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NEGOTIABILITY AND THE RENVOI DOCTRINE

A recent English case decides two interesting and very important questions in the Conflict of Laws. A, of Liverpool, bought cotton from B in the United States, who drew a bill of exchange on A, which contained in the margin the date of the sale contract and a reference to the quality of the cotton and in the body of the document the words "value received and charge the same to account of $\frac{100}{\text{R.S.M.I.}}$ bales of cotton." C, in New York, in good faith purchased the draft with what purported to be the bill of lading of the cotton attached, and sent the documents to A, who accepted the draft and paid it at maturity. The bill of lading was a forgery and no cotton had been shipped. On discovery of the fraud, A brought an action in the District Court of the United States for the Southern District of New York to recover back from C the amount of the money paid. The trial court, treating the question as one of American law, rendered judgment in A's favor. The judgment was reversed by the Circuit Court of Appeals[1] and a new trial ordered on the ground that the case was governed by English law and that the trial judge had disregarded the evidence before him of what the English law was. In order to avoid the necessity of taking evidence of expert witnesses concerning English law at the new trial, C decided to obtain a declaratory judgment of the English courts upon the English law applicable.[2] The King's Bench Division held that the judgment of the American court was binding upon the parties in England, but that according to English law the rights of the parties depended upon American law. It was held, therefore, that A was entitled to recover the money paid. *Guaranty Trust Co. of New York v. Hannay & Co.* [1918] 1 K. B. 43.

I

It is evident at the outset that the English court sanctions the *renvoi* doctrine in the Conflict of Laws. It purports to decide the case according to English law as directed by the judgment of the United States Circuit Court of Appeals, but it decides it actually according to American law. The term "English law" to which the American judgment referred may have one of two meanings. It may mean the internal law of England relating to negotiable instruments, foreign bills of lading, etc., exclusive of the English rules of the Conflict of Laws, or it may mean the English law as a whole, inclusive of its rules of the Conflict of Laws. The *renvoi* doctrine, so-called, signifies that the foreign law, to which the rules of the Conflict of Laws of the forum refer the controversy, is understood in the latter sense. The King's Bench Division accepts the interpretation last mentioned, apparently without being aware that in so doing it takes sides with respect to one of the most disputed problems in the Conflict of Laws.[3] Indeed, it accepts the *renvoi* doctrine in its most extensive form—

[1] *Guaranty Trust Company of New York v. Hannay et al.* (1913, C. C. A. 2d) 210 Fed. 810.

[2] For a discussion of the English procedure permitting merely declaratory judgments, see article by Prof. Borchard to appear in the following number.

[3] For a discussion of the problem, see Lorenzen, *The Renvoi Theory and the Application of Foreign Law* (1910) 10 COLUMBIA L. REV. 190, 327, and *The Renvoi Doctrine in the Conflict of Laws—Meaning of "The Law of a Country"* (1918) 27 YALE LAW JOURNAL, 509; Schreiber, *The Doctrine of the Renvoi in Anglo-American Law* (1918) 31 HARV. L. REV. 523. A bibliography of the subject may be found in 27 YALE LAW JOURNAL, pp. 531-534.

that of "forward reference." In applying it to the validity and obligation of contracts, as distinguished from capacity and matters of form, it goes beyond any English[4] or Continental[5] court in the matter. Practical considerations of a very decisive character speak against the adoption of the *renvoi* doctrine in any form.[6] Its application to contracts in general is well-nigh impossible. Hence it is recognized by even the most ardent advocates of the doctrine that it should not be extended to commercial contracts.[7] All questions of the Conflict of Laws should be settled, save in a few exceptional cases,[8] by the rules of the Conflict of Laws of the forum, and the foreign law which these rules adopt should be understood to be the foreign law on the ultimate question to be determined, and not the foreign rules of the Conflict of Laws.

II

How did the English court reach the conclusion that American law was applicable? It was conceded in the case that the acceptor could recover his money if the draft was non-negotiable.[9] And it was found that according to the American law of Bills and Notes the instrument paid was a mere conditional order, but that, if it were governed wholly by the English law of Bills and Notes, it would be a negotiable draft. The question therefore arose whether, as regards the English acceptor, the law of England or that of the United States should decide the negotiability of the instrument. The English court answered this question by reference to the Conflict of Laws provisions of the English Bills of Exchange Act. Section 72 of that Act provides as follows:

"(1) The validity of a bill as regards requisites in form is determined by the law of the place of issue. . . .

"Provided that . . . (b) Where a bill, issued out of the United Kingdom, conforms, as regards requisites in form, to the law of the United Kingdom, it may, for the purpose of enforcing payment

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[4] (1910) 10 COLUMBIA L. REV. 332, *et seq.;* (1918) 31 HARV. L. REV. 537, *et seq.*

[5] (1910) 10 COLUMBIA L. REV. 192-193.

[6] (1910) 10 COLUMBIA L. REV. 205-206; (1918) 27 YALE LAW JOURNAL, 524, *et seq.*

[7] Although the German code has accepted the *renvoi* doctrine, the consensus of German juristic opinion appears to have been opposed to the application of the doctrine to contracts in general. See 4 *Verhandlungen des 24 Deutschen Juristentages*, 76.

[8] Concerning such exceptions, see (1918) 27 YALE LAW JOURNAL, 529, *et seq.*

[9] If there had been a difference between the English and American law on this point, the English law would probably have controlled, even though the question arose in the United States, because the matter relates to the *performance* of the contract.

thereof, be treated as valid between all persons who negotiate, hold, or become parties to it in the United Kingdom."

These provisions apparently support the proposition that if the instrument is negotiable under the law of the place of its issue it will be deemed so with respect to all parties, but if it is non-negotiable according to such law, it may be negotiable, nevertheless, as between persons who hold or become parties to it in the United Kingdom. The conditions required by proviso (b) of the English Act are, however, (1) that the bill shall conform to the law of the United Kingdom as regards requisites of form; (2) that the suit shall be "for the purpose of enforcing payment thereof"; (3) that it arise *between* persons who negotiate, hold, or become parties to it in the United Kingdom. The instant case appears to be the first involving an interpretation of this proviso of the English Act. Had the case turned wholly on the second of the above conditions, that is, had both parties to the suit become parties to the instrument in England, an interesting question might have arisen in determining whether the instrument was to be considered as negotiable for the purpose of enforcing payment against the acceptor even though all the facts were known, but non-negotiable when the suit was the other way, so that the acceptor, having paid voluntarily in ignorance of the facts, could at once recover back what he had paid. It seems absurd to say that a party can, on a given state of facts, recover back money paid, although, if he had not already paid it, he could now on the same state of facts be compelled by suit to pay. In the actual case, however, it is not quite clear whether the second or the third condition was held controlling. The court admits that if the acceptor had refused to pay an English holder, suit might have been maintained on the acceptance. But the question was, says the court, "Was this draft a conditional order when the plaintiffs bought it, and when they presented it for acceptance to the defendants, and they accepted it? This question is untouched by the proviso." It is true that the plaintiff, C, did not become a party to the instrument in the United Kingdom, but C transmitted it to a bank in Liverpool to be presented there to A for acceptance, and after acceptance C negotiated it in England, and payment was finally made to a London bank, as the ultimate holder. It would seem therefore that C might have been held within the description of "persons who *negotiate, hold,* or become parties to [an instrument] in the United Kingdom."

Enough has been said to show the difficulties of construing the proviso of the English Act and to indicate a doubt whether, purely as a question of construction, the decision of the King's Bench Division was correct. It would have been better if the proviso in the English Act had followed the example of either the Argentine Commercial

Code[10] or the German Bills of Exchange Law,[11] and simply imposed general liability on any person becoming a party to the instrument in the United Kingdom.

The proviso being out of the case, the English court proceeded to apply the general Conflict of Laws provision of subsection (1) of Section 72 of the English Act. The case illustrates in a most striking manner the strange consequences to which the recognition of the *renvoi* doctrine in the Conflict of Laws may lead. An American appellate court decides that the lower court erred in applying American law to determine the negotiability of an instrument with respect to an acceptor, and that this question is to be determined according to English law. The judgment is regarded as binding upon the parties in an English court. Suit is brought thereupon in England to get a decision on the English law, and behold, it is gravely answered that American law governs! One almost wonders why the English court did not go one step further. If "English law" includes English Conflict of Laws, why does not "American law" include American Conflict of Laws? Having found, then, that the "English law" invoked by the American court "throws the parties back upon American law," why did not the English court hold, under the decision of the American court, recognized as binding on the parties, that "American law" would "throw the parties back upon English law?" And so the game of battledore and shuttlecock might continue indefinitely.

Or, if it be said that the *renvoi* principle can be applied but once in a single controversy, it is interesting to speculate on what law of Bills and Notes the English court would have applied, had the suit been brought in England in the first instance. Apparently it would have been held, under the Bills of Exchange Act, that American law governed. Would the *renvoi* then have been invoked to apply the American doctrine of Conflict of Laws and "throw the parties back upon English law?" If so, the only reason for reaching a different result in this case, and finally applying American Bills and Notes law, would seem to be that in this case an American court had first held, in a decision binding on the parties, that English law applied!

