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THE LAW SCHOOL

The one hundred and second year of its existence opens upon the Law School with a further increase in enrollment. The registration figures for the last three years are as follows:

	1923–24	1924–25	1925–26
Graduate Class..........	12	13	11
Third Year Class........	102	111	106
Second Year Class.......	101	82	137
First Year Class........	75	132	118
Students from other Departments of the University..............	40	70	48
Total..............	330	408	420

The same necessity of dividing the First Year Class into sections which was felt last year is again apparent, the total registered for first year work being more than 150 and a new building appears as a greater need than ever.

Degrees from 107 different institutions in the United States and foreign countries are represented in the enrollment for 1925–1926, and students from forty-four different states of the Union are at present in attendance at the School. Among the Universities and Colleges having five or more alumni at the Law School are Cornell University, 12; Dartmouth College, 5; Georgetown University, 9; Harvard University, 6; Holy Cross College, 27; Princeton University, 7; Trinity College, 10; University of Pennsylvania, 11; University of Tennessee, 5; Vanderbilt University, 6; Wesleyan University, 6; Yale University, 123.

The 1925 Summer Session demonstrated even more forcibly than last year's session the popularity of this annual feature, as the following comparison of the respective enrollments of the past two summers will attest:

	1924	1925
First Semester.....................	124	135
Second Semester....................	115	136

This is the largest summer enrollment which the School has as yet enjoyed, and was notable in the fact that ten teachers from other law schools were enrolled, taking the courses leading to graduate degrees which attendance upon three such sessions makes possible.

During the past year two members of the faculty resigned. Professor Edmund M. Morgan returned to the Harvard Law School, from which he graduated; and Associate Professor Karl N. Llewellyn accepted a professorship in Columbia Law School. In addition, two of the younger members of the faculty have carried out their previous intentions and entered into practice, Mr. Daniel D. Morgan in New Haven, and Mr. John F. Caskey in New York.

The additions to the faculty have brought five new men to New Haven. Mr. Roscoe B. Turner, a graduate of the College of Idaho in 1916 and of the Yale Law School in 1920, has been appointed as Assistant Professor, teaching the subjects of Sales and Negotiable Instruments. Mr. Kenneth C. Sears, Professor of Law at the University of Missouri, is here as Visiting Professor, and will teach the courses in Agency and Evidence formerly given by Mr. Edmund Morgan. The course in Trial Practice is being given this year by Professor Young B. Smith, of Columbia University, who has also accepted a visiting professorship in the Law School. Pursuing the policy inaugurated last year, the faculty has added two Teaching Fellows who will pursue courses of graduate study and do a limited amount of teaching. These men are Professor Merrill Isaac Schnebly of the University of Indiana, who will give the courses in Persons and Wills, and Professor Thomas Edgar Atkinson of the University of North Dakota, who will be in charge of the course in First Year Procedure and the briefing work of the law clubs. Mr. Robert M. Hutchins, a graduate of the Law School in 1925, and Secretary of Yale University, has been appointed a special lecturer for the year, to give the courses in Public Service Law and Trade Regulation. A new course, known as the Law of Credit Transactions, which amalgamates the major portions of Suretyship, Bankruptcy and Mortgages, is now being offered by Professor Sturges.

THE APPLICATION TO INSURANCE CONTRACTS OF THE IMPLIED WARRANTY OF SALES LAW

The following situation frequently occurs in insurance litigation. A policy, issued upon oral application and without inquiry into one or more of the numberless factors pertinent to the risk, is accepted by the applicant and filed away without reading. Upon occurrence of the loss it is discovered that an express condition precedent to the policy holder's right has not been fulfilled, because of a state of facts existent and known to the insured at the time of issue of the policy, but unknown to the insurer by reason of the agent's failure to ask the questions contained in the usual application form. On the insurer's refusal to pay, a suit on the policy or for its reformation is brought.

Under the familiar law of contracts, developed to meet the average situation of parties dealing with each other on an equal footing and hence at arm's length, the plaintiff cannot recover at common law. The parol evidence rule,[1] founded upon the soundest principles of policy, is a perfect defense. It works no very great hardship to hold a man bound by the terms of a written contract upon his acceptance of the instrument, regardless of whether he has read it or not. Any other rule would be likely to work great injustice by opening the door to the very mass of uncertain and

[1] Anson, *Contracts* (Corbin, 4th Am. ed. 1924) sec. 347; 2 Williston, *Contracts* (1920) sec. 631; 5 Wigmore, *Evidence* (2d ed. 1923) sec. 2400–2478.

easily falsified oral testimony which the writing was designed to supplant. It is, moreover, contrary to our ideas of justice that a man should be allowed to take advantage of the beneficial provisions of a contract and at the same time evade the consequences of those that are prejudicial.[2] In equity the plaintiff apparently can expect no greater success. The conventional conception of neither fraud[3] nor mutual mistake[4] is satisfied by a simple failure of the insurer to inquire into the facts constituting the non-fulfillment of a condition or of the insured to notice the express provisions of the policy.

No relief seems available from the doctrines of waiver and estoppel. Waiver, said to be "an intentional relinquishment of a known right",[5] is inapplicable, as the situation lacks the essential element of knowledge by the insurer (even by its agent) of the circumstances amounting to a non-fulfillment of a condition. Estoppel, properly raised only by a misstatement (express or implied) of fact, on which the plaintiff has reasonably relied to his detriment,[6] is scarcely available, because no statement is to be inferred that the policy covered the risk for which it was taken out, since, by hypothesis, the insurer was unaware what that risk was.

Accordingly not a few courts have held for the insurer in such cases.[7] Two recent decisions to this effect are *Mishiloff v. American Central Ins. Co.* (1925) 102 Conn. 370, 128 Atl. 33, involving a suit for reformation of an automobile theft insurance policy issued to a conditional vendee with the usual condition regarding "sole and unconditional ownership", and *Hardin v. Liverpool & London & Globe Ins. Co., Ltd.* (1925) 189 N. C. 423, 127 S. E. 353, involving a suit to recover on a fire insurance policy with a similar condition, issued to a mortgagor on a dwelling house. In the former case the fact that the policy was "brokeraged" (written by an "insurance broker", not by the agent of the insurer) furnished

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[2] *Cf.* Root, J., dissenting in *Neher v. Western Assur. Co.* (1905) 40 Wash. 157, 160, 82 Pac. 166, 167.

[3] 3 Williston, *op. cit. supra* note 1, at ch. 41, p. 2645.

[4] 3 Williston, *op. cit. supra* note 1, at ch. 42, p. 2728.

[5] Vance, *Waiver and Estoppel in Insurance Law* (1925) 34 YALE LAW JOURNAL, 834, 846, and cases cited; eleven typical fact situations constituting waiver are examined, p. 841.

[6] Vance, *op. cit. supra* note 5. The elements of estoppel are discussed at p. 858; typical fact situations constituting estoppel at p. 857.

[7] *Beck v. Hibernia Ins. Co.* (1875) 44 Md. 95; *Mers v. Franklin Ins. Co.* (1878) 68 Mo. 127; *McFarland v. St. Paul Fire & Marine Ins. Co.* (1891) 46 Minn. 519, 49 N. W. 253; *Wilcox v. Continental Ins. Co.* (1893) 85 Wis. 193, 55 N. W. 188; *Syndicate Ins. Co. v. Bohn* (1894, C. C. A. 8th) 65 Fed. 165; *Aetna Ins. Co. v. Holcomb* (1896) 89 Tex. 404, 34 S. W. 915; *Orient Ins. Co. v. Williamson* (1896) 98 Ga. 464, 25 S. E. 560; *Dumas v. North-*

a reason in addition to those in the typical case for holding that there was no waiver. In each case the court decided in favor of the insurer after discussing principles and authorities in the customary fashion.

A line of cases to the contrary, extending back for half a century, for which the prevailing notions of justice in the community may be responsible, presents a variety of theories upon which many courts have relied in reaching a contrary result. Some of the early decisions were apparently based on a misconception of the factual situation, the courts failing to distinguish the defense of non-fulfillment of the condition from the then more usual one of concealment.[8] All that these cases really stand for is the doctrine that concealment will not avoid a policy (even though it contain a statement that the insured has divulged all matters pertinent to the risk) where the only unanswered questions are those that were never asked.[9] In numerous decisions use is made of a "conclusive presumption" that the insurer issued the policy on his

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western Nat. Ins. Co. (1898) 12 App. D. C. 245; *Rosenstock v. Mississippi Home Ins. Co.* (1903) 82 Miss. 674, 35 So. 309; *Parsons, Rich & Co. v. Lane* (1906) 97 Minn. 98, 106 N. W. 485 (leading case); *Virginia Fire & Marine Ins. Co. v. Case Threshing Mach. Co.* (1907) 107 Va. 588, 59 S. E. 369; *Rochester German Ins. Co. v. Schmidt* (1908, C. C. A. 4th) 162 Fed. 447; *Lancaster v. Southern Ins. Co.* (1910) 153 N. C. 285, 69 S. E. 214; *Eagle Ins. Co. v. Main* (1922) 140 Md. 220, 117 Atl. 571; *Del. Guidici v. Importers' and Exporters' Ins. Co.* (1923) 98 N. J. L. 435, 120 Atl. 5; *Virginia Fire & Marine Ins. Co. v. Lennon* (1924) 140 Va. 766, 125 S. E. 801.

8 *Quarrier v. Peabody Ins. Co.* (1877) 10 W. Va. 507; *Dooly v. Hanover Fire Ins. Co.* (1896) 16 Wash. 155, 47 Pac. 507. This discrepancy in the authorities has been pointed out by a court deciding in favor of the insurer. *Parsons, Rich & Co. v. Lane, supra* note 7, at 109, 106 N. W. at 490. And by a dissenting judge in a contrary case. *Glens Falls Ins. Co. v. Michael* (1907) 167 Ind. 659, 686, 74 N. E. 964, 972. In these opinions numerous other distinguishable cases customarily cited were examined and their inapplicability to the instant situation pointed out. The *Dooly* case, *supra*, has been expressly followed in *Burrows v. McCalley* (1897) 17 Wash. 269, 49 Pac. 508; *Neher v. Western Assur. Co., supra* note 2; *Gregerson v. Phenix Fire Ins. Co.* (1918) 99 Wash. 639, 170 Pac. 331; see also *Washington Fire Relief Assoc. v. Albro* (1924) 130 Wash. 114, 119, 226 Pac. 264, 266.

