the property.

JORDAN, J. . . . A seller has a lien upon them for the purchase money unpaid so long as they remain in his possession, and this lien exists only when the property in the goods has passed to the buyer, as no man can have a lien upon his own goods. As the seller's right of lien depends upon actual or constructive possession, he cannot

maintain it, generally speaking, after the property sold has come into the possession of the purchaser. The authorities sustain the proposition that there may be such a constructive delivery of the goods or chattels as will suffice to pass title, but will not destroy the lien. If the property sold be counted out or set apart for the purchaser, there is such a constructive delivery of the same as to vest the title thereto in the purchaser, and the property will be at his risk, but the seller will retain the right to refuse to deliver it without payment provided the sale was not upon credit. . . .

The lien, if it once exists, will continue in favor of the seller as against a subpurchaser, if the former has in no way assented to or induced the resale of the property, so as to be estopped by the application of the rule that where one of two innocent persons must suffer by the act of the third, he who has enabled such third person to occasion the loss must bear it himself.

It appears from the summary of the evidence which we have set out, that, when appellees sold lumber to Root, it would be measured and set apart upon sticks in their mill yard, and there it remained until they would haul it to the railroad station, and place it upon the cars for shipment. . . . The sales seem to have been made for cash, or that which was to appellees equivalent thereto. . . .

The lumber in question was, at the time of the commencement of this action, still in piles upon sticks in appellees' mill yard, with the amount of the purchase price involved unpaid. We therefore think and so hold, that, under the facts, appellees had such possession of the lumber as to entitle them to their lien as against Root.

Judgment for plaintiff.

ABRAHAM v. KARGER

1898, 100 Wis. 387, 76 N.W. 330

Clara Abraham brought an action of replevin for a specified lot of merchandise alleged to have been purchased from Karger. The evidence disclosed that plaintiff was to give in payment $2,000 in cash and a negotiable note of one Meyer for $500. The defendant refused to accept the note, claiming that he had not agreed to do so. After a proper tender and a refusal to surrender the goods, this action was brought. The defendant requested the lower court to instruct the jury that under the evidence an action of replevin could not be maintained. The court refused the instruction and this appeal is prosecuted.

PINNEY, J. There is nothing to show that the contract was executory, so far as anything remaining to be done to the goods was concerned. The evidence shows that they were ready for delivery,

and set apart, and the price agreed upon, and a partial delivery made before the tender of the $500 note. The goods were in the sight of the parties, and were pointed out in the presence of Karger, the defendant. . . . There can be no doubt but that, under the circumstances stated, the title to the goods and the right of possession as well, passed to the plaintiff, and, if afterwards they were wrongfully detained, she might maintain replevin for them.

ROLAND M. BAKER CO. v. BROWN

1913, 214 Mass. 196, 100 N.E. 1025.

Brown, who was financing the purchase of imported hides by Massachusetts Hide Company, received an order bill of lading on some hides. He indorsed the bill of lading in blank and gave it to the Hide Company, who was authorized to negotiate it to one Baker —represented by the Hide Company to be a purchaser. Disobeying instructions, Hide Company negotiated the bill of lading to Columbia Leather Company in payment of a debt. It in turn negotiated the bill to the plaintiff, who had no knowledge of the fraud practiced by the Hide Company. Brown obtained the hides from the shipping company by surrendering a duplicate bill of lading. Baker then sued Brown for conversion. The lower court gave judgment for the defendant.

SHELDON, J. . . . By this transaction, under the common law as declared by our decisions, the title to the hides remained in the defendants; the Hide Company had no power to dispose of them in any other way than by a sale to Baker; and no one else could by a purchase from the Hide Company or by any dealing with it acquire a title to the hides which would be good against the defendants. The bill of lading merely represented the goods themselves; the Hide Company had no greater right, and could pass to any purchaser other than Baker no greater right, than if its possession with this limited authority had been of the goods themselves instead of the bill of lading which was their representative. . . .

But before any of these transactions took place our Uniform Bills of Lading Act (St. 1910, c. 214) had been passed. . . . By section 38, "the validity of the negotiation of a bill is not impaired by the fact that such negotiation was a breach of duty on the part of the person making the negotiation. . . ."

The effect of the statute has been to change fundamentally the rights of parties to transactions within its purview. In the present case if the statute applies to it, when the defendants delivered their bill of lading to the Hide Company, with their unconditional and unlimited indorsement thereon, they intrusted their property to the

honesty of that company and relinquished their right to set up their title against anyone who might in good faith, for value, and without notice of the duty which rested upon the Hide Company, purchase from that company the goods described in the bill and take from that company a delivery of the bill itself duly indorsed by it. The previous decisions of this court, by which the defendants were protected against the consequences of their agent's breach of duty, have been abrogated and nullified by the statute. . . .

It follows from what has been said that the Columbia Company by its purchase from the Hide Company and the indorsement and delivery of the bill of lading acquired as against the defendants a good title to the hides, and that title passed to the plaintiff by its purchase from the Columbia Company. The act of the defendants in obtaining the hides from the carrier by means of the second bill of lading was, as to the plaintiff, wrongful and having been done under a claim of right, constituted a conversion, for which they became liable to the plaintiff; and no demand was necessary before bringing the action. . . .

Judgment of lower court reversed.

CHAPTER III

BAILMENTS OF PERSONAL PROPERTY

BOWEN v. ISENBERG BROS. CO.

1907, 22 Del. 230, 67 Atl. 152.

Action to recover damages to carpets placed with defendant.

LORE, C. J. (charging the jury). Wilkes Bowen, the plaintiff in this case, has brought this action against the defendant, Isenberg Bros. Company, to recover damages for injuries which he alleges his carpets received through the negligence of the defendant company. Plaintiff claims that on or about May 30, 1905, he delivered to the defendant company a certain lot of carpets to be cleaned at their carpet cleaning establishment and to be by them stored and safely kept until delivered back again to the plaintiff; that said service was to be performed by the defendant for hire. The plaintiff further claims that the defendant so negligently conducted itself in respect to said carpets that they were greatly damaged and ruined.

The undisputed proof in this case establishes the relation of bailor and bailee between the plaintiff and the defendant; that is to say, the defendant became the bailee of the plaintiff of certain carpets to be by it cleaned and returned for hire. That relation imposed upon the defendant a certain duty, which was to take reasonable and proper care of said carpets; and we will say to you that the care required was just such care as an ordinarily prudent man would take under like circumstances with respect to his own property. And if you find in this case that all through this transaction the defendant did take such reasonable and proper care as an ordinarily prudent man would take under like circumstances, then the plaintiff cannot recover. . . .

If you believe that the carpets of the plaintiff were damaged as a result of the fire only, and that said fire was not caused by the negligence or carelessness of the defendant, its agents or servants, then the plaintiff is not entitled to recover. But if you believe that, after the damage done to these carpets by the fire, they were damaged by the careless and negligent manner in which the defendant conducted its business, in not taking proper care of them, then, while the plaintiff could not recover for the damages sustained from the fire, he would be entitled to recover for whatever damages were caused by the negligence of the defendant after the fire. (Verdict for defendant.)

GAGNON v. DANA et al.

1898, 69 N.H. 264, 39 Atl. 892.

This action was brought by Frank Gagnon against Dana & Provost for personal injuries resulting from a fall of staging while working at the Sacred Heart Hospital, in Manchester, occasioned by the breaking of an unsound and decayed bracket. The plaintiff was employed by one Gay, who borrowed this bracket, along with others, from the defendant. There was some slight evidence that the defendants knew the brackets were defective, although the evidence was conflicting on this point. The lower court instructed the jury that it was the defendants' duty to notify the plaintiff's employer of any known defects, or defects of which they ought to have known. The correctness of this instruction is in dispute, the defendants contending that it was improper.

Blodgett, J. The brackets having been loaned by the defendants for the use of the borrower, without any reward or compensation to be received by them from him, their only duty in respect to defects was to inform him of any of which they were aware, and which might make the use of the loan perilous to him or to his servants, one of whom was the plaintiff. "The ground of this obligation is that, when a person lends, he ought to confer a benefit, and not to do a mischief." . . . But the obligation of a mere lender goes no farther than this, and he cannot, therefore, be made liable for not communicating anything which he did not in fact know, whether he ought to have known it or not. . . .

It would be the greatest injustice as well as extending the law beyond any recognized principle, to subject him to liability for defects of which he is not aware; and especially in a case like this, where the defect complained of was apparently as open to ascertainment by the plaintiff as it could possibly have been to the defendants. . . . While in many respects the duties and liabilities of the parties are materially different in the case of a gratuitous bailment and one for hire, it is enough for the present purpose to observe that while in the former the benefit is exclusively to the bailee, and therefore the liability of the bailor for defects in the thing loaned extends only to those which are known to him and not communicated to the bailee, in the latter, the bailment being for the mutual benefit of both alike, the bailor's obligation is, and of right ought to be, correspondingly enlarged; and it is therefore his duty to deliver the thing hired in a proper condition to be used as contemplated by the parties, and for failure to do so he is justly liable for the damage directly resulting to the bailee or his servants from its unsafe condition.

Judgment for defendants.

McCURDY v. WALLBLOM CO.

1905, 94 Minn. 326, 102 N.W. 873.

This was an action of trover to recover the value of certain household furniture. The plaintiff stored furniture with the defendant, while the latter conducted business at a certain location. Later the defendant, without the consent or knowledge of the plaintiff, moved his business to a new location nearby. While at the new location the goods were destroyed by fire, no question of negligence being involved.

Jaggard, J. . . . Where goods which have been removed by the bailee from an agreed to another place of storage without notice to or consent of the bailor are destroyed by fire, the bailee is liable in an action at law for the reasonable market value of the goods. Schouler, Bailments, 106. Such a state of facts makes out "a case of the defendant having taken the plaintiff's goods to a place where he had no right to take them; therefore he must pay the loss." . . . The bailor is entitled to the safety, to the convenience, and to any and every advantage of the agreed location. He is entitled to unchanged hazards as to things priceless to him personally, as well as to things only merchantable. . . .

Any other rule here applied would serve no useful purpose, but would easily conduce to misappropriation and fraud, put a premium on craftiness, jeopardize the property of the ordinary prudent man, and wholly fail to afford adequate protection to the community in general.

Judgment for plaintiff.

CARPENTER v. BALTIMORE & O. R.R. CO.

1906, 22 Del. 15, 64 Atl. 252.

This was an action to recover the damages occasioned to a certain piano in shipment over the defendant's railway, it being agreed that the defendant was a common carrier of goods. The defendant contended that they were limited to $5 per hundred weight, because of the following provision: "Rel Val 500 per cwt."

Spruance, J. (charging the jury) . . . "A common carrier is one who undertakes and exercises as a public employment, the transportation or carriage of goods for persons generally, from place to place, whether by land or by water, and to deliver them at the place appointed, for hire or reward, and with or without a special agreement as to price." McHenry V. P., W. & B. R. R. Co., 4 Har. 448. "A common carrier is bound to exercise the strictest care, and to deliver safely at their place of destination the goods intrusted to

him. He is regarded by the law in the light of an insurer; and in case goods are injured, lost, or destroyed, nothing will excuse or discharge him but the act of God or of the public enemies. By the act of God is meant such inevitable accident as cannot be prevented by human care, skill or foresight." . . . "Men engaged in the various business transactions of life are obliged of necessity to intrust common carriers with their goods. If such carriers are to be excused from all loss, destruction of, or injury to goods in case it be shown that they have used due care, precaution, or attention, the party employing them could never show the want of such care, unless he had an agent to accompany his goods during the whole time occupied in their transportation." . . .

The above-stated rule of law as to liability of the carrier is subject to certain qualifications, as, for example, the carrier is not held responsible for loss or injury occasioned by bad or imperfect packing or other carelessness of the shipper. . . .

Where there is a contract fairly made between the shipper and the common carrier, whereby, in consideration of a reduced rate of freight, it is agreed that in case of loss or injury the carrier shall be liable only to the extent of an agreed valuation of the goods, such contract is valid and will operate as a limitation upon the carrier. . . . Whenever a common carrier claims that he has by special agreement been released by the shipper from the operation of the before mentioned common law rule for the ascertainment of damages in case of loss or injury to goods transported, it is incumbent upon the carrier to prove such special agreement to the satisfaction of the jury, and upon failure to do so the said common law rule prevails. If such alleged special agreement is in writing, it must be expressed in such manner and form as to be understood by a person of average intelligence; or if not so expressed it must be shown to have been explained to the person to be bound, unless such person himself had such knowledge of the subject as would enable him to understand the meaning of the writing. (The jury found such was not true in this case and gave judgment for plaintiff for $270.)

WALTERS et al. v. DETROIT UNITED RY. CO.

1905, 139 Mich. 303, 102 N.W. 745.

CARPENTER, J. On the 7th of April, 1903, plaintiffs . . . placed property in the custody of defendant's agent at Trenton, with instructions to ship the same over defendant's railway—defendant is a common carrier of merchandise—to them at Pontiac, Oakland county, on Friday, April 10th. . . . The goods were in fact shipped on the 8th and arrived in Pontiac on the 9th. They were placed

in defendant's warehouse, and were there destroyed by fire, Tuesday, April 14th, before notice of their arrival was given to plaintiffs. Plaintiffs brought suit and recovered judgment upon the ground that defendant's liability as common carrier continued at the time the goods were destroyed. Defendant insists that a verdict should have been directed in its favor.

There was no evidence of negligence. If, at the time the goods were destroyed by fire, defendant continued to hold them under its responsibility as a common carrier, it was liable. If it did not so hold them, it was not liable. Jurists have not agreed as to the obligation of a carrier who holds goods after transit, awaiting delivery. Respecting this question, "three distinct views have been taken: First, that when the transit is ended, and the carrier has placed the goods in his warehouse to await delivery to the consignee, his liability as carrier is ended, also, and he is responsible as warehouseman only; second, that merely placing the goods in the warehouse does not discharge the carrier, but that he remains liable as such until the consignee has had reasonable time after their arrival to inspect and take them away in the common course of business; third, that the liability of the carrier continues until the consignee has been notified of the receipt of the goods, and has had reasonable time, in the common course of business to take them away after such notification." McMillan v. M. S. & N. O. R. Co., 16 Mich. 102. . . .

We have no hesitancy in declaring that the carrier's obligation continues until the lapse of a reasonable time after he has notified the consignee of the arrival of the goods. . . . In stating this conclusion, we have not overlooked defendant's contention that the rule does not apply where, as in this case, plaintiffs knew the probable date of shipment, and the probable time of arrival of the goods. To insist that this circumstance exempts the carrier from liability is to deny the existence of the rule we have just declared. To be more precise, it is to insist that the second, and not the third, of the rules heretofore stated, is the correct one.

Judgment affirmed.

Book VI

SECURITY FOR CREDIT TRANSACTIONS

CHAPTER I

BAILMENTS AS SECURITY

HARRIS v. COE et al.

1898, 71 Conn. 157, 41 Atl. 552.

An action of replevin to recover certain property levied on by defendant Coe, a deputy sheriff, in favor of Taylor. The property in question was shipped by plaintiff to one Mamory for sale by the latter. It was levied on as property of Mamory.

HALL, J. . . . Was the contract in question one of sale or bailment? . . . What were, then, the terms of the parol contract which we are asked to construe, and under which the goods in question were delivered to Mamory? For the period of one month, the plaintiff, from his store, was to furnish to Mamory certain goods, which the latter was to select and to sell for the former on consignment, accounting each week for all goods sold, at prices designated by the plaintiff, and marked upon the goods. At the expiration of the month, there was to be a final settlement, when Mamory was to receive for his services 15 per cent of the prices fixed by the plaintiff, upon all goods sold. Transportation charges were to be paid by Mamory. The trial court found that there was no intention of a sale of any kind to Mamory, but that it was intended that he should receive the goods and sell them as agent of the plaintiff, on consignment. . . . By the express terms of the agreement, the goods were delivered to him upon consignment. It was expressly provided that he was to receive and sell them as the plaintiff's agent, and that each week he should account for all goods sold at the plaintiff's fixed price, including his commission of 15 per cent, which was to be paid to him by the plaintiff on final settlement at the end of the month. A consignment of goods for sale is ordinarily a bailment. The word "consignment" does not imply a sale. The very term imports an agency, and that title is in the consignor.

But the defendant claims that notwithstanding it appears by the terms of the contract to have been the real intention of the parties that Mamory should receive and sell the goods as plaintiff's agent, and receive a commission from him, yet, because the consignee, though bound to account to the consignor at a fixed price, might himself sell at any price, the contract is in law one of sale. We do not think that the absence of a limitation upon the price at which goods may be sold by a consignee, who is to account to his consignor

at a fixed price, will transform an agreement made in good faith, and clearly intended by both parties to be one of agency, into a contract of sale. . . . It has been distinctly held in this state that such power in the consignee does not of itself render a contract intended to be one of consignment a contract of sale. . . .

Judgment for plaintiff.

LEWIS v. GRAY

1912, 109 Me. 128, 83 Atl. 1.

This was an action of trover to recover the value of certain hay. The plaintiff became the owner of the hay in question, which was stacked on a certain farm. The defendant later purchased the farm and notified the plaintiff that unless the hay was removed storage would be charged. Some time later plaintiff demanded the hay and the defendant refused delivery, contending that he was entitled to a lien for storage.

KING, J. It is not claimed that the defendant had any statutory lien, nor that he had any lien on the hay by virtue of an express contract therefor in the nature of a pledge. Did he have a common-law lien, so called—a lien arising under the rules of the common law? We think not. . . .

Particular liens have always been admitted by the common law in favor of those persons, such as innkeepers, carriers, common carriers, and warehousemen, who are bound by law to serve the public in their trades and occupations. And the privilege of a particular lien, the privilege to detain and hold possession of some particular property of another as security for some debt or obligation, has been extended to other persons, in a variety of cases, where such persons by their labor and skill have imparted an additional value to the goods. This includes artisans, tradesmen, mechanics, and laborers who receive property (although not obliged to receive it) for the purpose of mending, repairing, and improving its condition for him, and they have by the common law, a lien on such property until the reasonable charges for their labor and expenses thereon are paid.

But the defendant, under the facts in this case, cannot be classed with those persons who are allowed liens because they are bound by law to receive and care for the goods of others. He was under no obligation to permit the hay to remain on the premises. He was not a warehouseman, nor in the business of storing goods. He was at most a voluntary bailee of the hay under an agreement with the owner that he was to be paid reasonable compensation for its storage. Nor can he be reasonably classed with those persons who are

given liens on specific property which has been enhanced in its intrinsic value by their skill and labor bestowed upon it.

Judgment for plaintiff.

ABRAHAM HEILBRON et al. v. GUARANTEE LOAN & TRUST CO.

1896, 13 Wash. 645, 43 Pac. 932.

Respondents, plaintiffs in the court below, as executors of the estate of George H. Heilbron, brought this action to recover possession of two insurance policies. It appeared that Heilbron was the manager of the appellant bank and also a heavy borrower. A question arose about the security for these loans, and he told the secretary of the bank that, if anything happened to him, he desired the secretary to place the policies with the other collateral as security. He told the secretary where to find the policies—among Heilbron's private papers—but they remained undisturbed and were never entered on the books as collateral. After Heilbron's death the secretary removed them, placing them with other collateral.

GORDON, J. . . . We think it clearly shows that the policies were not pledged by the deceased. His conduct and conversation were not sufficient for that purpose. There was neither possession nor right of possession in the appellant during the lifetime of the deceased, and as possession was lacking no pledge resulted. The bank, therefore, never, during the lifetime of George H. Heilbron, had possession of the policies in dispute. His death revoked the authority upon which appellant relied when thereafter it went by its secretary, Mr. Downing, to his private papers and took said policies therefrom.

"To constitute a pledge, the pledgee must take possession; and to preserve it he must retain possession. An actual delivery of property capable of personal possession is essential." Jones, Pledges, sec. 23. . . . Of course a symbolical delivery is sufficient where the property is incapable of manual delivery and that is the extent to which the cases . . . go.

Judgment for plaintiff.

FOSTER v. ABRAHAMS

1925, (Cal. District Court of Appeal) 241 Pac. 274.

The plaintiff had borrowed $300 and had given therefor to one Hamaker her collateral note, which pledged a certain diamond ring as security. The note read:

And I hereby deposit with said W. N. Hamaker as collateral security for the payment of this and any other liability or liabilities of mine to said W. N. Hamaker or other holder thereof, due or to become due, or that may be hereafter contracted, the following property, viz: One diamond (3 large stones and several small stones) ring, platinum setting.

Hamaker negotiated the note and delivered the security to the defendant, who had at one time acted as attorney for the plaintiff in a divorce action—for which the plaintiff had not compensated him. The plaintiff tendered the principal and interest of the note and demanded the ring, but the defendant contended that he might hold the ring as security for the note and his legal fees amounting to $260. This is an action to recover the ring. Lower court gave judgment for defendant.

STURTEVANT, J. The appellant earnestly urges many reasons why the note should not be construed as providing security to Mr. Abrahams for his fee and expenditures in the divorce action; but that it should be construed as providing security for the $300 and the interest thereon. The point is a new one in California. The appellant cites no case that rules the point. The respondent cites and relies upon the case entitled Oleon v. Rosenbloom 247 Pa. 250. In that case two notes were involved. (Each contained a provision similar to the one in the case at bar.) The Supreme Court of Pennsylvania stated that there was no case in Pennsylvania that exactly ruled the point and then that court cited and discussed certain cases in other jurisdictions, and thereafter reached the conclusion that an indorsee of a note for the security of which collateral is pledged is entitled to the benefit of a provision in a note that the collateral is security for the payment of this or any other liability or liabilities to the holder hereof now due or to become due so that he can apply the collateral to other claims held by him against the maker. On the authority of that case we think that the judgment of the trial court should be affirmed.

MINNEAPOLIS AND N. ELEVATOR COMPANY v. BETCHER

1889, 42 Minn. 210, 44 N.W. 5.

As collateral security for notes falling due on or before July 1, 1886, the defendant pledged to the plaintiff a quantity of wheat. The plaintiff sold in March, 1887, but failed to realize enough to pay in full. It seeks to recover the deficiency. In May, 1886, the defendant instructed plaintiff to sell. At that time the wheat would not have sold for enough to pay the notes but would have sold for more than it did in March, 1887.

MITCHELL, J. . . . In the absence of an express contract between the pledgor and pledgee, making it the absolute duty of the latter to sell at a specified time, he is not obliged to sell even when requested to do so by the former. The power to sell is a right, not a duty. The exercise of ordinary care in respect to the thing pledged is the duty which the law imposes upon the pledgee, and for the breach of that duty only does he become liable. After the contract of pledging is made, neither party can, by anything he alone can do, vary the duties or powers attaching to the relation. Of course, the condition and character of the property might be such that a failure to sell would amount to a want of ordinary care; and it may be, as held in some cases, that a request to sell might be an element in the proof of negligence. But no such questions are presented in this case. The answer and charge of the (lower) court proceed upon the theory, that, independently of any question of negligence in the care of the property, it is the absolute duty of the pledgee to sell whenever requested by the pledgor. Order reversed.

GENERAL MOTORS ACCEPTANCE CORP. v. HUPFER

1925, 113 Neb. 228, 202 N.W. 627.

THOMPSON, J. This is an action of replevin to recover four automobiles. . . . Plaintiff based the right to recover on a purchase made of them by it from the Oakland Motor Car Company in December, 1919. . . . Prior to the unloading of the cars, and prior to the delivery of the bill of lading to Trotter (a retailer), the latter was required to, and did, execute to the plaintiff the following trust receipt:

> I (we) hereby acknowledge that said motor vehicles are the property of the General Motors Acceptance Corporation and agree to make and hold the same for the purpose of storing said property. . . . I agree not to sell, loan, deliver, pledge, or otherwise dispose of any of said motor vehicles to any other person except upon written order from General Motors Acceptance Corporation for release from trust upon payment to the bank mentioned therein of the amount required by said order, and upon the indorsement on the back of this trust receipt by said bank of a release from trust.

Before Trotter came into possession of the cars, he executed a chattel mortgage upon them to the defendant, to secure a promissory note which he had executed to the defendant. . . . That leaves for our determination the question, what is the legal effect of the trust receipt? Under it, Trotter had but one use he could make of these automobiles, and that was to display them; and he

had but one trust, and that was to care for and protect them. He might become the owner by complying with the terms of the receipt, but until such compliance is had he is a bailee and no more. Thus, this trust receipt was not an absolute sale, mortgage, conditional sale, or lease, and it was not necessary that it be recorded. . . . As Trotter was at all times without ownership in the automobiles, the mortgage to the defendant was void; but were it a valid mortgage, plaintiff's right would, nevertheless, be prior.

Judgment for plaintiff.

DONN v. AUTO DEALERS INV. CO.

1944, 385 Ill. 211, 52 N.E.(2) 695.

Action by Donn against Auto Dealers Investment Company to recover for conversion of automobiles. Both plaintiff and defendants had filed statements with the Secretary of State under the Trust Receipts Act, setting forth that they expected to engage in financing by means of trust receipts the purchase of cars for resale by one Walter. The plaintiff filed his notice on May 25, 1939 and the defendant filed notice on August 16, 1939. Walter borrowed money on trust receipts from each of the parties from time to time and in some instances both advanced money to him on the same cars, each being unaware that the other had advanced money thereon. The defendant was the first to make advances on these particular cars, plaintiff's advances being made some time thereafter. Walter defaulted on his payments and the defendant took possession of the cars, selling them for $2,240 and applying the same on the indebtedness of Walter to him.

STONE, J. . . . The Trust Receipts Act is evidently the result of an effort to meet the needs of the business of financing the purchase and sale of goods on credit without the use of chattels mortgages, and without recording each lien transaction. The apparent purpose in permitting the filing of a statement by such financier and dealer is to have some method of giving notice to other prospective creditors that the former are doing business by the trust receipt financing method. The purpose seems to have been to retain the advantages of a security interest in goods by use of the trust receipt and yet to eliminate, as far as possible, both secret liens and the necessity of recording each transaction.

Section 13 of the act provides that when a financier contemplates trust receipt transactions with reference to goods, he may file with the Secretary of State a statement signed by himself as entruster and the dealer as trustee, giving the chief place of business of each, and stating that the entruster is engaged or expects to be engaged

in financing under trust receipts the acquisition of goods by the trustee, describing such goods in general terms. The life of such statement is one year from the date of filing. •At any time within that year a like statement or affidavit may be filed by the entruster alone, which makes such statement valid for another year and preserves such liens as he may have.

There is nothing in the act which prevents more than one entruster filing a statement signed by himself and the same trustee, and it is conceded by counsel for plaintiff in this case that defendant and Walter properly filed their statement with the Secretary of State, so that the pivotal question in this case concerns the right of these two entrusters to prior security liens in the automobiles acquired by Walter upon which both entrusters had advanced money to him. In other words, whose rights are superior in the automobiles in controversy? Determination of this question requires construction of various parts of the statute. The first question is whether an entruster by merely filing a statement with the Secretary of State, secures a prior lien on automobiles for which he has not yet made advancements, or does such lien, so far as another entruster is concerned, arise out of trust receipt transactions when actually entered into and trust receipts taken? . . .

Where two entrusters' statements are filed, the benefit of the statute is afforded to both. Counsel concede this to be true but plaintiff's counsel argue that as between the two entrusters, where the one who first filed his statement has advanced money to a trustee without actual knowledge that another entruster later filing had also advanced money to the same trustee, his security lien is prior. They argue that because of the prior filing the appellant had an inchoate security interest in all of Walter's automobiles for one year, and that the defendant, as well as the rest of the world, had constructive notice of such inchoate interest and that unless and until plaintiff received "actual personal notice that the defendant was also an entruster," appellee had a right to deal on the assumption that he was the only entruster. Counsel do not point to any provisions of the statute so providing and we find none. We find nothing in the act warranting the conclusion that the General Assembly intended that there be such discrimination between entrusters. Nor is there any warrant for saying that the first entruster is not given like constructive notice by the filing of a second entruster's statement with the Secretary of State. . . .

These provisions of the act indicate that the thing which vests in the entruster a security interest in the goods acquired by the trustee is the trust receipt transaction and not the filing of the statement with the Secretary of State. The filing of such statement

serves to put all contemplated creditors on notice and defendant, when he filed his statement, had constructive notice of plaintiff's filing and was put on inquiry to learn from the trustee whether plaintiff held security interest in the goods sought to be so pledged to him. Plaintiff, by the same token, had constructive notice of defendant's statement when and after it was filed and thereafter was likewise put on inquiry to learn from the trustee whether defendant had advanced funds and received trust receipts on the specific goods offered to him, the plaintiff, for a trust receipt transaction. . . .

No harm can result to either entruster, since taking a statement of the trustee as to advances on the same goods by other entrusters, prior to entering into any trust receipt transaction, involves little or no effort and no delay. The statutes of this State cover situations where false statements are made to secure credit. We are of the opinion there is nothing in the act which indicates a legislative intent that so great a discrimination between the rights of entrusters should exist as plaintiff claims. We think the purpose of the act is better met by so construing it as to encourage its wider use than by limiting the security provided to the one entruster who first gets his statement on file. Such a construction would result in a monopoly for such entruster on the business of a trustee, since no one would enter into that relationship with him who finds on file with the Secretary of State his statement with another entruster. Under the act an entruster, during the year his statement is alive, may, alone, file another statement with the Secretary of State, thus perpetuating the relationship without the consent of the trustee.

We are of the opinion therefore that as between these two entrusters, where all the trust receipt transactions involved occurred after both had filed a statement, the defendant, who first advanced funds and took a trust receipt, took priority over the claim of the plaintiff, who later advanced money to the same trustee on the same property, and this regardless of which first filed his statement with the Secretary of State. . . .

COMMERCIAL CREDIT CO. v. BARNEY MOTOR CO.

1938, 10 Cal.(2) 718, 76 Pac.(2) 1181.

The purchases of automobiles by Bernard Negra, doing business under the name of Barney Motor Co., was financed by the plaintiff. Title to the cars was retained by plaintiff, but, under a trust receipt, possession was entrusted to Negra with authority to sell for cash. Negra sold the car under conditional sale to Oscar Tonolla

and then sold the conditional sale contract to American Trust Company. The proceeds were not remitted to the finance company and it now brings suit to recover the car from Tonolla, the Trust Company intervening.

SHENK, J. The method of financing dealers in the retail sales of automobiles under the so-called "trust receipt" has come into common practice. This method enables the retail dealer to obtain advances from a financing company to pay the purchase price to the distributor and, at the same time, receive possession of the automobile for the purpose of placing it on the salesroom floor for exhibition and sale to a prospective customer. Title is transferred directly from the distributor to the finance company, which retains such title under the trust receipt until the amount advanced as the purchase price is repaid. The validity of such trust receipts as title retention documents has been established by the courts. Subsequent to the events hereinbefore related and in 1935 Stats., p. 1930, the Legislature (Colo.) recognized the common practice and adopted the Uniform Trust Receipts Law. . . .

The title holder, having clothed the dealer with all the appearance of ownership or authority to sell, could not be heard to assert title or ownership as against a purchaser for value without actual notice of the reserved title who had been led by appearances created by the true owner to believe that the dealer had authority to dispose of the title in the usual course of trade. Under such cases, the rights of the purchaser did not necessarily depend on the actual title or authority of the dealer, but were derived from the act of the true owner, which precluded him from disputing, as against an innocent party, the existence of the title or power which, through negligence or mistaken confidence, he had caused or allowed to be vested in the party making the sale. . . .

We are satisfied on the present record that the trial court was justified in concluding that facts were not disclosed which would place the bank on inquiry as to the true owner of the title, and that Negra's authority to sell for cash was not exceeded by the sale to Tonolla under conditional sale contract and the receipt by Negra of the full purchase price in cash from the bank. We have recently held that the authority to sell for cash confers upon the agent ostensible authority to negotiate the sale for cash or its equivalent. . . . In the absence of any fact or showing, and none appears, that there existed bad faith or collusion on the part of the bank in the sale, no duty devolved upon it to see to the proper application of the funds advanced by it and received by Negra as the customer's purchase price of the car. [The judgment for defendant was affirmed.]

UNIVERSAL CREDIT CO., Inc. v. CITIZENS STATE BANK OF PETERSBURG

1945, (Ind.) 64 N.E.(2) 28.

O'MALLEY, J. The appellant brought this action against the appellee to recover conditional sales contracts or their value. The appellant is a corporation engaged in financing automobile transactions between the manufacturer and the dealer. In the instant case it entered into an agreement with the Tiffin Motor Company, Incorporated, of Petersburg, Indiana, an automobile dealer, by the terms of which it would furnish the money to purchase automobiles from the Ford Motor Company. In September 1940, these parties signed and filed with the Secretary of State of Indiana their "Statement of Trust Receipt Financing," as provided by statute. . . .

There are seven automobile transactions involved in this matter. In each of them the automobile dealer sold the car to an individual and received a conditional sale contract from the purchaser. Each of these contracts was sold to the appellee by the dealer.

The use of the trust receipt transaction is not new and decisions concerning the same have been pronounced in numerous jurisdictions in the United States and Great Britain. Under the law applied to transactions of this kind prior to the adoption of the Uniform Trust Receipts Act various courts made rulings that have a value in showing the development of and necessity for this type of financing. . . .