[10] The Argentine Code applies only to endorsers. It reads as follows: "Nevertheless, if the statements made in a foreign bill of exchange are sufficient according to the laws of the Republic, the circumstance that they are defective according to foreign laws cannot give rise to defences against endorsements afterwards added in the Republic." Art. 738.

[11] The German Code provision refers to acceptors as well as to endorsers. It provides as follows: "If, however, the statements inserted abroad on the bill satisfy the requirements of the inland law, no objection can be taken against the legal liability incurred by statements subsequently made within the Empire (Inland) on the ground that the statements made abroad do not satisfy the foreign law." Art. 85.

It is to be remembered, however, that the real question is whether the English court correctly interpreted the American decision, and that the American court will have the last word. When the Circuit Court of Appeals referred the parties to English law, did it mean English Bills and Notes law only, or English Conflict of Laws? The opinion would seem to indicate the former. The evidence which the lower federal court disregarded seems to have related solely to the law of Bills and Notes, as distinguished from Conflict of Laws. If this is what the Circuit Court of Appeals meant, then its decision conclusively determined between the parties all questions of Conflict of Laws involved, and the only question left open was what the English law of Bills and Notes might ultimately be found to be. The English court discussed this question and held that under English Bills and Notes law the acceptor would be bound and could not recover back. So much of the decision, if it stands unreversed in England, would presumably be binding on the parties in subsequent proceedings in the American courts. The rest of the English decision the American courts are at liberty to disregard, as at variance with the decision already rendered by the Circuit Court of Appeals between the same parties on the question of Conflict of Laws, and resulting only from a misinterpretation of that decision by the English court.

It is to be hoped that the New York federal courts will hold fast to the distinction between questions of Conflict of Laws and questions of Bills and Notes, and will not be misled by any errors of the English courts into giving their sanction to this astonishing and unfortunate extension of the *renvoi* doctrine. To follow the English courts into that maze can lead only to hopeless confusion in our commercial law.

As this is written, we note a report in a New York newspaper for May 30th to the effect that the English decision has been reversed by the Court of Appeals. The grounds of reversal are not stated, but may be awaited with interest.

III

A few words may be added in regard to the American rule of Conflict of Laws in respect to the negotiability of instruments, which was applied by the Circuit Court of Appeals in the case under discussion. Most American courts decide the question in accordance with the general rule that the law of the place of payment governs the validity and obligation of contracts.[12] As each endorsement or acceptance on a bill or note is regarded as a separate contract governed by the law

[12] *Strawberry Point Bank v. Lee* (1898) 117 Mich. 122, 75 N. W. 444; *Barger v. Farnham* (1902) 130 Mich. 487, 90 N. W. 281; *Freeman's Bank v. Ruckman* (1860, Va.) 16 Gratt. 126.

of the place of its performance, and this place of performance is not necessarily the same for all parties, the conclusion has been drawn that the negotiability of the instrument should be determined with respect to each party by the law governing his contract.[13] The United States Circuit Court of Appeals held therefore, upon the basis of the American decisions, that the liability of the English acceptor in the present case was controlled by English law. It is submitted, however, that the principle on which the American courts proceed is unsound, and that the provisions of the English Bills of Exchange Act approach more nearly to the correct solution of the problem. Bills of exchange cannot be regarded from a purely local point of view. They have international functions to perform, and they cannot serve this purpose unless the status as negotiable documents which the law at the time of their issue has conferred upon them is recognized in all countries with respect to all parties. Whether the governing law should be the law of the place where the original instrument was issued, that is, the law of the place where it was delivered, or whether it should be controlled by the law of the place where the principal contract was to be performed, need not be investigated here, although it would seem reasonably clear that in the absence of an international agreement adopting the law of the place of payment of the instrument as the law governing the rights and obligations of *all* parties, the law of the place of issue should be given the preference.

It does not follow, of course, that if the original instrument is non-negotiable under the law applicable at the time of its creation, a person accepting or endorsing the instrument in a different state or country might not justly be held in the courts of that state or country as an acceptor or endorser of a negotiable instrument. If the original instrument would have been regarded as negotiable had it been executed in the state where the person in question becomes a party to the instrument, there is no reason why on grounds of local policy aiming to protect purchasers of foreign bills of exchange the local acceptor should not be deemed by his own courts to have assumed liability on that basis.[14]

As regards an endorser, such a result may be derived without express legislation from his implied warranty that at the time of the endorsement the instrument is an existing bill or note. The endorsee, who is not chargeable with knowledge of foreign law, may well claim that the endorser's warranty should protect him against a non-validity arising from foreign law. An acceptor, on the other hand,

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[13] *Hyatt v. Bank of Kentucky* (1871, Ky.) 8 Bush. 193; *Mackintosh v. Gibbs* (1911) 81 N. J. L. 577, 80 Atl. 554; *Nichols v. Porter* (1867) 2 W. Va. 13.

[14] See Lorenzen, *The Rules of the Conflict of Laws Applicable to Bills and Notes* (1917) 1 MINN. L. REV. 328-332.

does not warrant the validity of the instrument and hence would not be estopped, without specific legislation to that effect, to set up the invalidity of the original instrument under a foreign law. In a number of foreign countries both the endorser and the acceptor are made liable under the above circumstances by express legislation.[15]

While the foregoing argument would lead to the conclusion that, in a case like the instant cases, the American courts should on principle apply American law to determine the rights of all parties, this criticism of the American decision should not obscure the fact that it was not only in accord with the great weight of American authority, but was a binding adjudication between the parties. Rightly or wrongly, it settled the rule for this case that English law was to apply, and no question of its theoretical soundness will justify the English court in "throwing the parties back on American law."

AMENDMENTS FROM EQUITY TO LAW AND THE STATUTE OF LIMITATIONS

Looked at from different viewpoints a given set of facts may be regarded as giving rise to different causes of action. A trespassory taking and carrying away of another's chattel, for example, may be looked at as an unlawful invasion of another's possession, for which the common law remedy is an action of trespass; it may, on the other hand, be viewed as an assertion of that kind of unlawful dominion over another's property which we call a conversion, for which the common law action is trover.[1] Again, according to many authorities, it may be treated (where the chattel is permanently retained by the tort feasor) as resulting in an unjust enrichment for which an action of *indebitatus assumpsit* for goods sold and delivered will lie.[2] If to the trespassory taking and retention there be added the additional fact that the chattel has been sold by the tort feasor, it is universally held that an action for money had and received may be brought. In other cases either trespass for injury to person or property or trespass on the case for negligence resulting in injury to person or property will lie—*e. g.*, where one negligently drives his carriage against the person or property of another.[3] In still others, the injured person has his choice between legal and equitable actions. An example of the latter

[15] German Bills of Exchange Law, art. 85; Argentine Commercial Code, art. 738. See also English Bills of Exchange Act, sec. 72, subsection (1), proviso (b), discussed in the text.

[1] *Basset v. Maynard* (1601, Q. B.) Cro. Eliz. 819, is one of the early cases so holding; see also 1 Rolle, *Abr.*, 105 (M) pl. 5.

[2] One of the best discussions of the problem involved is found in the opinion in *Braithwaite v. Akin* (1893) 3 N. D. 365, 56 N. W. 133.

[3] *Williams v. Holland* (1833, C. B.) 10 Bing. 112.

kind is found where property has been obtained by means of fraud. Here if the property conveyed be real estate, it may be recovered by bill in equity; on the other hand, the injured party has his option to retain what he received from the defendant and sue at law for damages in an action for deceit.

In cases of this kind the question arises whether commencing an action in which one of two or more alternative remedies is asked will stop the running of the statute of limitations against the other remedies, at least to the extent that the plaintiff may amend his statement of claim so as to shift to one of the other points of view without being subject to defeat by a plea of the statute. This problem is involved in the recent case of *Friederichsen v. Renard* (1918, U. S.) 38 Sup. Ct. 450. The petitioner in that case filed a bill in equity in the United States District Court for the District of Nebraska, asking for the cancellation of a deed to land, on the ground that the defendants had obtained the same by fraudulent representations as to land which the petitioner took in exchange. The master to whom the case was referred reported that the plaintiff had lost the right to equitable relief because, after learning of the fraud, he had cut a quantity of timber on the land received from the defendants. The case was then, pursuant to equity rule 22, transferred to the law side of the court, and the plaintiff was permitted to file an amended petition praying for a judgment at law for damages for deceit. To the amended petition the defendants pleaded the Nebraska four year statute of limitations. The District Court held that the cause of action stated in the amended petition was barred by the statute. This judgment, affirmed by the Circuit Court of Appeals, was unanimously reversed by the United States Supreme Court, on the ground that the causes of action stated in the original petition and in the amended petition were but different aspects of one transaction, and that, for the purpose of preventing the statute of limitations from continuing to run against them, suit on one was suit on both.