9 Cases are numerous in which this doctrine is announced on facts justifying its application. *Satterthwaite v. Mutual Ben. Ins. Assoc.* (1850) 14 Pa. 393; *Boggs v. America Ins. Co.* (1860) 30 Mo. 63; *Rawls v. American Mutual Life Ins. Co.* (1863) 27 N. Y. 282; *Union Assur. Soc. v. Nalls* (1903) 101 Va. 613, 44 S. E. 896; *Connecticut Fire Ins. Co. v. Colorado Leasing Co.* (1911) 50 Colo. 424, 116 Pac. 154; *Humble v. German Alliance Ins. Co.* (1911) 85 Kan. 140, 116 Pac. 472. Such decisions may have induced the general change in the practice of insurance companies from reliance on representations contained in the *application* to reliance on conditions precedent prescribed in the *policy*. See *German Mut. Ins. Co. v. Niewedde* (1895) 11 Ind. App. 624, 628, 39 N. E. 534, 535, for another reason for the insertion of the conditions. Apparently in the first two cases cited *supra* note 8 the courts, being accustomed to the old situation, failed to see the difference between it and the new.

own knowledge of the existent facts.[10] Thus, by a fiction, an additional element unsupported by the evidence is introduced into the case and an estoppel[11] is constructed. In other cases the courts have justified the finding that a so-called waiver exists by saying that to hold otherwise would be to attribute to the insurer a method of doing business falling but little short of obtaining money under false pretenses.[12]

So many courts have gone far afield to seek a justification for making a decision opposite to that which they would unhesitatingly make if the subject matter of the contract were other than insurance that an economic reason may be suspected. Courts have often mentioned the peculiar circumstances governing the formation of the insurance contract[13] and reference to them seems unnecessary. The contract has been called one of "adhesion",[14] as the insured merely "adheres" to it with little choice as to its terms. Unfamiliar with the elements which determine the quality of a risk, the average applicant for insurance customarily and reasonably relies on the agent, who he knows is familiar with the business, to issue him a policy fully covering the risk against which he wishes protection. The policy he receives is a complicated, ready-made mechanism composed of innumerable finely printed clauses couched in unfamiliar legal language, the meaning and legal effect of which he would have great difficulty in understanding if he should read them. The common practice is, moreover, *not* to read the policy, and a growing number of courts, recognizing that the custom of the community is one of the circumstances

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[10] *Philadelphia Tool Co. v. British Am. Assur. Co.* (1890) 132 Pa. 236, 19 Atl. 77; *Hanover Fire Ins. Co. v. Bohn* (1896) 48 Neb. 743, 67 N. W. 774; *Phenix Ins. Co. v. Fuller* (1898) 53 Neb. 811, 74 N. W. 269; *Arthur v. Palatine Ins. Co.* (1899) 35 Or. 27, 57 Pac. 62; *Farmers' & Merchants' Ins. Co. v. Mickel* (1904) 72 Neb. 122, 100 N. W. 130; *Farmers' State Bank v. Tri-State Mut. Fire Ins. Co.* (1919) 41 S. D. 398, 170 N. W. 638; *Murphey v. Liverpool & London & Globe Ins. Co., Ltd.* (1923) 89 Okla. 207, 214 Pac. 695; and see *Milison v. Mutual Cash Guaranty Fire Ins. Co.* (1909) 24 S. D. 285, 288, 123 N. W. 839, 840.

[11] The courts frequently use the word "waiver" instead of "estoppel". For the distinction between these concepts see Vance, *op. cit. supra* note 5, *passim*.

[12] *Wright v. Fire Ins. Co.* (1892) 12 Mont. 474, 31 Pac. 87; *German Mut. Ins. Co. v. Niewedde, supra* note 9; *Allesina v. London Ins. Co., Ltd.* (1904) 45 Or. 441, 78 Pac. 392; *Great So. Fire Ins. Co. v. Burns* (1915) 118 Ark. 22, 175 S. W. 1161; *Johnson v. Rocky Mountain Fire Ins. Co.* (1924) 70 Mont. 411, 226 Pac. 515.

[13] See *Philadelphia Tool Co. v. British Am. Assur. Co., supra* note 10, at 241, 19 Atl. at 78; *Allesina v. London Ins. Co., Ltd., supra* note 12, at 445, 78 Pac. at 393; *Great So. Fire Ins. Co. v. Burns, supra* note 12, at 28, 175 S. W. at 1162.

[14] See Patterson, *The Delivery of a Life Insurance Policy* (1919) 33 HARV. L. REV. 198, 222.

determining a standard of due care, have held this practice not to be negligence.[15] Accordingly policies have been reformed for mutual mistake, although the mistake must have become apparent to the insured if he had examined the contract.[16] Similarly, in suits on the policy, courts have not let failure so to examine prevent recovery, relying on the ground of waiver or estoppel.[17] Thus a tendency is marked to relax the strict rules of accountability to which a contracting party is ordinarily held.

In the every-day language of the streets, a man "buys" insurance. This terminology, upon examination, does not seem so metaphorical as at first it may appear. The policy, it has been

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[15] *Fitchner v. Fidelity Mut. Fire Assoc.* (1897) 103 Iowa, 276, 72 N. W. 530; *Medley v. German Alliance Ins. Co.* (1904) 55 W. Va. 342, 47 S. E. 101; *Niagara Fire Ins. Co. v. Jordan* (1910) 134 Ga. 667, 68 S. E. 611; *Salmon v. Farm Prop. Mut. Ins. Assoc.* (1915) 168 Iowa, 521, 150 N. W. 680; *Carlton Lumber Co. v. Lumber Ins. Co.* (1916) 81 Or. 396, 158 Pac. 807 (negligence, but not such as to prevent relief); *Fidelity & Casualty Co. v. Palmer* (1917) 91 Conn. 410, 99 Atl. 1052; *Connecticut Fire Ins. Co. v. Wigginton* (1918) 134 Ark. 152, 203 S. W. 844; *Giammares v. Allemania Fire Ins. Co.* (1918) 89 N. J. Eq. 460, 105 Atl. 611 (citing cases); *Bach v. People's Nat. Fire Ins. Co.* (1922) 97 Conn. 336, 116 Atl. 603; *contra: Bostwick v. Mutual Life Ins. Co.* (1902) 116 Wis. 392, 89 N. W. 538 (but not if the insured is an ignorant foreigner: *Komula v. General Accident, Fire & Life Assur. Corp., Ltd.* (1917) 165 Wis. 520, 162 N. W. 919); *Lumber Underwriters v. Rife* (1915) 237 U. S. 605, 35 Sup. Ct. 717; *Prudential Cas. Co. v. Miller* (1919, C. C. A. 6th) 257 Fed. 418; *Metzger v. Aetna Ins. Co.* (1920) 227 N. Y. 411, 125 N. E. 814.

[16] *Home Ins. Co. v. Myer* (1879) 93 Ill. 271; *Niagara Fire Ins. Co. v. Jordan, supra* note 15; *Agricultural Ins. Co. v. Anderson* (1919) 120 Miss. 278, 82 So. 146; *Sundin v. County Fire Ins. Co.* (1919) 144 Minn. 100, 174 N. W. 729; *Insurance Co. of N. A. v. Cleveland* (1920) 91 N. J. Eq. 371, 110 Atl. 582; *Georgia Cas. Co. v. Lumber Co.* (1920) 187 Ky. 511, 219 S. W. 442; *Newark Fire Ins. Co. v. Martinsville Harness Co.* (1920) 74 Ind. App. 14, 128 N. E. 616; *Northwestern Nat. Ins. Co. v. Chambers* (1922) 24 Ariz. 86, 206 Pac. 1081; *Tomato Products Co. v. Manufacturers' Liability Ins. Co.* (1922, 1st Dept.) 203 App. Div. 678, 197 N. Y. Supp. 497; *Home Ins. Co. v. Gaines* (1923, Colo.) 218 Pac. 908; *Robinson v. Union Auto. Ins. Co.* (1924, Neb.) 198 N. W. 166; *Merchants' & Manufacturers' Alliance v. Hansen* (1924, Tex. Civ. App.) 258 S. W. 257; *Brodie v. Atlas Assur. Co.* (1925, La.) 104 So. 620; *American Ins. Co. v. Jueschke* (1925, Okla.) 237 Pac. 585.