The Act with which we are concerned was the result of the needs of merchants and dealers in handling products and machines which are used and needed by the purchasing public. Although originally it was used exclusively in the importing business, the mass production of automobiles, trucks, and various labor-saving devices has created a field for the use of loaning corporation facilities which could not be properly served without the creation of the statutory trust receipt.

Under the statute, § 51-601 et seq., Burns' 1933 (Supp.), it is immaterial whether the third party conveys title to the dealer (trustee) or to the entruster, as long as there is an underlying contract outlining the terms to govern the transaction, the giving of new value, and the giving of the instrument which conveys or transfers a security interest to the entruster, together with possession in the trustee for one of the purposes enumerated in the statute. . . .

The section of the statute which is pertinent to the instant case is as follows:

"Where under the terms of the trust receipt transaction, the trustee . . . , having liberty of sale or other disposition, is to account

to the entruster for the proceeds of any disposition of the goods, documents or instruments, the entruster shall be entitled, to the extent to which and as against all classes of persons as to whom his security interest was valid at the time of disposition by the trustee, as follows: . . .

"(b) To any proceeds or the value of any proceeds (whether such proceeds are identifiable or not) of the goods, documents or instruments, if said proceeds were received by the trustee within ten (10) days prior to . . . demand made by the entruster for prompt accounting; and to a priority to the amount of such proceeds or value; and also

"(c) To any other proceeds of the goods, documents or instruments which are identifiable, unless the provision for accounting has been waived by the entruster by words or conduct; and knowledge by the entruster of the existence of proceeds, without demand for accounting made within ten (10) days from such knowledge, shall be deemed such a waiver." § 51-610, Burns' 1933 (Supp.).

The statute known as the Uniform Trust Receipts Act, a section of which is above set out, gives rights beyond the immediate goods on which the lien is taken under the contract. For ten days after a sale or trade by the dealer (trustee), the entruster is protected by a lien on the proceeds without taking any affirmative steps, but a failure to demand an accounting of the proceeds of a sale from the dealer within ten days, after knowledge of the sale, is a waiver of the lien of the entruster on such proceeds. The terms of the statute make it necessary that a constant and close scrutiny be kept on every sale or trade on the part of the dealer, who is in a position to do harm to innocent third parties by and through the indicia of ownership placed in or permitted to come into his possession by the entruster. . . .

In the first twelve paragraphs of this complaint there is no allegation as to the time at which knowledge of the sale came to the entruster. The date of the sale and the date of demand are each set out and it is thus disclosed that more than ten days elapsed between the sale and the demand. Since a demand not made within ten days of knowledge of the time of sale is ineffectual to continue the entruster's lien, the court did not err in sustaining the demurrer as to each of these paragraphs of complaint. In the last two paragraphs, demand is alleged as of the date of the sale. It was a demand for the payment of a specified sum of money. Prior to that demand the dealer had assigned the note which was received in the sale of the automobile in question and had received its value from the appellee, and the proceeds in the hands of the trustee consisted

solely of money. Under such conditions a demand for the proceeds which were then in the hands of the dealer (trustee), would have been no broader in effect than the simple demand for the amount of money then due the entruster. This demand satisfied the statute.

The court erred in sustaining the demurrer to the thirteenth and fourteenth paragraphs of complaint.

The judgment is reversed with instructions to the trial court to overrule the demurrer to the thirteenth and fourteenth paragraphs of complaint. As to all other things the judgment is affirmed.

CHAPTER II

CHATTEL MORTGAGE

TOWNSEND BRICK & CONTRACTING CO. v. ALLEN et al.

1900, 62 Kan. 311, 62 Pac. 1008, 52 L.R.A. 323.

John W. Allen, James P. McGuire, John H. Barry, and T. J. Emlen, who owned six acres of land, upon which there were machinery and appliances for the manufacture of bricks, leased the same to John Gaffney for one year. The agreement provided that the lessors should have and retain a lien on the clay and material taken from the premises, and upon brick manufactured there to secure the payment of rent. Gaffney manufactured large quantities of brick, and on Nov. 10, 1894, Townsend Brick & Contracting Co. purchased a large quantity of the brick. At the time this controversy arose $250 was due for rent and plaintiffs maintain they are entitled to a lien.

JOHNSTON, J. . . . It may be assumed that the lease created a lien on any brick that had been made and were in existence when the lease was executed and filed in the office of register of deeds, but can it be held to create a lien on brick made long afterwards? None of the brick in controversy had been made when the lease was executed, and even the clay and shale from which brick were subsequently made were then in the bank and in a natural state. . . . The clay and shale in the bank have peculiar qualities, necessary for the manufacture of vitrified brick—qualities which ordinary clay does not contain; but no portion of the same which ultimately became an element in the brick in controversy was in any manner set apart by severance or by the marking of the place from which it should be taken. . . . The lessee, Gaffney, had the right to take clay and shale for the purpose of making brick from any portion of the six-acre tract leased to him. Certainly the brick in controversy were not in actual existence when the chattel mortgage was made, and the clay and shale which entered into the manufacture could not be identified in any manner.

The general rule is that no one can mortgage property which does not exist or which does not belong to him. It is true, parties may make contracts with reference to afterwards acquired property which will be upheld as between themselves, but such contracts are not to be considered as chattel mortgages. The contention here is

that the clay and shale used in producing the brick in controversy were in existence; that these constituted the principal elements which entered into the making of the bricks in controversy, and therefore they had a potential existence, to which the lien might attach. . . .

Other elements and forces were employed in the manufacture, so that the identity of the clay was entirely lost; and the product, as we have seen, is worth about 40 times more than the clay which entered into it.

It having been held that the instrument was insufficient to constitute a lien on the brick in controversy it is unnecessary to consider (other) points.

Judgment for defendant.

McMASTER v. EMMERSON et al.

1899, 109 Iowa 284, 80 N.W. 389.

J. H. and D. E. Newman, owners of 80 acres of land, gave a chattel mortgage on all crops, including corn, oats, and hay, to be grown thereon for the succeeding four years. This mortgage was assigned to plaintiff, after being properly recorded. Later the Newmans gave a lease to Emmerson for one of the years, and a large amount of corn was raised by Emmerson's tenant Stacy. Right to the corn in question is involved.

LADD, J. The obstacle in the way of the recovery for the value of the corn raised on the land by Stacy is the fact that the Newmans never acquired any interest in it to which the mortgage attached. . . . Before the mortgage attaches, the crops . . . must come into existence and be acquired by the mortgagor. Unless so acquired, the mortgage never becomes a lien, since there is no interest of the mortgagor which he might have conveyed. . . . A chattel mortgage on crops to be thereafter grown gives the mortgagee no interest in, or lien upon, the land. It attaches as a lien only on the interest which the mortgagor may have in the crops when they come into being. The chattel mortgage, executed by the Newmans, not being a lien on their land, did not interfere with its sale or prevent them from leasing it. They did lease it to Emmerson, receiving full payment, and he to Stacy. Under the circumstances no one will say that the Newmans retained any interest whatever in the crops raised by Stacy. They never acquired, then, the property which they had previously mortgaged, and for this reason the mortgage never attached.

Judgment for defendant.

SEACOAST FINANCE CORP. v. CORNELL et al.

1927, 104 N.J. L. 24, 138 Atl. 695.

This was a replevin suit by plaintiffs, as mortgagees, to recover an automobile from defendant and certain garage keepers who maintained a lien. The state law provided that one obtaining a garage keeper's lien should not have a superior lien to prior mortgages properly recorded. The affidavit of consideration was made by the mortgagor instead of the mortgagee, and the acknowledgment and proof were made by the mortgagee instead of by the mortgagor. Despite these errors it was recorded. The lower court denied the validity of the mortgage both as to the mortgagor and the garage keeper.

PARKER, J. . . . So far as relates to the controversy between plaintiff and the garage keepers, the judgment was manifestly right. Plaintiff concedes that the chattel mortgage was invalid under the Chattel Mortgage Act as against creditors, but its claim, as we understand it, is that the act of 1925, in using the phrase "properly recorded" refers to the official action of the recording officer in receiving the paper, copying it into the books, etc. But we are unable to take that view of the matter. . . . To us it seems quite plain that the words "properly recorded" mean "lawfully recorded," i.e., with the sanction and under the restrictions of the Chattel Mortgage Act; and a glance at that act, sections 5 and 6 in particular (C. S. P. 468), will show that no chattel mortgage was meant to be eligible for record unless acknowledged or proved according to law, and with the added affidavit of consideration by the mortgagee, his attorney, or agent.

There was error, however, in adjudging the mortgage invalid as against Cornell. It is familiar law that a chattel mortgage, invalid as against creditors for want of the statutory affidavit and proper record, is valid as between the parties to it. . . .

FIRST NATIONAL BANK of ELLSWORTH, MINN., v. RIPLEY, SHERIFF, et al.

1927, 204 Ia. 590, 215 N.W. 647.

This action was brought to enjoin the foreclosure of a chattel mortgage. The mortgagor, Meyeran, residing in Minnesota, near the Iowa line, mortgaged the property in question to appellant's assignor. Later he moved into Iowa, and shortly thereafter gave another mortgage on the same property, which was properly recorded in Iowa. There was some slight evidence to indicate that the first mortgagee knew of his removal.

FAYVILLE, J. . . . Appellant's chattel mortgage was duly recorded in accordance with the laws of the state of Minnesota. The property was removed to the state of Iowa, and the mortgagor thereafter gave a chattel mortgage thereon to appellee. In the early case of Smith v. McClean, 24 Iowa, 322, we said: "A chattel mortgage, valid under the law of the state where executed, will be so held by the courts of a sister state, to which the property may be removed." . . .

We hold that the lien of appellant's mortgage was senior and superior to that of the appellee Nagle, after the property was removed to this state, and was not lost merely by the fact of such removal. . . .

We are not called upon in this case to determine whether the lien of a mortgage, duly executed and recorded in a foreign state, will or will not be recognized in this state where the mortgagee consents to the removal of the property from the state where the mortgage was executed. There is no sufficient evidence in the record that would sustain a finding that the mortgagee gave consent to the removal of the property from the state of Minnesota. The mere fact that he knew that the mortgagor removed from the farm where he was living in Minnesota to a farm a few miles distant in Iowa would not deprive the mortgagee of the right to enforce such mortgage.

We are not disposed to acquiesce in appellee's contention that, where a mortgagee has knowledge that the mortgagor has removed the property from the state where the mortgage was given to a foreign state, he is required "to exercise diligence to recover the property."

Judgment for defendant.

ILLINOIS NAT. BANK & TRUST CO. v. HOLMES

1941, 311 Ill. App. 286, 35 N.E.(2) 823.

DOVE, J. In a proceeding to try the right of property in certain livestock seized by virtue of an execution issued out of the circuit court of Stephenson County in favor of W. F. Holmes and against Wm. R. Lewis, the county court found the right of property in the Illinois National Bank and Trust Company of Rockford and that it had a superior lien by virtue of a chattel mortgage which it held, and from an order so finding and releasing the property levied upon from the lien of the execution and adjudging the costs against W. F. Holmes, the execution creditor, he, the said Holmes, has prosecuted this appeal.

The evidence discloses that Wm. R. Lewis was indebted to ap-

pellee in the sum of $1,344.10 and evidencing that indebtedness he signed two notes, each payable to the order of the appellee and due six months after date. To secure the payment of these notes, Lewis signed a chattel mortgage upon the livestock levied upon. These notes and mortgage, and the certificate of acknowledgment of said mortgage, all bear the date of July 11, 1940, but were in fact signed, acknowledged and delivered by Lewis to appellee on July 20, 1940, and the mortgage was filed for record on July 23, 1940. The record further discloses that on October 14, 1940, appellant recovered a judgment in the circuit court of Stephenson County against the said Wm. R. Lewis, upon which an execution duly issued and a levy made by the sheriff upon the livestock described in appellee's chattel mortgage.

The question presented for determination requires an interpretation of Sec. 4, Chap. 95, Ill.Rev.St.1939 which provides: "No mortgage, trust deed or conveyance of personal property having the effect of a mortgage or lien upon such property hereafter executed shall be valid as against the creditors of the mortgagor, even though admitted to record, as hereinafter provided, unless it shall be deposited for filing or recording in the office of the recorder of deeds of the proper county within ten days of its execution, and any such mortgage, trust deed or conveyance of personal property not deposited for filing or recording within ten days of the execution thereof shall be fraudulent and void as to such creditors."

Counsel for both parties agree that under the foregoing provisions a chattel mortgage to be valid as to third parties must be recorded or filed within ten days of its execution and that the statute with reference to the execution and recordation of chattel mortgages is in derogation of the common law and must be strictly construed. Counsel for appellant insist that this chattel mortgage was, in fact, executed on July 11, 1940, the date it bears, and not having been filed for record until July 23, 1940, the statute was not complied with. Counsel argue that the statute was enacted for the specific purpose of protecting third persons from just such situations as this record discloses and that to sanction the construction of the statute adopted by the court below would result in a legal fraud upon appellant. . . .

In the absence of a statute requiring it, a date is not necessary to the validity of a chattel mortgage, hence a mere mistake in dating the instrument will not invalidate it. While the date of the mortgage is presumably the date of the execution, this presumption is merely prima facie. Antedating a valid chattel mortgage, if not done with fraudulent intent, will not void it. . . .

In the instant case, there was not only no delivery of the note or

mortgage prior to July 20, 1940, but they were not signed nor was the mortgage acknowledged until that day. Manifestly, those acts are as essential to "execution" as is delivery. This mortgage, therefore, although dated July 11, 1940, was not executed until it was signed, acknowledged and delivered by the mortgagor and accepted by the mortgagee. This occurred on July 20, 1940, and having been recorded on July 23, 1940, the statutory provision was complied with and the trial court correctly so held. The judgment will therefore be affirmed.

Judgment affirmed.

BALDWIN v. BOYCE

1898, 152 Ind. 46, 51 N.E. 334.

Action by Mary Baldwin to foreclose a mortgage against Sarah Herman. The defendant intervened and claimed title to the property, which raised a question concerning the validity of the mortgage. The property mortgaged was described as: "All and singular the restaurant and hotel furniture and fixtures located in and situated in and about the 1st, 2nd, and 3rd stories of No. 313 East Main Street." Then followed a statement of the articles such as chairs, desks, shelves, coffee urn, etc. The mortgage further indicated that the mortgagor was in possession. The description is questioned because the town was inadvertently omitted, although the county is indicated.

JORDAN, J. . . . Appellee virtually concedes that, if the instrument contained anything by which the property might be identified, then, in that event, it might be held sufficient. The insistence is that the instrument states but one thing that would, if certain, afford means of identification, and that is that the mortgaged goods are situated at "No. 313 East Main St." but as to where "East Main Street" is located, it is asserted, is left wholly indefinite by the mortgage. The rule is well settled in this jurisdiction, as well as elsewhere, that the description in a chattel mortgage must be reasonably certain; and a description of the property which will enable third persons, aided by inquiries which the instrument itself indicates or suggests, to identify the mortgaged property is sufficient. . . .

Cobbey, Chat. Mortg. sec. 188, states the rule as follows: "The general rule seems to be that, as between the parties, any description is good if the parties at the time knew and understood what the mortgage covered; that as to third parties, where the property intended to be mortgaged was identified at the time, any description which points out the particular property, or suggests inquiries by

which it can be identified outside of the instrument, is good against the world." Applying the principles to which we have referred to the mortgage in the case at bar, and testing it thereby, we are of the opinion that the description therein must be held sufficient.

Judgment for plaintiff.

VAN SANT v. AUSTIN-HAMILL-HOOVER COMMISSION COMPANY

1927, 221 Mo. App. 1096, 295 S.W. 506.

This is an action for damages to recover for the alleged conversion of certain cattle. The cattle were sold by the plaintiff to one C. O. Hopkins and the purchase price was secured by a chattel mortgage on the cattle. Some of these cattle were sold by Hopkins to the defendant, without plaintiff's knowledge, and without actual knowledge on defendant's part of plaintiff's mortgage. Other facts appear in the opinion.

Frank, C. . . . The law is well settled that when a mortgagee of personal property, after the execution of the mortgage, gives his consent, either verbal or written, to the mortgagor in possession of such property, to make an absolute sale of the property, the lien of the mortgage is waived, and the mortgagee cannot claim the property or its value from one who has purchased it with or without knowledge of the mortgage. . . .

Plaintiff contends, however, that the mortgagee's consent to the sale of the cattle was given on condition that the mortgagor notify the mortgagee of the intended sale before the cattle were shipped and that such conditional consent did not amount to a waiver of the mortgage lien because the condition was not performed by the mortgagor before he sold the cattle. . . .

We do not think the evidence supports this contention. Plaintiff's version of his arrangement with the mortgagor relative to the sale of these cattle is as follows:

"My arrangement with Mr. Hopkins was that he should take these cattle home, put them on feed, and when the cattle were ready for market according to his judgment he should ship these cattle when he got ready wherever he pleased, and to whom he pleased, but he was to notify me before the cattle were shipped so that I could notify the commission firm that he shipped to, the amount that I held against these cattle, and they would send me draft direct."

This arrangement gave the mortgagor a general authority to sell. The condition that plaintiff was to be notified before the cattle were

shipped does not affect the mortgagor's right to sell, but goes only to the collection and application of proceeds of sale. . . .

In 11 Corpus Juris, p. 625, sec. 393, it is said: "When a mortgagee's consent to a sale by the mortgagor is given on condition, the condition must be performed in order to render the consent a waiver of the mortgage lien as between the parties, or as against the purchaser who was a party to the condition or had knowledge thereof, . . . but nonperformance of a condition imposed on a mortgagor will not affect the rights of a purchaser who does not participate therein, or have knowledge thereof."

Judgment for defendant.

Chapter III

CONDITIONAL SALES

ADAMS v. ASKINS

1927, 215 Ala. 632, 112 So. 199.

Bouldin, J. The suit is in detinue for the recovery of a Ford car. The sole question presented is the refusal of the affirmative charge, with hypothesis, to defendant.

Some evidence of the plaintiff tended to show that the car was sold by plaintiff for $275, of which $150 was paid cash, and the car delivered to defendant on a promise to pay the balance or secure it by note the following week, with stipulation that the title would remain in the vendor until the balance of purchase money was paid or secured. This, if true, constituted the transaction a conditional sale.

A conditional sale by parol, is, as to the condition, good between the parties. The statute requiring chattel mortgages to be in writing has no application.

The vendee under conditional sale, receiving and holding possession from his vendor, cannot question the vendor's title in a suit in detinue upon condition broken.

Judgment for plaintiff affirmed.

FAIRBANKS-MORSE & CO. v. PARKER et al.

1925, 167 Ark. 654, 269 S.W. 42.

Appellant brought this action against appellees, to recover three gasoline engines. It appears that these engines were sold from time to time to J. C. Shepherd. Notes were accepted in settlement, and the contract provided that title was to be retained by appellant. Shepherd, without the consent or knowledge on the part of the appellant, sold these engines to defendant, who has now been in possession of them for three years. He claims title by a three year adverse possession. The plaintiff did not know of the adverse possession. Judgment of the lower court was given for defendant.

Hart, J. We think the decision of the circuit court was wrong. There is no showing in the record that appellees claimed the property adversely to the rights of appellant, or that the latter waived his right to retake the property under his contract, for failure to pay the purchase money. The contract in each case was in writing and in express terms stated that the title to the property should re-

main in the seller until it was paid for. The fact that the original purchaser sold the engines did not give the second purchaser any greater rights than the original purchaser possessed, in the absence of notice to the seller, or of facts equivalent to notice, that the second purchaser claimed the property adversely to the rights of the seller. In conditional sales of personal property where the title is retained by the vendor until the purchase price is paid, the vendee acquires an interest that he can sell or mortgage without the consent of the vendor; but the vendor's right to recover the property, if the purchase price of the property is not paid, is not prejudiced by such sale or mortgage. . . .

Judgment for plaintiff.

HARE & CHASE, Inc. v. HUTCHISON et al.

1927, 3 W.W. Harr. 384, 138 Atl. 611.

This was a suit to recover the balance due on a promissory note. The defendants had given a note for $1,863 to the Hoey Motor Co., the same being the balance of the purchase price of an automobile. The note was not paid and the plaintiff repossessed the car and sold it. The proceeds were applied on the note and this is an action for the deficit. Delaware has adopted the Uniform Conditional Sales Act providing as follows:

"Sec. 24. (Election of Remedies.) After the retaking of possession as provided in section 16 the buyer shall be liable for the price only after a resale and only to the extent provided in section 22."

"Sec. 22. (Deficiency on Resale.) If the proceeds of the resale are not sufficient to defray the expenses thereof, and also the expenses of retaking, keeping and storing the goods and the balance due upon the purchase price, the seller may recover the deficiency from the buyer, or from anyone who has succeeded to the obligations of the buyer."

RODNEY, J. . . . It has been held in other jurisdictions construing statutes other than the Uniform Conditional Sales Act that the retaking of the goods by a conditional vendor was an election of one of two existing remedies and that such action prevented the later exercise of the remedy for the recovery of the purchase price.

We shall not pause to consider these cases for we find none in which such a construction is put upon the Uniform Conditional Sales Act. Since the adoption of this act by Delaware in 1919, the right of a conditional vendor, after default, to retake the goods, resell them and then recover any deficiency in the purchase price has been fixed by the terms of the act itself. A conditional vendor is a

favored creditor. Not only has he the remedy of the ordinary vendor, but he has, in addition, the reservation of title in himself. . . .

The Uniform Conditional Sales Act, and especially section 22, substantially adopts the theory that the buyer has the use of the goods until default; that after default they are then retaken, resold, and proceeds credited to account of buyer; that then the seller may recover from the buyer the deficiency of the purchase price, for the buyer has had the entire benefit of the goods which the seller lost by the resale.

Judgment for plaintiff.

C. I. T. CORPORATION v. COREY, Sheriff

1938, 58 Ida. 763, 79 Pac.(2) 542.

Cox Motor Company sold a car to Melvin Gardner on a conditional sale contract, the contract being sold and assigned to the Western Finance Company. Some time later, Gardner borrowed $300 of George Ball and gave a chattel mortgage on the car as security for the loan. Being in default on the contract, the buyer later permitted the Western Finance Company to repossess the car. It then took the car to the Cox Motor Company, who had guaranteed payment, and the latter resold the car to Gardner. This conditional sale contract was assigned to the plaintiff. Gardner later defaulted on the mortgage and the sheriff has taken the car into his possession for the benefit of the mortgagee. The defendant contends that there was really no repossession and that the second sale is a nullity. The lower court supported this contention and gave judgment for the defendant.

Budge, J. . . . The real question is whether or not there was a repossession by the Western Finance Company. 7 Blashfield Cyclopedia of Automobile Law and Practice, permanent edition, sec. 4633 recites: "Where an automobile is sold on condition that the title thereto shall not vest in the vendee until the payment of the specified purchase price, the legal title remains in the vendor until the payment is made, and, if the vendee fails to make the payment within the specified time, the vendor is entitled to the possession of the property. And where the vendor elects to recover possession of the property on default in payment by the buyer, it is the duty of the buyer, upon demand, to surrender the possession to the vendor.

"The conditional vendor may retake possession on default of the buyer without any agreement to such effect and he may do so without resort to the courts, if he can obtain the machine without breach

of the peace, and this is especially true where the contract authorizes such a retaking." . . .

The conditional sale contract provides in part as follows:

> Should said purchaser fail to make any of said payments in the amounts, manner and within the time herein provided for, or should said purchaser fail to perform any of the terms or conditions hereof in the manner and within the time herein provided for, said seller or seller's assignee shall have the option, without demand or notice, to exercise either of the following remedies, to-wit:
>
> Take immediate possession of said property, attachments, accessories and equipment whenever and wherever found, and without notice or demand declare the purchaser in default and in such event all the rights, titles and equities of said purchaser in and to said personal property shall immediately cease and determine, and said seller or seller's assignee shall be released from all obligations to transfer or deliver said personal property to said purchaser, and all sums of money theretofore paid and then due and unpaid by said purchaser to said seller hereunder shall remain the sole property of the seller or the seller's assignee, and shall be considered as compensation for the use, wear, tear and depreciation of said personal property by said purchaser, and said purchaser agrees to forthwith pay said seller or seller's assignee all payments and interest then due and unpaid as part compensation for the use of said personal property as aforesaid. . . .

We are constrained to hold that there was a retaking or repossession on the part of the Western Finance Company and a transfer to the Cox Motor Company. The court's findings are not supported by but are contrary to the evidence, and the judgment must be reversed and it is so ordered, with instructions to the trial court to enter judgment in favor of appellant.

LAMBERT v. ROBINSON et al.

1894, 162 Mass. 34, 37 N.E. 753.

The declaration in this cause is for breaking and entering the plaintiff's close and an assault upon the plaintiff. The plaintiff purchased some furniture of the defendant, payable in installments, with an agreement that, in case of failure to make the payments, the defendant, C. H. Robinson & Co., "may without demand or notice, or being deemed guilty of any trespass or tort . . . enter any house or place where said articles may be, and take possession of and remove said articles therefrom."

LATHROP, J. . . . Soon after the defendant's servants entered upon the plaintiff's premises, they attempted to remove furniture, and were resisted by the plaintiff, and it was during this resistance

that the assault complained of occurred. The defendant's servants did not succeed in getting the furniture, and it is still in the possession of the plaintiff.

We are met at the outset with the question, What is the rule of law applicable to the conduct of a person who has a right to enter upon the land of another? The plaintiff contends that the defendants had no right to use personal violence when resisted; and that they could not enforce their rights by a breach of the peace; and that upon being resisted, they should have desisted, and resorted to legal remedies. The defendants upon the other hand contend that, having a right to enter and remove the furniture, they were entitled to use such force as necessary, and that they were only liable in case they used excessive force.

The case of Low v. Elwell, 121 Mass. 309, must be considered as settling the law of this commonwealth that a person who has a right to enter upon the land of another, and there do an act, may use what force is required for the purpose, without being liable to an action. . . .

The remaining question is whether there was evidence of the use of excessive force on the part of defendant's servants. . . . We are of the opinion that there was. . . . One of the servants (of defendant) went around to the rear of the house, and opened a window, jumped into the house and pushed the plaintiff's wife violently against the side of the house; and that when the plaintiff arrived, he found these servants sitting down in the parlor; and that he asked them why they were there, and what they wanted and opened the doors, and requested them to go out, and they made no reply; that he then went to the kitchen and got a rolling pin, and returned into the room where the men were; and that thereupon one of them seized him by the arm, and another of them wrested the rolling pin from him "and committed the assault complained of." It is impossible, on this evidence, to say that there was no evidence of excessive force.

Judgment for plaintiff.

AUTOMOBILE SERVICE CORPORATION v. COMMUNITY MOTORS, Inc.

1941, 312 Ill. App. 263, 38 N.E.(2) 512.

SCANLAN, J. An action to recover $103.42, alleged to be due plaintiff from defendant. The case was tried by the court without a jury, the issues were found against plaintiff, and it appeals from a judgment entered upon the finding.

No question is raised as to the pleadings. The facts are not dis-

puted. One Benson purchased from a certain automobile dealer, not named in the record, a Hupmobile sedan and executed a conditional sales agreement for the unpaid balance of the purchase price. The agreement contained the usual provisions retaining title until purchase price was paid in full. Thereafter, on September 7, 1935, for value, Benson executed a chattel mortgage to plaintiff on the automobile in the sum of $105.65. The chattel mortgage was duly acknowledged and recorded. At the time of the suit there was a balance of $103.42 due on the mortgage. On February 21, 1936, Benson purchased from defendant "(who then was and still is a regular automobile dealer, selling cars to the public) a certain Pontiac automobile, and as part consideration of said purchase traded in the Hupmobile automobile, which is the subject matter of this litigation, and received due credit therefor in the sum of $300 as against the purchase price of the Pontiac automobile which he was then purchasing from the defendant for the sum of $583.31; that of said $300 credit, $225.69 was the indebtedness on the Hupmobile under said conditional sales agreement, and $74.31 for Benson's equity in said Hupmobile." Defendant "then and there paid, by its check to the Associates Investment Company, the holder of said Conditional Sales Agreement, the sum of $225.69," which was the balance due upon said agreement. Plaintiff first learned on May 15, 1936, that defendant had had possession of the Hupmobile and immediately demanded possession thereof from defendant, but at the time of the demand defendant no longer had possession of the Hupmobile, having sold it on March 7, 1936, "to a customer in regular course of business for the sum of $295 and then delivered said Hupmobile to said customer."

In the trial court defendant contended that Benson could not execute a valid chattel mortgage because of the conditional sales agreement. Plaintiff contended that Benson, a conditional vendee, had sufficient interest or property in the Hupmobile purchased by him to execute a chattel mortgage thereon. The trial court sustained plaintiff's contention. That ruling was sound. . . . There are many cases that hold that a conditional sales vendee has an interest which he can assign, sell, mortgage, or give away, subject to the rights of the conditional sales vendor or the latter's assignee. . . . In this court defendant has changed its position. While it states that "the question as to whether a conditional vendee may execute a valid chattel mortgage has never been squarely passed upon by the Illinois courts," it admits that "out-of-state authorities" have held that a conditional vendee may mortgage his interest in a chattel, and its position here is that "a chattel mortgage by the vendee under a conditional sales contract gives the

mortgagee no title to or right to possession of the chattel until after discharge of the conditional sales contract." When defendant paid the balance due under the conditional sales agreement the lien of plaintiff's mortgage became paramount. This was conceded by defendant's counsel on the oral argument.

The reason given by the trial court for holding in favor of defendant was that "the defendant here cannot be guilty of conversion unless prior to the sale of the automobile secured from Benson, the plaintiff here made a demand upon the defendant and thence took action for the recovery of the chattel;" that defendant "had an absolute right to sell the automobile subject to the mortgage of the plaintiff and that plaintiff has mistaken its remedy by not proceeding against the automobile." It is agreed that defendant acquired and sold the automobile prior to the time that plaintiff had notice that defendant had had possession of it. The defense in the trial court—as appears from the opinion of the trial judge—was that plaintiff's chattel mortgage was void and of no effect and that therefore defendant had a paramount title and right to possession. Under the circumstances of this case and the position taken by the parties in the trial court, demand was unnecessary. Indeed, it would have been useless. . . .

The ruling of the trial judge that the sole remedy of plaintiff was a "proceeding against the automobile" was based upon the unwarranted assumption of fact that defendant sold the car to the purchaser "subject to the mortgage of plaintiff," and the erroneous theory of law that no action could be taken by plaintiff against defendant because no demand had been made on defendant prior to the sale. In the trial court and here the bold defense is interposed that plaintiff's sole action is against the innocent purchaser and the car. That such a defense is not in accord with honest trade practices is clear, and it is surprising that it should be interposed by a "regular automobile dealer." . . .

The judgment of the Municipal Court of Chicago is reversed and judgment is entered here for the plaintiff and against the defendant in the sum of $103.42.

McMULLEN MACHINERY CO. v. GRAND RAPIDS TRUST CO.

1927, 239 Mich. 295, 214 N.W. 110.

This is an action to recover certain machines sold to the Field Body Corp., for whom the defendant is receiver. The machines were sold under a conditional sale agreement whereby title was to be retained until they were fully paid for, although if not paid at

the end of thirty days notes were to be given in settlement. Notes were taken and discounted with a certain bank, but many of them were renewed and finally had to be taken up by the plaintiff. All machines were charged in an open account along with various supplies. As payments were made from time to time the account was credited without any particular application. The lower court, contrary to plaintiff's desire, applied them against the charges as they fell due. In this manner some of the machines had been paid for. If the plaintiff is allowed to credit them against the unsecured items, none of the machines are paid for.

SNOW, J. It is first contended by the receiver that the sale of the notes given by the defendant to petitioner at various times, as payments on the machinery, and open account, amounted to a passing of the title of the machinery to the defendant, thereby destroying any right of ownership or possession that petitioner might have had by reason of its title retaining contracts of sale in the first instance. . . .

The petitioner never sold or assigned the contracts themselves. It indorsed and used the notes only as accommodation paper. They were renewed by the maker from time to time, and when the bank refused to carry the renewals longer, petitioner took them up and paid them. The doing of this was in fact contemplated by the terms of the contracts, which provided for the evidencing of indebtedness by notes bearing the date of shipment of the goods sold.

The giving of the notes in the first instance was not understood by either of the parties as payment, and cannot be so regarded. . . . Petitioner also still owned and possessed the original contracts of sale, which it had never assigned. It had, in fact, done nothing which showed any intention of abandoning its rights under these contracts. We are therefore constrained to hold that the sale of the notes to the bank did not pass title of the machinery to the defendant. . . .

It is next urged by the defendant that because petitioner's books showed a general account, containing both the conditional sales and other items, petitioner had thereby destroyed the retention of title features of the contracts, and had made them mere securities for payment of the entire indebtedness in the nature of chattel mortgages, and therefore void as to other creditors because of a failure to record. Petitioner has never claimed any security on open accounts, and we do not think that the manner adopted by it in carrying the different items on its books indicates any intention or attempt on its part to do so. . . . (The court also upheld the lower court in applying payments against those accounts first due, where the creditor had made no definite application.)

LODEN v. PARIS AUTO CO.

1927, 174 Ark. 720, 296 S.W. 78.