The result reached by the learned court seems equally sensible and sound, but it departs very clearly from older traditions. Obviously, so long as law and equity were administered by separate tribunals, the petitioner in the principal case would have been unable to meet successfully the plea of the statute when, after losing in the equitable proceeding, he began the suit at law. Now that one tribunal administers both law and equity, however, the problem should be treated as not different from that in cases in which the plaintiff seeks to amend from one common law form of action to another. In cases of the latter kind the various jurisdictions have rules of varying strictness and liberality. In some an amendment which seeks to shift from one common law form to another, as from trespass to case or case to trespass, while permissible as an amendment, is regarded as substantially beginning a new action and so subject to a plea of the statute of limitations, even though it is apparent that the same general transaction is involved.[4] Other courts take a more sensible and liberal view, similar to that in the principal case, and do not allow the statute to defeat an honest litigant who has been trying to enforce his rights, but who has been badly advised by his lawyer as to the precise remedy open to him.[5] The question is, it seems clear, purely one of the fair construction to be given to the statute of limitations, *i. e.*, what may fairly be called starting suit within the meaning of the statute so as to give the defendant fair notice of the nature of the plaintiff's claim? In certain jurisdictions—fortunately few in number—a most narrow and illiberal view prevails, *viz.*, that a declaration which omits absolutely an essential allegation may not, after the statute has run, be amended to insert the missing allegation, even though no attempt is made to change the form of action.[6] The reason given for this illiberal view is that the original declaration was defective in substance and so in legal effect equivalent to no declaration at all. Decisions of this kind cannot be supported upon any ground of policy or fair dealing. The rules which determine what allegations must go into a declaration or statement of claim are necessarily in many respects arbitrary, and a litigant ought not to lose his cause of action because his attorney has made an error of the kind in question. For this reason the rule in most jurisdictions is contrary to that established by the courts just referred to.[7] The just rule would seem to be that where there has been a fair and honest attempt within the statutory period to enforce the rights growing out of the transaction in question, a plea of the statute should not be permitted to bar the plaintiff from shifting to a different remedy, although the result may be to change from one form of action to another, or even from equity to law or law to equity. It is indeed fortunate that the Supreme Court has added the weight of its great authority upon the side of justice and common sense.

FOREIGN INHERITANCE TAXES AS DEDUCTIBLE ADMINISTRATION EXPENSES

The increasingly prevalent mode of taxation commonly known as the inheritance tax is usually based upon the theory that the tax is laid upon the legal privilege of the legatee, devisee or heir to acquire property of the decedent by will or by descent.[1] The measure of the

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[4] *Hess v. Birmingham Ry. Co.* (1906) 149 Ala. 499, 42 So. 595.

[5] *Reynolds v. Missouri, K. & T. R. R. Co.* (1917, Mass.) 117 N. E. 913.

[6] *Foster v. St. Luke's Hospital* (1901) 191 Ill. 94, 60 N. E. 803.

[7] *McLaughlin v. West End St. Ry. Co.* (1904) 186 Mass. 150, 71 N. E. 317.

[1] While the tax is commonly described as a tax on the privilege of succession, it is believed to be more strictly accurate to consider it a tax on the

tax is commonly the value of the property so acquired as of the time of death of the testator or the intestate decedent. Consequently the tax is determined by the value of the beneficiary's "net succession," that is, the property which remains for distribution to him after payment of debts and expenses of administration.[2] But just what items may properly be included as expenses of administration is a matter on which the courts have frequently reached different conclusions. In *Corbin v. Townshend* (1918, Conn.) 103 Atl. 647, the Supreme Court of Connecticut has rendered a decision of first impression holding that the estate tax payable under the federal act, and also inheritance taxes payable under the statutes of various states, are expenses of administration properly deductible in determining the net estate subject to the Connecticut inheritance tax of a testatrix resident in Connecticut.

The Connecticut tax is of the sort above mentioned—a succession tax or "death duty" prescribed in respect to the beneficial interest passing by force of Connecticut law to the beneficiaries of the decedent, and measured by the value of the property so passing,[3] *i. e.*, by the value of the distributive share as of the time of the

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exercise of such privilege, *i. e.*, on the *passing* of the property. When a legatee renounces his legacy, no tax in respect to such legacy is collectible. *Matter of Wolfe* (1903, N. Y.) 89 App. Div. 349, 85 N. Y. Supp. 949, affd. 179 N. Y. 599, 72 N. E. 1152; *Estate of Stone* (1906) 132 Iowa, 136, 109 N. W. 455.

Sometimes the tax appears to be considered as a tax upon the privilege of the decedent to transmit rather than upon the privilege of the beneficiary to acquire. In *Minot v. Winthrop* (1894) 162 Mass. 113, 38 N. E. 512, Field, C. J., said: "But the right or privilege taxed can perhaps be regarded either as the right or privilege of the owner to transmit it on his death, by will or descent, to certain persons, or as the right or privilege of these persons to receive the property." See also *United States v. Perkins* (1895) 163 U. S. 625, 628, 16 Sup. Ct. 1073. In *Nettleton's Appeal* (1903) 76 Conn. 235, 56 Atl. 565, Hamersley, J., said:

"Nor is it material to the essence of the tax at what time it is ascertained and collected during the passage of the property, through the channel of the law, from the dead to the living; whether the property is tapped as it falls from the lifeless hand, or midway in its course, or as it passes into the grip of the new owner; whether it is called a probate, a succession, or a legacy tax. Such nomenclature is convenient; its distinctions may be important for clear discussion of the policy of death duties and the mode of using this form of taxation; and an accurate conception of them may serve to throw light upon the actual intent of the legislature, when language of doubtful meaning is used, in determining the amount and manner of enforcing the tax."

[2] Sometimes the deduction of debts and expenses of administration from the appraised value of the estate is expressly provided for statute, as in the present Connecticut law. Acts 1915, ch. 332, sec. 5. In other cases the courts have recognized the doctrine without express statutory declaration. See *Gallup's Appeal* (1904) 76 Conn. 617, 620; 57 Atl. 699, 700; *Estate of Kennedy* (1910) 157 Cal. 517, 108 Pac. 280; Ross, *Inheritance Taxation*, sec. 270.

[3] This was the construction placed upon the former statute. See *Hopkins' Appeal* (1905) 77 Conn. 644, 649; 60 Atl. 657, 659. The present law (Acts 1915, ch. 332) expressly provides:

decedent's death and not by the net gain to the estate of the distributee. The latter is less than the former by the amount of the Connecticut inheritance tax.

I. THE FEDERAL TAX

The federal tax must likewise be construed as a tax in the nature of a death duty, for if it were a direct tax upon the property it would be unconstitutional.[4] Moreover, it is expressly laid upon the "transfer" of the estate. But unlike the Connecticut tax or the former federal inheritance tax it is levied upon the estate as an entity, and is paid by and out of the estate, instead of by the beneficiaries out of their shares.[5] With reference to the federal tax the Connecticut court said:

"The federal act of 1916 imposes a tax payable out of the estate before distribution, thus differing from the federal inheritance tax of 1898, payable by the individual beneficiaries. It is not a tax upon specific legacies, nor upon residuary legatees. It is taken from the net estate 'before the distributive shares are determined rather than off the distributive shares.' Its payment diminishes *pro tanto* the share of each beneficiary. The executor or administrator must pay the tax out of the estate before the shares of the legatees are ascertained. It is an obligation against the estate and payable like any expense which falls under the head of administration expenses. The tax paid is no part of the estate at the time of distribution; it has passed from the estate and the share of the beneficiaries is diminished by just so much . . .

"Sec. 3. All property owned by any resident . . . which shall pass by will or by the provisions of the general statutes relating to the distribution of intestate estates, . . . shall be liable to a tax as hereinafter provided.

"Sec. 5. The net estate for taxation purposes shall be ascertained by adding to the appraised value of the inventoried estate [certain gains] and deducting therefrom the amount of claims paid, all funeral expenses and expenses of administration, . . . and losses incurred during the settlement of the estate in the reduction of choses in action to possession. . ."

The opinion in the principal case states that the Act is a re-enactment of the provisions of the former statute in the light of their settled construction.

[4] See *Knowlton v. Moore* (1900) 178 U. S. 41, 20 Sup. Ct. 747.

[5] The Revenue Act of Sept. 8, 1916 (ch. 463), as amended March 3, 1917 (ch. 159), imposes a tax (sec. 201) "upon the transfer of the net estate of every decedent" dying after the passage of the Act. It is based upon the amount of the entire estate, less an exemption of $50,000 and certain specified deductions (sec. 203), without regard to the value of the shares of the several beneficiaries or the degrees of their relationship to the decedent. The intent of the Act is expressed (sec. 208) to be that "so far as is practicable and unless otherwise directed by the will of the decedent the tax shall be paid out of the estate before its distribution." U. S. Comp. St. 1916, sec. 6336½, a-m, 39 Stat. 777, 1002.

In (1917) 3 AM. BAR ASSN. JOUR., 178, it is said: "The Federal Estate Act was carefully drawn so that it would not duplicate the inheritance taxes of the states, but would come off the net estate before the distributive shares were determined rather than off the distributive shares."

"Any expense arising by operation of law which is a charge against or must be paid out of the estate is an administration expense within the meaning of this term as used in section 5 of the [Connecticut] Act of 1915.

"The payment of the federal tax is an expense of the estate, as much so as any expense of administration."