[17] *Kister v. Lebanon Mut. Ins. Co.* (1889) 128 Pa. 553, 18 Atl. 447; *McElroy v. British Am. Ins. Co.* (1899, C. C. A. 9th) 94 Fed. 990; *Allen v. Phoenix Assur. Co.* (1908) 14 Idaho, 728, 95 Pac. 829; *Central States Fire Ins. Co. v. Wright* (1925, Tex. Civ. App.) 273 S. W. 629. Most of the cases do not mention the failure of the insured to read the policy. *Miller v. Prussian Nat. Ins. Co.* (1909) 158 Mich. 402, 122 N. W. 1093; *Insurance Co. of Pa. v. Indiana Reduction Co.* (1917) 65 Ind. App. 330, 117 N. E. 273; *Stebbins v. Westchester Fire Ins. Co.* (1921) 115 Wash. 623, 197 Pac. 913; *Midland Motor Co. v. Norwich Union Fire Ins. Soc.* (1925, Mont.) 234 Pac. 482. But the fact must be implied, since an insured who knows at the time of issue that the policy is incorrect is uniformly precluded from recovery. *Mutual Life Ins. Co. v. Hilton-Green* (1916) 241 U. S. 613, 36 Sup. Ct. 676; *Bratley v. Brotherhood* (1924, Minn.) 198 N. W. 128.

pointed out, is in effect a highly complex machine, as intricate and as incomprehensible in its details to the layman as an automobile. He looks upon the two in very much the same way. The one is a vehicle of physical transportation, the other of financial protection. Each is a commodity sold him by the agent of the producer. If his automobile breaks down and fails, in consequence of defective mechanism, to afford efficient transportation, he can hold the manufacturer responsible on an implied warranty of fitness.[18] If his insurance policy breaks down and fails to cover the risk for which it was secured, why should he not be able to hold the insurer responsible on a similar warranty? This analogy apparently has never been expressed by any court, although the opinions of several would seem to suggest it.[19] At least it seems to rationalize more plausibly the result which many courts are reaching than the "false pretenses" and "conclusive presumptions" which they have expressly mentioned.[20] The implied warranty of reasonable fitness for an intended purpose has not been confined to the law of sales. It has been applied to bailments of chattels for hire,[21] to the leasing of furnished dwellings for short terms,[22] and in at least one state to leases in general.[23] Its extension to insurance

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[18] Sales Act, sec. 15 (1); 1 Williston, *Sales* (2d ed. 1924) secs. 227, 235; *Bobrick Chemical Co. v. Prest-O-Lite Co.* (1911) 160 Calif. 209, 116 Pac. 747; *Delaware Engineering Co. v. Pusey & Jones Co.* (1920, Del.) 112 Atl. 371; *Robinson v. Barteldes Seed Co.* (1921) 139 Md. 486, 115 Atl. 757; *Temple v. Keeler* (1924) 238 N. Y. 344, 144 N. E. 635; *Patterson Foundry Co. v. Detroit Stove Works* (1925, Mich.) 202 N. W. 957; *Grace & Co. v. National Wholesale Grocery Co.* (1925, Mass.) 146 N. E. 908; *Lorraine Mfg. Co. v. Allen Mfg. Co.* (1925, Colo.) 234 Pac. 1055; *Dalton Adding Mach. Sales Co. v. Denton* (1925, Okla.) 234 Pac. 201.

[19] See cases cited *supra* note 12; also *Northwestern Nat. Ins. Co. v. Chambers, supra* note 16, at 94, 206 Pac. at 1084.

[20] *Supra* notes 10, 12.

[21] *Fowler v. Lock* (1872) L. R. 7 C. P. 272. Early American cases seem to require negligence. *Hadley v. Cross* (1861) 34 Vt. 586; *Horne v. Meakin* (1874) 115 Mass. 326. But more recent cases state the usual sales rule of implied warranty. *Famous Players Film Co. v. Salomon* (1918) 79 N. H. 120, 106 Atl. 282; *Mallory S. S. Co. v. Druhan* (1920) 17 Ala. App. 365, 84 So. 874; *Hoisting Engine Sales Co. v. Hart* (1923) 237 N. Y. 30, 142 N. E. 342. The last case states the rule after a careful consideration of authorities. The court declares that it is unnecessary to consider whether the Sales Act applies, as suggested in 2 Williston, *op. cit. supra* note 1, sec. 1041.

[22] *Smith v. Marrable* (1843, Exch.) 11 M. & W. 5; *Wilson v. Hatton* (1877) L. R. 2 Exch. Div. 336; *Ingalls v. Hobbs* (1892) 156 Mass. 348, 31 N. E. 286; *Young v. Povich* (1922) 121 Me. 141, 116 Atl. 26.

[23] Louisiana: *Bennett v. Southern Scrap Material Co.* (1908) 121 La. 204, 46 So. 211; *O'Rourke v. Fulton Bag & Cotton Mills* (1913) 133 La. 955, 63 So. 480. The Georgia doctrine goes almost as far. *Thompson v. Walker* (1909) 6 Ga. App. 80, 64 S. E. 336; *Mc Yere v. Withers* (1915) 15 Ga. App. 688, 84 S. E. 163; *Gibbons v. Hoefeld* (1921) 299 Ill. 455, 132 N. E. 425. The majority doctrine is *contra. Valin v. Jewell* (1914) 88 Conn. 151, 90 Atl 36; *Wood v. Carson* (1917) 257 Pa. 522, 101 Atl. 811; *Hopkins v. Mur-*

law does not seem strained in view of the results already being reached by the courts.

STOCK DIVIDENDS VERSUS DIVIDENDS IN STOCK

"A word is not a crystal, transparent and unchangeable, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and time in which it is used".[1] The truth of this striking statement by Mr. Justice Holmes is exemplified in the action of the Supreme Court of the United States in determining the scope of the constitutional power granted by the Sixteenth Amendment to the Federal Constitution enabling Congress "to lay and collect taxes on incomes from whatever source derived". The well known decision of the Supreme Court in the case of *Eisner v. Macomber*[2] (four justices dissenting) that stock dividends are not "income" within the meaning of the Sixteenth Amendment and so not taxable as such, lays down what seems at first sight a simple rule, but one which has given rise to possibly unforeseen complications. Cash dividends have been admitted by all to be "income" within the meaning of the amendment.[3] Mr. Justice Holmes, convinced of the truth of the statement quoted above, came to the conclusion that for the purpose of the constitutional amendment, though not necessarily for any other purpose, there was no sound basis for distinguishing stock dividends from cash dividends.[4] Whether or not there is any valid reason for making the distinction which the majority of the court did and whether the usual arguments of the courts

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phy (1919) 233 Mass. 476, 124 N. E. 252; *Kutchera v. Graft* (1921) 191 Iowa, 1200, 184 N. W. 297; *Dwyer v. Woollard* (1923, 3d Dept.) 205 App. Div. 546, 199 N. Y. Supp. 840.

[1] *Towne v. Eisner* (1918) 245 U. S. 418, 38 Sup. Ct. 158.

[2] (1920) 252 U. S. 189, 40 Sup. Ct. 189.

[3] Not only have cash dividends been held to be "income" within the meaning of the Sixteenth Amendment, but a stockholder has been held to have received "income" when a cash dividend was declared and paid to him after the effective date of the Act of 1913, even though the dividend came from assets accumulated by the corporation prior to the effective date of the Amendment. *Lynch v. Hornby* (1918) 247 U. S. 339, 38 Sup. Ct. 543. A distribution by a corporation of its stock holdings in another corporation is "income" although the stock distributed had been acquired before the Sixteenth Amendment. *Peabody v. Eisner* (1918) 247 U. S. 347, 38 Sup. Ct. 546. As to the question of a dividend paid in stock of a corporation other than the declaring corporation, see *infra* note 9. It has also been held that a cash dividend with the preferential right to subscribe to additional shares is "income". The court said, "Every stockholder could take the money and use it as he chose". *Hyde v. Holmes* (1908) 198 Mass. 287, 84 N. E. 318; *Smith v. Cotting* (1918) 231 Mass. 42, 120 N. E. 177.

[4] "I think the word 'incomes' in the Sixteenth Amendment should be read in a sense most obvious to the common understanding at the time of its adoption. For it was for public adoption that it was proposed. The known purpose of this amendment was to get rid of nice questions as to what might

are sound are questions which have been so fully and ably discussed by many writers that additional discussion seems superfluous.[5] In any event, it seems at least improbable that that decision will be overruled; and doubtless the corporations of the country have adjusted their financial arrangements in accordance with it, so that a reversal would involve the business community in serious complications. For these reasons, the present discussion will accept the result of that case as settled law and will be confined to the complications which necessarily result from drawing the distinction between cash and stock dividends.

In approaching this problem, it must not be forgotten that—if the view of Mr. Justice Holmes in the passage quoted is sound—in determining the meaning to be given to the word "income" as used in the Sixteenth Amendment, the particular problem, viz., taxation under the Sixteenth Amendment, must be kept steadily in view.[6] It is not decisive that the same word may have had a certain meaning given to it by economists or even by the courts when deciding another and different problem. For this reason, for example, cases settling whether or not stock dividends are "income" or an addition to "principal" as between a life tenant and a remainderman in the law of trusts throw but little light upon the constitutional question.[7]

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be direct taxes, and I cannot doubt that most people not lawyers would suppose when they voted for it that they put a question like the present to rest". Holmes, J., dissenting in *Eisner v. Macomber*, *supra* note 2.

[5] Clark, *Eisner v. Macomber and Some Income Tax Problems* (1920) 29 YALE LAW JOURNAL, 735; Seligman, *Implications and Effects of the Stock Dividend Decision* (1921) 21 COL. L. REV. 313; Warren, *Taxability of Stock Dividends as Income* (1920) 33 HARV. L. REV. 885; Powell, *Stock Dividends, Direct Taxes, and the Sixteenth Amendment* (1920) 20 COL. L. REV. 536; Clark, *The Stock Dividend Decision* (1920) 23 THE NEW REPUBLIC, 59; *The Supreme Court v. The Supreme Court* (1920) 21 THE NEW REPUBLIC, 235.

[6] That the purpose may vary considerably in different cases is well illustrated by the recent case of *People ex rel. Clark v. Gilchrist* (1925, App. Div. 3d Dept.) 211 N. Y. Supp. 679. The Income Tax Law of New York makes stock dividends expressly taxable as "income". It was contended by the relator that the court was bound by the rule of the *Eisner* case. The court, however, held that that case decided only that stock dividends are not taxable as "income" *under the Sixteenth Amendment.* The court said: ". . . *Eisner v. Macomber* is not an authority against this state tax as seems sometimes to have been assumed, but on the contrary is an authority in favor of the tax. The court expressly stated that the purpose of Congress to tax stock dividends as "income" is plainly evinced, but such purpose was thwarted by the constitution. The State Legislature is not hampered by constitutional restrictions . . . the Legislature may make its own definition and when it manifests its intention to include stock dividends as income or to bring them within the purview of the Income Tax Law that is the end of the matter".