This was an action to recover for the conversion of a Dodge car. Plaintiff sold it to one Parsons, who sold it to defendant, who in turn again sold it to another party. It appeared that the defendant obtained it in a trade for a Chrysler. At the same time this suit was instituted the plaintiff started an action against Parsons to obtain the purchase price, and finally obtained a judgment, although it remained unpaid.

McHaney, J. . . . There is another rule that would preclude the appellee from recovery against the appellant in this action, and this, too, appears on the face of the complaint, which makes the complaint open to demurrer and that is that where a vendor of chattels has reserved the title until the purchase price is paid on breach of condition, he has two remedies: One is to retake the chattel and thereby cancel the debt, and the other is to sue for the debt and thereby waive his title to the property. So in such a case the vendor has the right to elect which remedy he will pursue, and having elected to pursue the one, he is precluded from using the other. . . . This court quoted with approval from Bell v. Old, 88 Ark. 99, 113 S. W. 1023, as follows:

"The principle is well established that the seller of personal property who has reserved title until the purchase price is paid may, upon default in payment, retake the property and thereby cancel the debt, or he may sue to recover the debt and thereby affirm the sale, in which case he looks to the debtor and not to the property; in the other case he looks to the property and not to the debtor."

Judgment for defendant.

Chapter IV
SURETYSHIP

WATKINS CO. v. BRUND et al.

1931, 160 Wash. 183, 294 Pac. 1024.

Action by J. R. Watkins Company against Joseph Buerkli, the latter having signed a bond which guaranteed the payment by one Brund of $988.54 to plaintiff and such additional sums as arose out of a certain sales agreement between the plaintiff and Brund. The bond was signed by Buerkli with the definite understanding between him and Brund that it was not to be delivered to the plaintiff until the signature of one Kalb had been obtained. Disregarding this agreement, Brund procured Heim, financially irresponsible, to sign the agreement, and mailed it to the plaintiff. Brund defaulted and plaintiff seeks to recover from Buerkli. The lower court gave judgment for the plaintiff.

Beeler, J. . . . The trial court found, which finding is supported by the record, that respondent knew nothing whatever of the understanding or agreement between Brund and Buerkli, and furthermore, that it had no means of obtaining any knowledge concerning the negotiations between them. . . . It was wholly a secret understanding between appellant and Brund. [Here he quotes the rule as found in 21 R. C. L. 968.]

"Hence, the rule sustained by the great weight of authority is that the agreement of a surety with his principal that the latter shall not deliver a bond until the signature of another be procured as a cosurety will not relieve the surety of liability on his bond although the cosurety is not obtained, where there is nothing on the face of the bond, or in the attending circumstances, to apprise the taker that such further signature was called for in order to complete the instrument. In such cases the surety, having vested his principal with apparent authority to deliver the bond, is estopped to deny his obligation to the innocent holder, on the principle that where one of two innocent persons must suffer, the loss must fall upon him who puts it in the power of a third person to cause the loss."

The judgment is affirmed.

JOSEPH GARD v. JAMES E. STEVENS

1864, 12 Mich. 292.

Manning, J. The action is assumpsit for the price of leather sold to one Gates, on the following guaranty:

St. Joseph, Sept. 18, 1858.

Joseph Gard, Dear Sir:

If you will let the bearer have what leather he wants, and charge the same to himself, I will see that you have your pay in a reasonable length of time. Yours, etc.

J. E. Stevens.

As plaintiff sold leather to Gates at several different times, and for different amounts, the first question is whether the guaranty is limited as to time. We think it is limited to a single purchase or transaction. We must hold this, or that it is unlimited both as to time and amount. Every person is supposed to have some regard to his own interest; and it is not reasonable to presume any man of ordinary prudence would become surety for another without limitation as to time or amount, unless he has done so in express terms, or by clear implication. If the guaranty was limited in express terms, either as to time or amount, but not as to both, it might be said it was the intention of the guarantor to leave it open as to the other, or that a further limitation could not be implied. But where it contains no express limitation as to either, and it can be inferred that it was the intention of the guarantor to leave it open as to both, we think it must be understood as referring to a single transaction. . . .

Judgment for defendant.

FIRST NATIONAL BANK v. DAVIS et al.

1901, 87 Mo. App. 242.

Smith, P. J. Defendants, John Davis as principal and Patrick Davis as surety, executed their promissory note to the plaintiff bank for $1,152, due in 12 months after date, and contemporaneously with the execution of said note the defendant John Davis executed to his codefendant and surety Patrick Davis a deed of trust on his land to secure the latter "against any loss he may sustain by reason of his said suretyship." The value of the security so given was in excess of the amount of the debt. When the debt fell due neither of the defendants was in a condition to pay it. The time of payment was extended, but whether or not with the consent of the

surety the evidence is sharply in conflict. Both of the defendants, after the giving of the note and mortgage, became insolvent.

The object of this suit was to recover judgment against the principal debtor on the said promissory note, and to have said deed of trust declared a lien on the land therein described as of the date thereof, for the purpose of securing to said creditor the payment of the amount adjudged in said promissory note. . . . The question here for decision is whether or not the creditor can have recourse in equity to satisfy his debt to the mortgage security taken by the surety from the debtor for his indemnity.

The property of the principal debtor belongs to the creditor which, under certain circumstances, the latter may subject in the hands of the surety to the satisfaction of his debt. The holder of such indemnity is a trustee for the creditor. . . . If the debtor gives his surety indemnity, the creditor may avail himself of it by subrogation, even though in the first instance it was unknown to him. . . . It is, as has been stated, at once clothed with a trust character and the creditor immediately acquires a right and interest in it that cannot be defeated by the surety. . . .

But suppose it be true, as the debtor here contends, that the creditor did extend or enlarge the time of payment of the debt; did that have the effect to discharge the surety and withdraw the security from the operation of the trust in which it had been placed? Where a surety, as here, is fully indemnified in property he is estopped to set up against the creditor the defense that the time of payment has been extended in favor of the principal without his consent, because such surety is the virtual principal, and ought to be bound by every enlargement of the time of payment quite as much, or perhaps more than the principal debtor. . . . This is not a case where a stranger has chosen to bestow upon the surety a benefit and a preference from considerations personal, in order to make good to him exclusively any loss to which he might be subjected in consequence of his suretyship for another. Of course, in such case the creditor could not, upon any ground of priority of interest, claim any share or interest in the benefit of such benevolence. . . .

Judgment for plaintiff.

MURRAY CITY v. BANKS et al.

1923, 62 Utah 296, 219 Pac. 246.

Banks was an officer of the plaintiff, and the American Surety Company signed Banks' official bond. A shortage in Banks' accounts was discovered and certain officers of the plaintiff took a note

from him for the amount of the shortage, bearing 6 per cent interest and falling due in six months. This action was instituted to recover the shortage from Banks and his surety.

CHERRY, J. . . . The trial court made findings of fact to the effect that the note had been executed and delivered to the plaintiff, and a payment made and credited on it, and concluded that the plaintiff, by accepting the note, thereby extended the time of payment of the amount due until September 1, 1920, without the knowledge or consent of the surety, and the surety was thereby relieved from liability. . . .

Does an agreement of the obligee of a bond, extending the time of payment to the principal, without the consent of the surety of itself and without a showing of prejudice, discharge the surety when the latter is engaged in the surety business for hire, and as such has executed the undertaking? The law of suretyship, of late years, has undergone a change. In the interpretation of the surety's liability a distinction is made between a voluntary gratuitous surety and one who makes suretyship a business for compensation. . . .

The same distinction is made, and the corresponding rule is applied, to both the determination of the surety's liability in the first instance and the sufficiency of the grounds by which he may be later discharged from liability. The courts generally hold that a compensated surety can be relieved from its obligation for suretyship only where a departure from the contract is shown to be a material variance, and that it must show some injury done before it can be absolved from its contract. . . . There was no sufficient ground appearing to justify the discharge of the surety. The trial court erred in granting the nonsuit and entering judgment for the surety.

The judgment is reversed.

MAGAZINE DIGEST PUB. CO., Limited v. SHADE et al.

1938, 330 Pa. 487, 199 Atl. 190.

DREW, J. This suit in assumpsit was brought to recover money alleged to be due under a contract between plaintiff and Mutual Magazine Distributors, Inc., on which contract defendants were guarantors. In their affidavit of defense defendants denied liability on the ground that they were discharged by a subsequent oral agreement which altered the original contract without their knowledge or consent. . . .

Under its original contract Mutual Distributors agreed to buy plaintiff's magazines at 14½¢ a copy for resale to retailers at 16½¢. Defendants guaranteed Mutual's obligation to pay plaintiff, with the additional stipulation that:

> . . . the publisher (plaintiff) may in his absolute discretion and without diminishing the liability of the guarantors (defendants), grant time or other indulgence to the distributor and may accept or make any composition or arrangements when and in such manner as the publisher may think expedient.

The parties continued under this contract until September 19, 1933, when Mutual was in arrears to the extent of $1,162.12. On that date it was orally agreed between plaintiff's president and the president of Mutual that if plaintiff refrained from terminating the contract, Mutual would pay the increased price of 15¢ a copy for the magazines. . . .

We cannot agree that defendants are liable for Mutual's debts under the substituted agreement of September 19, 1933. Even compensated guarantors—and defendants are not shown to be such—are not liable when the original contract on which their undertaking was made is materially changed without their assent. Sall B. & L. Ass'n. v. Heller, 314 Pa. 237, 171 A. 464. A gratuitous or accommodation guarantor is discharged by any change, material or not, and "even if he sustains no injury by the change, or if it be for his benefit, he has a right to stand upon the very terms of his obligation and is bound no farther." 100 Pa. 500,505. But there can be no doubt here the alteration was material. To the distributor it meant 25 per cent less in its sale profit, to the plaintiff it made the difference between the terminating and continuing contractual relations with the distributor, and to the defendants it meant an increase in their obligation of $1,118.05 on 223,609 magazines received from the publisher after the new contract was in force. . . . Nor can the legal effect of alteration be escaped by limiting recovery against guarantors to the rate set in the original contract. The very theory of their defense is that after the change there is a new contract on which the guarantor has not agreed to be liable to any extent. . . .

Defendants are not relieved, however, from Mutual's debts which accrued while the original contract remained in force. The subsequent variation of that contract had no effect upon the liability that had already become fixed. Consequently defendants were not discharged as to it.

ACRES v. CURTIS

1887, 68 Tex. 423, 4 S.W. 551.

Curtis brought this suit against Brannon Bros. and also against H. Eddy, A. S. Mercer, and the appellant C. F. Acres. He and the

last three parties were sureties on a note executed by Brannon Bros. in favor of George W. West for $2,842.60, which note bore interest at 12 per cent and in case of legal proceedings 10 per cent for attorney's fees was to be added. Curtis paid the note with interest, which amounted to $3,193.17. Brannon Bros. were insolvent and Curtis maintained that his cosureties were bound to pay him their pro rata share of the above sum, with interest, and 10 per cent attorney's fees. He obtained judgment for $3,691 against Brannon Bros. and a joint judgment against the cosureties for $2,792.41, which was three fourths of the principal, interest, and attorney's fees.

Willie, C. J. . . . It is apparent that the recovery given to Curtis against his cosureties was three fourths of the amount due on the note at the date of the judgment, with attorney's fees added. The appellee was not entitled to such a judgment under the allegations of his petition. He was one of four cosureties on the note. When he paid it he became entitled to contribution from each of his cosureties in aliquot parts, according to their number; that is to say, one fourth of the amount paid, with interest, from each surety. . . .

He was not entitled to recover the whole three fourths from these three sureties in a joint judgment against them. The injustice of such a judgment is apparent from the fact that the whole of it could be made out of one defendant, and, in case of the insolvency of the others, this defendant would be forced to pay three times the amount the plaintiff was entitled to recover of him. The rule in equity in case of such insolvency is that the solvent sureties bear equally the burden of payment. This rule, as well as that which requires all the sureties when solvent to share equally in the payment, is violated by the present judgment. . . .

Nor can we perceive upon what principle the plaintiff recovered 10 per cent attorney's fees of the defendant sureties. He had not paid attorney's fees to the owner of the note. They were not to be paid except in case of suit, and it does not appear that any suit had been commenced on the note when he took it up. He says that he was forced to pay it, but the inference is that this was by reason of the insolvency of the makers. At all events, he paid no attorney's fees, and was entitled to receive contribution only for what he did pay. A surety cannot speculate off of his cosureties. If he purchases the note for less than its face value, they are entitled to share in the benefit of the bargain. Much less can he get from them more than a proportionate share of the face value if he pays the note in full.

From this it is apparent that the judgment below was wrong.

SMITH et al. v. STATE OF MARYLAND

1877, 46 Md. 617.

ROBINSON, J. This is a motion to quash an execution issued on a judgment recovered by the appellee against the appellants and Mary Payne, executrix of B. N. Payne, sureties on the bond of Nelson Cooper, one of the tax collectors of Baltimore County.

At the request of one of the heirs at law of Payne, a statement was made, showing the ratable proportion due by each defendant in the judgment, and upon the payment of Payne's proportion as thus ascertained, the appellee directed the clerk to enter the judgment satisfied as against his executrix. The appellants contend that, being cosureties, the entry of satisfaction as against the executrix Payne discharges them from all liability on account of said judgment.

Now, it is true that any valid contract or agreement between the creditor and the principal, or between the creditor and a surety, without the concurrence of cosureties, whereby the latter are subjected to an increased risk, operates as a discharge of such sureties. And hence the release by a creditor of the principal releases also the surety, because the latter is entitled, upon the payment of the debt, to be subrogated to all the rights and remedies of the creditor, and the creditor cannot, by his own act, prejudice or in any manner impair these rights without forfeiting his remedy against the surety.

It seems also to be well settled that the release of one or more sureties without the assent of the cosureties will operate *at law* to discharge the latter, because it is a cardinal principle of suretyship that the surety has the right to stand by the very terms of the contract and the creditor will not be permitted to change or alter the contract without concurrence of all the parties to it.

In equity, however, the rule is different. . . . Accordingly it has been held that where the creditor releases one surety, reserving his remedy against the others, the effect of such release operates only to discharge the cosureties from the ratable proportion which the surety thus released ought to have contributed, and such further proportion as he ought to have borne arising from the insolvency of any of the other sureties. . . .

The effect of that entry so far as they are concerned is to release them from the payment of Payne's proportion of the judgment, and should any of the cosureties prove insolvent, to release them from the payment of Payne's proportion of the loss arising from such insolvency. . . .

Judgment for defendant.

HOOVER, Appellee v. MOWRER et al.

1891, 84 Iowa 43, 50 N.W. 62.

This was an action on a promissory note. It appears that the note was made by one Mowrer to R. W. Adams, E. O. Craig, C. Hoover, and James Hoover and by them indorsed to the plaintiff for the accommodation of Mowrer, the four indorsers thus becoming sureties. It further appears that Mowrer became insolvent, but that Adams and Craig took a chattel mortgage on some stock in trade to protect them. Hoover & Hoover are now attempting to force them to share the proceeds from a sale of the mortgaged goods.

BECK, C. J. . . . We are first required to determine whether Craig & Adams may appropriate the proceeds of the mortgaged property to their exclusive benefit, or whether the mortgage should be regarded as security for all the indorsers of the note. Counsel for the appellees state quite correctly, we think, the rule of law, "that securities obtained by one surety inure to the benefit of all. . . ." The rule exists for the protection of the sureties, and not for the good of the creditors or the principal debtor. By the contract of sureties, they became severally bound for the debt of the principal. But it is plain that each should contribute equally in case they are called upon to pay the debt. One cannot in any way escape the burden while his cosurety is not relieved. . . . Each surety is authorized to rely upon this rule to protect himself from imposition and fraud which his cosurety and principal might practice upon him. The principal, by indemnifying one of the sureties, would relieve him of the burden of suretyship which the other still carried. This would be unfair and inequitable. In case it is done with the knowledge and consent of the other surety, it would thereby be relieved of objection, for the surety could not complain of that to which he assents.

CHAPTER V

INSURANCE

NEW YORK LIFE INS. CO. v. BABCOCK

1898, 104 Ga. 67, 30 S.E. 273.

This was a suit upon a policy of life insurance. The premium was paid and the receipt taken in payment therefor stated that the policy was not to become effective until delivered to the insured in good health. Some question arose concerning the effectiveness of this insertion, but the court assumed that it was binding. The application was passed on by the company and the policy mailed to the local agent. He held it for three days, when it was called for by an employee of the insured. The agent asked if the insured was ill and was informed that he was not. The policy was then delivered, whereupon the employee informed the agent that the insured was dead, he having died the previous day from a pistol wound, being in good health until that time.

LEWIS, J. . . . The fundamental question to be determined in the legal construction of all contracts is, What was the real intention of the parties? Where one party makes a proposition to purchase a thing which is unconditionally accepted by another, the contract of purchase becomes complete. There is no reason why the same rule should not be applied when a written application is made for an insurance policy. So long as the application is not acted upon by the insurance company, of course no contract has been consummated. . . . But when the application is accepted, and nothing remains for the applicant to do, the contract becomes complete. Actual delivery of the policy to the insured is not essential to the validity of the contract, unless expressly made so by its terms. . . .

Assuming that this condition constitutes a part of the agreement between the parties, it then becomes a material question as to whether or not such delivery was effected before the death of the insured. This is also a question of intention, and must be determined from the facts and circumstances of this case. As a general rule, whenever one parts with the custody and control of anything with the intention at the time that it shall pass into the possession of another, its delivery to such other person has, in contemplation of law, become complete. The mere manual possession of the thing intended to be delivered is of little consequence. Such possession may exist without any legal delivery, and it may not exist when a legal delivery has been effected. . . . The controlling question,

then on this subject of delivery, is not who has the actual possession, but who has the right of possession. . . . When this application was accepted at the home office in New York, and a policy issued thereon was placed in the mails for the sole purpose of ultimately reaching his hands, the company parted with its possession and control of the paper. The intention to deliver was complete. . . .

Judgment for plaintiff.

MUTUAL LIFE INS. CO. v. DENTON

1927, 93 Fla. 276, 112 So. 53.

Mrs. Denton brought this action to recover upon two policies of life insurance for $1,000 each. The defense asserted by the company was that Denton had stated in the application as follows:

> I have never made an application nor submitted to an examination for life insurance upon which a policy has not been issued on the plan and premium rate originally applied for.

The facts indicated that shortly before his application with this company, Dr. Welch, acting for another company, had refused him a satisfactory report because of tuberculosis.

Ellis, C. J. . . . There can be no doubt that an applicant for life insurance should exercise toward the company to which he applies for it the same degree of good faith which the company is required to exercise toward him and which he rightly expects. . . .

The representation that the applicant had made no prior application for insurance in any company was a material one. A statement that no policy had been issued if an application had been made would obviously have placed the company upon inquiry which would have led to the disclosure of the facts appearing in this case. . . . The information which the company sought by the question and which it had a right to receive from the applicant in full without qualification, abatement, or deception, fully and in good faith, was, Had the applicant, through the usual channels of securing life insurance, or directly to any company, theretofore applied for insurance and was the insurance obtained? . . .

It would seem to be unnecessary to cite authorities in support of the proposition that the disclosure sought by the question was as to a material fact necessary to be ascertained to enable the company adequately to estimate the nature of the risk in the event it should, in view of all the facts, issue the policy, and that an untrue answer would vitiate the policy. . . .

Judgment for defendant.

CREED v. THE SUN FIRE OFFICE

1893, 101 Ala. 522, 14 S. 323.

COLEMAN, J. . . . The next proposition involves a question new in this state. Has a creditor an insurable interest in a building, the property of the estate of his deceased debtor, which may be subjected to his debt, the personal property being insufficient to pay the debts of the estate? After much deliberation our conclusion is that he has an interest which may be insured. We concede and affirm that a simple contract creditor without a lien either statutory or contract, without a jus in re or jus ad rem, owning a mere personal claim against his debtor, has not an interest in the property of the debtor. Such contracts are void as being against public policy. We do not think the principle applies after the death of the debtor, as to property liable for the debt and which, if destroyed, will result in the loss of the debt. The real estate as well as the personal property of a deceased debtor is liable for his debts but the real estate cannot be subjected to the payment of his debts until after the personalty has been exhausted. After the death of the debtor the debt is no longer enforceable in personam. The proceedings to reach the property of the estate of the deceased debtor are in rem. The property of the debtor takes the place of the debtor and becomes, as it were, the debtor.

The relation of debtor and creditor invests the creditor with an insurable interest in the life of his debtor to the extent of the debt. . . . It would seem upon like principles that when the property becomes directly subject to proceedings in rem for the satisfaction of the debt, the creditor should become invested with an insurable interest in the property. Certainly if a creditor cannot obtain satisfaction of his debt from the personal property of his deceased debtor, and has a legal right which cannot be defeated, to enforce its collection, by proceeding in rem against a building belonging to the estate of the deceased debtor, and if it be true that the destruction of the building by fire would immediately and necessarily result in pecuniary loss, the loss being the direct consequence of the fire, the creditor has an interest in the protection of the building.

Judgment for plaintiff.

ELLIS v. NORWICH UNION FIRE INS. SOC.

1927, 259 Mass. 540, 156 N.E. 696.

This is an action to recover on three policies of insurance. The plaintiff, intending to make some soap, placed the proper ingredients in an aluminum pot and placed it over a "fairly hot fire."

She then forgot about it, and shortly thereafter went to Boston. Neighbors, seeing the smoke, called the fire department. The fireman testified that he saw smoke forcing itself from under the cover of the pot, and that when he removed it from the flame it was a solid black crinkled mass. An expert in physics and chemistry testified that under such conditions, if the pot was not covered, there would be a flame inside, and if covered, there would be a flame from the gases as they emerged. There was evidence of damage by smoke. The judge in the lower court directed a verdict for the defendant.

SANDERSON, J. . . . The plaintiff does not contend that she can recover under the policies if the only fire was the flame of the gas stove, but that she has a right of action if she proves damage from a separate and distinct fire either in the pot or from the gases escaping therefrom.

Upon the evidence the jury could have found that a fire separate and distinct from the gas flame had existed either in or outside the pot. In Way v. Abington Mu. Fire Ins. Co., 166 Mass. 67, 43 N.E. 1032 . . . the plaintiff recovered for injury to his house caused by smoke produced by a chimney fire which caught from a fire in a stove connected with the chimney. The court said:

"A chimney is not intended to be used as a place in which to kindle fires, or to have fires for use or enjoyment in connection with the occupation of a building." "We are inclined to the opinion that a distinction should be made between a fire intentionally lighted and maintained for a useful purpose in connection with the occupation of a building and a fire which starts from such a fire without human agency in a place where fires are never lighted or maintained." . . .

The plaintiff's negligent conduct does not prevent her from recovering. There is nothing to show that she intended to have any fire except the flame of the gas stove. . . .

In accordance with the terms of the report, judgment is to be entered for the plaintiff for $350, with interest and costs.

GERHARD v. TRAVELERS FIRE INS. CO.

1945, 246 Wis. 625, 18 N.W.(2) 336.

WICKHEM, J. The question in this case is whether damage to plaintiff's summer cottage located on the east shore of Green Bay by ice blown across the bay and against the cottage is within the coverage of a policy issued by the defendants to the plaintiff. The question arises on what is denominated an extended coverage indorsement insuring, in addition to fire risk assumed by the principal part of the policy, perils of "windstorm, cyclone, tornado and hail,"

. . . except as hereinafter provided. The promise which is of importance here is as follows, "This Company shall not be liable for any loss or damage . . . occasioned directly or indirectly by or through any tidal wave, high water, overflow, cloudburst, theft; nor for any loss or damage caused by water or rain, whether driven by wind or not, unless the building insured, or containing the property insured, shall first sustain an actual damage to the roof or walls by direct force of the wind, and shall then be liable for only such damage to the interior of the building, or the insured property therein, as may be caused by water or rain entering the building through openings in the roof or walls made by direct action of the wind, or by water from sprinkling or other piping broken by such damage to roof or walls."

On the occasion in question the ice on the bay was a large sheet varying from one foot to twenty-eight inches in thickness. There was some question whether the ice extended completely from one shore to the other. About noon with the wind velocity at the weather bureau registering fifteen miles an hour, the ice moved toward the shore a few feet. Between 2 and 3 P.M., with a wind of 18 or 19 miles per hour, the ice moved in another six feet. At that time it was within forty feet of the cottage. Between 4 and 5 o'clock P.M., with the weather bureau registering velocities of 28 and 25 miles per hour, respectively, the ice sheet reached plaintiff's cottage with a sudden swift movement from west to east. It moved inland to the shore, sliding up over the land, the edges breaking off, and the ice cakes piling eight to twelve feet high.

Defendant's contention is that this loss was not caused by windstorm, and that in any event, it was not caused by direct action of the wind. It claims that a windstorm is a high wind with little or no precipitation; something more than an ordinary gust or breeze, amounting to an outburst of tumultuous force. This definition would eliminate zephyrs, breezes and other slight air disturbances.

This policy was drafted by defendant and not only contains no definition of windstorm but uses merely the word "wind" in three or four places in the policy in referring to or limiting its liability. . . . In the absence of definition of limitation in the policy, we think that a windstorm must be taken to be a wind of sufficient violence to be capable of damaging the insured property either by its own unaided action or by projecting some object against it. This is especially true where as here the more violent forms of windstorms are specifically named as something different from mere windstorm. Any other view would work an injustice on the insured. . . .

Contention that the cottage was not injured by the direct force of

the wind is without merit. While the policy expressly excludes from coverage situations where the damage is caused by water unless the wind shall first have breached the walls of the building, that does not mean that hard objects projected against the building by the immediate force of the wind can be eliminated from the policy. They were not expressly limited, and under all tests known to the law constitute damage done by direct action of the wind.

Judgment for plaintiff affirmed.

KINNEY v. ROCHESTER GERMAN INS. CO.

1908, 141 Ill. App. 543.

Action to recover on a fire insurance policy.

The plaintiff, through his agent McCrague, who in turn acted through Cummings & Co., insurance brokers, obtained a policy of fire insurance for $1,500 through defendant's local agents, Hermann & Co. On October 19, 1906, Hermann & Co. notified Cummings & Co. that they desired to cancel the policy and that it would continue only until October 24th at noon. In some manner Cummings & Co. were in possession of the policy and they returned the same to the defendant's agent. A fire occurred early on October 25th. The previous day Hermann & Co. figured the rebate and the day of the fire they credited the account of Cummings & Co. for the proper amount, still unaware of any fire. Cummings & Co. maintained an open account with Hermann & Co.

Brown, J. . . . Mr. Kinney testified: "I never received any notice from the Rochester German Insurance Company or its agents of any intention on their part to cancel this policy. Neither the defendant nor George Hermann & Co. ever paid or offered to pay me any portion of the return premium."

This statement of the evidence is sufficient to show, we think, that no proper notice under the cancellation clause in the policy was given to the plaintiff nor the requisite repayment of premiums to him made. H. D. Cummings & Co. were simply the insurance brokers for the plaintiff. It does not appear that they had or assumed to have any authority to receive either notice of cancellation or premium rebate for him. It is very probable that if this fire loss had not unfortunately occurred when it did, a few days later the cancellation would have been properly accomplished by the assent of the assured. Cummings & Co. would probably have notified the plaintiff. . . .

Their employment by Mr. Kinney through his agent to procure the insurance gave them no authority to surrender or cancel the policy, or to receive the return premium or cancellation. . . .

"The insured does not have to tender his policy in order to entitle him to receive back the unearned premium, but it is for the company desiring cancellation to seek the assured and tender the money to him, and until it does so, the cancellation has not been effected." No such tender was shown here. The "crediting" Cummings & Co. "with the unearned premium for the unexpired term" was not such a return or tender.

Judgment for plaintiff.

ALDRIDGE v. PIEDMONT FIRE INS. CO.

1945, 183 Va. 830, 33 S.E.(2) 634.

The plaintiff carried a $1,000 policy of fire insurance upon a barn in which he kept certain horses, harness, saddles, and other riding and driving equipment. During the second week in June he moved the horses, saddles, and equipment from the barn and thereafter failed to make use of it until a fire occurred on July 28. This is a suit to recover for the fire loss suffered.

BROWNING, J. . . . The policy contains two provisions concerning vacancy. One is found in the printed standard policy proper, which is this:

> Unless otherwise provided by agreement in writing added hereto this company shall not be liable for loss or damage occurring . . . (f) while a described building, whether intended for occupancy by owner or tenant, is vacant or unoccupied beyond a period of ten days.

The other is found on the back of what is called a rider attached to the policy. It is this:

> Vacancy Permit—Permission is hereby granted for the within described dwelling to become and remain vacant or unoccupied for a period of not exceeding thirty (30) days (including the period of ten days allowed in the printed conditions of this policy) at any one time. It is understood and agreed that if the vacancy or unoccupancy exceeds thirty days at any one time, permission for same must be specifically indorsed hereon, or this entire policy shall be null and void. . . .

As we have seen, Mr. Aldridge moved his horses and equipment out of the barn during the second week in June, 1943, because of a misunderstanding with his daughter, who owned the land upon which the barn stood. He sold a portion of these things in Petersburg and did not resume occupancy of the building. His own testimony, which is uncontradicted, shows this and we can reach no other reasonable conclusion than that he had abandoned it and that

the period of such abandonment was more than 10 days, indeed, more than 30 days. . . .

One of the witnesses, a lieutenant of the Petersburg Fire Department, testified that when he arrived at the scene of the fire he noticed an old tractor and some old lumber piled under the shed. That incident is not urged, however, as evidence of continued occupancy. We think it could not be. The barn had been used by the plaintiff as a place for his horses and riding equipment in the conduct of a riding school.

In the case of Limberg v. German Fire Insurance Co., 90 Iowa 709, 57 N.W. 626, 23 L.R.A. 99, 48 Am. St. Rep. 468, we find this syllabus:

"The mere use of a store building as a place in which to store a few articles of personal property, no other business being carried on therein, renders the building 'vacant and unoccupied' within the meaning of these words as used in an insurance policy. . . .

We think the court was plainly right in holding that the vacancy of the barn by the plaintiff for a longer period than 10 days vitiated the policy and defeated recovery thereon.

Judgment for defendant is affirmed.

RABINOWITZ v. NATIONAL FIRE INS. CO.

1927, 258 Mass. 508, 155 N.E. 435.

This is an attempt to recover upon two policies of fire insurance. At the time of the fire and for some time prior thereto, the plaintiff kept upon his shelves firecrackers for sale without having obtained any city license therefor as was required by ordinance.

Crosby, J. . . . It is plain from the testimony of the plaintiff that he kept and stored on his premises firecrackers which contained gunpowder without a permit or license therefor, in violation of section 14. The keeping and storage of firecrackers without any permit or license from the date the policies were issued until the fire occurred were in direct violation of the provision of the policies that: "They shall be void . . . if gunpowder or other articles subject to legal restriction shall be kept in quantities or manner different from those allowed or prescribed by law."

It is a matter of common knowledge that the keeping and storage of gunpowder in a building increased the risk. If so kept in violation of law and in violation of the terms of the policy, the insurer is not liable under the contract of insurance. . . .

As it is admitted by the plaintiff that, when these policies were issued and thereafter until the time of the fire, firecrackers containing gunpowder were kept and stored by him without permit or li-

cense as required by law the policies never were in force and he cannot recover. . . .

ANTLEY v. ST. MATHEWS NATIONAL BANK

1927, 139, S.C. 23, 137 S.E. 199.

This is an action to determine the right to the proceeds of a policy of insurance. The plaintiff was the beneficiary and the defendant was the pledgee, to whom the $2,000 policy had been pledged to secure an indebtedness of approximately $2,100. The pledge was made without the consent of the beneficiary, although the right to change beneficiaries had been reserved. No formal change of beneficiary had been made at the time of the insured's death. The lower court gave judgment for the plaintiff.

Cothran, J. . . . "The contract may reserve to the insured the right to change the beneficiary at will; and, when this is done, the nominated beneficiary acquires no vested interest in the policy or its proceeds, and until the death of the insured has a mere expectancy." Merchants Bank v. Garrard, 158 Ga. 867, 124 S.E. 715.

The case last named is in exact parallel with the case at bar, and it is there held that the assignment was in effect a change of the beneficiary, what our court practically held in the Deal Case. . . . In 37 C.J. 581, it is said: "On the other hand, where the right to change the beneficiary has been reserved in the policy so that the beneficiary does not have a vested right or interest, it is held that the insured has complete control and domination of the policy; that his right to change the beneficiary includes the lesser right partially to affect the rights of the beneficiary by assigning or creating a lien on the policy; and that he may do directly what he might do after having changed the beneficiary to himself or his estate." . . .

The judgment of this court is that the decree of the Circuit Court be reversed, and that the case be remanded to that court for the purpose of rendering judgment in favor of the defendant St. Mathews National Bank.

POWELL v. MUTUAL INS. CO.

1924, 313 Ill. 161, 144 N.E. 825.

The appellant issued to Alfred E. Powell four policies of insurance during the year 1919, the last two of which were issued October 27, 1919. The policies all contained a two-year incontestable clause. A trifle over a year after the policies were issued the appellant ascertained that fraudulent answers had been given to the questions in the application. It immediately tendered the premiums and informed the insured that it had rescinded. On Octo-

ber 26, 1921, the insured died and the beneficiaries are now suing. The plaintiffs contend that the policy was not contested.