It is submitted that this reasoning and the result to which it leads are sound. A similar decision was recently rendered in Minnesota,[6] but several lower New York courts have decided otherwise.[7]

II. TAXES LEVIED BY OTHER STATES

The court's decision that inheritance taxes paid other states are likewise deductible is based upon the premise that such taxes "are upon the same basis as the federal tax; they must be paid before the executor or administrator can reduce the bonds or stock to possession." "These cannot be transferred until the state tax is paid and the value of the security so transferred is reduced by the amount of the tax which the executor or administrator has had to pay." But is this premise sound? The federal tax, as the court has indicated, is payable out of the estate as a whole before the distributive shares are determined, but this is not usually the case in respect to state inheritance taxes. They are commonly levied upon the succession of the individual distributive shares and chargeable against these shares, not imposed upon and paid by the estate as a whole before the distributive shares are determined. Take, by way of illustration, the tax of Wisconsin which was one of those involved in the principal case. The theory of the Wisconsin tax is precisely the same as that of Connecticut—a tax upon the privilege of succession, chargeable against the distributive share passing to the individual beneficiary and measured by the value of the property so passing before the tax itself is taken off.[8] In stressing the argument that the foreign tax must be paid before the property can be reduced to possession by the executor, the court has evidently confused a provision for enforcing the tax with the theoretical basis of the tax. This is the more strange

[6] *State v. Probate Court* (1918, Minn.) 166 N. W. 125.

[7] *In re Bierstadt's Estate* (1917, Surr.) 163 N. Y. Supp. 1104, affd. (1917) 178 App. Div. 836, 166 N. Y. Supp. 168; *In re Sherman's Estate* (1917, App. Div.) 166 N. Y. Supp. 19. These decisions were much influenced by an earlier case holding that the inheritance tax imposed by the War Revenue Act of 1898 was not deductible in determining the state tax. *Matter of Gihon* (1902) 169 N. Y. 443, 62 N. E. 561. In Massachusetts an opposite conclusion had been reached on the federal tax of 1898. *Hooper v. Shaw* (1900) 176 Mass. 190, 57 N. E. 361.

[8] Wis. Stat. 1911, secs. 1087-1 to 1087-24; Laws 1913, ch. 627. For cases construing the statute, see *Beals v. State* (1909) 139 Wis. 545, 121 N. W. 347; *Estate of Bullen* (1910) 143 Wis. 512, 128 N. W. 109; *Estate of Smith* (1915) 161 Wis. 588, 155 N. W. 109.

because the Connecticut statute has a like clause, and in the words of the court itself: "This [the Connecticut tax], by section 10, is required to be paid by the administrator or executor from the funds passing to the beneficiaries."

When, therefore, the foreign tax is levied upon and payable out of the beneficiaries' shares, it is submitted that it cannot properly be considered as an expense of administration and should no more be deducted than should the Connecticut tax itself.[9] Since the taxes of both states are based upon the same theory, there is believed to be no more reason for allowing the Wisconsin tax to be deducted to determine the Connecticut tax, than there would be for allowing the Connecticut tax to be deducted to determine the Wisconsin tax. The impracticability of applying a rule which permits deductions by each state is obvious.

Under the ruling of the Treasury Department state inheritance taxes were for a time deducted in determining the federal estate tax, but by a later order this ruling was repealed.[10]

Another state inheritance tax involved in the principal case was that of New Jersey. There is more reason for permitting the deduction of this tax. It appears from the New Jersey decisions that the inheritance tax of that state is not based upon the same theory as are those of Connecticut and Wisconsin. As applied to personal property of non-resident decedents, the New Jersey statute has been construed as imposing a tax, not on the "singular succession" of the individual legatee or distributee, but on the "universal succession" of the foreign executor or administrator.[11] In other words, the New Jersey court takes the view that all New Jersey law does is to permit the property to vest in the executor or administrator and thus become a part of the general estate, the law of the state of the decedent's domicile then prescribing how it shall pass to the individual beneficiaries. Hence the only succession New Jersey taxes is the succession of the executor or administrator to the New Jersey personalty as a whole, not the passing of the several distributive shares to the beneficiaries. This construction of the New Jersey tax may furnish a sound foundation for the argument that it is laid upon the same basis as the federal tax and should be charged against

[9] The authorities from other states are not numerous and are conflicting. Allowing deduction of foreign tax, see *In re Van Beil's Estate* (1917) 257 Pa. 155, 101 Atl. 316; *Bullard v. Redwood Library* (1914) 37 R. I. 107, 91 Atl. 30. Disallowing deduction, see *Matter of Penfold* (1915) 216 N. Y. 171, 110 N. E. 499; *Matter of Gihon* (1902) 169 N. Y. 443, 62 N. E. 561.

[10] T. D. No. 2524, Sept. 10, 1917.

[11] *Carr v. Edwards* (1913, Ct. Err.) 84 N. J. L. 667, 87 Atl. 132; *Senff v. Edwards* (1913, Sup. Ct.) 85 N. J. L. 67, 88 Atl. 1026; *Maxwell v. Edwards* (1916, Sup. Ct.) 89 N. J. L. 446, 99 Atl. 138; *Security Trust Co. v. Edwards* (1917, N. J. Ct. Err.) 101 Atl. 384.

the estate as a whole like a general expense of administration. Therefore the deduction of the New Jersey tax as well as of the federal tax is perhaps justified, but the Wisconsin tax cannot properly be so treated for the reasons already indicated. The Connecticut court, however, lumped all foreign state inheritance taxes together without considering whether there was any difference in their character.

The apparent injustice of compelling a beneficiary to pay a duty to two states on something he does not get, namely, the full amount of his legacy or distributive share, no doubt inclines the court of the decedent's domicile to permit the deduction of foreign inheritance taxes. But this injustice is really the result of double taxation, of allowing more than one state to levy a duty on the transfer of the same property. It arises from the fact that the state of the decedent's domicile, on the fiction *mobilia sequuntur personam,* asserts that it grants the privilege of succession and so may tax it, while the other state, the state of the *situs,* asserts that it has the power of controlling how the property within its limits shall pass, that it grants the privilege of allowing such property to pass in accordance with the rules of the domicile, and therefore may tax this privilege.[12] It is not, however, the purpose of this discussion to enter upon a consideration of the validity of the theories which lead to double taxation. It is sufficient that the possible weakness of the court's opinion, in classifying all foreign state inheritance taxes as similar to the federal estate tax rather than analyzing them separately, has been pointed out, in the hope that, if incorrect, the rule laid down by the court with respect to deducting other state taxes may be corrected, or if correct, that the reasons for the decision may be more clearly set forth in later cases.

EFFICIENCY OR RESTRAINT OF TRADE

To develop a just, reasonable and practicable construction of the Sherman Anti-Trust Act and apply it to the complicated facts of our industrial and commercial structure is not a simple task. No rule of thumb, no test capable of easy and instant application to every situation, could either work justice or secure the economic ends for which the act was passed. The test of legality must first be expressed in broad general terms, like the act itself; it must then be applied with painstaking study and discrimination to the facts of each case, bearing always in mind the clear general purpose of the act; the border-line between lawful and unlawful must be pricked out, point

[12] See *Estate of Bullen* (1910) 143 Wis. 512, 520; 128 N. W. 109, 111. The evil of double taxation has been partially removed by recent legislation in Wisconsin. See Laws 1913, ch. 627, sec. 2. For similar legislation in Massachusetts, see Acts 1909, ch. 490, Part iv., sec. 3.

by point, as specific cases arise. The "rule of reason," much misunderstood and much criticised when it was first announced,[1] laid a sound foundation for future development. It focussed attention on the evils which the statute was intended to reach, which may be summed up as the artificial creation of non-competitive conditions in the sale of any product entering into interstate commerce, with the resulting enhancement of prices, deterioration of product, reduction of output, and other "characteristic evils of monopoly." An arrangement or course of conduct, whatever its form, whose purpose or necessary effect is predominantly or in any substantial degree to produce these evils is forbidden. One not so intended and not so resulting is outside the purview of the act.[2]

But however simply it may be stated, difficult questions of fact must arise in the application of such a rule. The law aims to secure, for the benefit of the consumer, vigorous and efficient competition. But the chief spur to competition is the desire to get the largest possible share of the business. Neither that object, nor even notable success in its achievement, can be held unlawful without defeating the very purpose of the statute. It is then a question of means. But the means employed for efficient competition may closely resemble those of monopoly. The union of two or three out of many competing concerns may be the best means to more effective competition. The added strength so obtained may make the difference between survival and failure in the war of competition. It seems clear that under the "rule of reason" such a combination is not unlawful. But the same combination as a step in a definite plan to eliminate competition and control the industry would be forbidden. And as intent may often be judged only by acts, it is easy to see that as combination is carried a little further and a little further, difficult questions of fact may arise in regard to the intent to be inferred. Nor is it wholly a question of intent. Combination may reach the point where, whatever its intent, the necessary practical result is to give the combined organization a substantial domination of the market, to free it from the checks and the spurs of effective competition. It can hardly be doubted that combination carried to that point is, regardless of its intent, within the reach of the law.

Again there can be no objection to the combination of two con-

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[1] In *Standard Oil Co. v. United States* (1911) 221 U. S. 1, 31 Sup. Ct. 502; *United States v. American Tobacco Co.* (1911) 221 U. S. 106, 31 Sup. Ct. 632.