[7] It has generally been held that stock dividends are "capital" and as such

Having determined that under the Sixteenth Amendment stock dividends are "capital" and that cash dividends are "income" the court has necessarily been called upon in subsequent cases to determine where the line is to be drawn, and what type of dividend shall be called a stock dividend. As is so frequently the case a distinction which seems at first sight simple turns out to be extremely complex; and there are cases that do not fall clearly within either one or the other of these classes, but in a "twilight zone" intermediate between the two.[8] It has been held that a distribution by a corporation of its stockholdings in another corporation is "income" and so taxable.[9] This amounts to saying that a declaration of dividends in the stock of another corporation and not in the stock of the declaring corporation is "income". Prof. T. R. Powell has expressed the result well by saying that dividends to be stock dividends within the rule of the *Eisner* case must be dividends in the stock of the declaring corporation, and that a dividend in the stock of a different corporation is a "dividend in stock" rather than a "stock dividend". This, he says, is because the dividend in stock transfers to the stockholder what had previously been assets of the corporation.[10] It would indeed be extraordinary if it were held that profits distributed as cash dividends were "income", but profits distributed in the form of some other kind of property—shares of stock in another corporation—were not.

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go to the remainderman. *Gibbons v. Mahon* (1890) 136 U. S. 549, 10 Sup. Ct. 1057; NOTES (1917) 4 VA. L. REV. 660. The Massachusetts Income Tax Law provides that stock dividends are taxable as "income". It has been held that this may be done even though stock dividends are treated as "capital" and as between life tenants and remaindermen go to the latter. *Tax Commissioner v. Putnam* (1919) 227 Mass. 522, 116 N. E. 904.

[8] See Wurzel, *Juridical Thinking* (1917) 9 *Modern Legal Philosophy Series*, 342 *et seq.* "In our approach towards exactness we constantly tend to work out definite lines or equators to mark distinctions which we first notice as a difference of poles. It is evident in the beginning that there must be differences in the legal position of infants and adults. In the end we establish twenty-one as the dividing point. . . . When he has discovered that a difference is a difference of degree, that distinguished extremes have between them a penumbra in which one gradually shades into the other, a tyro thinks to puzzle you by asking where you are going to draw the line, and an advocate of more experience will show the arbitrariness of the line proposed by putting cases very near to it on one side or the other." Holmes, (1920) *Collected Legal Papers* 232. See Holmes, J., dissenting in *Haddock v. Haddock* (1906) 201 U. S. 562, 631, 26 Sup. Ct. 525, 553.

[9] *Peabody v. Eisner* (1918) 247 U. S. 347, 38 Sup. Ct. 546. ". . . the dividend of the Baltimore and Ohio shares was not a stock dividend but a distribution in specie of a portion of the assets of the Union Pacific, and is to be governed for all present purposes by the same rule applicable to the distribution of a like value in money."

[10] Powell, *Protecting Property and Liberty* (1925) 40 POLIT. SC. QUART. 426.

If this distinction is made, it becomes necessary to determine whether the stock distributed is in the same corporation that declares the dividend or in a different corporation. In the case of *United States v. Phellis*,[11] decided a year after the *Eisner* case, the directors of a New Jersey corporation created another corporation in Delaware and transferred to it property in exchange for shares of stock which it distributed to the shareholders in the New Jersey corporation in proportion to their original holdings. A divided court held that the dividends in the new stock were "income". In the case of *Rockefeller v. United States*,[12] a similar result was reached on facts which were substantially the same except that the new corporation was created in the same state. In both cases the original corporation continued its operations, and in both cases the old corporation and the new were practically identical.

A similar problem is raised when the old corporation does not remain in existence after the formation of the new one. Thus, in the case of *Cullinan v. Walker*,[13] a Texas corporation was dissolved and the liquidating trustees transferred its assets to two new corporations in exchange for their stock. This stock they transferred to a Delaware holding corporation in exchange for its stock, which was distributed to the shareholders in the old corporation. It was held that the dividend so paid was "income" within the meaning of the Sixteenth Amendment. The reason given by the court was that the gain taxed "resulted from a dividend in liquidation actually distributed in the stock of a holding company incorporated under the laws of a foreign state, not organized for the purpose of carrying on the old business, and which held no title to the original assets". On the other hand in the case of *Weiss v. Stearn*,[14] involving substantially similar facts, except that the new corporation was created in the same state and took over the assets and business of the old corporation, a contrary result was reached. It is difficult to find any sound basis upon which to distinguish these two cases, and the results seem, therefore, in conflict.

In the recent case of *Marr v. United States* (1925, U. S.) 45 Sup. Ct. 575, a divided court followed the rule as laid down in *United States v. Phellis*[15] and in *Rockefeller v. United States*.[16] A New Jersey corporation had accumulated from profits a large

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[11] (1921) 257 U. S. 156, 42 Sup. Ct. 63.

[12] (1921) 257 U. S. 176, 42 Sup. Ct. 68. For a brief but able discussion of these two cases see, Powell, *Supreme Court's Review of Legislation, 1921–1922* (1922) 37 POLIT. SC. QUART. 492.

[13] (1923) 262 U. S. 134, 43 Sup. Ct. 495.

[14] (1924) 265 U. S. 242, 44 Sup. Ct. 490. See Powell, *op. cit. supra* note 10.

[15] *Supra* note 11.

[16] *Supra* note 12.

surplus. Its officers caused a new corporation to be organized in Delaware. The appellants, stockholders in the New Jersey corporation, received in exchange for stock held by them in that corporation stock in the new corporation. The difference between the cost of their stock in the New Jersey corporation and the value of the stock in the Delaware corporation was $324,466.57. The Treasury Department ruled that this difference was "income", and assessed an additional income tax. The appellants paid it under protest and brought suit to recover the amount. It was held that such a difference was "income" within the meaning of the term as used in the Sixteenth Amendment. It seems clear that the factual situation in the instant case is substantially similar to that of the *Phellis* and *Rockefeller* cases, and that a similar rule should be followed. The result reached by the court seems sound.

It is apparent from an examination of these cases that no rule of thumb can be laid down as to what is and what is not income under the Sixteenth Amendment. Whether or not the stock issued is in substantially the same corporation is one of those troublesome questions of degree. The more recent decisions perhaps indicate a tendency on the part of a majority of the Supreme Court to limit the rule of *Eisner v. Macomber* that stock dividends are not "income". Possibly this is due to a more or less unconscious feeling on the part of a majority of the court as it is now constituted that the decision in *Eisner v. Macomber* was an unfortunate one, and that that ruling should therefore be extended no further than is absolutely necessary.

OPTION COVENANTS AND THE RULE AGAINST PERPETUITIES

Although the rule against perpetuities is of relatively recent growth it was firmly established before the occasion arose to determine whether it applied to option contracts. In 1879 in what seems to be the first case involving the question it was held that a preëmption covenant contained in a deed of conveyance of surface land (that is to say a covenant giving the grantee, his heirs and assigns, an option to purchase the mineral rights to the land in case the grantor should ever desire to sell them) was not obnoxious to the rule.[1] The decision was based on the theory that the rule was designed merely to prevent suspension of the power of alienation for longer than the prescribed time and therefore would not be infringed, since the covenantor and covenantee acting together could at any time convey good title to the land. But in 1882 this case was overruled in *London and South Western Ry. v. Gomm*[2], in which it was decided that a covenant in

[1] *Birmingham Canal Co. v. Cartwright* (1879) L. R. 11 Ch. Div. 421.
[2] (1882) L. R. 20 Ch. Div. 562.

a deed giving the grantor an unlimited option to repurchase was void as a perpetuity, since it clogged, even if it did not wholly prevent, the alienation of the land.[3] This decision has been followed uniformly in England[4] and generally in this country,[5] it being stated by the courts in cases involving a variety of circumstances that an option to purchase land which possibly may not be exercised within the limit prescribed by the rule is void as creating an undesirable restriction on freedom of alienation.

A well known exception to the rule against perpetuities existent from the earliest times is found in the case of the lessor's cov-

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[3] For the two interpretations of the rule see *Woodall v. Bruen* (1915) 76 W. Va. 193, 195, 85 S. E. 170; Fraser, *The Rationale of the Rule Against Perpetuities* (1922) 6 MINN. L. REV. 560.

[4] *Trevelyan v. Trevelyan* (1885, Ch. Div.) 53 L. T. (N. S.) 853 (essential facts as in *Gomm* case, *supra* note 2); *Manchester Ship Canal Co. v. Manchester Racecourse Co.* [1900] 2 Ch. 352, *aff'd* [1901] 2 Ch. 37 (essential facts as in *Birmingham Canal Co.* case, *supra* note 1); the case of *Southeastern Railway Co. v. Associated Portland Cement Manufacturers* [1910] 1 Ch. 12, is distinguishable, as the court construed the deed as reserving a present easement, not an option to create one; see Williams, *Contracts in Restraint of Alienation and the Rule Against Perpetuities* (1910) 54 SOL. JOUR. 471, 501.