STONE, J. . . . This clause amounts to an agreement between the insurer and the insured that after the expiration of such period the company shall be estopped from contesting the policy or setting up any defense, except such as may be reserved therein or such as is allowed on the grounds of public policy. The stipulation does not waive all defenses and does not condone fraud, but recognizes fraud and all other defenses and constitutes a short statute of limitations in favor of the insured, the purpose of which is to fix a limited time in which the insurer must ascertain the truth of the representations made, and, in case of a breach of warranty, the insurer must, under this clause, assert its claim within the two-year period, either by affirmative action or by defense to a suit brought on the policy by the beneficiary within two years. . . .

It will be seen from an examination of the authorities, that by the great weight of authority in this country, to contest a policy for fraud it is essential that the insurer proceed, by way of defense, to a suit brought upon the policy or by independent action to cancel the same, and that notice of rescission, with tendering back premiums and interest, is not a contest within the meaning of the clause. . . .

Mere notice of rescission for fraud settles nothing. Actual rescission is permitted for fraud without the consent of the other party to a contract where such fraud is shown but the right to rescind does not exist unless fraud is proven. Charging fraud and serving notice of rescission cannot, of itself, be a rescission for fraud. It still remains to be proved whether or not fraud in fact exists. . . .

The plaintiff in error did not contest the policies in the manner required under the rule stated. . . .

Judgment for plaintiff.

NEW YORK LIFE INS. CO. v. VEIT et al.

1945, 294 N.Y. 222, 62 N.E.(2) 45.

This is an action by the plaintiff to recover of the defendant a portion of the life insurance paid to the defendant upon the death of his wife. After payment had been made, the plaintiff learned that the age of the wife had been understated by sixteen years, and the policy provided in such a case that the insurer should pay such sum as the premium would buy at the correct age. The amount of the policy was $25,000, whereas the premium at the true age would have purchased only $15,077. This is a suit to recover the difference.

DESMOND, J. Defendants, pointing out that more than seventeen years elapsed between the issuance of the policy and the bringing of this suit, argue that plaintiff's claim of fraud is barred by the "incontestability clause" in the policy. That clause, which, like the misstatement of age clause above discussed, is mandatory in New York, Insurance Law, § 155, Consol. Laws, c. 28, says that the policy "shall be incontestable after two years from its date of issue except for non-payment of premium." This court seems never to have decided whether or not such an incontestability clause operates to prevent the enforcement, after two years, of an "age adjustment" or "misstatement of age" provision found with it in the same life insurance policy. Other courts in this State have uniformly held, as have many courts elsewhere, that an incontestability clause does not bar the insurer from litigating the question of the insured's true age in an effort to limit the policy's coverage to the amount procurable at insured's correctly stated age, for the premium paid. We think those holdings correct. The position taken here by the insurer involves no contest of, or attack on, the policy itself. It represents an effort by the insurer not to invalidate or cancel the policy but to confine the insurer's liability, within the express terms of the policy, to the amount for which the policy would have been written had the truth been known. The incontestability clause forbids, after two years, such a contest as seeks to question the original or continued existence of the policy. It does not prohibit a contest the purpose of which is to demand the enforcement of a term of the policy itself. As Chief Judge Cardozo wrote in Matter of Metropolitan Life Ins. Co. v. Conway, 252 N.Y. 449, 452, 169 N.E. 642, an incontestability clause "is not a mandate as to coverage, a definition of the hazards to be borne by the insurer. It means only this, that within the limits of the coverage the policy shall stand, unaffected by any defense that it was invalid in its inception, or thereafter became invalid by reason of a condition broken." So, as Judge Lehman said in another connection in Apter v. Home Life Insurance Company of New York, 266 N.Y. 333, 338, 339, 194 N.E. 846, 848, 98 A.L.R. 1281, the insurance company's assertion in this suit that the policy coverage was actually $15,077, instead of $25,000, "is in exact accord with the written contract of the parties and is not in conflict with the provision that the validity of the written contract may not be contested." Our conclusion that the incontestability clause did not ban the enforcement, after two years, of the age adjustment clause, gets further support when we consider that it was not only by the same statute, but by the same paragraph thereof, that the Legislature originally mandated the inclusion of these two clauses in the old "standard form policy."

They must be read and enforced together so that neither cancels the other.

Judgment for plaintiff.

PRUDENTIAL INS. CO. v. DEYERBERG et al.

1927, 101 N.J. Eq. 90, 137 Atl. 785.

This is a contest for money paid into court by the Prudential Ins. Co. on a policy of insurance for $500 issued by it on the life of Herman H. Deyerberg, payable to his "administrators, or assigns." One Helene Elschepp claims the proceeds by reason of an assignment. The policy was delivered to her as a gift, but later returned to the insured for safekeeping, whereupon he gave her a written statement indicating that the policy was to be paid to her. Herman F. Deyerberg claims as administrator, in as much as there was no change of beneficiary. The policy contained a provision that an assignment must be written, and notice given before it would bind the company.

FIELDER, Vice Chancellor. . . . As a general rule, the interest of an individual designated as beneficiary in a policy of insurance is a vested property right, payable to him if he outlives the insured, which right can only be divested by the insured making a change in beneficiary in the manner provided by the policy contract. Consequently an assignment of such a policy by the insured, even if made in full compliance with terms similar to those contained in the policy now under consideration, is ineffectual as against such beneficiary. . . . But where the sole beneficiary named in the policy is the executors, administrators or assigns of the insured, the policy, in effect, is made payable to the insured himself, or in the event of an assignment by him, to his assignee, and such is the situation with respect to the policy now under consideration. Although the insured could have made it payable to a new beneficiary only in the manner provided in the policy, he could make a valid assignment of it and of the money to become due thereon because no individual beneficiary had any interest therein. . . . Failure of the insured to comply with the policy provision that any assignment must be in writing cannot avail the administrator, because such provision was an agreement between the insured and the insurer alone, which the latter waived by paying the proceeds of the policy into court.

Book VII

REAL PROPERTY

CHAPTER I

PRINCIPLES OF REAL PROPERTY

COOK v. WHITING

1855, 16 Ill. 480.

Plaintiff brought this action to recover the value of logs and timber removed from his land by defendant. Defendant had sold the land in question to the plaintiff. Prior to the sale, while still owner of the land, defendant cut down a large quantity of timber with the intention of building corn cribs, fences, etc., upon the land. It was admitted that the timber sued for was lying upon the premises and not attached to the soil, and that after the sale of the land defendant had taken this timber away and sold it. Defendant contends that he had the right to do so, since these felled trees were personal property and did not pass by the deed to the land.

SCATES, C. J. The hewed timbers, posts and round logs sued for in this case were neither fixtures nor appurtenances to the land, but personal property, and did not, therefore, pass by the deed as part of the realty. . . . Here the separation by the act of the owner was complete and he had unquestionably converted it into personalty, though with the intention of reannexing it to the land at some future time. But before this was done, he sold his land and conveyed it; therefore no title to the hewn logs in question passed to the plaintiff.

PIERCE et al. v. CHERRY VALLEY FARMS, INC.

1945, (Ohio App.) 63 N.E.(2) 46.

The plaintiff owned certain real property which was subject to an easement in favor of an electric railway. The railway had recently been authorized to abandon its service but for a period of over twenty years had been using its poles and wires to carry electric energy to certain private users in addition to serving the electric railway. The defendant contends this action broadened the easement by adverse possession, whereas the plaintiffs have filed this bill to quiet their title, urging that it is free and clear of any easement. The Marion-Reserve Power Company entered the case, claiming the easement.

STEVENS, J. It is the rule that "Where an easement is granted to be exercised within certain limits, and the grantee openly exercises a privilege in excess of the limit, continuously and without inter-

ruption for the requisite period, under claim of right, a second grant may be presumed, superadded to the first and covering the larger right. This rule, however, cannot apply where the use in excess of the grant was not under an adverse claim of right . . ." 28 Corpus Juris Secundum, Easements, § 14 subsec. e.

It is apparent that, up to 1931, when the railway operation was abandoned, the maintenance of poles and wires on the land covered by the easement in question was necessary to the operation of an electric railway; it is further apparent from the evidence that certain electric energy was sold by the railway company and its successors to private users.

There is, however, in our opinion, a dearth of evidence to show that Cole, or his successors in title up to 1931, knew that the railway company and its successors claimed a right to maintain a pole line over said property for the purpose of furnishing light and power, to private users, independent of the operation of an electric railway.

The increased burden imposed upon the land was surreptitious, and of such character as not to put the owner of the servient estate upon inquiry.

The user to all appearances was in accord with the grant.

A concealed increased burden upon a servient estate cannot furnish the basis for acquisition of an easement by prescription, because it lacks some of the elements necessary to create an easement by prescription: *viz.*, that it must be adverse, under claim of right, continuous and uninterrupted, *open* and *notorious*, exclusive, *with the knowledge and acquiescence of the owner of the servient tenement*, and must continue for the full prescriptive period, while the owner of the servient tenement is under no legal disability to assert his rights, or to make a grant.

It is our opinion that neither the Marion-Reserve Power Company, nor its predecessors in title, acquired, by prescription, an easement to maintain a pole line and wires over the 4.54 acre strip in controversy, for the transmission of electric energy to be sold to private users for power and light.

Judgment for the plaintiff.

VAN ANTWERP v. HORAN, et al.

1945, 390 Ill. 449, 61 N.E.(2) 358.

The question presented for the court's consideration is whether a joint tenancy is severed by a levy made under an execution upon the share of one of the joint tenants, no sale having taken place at

the time of the death of the tenant against whom the levy was made.

THOMPSON, J. . . . The characteristics of a joint estate are derived from its unity, which are the unity of interest, the unity of title, the unity of time and the unity of possession. It is the destruction of one or more of the four unities that severs and destroys the joint tenancy and this may be done by a conveyance, voluntary or involuntary, of the interest of one of the joint tenants, and the unity of title and interest being destroyed, the interest severed is changed into a tenancy in common. . . . It is recognized that the interest of the joint tenant in real estate is subject to levy and sale upon execution. . . .

The appellants urge, however, that the making of the levy destroys the identity of interest in that this is such an act in reduction of the interest of the joint tenant as to destroy the unity of interest and to bring about a severance of the joint tenancy. This court has previously considered the question of the effect of a judgment lien on the interest of a joint tenant and has held that the judgment lien does not sever the joint tenancy and that by the taking of the judgment nothing was done to sever this estate. Peoples Trust & Savings Bank v. Haas, 328 Ill. 468, 160 N.E. 85. This presents to us for consideration the effect of the levy upon the interest of the judgment debtor holding as a joint tenant. To be specific, does a levy made under an execution upon the share or interest of one of the joint tenants, sever or terminate, before final sale, the joint tenancy? This presents a new proposition and we have been cited no authority in which this exact and precise question has been passed upon in this or any other court. . . .

The taking of a judgment gives to the judgment creditor a lien upon the property of the judgment debtor, and we have held before that the attaching of a judgment lien upon the interest of a joint tenant does not sever the joint tenancy. Peoples Trust & Savings Bank v. Haas, 328 Ill. 468, 160 N.E. 85. By following this decision, it is clear that if the attaching of a judgment lien upon the interest of a joint tenant does not sever the joint tenancy, the making of a levy upon the interest of the joint tenant debtor would not be such act as would sever the joint estate, because of the fact that the levy gives no greater interest than that which the judgment creditor already possessed. . . .

Judgment for the surviving joint tenant.

CHAPTER II

REAL ESTATE MORTGAGES

McGILL v. NATIONAL BANK OF TOPEKA

1938, 77 Pac.(2) 944, 147 Kan. 605.

This was an action to have a certain deed, and contract to reconvey, adjudged to be a mortgage. The plaintiff owed money to various parties and obtained $805.62 from the defendant with which to meet his obligations, giving a deed to certain real estate which had been divided into six lots. An option agreement was signed which recited that the plaintiff had sold certain property to the defendant and was given a four-year option to repurchase upon complying with the terms of the agreement. The agreement contained a promise to pay $200 with 6% interest from April 1, 1930 on or before April 1, 1932 and $605.62 with 6% interest on April 1, 1934. The plaintiff agreed to pay taxes and upon default for a period of sixty days the contract was to become void.

HARVEY, J. . . . Thereafter the plaintiff paid defendant $24, April 14, 1931, $26.25, on June 22, 1931, and $10, March 16, 1932. On December 27, 1933, the defendant conveyed one of the lots to Ralph D. Combest for $300, and on August 6, 1935, conveyed another one of the lots to Combest for $400. . . .

In this case, whether a debt existed depends almost entirely upon the construction given to the instrument executed by the parties and denominated "option." . . . The paragraph designated first in the instrument contains a definite agreement on the part of J. C. McGill to pay $200, with 6% interest by a date named, and the next paragraph contains a similar definite agreement to pay $605.62, with interest by a date named. We see nothing in the instrument to have prevented the defendant from suing on these covenants.

In addition to that, the record indicates that the deed to the bank was not made for any indebtedness plaintiffs owed to the bank. It was made to enable the plaintiffs to pay debts owed to other parties. The statutes under which the defendant bank was incorporated and does business do not permit it to buy real property other than that needed in its banking business, or in payment of debts due the bank. It is not contended that it purchased this property for any of these purposes and it will not be presumed the bank intended to transact the business in a manner in violation of the statutes. We give weight to this fact in determining the intention of the parties. . . .

Defendant paid out $805.62, and has received payment from plaintiff, and the sale of three lots, of $1,060.25. Three of the lots remain. Since the contract to reconvey was not recorded, this action should not be permitted to effect the title to the lots conveyed by defendant to Combest. There was no evidence as to which of the parties was in the possession of the property when this action was brought, or when it was tried. It appears to be unimproved lots. Neither was there any evidence as to who has paid the taxes on the property since the deeds and the contract were made. Upon the record before us, there should be a computation of the balance if any, due the defendant in view of the money it had paid out and appropriate decree rendered.

THOMAS et al. v. HOME MUTUAL BUILDING LOAN ASSOCIATION et al.

1910, 243 Ill. 550, 90 N.E. 1081.

On October 21, 1898, Grace S. Coffin executed a mortgage upon certain real estate to the Home Mutual Building Loan Association Grace S. Coffin then conveyed said premises to Henrietta Suell with a clause that upon her death it would revert back to her, and by the deed of conveyance the grantee, Suell, "assumes all encumbrances which are now of record against said property." Suell died and this suit is an action to collect the amount of the mortgage as a claim against the estate of Suell, as against subsequent grantees from Coffin who took title by reversion.

Cook, J. . . . By the terms of the deed from Mrs. Coffin, Mrs. Suell, the grantee, assumed all encumbrances which were then of record against the property. That was part of the consideration for the conveyance. Where a grantee in a deed assumes an encumbrance upon the property conveyed, using the langauge contained in the deed from Mrs. Coffin to Mrs. Suell, the effect of the word "assumes" is the same as though the parties had instead used the expression "assumes and agrees to pay," and imposes a personal liability upon the grantee to pay the encumbrance in question. . . . When Henrietta Suell accepted this deed from her daughter she not only became personally liable to pay the encumbrance held by the Building Loan Association as a part of the consideration of the deed, but as between herself and her daughter, she became the principal debtor. Had Mrs. Coffin retained title to this land after the death of Mrs. Suell, she would have had the right to compel the estate of her mother to pay the judgment. . . . The rights of Mrs. Hammond, as grantee of Mrs. Coffin, were no less. Until the pay-

ment of the claim of the association by the estate of Mrs. Suell, the association had the right to foreclose its mortgage and subject the real estate to its payment.

KALEN v. GELDERMAN et al.

1938, 66 S.D. 53, 278 N.W. 165.

Suit to collect a note and to foreclose a mortgage which secured the note. The negotiable note had been negotiated to the plaintiff and the mortgage assigned to him without a record of the assignment being made. The amount of the indebtedness was paid to a former holder of the note, who insisted that the note had been lost, and the mortgage was released of record by him. A new loan was then made to the owner by one of the defendants, who accepted a mortgage on the premises involved as security for the new loan.

RUDOLPH, J. . . . It is established by the great weight of authority that, "in the absence of statute to the contrary, the assignee of a mortgage securing a negotiable instrument need not record his assignment in order to invalidate payments made by the mortgagor or others to the mortgagee, even though the recording laws provide for the recordation of assignments of mortgages, and in making payment the payor relies on the mortgage at his peril." See 89 A. L. R. 193, and the cases there cited. In this state it is held that a mortgage is merely an incident of the debt it secures, and that a transfer of the debt secured by a mortgage carries with it the security. . . .

We are convinced that the recording acts have no effect upon the payment in so far as the Geldermans are concerned. The Geldermans relied upon the statements of Jessie Langman that she had lost the note, and their reliance was misplaced. It was for them, under the well established rule, to pay the note to the legal owner and holder at the time of such payment, and payment to another person not in possession thereof is not binding.

It is further well established by authority, that, "where a release or satisfaction of a mortgage has been entered of record by the original mortgagee, or the mortgage has been canceled, a subsequent purchaser or mortgagee for value and without notice of the assignment will be protected against the lien of a prior unrecorded assignment of the mortgage. . . ." Was the Federal Farm Mortgagee Corporation a subsequent mortgagee for value without notice of the assignment within the rule above announced? We are convinced that it was not. . . . This defendant was advised by the Costello Company before sending its bonds to New York that the Costello Company had been unable to obtain the note which the bonds were

to satisfy. The mortgage company clearly had within its power after receiving this information the right to refuse to send these bonds to Langman at New York until such outstanding note was produced.

[Judgment of the lower court for the defendant was reversed.]

Chapter III
LANDLORD AND TENANT

THOMPSON v. BAXTER

1909, 107 Minn. 122, 119 N.W. 797.

Brown, J. . . . It appears that plaintiff is the owner of the premises; that she acquired title thereto by purchase from a former owner who had heretofore entered into a contract by which he leased the premises to the defendant at an agreed monthly rent of $22; and plaintiff's title is subject to all rights that became vested in defendant thereby. The lease . . . contained the following stipulation: "To have and to hold the above rented premises unto the said party of the second part (the tenant) for the full term of which he shall wish to live in Albert Lea from and after the first day of December 1904." The only question involved under the stipulation is the construction of its provisions of the lease. Defendant has at all times paid the rent as it became due; . . . plaintiff contends that the lease created either a tenancy at will, at sufferance, or from month to month, and that plaintiff could terminate the same at any time by proper notice. The trial court held in harmony with the defendant's contention that the contract created a life estate in defendant terminable only at his death or removal from Albert Lea. . . .

A determination of the question presented involves the construction of the lease and a brief examination of some of the principles of law applicable to tenancies at will, at sufferance, from month to month, and life estates. . . .

Tenancies at will may be created by express words or they may arise by implication of law. Where created by express contract the writing necessarily so indicates and reserves the right of termination to either party, as where the lease provides that the tenant shall occupy the premises so long as agreeable to both parties. . . . Such tenancies arise by implication of law where no definite time is stated in the contract, or where the tenant enters into possession under an agreement to execute a contract for a specific term and he subsequently refuses to do so or one who enters under a void lease, or where he holds over pending negotiations for a new lease. The chief characteristics of this form of tenancy are (1) uncertainty respecting the term; (2) the right of either party to terminate it by proper notice. . . . He is called a tenant at will "because he hath no certain or sure estate for the lessor may put him out at any time it pleases him." A tenancy at sufferance arises where the tenant

wrongfully holds over after the expiration of his term, differing from the tenancy at will, where the possession is by the permission of the landlord. . . . A tenancy from month to month or year to year arises where no definite time is agreed upon and the rent is fixed at so much per year or month as the case may be and is terminable at the expiration of any period for which the rent has been paid. . . .

From these general principles of law of tenancy, it is quite clear that the lease under consideration does not come under either class mentioned. . . .

The trial court properly held that it vested in defendant a life estate terminable only at his death or his removal from Albert Lea.

WALSH v. SCHMIDT

1910, 206 Mass. 405, 92 N.E. 496.

KNOWLTON, C. J. This is an action of tort to recover for personal injuries received by the plaintiff while standing on a chair on a porch at rear of a dwelling house, washing a window. One leg of the chair broke through the floor near the wall of the building and the plaintiff fell. The defendant was the owner of the house which the plaintiff's husband occupied as his tenant. The declaration is for negligence of the defendant in allowing the floor to become rotten and defective. The plaintiff, her husband, and his family had lived in the house about five months at the time of the accident. . . .

It is plain that there was no implied contract or duty on the part of the defendant to keep the premises in a safe condition while they were in the possession of the tenant. . . . There was no allegation or evidence that there was any fraud on the part of the defendant or any liability for the concealment of a dangerous condition of which he had knowledge. . . . There was no implied warranty that the house or piazza floor was safe and fit for occupancy at the time of letting. . . .

The floor was open to inspection from below as well as from above. Neither the plaintiff nor her husband ever complained to the defendant of the condition of the floor. . . .

We are of the opinion that the jury were not warranted in finding that there was an express warranty of soundness and strength of every part of the house including the floor of the piazza.

PETZ v. VOIGT BREWING CO.

1898, 16 Mich. 418, 74 N.W. 651.

This is an action by the landlord to recover rent. The defendant defends upon the theory that he has a right to set off money ex-

pended for repairs against the rent and that said rent should be abated during the period for repair. The premises were occupied for a restaurant and dwelling and the lease contained a covenant that the tenant should keep the premises in good repair and at the expiration of the term deliver up the same in like condition when taking, reasonable use and wear thereof excepted. There was no agreement on the part of the lessor to repair. The tenant occupied the premises for several years, and at the time of the trial contended that the premises were unfit for occupation.

LONG, J. . . . It is well settled that the landlord, in the absence of covenants on his part, is not required to repair, even when the premises become defective by reason of deterioration or decay. . . . Rent is payable even when demised premises have become untenantable by inherent defect, provided they were habitable at the time of the demise and there being no fraud on the part of the landlord.

In the present case it appeared that the defendant had occupied these premises for many years. . . . If the premises were then out of repair he had as much knowledge of it as the plaintiff. . . . There being no agreement in the lease that the lessor could make repairs, the lessee would be liable for rent even if the lessor did make them, unless there was an agreement that the rent should not continue during that time. . . . The case is not like Leonard v. Armstrong, 73 Mich. 577, 41 N.W. 695. There the unhealthy condition of the premises existed when the tenant entered. In the present case the jury found that the defects which required the rebuilding of the wall, etc., were made necessary by the uses and changes in the building during the time the defendant had control. . . . Clearly the entry of the plaintiff with the defendant's consent to make these repairs under these circumstances was not an eviction of the premises.

WHELLKIN COAT CO. v. LONG BRANCH TRUST CO.

1938, 121 N.J.L. 106, 1 A.(2) 394.

This was an action to recover for damages occasioned to certain furs which had been placed with a tenant of the defendant for treatment. The tenant had rented only a portion of the building, the defendant having retained control over common passageways and the roof. The goods were damaged as a result of a leaky roof.

PARKER, J. . . . The general theory of recovery was, of course, based upon the proposition that Silberstein, as a tenant doing business as a treater of furs, received the property of the Coat Company in the normal course of his business; that this property was law-

fully on the premises and as of right and not by mere license; that it was the duty of the owner of the building to exercise reasonable care to see to it that the roof was kept in reasonable repair, not only as regards the safety of persons, but also as respects property lawfully there; that that duty was not performed and that the damage resulted in consequence. We think that this theory is supported by a long line of cases. . . . We do not think that it is claimed by appellant that this rule is confined merely to persons and does not apply to property, but if such claim is made, we think it is without substance. . . .

The second point reads as follows: "The Court should have granted the motion for a non-suit on plaintiff's opening, it appearing that there was no contractual relation between the defendant and the Whellkin Coat Company, and no duty owed to the Whellkin Coat Company, Inc., by defendant, the Whellkin Coat Company having been simply a bailor in placing their goods in the hands of George Silberstein for processing."

As to this point we are unable to see that any contractual relation between the plaintiff and the defendant was necessary any more than a contractual relation would be necessary in a case where a visitor to a tenant in a tenement house sustains injury because of the defective condition of a staircase. Such cases are an every day matter. The furs were on the premises in the course of Silberstein's legitimate business and were therefore in that place by invitation in the legal sense of the term.

Judgment for plaintiff affirmed.

HADDEN v. KNICKERBOCKER

1873, 70 Ill. 677, 22 Am. Rep. 80.

Randall was a tenant of appellant Hadden and was in arrears for rent of premises occupied by him. The landlord issued his warrant and placed it in the hands of Graves to be executed. After the warrant was issued, but before it was levied, Knickerbocker claims to have purchased the property in controversy from Randall and to have taken it into his possession. The property was taken from the possession of Knickerbocker under a distress warrant. Knickerbocker seeks to recover the goods.

Scott, J. . . . The record presents the direct question whether the landlord had a lien upon the property after it had been removed from the demised premises, which he could enforce against bona fide purchasers.

At common law, a distress for rent had to be made upon the demised premises, and the right of the landlord to distrain termi-

nated with the removal of the goods. . . . Even the goods of a stranger if found upon the demised premises might be seized. In this respect the common law has been enlarged and modified by the provisions of our statute. By our laws the landlord may distrain the goods of the tenant anywhere the same may be found in the county, where the demised premises are situated, but not the goods of a stranger, although found on the premises. This provision of the statute, however, has exclusive reference to the property of the tenant. . . . Hence, this statute cannot be so construed as to authorize the landlord to distrain property in the hands of a stranger, although he may have purchased it of the tenant.

The lien of the landlord was superior to all junior liens, so long as the property remained upon the premises occupied by the tenant, but could not prevail against any prior liens or over the right of bona fide purchasers after the property had been removed. . . . A lien is expressly given to landlords by statute upon crops growing or grown upon the demised premises in any year for the rent that shall accrue during the current year (R.S. 1845, p. 355, Sec. 8). But no specific lien is created or given as to other property of the tenant.

In the case at bar the property purchased had been removed from the demised premises prior to the levy of the distress warrant. . . . The property had been sold and removed by the consent of the tenant and the right to distrain did not exist even at common law or by any provision of our statute.

MECHANICS' LIEN LAWS

HIGHTOWER v. BAILEY et al.

1900, 108 Ky. 198, 56 S.W. 147.

This was a petition to establish a mechanic's lien on premises owned by Walling & Co. Walling & Co. entered into a contract with Bailey & Koerner for the construction of a grain elevator. Bailey & Koerner purchased needed lumber from H. W. Clark, who in turn purchased lumber from Hightower to fill the needs of the contractors.

HAZELRIGG, C. J. . . . While the case seems to have been heard below on the theory that Clark was a subcontractor, and Hightower a materialman, within the meaning of the statute, the pleadings do not sustain such theory. Hightower is a lumberman and furnished materials, it is true, but he furnished them to Clark, another materialman. . . . Clark and Hightower were both materialmen, but the statute does not give a lien to a materialman who furnishes materials to another materialman.

The materials for which the statute gives a lien are those which are furnished to an owner, a contractor, a subcontractor, an architect, or an authorized agent. We cannot extend the statute beyond its plain language and evident meaning. The hardships to owners are apt to be considerable, even under the terms of the statute. If the right to the liens could be extended beyond the terms, then it could be extended indefinitely, and there would be no safety in contracting for the erection of a building. The statute so extended would be impractical. . . .

A strict application of this rule should be made in this case, because it appears from the plaintiff's pleadings that when he shipped the first lumber to Clark he did not know for what particular purpose or for whose building the lumber was intended, and he could not, therefore, have sold it on the credit of the building of Walling & Co., to be erected, but trusted alone in Clark's credit. It was a simple and ordinary sale of lumber merchant to another like merchant, and apparently on the sole credit of the purchasing merchant.

MOORHEAD LUMBER CO. v. REMINGTON

1925, 165 Minn. 411, 206 N.W. 653.

This was an action by the plaintiff to foreclose a lien for materials furnished to a packing company. The packing plant was located

upon ground leased from the Great Northern Railway and was held subject to a certain chattel mortgage. Objection was also raised to the time of filing the lien. It was filed within the proper time if the last delivery of material is to be included. This particular material was used in repairing a silo which was situated near the packing plant, although the materialman delivered it to the plant and thought it was to be used in improving the plant.

Holt, J. Plaintiff's manager testified that all the material was furnished and delivered on the premises for the addition contemplated to be made, when, in the spring, the packing company requested plaintiff to furnish the materials needed for the erection of the addition. . . . The materials ordered and furnished on the last-mentioned date were suitable for the construction of such a frame addition as was built and plaintiff's manager did not know that the same or any part thereof was used or was intended to be used on the silo. All of the materials were furnished upon an open running account for the construction of the addition. Other decisions are decisive on this point in favor of the plaintiff. . . .

No doubt the leasehold interest of the packing company in the premises was subject to a mechanic's lien as real estate. . . . The structures, including the addition in question, were real estate and not personal property. . . . It follows that the land with the buildings erected thereon, being to all intents and purposes real estate, plaintiff was not bound by constructive notice of encumbrances placed thereon by the packing company unless the same were recorded in the mode prescribed for the recording of real estate conveyances and mortgages.

Judgment for plaintiff.

KNICKERBOCKER ICE CO. v. HALSEY BROS. CO.

1913, 178 Ill. App. 629.

This was a bill to enforce a mechanic's lien. The premises were owned by Halsey Bros. Co. Material was furnished by the plaintiff to one Mueller, a mason contractor engaged in improving the defendant's property. At one time the owner obtained a sworn statement from the contractor which showed $150 due and $1,400 later to become due the plaintiff. A subsequent sworn statement indicated only $900 to become due the plaintiff. The defendant then paid to Mueller the full contract price with the exception of the $900. The sworn statement was incorrect and plaintiff claims a lien for $1,400.

Smith, J. . . . It is the contention of the appellant that under this section "the owner is to take one statement from the contractor

and is to retain at all times the amounts shown thereby to be due or to become due the contractor." . . . We are of the opinion that it makes no such limitation, and, unless the owner has received notice from the subcontractor of his claim, as provided by the act, or unless the owner has notice that a sworn statement made to him by the contractor is false, he may rely thereon without investigation of the truth thereof, and be protected thereunder as provided in said act. In the ordinary course of business, contracts are frequently modified, and it seems to us that, where a subcontractor gives no notice of his claim to the owner, he thereby indicates his reliance upon the truth of the contractor's sworn statements to the owner, and should not complain if the owner relies thereon; and if the owner, without notice from the subcontractor and in good faith, relies and acts upon the sworn statements of the contractor, and by reason of the false statements therein fails to retain in his hands a sufficient sum to meet the subcontractor's claim, the subcontractor and not the owner should bear the loss, if any, or look to the contractor for the payment of the balance due on his claim.

Book VIII

TRADE REGULATIONS

CHAPTER I

GOVERNMENT AND BUSINESS FREEDOM

STATE EX REL. v. FARMERS UNION CREAMERY

1938, 160 Or. 205, (84 P.(2d) 471).

BAILEY, J. This suit was instituted . . . against Farmers Union Cooperative Creamery, a corporation of Sheridan, Oregon, to restrain the defendant from

"(1) Buying or receiving from the producers thereof any cream for any commercial use or purpose until such time as the defendant shall (a) maintain at each creamery, receiving station or other place where such cream is received, a cream grader duly licensed as such under chapter 279, Oregon Laws 1937, and qualified to grade cream in accordance with the official grades and standards established by the state department of agriculture pursuant to said chapter 279, and (b) post and keep posted in a conspicuous place at each creamery or other place where cream is received by or for it the price differential between the grades of cream received by it; and

"(2) Making or maintaining to the producers of different grades of cream bought or received from such producers for any commercial use or purpose the same price per pound of butterfat content."

From a decree granting to the plaintiff the full relief prayed for in the complaint except costs and disbursements, the defendant has appealed.

Chapter 279, Oregon Laws 1937, provides that the state department of agriculture shall establish official grades and standards of quality and condition applicable to all milk and cream, except milk and sweet cream sold in fluid form for human consumption, purchased or obtained from the producer thereof for any commercial use or purpose. It further provides that any person who shall buy or receive any such milk or cream from the producer thereof shall cause the same to be graded at the time and place of receiving it, by a competent grader or graders employed by the person buying or receiving the milk or cream, who shall be licensed as such grader or graders by the state department of agriculture. . . .

It is the contention of the defendant that the provisions of this act which require the employment of licensed graders, the grading of milk and cream and the keeping of records of such grading are unconstitutional and void as applied to the defendant's operations, in that the act forces the defendant to pay out "large sums of money therefor, without any resulting benefit to it or to the public in gen-

eral, thus amounting to taking" its property without due process of law, in contravention of the fourteenth amendment of the constitution of the United States. The defendant further argues that that part of the law which requires the payment of a price differential of at least one cent per pound of butterfat content between different grades of milk and cream is likewise unconstitutional, for the reason that it interferes with and impairs the obligation of contracts between the defendant and its members and patrons, by preventing the defendant and its members and patrons from returning to such members and patrons the exact amount which it has agreed and covenanted to return, in direct conflict with section 10 of article I of the constitution of the United States and section 21 of article I of the constitution of the state of Oregon. . . .

The plaintiff argues that the state of Oregon has an inherent right under its police power to enact and enforce this legislation, and in support of this contention many authorities are cited which uphold legislation enacted in the public interest even though such law or laws may interfere with individuals' rights to contract.