[2] The "rule of reason" means merely that the test is not formal, technical or arbitrary, to be applied like a foot-rule, but calls for intelligence, reason and common sense in its application. Some early misconceptions of its meaning have been brushed away by later decisions. See for example, *Thomsen v. Cayser* (1917) 243 U. S. 66, 37 Sup. Ct. 353, discussed in (1917) 27 YALE LAW JOURNAL, 139.

cerns, making and selling two lines of goods, not competitive but supplementary. A maker of office desks and chairs and a maker of filing cabinets may properly unite, to secure the advantages of offering a complete line of office furniture. Here is only increased efficiency, and not restraint of trade. But here again, specific cases will not always be clear cut. The principal lines of the two combining concerns may have been desks and filing cases respectively; but both may have made chairs. Or one may have made flat-topped desks and the other roll-topped. Are these competing or supplementary lines?

Add further to the supposed combination the lawful monopoly of patent rights; large capital; remarkable business acumen and efficiency; and great commercial success; and the problem of determining how far the initial combination contributed to the business success attained, and whether its contribution was through legitimate increase in efficiency or through illegitimate suppression of existing or possible competition, is full of complications.

Such were some of the elements in the problem presented to the Supreme Court in *United States v. United Shoe Machinery Co.* (1918) 38 Sup. Ct. 473. The questions involved were so largely questions of fact that except as every actual decision gives concreteness to establish rules of law, the case adds little to the legal definition of the offenses denounced by the Sherman Act. The decision in favor of the company does, however, further emphasize some points which were tolerably clear before, as that neither mere size nor the fact of getting most of the business constitutes in itself an illegal monopoly. No doubt great size and wealth in themselves give power that may be abused, but if size and wealth are attained by legitimate means, the law must be content to watch for signs of abuse. On this point the conclusion of the majority of the court is summed up as follows: "The company, indeed, has magnitude, but it is at once the result and cause of efficiency, and the charge that it has been oppressively used has not been sustained."

The Government charged a general scheme of monopoly to which all the specific acts alleged were contributory and subordinate. These acts were of three general classes: first, the combination in 1899 of three or four companies manufacturing shoe machinery; second, the subsequent acquisition of a large number of smaller businesses, patent rights, etc., in the shoe machinery field; and third, the method of doing business by which machines were leased under leases alleged to contain oppressive clauses designed to extend and perpetuate the monopoly.[3]

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[3] The very complicated issues of fact involved in the sifting of these charges had been considered with painstaking fullness by the three judges who tried

With regard to the original combination, it appeared that the machines the constituent companies were making were in general non-competing, and that the chief result of the combination was to give the United Company a more nearly complete line of shoe machinery. That such a combination would involve no violation of the Sherman Act was obvious, and had already been decided by the Supreme Court in a criminal suit based on the same alleged monopoly.[4] The Government charged, however, that in respect to one type of machine, namely lasting machines, there was competition between two of the constitutent companies; and, in respect to welt-sewing machines, between one of these and a third constituent company. Had these claims been fully sustained by the evidence, the decision might have thrown some light on one of the many questions of degree involved in the application of the general rule of the Sherman Act to particular cases. It appeared, however, that the alleged competing machines were in general adapted to use on entirely different types of shoes, though there was some speculative possibility that by further improvement and adaptation they might have become more fully competing. In one instance such improvement was later made by the United Company. It is sufficient to say on this point that the findings of the District Court, virtually adopted by the Supreme Court, reduced the actual competition between the machines in question at the time of the combination very nearly to the vanishing point, and left only possibilities of future competitive development, much too speculative to furnish a basis for dissolving a combination which had stood unchallenged for twelve years before the bill was filed, and had long since practically superseded the original machines by the improvements it had itself developed.

Similar findings disposed of the long line of subsequent acquisitions, impressive in the mass, but losing most of their significance when examined in detail. The most important, that of the Plant shoe machinery patents, was complicated by mutual claims of patent

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the case in the District Court, each of whom wrote a long opinion, concurring in the decision in favor of the defendants. *United States v. United Shoe Machinery Co.* (1915, D. Mass.) 222 Fed. 349. The majority opinion in the Supreme Court discusses some few portions of the evidence in some detail, but rather by way of illustration than exhaustive consideration, and in the main adopts and relies on the findings and conclusions of the lower court. Two of the three dissenting judges also wrote opinions but they merely summarized certain portions of the evidence with the conclusions drawn therefrom. For any statement of the evidence in sufficient detail to judge of the merits of the conclusions, the opinions in the District Court must be carefully studied, and even these could give only an incomplete summary,—so great was the number and so complicated the details of the transactions covered by the inquiry.

[4] *United States v. Winslow* (1913) 227 U. S. 202, 33 Sup. Ct. 253.

infringement, by pending and threatened litigation, and by the fact that the Plant machinery, while ineffective and of little commercial value as it stood, contained patented features which could be developed as improvements to the United Company's machines, thus producing more efficient machinery than either Plant or the United Company could produce without the use of the other's patents.

If the difficulties which may arise on the facts in determining the legality of a *combination* are considerable, the difficulties of determining when conduct other than combination becomes an unlawful "attempt to monopolize" are still greater. Here it is perhaps even more true that the methods of legitimate competition may closely resemble the methods of attempted monopoly. Again it must be emphasized that monopoly in a legal sense is not simply getting all the business. Monopoly involves the idea of exclusion. "Monopolizing," in the absence of combination, means, within limits yet to be clearly defined by statutes or decisions, the exercise of oppressive, coercive or unfair means to exclude competitors from the market. The principal claim of the Government in regard to the United Company's leases will serve as an illustration. The claim was that by so-called "tying clauses" the lawful patent monopoly of certain "essential" machines was used to force shoe manufacturers to take also the United Company's auxiliary machines, with which otherwise manufacturers of other lines of shoe machinery might successfully have competed. If this claim had been sustained by the evidence it would seem from the reasoning of previous decisions that a violation of the law might perhaps have been found.[5]

But the facts were found not to support the charge. The whole leasing system was attacked by the Government as merely an instrument devised by the United Company to foster its monopoly. But the lower court found, and the Supreme Court affirmed the finding, that the leasing system was employed by the constituent companies before the combination; that it had a sound economic basis and had proved highly advantageous to shoe manufacturers and to the shoe manufacturing industry, particularly in enabling the small shoe manufacturer to compete successfully with his larger rival; and that on the whole the changes made by the United Company in the forms of the leases had been in the direction of greater liberality rather than less. The principal "tying clause" required the leased machine to be used only in connection with certain other machines leased from the

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[5] See especially *Motion Picture Patents Co. v. Universal Film Mfg. Co.* (1917) 243 U. S. 502, 37 Sup. Ct. 416, discussed in (1917) 26 YALE LAW JOURNAL, 600; and *cf. Standard Sanitary Mfg. Co. v. United States* (1912) 226 U. S. 20, 33 Sup. Ct. 9.

United Company. On violation of this condition the United Company could cancel the lease. The Government's expert testified that the Goodyear welter and stitcher were the only two "essential" machines, and the District Court's finding was practically to the same effect.[6] Had these machines been leased only on condition that they be used with other machines of the defendant, there would have been strong ground for the Government's charge. It appeared, however, that leases of these two machines had never contained that clause. The lessees of the welter and stitcher were entirely free to use them with any machinery of other manufacturers for performing other operations. It was the subordinate machines that were restricted to use with the Goodyear welter and stitcher. And even the subordinate machines were always obtainable on so-called unrestricted leases, without the "tying clause," on the same royalty, but with the addition of an initial payment.

What, then, was the reason for the "tying clause"? The royalties were fixed at so much a pair of shoes. The welter and stitcher had the largest royalties attached to them and had also recording devices to determine the number of shoes operated upon, which greatly simplified the difficult question of royalty accounting. The defendant could therefore afford to lease its subordinate machines on better terms to those who also used its welter and stitcher. There were other business reasons for the arrangement. It appeared that the efficiency of all the machines, and consequently their output and the royalties earned, depended on the very careful adaptation of each machine to use with the machines preceding and following it in the process of shoe manufacture. Again the United Company gave an inspection and repair service without additional charge, the cost of which per machine would evidently be less in a factory where many United machines were in use. These and other reasons were sufficient to justify the company in making better terms for a full set of machines than for individual machines. In fact most of the clauses to which the Government objected finally came down either to the question of a wholesale as against a retail rate, or to an inducement to the shoe manufacturer to make the greatest possible use of the machines leased, resulting in larger royalty earnings, and incidentally making possible a lower royalty rate.

But arrangements like that condemned in the *Motion Picture Co.* case[7] have something of the same element of a wholesale as against a retail transaction, with the very important addition, however, that in that case the vendor who sought to link two products together

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[6] See 222 Fed. at p. 395.

[7] *Supra,* note 5.

refused to furnish them at all for separate use. But suppose that a company engaged in furnishing machinery for electric power plants refuses to take any contracts except for a complete installation. Is such a course of business in violation of the Sherman Act? Does it become so if the company has a lawful patent monopoly of one machine entering into the installation, so superior that its desirability, in connection with the policy described, furnishes a strong inducement to go to that company for the entire installation? There are difficult questions here, which future cases must answer. All we can gather from the *Shoe Machinery* case is that if alternative terms are offered for separate machines, and if there are legitimate business reasons for the wholesale rate, and if the course of business as a whole negatives the intent to make one or two superior machines a lever to force the sale of the rest, the arrangement may be upheld. While it gives us no final test for all cases, this seems a sound and sensible result as far as it goes.