[5] *Winsor v. Mills* (1892) 157 Mass. 362, 32 N. E. 352 (agreement providing for certain land to be held for the joint benefit of two several owners until both should agree to discontinue arrangement and giving one a power to purchase a specified portion for a specified price any time during duration of the arrangement); *Starcher Bros. v. Jeff Duty* (1907) 61 W. Va. 373, 56 S. E. 524 (one year purchase-option contract renewable yearly forever); *Barton v. Thaw* (1914) 246 Pa. 348, 92 Atl. 312 (deed of mineral rights containing a surface purchase-option covenant); *Woodall v. Bruen, supra* note 3 (two deeds of land with covenants to reconvey mineral rights at grantor's option, one unlimited in time, the other within ninety-nine years); *Henderson v. Bell* (1918) 103 Kan. 422, 173 Pac. 1124 (covenant in deed giving grantor the power of preëmption); *Lewis Oyster Co. v. West* (1919) 93 Conn. 518, 107 Atl. 138, discussed in COMMENTS (1919) 29 YALE LAW JOURNAL, 87 (same facts); *Eastman Marble Co. v. Vermont Marble Co.* (1920) 236 Mass. 138, 128 N. E. 177 (contract settling boundary, containing twenty-five year purchase-option covenant); *Turner v. Peacock* (1922) 153 Ga. 870, 113 S. E. 585 (deed with covenant giving grantee an option to purchase certain additional land); *Skeen v. Clinchfield Coal Corp.* (1923) 137 Va. 397, 119 S. E. 89 (same); *contra*: *Buck v. Walker* (1911) 115 Minn. 239, 132 N. W. 205 (upholding covenant in a deed of land excepting minerals, which gave grantee an unlimited option to pay damages or repurchase the land); *Mineral Land Inv. Co. v. Bishop Iron Co.* (1916) 134 Minn. 412, 159 N. W. 966 (upholding a fifty-year option for a lease); *cf. Ball v. Milliken* (1910) 31 R. I. 36, 76 Atl. 789 (not mentioning the rule against perpetuities, but upholding a covenant in a deed binding the grantee to convey to the grantor on breach of condition); J. R. R., *The Rule Against Perpetuities as Applied to Options*, NOTE AND COMMENT (1916) 14 MICH. L. REV. 231; J. R. Rood, *Options and the Rule Against Perpetuities* (1917) 23 CASE AND COMMENT, 835; (1917) 15 MICH. L. REV. 526.

enant to renew a lease at the lessee's option.[6] This, it appears, has always been held valid even though granting a power to require a perpetual series of renewals,[7] and even though the first occasion for exercise of this power will be after the prescribed period has run.[8] Although an attempt has been made to rationalize the exception by means of the fiction that the power to renew is part of the lessee's present interest and that he takes substantially a fee,[9] it cannot thus be explained away. Its existence, however, can be accounted for by reference to the origin of the rule against perpetuities. It is a judge-made rule, a rule of policy necessitated by the increased freedom in the creation of contingent future estates brought about by the operation of the Statute of Uses. It was aimed to curb the power of the great English landed proprietors by disabling them from placing obstacles in the way of the alienation of their estates out of their respective families for a period longer than was deemed politic. In the era in which the rule was taking shape leaseholders were scarcely a class of persons likely to impair the best interests of society by acquiring too much land. Accordingly it seems never to have been brought to the attention of the courts that, logically, the customary covenants for the renewal of leases would fall under the letter of the ban which was being established.

Two other exceptions merit mention. A so-called "right of forfeiture and re-entry" (really a power) reserved to a grantor or lessor in a deed of conveyance or of lease for however long a term has been held valid by American courts,[10] in many cases

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[6] Apparently the earliest decision to this effect is *Bridges v. Hitchcock* (1715) 1 Bro. P. C. 522.

[7] *Bridges v. Hitchcock, supra* note 6; *Furnival v. Crew* (1744) 3 Atk. 83; *Copper Mining Co. v. Beach* (1823, Ch.) 13 Beav. 478; *Sadlier v. Biggs* (1853) 4 H. L. 435; *Blackmore v. Boardman* (1859) 28 Mo. 420; *Banks v. Haskie* (1876) 45 Md. 207; *Hoff v. Royal Metal Furniture Co.* (1907, 2d Dept.) 117 App. Div. 884, 103 N. Y. Supp. 371, *aff'd* (1907) 189 N. Y. 555, 82 N. E. 1128; *Wynn v. Conway Corp.* [1914] 2 Ch. 705; *Thaw v. Gaffney* (1914) 75 W. Va. 229, 83 S. E. 983; *Becker v. Submarine Oil Co.* (1921) 55 Calif. App. 698, 204 Pac. 245 (not mentioning the contrary decision of *Morrison v. Rossignol* (1855) 5 Calif. 65).

[8] *Banks v. Haskie, supra* note 7; *Toms v. Williams* (1879) 41 Mich. 552, 2 N. W. 814.

[9] See Gray, *Rule Against Perpetuities* (3d ed. 1915) sec. 230. He says that the rule against perpetuities, practical though strict, treats the situation according to effect and not form. Although this text is retained from the first edition, it is admitted (sec. 230 a) that Williams in *Options to Purchase in Leases and the Rule Against Perpetuities* (1898) 42 SOL. JOUR. 628, has pointed out that the construction seems strained in those cases where the power of renewal must be exercised at a set time or on payment of a fine.

[10] *French v. Old South Society* (1871) 106 Mass. 479; *Wakefield v. Van Tassell* (1903) 202 Ill. 41, 66 N. E. 830.

without mention of the rule against perpetuities.[11] In England it has been held void under the rule.[12] In neither country is a possibility of reverter after a fee on special limitation obnoxious thereto.[13] The validity of these two interests, like that of renewal options in leases, can be accounted for by the fact that they were well established long before the rule against perpetuities was born. It may also be noted that they are not sufficiently numerous to be harmful to the public.

Although a lease for a term longer than the perpetuity period frequently contains a covenant giving the lessee an option to purchase the fee at any time during the term, up to the beginning of the twentieth century the question of the validity of such a covenant apparently had never been before the courts.[14] In at least two cases in the United States such covenants had been enforced without mention of perpetuities.[15] Text writers had discussed the problem and arrived at divergent conclusions.[16] The situation seems to bear strong resemblances to three of those previously discussed. It is difficult to perceive any substantial difference between a purchase-option covenant contained in a deed of lease and a similar covenant in other deeds of conveyance, since in both cases the option holder has the power to create in himself after the prescribed period has run the same set of legal

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[11] *Lessee of Sperry v. Pond* (1832) 5 Ohio, 387; *Pickle v. McKissick* (1853) 21 Pa. 232; *Scott v. Stipe* (1859) 12 Ind. 74; *Taylor v. Cedar Rapids Ry.* (1868) 25 Iowa, 371; *Horner v. Chicago Ry.* (1875) 38 Wis. 165; *Cowell v. Springs Co.* (1879) 100 U. S. 55; *Langley v. Chapin* (1883) 134 Mass. 82; *Smith v. Barrie* (1885) 56 Mich. 314, 22 N. W. 816; *Upington v. Corrigan* (1896) 151 N. Y. 143, 45 N. E. 359; *Oxford Bd. of Trade v. Oxford Iron & Steel Co.* (1911) 81 N. J. L. 694, 80 Atl. 324; *Southwick v. New York Christian Missionary Soc.* (1912, 4th Dept.) 151 App. Div. 116, 135 N. Y. Supp. 392, *aff'd* (1914) 211 N. Y. 515, 105 N. E. 204; *Rook's Creek Church v. Church of Pontiac* (1919) 290 Ill. 133, 124 N. E. 793.

[12] *Dunn v. Flood* (1883) L. R. 25 Ch. Div. 629; *In re Hollis Hospital* [1899] 2 Ch. 540; *In re Da Costa* [1912] 1 Ch. 337.

[13] *North v. Graham* (1908) 235 Ill. 178, 85 N. E. 267; *Pond v. Douglass* (1909) 106 Me. 85, 75 Atl. 320; *Board of Freeholders v. Buck* (1912) 79 N. J. Eq. 472, 82 Atl. 418; *Pennsylvania Horticultural Soc. v. Craig* (1913) 240 Pa. 137, 87 Atl. 678 (discussing the rule against perpetuities); *Fall Creek Tp. v. Shuman* (1913) 55 Ind. App. 232, 103 N. E. 677; *Loomis v. Heublein* (1916) 91 Conn. 146, 99 Atl. 483; *Des Moines Ry. v. Des Moines* (1916, Iowa) 159 N. W. 450; *Puffer v. Clark* (1918) 202 Mich. 169, 168 N. W. 471; see *Yarbrough v. Yarbrough* (1925, Tenn.) 269 S. W. 36, 38; and dicta expounded in Gray, *op. cit. supra* note 9, secs. 33, 40.

[14] Mr. Williams, *op. cit. supra* note 9, stated that the question had never been decided.

[15] *Prout v. Ruby* (1872, U. S.) 15 Wall. 471; *Hagar v. Buck* (1872) 44 Vt. 285.

[16] A number of such discussions are mentioned by Williams, *op. cit. supra* note 9.

relations with respect to the land. Likewise there seems to be no real difference between a purchase-option covenant and a renewal-option covenant in a deed of lease, since in both cases the option holder's power is to create in himself a right to perpetual possession of the land (plus numerous subsidiary legal relations) with the distinction, which seems more apparent than actual, that in the case of the lease the power is exercised periodically to create rights to possession for successive terms. Moreover, a power of entry for condition broken seems, on analysis, very similar to a lessee's option to purchase, for each is a power in one of the two parties who together have the complete group of legal relations constituting property in land to vest in himself the totality of those relations.

In 1905 the leading case of *Woodall v. Clifton*[17] established for England the doctrine that the purchase-option covenant in a lease is no exception to the rule against perpetuities but comes within the doctrine of the *Gomm* case.[18] The court was of the opinion[19] that the exception of the renewal-option covenant was difficult to justify logically and should not be extended; moreover, that the classic justification for that exception, the fiction that the added term is part of the original estate of the lessee, could not be applied to the new situation. This holding is law today in England.[20] In Ireland a series of analogous cases have decided that a clause in an instrument in which a legal rent charge is created providing that the charge may be determined at any time by paying a fixed sum of money is in violation of the rule against perpetuities,[21] while a clause in a similar instrument providing that the rent may be fined down to a peppercorn is valid.[22] In Amer-

[17] [1905] 2 Ch. 257.

[18] *Supra* note 2.

[19] Opinion of the trial judge, Warrington, J., printed in *Woodall v. Clifton*, *supra* note 17, at 259. The decree was affirmed by the Court of Appeal in *Woodall v. Clifton*, at 278.

[20] *Worthing Corp. v. Heather* [1906] 2 Ch. 532 (specific performance of a purchase-option covenant was denied in a suit by the lessee of a thirty-year lease, but damages were awarded on the theory that inasmuch as at common law no interest in land is created by the covenant the rule against perpetuities does not apply. But *cf. Eastman Marble Co. v. Vermont Marble Co.*, *supra* note 5, at 153, 128 N. E. at 183, holding in a case involving a purchase-option covenant contained in a deed that damages were not allowable as being equally with specific performance outside the policy of the law); *Rider v. Ford* [1923] 1 Ch. 541 (carefully distinguishing between purchase- and renewal-option covenants, but not discussing the reason for this distinction).

[21] *In re Tyrrell's Estate* [1907] 1 Ir. R. 292, overruling *Switzer v. Rochford* [1906] 1 Ir. R. 399; *In re Donoughmore* [1911] 1 Ir. R. 211.