In referring to the police power of a state, the supreme court of the United States in Nebbia v. New York, 291 U.S. 502 (78 L. Ed. 940, 54 S.Ct. 505, 89 A.L.R. 1469), observed:

"Under our form of government the use of property and the making of contracts are normally matters of private and not of public concern. The general rule is that both shall be free of governmental interference. But neither property rights nor contract rights are absolute; for government can not exist if the citizen may at will use his property to the detriment of his fellows, or exercise his freedom of contract to work them harm. Equally fundamental with the private right is that of the public to regulate it in the common interest." . . .

The production of milk is one of the chief industries of this state. It not only affects the health and welfare of the people, but has a direct bearing on the economic condition and general prosperity of Oregon.

In the case at bar there is evidence to the effect that the grading of cream and milk and the payment of a price differential according to grade have a tendency to raise the standards of milk and cream. There is further evidence to the effect that better grades of cream will produce better grades of butter and that when butter of better grade is produced the consumption of butter is increased within this state and the demand for it from outside the state rises. . . .

11. The act assailed deals with an industry subject to regulation in the common interest. It is neither arbitrary, unreasonable nor discriminatory. It does not appear to have been enacted to accom-

plish any ulterior or improper purpose. In our opinion, chapter 279, Oregon Laws 1937, is constitutional, and therefore the decree appealed from is affirmed.

CLARK et al. v. NEEDHAM et al.

1900, 125 Mich. 84, 83 N.W. 1027.

Action by George D. Clark and William L. Cowles against Alvin W. Needham and others for the collection of rent. Verdict for defendants, and plaintiffs appeal.

Plaintiffs are copartners carrying on a manufacturing business in Connecticut. One portion of their business was the manufacture of chaplets, which consist of pieces of wire and a plate riveted to the ends to support cores in castings. The defendants are copartners carrying on a like business in Michigan, at Detroit. Negotiations were entered into between the parties to induce plaintiffs to cease the manufacture of these chaplets. These negotiations culminated on November 4, 1897, in two leases, so called. The first stipulated that the plaintiff should lease their plant and equipment to the defendant at an annual rental of $1,500. It was further agreed that the plaintiff, with a single exception, was to refrain from the manufacture of chaplets. The second agreement provided that, for the consideration of one dollar, the defendant should lease the plant and equipment back to the plaintiff for use of any kind except the manufacture of chaplets.

Grant, J. [After stating the facts.] These two instruments constitute but one instrument, and must be construed together. Briefly stated, the agreement is this: Plaintiffs, in consideration of $1,500, to be paid to them annually, agreed for a period of five years not to manufacture or sell chaplets, except for only one party. Plaintiffs' sales were not limited to the place of manufacture, but extended into other states. The plain object of the agreement was to substantially close this part of plaintiffs' business, and to give defendants a monopoly of it. The parties evidently recognized the invalidity of such a contract, put in plain and unequivocal language, and sought to evade it by these two so-called leases. The arrangement was a bare subterfuge to evade the law. Defendants did not buy out plaintiffs' business machinery, and plant, or lease them for the purpose of continuing their (plaintiffs') business. The result intended and accomplished was to close that part of plaintiffs' business, to throw their employees out of employment, and to deprive the public of any benefit from the continuance of their business. This is not the case of Beal v. Chase, 31 Mich. 490, where Beal purchased the entire plant, business, and good will of Chase for

the purpose of continuing the same business. In that case both the employees and the public derived the same benefit as though the business were to be continued by Chase.

The learned counsel for plaintiffs concede the invalidity of those contracts which are entered into for the express purpose of, and result in, closing one's business for the benefit of a rival business, in throwing employees out of employment, and in depriving the public of the benefit of such business. Such contracts tend to destroy competition and create monopolies, and are void. Plaintiffs, however, seek to avoid the result of this contract on the ground that it is not in general restraint of trade, but is limited as to time and subject-matter. They concede that it is unlimited as to territory, and that the contract, if binding, covers the entire United States. . . .

This contract is clearly within the inhibition of the laws of the United States (26 Stat. 209, c. 647) and the laws of this state (Comp. Laws, Sec. 11, 377). We settled the principle governing contracts of this character in Association v. Starkey, 84 Mich. 76, 47 N.W. 604, and further discussion is unnecessary. Judgment affirmed. The other justices concur.

UNITED STATES v. GENERAL ELECTRIC CO.

1926, 272 U.S. 476, 47 Sup. Ct. 192.

TAFT, C. J. This is a bill in equity brought by the United States in the District Court for the Northern District of Ohio to enjoin the General Electric Company, the Westinghouse Electric and Manufacturing Company, and the Westinghouse Lamp Company from further violation of the [Sherman] Anti-Trust Act. The bill made two charges, one that the General Electric Company in its business of making and selling incandescent electric lights had devised and was carrying out a plan for their distribution throughout the United States by a number of so-called agents, exceeding 21,000, to restrain interstate trade in such lamps and to exercise a monopoly of the sale thereof. . . .

The Government alleged that the system of distribution adopted was merely a device to enable the Electric Company to fix the resale prices of lamps in the hands of purchasers, that the so-called agents were in fact wholesale and retail merchants, and the lamps passed through the ordinary channels of commerce in the ordinary way, and that the restraint was the same and just as unlawful as if the so-called agents were avowed purchasers handling the lamps under resale price agreements. The Electric Company answered that its distributors were bona fide agents, that it had the legal right to market its lamps and pass them directly to the consumer by such

agents, and at prices and by a system prescribed by it and agreed upon between it and its agents, there being no limitation sought as to resale prices upon those who purchased from such agents. . . .

The question is whether, in view of the arrangements made by the company with those who ordinarily and usually would be merchants buying from the manufacturer and selling to the public—such persons are to be treated as agents, or as owners of the lamps consigned to them under such contracts. If they are to be regarded really as purchasers, then the restriction as to the prices at which the sales are to be made is a restraint of trade and a violation of the Anti-Trust law. . . .

But it is said that the system of distribution is so complicated and involves such a very large number of agents, distributed throughout the entire country, that the very size and comprehensiveness of the scheme brings it within the Anti-Trust law. We do not question that in a suit under the Anti-Trust Act the circumstance that the combination effected secures domination of so large a part of the business affected as to control prices is usually most important in proof of a monopoly violating the Act. But under the patent law the patentee is given by statute a monopoly of making, using and selling the patented article. The extent of his monopoly in the articles sold and in the territory of the United States where sold is not limited in the grant of his patent, and the comprehensiveness of his control of the business in the sale of the patented article is not necessarily an indication of illegality of his method. . . .

We are of opinion, therefore, that there is nothing as a matter of principle, or in the authorities, which requires us to hold that genuine contracts of agency like those before us, however comprehensive as a mass or whole in their effect, are violations of the Anti-Trust Act. The owner of an article, patented or otherwise, is not violating the common law, or the Anti-Trust law, by seeking to dispose of his article directly to the consumer and fixing the price by which his agents transfer the title from him directly to such consumer.

Judgment for defendant.

BRECHER v. BROWN

1945, 235 Iowa 627, 17 N.W.(2) 377.

SMITH, J. On March 25, 1943, the parties hereto executed a written agreement by which plaintiff employed defendant as a "veterinary assistant" in Storm Lake, Iowa, "for an indefinite period of time" at a salary of $200 per month "until changed by further agreement."

. . . It is further stipulated and agreed that upon the termination of Second Party's employment by First Party that the Second Party will not engage in the practice of veterinary medicine or surgery, or any competing business to that of First Party, in Storm Lake, Iowa, or a territory within a radius of twenty-five miles of Storm Lake, Iowa, without the express written consent of First Party.

Both parties were licensed veterinarians, plaintiff with an established practice of some ten or eleven years in that vicinity and defendant recently admitted to practice. Plaintiff also has a veterinary hospital in connection with his practice.

They operated under the agreement until December 29, 1943, when defendant quit and soon thereafter opened a veterinary office and hospital about one hundred feet from plaintiff's and engaged in practice for himself. This suit is brought by plaintiff to enjoin defendant "from the practice of veterinary medicine and surgery . . . and the operation of a veterinary hospital at Storm Lake, Iowa." The trial court denied the relief asked and plaintiff appeals.

The facts are not materially in dispute. . . .

Appellant testified that his most remote clients were: one southeast of Storm Lake, twenty-six miles; one northeast, twenty-one miles; one northwest, twenty-two or twenty-three miles; and that his practice extended west of Alta and south and southwest, about fifteen miles. He said he expected to extend the area of his practice in the future.

Appellant argues but one proposition, viz., that the trial court erred in holding the contract unenforceable as against public policy on the ground that the restrictions therein were unreasonable. That is the ultimate and only question for our decision. . . .

In the Restatement of the Law of Contracts, § 515, the rule, so far as is pertinent here, is said to be: "A restraint of trade is unreasonable, in the absence of statutory authorization or dominant social or economic justification, if it (a) is greater than is required for the protection of the person for whose benefit the restraint is imposed or (b) imposes undue hardship upon the person restricted, or (c) tends to create, or has for its purpose to create, a monopoly . . . or . . . (e) is based on a promise to refrain from competition and is not ancillary either to a contract for the transfer of good will or other subject of property or to an existing employment or contract of employment."

. . . In arriving at this modern rule the older and more rigid tests, making the consideration of time and space conclusive according to certain formulas, have been rejected or at least not so rigorously applied. See 17 C.J.S., Contracts, § 246. However, we

still find them helpful in appraising the elusive quality of reasonableness. Under earlier decisions the courts held that restrictions unlimited as to both time and space were invalid, those limited as to time but unlimited as to space were also held invalid, while those limited as to space but unlimited as to time and those limited as to both time and space were ordinarily upheld. See discussion in 17 C.J.S., Contracts, §§ 241-245.

. . . We have only to inquire as to the reasonableness of the restriction as a protection to appellant's rights and as a limitation upon appellee's. We are constrained to agree with the trial court that the area attempted to be reserved by appellant is much greater than reasonably necessary to his protection. The fact that he has a patron twenty-six miles away and others somewhat less remote does not fix the area of his practice as a circle with a twenty-five mile radius. The plat produced by appellee shows that such a circle would take in parts of every county adjoining Buena Vista County and would include county seats of at least three of the adjoining counties. As pointed out by the "Findings" of the court it would include "an area larger than Buena Vista County and so far from Storm Lake that it could not possibly be served by plaintiff, unless he is entitled by taking in partners or employing a number of veterinarians to establish a clientage there. . . .

Our judgment is in accord with that of the trial court. The restriction is not reasonably limited to the protection of appellant's interests and by the same token would impose undue hardship upon appellee and is accordingly against public policy. . . .

Affirmed.

WITTENBERG et al. v. MOLLYNEAUX

1900, 60 Neb. 583, 83 N.W. 842.

Action by John T. Mollyneaux against Marcus Wittenberg and others. Judgment for plaintiff, and defendants bring error.

SULLIVAN, J. John T. Mollyneaux brought this action in the district court to recover damages of Marcus Wittenberg and his codefendants for breach of a covenant contained in a deed of conveyance. In June, 1889, the plaintiff was the owner of a hotel in the city of Sutton, and the defendants were at the same time the owners of another hotel in the same city. The parties agreed to exchange their properties, and the agreement was carried into execution. The conveyance made by Mollyneaux to the defendants provided that the premises therein described should not be used for hotel purposes for a period of two years. The petition alleges that this stipulation has been violated, and that the plaintiff has been damaged

thereby. Issues were joined by the filing of an answer and reply. The cause was tried by a jury, and, there having been a verdict and judgment for the plaintiff, the defendants bring the record here for review, alleging error in the admission and exclusion of evidence, and in the giving and refusal of instructions.

Many of the rulings assigned for error assume that the covenant upon which the action is grounded is valid and enforceable. This position is resolutely assailed by counsel for the defendants. They contend that, there being only two hotels in Sutton, the closing of one would give the owner of the other a monopoly, and that such a result would be prejudicial to the interests of the traveling public, and contrary to the policy of the state. We think the restriction upon the use of defendants' property was not unlawful. Contracts which impose unreasonable restraints upon the exercise of any business, trade, or profession are said to contravene sound public policy; but partial restraints are not deemed to be unreasonable when they are ancillary to an actual purchase of property, made in good faith, and are apparently necessary to afford fair protection to the purchaser. Although such agreements tend to suppress competition, and bring about conditions favorable to the creation of monopolies, they are in harmony with the policy of the state, which is to promote commerce by facilitating the sale and transfer of property. Of course, if it be shown that the main purpose of the agreement is to secure a monopoly, and that the purchase of the property was a mere incident or means to that end, it is within the rule applicable to ordinary combinations in restraint of trade, and will not be enforced. . . .

The defendants in this case, notwithstanding the contract in question, were at liberty to engage in the hotel business at Sutton. So was any one else who might choose to do so. And the business might be established and carried on anywhere within the corporate limits except upon the premises formerly owned by Mollyneaux. Under these circumstances, it would seem that the public interests were not formidably threatened by the restrictive covenant, which was doubtless designed to secure to the plaintiff the patronage of his old customers. . . .

The plaintiff undertook to prove his damages by showing loss of patronage resulting from the operation of the hotel conveyed by him to the defendants. The evidence offered for that purpose was the best attainable under the circumstances, and was of the same character as that recognized as competent in Wittenberg v. Mollyneaux, 55 Neb. 429, 75 N.W. 835, and Wittenberg v. Mollyneaux, 59 Neb. 203, 80 N.W. 824. Feeling entirely satisfied with the views entertained by the court when these decisions were made, we will

not enter upon a reexamination of the question at this time. That a party may recover for gains prevented, as well as for losses sustained, when such damages are not only the certain, but the natural and probable, result of the wrong complained of, is a point no longer open to dispute in this state.

Affirmed.

NEWELL v. MEYENDORFF

1890, 9 Mont. 254, 23 Pac. 333.

De Witt, J. The complaint is for the price of cigars sold and delivered by plaintiffs to defendant. Defendant answered, and admitted the sale and delivery, and set up in recoupment a contract, the terms of which were, generally, that in 1886 he was dealing in cigars; that plaintiffs approached him to sell their "Flor de B. Garcia Cigars," agreeing that defendant should have the sole and exclusive right of selling, handling and dealing in said cigars in Montana; that plaintiffs would not sell said cigars to any one else in the territory; that defendant would cease advertising and selling various other valuable brands of cigars in which he was dealing, and from the sale of which he was deriving much profit; that he would accept said sole agency, would purchase said brand of cigars from plaintiffs, and would introduce and promote the sale thereof to the best of his ability. The answer further alleges, in detail, the performance by defendant of his part of the contract, and the expenditure of large sums of money in placing said cigars upon the market. Then follows the allegation of breach by plaintiffs, in that they sold the said brand of cigars to other dealers in the territory, by which breach the defendant suffered great damage in his business, which damage he recoups against the plaintiff's account for the cigars sold. The court below sustained a demurrer to this answer, on the ground that the contract pleaded was void, as against public policy, being in restraint of trade, and could not be pleaded in recoupment. . . .

We will first construe the contract as to whether it must be considered void as in restraint of trade. The rule that contracts that are in restraint of trade shall be void, as against public policy, is among our most ancient common law inheritances. . . . A recitation alone, of the rule and its reasons, seems to us sufficient to take the contract under consideration out of the operation of its prohibitions. The contract is not general; it is limited as to place and person. The public is not deprived of the alleged restricted party's industry. On the contrary, the contract provides for the placing upon the Montana market the product of the plaintiffs' industry, by the selection and services of a local Montana agent, interested in the

success of sales, and to be rewarded by such success. Nor is there any injury to the party himself, the plaintiffs, by their being precluded from pursuing their occupation. Rather, by the contract, they seem to have sought a means of extending the field of their operations, and not of restricting them. In the light of the authorities, the rule and the reasons therefor, and the facts, we are clearly of the opinion that the contract was not in restraint of trade, and not void. It was simply a contract, for a consideration, for the enlistment of the services of an agent for the plaintiffs in their business. . . .

Judgment for defendant.

STANDARD FASHION CO. v. MAGRANE-HOUSTON CO.

1922, 258 U.S. 346.

Day, J. Petitioner brought suit in the United States District Court for the District of Massachusetts to restrain the respondent from violating a certain contract concerning the sale of patterns for garments worn by women and children, called Standard Patterns. The bill was dismissed by the District Court and its decree was affirmed by the Circuit Court of Appeals. 259 Fed. 793. (The case is here on certiorari.)

Petitioner is a New York corporation engaged in the manufacture and distribution of patterns. Respondent conducted a retail dry goods business at the corner of Washington Street and Temple Place in the City of Boston. On November 25, 1914, the parties entered into a contract by which the petitioner granted to the respondent an agency for the sale of Standard Patterns at respondent's store, for a term of two years from the date of the contract, and from term to term thereafter until the agreement should be terminated as thereinafter provided. Petitioner agreed to sell to respondent Standard Patterns at a discount of 50 per cent from retail prices, with advertising matter and publications upon terms stated; and to allow respondent to return discarded patterns semiannually between January 15th and February 15th, and July 15th and August 15th. . . . Respondent agreed not to assign or transfer the agency, or to remove it from its original location without the written consent of the petitioner, and not to sell or permit to be sold on its premises during the term of the contract any other make of patterns, and not to sell Standard Patterns except at label prices. Respondent agreed to permit petitioner to take account of pattern stock whenever it desired, to pay proper attention to the sale of

Standard Patterns, to conserve the best interests of the agency at all times, and to reorder promptly as patterns were sold. . . .

. . . The real question is: Does the contract of sale come within the third section of the Clayton Act because the covenant not to sell the patterns of others "may be to substantially lessen competition or tend to create a monopoly."

The Clayton Act, as its title and the history of its enactment disclose, was intended to supplement the purpose and effect of other anti-trust legislation, principally the Sherman Act of 1890. The latter act had been interpreted by this court to apply to contracts, combinations and conspiracies which unduly obstruct the free and natural flow of commerce . . .

The Clayton Act sought to reach the agreements embraced within its sphere in their incipiency, and in the section under consideration to determine their legality by specific tests of its own which declared illegal contracts of sale made upon the agreement or understanding that the purchaser shall not deal in the goods of a competitor or competitors of the seller, which may "substantially lessen competition or tend to create a monopoly." . . . It was intended to prevent such agreements as would under the circumstances disclosed probably lessen competition, or create an actual tendency to monopoly. That it was not intended to reach every remote lessening of competition is shown in the requirement that such lessening must be substantial.

Both courts below found that the contract interpreted in the light of the circumstances surrounding the making of it was within the provisions of the Clayton Act as one which substantially lessened competition and tended to create monopoly. These courts put special stress upon the fact found that, of 52,000 so-called pattern agencies in the entire country, the petitioner, or a holding company controlling it and two other pattern companies, approximately controlled two-fifths of such agencies. As the Circuit Court of Appeals summarizing the matter pertinently observed:

"The restriction of each merchant to one pattern manufacturer must in hundreds, perhaps in thousands, of small communities amount to giving such single pattern manufacturer a monopoly of the business in such community. Even in the larger cities, to limit to a single pattern maker the pattern business of dealers most resorted to by customers whose purchases tend to give fashions their vogue, may tend to facilitate further combinations; so that the plaintiff, or some other aggressive concern, instead of controlling two-fifths, will shortly have almost, if not quite, all the pattern business."

We agree with these conclusions, and have no doubt that the contract, properly interpreted, with its restrictive covenant, brings it fairly within the section of the Clayton Act under consideration.

Affirmed.

FEDERAL TRADE COMMISSION v. SINCLAIR REFINING COMPANY

1923, 261 U.S. 463

MR. JUSTICE MCREYNOLDS delivered the opinion of the Court.

In separate proceedings against thirty or more refiners and wholesalers, the Federal Trade Commission condemned and ordered them to abandon the practice of leasing underground tanks with pumps to retail dealers at nominal prices and upon condition that the equipment should be used only with gasoline supplied by the lessor. Four of these orders were held invalid by the circuit courts of appeals for the third and seventh circuits, . . . The proceedings, essential facts and points of law disclosed by the four records now before us are so similar that it will suffice to consider No. 213, as typical of all.

July 18, 1919, the Commission issued a complaint charging that respondent, Sinclair Refining Company, was purchasing and selling refined oil and gasoline and leasing and loaning storage tanks and pumps as part of interstate commerce in competition with numerous other concerns similarly engaged; and that it was violating both the Federal Trade Commission Act, 38 Stat. 717, and the Clayton Act, 38 Stat. 730.

The particular facts relied on to show violation of the Federal Trade Commission Act are thus alleged—

Paragraph Three. That respondent in the conduct of its business, as aforesaid, with the effect of stifling and suppressing competition in the sale of the aforesaid products and in the sale, leasing, or loaning of the aforesaid devices and other equipments for storing and handling the same, and with the effect of injuring competitors who sell such products and devices, has within the four years last past sold, leased, or loaned and now sells, leases, or loans the said devices and their equipment for prices or considerations which do not represent reasonable returns on the investments in such devices and their equipments; that many such sales, leases, or loans of the aforesaid devices are made at prices below the cost of producing and vending the same; that many of such contracts for the lease or loan of such devices and their equipments provide or are entered into with the understanding that the lessee or borrower shall not place in such devices, or use in connection with such devices and their equipments, any refined oil or gasoline of a competitor. . . .

Respondent's written contract does not undertake to limit the lessee's right to use or deal in the goods of a competitor of the lessor, but leaves him free to follow his own judgment. It is not properly described by the complaint and is not within the letter of the Clayton Act. But counsel for the Commission insist that inasmuch as lessees generally—except garage men in the larger places—will not encumber themselves with more than one equipment, the practical effect of the restrictive covenant is to confine most dealers to the products of their lessors; and we are asked to hold that, read in the light of these facts, the contract falls within the condemnation of the statute.

There is no covenant in the present contract which obligates the lessee not to sell the goods of another; and its language cannot be so construed. Neither the findings nor the evidence show circumstances similar to those surrounding the "tying" covenants of the Shoe Machinery Company. Many competitors seek to sell excellent brands of gasoline and no one of them is essential to the retail business. The lessee is free to buy wherever he chooses; he may freely accept and use as many pumps as he wishes and may discontinue any or all of them. He may carry on business as his judgment dictates and his means permit, save only that he cannot use the lessor's equipment for dispensing another's brand. By investing a comparatively small sum, he can buy an outfit and use it without hindrance. He can have respondent's gasoline, with the pump or without the pump, and many competitors seek to supply his needs.

The cases relied upon are not controlling.

Is the challenged practice an unfair method of competition within the meaning of § 5 of Federal Trade Commission Act? . . . Upon the contrary, it appears to have promoted the public convenience by inducing many small dealers to enter the business and put gasoline on sale at the crossroads. . . .

The judgments below must be affirmed.

INTERNATIONAL BUSINESS MACHINES CORP. v. UNITED STATES

1936, 298 U.S. 131.

STONE, J. This is an appeal, section 238 of the Judicial Code, from so much of a decree of a District Court for Southern New York as enjoins the appellant from leasing its tabulating and other machines upon the condition that the lessees shall use with such machines only tabulating cards manufactured by appellant, as a

violation of section 3 of the Clayton Act, 38 Stat. 731, 15 U.S.C., sec. 14. . . .

To insure satisfactory performance by appellant's machines it is necessary that the cards used in them conform to precise specifications as to size and thickness, and that they be free from defects due to slime or carbon spots, which cause unintended electrical contacts and consequent inaccurate results. The cards manufactured by appellant are electrically tested for such defects.

Appellant leases its machines for a specified rental and period, upon condition that the lease shall terminate in case any cards not manufactured by the lessor are used in the leased machine. . . .

Appellant insists that the condition of its leases is not within the prohibition of the Clayton Act, and it has assigned as error the conclusion of the district court that the condition tends to create monopoly. But its principal contentions are that its leases are lawful because the protection secured by the condition does not extend beyond the monopoly which it has acquired by patents on the cards and on the machines in which they are used, and that in any case the condition is permissible under section 3 of the Clayton Act because its purpose and effect are only to preserve to appellant the good will of its patrons by preventing the use of unsuitable cards which would interfere with the successful performance of its machines . . .

The conclusion of the trial court that appellant's leases infringe the monopoly provisions of the section does not want for support in the record. The agreed use of the "tying clause" by appellant and its only competitors, and the agreement by each of them to restrict its competition in the sale of cards to the lessees of the others, have operated to prevent competition and to create a monopoly in the production and sale of tabulating cards suitable for appellant's machines, as the district court found. The commerce in tabulating cards is substantial. Appellant makes and sells 3,000,000,000 cards annually, 81 per cent of the total, indicating that the sales by the Remington Rand company, its only competitor, representing the remaining 19 per cent, are approximately 600,000,000. . . .

But we do not place our decision on this narrow ground. We rest it rather on the language of section 3 of the Clayton Act which expressly makes tying clauses unlawful, whether the machine leased is "patented or unpatented." The section does not purport to curtail the patent monopoly of the lessor or to restrict its protection by suit for infringement. But it does in terms deny to the lessor of a patented, as well as of an unpatented machine, the benefit of any condition or agreement that the lessee shall not use the supplies of

a competitor. The only purpose or effect of the tying clause, so far as it could be effectively applied to patented articles, is either to prevent the use, by a lessee, of the product of a competitor of the lessor, where the lessor's patent, prima facie, embraces that product, and thus avoid judicial review of the patent, or else to compel its examination in every suit brought to set aside the tying clause, although the suit could usually result in no binding adjudication as to the validity of the patent, since infringement would not be in issue. The phrase "whether patented or unpatented" would seem well chosen to foreclose the possibility of either alternative.

. . . we can perceive no tenable basis for an exception in favor of a condition whose substantial benefit to the lessor is the elimination of business competition and the creation of monopoly, rather than the protection of its good will, and where it does not appear that the latter can not be achieved by methods which do not tend to monopoly and are not otherwise unlawful.

Affirmed.

REVLON NAIL ENAMEL CORPORATION v. CHARMLEY DRUG SHOP

1938, 123, N.J. Eq. 301, 197 Atl. 661.

Injunction suit under the Fair Trade Act by the Revlon Nail Enamel Corporation against the Charmley Drug Shop, in which it is sought to enjoin the defendant from selling the plaintiff's product for less than an agreed price.

BIGELOW, Vice Chancellor. This is the final hearing in a cause on the so-called Fair Trade Act, R. S. 1937, 56:4-3 to 56:4-6, N. J. Annual 1935, sec. 217-13 to 217-16. The method adopted by complainant in order to take advantage of the statute was to make a price-fixing contract with only one of the dealers retailing its product—nail polish—and then to notify the other dealers and the trade in general of the existence of that contract and the price so established.

No valid objection can be taken to this procedure. While most producers make identical price-fixing contracts with a large number of their customers, that course is unnecessary; a single valid contract is enough to put the statute in operation.

Complainant's contract was made last September with one Eckert, a beauty parlor owner. In the next three months, or until the hearing of the suit, he sold less than a dozen bottles of the nail polish. It is doubtless so, to be an effective basis for the suit, the contract must be a bona fide one. To take an example suggested by counsel, a contract establishing the resale price of nail polish

made, let us say with a lawyer, a man who does not sell or expect to sell, nail polish, would be a fraud on the statute and would not entitle complainant to relief. Eckert was, and still is, in the business of selling nail polish, abiding by the terms of the agreement. The contract with him is sufficient for the purpose of this suit.

The only other question in the cause arises out of the refusal of complainant to supply defendant with nail polish. The circumstances are these: Complainant's nail polish is sold through a wholesaler to beauty parlors where much is used and some is resold. The beauty parlors are complainant's principal outlet, but it also sells to department stores. Complainant finds that beauty parlors will not purchase its product if it is also sold by drug stores. Hence it refuses to sell to drug stores and tries to prevent them from handling its nail polish. Defendant operates a drug store, and, with two or three other druggists in Newark, obtain the product in some way unknown to the complainant.

A producer, while unfairly discriminating against a dealer, cannot obtain the aid of chancery against him. To obtain equity, one must do equity. . . . But in the present case, complainant does not discriminate against defendant. Defendant happens to belong to a class—druggists—with whom plaintiff believes it poor policy to deal, and who, it hopes will not handle its product. Complainant's refusal to sell to defendant is not inequitable. . . . It may properly adopt such general policies consistent with sound business ethics, as it is believed will promote its business. The injunction will be granted.

CHAPTER II

BUSINESS TORTS

VON BREMEN et al. v. MacMONNIES et al.

1910, 200 N.Y. 41, 93 N.E. 186, 32.

On May 10, 1904 Henry Von Bremen, and the defendants Frank MacMonnies and William Von Elm entered into a copartnership to buy and sell all sorts of fancy groceries, which copartnership by the terms of the agreement was to continue until the 30th day of April, 1909. On February 10, 1909, the defendants sold to the plaintiff Henry Von Bremen "all their right, title, and interest in all the assets, good will, trade-marks, and other property of every name and nature whatsoever and wherever located of the firm of Von Bremen, MacMonnies & Co., together with all debts and things in action due or owing by or from any person or corporation to said firm." The consideration for this transfer was the payment of $44,000, which was $1,500 more than the book value of the property transferred. There was no specific valuation of the good will.

The plaintiffs under the firm name of Von Bremen, Asche & Co., have succeeded to the business thus purchased by the plaintiff Henry Von Bremen individually. Shortly after his purchase, the defendants formed a partnership under the firm name of MacMonnies & Von Elm for the transaction of a similar business in fancy groceries. In the competition which thus arose the defendants have done or threatened to do various acts which the plaintiffs contend have a tendency to lessen or destroy the good will of the business which they acquired from the defendants by means of the transfer which has been mentioned. The present suit was brought to enjoin such acts. The trial court enjoined the defendants from using the cable address of the old firm, which was "MacMonnies"; from using a list of 2,200 dealers in fancy groceries which had been compiled by the old firm; and from using labels, brands, trade-marks, bottles, tins, and other packages, such as were exclusively owned or controlled by the old firm. The interlocutory judgment also directed an accounting for the profits realized by the defendants and an assessment of the damages sustained by the plaintiffs.

Upon their appeal to the Appellate Division, the injunction granted at Special Term was extended so as to enjoin the defendants from soliciting the agency for the sale of articles of which the old firm had the exclusive agency and from soliciting orders for

goods packed under special labels, trade-marks, and brands devised for the old firm for special customers.

BARTLETT, J. . . . The principal question presented by the plaintiffs' appeal to this court is whether the injunction should be thus extended. The answer to this question depends upon the meaning to be given to the term "good will" in the transfer of the business of the old firm of Von Bremen, MacMonnies & Co. to the plaintiff Henry Von Bremen on February 10, 1909. If the law assigns a definite meaning to the term as used or implied in the voluntary transfer of a business, it must be presumed that such was its signification in this contract. We have to inquire, then, what are the restraints which the law imposes upon the assignor of the good will of a business, who transfers the same voluntarily, and not as the result of bankruptcy proceedings or under like compulsion.

Whatever definition of good will may be adopted, however, it appears to have been uniformly held that in case of a transfer thereof, the assignor, in the absence of an express agreement to the contrary, may carry on a similar business in the same locality. The question which has given most trouble to the courts in such cases has related to the right of the vendor of the good will to solicit business from the customers of the old firm. . . .

The substance of the decision of the House of Lords in Trego v. Hunt may be briefly stated. The sale of the good will of a business, even when the vendor himself is a party to the contract, does not impose upon him any obligation to refrain from carrying on a trade of the same nature as before. The obligations imposed upon the vendor in the case of the sale of the good will are not necessarily the same under all circumstances. Lord Herschell conceded it to be the settled law that whenever the good will of a business was sold, the vendor did not, by reason only of that sale, come under a restriction not to carry on a competing business. In cases where a partnership has been dissolved by effluxion of time or death, he thought it would be absurd to hold that those who formerly constituted the firm or their survivors should be restrained from carrying on what trade they pleased. . . .

Lord Herschell deemed it immaterial to consider whether, on the sale of a good will, "the obligation on the part of the vendor to refrain from canvassing the customers is to be regarded as based on the principle that he is not entitled to depreciate that which he has sold or as arising from an implied contract to abstain from any act intended to deprive the purchaser of that which has been sold to him and to restore it to the vendor." He was satisfied that the

obligation existed and that it ought to be enforced by a court of equity. . . .

The interlocutory judgment must therefore be modified by extending the injunction so as to forbid the defendants from soliciting business from any customers of the former firm of Von Bremen, MacMonnies & Co., and as thus modified affirmed, with costs to the appellants. . . .

Affirmed.

TUTTLE v. BUCK

1909, 107 Minn. 145, 119 N.W. 946.

Action by Edward C. Tuttle against Cassius M. Buck.

For more than 10 years last past he has been and still is a barber by trade, and engaged in business as such in the village of Howard Lake, Minn., owning and operating a shop. The defendant is possessed of large means, and is a banker in the village of Howard Lake and is nowise interested in the occupation of a barber. For the sole purpose of injuring the trade of the plaintiff and of accomplishing his threats of ruining the plaintiff's business and driving him out, the defendant fitted up and furnished a barber shop in said village for conducting the trade of barbering. Failing to induce any barber to occupy said shop on his own account, the defendant has hired a barber to occupy said shop, and to serve so many of plaintiff's patrons as said defendant has been or may be able to direct from plaintiff's shop.