One clause in certain of the United Company's leases seems to have been directly within the rule of the *Motion Picture Co.* case.[8] Leases of "metallic machines" (for attaching to shoes certain metallic fastenings) required the purchase of the fastening material from the defendant in lieu of royalty. This clause is not discussed in the opinion of the District Court, but is incidentally mentioned and might be taken as inferentially approved by the Supreme Court opinion. But too much weight can hardly be attached to this reference. The bill alleged a monopoly or attempted monopoly of shoe machinery, not of fastening material. If the clause in regard to metallic fastenings tended to unlawful monopoly of anything, it was of fastening material. It had therefore no tendency to support the charge in the bill, unless on the theory of cumulative evidence of general monopolistic intent. It was doubtless in this light that the majority opinion of the Supreme Court referred to it as a "mere make-weight" and "not of special materiality." It is to be noted also that when the case was tried in the lower court the *Dick* case,[9] since overruled by the *Motion Picture Co.* case, still stood as law on the validity of such conditions as that involved in the clause in question; and this is probably a further reason why objections to that clause were not pressed at the trial, or discussed by the District Court.

It may be possible, however, that we have not heard the last word on the legality of such a condition; that in a given case legitimate business reasons might be found to justify it, and take it out of the prohibition imposed by the *Motion Picture Co.* case. It is certain

[8] *Supra*, note 5.

[9] *Henry v. A. B. Dick Co.* (1912) 224 U. S. 1, 32 Sup. Ct. 364.

that we have not heard the last word on the shoe machinery leases. The case just decided turned wholly on the Sherman Act, the suit having been begun before the Clayton Act was passed. It is generally understood that certain provisions of the Clayton Act were aimed directly at the United Shoe Machinery Co. and its leases, though possibly rather at what was supposed to be their purpose and effect than at what the court in the Sherman Act case found these to be. A federal suit against the company under the Clayton Act is now pending in a different federal district from that in which the Sherman Act case was tried.[10] The ultimate determination of the legality of the leases under the present law must await the decision of that case.

The case just decided, as has been said, turned almost wholly on questions of fact.[11] Whether the conclusions of the District Court, affirmed by the majority of the Supreme Court, on these questions of fact, or those of the dissenting judges in the higher court, were more nearly correct, only one who had read all the evidence could reasonably undertake to judge. It may be said, however, as the Supreme Court held, that every reasonable presumption should be indulged in favor of the unanimous conclusion of the judges who sat through the long trial, heard most of the testimony in open court, and carefully read and sifted all the evidence. It should be said also that their opinions are thorough, well-reasoned, and much more convincing than the generalities of the dissenting opinions in the court above, which seem rather to jump to conclusions. Considering the popular impressions of the "Shoe Machinery Trust," the fondness which the Department of Justice has very naturally displayed for such shining marks, and the enormous labor involved in going carefully into the multitudinous issues which such a prosecution raises, it is rather reassuring to those who fear the tendencies of popular government that the Supreme Court, which has heretofore found so uniformly for the Government in all the big trust prosecutions, should have given this proof of its willingness to weigh each case on the

[10] See *United States v. United Shoe Machinery Co.* (1916, E. D. Mo.) 234 Fed. 127, in which the defendant's motion to dismiss was denied,—a decision, of course, purely on the sufficiency of the allegations of the bill, and preliminary to the taking of evidence to support the allegations. How far the findings in the Sherman Act case in regard to the intent and effect of the lease clauses under attack may be held to be *res adjudicata* in the Clayton Act suit is an interesting question.

[11] It is perhaps fortunate that the case turned largely on fact rather than law; for it was in effect a minority decision. Justices McReynolds and Brandeis, having been concerned as counsel at earlier stages of the case, took no part in the decision, and the remaining seven judges divided four to three. There might therefore have been some doubt of the ultimate authority of any new law laid down.

evidence and to discriminate where it finds judicial discrimination to be warranted. The demonstration would of course be more impressive had the result not been reached by so narrow a margin.

It must not be forgotten, in judging the correctness of the decision, that the ultimate result of the efficient competition which the law seeks to foster may appear superficially much like the result of the monopoly which it prohibits. A number of facts which appear to have been established, such as the continual efforts of the United Company to improve its product by constant experiment and large expense, its policy of giving its customers the benefit of these improvements without additional charge, the testimony of the witnesses to the excellence of its service, the lack of any substantial proof of unreasonable rates or charges, the repeated refusals to buy competing businesses or patents, much more numerous than the acquisitions actually made, the high level of efficiency constantly maintained, and the fact that so far as competition with patented machines is possible there has always been competition, tend strongly to support the conclusion of the majority of the court that here was a success established by distancing rather than by suppressing competitors, and maintained only by unremitting effort for greater efficiency in the face of actual or possible competition. In these days when we are realizing as never before the value of industrial efficiency, a decision that the law has no quarrel with success so obtained is particularly timely.

TORT AND CONTRACT IN THE MARKETING OF FOOD

It was a dictum in New York which introduced into American law the doctrine that in sales of foodstuffs a dealer always impliedly warrants their fitness for consumption.[1] The question has just come before the Court of Appeals for the first time, and the doctrine has been squarely affirmed, in *Race v. Krum* (1918, N. Y.) 118 N. E. 853.[2] The plaintiff purchased and ate at the defendant's drug store ice cream manufactured by the defendant. In an action for damages for illness caused by the presence in the cream of a filth product, tyrotoxicon, the trial court charged that the defendant impliedly warranted the cream wholesome and fit to eat. The instruction was on appeal held correct.

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[1] See *Van Bracklin v. Fonda* (1815, N. Y. Sup. Ct.) 12 Johns. 468.

[2] Discussed (1918) 16 MICH. L. REV. 555; the problem involved is also considered in (1908) 15 L. R. A. (N. S.) 884. The present comment deals wholly with liability to the *consumer* of food intended for human beings. See also (1914) 48 L. R. A. (N. S.) 213, 219; and on the more general relations of the topic, *ibid.* 213, and (1909) 19 *ibid.* 923.

The court expressly distinguishes the case from that of an innkeeper or restaurateur. These latter have been held not to warrant because they do not sell; they merely set before a guest food, to which title does not pass, but which the guest in return for his money receives the privilege of consuming on the spot so far as he desires to.[3] On the soundness of this doctrine the court refuses to pass; in the instant case, it finds a clear sale. Yet it is hard to see wherein the serving of ice cream over the counter of a drug store differs in this respect from the serving of ham and eggs at a lunch counter. But without further regard to whether or not such cases do in fact and general understanding constitute sales, it is submitted that the existence of an implied warranty need not be conditioned on the existence of a strict sale. Implied warranties rest either on an attempt to interpret the parties' true mutual understanding, or on public policy; the warranty of wholesomeness of food belongs to the latter class.[4] The considerations of policy which attach that warranty of wholesomeness to the sale of meat to a consumer in the market[5] apply with equal force to the serving of meat to a guest in a hotel; if anything, they are stronger, because the guest has less opportunity than the ordinary purchaser in the market to discover defects in food

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[3] *Merrill v. Hodson* (1914) 88 Conn. 314, 91 Atl. 533, criticized (1914) 24 YALE LAW JOURNAL, 73, where two criminal cases are cited which held such serving to be a sale. See also (1917) 27 YALE LAW JOURNAL, 140. What the true relations of the parties are in such a case is something of a problem. Certainly title does not necessarily pass to all the food; the guest may reject part; it is part of the contract that the innkeeper will dispose of all the guest may leave. But suppose the latter desires to take some of the food to his room to eat later—fruit, for example. Or suppose a pearl is found by the guest in oysters served on the half-shell. It has been suggested that the situation may be different in a hotel dining room or conventional restaurant on the one hand, and in a self-serve dairy-lunch on the other; or even different according to whether service is *table d'hôte* or *à la carte*. *Cf. Valeri v. Pullman Co.* (1914, S. D. N. Y.) 218 Fed. 519, 521; but *cf.* also the seeming facts in *Leahy v. Essex Co.* (1914, N. Y.) 164 App. Div. 903, 148 N. Y. Supp. 1063. Perhaps there might also be a difference as to kinds of food. The test may well be found in an attempt by the server of food to revoke and retake possession before the food is consumed.

[4] "The consequences resulting from the purchase of an unsound article may . . . prove so disastrous to the health and life of the consumer," etc. "The vendor has so many more facilities for ascertaining the soundness," etc. *Wiedeman v. Keller* (1898) 171 Ill. 93, 99, 49 N. E. 210, 211. *Cf.* on the related question of the public policy back of criminal regulation of sales of food (1916) 26 YALE LAW JOURNAL, 67; and (1917) *ibid.* 416; also (1918) 27 *ibid.* 961; and see a suggestive discussion by Hand, J., in *Valeri v. Pullman Co., supra.*

[5] *Rinaldi v. Mohican Co.* (1916, N. Y.) 171 App. Div. 814, 157 N. Y. Supp. 561 (warranty of retailer); *Catani v. Swift and Co.* (1915) 251 Pa. 52, 95 Atl. 931 (warranty of manufacturer to consumer for goods resold in the original package).

set before him. Why cannot the warranty be attached to the sale of a privilege of consuming food[6] as well as to the sale of the food itself?