[22] *In re Browne* [1911] 1 Ir. R. 205. This distinction is used by Rood, *Options and the Rule Against Perpetuities*, *supra* note 5, as a glaring example of the absurd results achieved by applying the rule against perpetuities to option contracts.

ica until recently there was apparently but a single case determining the validity of purchase-option covenants in long-term leases: *Hollander v. Central Metal and Supply Co.*[23] This case, which considers the English authorities and repudiates them, has been considered by some text writers[24] as expressing a purely local rule founded upon the Maryland practice of holding land by long-term leases; and such a conclusion indeed is to be inferred from the language of the court.[25] But the recent case of *Keogh v. Peck* (1925) 316 Ill. 318, 147 N. E. 266, seems to indicate that the Maryland rule is perhaps wider in its application.

In this case the rule against perpetuities was one of the defenses pleaded to a bill for specific performance of a purchase-option covenant in a ninety-nine year lease. The court examined a few authorities[26] cited in favor of this plea and distinguished them on the grounds, first, that in none of them was the option covenant contained in a lease, and, secondly, that they all were based on the conception that an option to purchase created an interest in land, whereas "in this state no title, legal or equitable, is granted and no interest in land is created in the holder of the option by the option agreement." [27] The court then compared the covenant in question first with renewal-option covenants and secondly with conditions in deeds of conveyance or of lease giving the grantor or lessor for their breach an option of forfeiture and re-entry, and was unable to find any distinction between them and the covenant in issue. It then referred to the *Hollander* case[28] mentioned above and decided that the instant covenant was valid under the rule against perpetuities.

The court in distinguishing authorities apparently overlooked the indistinguishable doctrine of *Woodall v. Clifton*[29] though it subsequently quoted from the case *arguendo*. Moreover, even though it be admitted that the rule against perpetuities is inapplicable to purely contractual rights,[30] the statement that in

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23 (1909) 109 Md. 131, 71 Atl. 442.

24 Gray, *op. cit. supra* note 9, at 205, note 2; (1924) 22 MICH. L. REV. 279; (1924) 10 VA. L. REV. 333; other writers have given the decision more credit: J. R. R., *op. cit. supra* note 5, at 231; Rood, *op. cit. supra*, note 5, at 836; Abbot, *Leases and the Rule Against Perpetuities* (1918) 27 YALE LAW JOURNAL, 878, 888.

25 109 Md. at 159, 71 Atl. at 447, quoting *Banks v. Haskie, supra* note 7, at 218.

26 *London & South Western Ry. v. Gomm, supra* note 2; *Winsor v. Mills, supra* note 5; *Starcher v. Duty, supra* note 5; *Lewis Oyster Co. v. West, supra* note 5.

27 At 271.

28 *Supra* note 23.

29 *Supra* note 17.

30 This doctrine has been frequently stated by courts and text writers: *Worthing Corp. v. Heather, supra* note 20, at 542; Gray, *op. cit. supra* note 9, sec. 329; but see NOTES (1925) 25 COL. L. REV. 77.

Illinois no interest in land is created by a purchase-option covenant seems hardly justified by the authority cited by the court.[31] The decision, therefore, does not seem sustainable on either of the first two grounds advanced. It may, however, be recognized as the first extension of the Maryland rule,—which may indeed become the American rule, for there are at present at least two[32] American jurisdictions for it and apparently none against it.

The rule against perpetuities being merely a rule of policy there seems to be no reason why new exceptions to its operation should not be developed by the courts as policy dictates. The peril of dominance by an oligarchy composed of a small landed aristocracy does not exist in America. Here the only justification for the rule seems to be the maxim that land should be freely alienable in order that it may come into the hands of the man most likely to improve it for his own benefit and for the general good of society. In this country long-term leases have proved a profitable method of land tenure, advantageous alike to lessor and lessee, under which at least one large city, Baltimore, has grown to prosperity.[33] The reversion, valuable because of the rent annexed to it, sells as a sound and stable investment of unfluctuating value; the term is likewise assignable. The termor, protected by the purchase-option covenant, is safe in making any development of the property which economic need may require,[34] and any purchaser of the term may, by exercising

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[31] *Gall v. Stoll* (1913) 259 Ill. 174, 102 N. E. 225. The decision is merely that no title, legal or equitable, is vested in the purchaser of land by virtue of a "bond for a deed" (a contract to convey to the purchaser upon his making certain specified payments). Not until those payments are made, says the court, does the right to specific performance accrue and the equitable title vest. That is not at all the same thing as saying that a covenant giving an option to purchase creates no interest in land. By the Hohfeld system of analysis an option is a power-liability relation. Hohfeld, *Fundamental Legal Conceptions* (1913) 23 YALE LAW JOURNAL, 16.) The option holder has a power to create in himself a right in the land. The landowner has a liability to have created in him a duty to convey the land. The power of the option holder is surely an interest in land, as many courts have declared; *e. g.*, see *Manchester Ship Canal Co. v. Manchester Racecourse Co.*, *supra* note 4, at 366. For a collection of judicial definitions of an interest in property see 2 *Words and Phrases* (2d Series, 1914) 1137. That an express power to create an estate in land, known customarily as a power of appointment, is within the rule of perpetuities is everywhere acknowledged. Gray, *op. cit. supra* note 9, at 379.

[32] Maryland and Illinois; this does not include the United States Supreme Court and Vermont which have decided the same way without consideration of the rule against perpetuities. See *supra* note 15.

[33] *Banks v. Haskie*, *supra* note 7.

[34] *Cf.* Abbot, *op. cit. supra* note 24, at 886.

the option, acquire the whole fee at will. It thus seems that though upon analysis a purchase-option covenant contained in a deed of lease creates the same legal relations as one contained in other deeds of conveyance, its economic effect is beneficial rather than injurious. Our law is not a merely logical system; consciously or unconsciously, courts frequently base decisions on grounds of economic betterment. The growth of the rule against perpetuities is an instance of this. *Cessante ratione, cessat ipsa lex.* A new exception to the rule against perpetuities may well be born.

RIGHTS OF A DEPENDENT BENEFICIARY UNDER INSURANCE POLICIES PROCURED WITH MISAPPROPRIATED FUNDS

The embezzler or defaulter who uses part of his ill-gotten gains to purchase insurance for innocent dependents precipitates a struggle for the proceeds of the policies so obtained. The claim of his widow or other beneficiary is usually met with an attempt on the part of the defrauded person to follow his money into the policies procured therewith and secure the proceeds of such policies. A recent case, *Truelsch v. Northwestern Mutual Life Insurance Co.* (1925, Wis.) 202 N. W. 352 (one judge dissenting) may be added to the list of authorities favoring this contention of the defrauded party.[1] The insured had embezzled $4,477.73 from his employers. With part of the stolen funds he paid all the premiums on three policies of life insurance, and the last two of three premiums on a fourth policy; the whole amount of insurance aggregating $5,500. In an action to impress a trust upon the policies, it was held that while the widow was entitled to one-third of the fourth policy, proportionate to the honest premium paid therefor, the plaintiff was equitably entitled to the balance of the proceeds up to the amount of the embezzlement, which was all that was claimed in the bill.

The cases which deny the beneficiary's claim to the proceeds of such policies are professedly based upon that rule of the law of trusts permitting the following of trust funds into their product.[2]

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[1] *Shaler v. Trowbridge* (1877) 28 N. J. Eq. 595; *Holmes v. Gilman* (1893) 138 N. Y. 369, 34 N. E. 205; *Massachusetts Bonding and Insurance Co. v. Josselyn* (1923) 224 Mich. 159, 194 N. W. 548; *Vorlander v. Keyes* (1924, C. C. A. 8th) I Fed. (2d) 67; *cf. Bromley v. Cleveland C. C. & St. L. Ry.* (1899) 103 Wis. 562, 567, 79 N. W. 741, 743; *contra*: *Bennett v. Rosborough* (1923) 155 Ga. 265, 116 S. E. 788, criticised in (1923) 26 A. L. R. 1408, note; (1923) 33 YALE LAW JOURNAL, 207.

[2] *Shaler v. Trowbridge, supra* note 1, at 602; *Holmes v. Gilman, supra* note 1, at 376, 34 N. E. at 206; *Massachusetts Bonding and Insurance Co. v. Josselyn, supra* note 1, at 162, 194 N. W. at 549; *Vorlander v. Keyes, supra* note 1, at 69; *Truelsch v. Northwestern Mutual Life Insurance Co.* cited in text p. 220, at 357.

The defrauded person is thus given the adventitious advantage which results from the greatly increased value of the policy, consequent upon the death of the insured. The recovery of this increase in value is not based on any meritorious act of the defrauded person, but on the idea that the trustee must not be permitted to gain by his wrongdoing in improperly investing another's funds.[3] The constructive trust is in no way dependent upon the agreement or the intention of the parties; it is a device to attain the ends of justice.[4] No compulsion should attach to its use in a case where countervailing considerations are involved in such manner as to cause its application to work injustice.[5] It has been expressly stated that life insurance does not differ from other forms of investment in this type of case.[6] But in making such a statement the courts seem not to have given adequate consideration to the functional aspect of life insurance. It is submitted that to emphasize this factor and to permit the defrauded person to recover only the amount of the premiums stolen, plus interest, is to reach a sounder result. Only life insurance for the benefit of dependents, however, is within the scope of this discussion.

Practically all the cases heretofore decided have declared that the entire amount of the insurance money is subject to a trust,

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[3] "This excess above full compensation is not given to the *cestui que trust* by reason of any merit on his part. It comes to him as a mere windfall. Public policy demands that the faithless trustee should not retain any advantage derived from his breach of trust. Hence the wholesome rule that whatever a trustee loses in the misuse of the trust fund he loses for himself, and whatever he wins he wins for the beneficiary." Ames, *Lectures on Legal History* (1913) 413.

[4] 1 Perry, *Trust and Trustees* (6th ed. 1911) sec. 166; 3 Pomeroy, *Equity Jurisprudence* (4th ed. 1918) 2405. This has been recognized in the cases under consideration. *Cf. Shaler v. Trowbridge, supra* note 1, at 602.