ELLIOTT, J. . . . To divert to one's self the customers of a business rival by the offer of goods at lower prices is in general a legitimate mode of serving one's own interest, and justifiable as fair competition. But when a man starts an opposition place of business, not for the sake of profit to himself, but regardless of loss to himself, and for the sole purpose of driving his competitor out of business, and with the intention of himself retiring upon the accomplishment of his malevolent purpose, he is guilty of a wanton wrong and an actionable tort. In such a case he would not be exercising his legal right, or doing an act which can be judged separately from the motive which actuated him. To call such conduct competition is a perversion of terms. It is simply the application of force without legal justification, which in its moral quality may be no better than highway robbery.

Nevertheless, in the opinion of the writer this complaint is insufficient. It is not claimed that it states a cause of action for slander. No question of conspiracy or combination is involved. Stripped

of the adjectives and the statement that what was done was for the sole purpose of injuring the plaintiff, and not for the purpose of serving a legitimate purpose of the defendant, the complaint states facts which in themselves amount only to an ordinary everyday business transaction. There is no allegation that the defendant was intentionally running the business at a financial loss to himself, or that after driving the plaintiff out of business the defendant closed up or intended to close up his shop. From all that appears from the complaint he may have opened the barber shop, energetically sought business from his acquaintances and the customers of the plaintiff, and as a result of his enterprise and command of capital obtained it, with the result that the plaintiff, from want of capital, acquaintance, or enterprise, was unable to stand the competition and was thus driven out of business. The facts thus alleged do not in my opinion, in themselves, without reference to the way in which they are characterized by the pleader, tend to show a malicious and wanton wrong to the plaintiff.

A majority of the Justices, however, are of the opinion that on the principle declared in the foregoing opinion, the complaint states a cause of action.

Judgment for plaintiff affirmed.

AMERICAN BANK & TRUST CO. et al v. FEDERAL RESERVE BANK OF ATLANTA, GA., et al.

1921, 256 U.S. 350, 41 Sup. Ct. 499.

Appeal from the United States Circuit Court of Appeals for the Fifth Circuit.

Suit by the American Bank & Trust Company and others against the Federal Reserve Bank of Atlanta, Ga., and others.

HOLMES, J. . . . This is a bill in equity brought by country banks incorporated by the state of Georgia against the Federal Reserve Bank of Atlanta, incorporated under the laws of the United States, and its officers. It was brought in a state court, but removed to the District Court of the United States on the petition of the defendants. A motion to remand was made by the plaintiffs but was overruled. The allegations of the bill may be summed up in comparatively few words. The plaintiffs are not members of the Federal Reserve System and many of them have too small a capital to permit their joining it—a capital that could not be increased to the required amount in the thinly populated sections of the country where they operate. An important part of the income of these small institutions is a charge for the services rendered by them in paying checks drawn upon them at a distance and forwarded, gen-

erally by other banks, through the mail. The charge covers the expense incurred by the paying bank and a small profit. The banks in the Federal Reserve System are forbidden to make such charges to other banks in the System. It is alleged that in pursuance of the policy accepted by the Federal Reserve Board the defendant bank has determined to use its power to compel the plaintiffs and others in like situation to become members of the defendant, or at least to open a nonmember clearing account with defendant, and thereby under the defendant's requirements, to make it necessary for the plaintiffs to maintain a much larger reserve than in their present condition they need. This diminution of their lending power coupled with the loss of the profit caused by the above mentioned clearing of bank checks and drafts at par will drive some of the plaintiffs out of business and diminish the income of all. To accomplish the defendants' wish they intend to accumulate checks upon the country banks until they reach a large amount and then to cause them to be presented for payment over the counter or by other devices detailed to require payment in cash in such wise as to compel the plaintiffs to maintain so much cash in their vaults as to drive them out of business or force them, if able, to submit to the defendant's scheme. . . .

A bank that receives deposits to be drawn upon by check of course authorizes its depositors to draw checks against their accounts and holders of such checks to present them for payment. When we think of the ordinary case the right of the holder is so unimpeded that it seems to us absolute. But looked at from either side it cannot be so. The interests of business also are recognized as rights, protected against injury to a greater or less extent, and in case of conflict between the claims of business on the one side, and of third persons on the other, lines have to be drawn that limit both. A man has a right to give advice but advice given for the sole purpose of injuring another's business and effective on a large scale, might create a cause of action. Banks as we know them could not exist if they could not rely upon averages and lend a large part of the money that they receive from their depositors on the assumption that not more than a certain fraction of it will be demanded on any one day. If, without a word of falsehood but acting from what we have called disinterested malevolence, a man by persuasion should organize and carry into effect a run upon a bank and ruin it, we cannot doubt that an action would lie. A similar result even if less complete in its effect is to be expected from the course that the defendants are alleged to intend, and to determine whether they are authorized to follow that course it is not enough to refer to the general right of a holder of checks to present them

but it is necessary to consider whether the collection of checks and presenting them in a body for the purpose of breaking down the petitioner's business as now conducted is justified by the ulterior purpose in view.

Decree for plaintiff.

HOPKINS CHEMICAL CO. v. READ DRUG & CHEMICAL CO.

1914, 124 Md. 210, 92 A. 478.

PATTISON, J. The appeal in this case is from the action of the Court below in sustaining the demurrer to a declaration of slander. . . . The defendant, its agent or agents . . . while endeavoring to make a sale of another article of dentrifice handled and sold by it at its store . . . falsely and maliciously spoke to one Marie E. Judge of and concerning the "A. C. Reynolds Tooth Paste" (which is manufactured by plaintiff) the following defamatory words, "that it was nothing else but grit, was very harmful to the gums and also would take the enamel off your teeth." . . .

For the injuries alleged to have been suffered by the plaintiff because of the utterance of such defamatory words, the plaintiff claimed ten thousand dollars damages. No special damage was alleged. . . .

The defamatory words were here spoken in disparagement of the quality of an article of dentifrice manufactured by plaintiff. By the law of libel and slander defamatory language is actionable without special damage when it contains an imputation upon one in respect of his office, profession, or trade. But it is not actionable at all when it is merely in disparagement of one's property or of the quality of the articles which he manufactures or sells, unless it occasions special damage. The language, however, may not only be spoken in disparagement of the property, but may also contain an imputation upon the manufacturer or vendor in respect to his trade or business in which event such words will be actionable per se. . . .

It is here said of the article of dentifrice manufactured by the plaintiff that it contained grit that would take or scratch the enamel from the teeth and other ingredients which were harmful or injurious to the gums. This language can hardly be said to attack the plaintiff or to impute to it deceit or malpractice in the manufacture of its article or dentifrice. No reference is made to the plaintiff at all. The tooth paste may have contained the ingredients the effect of which when used for cleansing the teeth, was to take the enamel therefrom or injure the gums. But this all could

be true and yet not impute to the plaintiff any deceit or malpractice in the manufacture of the article. . . .

To hold that these words contain an imputation against the plaintiff in respect of its trade or business, so as to render them actionable per se, or actionable without special damage, would be giving an unwarranted meaning to such utterances. . . .

We find no error in the ruling of the Court below in sustaining the demurrer to the declaration.

GEORGE G. FOX CO. v. HATHAWAY et al.

1908, 199 Mass. 99, 85 N.E. 417.

Bill to enjoin the defendant from unfair competition. Injunction denied by lower court.

KNOWLTON, C. J. This is a suit founded on the alleged unfair competition of the defendants, through the sale of a certain kind of bread made in imitation of bread previously manufactured and sold by the plaintiff. The plaintiff's bread is called Creamalt, and the loaves are of a size, shape, color and condition of surface that gives them a peculiar visual appearance which has come to be recognized by customers in connection with the name, as indicating the place of manufacture and the quality of the bread. . . . It appeared at the hearing that the defendants began to manufacture and sell bread in loaves of the same size, shape, color and general visual appearance as the plaintiff's, such that an ordinary purchaser, not making a careful examination would be likely to be deceived, and to buy the defendant's bread in the belief that it was the same kind that he had previously bought of the plaintiff's manufacture. . . . The evidence introduced by the plaintiff tended strongly to establish its contention that the defendants were taking advantage of the good will of its business and the demand for its bread by putting upon the market loaves similar in appearance, of their own manufacture. . . .

The principal contention of the defendants is that the use by the plaintiff of this combination of size, shape, color and condition of the surface to produce a general visual appearance for its loaf of bread, made in part of malt and milk, gives it no rights, or at least, gives it no rights against anyone who uses only this combination, without using the same or a similar name. . . .

There was nothing to show that the defendant's business interests required the combination of this shape with the same size, color, and general visual appearance that had become associated with the plaintiff's trade in this Creamalt bread.

The plaintiff had no exclusive right in any one of the features of the combination, and if the defendant had required the use of this combination for the successful prosecution of their business, they would have had a right to use it, by taking such precautions as would prevent deception of the public and interference with the plaintiff's good will. But the evidence shows that the defendants had no occasion to use this combination. . . .

It is to be noticed that the question is not whether dealers are liable to be deceived in buying from the manufacturer or the wholesaler, but whether the user is liable to be misled in buying from the retailer. . . . We are of the opinion that the defendants unnecessarily, with no apparent reason except to take advantage of the reputation built up by the plaintiff, produced and put upon the market an imitation of its loaves, adapted to use in deceiving that part of the public who had only a general knowledge and recollection of that which had been recommended to them, or which they had been accustomed to buy. . . .

Decree reversed.

STANDARD OIL CO. v. MITCHIE

1929, 34 F.(2) 802.

The plaintiff sued the defendant to enjoin certain practices indulged in by him. The defendant for years sold plaintiff's products and also conducted a repair service in connection with it. He quit purchasing of the plaintiff and the plaintiff acquired a station just across the street. The defendant used the name "Standard Service Station" painted so as to resemble the plaintiffs. The pumps and caps of attendants also resulted in a studied similarity to those of the plaintiff. Evidence was introduced tending to show that many customers were confused in thinking the defendant sold plaintiff's product.

Faris, District Judge. . . . But I am of the opinion that it cuts no decisive figure in the case whether defendant's intent here was good or bad; that is to say, as to whether he was engaged in a studied effort so to simulate the business of the plaintiff so that confusion would be brought about, and that he would financially profit from such confusion. . . .

If plaintiff by more than 30 years use of the word "Standard" has caused this word to be lifted from the public domain and to be applied and understood in the oil business as designating its business, and its gasoline and oils, then no one has the right to use this word in such wise as to cause confusion among customers. . . .

True it is that plaintiff trades under its corporate name of Stand-

ard Oil Company, while defendant trades under the name of Standard Service Station. He individually owns the business, although he does not use his individual name, or any part thereof in such business. So the question is pertinent whether in the oil business the name Standard Service Station is sufficiently similar to that of plaintiff as to be calculated to deceive the casual or unwary customer. . . .

The ruled cases have gone far against the defendant on this point. . . . There are cases holding [that unfair competition exists] in the use of "Gold Stripe" for "Gold Ribbon"; "Super-Flash" for "Silver Flash"; "Milcoa" for "Nucoa"; "White Lily" for "Lily White"; "Wheat Nuts" for "Grape Nuts"; and "Oh Johnnie" for "Oh Henry." . . .

Tested by the facts here, and the applicable law, I think there is scarcely room for doubt that the injunction herein should issue substantially as prayed.

AMERICAN WALTHAM WATCH CO. v. UNITED STATES WATCH CO.

1899, 173 Mass. 85, 53 N.E. 141, 43 L.R.A. 826, 73 Am. St. Rep. 263.

Bill by the American Waltham Watch Company against the United States Watch Company. Decree for plaintiff on report.

HOLMES, J. This is a bill brought to enjoin the defendant from advertising its watches as the "Waltham watch" or "Waltham watches," and from marking its watches in such a way that the word "Waltham" is conspicuous. The plaintiff was the first manufacturer of watches in Waltham, and had acquired a great reputation before the defendant began to do business. It was found at the hearing that the word "Waltham," which originally was used by the plaintiff in a merely geographical sense, now, by long use in connection with the plaintiff's watches, has come to have a secondary meaning as a designation of the watches which the public has become accustomed to associate with the name. This is recognized by the defendant so far that it agrees that the preliminary injunction, granted in 1890, against using the combined words "Waltham watch" or "Waltham watches" in advertising its watches, shall stand, and shall be embodied in the final decree.

The question raised at the hearing, and now before us, is whether the defendant shall be enjoined further against using the words "Waltham," or "Waltham, Mass.," upon plates of its watches without some accompanying statement which shall distinguish clearly its watches from those made by the plaintiff. The judge who heard the case found that it is of considerable commercial importance to

indicate where the defendant's business of manufacturing is carried on, as it is the custom of watch manufacturers so to mark their watches, but, nevertheless, found that such an injunction ought to issue. He also found that the use of the word "Waltham," in its geographical sense, upon the dial, is not important, and should be enjoined.

The defendant's position is that, whatever its intent and whatever the effect in diverting a part of the plaintiff's business, it has a right to put its name and address upon its watches; that to require it to add words which will distinguish its watches from the plaintiff's in the mind of the general public is to require it to discredit them in advance; and that if the plaintiff, by its method of advertisement, has associated the fame of its merits with the city where it makes its wares, instead of with its own name, that is the plaintiff's folly, and cannot give it a monopoly of a geographical name, or entitle it to increase the defendant's burden in advertising the place of its works. . . .

It is true that a man cannot appropriate a geographical name; but neither can he a color, or any part of the English language, or even a proper name to the exclusion of others whose names are like his. Yet a color in connection with a sufficiently complex combination of other things may be recognized as saying so circumstantially that the defendant's goods are the plaintiff's as to pass the injunction line. . . .

Whatever might have been the doubts some years ago, we think that now it is pretty well settled that the plaintiff, merely on the strength of having been first in the field, may put later comers to the trouble of taking such reasonable precautions as are commercially practicable to prevent their lawful names and advertisements from deceitfully diverting the plaintiff's custom.

We cannot go behind the finding that such a deceitful diversion is the effect, and intended effect, of the marks in question. We cannot go behind the finding that it is practicable to distinguish the defendant's watches from those of the plaintiff, and that it ought to be done. The elements of the precise issue before us are the importance of indicating the place of manufacture and the discrediting effect of distinguishing words, on the one side, and the importance of preventing the inferences which the public will draw from the defendant's plates as they now are, on the other. It is not possible to weigh them against each other by abstractions or general propositions. The question is specific and concrete. The judge who heard the evidence has answered it, and we cannot say that he was wrong.

Decree for plaintiff.

HANOVER STAR MILLING CO. v. METCALF

1915, 240 U.S. 403, 36 S.Ct. Rep. 357.

Hanover Star Milling Co. seeks to enjoin Metcalf from selling flour in Alabama, which he purchased from Steeleville Milling Company, under the brand "Tea Rose." Allen & Wheeler Company intervened and desires to enjoin Hanover Star Milling Co. from using the trade name "Tea Rose" for flour. Allen & Wheeler first used the trade name in 1872, but only on flour in Ohio, Pennsylvania and Massachusetts. In 1885 or 1886 Hanover Star Milling Company first used the trade name, without knowledge of any prior use, on its flour that was sold in Alabama, Georgia, Tennessee, and Florida, in which territory it had built up a very profitable business. Steeleville Milling Company, adopted the trade name in 1895 and sold its product in other southern states. At one time it competed with Hanover Star Milling Company's product but was induced to withdraw. Shortly before this action was started, however, it entered into active competition with Hanover Star Milling Company.

PITNEY, J. . . . Interesting and important questions are raised concerning the territorial extent of trademark rights. In behalf of the Hanover Company it is, in effect, insisted: (a) that the failure of the Allen & Wheeler Company and its predecessors to enter the southeastern territory with their Tea Rose flour and the fact that such flour has been and is wholly unknown there under that name, disentitle it to interfere with the Hanover Company's trade established in good faith in that territory under the trademark; (b) that the same considerations entitle Hanover to affirmative trademark rights of its own, enforceable against the Steeleville Company and everybody else over whom it has priority in that territory. . . .

The redress that is accorded in trademark cases is based upon the party's right to be protected in the good will of a trade or business. The primary and proper function of a trademark is to identify the origin or ownership of the article to which it is attached. Where a party has been in the habit of labeling his goods with a distinctive mark, so that purchasers recognize goods thus marked as being of his production, others are debarred from applying the same mark to goods of the same description because to do so would tend to deprive him of the profit he might make through the sale of the goods which the purchaser intended to buy. Courts afford redress or relief upon the ground that a party has a valuable interest in the good will of his trade or business and in the trade marks adopted to maintain and extend it. The essence of the wrong consists in the sale of the goods of one manufacturer or vendor as those of another. . . .

In short, a trademark is treated as merely a protection for the good will, and not the subject of property except in connection with an existing business. . . .

Expressions are found in many of the cases to the effect that the exclusive right to the use of a trademark is founded on priority of appropriation. . . . But these expressions are to be understood in the application to the facts of the cases decided. In the ordinary case of parties competing under the same mark in the same market, it is correct to say that prior appropriation settles the question. But where two parties are independently employing the same mark upon goods of the same class, but in separate markets wholly remote the one from the other, the question of prior appropriation is legally insignificant.

Of course, if the symbol or device is already in general use, employed in such a manner that its adoption as an index of source or origin would only produce confusion and mislead the public, it is not susceptible of adoption as a trademark. . . .

Decree in favor of Hanover Star Milling Co.

YELLOW CAB CO. OF SAN DIEGO v. SACHS et al.

1923, 191 Cal. 238, 216 Pac. 33.

The Yellow Cab Manufacturing Company manufactures taxicabs of a distinct size, style, and color which it sells to corporations in many cities throughout the United States. It aids in the formation of the corporations, the installation of records, and the training of drivers. It adopted a slogan, "The cab that took the tax out of taxi." In May, 1920, the "Yellow Taxicab Company of Los Angeles" was formed. At that time the defendant had been operating taxicabs in San Diego, California, and in September, 1920, changed its name to Yellow Taxicab Company of San Diego and used a fleet of yellow taxicabs. It entered into no contract with the Yellow Cab Manufacturing Company, although it used the same slogan. A few months later the Yellow Cab Manufacturing Company succeeded in financing its own Yellow Taxicab Company of San Diego and now seeks to enjoin the defendant from the use of the name and slogan.

Richards, J. . . . In so far as the Chicago Corporation is concerned it is clear that it never acquired any rights in or to the exclusive appropriation of either said name or slogan through any use thereof in the city of San Diego, and never having acquired such rights, it is plain that it neither did nor could transfer any such rights to the plaintiff herein.

"As the judgment cannot thus be supported upon the theory of

an invasion of an exclusive right to property in a trademark, the only ground for the support of the judgment is that which has come to be known as 'unfair trade dealing.' This is but a succinct statement of the principle that in the interest of fair commercial dealing, courts of equity, where one has been first in the field doing business under a given name, will protect that person to the extent of making competitors use reasonable precautions to prevent deceit and fraud upon the public and upon the business first in the field. . . . But, as has been intimated, relief in such cases really rests upon the deceit or fraud which the later comer into the business field is practicing upon the earlier comer and upon the public."

Applying the principle set forth above . . . it would seem clear that the plaintiff has acquired no right to the exclusive use of the trade name "Yellow Taxicab Company of San Diego" in connection with any business actually carried on under said name in the city of San Diego prior to the defendant's appropriation and use of said trade name in the business which they had established and were conducting at the time of the institution of this action.

Judgment for defendant affirmed.

WALL v. ROLLS-ROYCE OF AMERICA

1925, 4 F(2) 333.

Buffington, C. J. The appellant, Howard Wall, doing business under the name Rolls-Royce Tube Company, assigns for error the action of the Court below in enjoining him from using the name Rolls-Royce in carrying on his individual business. From the record and statement made at bar it appears Rolls-Royce is a hyphenated combination of the family names of the two founders of the British Corporation, Rolls-Royce, Limited; and that . . . the plaintiff Rolls-Royce of America, Incorporated, is a Delaware corporation, chartered in 1919 for the purpose of acquiring, extending, and increasing in the United States the business of the British Rolls-Royce Company, and has since been engaged in said business of making automobiles, aeroplanes, and parts thereof; that the defendant is an individual engaged in the business of selling radio tubes by mail; that he has no connection with either of said Rolls-Royce Companies; that he has no one associated with him in business, and no connection with or permission from any person by the name of Rolls-Royce, nor any license from either of said companies to use said names of Rolls-Royce; that trading as an individual and without any person being associated with him, or without any incorporation of that name, and without his individual name being used, he has entered into a mail order business, where he does not

come into personal contact with customers, but procures them by advertisements which do not mention him as an individual, but use the name "Rolls-Royce Tube Company." His advertisements describe his radio tubes by quotation marks as "Rolls-Royce" radio tubes and that such tubes are "like their name, significant of quality." The advertisement directs correspondence be sent to "Dept. A, of the Rolls-Royce Tube Company," thus giving the suggestion of a business made up of this and other departments. . . .

Upon no other theory than a purposed appropriation to himself, and an intent to convey to the public a false impression of some supposed connection with the Rolls-Royce industries, can Wall's actions and advertisements be explained. . . . That this veiling of his business under the name Rolls-Royce might, and indeed almost surely would, injure the real Rolls-Royce industries, and substantially detract from their goodwill and fair name, follows. It is true those companies made automobiles and aeroplanes, and Wall sold radio tubes, and no one would think when buying a radio tube, he was buying an automobile or an aeroplane. But this is not the test and gist of this case. Electricity is one of the vital elements in automobile and aeroplane construction, and having built up a fame and trade name in two articles of which electrical appliances were all important factors, what would more naturally come to the mind of a man with a radio tube in his receiving set on which the name "Rolls-Royce" with nothing else to indicate its origin, than for him to suppose that the Rolls-Royce Company had extended its high grade of electric product to the new, electric-using radio art as well, and if this Rolls-Royce radio tube proved unsatisfactory, it would sow in his mind at once, an undermining and distrust of the excellence of product which the words "Rolls-Royce" had hitherto stood for.

Injunction affirmed.

Chapter III

LABOR AND THE LAW

UNITED STATES v. DARBY

1941, 312 U.S. 100.

The appellee, Darby, was in business of manufacturing finished lumber for purpose of shipping to customers outside of the state of Georgia. He is charged with employing workmen under labor conditions which fail to conform to wage and hour standards set up by the Fair Labor Standards Act. The court viewed the purpose of the Act, and the question to be determined was whether the phrase in the Act, "produced for interstate commerce," embraced the particular business conducted by the appellee.

MR. JUSTICE STONE. . . . Its purpose . . . is to exclude from interstate commerce goods produced for the commerce and to prevent their production for interstate commerce, under conditions detrimental to the maintenance of the minimum standards of living necessary for health and general well-being; and to prevent the use of interstate commerce as the means of competition in the distribution of goods so produced, and as the means of spreading and perpetuating such substandard labor conditions among the workers of the several states.

. . . Without attempting to define the precise limits of the phrase, we think the acts alleged in the indictments are within the sweep of the statute. The obvious purpose of the Act was not only to prevent the interstate transportation of the prescribed product, but to stop the initial step toward transportation—production with the purpose of so transporting it. Congress was not unaware that most manufacturing businesses shipping their product in interstate commerce make it in their shops without reference to its ultimate destination and then after manufacture select some of it for shipment interstate and some intrastate according to the daily demands of their business, and that it would be practically impossible, without disrupting manufacturing business, to restrict the prohibited kind of production to the particular pieces of lumber, cloth, furniture or the like which later move in interstate rather than intrastate commerce.

. . . Congress to attain its objective . . . has made no distinction as to the volume or amount of shipments in the commerce or of production for commerce by any particular shipper or producer. It recognized that in present day industry, competition by a small

part may affect the whole and that the total effect of the competition of many small producers may be great . . . The legislation aimed at a whole embraces all its parts.

Judgment quashing the indictment reversed.

J. L. BRANDEIS & SONS v. NATIONAL LABOR RELATIONS BOARD

1944, 142 F.(2) 977.

A petition to review and set aside an order of the National Labor Relations Board. The petitioner is a corporation engaged in owning and operating a retail department store in Omaha, Nebraska. For the year ending January 31, 1943, about 75 per cent of the store's merchandise was purchased and shipped to it from outside the state; the out-of-state mail order sales amounted to .0024 per cent of its total sales for the year; and the packages sent to out-of-state customers were 4 per cent of the number of packages delivered in Omaha for the same period.

THOMAS, Circuit Judge. . . . The Act does not exempt the retail business as such from the scope of its coverage . . . The application of the Act does not depend upon the magnitude of the business nor the comparative amount of interstate sales. . . . In brief, the jurisdictional test in such a case as the present one is whether the stoppage of the business by reason of labor strife would tend substantially to affect interstate commerce. The principle applicable is one of degree. When the unfair labor practice involved is found to have such a close and substantial relation to the free flow of interstate commerce that the practice tends to obstruct that commerce, the jurisdiction of the Board to apply the preventive remedies of the Act is undoubted. The foregoing rules indicate the scope of the Board's jurisdiction under the Act whether the labor dispute involved occurs in a manufacturing establishment, a mining enterprise, a banking or a retail mercantile business.

So far we have considered only the effect of the sale of merchandise by petitioner to out-of-state customers. The Board, however, relied also upon the purchases of merchandise for stocking the store from points outside the state . . . The contention is that the Board erred in taking these outside purchases and shipments into consideration. Clearly if a strike of the employees in the store should lead to the closing of its doors and stop the selling of merchandise the flow of supplies from outside the state would soon stop also. The effect upon commerce would be close and substantial. But the petitioner says such a labor dispute would serve only to shift local commerce to competing stores and would not affect

the flow of interstate commerce . . . The basis of the contention is conjectural; but, even if true, it does not prove that a shutdown of the store would not substantially affect the flow of interstate commerce.

It is urged, also, that when shipments of out-of-state merchandise come to rest in the store interstate commerce ends and that what may occur thereafter does not directly affect it. The argument is unsound. If when selling at the store stops purchasing outside the state also stops, it is fair to say that the latter is the effect of the former . . .

The order is affirmed and a decree enforcing it will be entered.

WAGNER v. AMERICAN SERVICE CO.

1944, 58 F.Supp. 32.

Plaintiff brings this suit against his former employer to recover overtime compensation, liquidated damages, and attorney fees as provided by the Fair Labor Standards Act. The defendant denies plaintiff's contention that he was engaged in interstate commerce or in the production of goods for commerce and hence was not within the Act.

The evidence showed that the defendant was engaged in the manufacture and sale of artificial ice primarily for the retail and wholesale trade in Davenport, Iowa, and that the defendant sold ice to railroads for air conditioning and icing drinking water and also iced some refrigerator trucks knowing that it was to protect goods to be transported outside the State of Iowa. The activities of the plaintiff at all times primarily had to do with the manufacture of artificial ice and his work was necessary for the production of such goods.

DEWEY, J. . . . 1st, Is the manufacturing and furnishing of ice to protect or preserve goods being shipped in interstate commerce a production of goods for commerce?

2nd, Is it necessary to show the amount, percentage, or volume of the ice so manufactured and intended to be shipped in interstate commerce? And

3rd, Must it be established that the amount or volume of the goods that went into interstate shipments was substantial, or is it sufficient if any of the manufactured ice intended for interstate commerce reached that commerce?

From the authorities it would appear that the question of whether an employee is within the terms of the Act, where his work is necessary for the production of goods for interstate commerce, is not whether the goods were transported by the employer, but

whether the goods so manufactured were intended for interstate commerce. The fact that there was an intermediary between the sale and the shipment is immaterial. . . . [Cases cited.]

It is also apparent from the definitions that "commerce" includes "transportation" and "transmission," and hence the definition of "commerce" is broader than the legal definition of what constitutes commerce as heretofore defined by the Supreme Court of the United States. It seems to me therefore that although the ice was furnished for the protection and preservation of goods being transported in interstate commerce, and though it was not for commerce in the sense that it was not for trade but was expendable, yet it was produced for transportation and transmission from one state to another.

. . . It has been determined that it is unnecessary to show that any particular percentage of the manufactured goods should reach interstate commerce; . . . [Cases cited.] nor is it necessary to show the amount or volume of the goods shipped in interstate commerce, for if any amount reaches interstate commerce that would appear to suffice. . . . [Cases cited.]

Judgment for plaintiff.

LARSEN v. STATE INDUSTRIAL ACCIDENT COMMISSION

1931, 135 Or. 137, 295 P. 195.

RAND, J. Plaintiff, a workman employed in the construction of a sewer at Astoria, sustained an injury for which he filed a claim for compensation under the Workmen's Compensation Act. The State Industrial Accident Commission, after a hearing thereon, entered an order rejecting the claim upon the ground that the accident causing the injury did not arise out of or in the course of plaintiff's employment. From this ruling he appealed to the circuit court of Clatsop county and, upon the trial of the cause, the court directed a verdict for the Commission and from the judgment entered therein, plaintiff has appealed.

It appears from the evidence that plaintiff was in the employ of a public contractor and engaged in the construction of a sewer at Astoria; that on the morning of the accident, while proceeding to his work, he rode to the place of work in an automobile as a guest of a fellow-workman; that, upon reaching the place of work, the driver of the automobile in which he was riding left the street for the purpose of parking his car and drove on to a platform projecting from the level of the street over property abutting the same. Instead of stopping on said platform, the driver drove over the edge

thereof, causing the car to drop to the ground below, a distance of some ten feet, and causing plaintiff to sustain the injury complained of. . . . Plaintiff also offered evidence tending to show that on the day of the accident the tools he would have used if he had not been hurt were stored on the platform but the car was not driven on the platform for the purpose of obtaining the tools, but in order to find a parking space only. The contractor, so far as the evidence shows, had never authorized or directed any of his employees to use the platform for a parking space, or for any purposes of their own. . . .

1-4. Under these facts, the sole question is whether plaintiff sustained "a personal injury by accident arising out of and in the course of his employment caused by violent or external means," within the meaning of those words as used in section 49-1827, Oregon Code 1930. Before a workman can be entitled to compensation under the act, the injury must both arise out of and also be received in the course of employment. The words are used conjunctively and, therefore, both elements coexist for neither alone is sufficient: . . . The words "out of," as used in the statute, point to the origin or cause of the accident. The words "in the course of" point to the time, place and circumstances under which the accident takes place. The former are descriptive of the character or quality of the accident, while the latter relate to the circumstances under which an accident of that character or quality takes place: . . . Before an accident can be said to arise out of the employment, the injury must be directly traceable to the nature of the work or to some risk to which the employer's business exposes the employee. . . .

5. Applying these principles to the facts of the instant case, it seems plain that plaintiff's injury neither arose out of nor in the course of his employment. He was not at the time at work or performing any duty which he owed to the master, nor was he doing any act to further his master's interest. He rode upon the platform for purposes of his own and, in doing so, he incurred a risk which was not incidental to his employment but which was shared in common by all members of the public who might use the platform for parking purposes. The accident, therefore, did not arise in the course of his employment nor did it arise out of his employment, for there was no causal connection between the employment and the injury received. If his duties had required him to go upon the platform as a part of his work and he had then sustained an injury because of his being there in the performance of such duties, the situation might be different, but under the circumstances disclosed by the record he was there for purposes purely his own and not in the performance of any duty owed to the master.

For these reasons, it was proper for the court to direct a verdict for the defendant. The judgment must, therefore, be affirmed.

SANTA CRUZ FRUIT PACKING CO. v. NATIONAL LABOR RELATIONS BOARD

1938, 303 U.S. 453.

Petitioner was engaged in the business of canning fruits and vegetables in California and in disposing of its large output locally and in interstate and foreign commerce, 37 per cent going to destinations beyond the state. The goods shipped by boat were carried to the wharves on trucks loaded at the plant by warehousemen employed there. Many of these men were locked out by the company for having joined a labor union and eventually the movement of trucks from warehouse to wharves ceased. The teamsters refused to haul, the warehousemen at the dock warehouses declined to handle, and the stevedores between dock and ship refused to load the company's goods. The National Labor Relations Board found that the discharge of the employees and the refusal to reinstate them constituted an unlawful discrimination under the National Labor Relations Act. It ordered the company to desist from such practices, to reinstate, with back pay, the discharged employees, and to post notices, etc. . . .

Mr. Chief Justice Hughes. . . . Petitioner contends that the manufacturing and processing in which petitioner is engaged are local activities and that the Board was without jurisdiction over the labor dispute involved in this case.

There is no question that petitioner was directly and largely engaged in interstate and foreign commerce. We have often decided that sales to purchasers in another State are not withdrawn from federal control because the goods are delivered f. o. b. at stated points within the state of origin for transportation . . . A large part of the interstate commerce of the country is conducted upon that basis and the arrangements that are made between seller and purchaser with respect to the place of taking title to the commodity, or as to the payment of freight, where the actual movement is interstate, do not affect either the power of Congress or the jurisdiction of the agencies which Congress has established . . .

It is plain that the provision cannot be applied by a mere reference to percentages and the fact that petitioner's sales in interstate and foreign commerce amounted to 37 per cent, and not to more than 50 per cent, of its production cannot be deemed controlling. The question that must be faced under the Act upon particular facts is whether the unfair labor practices involved have such a

close and substantial relation to the freedom of interstate commerce from injurious restraint that these practices may constitutionally be made the subject of federal cognizance through provisions looking to the peaceable adjustment of labor disputes . . .