The common law history of this warranty doctrine, indeed, is almost wholly one of extension. It is based, ultimately, on a statement in Blackstone that "in contracts for provisions, it is always implied that they are wholesome."[7] But Blackstone's exception to *caveat emptor* rested in no wise on warranty, but on ancient criminal statutes;[8] the predication on it of the warranty doctrine, by a multitude of *dicta,*[9] and then by decided cases,[10] seems a case of growth by mistake.[11] Mistake or no, however, it is established law to-day, and the principal case, resting on it, reaches a sound result.[12]

For all that, the doctrine of warranty is not sufficient unto the needs it has been called upon to fill. For while a warranty protects only those "privy" to it,[13] the public policy on which the warranty rests demands protection of all consumers of foodstuffs. There have been heroic attempts to make the means meet the situation; it has been

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[6] The meaning of such a transaction seems to be that the innkeeper, for a money or credit consideration, extinguishes in himself certain rights in the food and creates in the guest certain others; the essential relation involved is a privilege in the guest to consume the food—a privilege which, though perhaps not transferable, is almost as valuable as the complete ownership. This may fairly be called a sale of a portion of the title to the food; for sale of the whole title, *i. e.,* of the food, is only the same operation applied to *all* the legal relations of which that title is made up.

[7] 3 *Bl. Comm.* *165.

[8] Benjamin, *Sales* (7th ed.) sec. 672; Williston, *Sales,* sec. 241; *Burnby v. Bollett* (1847, Exch.) 16 M. & W. 644.

[9] 2 Mechem, *Sales,* sec. 1356; 11 *R. C. L.* 1120; 15 *Am. & Eng. Enc. Law* (2d ed.) 1238; and cases cited.

[10] *Hoover v. Peters* (1869) 18 Mich. 51; *Sinclair v. Hathaway* (1885) 57 Mich. 60; *Wiedeman v. Keller, supra,* n. 4; *Sloane v. Woolworth Co.* (1916) 193 Ill. App. 620. In citing these cases it is not always noticed that those in Illinois were decided under a statute similar to that Blackstone had in mind. See *Wiedeman v. Keller, supra,* at p. 99. Indeed the whole matter is frequently regulated by statute. See *Catani v. Swift and Co., supra,* n. 5, at p. 56; *Flessher v. Carstens Packing Co.* (1916) 93 Wash. 48, 53; 160 Pac. 14, 16; and see note 12, *infra.*

[11] See citations *supra,* n. 8.

[12] It is something of a question, however, how far the Sales Act—which, although adopted in New York, is not discussed by the court in the principal case—should be held to have changed this common law rule. The English Sales of Goods Act brings the sale of an article of food, as to implied warranty, within the ordinary rule of reasonable reliance applied to sales of goods generally. 15 *Hals. Laws Eng.* 3; *Frost v. Aylesbury Dairy Co.* (C. A.) [1905] 1 K. B. 608. And the provisions of the American Uniform Sales Act are taken from the English Act. Williston, *Sales,* sec. 248.

[13] See *Ketterer v. Armour & Co.* (1912, S. D. N. Y.) 200 Fed. 322, 323, for this reason rejecting the strict warranty view in favor of liability practically in tort.

said that "a manufacturer, dealer, or other person may bring himself into privity with others under exceptional circumstances, and thereby be charged with a duty toward such person different or greater than that which he owes to" persons in general;[14] the "special circumstances" come down largely to knowledge that certain other persons were intended by the buyer to use the commodity bought,[15]—to a groping part-application of a sort of third party beneficiary rule. No theoretical difficulty appears, indeed, in recognizing warranties for the benefit of third persons;[16] but there is the practical question whether the courts would consciously accept such a doctrine, and just how far they would carry it if they did.

The idea of liability in tort seems simpler and more apt: that every manufacturer and dealer in foodstuffs is under a common law duty to any person who may reasonably be expected subsequently to use those foodstuffs, to use reasonable care to make and keep them wholesome.[17] And so it is very generally held: drugs, and then food,

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[14] *Hasbrouck v. Armour & Co.* (1909) 139 Wis. 357, 363; 121 N. W. 157, 160. This case follows an excellent discussion of the principles involved in food and other cases with the remarkable finding of fact that injury to the hand of a consumer was not a consequence to be expected from allowing a needle to become imbedded and hidden in a cake of soap. Attempts to follow the court in its application of theory to facts have led to regrettable results. See (1917) 27 YALE LAW JOURNAL, 281, criticizing *Jacobs v. Childs Co.* (1917, Mun. Ct.) 166 N. Y. Supp. 798 (nail in cake).

[15] So *Woodward v. Miller* (1904) 119 Ga. 618, 46 S. E. 847, where the defendant manufacturer sold a buggy he knew to be defective to a municipal corporation for the use of one of its employees; and the *Hasbrouck* case, *supra*, so explains *Bishop v. Weber* (1885) 139 Mass. 411, 1 N. E. 154, where a caterer was employed to furnish dinner to a man and his guests; but a later Massachusetts case finds that "there seems to be ground for holding that the declaration in *Bishop v. Weber* was good as a declaration on a contract between the plaintiff and the defendant." *Farrell v. Manhattan Mkt. Co.* (1908) 198 Mass. 271, 286; 84 N. E. 481, 487. The actual writ in the *Bishop* case covered both tort and contract; the decision was only that the action lay.

[16] There seems no reason to question that a warranty may to-day be treated as a contract, whether or no it took its origin in tort. *Cf. Nash v. Minnesota Title Ins. & T. Co.* (1895) 163 Mass. 574, 40 N. E. 1039.

[17] *Ketterer v. Armour & Co., supra*, n. 13; and see *Flessher v. Carstens Packing Co., supra*, n. 10, at p. 56; *Parks v. Yost Pie Co.* (1914) 93 Kan. 334, 337; 144 Pac. 202, 203; *Doyle v. Fuerst and Kraemer* (1911) 129 La. 838, 841; 56 So. 906, 907; *Ketterer v. Armour & Co.* (1917, C. C. A. 2d) 247 Fed. 921, 927. On what difference there may be between the liability of the manufacturer and that of the seller, see note 20, *infra*.

The benefit of this liability in tort extends to the members of the household of the purchaser of food or drink. See *Ketterer v. Armour & Co.* (C. C. A. 2d) *supra*, n. 17, at p. 923. It extends to a casual licensee or guest. *Watson v. Augusta Brewing Co.* (1905) 124 Ga. 121, 52 S. E. 152. It would seem, therefore to cover almost any consumer; but it would probably not be extended to benefit a thief, and possibly not a finder. Liability to one who buys to resell is of course a wholly different question, itself not free from conflict of authority.

have been brought under the ordinary rule of torts as to dangerous instruments.[18] The test of reasonable care serves also to avoid another difficulty of the warranty doctrine at which some courts have balked:[19] that it is absolute. It seems hard, for instance, to hold a retail dealer for damage caused by meat of good appearance, which he chose and kept carefully, and which bore the government stamp.[20]

Compare *Neiman v. Channellene Oil & Mfg. Co.* (1910) 112 Minn. 11, 127 N.W. 394; *Mazetti v. Armour & Co.* (1913) 75 Wash. 622, 135 Pac. 633; and the rule as stated in 15 L. R. A. (N. S.) 884.

[18] (1916) 25 YALE LAW JOURNAL, 679; see also, on the general duty of a manufacturer (1918) 27 *ibid.* 961; but see *Farrell v. Manhattan Mkt. Co., supra,* n. 15, at p. 286.

[19] *Bigelow v. Maine Central R. Co.* (1912) 110 Maine, 105, 85 Atl. 396, where it was said that with the changed conditions of modern industry, public policy might no longer impose upon caterer, seller or host the old implied warranty of wholesomeness; that with canned goods, as with other packed and branded food sold in the package, vendor and vendee rely equally on the brand, with no greater opportunity in the former to know the quality of the goods, unless their history or appearance put him on notice. This view as to canned goods appears to be finding approval. See *Flessher v. Carstens Packing Co., supra,* n. 10, at p. 54; but see *Chapman v. Roggenkamp* (1913) 182 Ill. App. 117.

[20] As in the Illinois cases, and as in *Rinaldi v. Mohican Co., supra,* n. 5, despite misgivings. Courts often comment on the severity of the rule, but seem to feel that its general working is nevertheless salutary. If so, the benefits must be found, as with the statute of frauds, not in the litigated cases, but in the regulation of conduct to prevent the question arising.