[5] For example: There is no equity in the *cestui que trust's* claim to the accession in value to the trust *res* (see *supra* note 3). His equity extends only to the value of the trust *res*, plus interest. When the trust *res* is given to an innocent donee whose astuteness in investing it increases its value, it would seem that the *cestui's* claim to the accession in value should be regarded as inferior to that of the innocent donee. See Ames, *op. cit. supra* note 3, at 417.

[6] The courts are almost unanimous in making this statement. See *Massachusetts Bonding and Insurance Co. v. Josselyn, supra* note 1, at 163, 194 N. W. at 549. Mr. Williston, writing on a somewhat similar question, was of the same opinion. Williston, *Can an Insolvent Debtor Insure his Life for the Benefit of his Wife?* (1891) 25 AM. L. REV. 185, 193. "If this suit had been presented in the life time of the husband, and the policy had been disposed of to the company for its surrender value, it would hardly have been insisted that he could claim, in a court of conscience, a right to any excess of the proceeds after refunding to his firm the amount of the premiums." Van Syckel, J., in *Shaler v. Trowbridge, supra* note 1, at 604. It is to be observed, however, that cases like the instant one, where the husband is dead, are different from the case put by the court just quoted. On the

where all the premiums have been paid with misappropriated funds. There are some dicta, however, to the effect that the person whose money has been used to pay the insurance premiums can recover only the amount so used plus interest.[7] Where only a part of the premiums has been paid with misappropriated funds, a trust has been impressed on a proportional part of the policy proceeds.[8] It has also been declared that when the first premium is paid with the insured's own money, and stolen money is used to pay subsequent premiums, the beneficiary is entitled to everything except the sums misapplied plus interest.[9] Misappropriated money in such a case is being used for the maintenance rather than the purchase of the chose in action.[10] This distinction, however, was not taken in the instant case.[11]

While it has been said that "the *cestui que trust* takes the whole of the insurance money, although ten times as much as the trust money misappropriated" [12] it is to be noted that in most of the cases decided the proceeds of the policies have in fact been less than the total sum taken. The circumstance that the insurance money exceeded the entire amount misappropriated, as in the instant case, was present only once before.[13] It is sig-

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death of her husband, the power to procure life insurance for the wife's benefit is destroyed; while she might still have exercised it during the life time of the husband on the discovery of his defalcations.

[7] *Hubbard v. Stapp* (1889) 32 Ill. App. 540, 546; *Thum v. Wolstenholme* (1900) 21 Utah, 446, 469, 61 Pac. 537, 542; *Bank of Stewart County v. Mardre* (1914) 142 Ga. 110, 111, 82 S. E. 519.

[8] *Dayton v. Claflin Co.* (1897, 1st Dept.) 19 App. Div. 120, 45 N. Y. Supp. 1005; *Vorlander v. Keyes, supra* note 1; *Massachusetts Bonding and Insurance Co. v. Josselyn, supra* note 1.

[9] See *Holmes v. Davenport* (1891, Sup. Ct. Spec. T.) 18 N. Y. Supp. 56, 63; *Thum v. Wolstenholme, supra* note 7, at 469, 61 Pac. at 540.

[10] By the prevailing view the contract of life insurance is regarded as an entire contract, and not a contract for a year with privilege of renewal. *New York Life Ins. Co. v. Statham* (1876) 93 U. S. 24. Analogous cases supporting the proposition in the text may be found in the law of trusts. *Hanna v. McLaughlin* (1902) 158 Ind. 292, 63 N. E. 475 (tracing trust funds into payment of mortgage of trustee; *held, cestui* entitled to lien upon property to the extent that his money had gone into it); *Bodwell v. Nutter* (1886) 63 N. H. 446, 3 Atl. 421 (trust money expended not in purchase of land, but in improvements upon it; *held,* no trust results to the owner of the money).

[11] In *Vorlander v. Keyes, supra* note 1, where half of the initial premium was paid with stolen funds, prorating was consistent with the position taken by the court.

[12] Ames, *loc. cit. supra* note 3.

[13] In *Massachusetts Bonding and Insurance Co. v. Josselyn, supra* note 1, the trustee owed $31,147.91 as a result of his misuse of trust funds; the total proceeds of the policies amounted to $62,180.53. After prorating the proceeds of the policies on which but part of the premiums had been paid with trust money, it was concluded that $54,471.80 belonged to the *cestui que trust,* but the decree limited recovery to the amount of the actual

nificant that in these two cases the defrauded person was given, not the whole proceeds of the policies, but only so much as was necessary to make good the sum embezzled.[14] Cases not involving insurance, in which trust property is followed into its product, do not show this unwillingness to permit the *cestui que trust* to recover the entire fruits of the improper investment.[15] The exceptional treatment of the life insurance contract in the instant case and in the Michigan case would perhaps indicate a tacit recognition of the fact that life insurance contracts for the benefit of dependents are to be regarded as different from other choses in action, in spite of the courts' declarations to the contrary.

But these decisions are open to more serious objection. It is well recognized that the *cestui que trust* must stand or fall on his ability to trace a particular *res* into a definite product.[16] If recovery is limited to the amount misappropriated, then the courts are no longer tracing the trust *res* (the amount of the premiums) into its final product and giving *that* product to the *cestui*. It

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shortage—$31,147.91. In *Vorlander v. Keyes*, *supra* note 1, the exact amount of the trustee's indebtedness to the defrauded person does not appear; he is described as being "heavily indebted".

[14] "The decree limited recovery to the amount of the actual shortage as determined by the probate court. This, we think, plaintiff was clearly entitled to. The conclusion reached is in accord with that expressed in *Holmes v. Gilman*. . . ." *Massachusetts Bonding and Insurance Co. v. Josselyn*, *supra* note 1, at 164, 194 N. W. at 549. But the extent of recovery when the insurance money exceeded the amount misappropriated was expressly left undetermined in the case on which the court relies. See *Holmes v. Gilman*, *supra* note 1, at 385, 34 N. E. at 209—"If the proceeds of these policies had been greater than the whole amount of the indebtedness of the husband to the *cestui que trust*, arising out of the husband's breach of trust, we do not decide what might in equity be the different rights of the wife and such *cestui que trust* in the balance, or whether any different rule could be logically applied." The instant case recognizes this, but seems to have overlooked the Michigan case. See *Truelsch v. Northwestern Mutual Life Insurance Co.* cited in text p. 220, at 360.

[15] *Weaver v. Fisher* (1884) 110 Ill. 146; *Bent v. Priest* (1885) 86 Mo. 475.

[16] This has been recognized in the cases under consideration. See *Holmes v. Gilman*, *supra* note 1, at 376, 34 N. E. at 206; *Massachusetts Bonding and Insurance Co. v. Josselyn*, *supra* note 1, at 162, 194 N. W. at 549. In some states the rule has been relaxed so as to allow the estate of the trustee to be charged with the trust where it can be shown to have been benefited by its use. *Hopkins v. Burr* (1898) 24 Colo. 502, 52 Pac. 670; *Reeves v. Pierce* (1902) 64 Kan. 502, 67 Pac. 1108. But the general rule is that the trust *res* can be followed only when the *cestui* is able to trace and identify it in particular property. *Slater v. Oriental Mills* (1893) 18 R. I. 352, 27 Atl. 443; *Spokane County v. First National Bank* (1895, C. C. A. 9th) 68 Fed. 979; *Matter of Hicks* (1902) 170 N. Y. 195, 63 N. E. 276; *Hewitt v. Hayes* (1910) 205 Mass. 356, 91 N. E. 332. The cases are discussed at length by Pound, C. in *City of Lincoln v. Morrison* (1902) 64 Neb. 822, 90 N. W. 905.

may seriously be questioned, then, whether the courts have not abandoned the path of the constructive trust, on which they profess to be proceeding.

Life insurance has its origin in the desire to protect the family.[17] While as late as 1815 a Massachusetts court was seriously considering whether the contract of life insurance was consonant with sound policy,[18] life insurance for the benefit of dependents has continued to play an increasingly important rôle in modern social engineering.[19] Not only has modern law recognized the legality of such provision against misfortune, but it has accorded very special protection to the beneficiaries of such insurance. Some form of exemption of insurance money in the hands of dependents from the claims of the insured's creditors is to be found in the statutes of practically every state in the Union.[20] Both

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[17] "But if the term 'insurance' be given a broader significance and be made to include any kind of conventional arrangement by which one or more persons assume the risk of perils to which others are exposed—that is, an arrangement for aiding the unfortunate—then it is equally unquestionable that insurance is as old as human society itself." Vance, *Early History of Insurance Law* (1908) 8 COL. L. REV. 1, 3. "The purpose of the insured, made possible by the insurer, is to extend his earning power beyond the term of his life for the express advantage of those who in his life were the beneficiaries of that earning power. The life insurance contract is sentiment transmuted with actuarial accuracy into the genuine substance which sustains widows and orphans in the months and years following the decease of the breadwinner." Blackburn, *The Life Insurance Contract, Being Unique, Should Be So Considered and Treated by Courts and Law Makers* (1916) (paper read before the Association of Life Insurance Counsel). See also 14 *Enc. Brit.* (11th ed. 1910) 656 *et seq.*

[18] *Lord v. Dall* (1815) 12 Mass. 115. And the ban of illegality on the life insurance contract was not lifted in France until 1820. See Vance, *Beneficiary in Life Insurance* (1922) 31 YALE LAW JOURNAL, 343, 346, note 19. The objection to life insurance was thus stated: " . . . that it is indecorous to set a price upon the life of a man, and especially a freeman, which, as they say, is above all price." Parker, C. J. in *Lord v. Dall, supra*, characteristically questioned the soundness of such an argument in the absence, at that time, of freedom in France.