The direct relation of the labor practices and the resulting labor dispute in the instant case to interstate commerce and the injurious effect upon that commerce are fully established. The warehousemen in question were employed by petitioner in loading its goods either into the cars of carriers or into the trucks which transported the goods to the docks for shipment abroad or to other States. The immediacy of the effect of the forbidden discrimination against these warehousemen is strikingly shown by the findings of the Board. . . .

It would be difficult to find a case in which unfair labor practices had a more direct effect upon interstate and foreign commerce.

The relief afforded by the Board, in requiring petitioner to desist from the unfair labor practices condemned by the Act and to reinstate the discharged employees with back pay, was properly sustained by the Circuit Court of Appeals, and its order is affirmed.

Affirmed.

MONTGOMERY WARD & CO. v. NATIONAL LABOR RELATIONS BOARD

1940, 115 F.(2) 700.

The petitioner is an Illinois corporation owning and operating a large retail and mail order house in St. Paul, Minnesota. For a long time the petitioner has maintained a system of espionage or surveillance of its employees, which has been used primarily for obtaining information as to their honesty, moral character, and efficiency. In 1936, 1937, and 1938 the system was utilized by the petitioner to secure information as to the attitude of its employees toward unionization and with respect to union activities; and it was this use of the system which caused the filing of charges by the union with the Board that petitioner has interfered with the rights of its employees and thus violated the Act.

Sanborn, J. . . . There is no direct evidence that the petitioner actually used the information secured through its espionage system to influence or coerce any of its employees with respect to joining or not joining a union or with respect to wages or conditions of employment. . . .

There was evidence in the record from which the Board might have found that the responsible officers of the petitioner did not actually use the information secured through the espionage system to

interfere with the rights of its employees guaranteed by the act; that in 1938 the petitioner discarded the system in so far as it touched upon union affiliations and activities of its employees, and that there was no likelihood of a resumption of the use of the system for procuring information about such matters. However, we think that the Board was not compelled to find non-interference with the employees' rights, and was not precluded from finding that the use of the system which the Board found objectionable might recur. . . .

For the purposes of this opinion, we shall assume, without deciding, that proof of the maintenance by an employer of a system of espionage, one of the purposes of which is to secure information relative to the attitude of his employees toward self-organization, joining a union, and kindred matters, is not alone sufficient to justify a finding that 8(1) of the Act has been violated by him. The Board in its decision expressed the opinion that such proof was, alone, sufficient, but if its finding that petitioner violated 8(1) is justified by the evidence as a whole, we are satisfied that the order of the Board should be affirmed.

In addition to proof of the existence of the espionage system and its use, there is evidence, as already pointed out, that the chief of the system had a bias against the union, which he communicated to some of petitioner's employees, and certainly to those whom he engaged as operatives. The statements of the chief, before referred to, tended to characterize the system, in so far as it was used to gather information relative to the union affiliations and activities of petitioner's employees, as one antagonistic to unionization. Moreover, from the evidence that the chief of the system had openly stated that he had operatives in the union, the Board could reasonably infer that the employees could hardly be ignorant of the existence of the system and of the interest of the petitioner in ascertaining their labor affiliations and activities. It is scarcely conceivable, we think, that the statements of the chief of the system and the knowledge of the employees of the use of the system to spy upon their union activities could have been without some effect upon their freedom in the exercise of the rights guaranteed by Sec. 7 of the Act.

. . . Our conclusion is that, under the evidence, the question of whether the petitioner had violated 8(1) of the Act is not a question of law for this court to decide, but was a question of fact for the Board to determine, and that its finding is conclusive upon the petitioner and upon this court.

The order of the Board will, as requested by it, be modified . . .

BIG LAKE OIL CO. v. NATIONAL LABOR RELATIONS BOARD

1945, 146 F.(2) 967.

LEE, Circuit Judge. This case comes to us on petition of the Big Lake Oil Company to review and set aside an order of the National Labor Relations Board pursuant to which the petitioner was ordered to cease and desist from certain unfair labor practices and to post appropriate notices. In its answer the Board requested that the order be enforced.

The order of the Board followed upon its finding that petitioner had, prior to the holding of an election to determine a collective bargaining representative, made written and oral statements to its employees which had interfered with, restrained, and coerced the employees in the exercise of rights guaranteed in Section 7 of the National Labor Relations Act, 29 U.S.C.A. § 157, thereby violating Section 8(1) of the Act, 29 U.S.C.A. § 158 (1). . . .

The facts pertinent to the determination of the issues are in the main uncontested and are as follows: In July of 1943, International Union of Operating Engineers, Local No. 709, affiliated with the A. F. of L., began a campaign to organize petitioner's employees, and a number of meetings were held. While these activities were going on, the vice president and general manager of petitioner wrote and posted upon petitioner's bulletin boards, and mailed to each employee, a letter addressed to the employees of the Big Lake Oil Company. . . .

Following a speech by a union representative, Grissett, assistant superintendent, asked whether it was permissible for him as well as others to ask questions, and permission being granted, asked whether there was any law which required the company "to give the men free $2500 insurance" or "to pay the men two weeks' Christmas bonus" or "to maintain a hospital and maintain a swimming pool, and things like that." Subsequently, and about a month before the election, Grissett stated that "if this union business came up . . . , that they might do away with the hospital, and bonus, and all"; that he didn't know for sure that this would be done, but "they could do that if it went over." . . .

When approached by an employee who asked about his prospects with the Company, Grissett told him that he could get somewhere if the matter was left up to Grissett, then added that if the union carried the election it would not be left in his hands; "it would be up to the union." . . .

Grissett of his volition spent the day and part of the evening be-

fore the election contacting the employees, showing them how to mark a sample ballot which he had in his possession; and following each interview, he checked the employee's name on the company pay roll. He testified that he instructed petitioner's foreman "to see that everyone that was eligible to vote go away . . . some time during the day to vote, if possible, on the company time."

The union lost the election by two votes. A week or so later Grissett told an employee, a member of the union, that "those leaders in the union had better watch their step," that the union was "not so smart after all," and that the petitioner "had the union full of spies all the time."

Upon these facts the Board found that petitioner had interfered with, restrained, and coerced its employees in violation of Section 8(1) of the Act.

. . . "The Act does not take away the employer's right to freedom of speech. The constitutional right of freedom of speech cannot be so abridged as to preclude an employer from expressing his views on labor policy or problems so long as such utterances do not, by reason of other circumstances, have a coercive effect on employees."

When, however, Grissett, by his questions in the open meeting, suggested that there was no law that required the company to provide insurance benefits, Christmas bonus, etc., which the company had previously provided, such questions were calculated to intimidate since they suggested that these benefits might be withdrawn. Grissett's other actions were likewise irregular and improper and revealed a persistent course to intimidate and coerce; his actions the day before the election in visiting the employees at work and showing them how to mark the ballot and, under the facts of this case, furnishing cars to carry employees to the polls, were outright interferences by the employer in a matter with respect to which the Act requires the employer to remain absolutely neutral.

. . . The petition to set aside the Board's order is denied, and the request of the Board for enforcement of its order is granted.

NATIONAL LABOR RELATIONS BOARD v. ARCADE-SUNSHINE CO.

1940, 313 U.S. 567.

EDGERTON, J. The National Labor Relations Board petitions for enforcement of an order against the respondent, Arcade-Sunshine Company, Inc., which operates a laundry and cleaning plant in the District of Columbia. On charges filed by the Laundry Workers Cleaners and Dyers Union the Board issued a complaint, held hear-

ings, and made extensive findings. It concluded that respondent had interfered with, restrained and coerced its employees in the exercise of the right to self-organization guaranteed by Section 7 of the National Labor Relations Act, 29 U.S.C.A. § 157, and had discharged William Jones because of union membership and activity. It therefore found that respondent had engaged in unfair labor practices within the meaning of § 8(1) and § 8(3) of the Act, 29 U.S.C.A. § 158 (1, 3). It ordered respondent to cease and desist from these practices, to reinstate Jones and make him whole for loss of pay, to reimburse government agencies for work relief payments made to him, and to post notices that it would cease and desist as ordered and would take the affirmative action required. Respondent contends that the findings are unsupported and that the order exceeds the Board's authority. . . .

Jones began work in 1926 as a steamer and presser. He joined the union in May, 1937. He attended meetings, distributed union circulars, and talked about the union. In June or July, respondent's president and foreman both questioned him about his membership. When he denied attending union meetings the president replied "You can't fool me; I know." The cashier, in the presence of the vice-president, asked Jones to sign the "loyalty" petition. He was one of the small minority who refused. A few weeks later the foreman discharged him. When he asked the president to reinstate him he was told, "You talk too much around here; you walk around and talk about the union."

Respondent contends that Jones was discharged for habitual drunkenness. The foreman so testified. Jones admitted that he "always did drink." The Board found that on the day of his 1937 discharge he was under the influence of liquor and could not do his work. In 1934 he was discharged, but reinstated a few days later. The foreman testified that Jones was drunk practically every day for ten years, that his usual output was about ten or twelve per cent of a fair day's work, and that the president called his attention to alcohol on Jones's breath at least four or five times a week for ten years. The president, who had full power to hire and fire, testified that during each year he told the foreman, sometimes three times a day, to discharge Jones. The Board found this testimony of the foreman and the president showed "an obvious effort to construct a case against Jones and to cover up the real reason for his discharge."

The Board's findings of fact, if supported by evidence, are conclusive. The evidence must be substantial, but substantial evidence means only "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." (Consolidated

Edison Co. v. N.L.R.B., 305 U.S. 197, 229, 59 S.Ct. 206, 217, 83 L.Ed. 126.) Much of the evidence on which the Board relied was contradicted; but it is for the Board, and not for us, to weigh conflicting testimony and pass upon credibility. Perhaps a reasonable mind might conclude that Jones was discharged solely for intoxication, but certainly a reasonable mind might conclude that there was a connection between his union activities and his discharge. This is enough to sustain the Board's order regarding Jones. Substantial evidence supports, also, the finding that respondent interfered with, restrained and coerced its employees in the exercise of their right to self-organization. It follows that, as the Board found, respondent engaged in unfair labor practices within the meaning of Sections 8(1) and 8(3) of the Act. . . .

It is so ordered.

NATIONAL LABOR RELATIONS BOARD v. FANSTEEL METALLURGICAL CORPORATION

1939, 306 U.S 240.

HUGHES, C. J. The Circuit Court of Appeals set aside an order of the National Labor Relations Board requiring respondent to desist from labor practices found to be in violation of the National Labor Relations Act, 29 U.S.C.A. § 151 et seq., and to offer reinstatement to certain discharged employees with back pay. While the other portions of the Board's order are under review, the principal question presented relates to the authority of the Board to require respondent to reinstate employees who were discharged because of their unlawful conduct in seizing respondent's property in what is called a "sit-down strike."

Respondent, Fansteel Metallurgical Corporation, is engaged at North Chicago, Illinois, in the manufacture and sale of products made from rare metals. . . . The findings of the Board show that in the summer of 1936 a group of employees organized Lodge 66 under the auspices of a committee of the Amalgamated Association of Iron, Steel and Tin Workers of North America; that respondent employed a "labor spy" to engage in espionage within the Union and his employment was continued until about December 1, 1936; . . . that meanwhile, and later, respondent's representatives sought to have a "company union" set up but the attempt proved abortive; that from November, 1936, to January, 1937, the superintendent required the president of the Union to work in a room adjoining the superintendent's office with the purpose of keeping him away from the other workers; that while in September, 1936, the Union

did not have a majority of the production and maintenance employees, an appropriate unit for collective bargaining, by February 17, 1937, 155 of respondent's 229 employees in that unit had joined the Union and had designated it as their collective bargaining representative; that on that date, a committee of the Union met twice with the superintendent who refused to bargain with the Union as to rates of pay, hours and conditions of employment, the refusal being upon the ground that respondent would not deal with an "outside" union.

Shortly after the second meeting in the afternoon of February 17th the Union committee decided upon a "sit-down strike" by taking over and holding two of respondent's "key" buildings. These were thereupon occupied by about 95 employees. Work stopped and the remainder of the plant also ceased operations. Employees who did not desire to participate were permitted to leave, and a number of Union members who were on the night shift and did not arrive for work until after the seizure did not join their fellow members inside the buildings. At about six o'clock in the evening the superintendent, accompanied by police officials and respondent's counsel, went to each of the buildings and demanded that the men leave. They refused and respondent's counsel "thereupon announced in loud tones that all the men in the plant were discharged for the seizure and retention of the buildings." The men continued to occupy the buildings until February 26, 1937. Their fellow members brought them food, blankets, stoves, cigarettes and other supplies. . . .

Respondent on regaining possession undertook to resume operations and production gradually began. . . . New men were hired to fill the positions of those remaining on strike.

. . . Upon the basis of these findings and its conclusions of law, the Board made its order directing respondent to desist from interfering with its employees in the exercise of their right to self-organization and to bargain collectively through representatives of their own choosing as guaranteed in Section 7 of the Act, 29 U.S.C.A.; . . . The Board also ordered the following affirmative action which it was found would "effectuate the policies" of the Act;—that is, upon request, to bargain collectively with the Amalgamated Association as stated above; to offer, upon application, to the employees who went on strike on February 17, 1937, and thereafter, "immediate and full reinstatement to their former position," with back pay, dismissing, if necessary, all persons hired since that date; to withdraw all recognition from Rare Metal Workers of America, Local No. 1, as a representative of the employees for the purpose of deal-

ing with respondent as to labor questions and to "completely disestablish" that organization as such representative; and to post notices of compliance. 5 N.L.R.B. 930.

. . . *The Authority of the Board to require the reinstatement of the employees thus discharged.* The contentions of the Board in substance are these: . . . (3) That the Board was entitled to order reinstatement or reemployment in order to "effectuate the policies" of the Act.

(1) For the unfair labor practices of respondent the Act provided a remedy. Interference in the summer and fall of 1936 with the right of self-organization could at once have been the subject of complaint to the Board. The same remedy was available to the employees when collective bargaining was refused on February 17, 1937. But reprehensible as was that conduct of the respondent, there is no ground for saying that it made respondent an outlaw or deprived it of its legal rights to the possession and protection of its property. The employees had the right to strike but they had no license to commit acts of violence or to seize their employer's plant. . . . The seizure and holding of the buildings was itself a wrong apart from any acts of sabotage. But in its legal aspect the ousting of the owner from lawful possession is not essentially different from an assault upon the officers of an employing company, or the seizure and conversion of its goods, or the despoiling of its property or other unlawful acts in order to force compliance with demands. To justify such conduct because of the existence of a labor dispute or of an unfair labor practice would be to put a premium on resort to force instead of legal remedies and to subvert the principles of law and order which lie at the foundations of society.

As respondent's unfair labor practices afforded no excuse for the seizure and holding of its buildings, respondent had its normal rights of redress. Those rights, in their most obvious scope, included the right to discharge the wrongdoers from its employ. . . .

. . . We are unable to conclude that Congress intended to compel employers to retain persons in their employ regardless of their unlawful conduct—to invest those who go on strike with an immunity from discharge for acts of trespass or violence against the employer's property, which they would not have enjoyed had they remained at work. Apart from the question of the constitutional validity of an enactment of that sort, it is enough to say that such a legislative intention should be found in some definite and unmistakable expression. We find no such expression in the cited provision.

. . . *The requirement of reinstatement of employees who aided*

and abetted those who seized and held the buildings. There is a group of fourteen persons in this class who were not within the buildings and hence do not appear to have been within the announcement of discharge, but who went on strike and fall within the order for reinstatement. . . .

. . . We are thus returned to the question already discussed and we think that in that respect these aiders and abettors, likewise guilty of unlawful conduct, are in no better case than the "sit-down" strikers themselves. We find no ground for concluding that there is any policy of the Act which justifies the Board in ordering reinstatement in such circumstances. . . .

The judgment of the Circuit Court of Appeals is modified accordingly and as modified is affirmed. It is so ordered.

NATIONAL LABOR RELATIONS BOARD v. P. LORILLARD CO.

1941, 117 F.(2) 931.

The National Labor Relations Board asks enforcement of its order issued against respondent, a corporation engaged in the manufacture and sale of tobacco products. The Board decided that the respondent had failed to bargain collectively, in violation of the Act, upon two grounds: (1) That the respondent refused to negotiate with respect to the counter-proposal which it offered to the contract submitted by the union; (2) that the respondent refused to confer in Middletown, where the plant was located, and insisted on conferences being held only in New York City.

ALLEN, J. . . . The Board is not authorized, by statute or court decision, to shape or control the course of the negotiations between employer and employee, so long as the employer bargains collectively, in accordance with the statute. . . . The Act nowhere attempts to define what agreement shall be offered by the employer or by the union in the bargaining. In fact, as pointed out by the Supreme Court, "The act does not compel agreements between employers and employees. It does not compel any agreement whatever. It does not prevent the employer 'from refusing to make a collective contract and hiring individuals on whatever terms' the employer 'may by unilateral action determine.'" National Labor Relations Board v. Jones & Laughlin Steel Corp., 301 U.S. 1, 45, 57 C.T. 615, 628, 81 L.Ed. 893, 108 A.L.R. 1352. . . . But if the employer is free to contract or to refuse to contract at will, he is likewise free frankly to state the terms upon which he may yield

and those upon which he will not yield. Collective bargaining requires negotiations by the employer with representatives of the employees, chosen by themselves, freely and without coercion, and has no reference to the terms of the agreement offered so long as the parties negotiate in good faith with the view of reaching an agreement. Each party to the controversy will necessarily offer a unilateral draft of the agreement contemplated, and such action, though it results in shaping the terms finally agreed upon, is in no way illegal. The sincerity of the employer's effort in negotiating with a labor organization, under the statute is to be tested by the length of time involved in the negotiations and the persistence with which the employer offers opportunity for agreement.

. . . Applying this test, the record does not show that the respondent had a fixed resolve not to enter into an agreement with the union. . . . The evidence, without contradiction, shows a sincere attempt on the part of respondent to negotiate with the union, even though, as hereafter shown, the respondent labored under the mistaken notion that these negotiations could be carried on by letter. The Board erred in deciding that the respondent had refused to bargain when it stated in advance certain terms to which it would not accede.

However, that part of the order which relates to the refusal of the respondent to bargain collectively must be affirmed because of the respondent's refusal to hold conferences at Middletown. The Board's order to bargain collectively in Middletown enjoins upon the respondent affirmative action such as the Board has authority to order for the purpose of effectuating the policies of the Act. . . . The collective bargaining features of the statute cannot be made effective unless employer and employees cooperate in the give and take of personal conferences. While negotiations by mail are sufficient if both parties accept that procedure, if the employees do not agree, the employer must make his representatives available for conferences at the plant where the controversy is in progress, and at reasonable times and places, so that personal negotiations are practicable. . . . But an even more emphatic reason for this holding is that both employees and management in the plant where the employees are hired, where they work, where they are laid off and discharged, are better able to understand mutual needs and seasonably to negotiate fair contracts than representatives far distant, unacquainted with the actual conditions and hampered by the limitations of telegraph or telephone.

. . . The respondent, in refusing to furnish representatives for personal conferences at Middletown, refused to accept the process of collective bargaining. . . .

NATIONAL LABOR RELATIONS BOARD v. GRISWOLD MFG. CO.

1939, 106 F.(2d) 713.

KALODNER, D. J. Is recognition of the union the essential basis of the collective bargaining guaranteed by the National Labor Relations Act (Act of July 5, 1935, c 372, 49 Stat. 449)? . . .

While there are other issues involved, hereinafter discussed in detail, the issue of union recognition is the crux of this controversy. . . .

Collective bargaining is one of the principal intendments of the National Labor Relations Act. Equal in importance is the intendment of this Act that employees shall be given the right to organize.

Accomplishment of the intendments (1) to organize and (2) to bargain collectively, become a mockery if recognition of the bargaining agency is withheld.

Before proceeding with further discussion of this paramount issue, a brief statement of the facts and contentions of the parties, as well as the rulings of the petitioner, is appropriate.

(2) The National Labor Relations Board has petitioned this court for enforcement of its order dated March 30, 1938, requiring the respondent, the Griswold Manufacturing Company, of Erie, Pennsylvania, to cease and desist from certain unfair labor practices under the National Labor Relations Act (49 Stat. 449, 29 U.S.C.A. § 151 et seq.) and to take affirmative action which the Board found would effectuate the policies of the Act. . . .

The facts are as follows: The board further found that the appropriate unit for collective bargaining, Section 9(b), 29 U.S.C.A. 159(b), was composed of the production employees of the respondent, to the number of approximately 370, excepting clerical and office employees, foremen and supervisory employees, and watchmen. It found that the Lodge included a clear (and high) majority of the employees in the appropriate unit, and that the Lodge was the exclusive representative of all the employees in such unit for purposes of collective bargaining in respect to rates of pay, wages, hours of employment, and other conditions of employment.

The board further found that on April 2, 1937, and at all times thereafter, the respondent refused to bargain collectively with the Lodge as the exclusive representative of its employees in respect to rates of pay, wages, hours of employment, and other conditions of employment, in that the respondent at all times refused to negotiate with the committee of the Lodge *as a representative of the Lodge,* but chose instead to treat the committee as a *committee of its employees.* . . .

In our opinion, the facts recited afford ample ground for the findings of the Board that the respondent is guilty of unfair labor practices; that it refused to bargain collectively, and that it interfered with and dominated the formation of the employees' union and with its administration. The consistently maintained refusal of the respondent to recognize Lodge 1197, *qua union lodge,* as the representative of the employees, is a refusal to bargain collectively, notwithstanding the respondent's willingness to recognize a group of members of the Lodge as such representatives. . . .

An employer interferes with self-organization of his employees when he throws the great weight of his support, through permitting "solicitation" of membership of a favored organization by foremen and assistant foremen, to the competitive disadvantage of a group of employees who want representation by an outside union. This is especially so when the foremen and assistant foremen stage a concerted membership drive, under supervision of the plant manager, in which thinly-veiled threats of dismissal are used as a "persuader."

The whole policy of the law is to redress an inequality of bargaining power by forbidding employers to interfere with the development of employee organizations, thereby removing one of the issues most provocative of industrial strife and bringing about the general acceptance of the orderly procedure of collective bargaining under circumstances in which the employer cannot trade upon the economic weakness of his employees. . . .

The Board's order is valid. It is supported by the record, and must be given effect.

Accordingly, a decree enforcing it will be entered.

MILK WAGON DRIVERS' UNION OF CHICAGO, LOCAL 753 v. ASSOCIATED MILK DEALERS

1941, 39 F.Supp. 671.

Action by Milk Wagon Drivers' Union of Chicago, Local 753, and others, against Associated Milk Dealers and others for the recovery of back wages claimed to be due members of plaintiff union under terms of an arbitration agreement and for an accounting. On defendants' motion to dismiss complaint. . . .

HOLLY, J. This is an action brought by the Milk Wagon Drivers' Union of Chicago, Local 753, a voluntary association, and the various officers and trustees of that organization, against some twenty-five milk dealers operating in the City of Chicago, for the recovery of certain back wages claimed to be due to the drivers of their wagons, members of the plaintiff union, under the terms of a certain arbitration agreement. Plaintiff prayed for an accounting from

each of the defendants for any monies due and owing to the individual employees who were members of the plaintiff union, and that a decree be entered requiring each of the defendants to pay plaintiffs the sum of $371,700 for the benefit of the Milk Wagon Drivers' employees of the defendants. Defendants have moved to dismiss the complaint.

The motion of defendants to dismiss must be sustained.

This is not a proper class action. Each milk wagon driver has his individual claim which he is entitled himself to prosecute. It would be a strange situation indeed if someone else, either labor union or labor union officer, were permitted to institute an action embodying the claims of perhaps thousands of individuals and they, without ever knowing such an action was instituted, were to be bound by the result of that suit. Hansberry, et al. v. Lee, et al., 311 U.S. 32, 61 S.Ct. 115, 85 L.Ed. 22, 132 A.L.R. 741. As Justice Shaw said in his dissenting opinion in the same case in the state court, Lee v. Hansberry, 372 Ill. 369, 377, 24 N.E.2d 37, 41, "Certainly no man's rights can be safe under such a rule of law."

Counsel for plaintiffs say this is not brought as a class action, but on no other theory may a suit for the benefit of many others, to which they are not made parties, be maintained.

An order accordingly will be entered May 5, 1941, at 10 o'clock A.M.

AMERICAN FEDERATION OF LABOR v. SWING

1941, 312 U.S. 321.

FRANKFURTER, J. . . . A union of those engaged in what the record describes as beauty work unsuccessfully tried to unionize Swing's beauty parlor. Picketing of the shop followed. To enjoin this interference with his business and with the freedom of his workers not to join a union, Swing and his employees began the present suit. In addition, they charged the use of false placards in picketing and forcible behavior towards Swing's customers. A preliminary injunction was granted. Answers were then filed denying violence as well as falsity of the placards. The union also moved to strike the complaint and the trial court, finding the complaint wanting in equity, granted the motion and dissolved the preliminary injunction. The appellate court, one of Illinois' intermediate courts of review, held that the trial court was in error. 298 Ill. App. 63, 18 N.E.2nd 258. This action of the appellate court was affirmed by the state supreme court. 372 Ill. 91, 22 N.E.2nd 857. It found that the complaint properly invoked equity for three reasons: (1) there was no dispute between the employer and his im-

mediate employees; (2) the placards were libelous; (3) there were acts of violence. Inasmuch as the supreme court affirmed the issuance merely of a preliminary injunction, we denied certiorari for want of a final judgment. 309 U.S. 659, 60 S.Ct. 514, 84 L.Ed. 1007. Thereupon, although as we have seen issue had been formally joined on the claims of libel and violence, the appellate court, by a procedure unrevealed by the record and without opinion, entered a permanent injunction ranging from peaceful persuasion to acts of violence. The decree recited "that this Court and the Supreme Court of this State have held in this case, that, under the law of this State, peaceful picketing or peaceful persuasion are unlawful when conducted by strangers to the employer (i.e., where there is not a proximate relation of employees and employer), and that appellants are entitled in this case to relief by injunction against the threat of such peaceful picketing or persuasion by appellees." . . .

. . . On its face the permanent injunction in that decree rested on the explicit avowal that "peaceful persuasion" is forbidden in this case because those who were enjoined were not in Swing's employ. Moreover, as we have seen, the supreme court of Illinois dismissed proceedings before it to review that decree on representations that the decree was in accordance with its mandate on the temporary injunction.

. . . We are asked to sustain a decree which for purposes of this case asserts as the common law of a state that there can be no "peaceful picketing or peaceful persuasion" in relation to any dispute between an employer and a trade union unless the employer's own employees are in controversy with him.

Such a ban of free communication is inconsistent with the guarantee of freedom of speech. That a state has ample power to regulate the local problems thrown up by modern industry and to preserve the peace is axiomatic. But not even these essential powers are unfettered by the requirements of the Bill of Rights. The scope of the Fourteenth Amendment is not confined by the notion of a particular state regarding the wise limits of an injunction in an industrial dispute, whether those limits be defined by statute or by the judicial organ of the state. A state cannot exclude workingmen from peacefully exercising the right of free communication by drawing the circle of economic competition between employers and workers so small as to contain only an employer and those directly employed by him. The interdependence of economic interest of all engaged in the same industry has become a commonplace. American Foundries v. Tri-City Council, 257, U.S. 184, 209, 42 S.Ct. 72, 78, 66 L.Ed. 189, 27 A.L.R. 360. The right of free communica-

tion cannot therefore be mutilated by denying it to workers, in a dispute with an employer, even though they are not in his employ. Communication by such employees of the facts of a dispute, deemed by them to be relevant to their interests, can no more be barred because of concern for the economic interests against which they are seeking to enlist public opinion than could the utterance protected in Thornhill's case. "Members of a union might, without special statutory authorization by a state, make known the facts of a labor dispute, for freedom of speech is guaranteed by the Federal Constitution." Senn v. Tile Layers Union, 301 U.S. 468, 478, 57 A.Ct. 857, 862, 81 L.Ed. 1229.

Reversed.

MLLE. REIF, INC. v. RANDAU

1937, 166 Mis. 247, 1 N.Y. Supp. 2d 515.

STEINBRINK, J. Motion by plaintiff for an injunction restraining defendants from picketing and other acts and conduction incidental thereto in a dispute in which the plaintiff is neutral. The defendants' officers and members of Local No. 3 of the Newspaper Guild of New York are "on strike" against the *Brooklyn Daily Eagle*. This strike has been in progress since September 13, 1937. The plaintiff conducts the business of a beauty parlor, with its main store at 721 Flatbush Avenue, Brooklyn, and a branch store in Manhattan. She has been engaged in this business for a great many years and in it has apparently built up a considerable patronage and good will. The sin with which she is charged by the defendants is that she advertises in the *Brooklyn Daily Eagle*. She has been such an advertiser for about ten years. She has neither part nor parcel in the grievances between the defendants and the *Brooklyn Daily Eagle*. None of her employees are on strike. To begin with, the defendants assert that the plaintiff is entitled to no relief, since non-compliance with section 876a of the Civil Practice Act is claimed. With more than formal respect for my brother, Mr. Justice Faber, I cannot subscribe to the holding that this is a labor dispute within the meaning of section 876a of the Civil Practice Act. . . .

. . . The defendants have the right to publicize in every lawful manner the fact that they are on strike against the *Brooklyn Daily Eagle*, but in thus publicizing this fact they may not use the names of those who are advertisers in the *Eagle*. The plaintiff sells no goods or products made by the *Eagle*. Rather, it seeks through the medium of the advertising columns to attract to itself patrons.

In connection with the picketing, there has been shouting, the

use of the word "scab" as applied to the plaintiff's establishment, and the appeal to the public not to have any work done at or to patronize the plaintiff's shop. . . .

The Civil Practice Act provides that in Kings county all foreclosure suits must be advertised in two daily newspapers published within the county. There are only two such daily newspapers in Kings county, one of which is the *Brooklyn Daily Eagle.* Will it be asserted that because the justices of this court designate the *Brooklyn Daily Eagle* for such advertising that either the homes of the justices or the courthouse itself may be picketed with such signs and accompanied by such acts as are detailed in the moving papers? The very persistence with which defendants' representatives pressed the plaintiff are coercive in effect and are of sufficient robustness to constitute illegal conduct. The defendants' activities are unquestionably intended and calculated to intimidate and coerce the plaintiff. . . .

. . . In the endeavor to equalize the age-old struggle between capital and labor, Legislatures have enacted statutes and courts have interpreted them so as to recognize what has frequently been referred to as peaceful picketing as the lawful advertising by labor of its grievances, as lawful appeals to those selling non-union made goods to discontinue so doing. These acts are not unlawful, but where there is attempt to interfere or ruin the business of one who is not concerned in the dispute between labor and its employer the boundary of lawful conduct is transgressed and the secondary boycott is called into being.

The injunction will be granted, but will be limited in its scope as was the modified injunction in Spanier Window Cleaning Co., Inc. v. Awerkin (supra).

APPENDIX

GENERAL

Power of Attorney

KNOW ALL MEN BY THESE PRESENTS, that..

....
(Set forth Name and Address)
(hereinafter referred to as the "Principal") has made, constituted and appointed, and by these presents does make, constitute and appoint..

....
(Set forth Name(s) and Address(es) distinctly)
a specimen of whose signature(s) appears in the lower left corner hereof, the true and lawful attorney(s)-in-fact of, for and in the name, place and stead of the Principal to do each and all of the following acts and things:

1. Open, maintain and/or reconcile any one or more deposit or other accounts either in the name of the Principal or otherwise with ——— BANK OF NEW YORK, (see footnote),* (hereinafter referred to as the "Bank");

2. Deposit with the Bank to the credit or for the account of the Principal any moneys, checks, drafts, promissory notes or other instruments for the payment of money; also, to endorse for deposit, collection, transmission and remittance, or otherwise, any and all such instruments and to deliver the same to the Bank for any of the indicated purposes;

3. Draw, make, execute and deliver any and all checks, drafts, promissory notes and other instruments for the payment of money payable by or at the Bank, and give any orders or directions by letter, telegram or otherwise for the withdrawal, transfer or other disposition of any funds at any time(s) held by the Bank on deposit or otherwise for or to the credit of the Principal, inclusive of any such instruments, orders or directions made payable to or for the account or benefit of the said attorney(s, or any of them);

4. Deposit with the Bank to the credit or for the account of the Principal any and all stocks, bonds or other securities or valuables registered in the name of or purporting to be owned by the Principal, and to endorse and cause all or any such securities to be transferred into the name of the Bank, or that of any nominee(s) of the Bank, or otherwise;

5. Purchase or otherwise acquire from or through the Bank any stocks, bonds, or other securities or valuables;

6. Sell, assign, transfer, substitute, pledge, withdraw or otherwise dispose of any stocks, bonds or other securities or valuables at any time(s) held by or in the possession or control of the Bank, and/or any one or more of its subsidiaries or affiliates, for or on behalf of the Principal and to collect and dispose of any interest, dividend or other payments thereon; also, to give any orders or directions by letter, telegram or otherwise for the withdrawal, exchange, transfer, sale or other disposition of any such stocks, bonds or other securities or valuables, inclusive of any such orders or directions to or for the account of the said attorney(s, or any of them);

7. Discount and/or negotiate with the Bank any promissory notes, drafts or other instruments for the payment of money;

8. Borrow money from and incur indebtedness to the Bank either through loans, advances, renewals or other forms of credit which may be extended at any time or from time to time by the Bank, with or without security, and to make and enter into such agreements in reference thereto as may be acceptable to the Bank;

9. Apply to and cause to be issued by or at the instance of the Bank any letters or other forms of credit, and to sign and deliver such indemnity or other agreements as the Bank may require in connection therewith;

10. Sign and deliver to the Bank any Trust or Bailee Receipts and any relative Statements of Trust Receipt Financing or other documents;

11. Pledge, assign, mortgage or otherwise transfer, hypothecate, and deliver to the Bank as security for all or any liabilities of the Principal to the Bank now existing or hereafter arising, any promissory notes, drafts or other instruments for the payment of money, stocks, bonds, accounts, bills receivable, or any other securities or property purporting to be owned or held by or for the account of the Principal;

12. Give any directions and make any agreements concerning the extension, renewal, discharge or collection of any promissory notes, checks, drafts or other instruments for the payment of money, or for the insurance, delivery, sale, pledge or other disposition of any documents, merchandise or other property, which may be now or hereafter in the possession or under the control of the Bank;

13. ....