In the *Rinaldi* case, in *Sheffer v. Willoughby* (1896) 163 Ill. 518, 45 N. E. 253, in the principal case, and often elsewhere, the rule of warranty is phrased to apply to a dealer *who makes or prepares the article* he sells; who is, therefore, a manufacturer; and again, to a *sale for immediate use.* If the latter qualification is intended to exclude liability for the spoiling of goods in the hands of the consumer, its presence is unnecessary; if it is intended to exclude the vendee's purchaser, it is again unnecessary in most instances, as the warranty is rarely—save where the original package rule (note 19, *supra*) is applied to exonerate the dealer—held to enure to the sub-vendee's benefit. The word "consumption" substituted for "immediate use" would be more accurate and less likely to mislead.

The restriction of the warranty to a sale by a manufacturer, it will be noticed, is not in consonance with the passage from Blackstone as read by the courts; it appears to rest on the thought that the opportunity to discover defects which is available to a dealer who does not prepare his food is not enough better than that of his patrons to justify the imposition of any warranty. This hardly holds true in fact. It is submitted that, subject always to the limitation pointed out in note 19, dealer and manufacturer should be on one footing as to warranty of food—as they are in other warranties under sec. 15 (1) of the Sales Act.

The tort obligation likewise would appear to rest on manufacturer and dealer alike. It may seem proper in many cases to hold the manufacturer rather more strictly to account than the dealer; the nicer definition of the standard of care must be left to each court on the facts of each case. *Cf.* note 21, *infra.* Of course a merely casual vendor will rarely be held on either theory. See *Burnby v. Bollett, supra,* n. 8; Williston, *Sales,* sec. 242; but see *Hoover v. Peters* (1869) 18 Mich. 51.

On this point of policy, however, the courts are not agreed;[21] many even of those cases which go off on the tort theory tend to place upon the seller—particularly if he be also the manufacturer—not a mere duty to use due care, but the liability of an insurer of the food sold;[22] a liability even broader than that under the implied warranty, because it extends to any person who may use the food.

The advantages of the tort doctrine, then, over that of implied warranty, are that it is no anomaly, but fits into the general law of the subject; that without danger of uncertainty or mistake it protects all those whom the public policy on which it rests is intended to protect; and—if this be an advantage—that it may easily be applied to impose a duty, not absolute, but tempered by reason.

But between the two theories there is no conflict. If a single one had to be chosen, certainly that of tort would be preferable; but there is no cause to choose a single one.[23] When a man ships goods by a common carrier, relations result which may impose liabilities not only in contract, but in tort as well. If a man under contract to repair something of mine makes a botch of it, he is liable not only in con-

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[21] Even in the cases which rest recovery on negligence the varying strictness of the requirements of proof leads to widely differing results. Some hold that the negligence must expressly be averred and proved. *Sheffer v. Willoughby, supra*, n. 20. Or that evidence tending to show that the plaintiff bought and ate food at the lunch room of the defendant, and had ptomaine poisoning in consequence, was not sufficient to enable the plaintiff to go to the jury on the question of negligence. *Crocker v. Baltimore Lunch Co.* (1913) 214 Mass. 177, 100 N. E. 1078; see also *Ketterer v. Armour & Co.* (C. C. A. 2d) *supra*, n. 17. Certainly the more liberal view in this matter is the preferable. So *Tomlinson v. Armour & Co.* (1908, Ct. Err.) 75 N. J. L. 748, 70 Atl. 314; *Watson v. Augusta Brewing Co., supra*, n. 17; *Doyle v. Fuerst & Kraemer, supra*, n. 17. But it should be noted that this very liberalization of procedure can be made to mean holding the defendant as an insurer. *Cf.* the cases in the following note. The Massachusetts rule appears to be peculiar unto itself: "As due care is no defence when the dealer makes the selection, so there is no liability for negligence when a dealer offers several articles of food for sale from which the buyer is to make his own selection. In offering . . . he impliedly represents that he believes all of them to be fit for food. That is the extent of his liability." *Farrell v. Manhattan Mkt. Co., supra*, n. 15, at p. 286. It is believed that the test of selection is not satisfactory, unless perhaps for warranty alone; as to which it might be justified as an application of the Sales Act. *Cf.* note 12, *supra*.

[22] *Parks v. Yost Pie Co., supra*, n. 17; *Catani v. Swift and Co., supra*, n. 5; *Jackson Coca Cola Bottling Co. v. Chapman* (1914) 106 Miss. 864, 64 So. 791; but see *Crigger v. Coca Cola Bottling Co.* (1915) 132 Tenn. 545, 179 S. W. 155.

[23] The possibility of recovery on either of two theories in cases where, for instance, a dealer himself prepares food and sells it to an immediate consumer, is often recognized and discussed by the courts; which at times—particularly when refusing recovery—distinguish sharply between the two. See *Crocker v. Baltimore Lunch Co., supra*, n. 21; *Hasbrouck v. Armour and Co., supra*, n. 14; and see also *Tomlinson v. Armour and Co., supra*, n. 21. On the other hand, some courts would merge the theories. See *Flessher v. Carstens Packing Co., supra*, n. 10.

tract for failure properly to perform, but in tort for misdoing.[24] And so in the situation under discussion, there may well be two liabilities, each with its own content. That New York has chosen to affirm the doctrine of implied warranty of wholesomeness is no cause for reproach—if only she does not for that reason disaffirm the rule of liability in tort.

FOREIGN CORPORATION TAXES AND INTERSTATE COMMERCE

The decision of the Supreme Court in the recent case of *International Paper Company v. Massachusetts* (1918) 38 Sup. Ct. 292, is of importance in that it reaffirms in the broadest language the doctrine laid down in the earlier case of *Western Union Telegraph Company v. Kansas,*[1] which there was reason to think had been considerably narrowed by later cases.

It will be remembered that in the *Western Union* case the court decided that a license fee imposed upon a foreign corporation for the privilege of doing local business and based upon a given per cent of its entire authorized capital was unconstitutional. It held that such a fee was necessarily "a burden and tax on the company's interstate business. . . . Such is the necessary effect of the statute, and that result cannot be avoided or concealed by calling the exaction of such a per cent of its capital stock a 'fee' for the privilege of doing local business."

The Western Union was a corporation engaged in interstate commerce, and its interstate business was so intimately connected with its intrastate business that they could not be separated as an economically sound business proposition.

Later decisions of the court, upholding statutes differing somewhat from that in question in the *Western Union* case were thought to limit the broad doctrine laid down in that case.[2] This was particularly true of the case of *Baltic Mining Company v. Massachusetts.*[3] In that case the court held constitutional a tax which was imposed for the privilege of doing local business and based upon the total authorized capital, but with a maximum limit of $2000. This act had been construed as not applying to corporations whose sole business was interstate commerce or which carried on interstate and intrastate business in such close connection that the intrastate business could not be abandoned without serious impairment of the interstate business of the corporation.[4] The Baltic Mining Company was

[24] (1917) 26 YALE LAW JOURNAL, 486.

[1] (1910) 216 U. S. 1, 30 Sup. Ct. 190.

[2] See cases cited in the principal case.

[3] (1913) 231 U. S. 68, 34 Sup. Ct. 15.

[4] See *Baltic Mining Co. v. Commonwealth of Massachusetts* (1911) 207 Mass. 381, 93 N. E. 831, at end of opinion.

described as carrying on "a purely local and domestic business quite separate from its interstate transactions." Contrasting this state of facts with the situation in the *Western Union* case, and holding that "Every case involving the validity of a tax must be decided upon its own facts," the court came to the conclusion that in the *Baltic Mining Co.* case the authorized capital was used in truth only as the measure of a tax, in itself lawful, without the necessary effect of burdening interstate commerce.

This language led constitutional lawyers to believe that the doctrine of the *Western Union* case would not be applied where the tax, though based upon total authorized capital, was laid upon and made the condition of doing a purely intrastate business, economically separable from interstate business.

The decision in the *International Paper Company* case, however, upsets this belief and reaffirms the broad language of the *Western Union* case. The statute, as construed by the court, was identical with that in the *Baltic Mining Co.* case, except that the maximum limit had been removed. The court now makes no mention of the fact that the intrastate and interstate business are separable, but lays down the broad rule that no excise tax, based upon total authorized capital, without maximum limit, may be laid upon a foreign corporation for the privilege of doing local business. It is apparent therefore that the separability of local and interstate business no longer enters into the question, and that the earlier decision in the *Baltic Mining Co.* case must stand wholly on the maximum limit.

The reason for this distinction seems unsatisfactory, since to the small corporation which does not receive the benefit of the limited maximum the tax under either statute equally affects its interstate commerce. Possibly the distinction may be justified on the ground that where there is no maximum the intention is evident to measure the tax by the whole business capital, both interstate and intrastate, which necessarily in every case means that the tax is greater if interstate commerce is greater, thus burdening interstate commerce, while where there is a reasonable maximum this intention is not manifest and the fact that it may burden interstate commerce in the case of small corporations is incidental only and not the intended effect of the statute. Hence the statute may be upheld as being a local regulation which merely incidentally affects interstate commerce, as has frequently been held of police regulations. This explanation, however, is not wholly satisfactory and it is to be hoped that the court will see fit more clearly to enunciate the grounds of its decision in future cases.[5]

W. W. G.

[5] For a full discussion of these cases see a series of articles (not yet completed) on *"Indirect Encroachment on Federal Authority by the Taxing Powers of the State"* by Thomas Reed Powell, in (1918) 31 Harv. L. Rev. 321, 572, 721, 932.