[19] *The Significance of the Recent Growth in Life Insurance* (1923) PROCEEDINGS OF THE 17TH ANNUAL MEETING OF THE ASSOCIATION OF LIFE INSURANCE PRESIDENTS, 102 *et seq.*

[20] Legislation was passed at comparatively early dates permitting a married woman to insure the life of her husband for her sole use to be free from his creditors. N. Y. Laws, 1840, ch. 80; Mass. Laws, 1844, ch. 82. Practically all of the modern statutes grant exemptions of life insurance for the benefit of wives and children. While the statutes vary in the degree of protection accorded, they may be grouped as follows: (1) those not limiting the amount of insurance exempted; (2) those limiting the amount exempted to a stated sum; (3) those limiting the amount exempted by the amounts of the premiums. For a complete list and analysis of the statutory exemptions in all the states see Young, *Bankruptcy and Exemption Statutes as Affecting Disposition of Life Insurance Proceeds* (1918) (paper read before the Association of Life Insurance Counsel). For a study

by judicial decision and by statute in many jurisdictions the privilege of an insolvent debtor to procure insurance to a reasonable amount for the protection of dependents is recognized.[21] It is to be noted that the case of *Cohen v. Samuels*,[22] holding that the trustee in bankruptcy may exercise the power reserved by the insured bankrupt to change the beneficiary and thus obtain the cash surrender value of the policy, did not involve an exemption statute. But where there are exemption statutes, the weight of authority under the Bankruptcy Act still favors the insured's wife's rights, though the power is reserved to change the beneficiary.[23] And

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of the extent to which statutes may control the disposition of life insurance proceeds, see Young, *Rights of Beneficiaries, Next of Kin, Creditors, and Others to Life Insurance Policies, and the Proceeds Thereof Under the Statutes of Maine* (1917) (paper read before the Association of Life Insurance Counsel). In the cases under consideration (and in the instant case) it is sometimes sought to defeat the defrauded person's claim to the proceeds of the policies by invoking one of the statutes herein mentioned. With the exception of *Bennett v. Rosborough*, *supra* note 1, such attempts have been unsuccessful. The soundness of that decision, resting as it does on Ga. Civ. Code, 1910, sec. 2498, may be questioned. (1923) 33 YALE LAW JOURNAL, 207; (1923) 26 A. L. R. 1408, note. The weakness of the Georgia statute has been the subject of judicial comment. ". . . the law of Georgia is not as explicit as the law of some of the states for the protection of the widow." Speer, J., in *In re Cohn* (1916, S. D. Ga.) 230 Fed. 733, 737. And the Supreme Court of the United States in construing that statute held that it did not protect the cash surrender value of the policy from the trustee in bankruptcy. *Cohn v. Malone* (1919) 248 U. S. 450, 39 Sup. Ct. 141; (1919) 28 YALE LAW JOURNAL, 603.

21 The leading case recognizing this privilege in the absence of statute is *Central National Bank v. Hume* (1888) 128 U. S. 195, 9 Sup. Ct. 41; *Pence v. Makepeace* (1879) 65 Ind. 345, 360; *contra*: *Lehman v. Gunn* (1899) 124 Ala. 213, 27 So. 475; Williston, *op. cit. supra* note 6. In some jurisdictions the creditor may recover premiums paid subsequent to insolvency. *Houston v. Maddux* (1899) 179 Ill. 377, 53 N. E. 599. This result is sometimes reached by statute. Minn. Gen. Sts. 1913, sec. 3465; Hurd's Ill. Rev. Sts. 1919, ch. 73, sec. 199; Ohio Rev. Gen. Code, 1921, sec. 9394. Where the statute is silent as to the disposition of the insurance money in excess of the statutory exemption, the creditors, by the prevailing view, can only recover the premiums paid in excess of the statutory exemption. *Bank v. Huiet* (1916, E. D. S. C.) 244 Fed. 216. But in *Cornwell v. Surety Fund Life Co.* (1921) 44 S. D. 391, 184 N. W. 211, defendants did not ask for limitation of recovery to amount of premiums paid for insurance in excess of amount exempted. See also Richards, *Insurance Law* (3d ed. 1916) 91.

22 (1917) 245 U. S. 50, 38 Sup Ct. 36; (1918) 27 YALE LAW JOURNAL, 403, 404.

23 *Young v. Thomason* (1912) 179 Ala. 454, 60 So. 272; *Jens v. Davis* (1922, C. C. A. 8th) 280 Fed. 706; *In re Johnson* (1910, D. C. Minn.) 176 Fed. 591. *In re Brinson* (1919, S. D. Miss.) 262 Fed. 707; *In re Pittman* (1921, E. D. N. C.) 275 Fed. 686; *Holden v. Stratton* (1905) 198 U. S. 202, 25 Sup. Ct. 656; *In re Orear* (1911, C. C. A. 8th) 189 Fed. 888; *contra*: *In re White* (1909, C. C. A. 2d) 174 Fed. 333; *In re Samuels* (1918, C. C. A. 2d) 254 Fed. 775; *Cohn v. Malone*, *supra* note 20; (1919) 28 YALE LAW

the exemption statutes of three states expressly include policies wherein the power is reserved to change the beneficiary.[24]

In protecting the interest of the dependent beneficiaries against the consequences of wrongful acts by the insured, the legislatures of some states have gone so far as to declare that neither suicide of the insured nor his execution for crime shall defeat the beneficiary's claim to payment.[25] Probably the policy underlying such legislation is to be found in unwillingness to give an unexpected profit to the insurer at the expense of the dependent beneficiary.[26] It is thus seen that the wife's interest in her husband's policy is protected from the vicissitudes of her husband's business, and from her husband's conduct. It is true enough that in all the cases mentioned above, the insured's own funds, and not misappropriated funds, were being used, but they serve to show that life insurance has been treated differently because of its functional aspects.

The courts have apparently had the notion that "trust principles" *must* be applied because *misappropriated* money is involved.[27] To take that position is to assume the very question at issue, and to ignore the presence of countervailing considerations. And the cause of the dependent beneficiary has further been impeded by the fear of the courts that fraud or dishonesty would be given judicial sanction if the dependents of the embezzler are to be permitted to recover the avails of the policies.[28] The trustee is not to be tempted into trying to make a profit from another's funds.[29] Yet everywhere except in New Jersey the trustee is permitted to obtain some profit with another's funds when he

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JOURNAL, 603. See also Patten, *Insured Wife's Rights under General Exemption Statutes* (1923) 3 BOST. L. REV. 75.

[24] Minn. Gen. Sts. 1910, secs. 3465, 3466; Pa. Laws, 1919, ch. 128, sec. 1; Ohio Gen. Code, 1921, secs. 9394, 9395.

[25] Mo. Rev. Sts., 1919, sec. 6150; *Knights' Templar & Masons' Life Endowments Co. v. Jarman* (1902) 187 U. S. 197, 23 Sup. Ct. 108.

[26] See Richards, *Life Insurance—Suicide and Execution for Crime* (1913) 22 YALE LAW JOURNAL, 292.

[27] "In this case, however, there is the fact which alters and colors the whole transaction and is fundamental and controlling in its nature, and that fact is that the monies which procured the insurance were trust monies, and although invested in the policies, they were subject at the very moment of such investment to the right of the owner of the funds to follow them. . . ." Peckham, J., in *Holmes v. Gilman, supra* note 1, at 384, 34 N. E. at 209. "Without a disregard of these fundamental rules of equity jurisprudence there is no logical or rational way of escape from the conclusion of the court below that, when the insured paid with the funds of the bank . . . he became a trustee *ex maleficio*." Sanborn, C. J., in *Vorlander v. Keyes, supra* note 1, at 70. See also *Dayton v. Claflin Co.* (1896, Sup. Ct. Trial T.) 41 N. Y. Supp. 839, 850.

[28] See *Shaler v. Trowbridge, supra* note 1, at 604.

[29] 1 Perry, *op. cit. supra* note 4, at 91.

mingles them with his own in wrongful investment.[30] Whether or not permitting a recovery on the policy will encourage wrongdoing is after all a matter of conjecture. The suppression of crime is an office of the criminal law rather than the civil law; the latter should not be shaped to encompass the ends of the former. And if the decisions are to be sustained because of the effect on crime, it would seem that the increase in value should go to the state as a penalty.[31] To say that the innocent wife must be held to have adopted the acts of her husband,[32] is to take a position which is untenable in view of the modern development of the law of domestic relations.[33]

The defrauded person's recovery of the increased value of the trust *res* in cases of constructive trusts has been aptly termed a "windfall",[34] and in the case of ordinary investment of trust property there seems to be no reason why he should not get it in the absence of a better claim. But since in life insurance, the increase over the misappropriated funds invested as premiums would go to a person who gives nothing in return for it, it is suggested that his claim has not as great equitable strength as that of the dependent beneficiary. Moreover, in many cases the investment of part of the stolen money in insurance lulls the dependents into a feeling of security, and prevents them from taking out other insurance in some legitimate way.[35] At any rate, to give this "windfall" to the defrauded person without giving adequate consideration to the functional aspects of life insurance is to fail to evaluate the situation properly.

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[30] *Bohle v. Hasselbroch* (1902) 64 N. J. Eq. 334, 51 Atl. 508; see Ames, *op. cit. supra* note 3, at 414.

[31] It will be understood that the writer does not contend that this should be done. Here, as elsewhere in this discussion, it is being attempted to show that the courts have not been consistent in the position they have taken.

[32] "His wife can derive, through so corrupt a source, no equitable rights to these policies." Van Syckel, J., in *Shaler v. Trowbridge*, *supra* note 1, at 605; see also *Dayton v. Claflin Co.*, *supra* note 27, at 849.

[33] According to the prevalent view in the United States, responsibility is not imposed on one spouse for the wrongs committed by the other. See COMMENTS (1925) 34 YALE LAW JOURNAL, 543, *passim*.

[34] Ames, *loc. cit. supra* note 3.

[35] It should be remembered that if the wife is to be deprived of the insurance money, she may have to be supported at the expense of the state: if there are children, they may have to be reared in poverty. For a discussion of the manner in which the state is relieved of the burdens of taking care of indigents, see Barnes, *The Federal Taxation of Life Insurance Companies* (1917) (paper read before the Association of Life Insurance Counsel).