(Here insert any such further authority as is desired)

And the Principal hereby gives and grants unto said attorney(s) (severally, collectively or otherwise as hereinafter stated) full power and authority to do and perform each and every act and thing whatsoever deemed by any such attorney or attorneys so acting to be necessary or proper to be done in and about the premises as fully and effectually to all intents and purposes as the Principal might or could do if personally present, with full power of substitution, delegation and revocation, hereby ratifying and confirming all and whatsoever the said attorney or attorneys so acting, or any substitute or substitutes, or delegate or delegates, shall lawfully do, or cause to be done, in or about the premises by virtue hereof.

It is understood that, unless terminated by operation of law, this Power of Attorney may be revoked only by notice in writing signed by the Principal and delivered to the Bank, and that any substitution or delegation hereunder shall be revoked only by notice in writing signed by the Principal and/or any such attorney or attorneys so acting; and, for the purpose of inducing the Bank to act hereunder, the Principal hereby agrees that the Bank, its successor or assigns, shall be saved harmless from any loss suffered or liability incurred by it or them in acting hereunder until notice of any such termination or revocation shall have been received by the Bank.

If more than one attorney-in-fact has been hereinbefore appointed, each and all of the aforesaid powers, discretionary and otherwise, may be exercised severally, collectively or otherwise as follows:

__ Each may act alone. __ Any..................................or more may act collectively.

__ ....

IN WITNESS WHEREOF, the Principal** having heretofore stricken out and omitted the paragraphs hereof numbered.., has caused this instrument to be duly executed this.................... day of.................................. 19........

Specimen signature(s) of
Attorney(s)-in-fact named above.

* NOTE: If it is desired that this Power of Attorney shall be applicable only to some particular office(s) or branch(es) of the Bank, please so indicate in the space provided therefor above.

** If TWO OR MORE PARTIES execute this Power of Attorney, the word "Principal" as used therein shall be deemed to refer to those parties collectively and severally. If a PARTNERSHIP, one or more of the General Partners should sign in its behalf. If a CORPORATION or ASSOCIATION, a duly certified copy of the By-Law or Resolution under authority of which it has been executed should accompany the delivery hereof.

[Acknowledgment to be used if PRINCIPAL is an INDIVIDUAL]

STATE OF.. }
COUNTY OF.. } ss.:

On the day of , 19 , before me personally came , to me known to be the person described in, and who executed, the foregoing instrument, and acknowledged that he (she) executed the same.

(Notary's Seal
to be affixed) ....

NOTARY PUBLIC, COUNTY OF..............................

MY COMMISSION EXPIRES.........................., 19........

[Acknowledgment to be used if PRINCIPAL is a PARTNERSHIP]

STATE OF.. }
} ss.:
COUNTY OF... }

On the day of , 19 , before me personally came , to me personally known, and known to me to be a member of the firm of , and known to me to be the individual described in, and who executed, the foregoing instrument in the name of the said firm, and he (she) duly acknowledged to me that he (she) executed the same for and in behalf of the said firm.

(Notary's Seal
to be affixed) ....

NOTARY PUBLIC, COUNTY OF..............................

MY COMMISSION EXPIRES......................., 19.......

[Acknowledgment to be used if PRINCIPAL is a CORPORATION]

STATE OF.. }
} ss.:
COUNTY OF... }

On the day of , 19 , before me personally came , to me known, who, being by me duly sworn, did depose and say that he (she) resides that he (she) is of the corporation described in, and which executed the above instrument; that he (she) knows the seal* of the said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said corporation, and that he (she) signed his (her) name thereto by like order.

(Notary's Seal
to be affixed) ....

NOTARY PUBLIC, COUNTY OF..............................

MY COMMISSION EXPIRES......................., 19.......

(*If such corporation have no seal, that fact must be stated in place of the statements required respecting the seal.)

Form 2. Demand Promissory Note

$ *1,000.00* NEW YORK, *March 1* 19___

On demand AFTER DATE THE UNDERSIGNED PROMISE(S)

TO PAY TO THE ORDER OF *E. Z. Way Co.*

One thousand and No/100 DOLLARS

AT *70 Fifth Ave. New York*

VALUE RECEIVED

NO. *677* DUE *Demand* *H. Hyde Co.*

Per A. B. Curtis, Treas.

Form 3. Installment Note with Waiver

No. ....

$.. Champaign, Ill., ... 19.......

At the dates hereinafter mentioned, for value received, I, or We, the undersigned, jointly and severally, promise to pay to the order of

THE FIRST BANK IN CHAMPAIGN

At Its Banking House, Champaign, Illinois

the sum of .... Dollars,

payable in installments as follows: .... Dollars on the .... day of each

and every month beginning on the .... day of .... 19........, for .... months

succeeding and a final payment of .... Dollars on the .... day of

.... 19........, with interest at the rate of 7 per cent per annum after maturity; and agree that on default in the payment of any installment the whole amount of this note shall then and there become due at the election of the holder thereof.

I, or We, agree to pay a "late charge" not to exceed five cents for each dollar for each payment more than fifteen days in arrears, to cover the extra expense involved in following up and handling delinquent payments. No single late charge shall exceed $5.00.

The makers, sureties, guarantors and endorsers of this note, jointly and severally, do hereby waive demand, presentment for payment, notice of non-payment and protest, and do each hereby waive notice of and consent to any and all extensions of this note or any part thereof from time to time without notice to us, and hereby waive any and all notice of whatsoever kind or nature, and waive the exhaustion of legal remedies hereon.

And further to secure the payment of said amount, the undersigned hereby jointly and severally irrevocably authorize and empower any attorney of any Court of Record to appear for them, or either of them, in such court at any time hereafter and confess a judgment without process against them or any one or more of them, in favor of legal holder of this note, for such sum as may appear to be unpaid and owing thereon, together with interest, costs and 15 per cent attorney's fees, and to waive and release all errors which may intervene in such proceeding, and consent to immediate execution upon such judgment, hereby ratifying and confirming all that said attorney may do by virtue hereof.

INSTALLMENT NOTE ....

....

Form 4. Collateral Note

$.. No..

Champaign, Ill.,.. 193.......

..................................*days after date, we, jointly and severally, promise to pay to the order of*

THE FIRST NATIONAL BANK IN CHAMPAIGN

At Its Banking House, Champaign, Illinois

....*DOLLARS,*

for value received, with interest at the rate of seven per cent, per annum from date until paid.

As collateral security for the payment of this note and any other present or future liabilities of the undersigned, or either or any of us to said Bank, whether direct or acquired by assignment, and whether absolute or contingent, the undersigned do(es) hereby assign, pledge and deliver to said Bank the following property:

And the undersigned agree(s) that: As additional security for said liabilities of the undersigned, or of either or any of us, said Bank shall have a lien upon any money, deposit account, credit, trust receipt, bonds, mortgages, or other property of any undersigned now or hereafter in possession, custody or control of said Bank or any of its officers, for safe keeping or otherwise. If any property herein pledged should decline in market value or in the Bank's opinion be insufficient to secure then existing liabilities, additional collateral security satisfactory to the Bank shall be deposited with it on demand. This note and all liabilities of the undersigned, or of either or any of us, shall mature and become due and payable at the option of said Bank upon the occurrence of any of the following: Failure to deposit additional collateral when and as demanded by the Bank, if any undersigned fails to meet at maturity any liability to the Bank, fails in business, makes a general assignment for benefit of creditors, becomes a judgment debtor, or insolvent, or if any attachment, receivership or voluntary or involuntary bankruptcy proceedings be commenced against any undersigned. Upon maturity of this note or any other of said liabilities, whether by exercise of option or otherwise, said Bank may resort to any or all property herein pledged, in such order as it may elect, and without demand or notice apply any money or deposit of any undersigned toward payment of such liabilities, and enforce collection of, or otherwise realize upon any or all of said property and may compromise, release or renew the same; and may also, without demand, advertisement or notice, sell at public or private sale, or at any exchange or broker's board, for such prices as it may deem best, either for cash or credit, or for future delivery, any or all of said property, with the right to said Bank to become purchaser at any public sale of the whole or any part of said property, free from any right or equity of redemption and without obligation to account for more than the sum bid. The net proceeds of said property after deducting all expenses incurred by said Bank in dealing with, enforcing, selling or disposing of said property, including reasonable attorney's fees, shall be applied in payment of the liabilities hereby secured, and the surplus, if any, paid to the undersigned. Any property herein pledged may, with the consent of said Bank, be withdrawn, be released or be exchanged for other property by any of the undersigned, which other property may likewise successively be withdrawn, be released or be exchanged, without prejudice to the rights of the Bank against any undersigned or any indorser or guarantor hereof, and all substituted property shall be subject to all terms hereof. The Bank shall not become liable, nor shall its rights against any party hereto be prejudiced, by failure to sue, demand, present for payment or otherwise, protest, give notice of protest, non-payment or other notice, nor failure to take any other action in respect to any property herein pledged; and said Bank shall be liable only for what it actually receives on account of said property after liquidating said expenses, attorney's fees and liabilities to said Bank. Upon any transfer hereof by the Bank any property then held as security under this agreement may be delivered to the transferee, who shall thereupon be vested with all rights and powers given to the Bank in respect thereto, and the Bank be discharged from any liability or responsibility in the matter. To further secure the payment of this note, we and each of us hereby irrevocably empower any attorney at any time hereafter to appear for us, either or any of us, in any court in term time or vacation, and confess judgment against us either or any of us, without process on this note in favor of any legal holder, for any or all of said liabilities of the undersigned, interest, costs and reasonable attorney's fees, and to release all errors and consent to immediate execution.

Address.. ....

Address.. ....

Due.. ....

Form 5. Judgment Note—Illinois form

$........ Champaign, Ill.,........194..... No........

........days after date, we, or either of us, promise to pay to the order of

THE BANK IN CHAMPAIGN, at its office

........DOLLARS

Value received, with seven per cent interest per annum from date until paid, and ten per cent of the principal hereof additional, as attorney's fees, if placed in the hands of an attorney for collection.

And to secure the payment of said amount, each of the undersigned do jointly and severally hereby irrevocably authorize any attorney of any Court of Record to appear for him in such court at any time hereafter, either in term-time or vacation, in any State or Territory of the United States, to waive the service of process and to confess judgment against him alone, or against him and one or more of the other makers of this note, in favor of the said payee, their order or assigns, upon said note for the above sum, and interest thereon to the day of the entry of said judgment, together with costs, damages and ten per cent of the principal hereof additional as attorney's fees; and also to file a cognovit for the amount thereof, with an agreement therein that no writ of error or appeal shall be prosecuted upon the judgment entered by virtue hereof, nor any bill of equity filed to interfere in any manner with the operation of said judgment, and to release all errors that may intervene in entering up said judgment, or issuing any execution thereon; and also to consent to immediate execution on said judgment; hereby ratifying and confirming all that said attorney may do by virtue hereof.

WITNESS our hands and seals this........day of

........A. D. 194.....

P. O........ ....(SEAL)

........(SEAL)

DUE........ ....(SEAL)

Form 6. Conditional Sale Note

$........ CHAMPAIGN, ILLINOIS,........194.....

........after date for value received, I, we, or either of us, promise to pay to

DILLAVOU BROS., or order........DOLLARS

at the office of DILLAVOU BROS., Champaign, Ill.

with interest at........per cent per annum from date........, and seven per cent per annum from maturity until paid.

This note (with........others) is given for........

....

and I hereby agree that title thereto, and to all repairs and extra parts furnished therefor, shall remain in the payee, owner or holder of this note until this note and renewals thereof, with interest, and all other notes given therefor shall have been

fully paid in money. If at any time he shall deem himself insecure, or if said property or any part thereof is levied upon, or the undersigned attempts to sell or remove the same, then the owner or holder hereof may declare this and every other such note due, and may take possession of said property, and sell the same at public or private sale, with or without notice, pay all expenses incurred thereby, and apply the net proceeds on this and other notes given for the purchase price thereof. In consideration of the use of said property, I agree to pay any balance remaining unpaid on this or any other such note after the net proceeds of such sale are applied, and if said property, or any part thereof, shall be lost, damaged or destroyed, I shall not on that account be entitled to a recission of this contract or abatement in price.

In Consideration Whereof, I hereby authorize irrevocably, any attorney of any Court of Record, in term time or vacation, to enter my appearance therein, at any time after date hereof, to waive all process and confess judgment or judgments, in favor of the legal holder hereof against me alone, or jointly with any or all other signers hereof, for such amount as may appear to be unpaid thereon, and costs, with attorney's fees of fifteen dollars plus 10 per cent of amount due hereon, and consent to immediate execution on the judgment so confessed, and waive all errors in the rendition thereof, and ratify and confirm all that my said attorney may do by virtue hereof.

P. O. ....

P. O. ....

No. ....

Form 7. Bill of Exchange

NEW YORK, *September 1* 19____

Thirty days after sight PAY TO THE ORDER OF

Harry S. Todler $ *550.00*

Five hundred fifty and no/100 - DOLLARS

FOR VALUE RECEIVED AND CHARGE TO ACCOUNT OF

TO *Alex Mfg. Co.*
Fresno, California

William G. Downitt

Form 8. Conditional Sale Contract

CONDITIONAL SALE CONTRACT

The undersigned seller hereby agrees to sell, and the undersigned buyer hereby agrees to buy, subject to the terms and conditions hereof, the following personal property, hereinafter for convenience referred to as "goods" (delivery and acceptance of which is hereby acknowledged by buyer), viz.:

Make or Trade Name Year Model Number

Motor Number Chassis Number together with extra equipment as follows:

For the total Time Purchase Price of........................$..........................
which is made up as follows:

(1) Cash Price..$..........................

(2) Cash Down Payment...................$..........................

(3) Trade-In (Down Payment in Goods)......$..........................

(Make..................................Model..............................)

(Motor..................................Serial..............................)

(4) Total Down Payment..................................$..........................

(5) Unpaid or Deferred Balance..............................$..........................

(6) Insurance—Fire, Theft, and Combined

Additional Coverage......$..........................

$..........................Deductible Collision.....$..........................$..........................

(7) Principal Balance....................................$..........................

(8) Finance Charge......................................$..........................

(9) Total Time Balance..................................$..........................

which buyer expressly agrees to pay at the office to be hereafter designated, of MANUFACTURING ACCEPTANCE CORPORATION, in..........................instalments of $..........................each and..........................instalment(s) of $..........................each in accordance with the Schedule of Payments hereinafter set out, with interest thereon after maturity at the highest lawful contract rate, and if this contract be placed with an attorney for collection, then, unless the same be in violation of some statute, an additional sum shall be paid by the buyer as attorney's fees, equal to fifteen per cent (15%) of the amount then unpaid, or if such amount be in violation of any such statute, then as large an amount, if any, as shall by law be permitted.

The terms, covenants and conditions of this agreement are as follows, viz.:

(1) Title to said property shall not pass to the purchaser until said time balance is fully paid in cash or until seller shall have obtained judgment against buyer for the unpaid balance of said purchase price.

(2) This contract may be assigned by the seller from time to time, and the legal holder of this contract from time to time shall be entitled to all of the rights of the seller hereunder. No waiver or extension of any payment, term, provision, covenant or condition should be considered as a payment or waiver of any default hereunder, nor be construed as a permanent waiver thereof. The failure of the seller to insist on prompt payment of any instalment when due hereunder or the acceptance of any delinquent payment shall not constitute a waiver of any subsequent default and seller shall have the right to repossess or exercise any other remedy reserved to it hereunder upon any subsequent default. No transfer, renewal, extension or assignment of this contract, or any interest hereunder, by the seller, voluntarily or involuntarily, or any loss, injury, destruction of or to the goods herein described, shall release the buyer from any obligation hereunder.

(3) No warranties either expressed or implied have been made by seller unless endorsed hereon in writing.

(4) The buyer shall at buyer's own cost and expense, keep said goods in first class order, repair and running condition and free from all taxes, liens, encumbrances, and charges for keep, repairs, storage, maintenance and accessories.

(5) Buyer agrees to procure, pay all premiums thereon and deliver to seller, an insurance policy or policies, issued by an insurance company satisfactory to seller, naming as beneficiaries or assureds buyer, seller and seller's heirs, administrators, successors and assigns, as their interests may appear, under which the property covered hereby is insured against loss or damage by collision, fire and theft thereof. Buyer expressly agrees that in the event of the failure of buyer to procure such policy or policies of insurance and to keep the premiums paid thereon, during the life of this agreement, seller and seller's heirs, executors, administrators, successors and assigns are hereby authorized to procure such policy or policies, and to pay all premiums thereon which be not paid when due. All amounts so paid by seller as premium on said insurance shall be added to the amounts due hereunder, and shall become due and payable with the instalment next due hereunder after such payment by seller. Failure of buyer to repay such sum or sums so paid by seller as premiums on such policy or policies when due, shall constitute a material breach of this agreement. The proceeds of any insurance, whether paid by reason of loss, injury, returned premiums or otherwise, shall be applied toward the replacement of the goods or the payment of this obligation at the option of the seller.

(6) Time is of the essence of this contract, and if the buyer shall default in any payment required by buyer to be made hereunder or in complying with any of the terms, covenants and conditions hereof, or if seller shall deem the said goods in danger of misuse, abuse, confiscation, or believe that the said goods are being depreciated in excess of the payments made by buyer hereunder, or believe buyer to be insolvent, then in any such event, seller may declare the entire amount then remaining unpaid hereunder to be due and immediately payable and sue therefor, or declare this contract

void and through legal process or otherwise, without notice or demand, take immediate possession of said goods. Said goods when retaken may be retained by seller and all payments made by buyer may, without demand, for performance of this agreement and without notice of default to buyer, be retained by seller as liquidated damages for breach hereof, for loss in value of said goods, and as rent for the use thereof. Buyer expressly agrees that seller may take possession of any other property in, upon or attached to said goods so retaken from buyer, and hold the same temporarily without any liability to buyer therefor. In the event any other property in, upon or attached to said goods is so taken by seller and not removed by buyer within five (5) days after demand therefor, seller may place the same in storage for the account of and at the expense of buyer. The rights given the seller by this contract shall be in addition to all rights given the seller by virtue of any statute or rule of law.

(7) Buyer hereby expressly releases and forever releases and discharges Seller, its successors and assigns, and their agents and employees of and from any and all damages and claims for damages resulting from trespass or otherwise growing out of the repossession of said goods.

(8) Any notice given to buyer hereunder may be given by delivering a copy thereof to buyer personally or by sending a copy thereof by United States Registered Mail postage prepaid, and addressed to buyer at his address given herein or at such other address as shall have been last given to seller by buyer, and such notice shall have been deemed to have been duly given when so mailed.

(9) The goods hereinabove described shall be kept, when not in use, at number..............

...., unless the buyer shall secure the consent in writing of the seller to a change in the place of storage or housing of such goods.

(10) Purchaser agrees to and does waive and release any and all rights, existing or that may be acquired, in or to the payment of any penalty, forfeit or damages for failure by the seller or holder of this contract, upon payment or satisfaction of this contract, to file a satisfaction certificate in compliance with any law or statute requiring the filing of same, except for failure to file such certificate within a reasonable time upon written demand delivered by the purchaser or by registered mail to the holder of this contract.

Executed in quadruplicate, one of which was delivered to and retained by the buyer

this..............................day of.., 19........

______________________________ (Seal)

.... By..

(Official Title, if Company)

....

(Seller's Address. Street, City, State)

SIGN IN INK

______________________________ (Seal)

(Buyer's Signature—Individual, Corporate or Firm Name)

....

(Witnesses to Buyer's and Seller's Signature)

By..

(Official Title, if Company)

ATTEST:
(Seal of Buyer if a Corporation)

....

(Buyer's Business Address. Street, City, State)

....

(Buyer's Secretary)

....

(Buyer's Residence Address. Street, City, State)

MAKE CERTAIN THAT DEALER'S RECOMMENDATION, ASSIGNMENT AND GUARANTY ON REVERSE HEREOF IS SIGNED

SCHEDULE OF PAYMENTS

$.......................1 mo. after date of contract	$.......................10 mos. after date of contract
$.......................2 mos. after date of contract	$.......................11 mos. after date of contract
$.......................3 mos. after date of contract	$.......................12 mos. after date of contract
$.......................4 mos. after date of contract	$.......................13 mos. after date of contract
$.......................5 mos. after date of contract	$.......................14 mos. after date of contract
$.......................6 mos. after date of contract	$.......................15 mos. after date of contract
$.......................7 mos. after date of contract	$.......................16 mos. after date of contract
$.......................8 mos. after date of contract	$.......................17 mos. after date of contract
$.......................9 mos. after date of contract	$.......................18 mos. after date of contract

(In states where acknowledgment or affidavit is necessary for filing or recording, Notary Public will insert necessary acknowledgment or affidavit in this space.)

DEALER'S RECOMMENDATION, ASSIGNMENT AND GUARANTY

To YELLOW MANUFACTURING ACCEPTANCE CORPORATION:

To induce you to purchase the within contract, the undersigned submits an accompanying statement which the undersigned believes to be substantially true, unless otherwise hereinafter stated, and certifies that said contract arose from the sale of the goods described in said contract, warranting that the title to said goods was at the time of the sale and is now vested in the undersigned free of all liens and encumbrances and that the undersigned has the right to assign such title.

For value received, the undersigned does hereby sell, assign and transfer to the YELLOW MANUFACTURING ACCEPTANCE CORPORATION, its successors or assigns, his, its or their right, title and interest in and to the within and foregoing contract and the goods covered thereby and authorizes said YELLOW MANUFACTURING ACCEPTANCE CORPORATION, its successors or assigns, to do every act and thing necessary to collect and discharge the same.

In consideration of the purchase of the said contract, the undersigned does hereby guarantee payment of all deferred payments as and at the respective times specified therein and covenants, in the event of the failure of the buyer to make any payment at the respective times and in the manner in said contract provided, or to perform any term, provision, covenant or condition provided by said contract to be made or performed by the buyer at the respective times and in the manner in said contract provided, to pay upon demand the full amount remaining unpaid to YELLOW MANUFACTURING ACCEPTANCE CORPORATION, its successors or assigns. The liability of the undersigned shall not be affected by any indulgence, compromise, settlement, extension of credit, or variation of terms effected by or with the buyer or any other person interested. Notice of acceptance of this guaranty, notices of nonpayment and non-performance, notices of amount of indebtedness outstanding at any time, protests, demands, and prosecution of collection, foreclosure and possessory remedies, and the right to remove any legal action from the court originally acquiring jurisdiction, are hereby expressly waived. In the event of repossession of the property covered by within contract for default by buyer, YELLOW MANUFACTURING ACCEPTANCE CORPORATION, its successors or assigns, may, at its election, sell the repossessed equipment at public or private sale and apply the proceeds thereof against the unpaid balance under the written contract or tender the repossessed equipment to the undersigned and the undersigned will pay to YELLOW MANUFACTURING ACCEPTANCE CORPORATION, its successors or assigns the amount of any deficiency established by any such sale or repurchase said property from YELLOW MANUFACTURING ACCEPTANCE CORPORATION, its successors or assigns in the event of tender thereof at a price equal to the unpaid balance of deferred payments at the time of such repossession, including interest, plus any and all costs of repossession. It is expressly agreed that in case of non-payment of either principal or interest when due, suit may be brought by the holder hereof against any one or more or all of us at the option of the holder, whether such suit has been commenced against the maker or not, and that in any such suit the maker may be joined with one or more or all of us, at the option of the holder.

....
(Seller's Signature)

....
(Official Title, if Company)

GUARANTY

In consideration of the making of the within contract by the seller therein and/or the purchase thereof by YELLOW MANUFACTURING ACCEPTANCE CORPO RATION, the undersigned does hereby guarantee payment of all deferred payments

as specified therein and covenants in default of payment of any installment or performance of any requirement thereof by buyer to pay full amount remaining unpaid to the seller, his or its heirs, executors, administrators, successors or assigns upon demand. The liability of the undersigned shall not be affected by any indulgence, compromise settlement, extension of credit, or variation of terms effected by or with the buyer or any other person interested. Notice of acceptance of this guarantee, notices of non-payment and non-performance, notices of amount of indebtedness outstanding at any time, protests, demands, and prosecution of collection, foreclosure and possessory remedies, and the right to remove any legal action from the court originally acquiring jurisdiction, are hereby expressly waived. It is expressly agreed that in case of non-payment of either principal or interest when due, suit may be brought by the holder hereof against any one or more or all of us at the option of the holder, whether such suit has been commenced against the maker or not, and that in any such suit the maker may be joined with one or more or all of us, at the option of the holder.

WITNESS:

....(L.S.)
(Guarantor)

....
(Address)

Form 9. Contract of Guaranty

SEVERAL SIGNERS

FOR VALUE RECEIVED and in consideration of advances made or to be made, or credit given or to be given, or other financial accommodation afforded or to be afforded to

....

....

(hereinafter designated as "Debtor"), by THE FIRST BANK, CHAMPAIGN, ILLINOIS (hereinafter called the "Bank"), from time to time, the undersigned hereby jointly and severally guarantee the full and prompt payment to said Bank at maturity and at all times thereafter of any and all indebtedness, obligations and liabilities of every kind and nature of said Debtor to said Bank (including liabilities of partnerships created or arising while the Debtor may have been or may be a member thereof), howsoever evidenced, whether now existing or hereafter created or arising, whether direct or indirect, absolute or contingent, or joint or several, and howsoever owned, held or acquired, whether through discount, overdraft, purchase, direct loan or as collateral, or otherwise; and the undersigned further agree to pay all expenses, legal and/or otherwise (including court costs and attorneys' fees), paid or incurred by said Bank in endeavoring to collect such indebtedness, obligations and liabilities, or any part thereof, and in enforcing this guaranty. The right of recovery, however, against the undersigned is limited to..Dollars ($..............................) plus interest on all loans and/or advances hereunder and all expenses hereinbefore mentioned.

In case of the death, incompetency, dissolution, liquidation or insolvency (howsoever evidenced) of, or the institution of bankruptcy or receivership proceedings against said Debtor, all of said indebtedness, obligations and liabilities then existing shall, at the option of the Bank, immediately become due or accrued and payable from the undersigned. All dividends or other payments received from the Debtor, or on account of the debt from whatsoever source, shall be taken and applied as payment in gross, and this guaranty shall apply to and secure any ultimate balance that shall remain owing to said Bank.

This guaranty shall be a continuing, absolute and unconditional guaranty, and shall remain in full force and effect until written notice of its discontinuance shall be actually received by said Bank, and also until any and all said indebtedness, obligations and

liabilities existing before receipt of such notice shall be fully paid. The death, dissolution or withdrawal of any one or more of the undersigned shall not terminate this guaranty until notice of any such death, dissolution or withdrawal shall have been actually received by said Bank, nor until all of said indebtedness, obligations and liabilities existing before receipt of such notice shall be fully paid. And in the event of any such death, dissolution or withdrawal and notice thereof to the Bank, this guaranty shall, notwithstanding, continue and remain in force against the survivor or survivors until discontinued as hereinabove provided.

The liability hereunder shall in no wise be affected or impaired by (and said Bank is hereby expressly authorized to make from time to time, without notice to anyone), any sale, pledge, surrender, compromise, settlement, release, renewal, extension, indulgence, alteration, substitution, exchange, change in, modification or other disposition of any of said indebtedness, obligations and liabilities, either express or implied, or of any contract or contracts evidencing any thereof, or of any security or collateral therefore. The liability hereunder shall in no wise be affected or impaired by any acceptance by said Bank of any security for or other guarantors upon any of said indebtedness, obligations or liabilities, or by any failure, neglect or omission on the part of said Bank to realize upon or protect any of said indebtedness, obligations or liabilities, or any collateral or security therefor, or to exercise any lien upon or right of appropriation of any moneys, credits or property of said Debtor, possessed by said Bank, toward the liquidation of said indebtedness, obligations or liabilities, or by any application of payments or credits thereon. Said Bank shall have the exclusive right to determine how, when and what application of payments and credits, if any, shall be made on said indebtedness, obligations and liabilities, or any part of them. In order to hold the undersigned liable hereunder, there shall be no obligation on the part of said Bank, at any time, to resort, for payment to said Debtor, or other persons or corporations, their properties or estates, or resort to any collateral, security, property, liens or other rights or remedies whatsoever.

All diligence in collection or protection, and all presentment, demand, protest and/or notice, as to any and everyone, of dishonor and of default and of non-payment and of the creation and existence of any and all of said indebtedness, obligations and liabilities, and of any security and collateral therefor, and of the acceptance of this guaranty, and of any and all extensions of credit and indulgence hereunder, are hereby expressly waived.

The granting of credit from time to time by said Bank to said Debtor in excess of the amount to which the right of recovery under this guaranty is limited and without notice to the undersigned, is hereby also authorized and shall in no way affect or impair this guaranty.

Notice act of commission or omission of any kind, or at any time, upon the part of said Bank in respect to any matter whatsoever, shall in any way affect or impair this guaranty.

Said Bank may, without any notice whatsoever to any one, sell, assign or transfer all of said indebtedness, obligations and liabilities, or any part thereof, and in that event each and every immediate and successive assignee, transferee, or holder of all or any part of said indebtedness, obligations and liabilities, shall have the right to enforce this guaranty, by suit or otherwise, for the benefit of such assignee, transferee or holder, as fully as if such assignee, transferee or holder where herein by name specifically given such rights, powers and benefits; but the said Bank shall have an unimpaired right to enforce this guaranty for the benefit of said Bank, as to so much of said indebtedness, obligations and liabilities that it has not sold, assigned or transferred.

No release or discharge of any one or more of the undersigned shall release or discharge any of the other of the undersigned, unless and until all of said indebtedness, obligations and liabilities shall have been fully paid and discharged.

This guaranty shall be construed according to the law of the State of Illinois, in which State it shall be performed by the undersigned.

This guaranty and every part thereof, shall be binding upon the undersigned, jointly and severally, and upon the heirs, legal representatives, successors and assigns of all the undersigned, and each of them, respectively, and shall inure to the benefit of said Bank, its successors, legal representatives and assigns.

SIGNED AND SEALED by the undersigned, at Champaign, Illinois, this..............

..............................day of..., 19.......

....(SEAL) ....(SEAL)

....(SEAL) ....(SEAL)

....(SEAL) ....(SEAL)

....(SEAL) ....(SEAL)

Form 10. Standard Mortgage Clause

UNIFORM STANDARD

STANDARD MORTGAGE CLAUSE

....

Loss or damage, if any, under this policy, shall be payable to..................................

....

mortgagee [or trustee] as interest may appear, and this insurance, as to the interest of the mortgagee [or trustee] only therein, shall not be invalidated by any act or neglect of the mortgagor or owner of the within described property, nor by any foreclosure or other proceedings or notice of sale relating to the property, nor by any change in the title or ownership of the property, nor by the occupation of the premises for purposes more hazardous than are permitted by this policy; provided, that in case the mortgagor or owner shall neglect to pay any premium due under this policy, the mortgagee [or trustee] shall, on demand, pay the same.

Provided also, that the mortgagee [or trustee] shall notify this Company of any change of ownership or occupancy or increase of hazard which shall come to the knowledge of said mortgagee [or trustee] and, unless permitted by this policy, it shall be noted thereon and the mortgagee [or trustee] shall, on demand, pay the premium for such increased hazard for the term of the use thereof; otherwise this policy shall be null and void.

This Company reserves the right to cancel this policy at any time as provided by its terms, but in such case this policy shall continue in force for the benefit only of the mortgagee [or trustee] for ten days after notice to the mortgagee [or trustee] of such cancellation and shall then cease, and this Company shall have the right, on like notice, to cancel this agreement.

Whenever this Company shall pay the mortgagee [or trustee] any sum for loss or damage under this policy, and shall claim that, as to the mortgagor or owner, no liability therefor existed, this Company shall, to the extent of such payment, be thereupon legally subrogated to all the rights of the party to whom such payment shall be made, under all securities held as collateral to the mortgage debt, or may at its option, pay to the mortgagee [or trustee] the whole principal due or to grow due on the mortgage, with interest accrued thereon to the date of such payment, and shall thereupon receive a full assignment and transfer of the mortgage and of all such other securities; but no subrogation shall impair the right of the mortgagee [or trustee] to recover the

full amount of.. claim.

Attached to and forming part of Policy No...

of the..Name of Insurance Company..

issued at its...Agency.

Dated...19.......

....Agent.

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