NOTES

RIGHT OF PURCHASER OF CASINGHEAD GAS TO INCOME TAX DEDUCTIONS FOR DEPLETION*

Tax administration of the problem of depletion allowances has departed so far from the generally accepted meaning of the term "depletion" that it is necessary for purposes of clarity to divorce the idea from superimposed legal concepts. Depletion is geologically defined as a gradual process of diminution of the mineral content of land by severance of the minerals. As used by accountants the term signifies a reduction in the value of capital assets caused by their consumption. Accordingly, when Congress provided for the granting of a reasonable allowance for depletion with respect to incomes gained from mines and oil and gas wells, it presumably intended to exclude from taxation that part of the taxpayer's annual gross income which represents a reduction in the value of his capital assets. When the last of the mineral assets has been removed, the sum total of the depletion allowances theoretically should equal the original value of the minerals in place, that is, the original capital assets. The administrative difficulties of ascertaining the exact quantity of migratory oil and gas reserves obviously precludes a high degree of accuracy in application of the theory. Yet in determining who

2. 2 Kester, Accounting Theory and Practice (3rd ed. 1933) 362.
3. For a collection of the depletion provisions of the various revenue acts see 2 Paul and Mertens, Law of Federal Income Taxation (1934) §21.03 et seq.; Helvering v. Twin Bell Oil Syndicate, 293 U. S. 312, 315 (1934). The Revenue Acts have varied greatly as to the bases of computing depletion, but little as to the parties entitled to an allowance. The second question has been shifted to the courts under the clause, "a reasonable allowance for depletion ..., according to the peculiar conditions in each case, ..." which appears in 40 Stat. 1067 (1918), Rev. Act of 1918, §214(a) (10) (individuals); §234(a) (9) (corporations) and all subsequent Rev. Acts. A few isolated interests have been specifically named as being entitled to an allowance. Ibid. (lessor and lessee) and subsequent Rev. Acts; 45 Stat. 800 (1928), Rev. Act of 1928, §23(1) (life tenant to the exclusion of remaindermen; income beneficiaries and trustee) and subsequent Rev. Acts.
6. From 1918 through 1925 depletion was computed on the alternative bases of cost or of fair market value of gas or oil on date of discovery or thirty days thereafter [40 Stat. 1067 (1918), Rev. Act of 1918, §214(a) (10); 42 Stat. 241 (1921), Rev. Act of 1921, §214(a) (10); 43 Stat. 260 (1924), Rev. Act of 1924, §204(c)]. In 1926 Congress, realizing the impossibility of valuing migratory mineral assets, substituted gross income for the previous base of discovery value [44 Stat. 16, Rev. Act of 1926, §204(c) (2)]. For an analysis of the methods of computing depletion allowances, see Comment (1934) 43 Yale L. J. 466.
is entitled to a depletion allowance, and in what amount, the basic principle must be kept in mind.

In a recent opinion the Circuit Court of Appeals for the Ninth Circuit held that a contract purchaser of casinghead gas had a depletable interest. An owner of oil lands contracted to sell his entire output of casinghead or wet gas to the taxpayer in return for a percentage of the taxpayer’s income on the gasoline recovered from the purchased gas. The taxpayer-vendee acquired no interest in the gas in place, but only a right to pipe the severed gas from the mouth of the well. Nevertheless, he was held to have some undefined “economic interest” entitling him to a depletion deduction from his gross income amounting to 27 1/2% of the difference between the contract price and the fair market value of the purchased gas where the latter is the higher sum. This was deemed complementary to depletion allowed the vendor and producer of the gas as measured by the contract price.

Although there is authority for the decision in several lower federal court opinions, the vendee would not seem to be entitled to the allowance under the geological concept of depletion developed under the guiding hand of the Supreme Court. It was first held that ownership of the absolute fee was necessary to entitle the taxpayer to an allowance. This attitude was modified by a subsequent holding that a lessee, by virtue of his right to remove minerals in place and retain part of them, has a “sufficient property interest” in the land to entitle him to a depletion allowance; at the same time, the lessor, by reason of his right to receive a portion of the production in the nature of a royalty, is also entitled to an allowance on his share of the production. Accordingly, the lessor’s gross income for income tax purposes is reduced by 27 1/2% of the value of that portion of the produced oil which is turned over to him by the lessee as royalty in the nature of rent, while the lessee’s gross income is reduced by 27 1/2% of the portion of the oil

8. For a general discussion of the casinghead gas industry together with a treatment of the forms of contracts usually employed, consult Glassine, OIL AND GAS LEASES AND ROYALTIES (1935) § 57 et seq.
which he retains. The sum of the reductions allowed equals 27\% of the value of the total oil produced, 27\% representing Congress' arbitrary evaluation of the oil in place, and 7\% representing the increase in value attributable to the process of severance. The ruling is supportable on the ground that the lessee had an interest in the minerals in place by virtue of his right to remove part of the minerals for his own use, and therefore extraction of those minerals constituted a depletion of his capital assets.

But introduction of the phrase "sufficient property interest" had unfortunate consequences, for the vagueness of the test misled other courts into holding that a lessee who had assigned his property interest and retained only an overriding royalty, i.e., a right to a percentage of production, was entitled to no depletion allowance since he had parted with his control over, and interest in, the land. When the Supreme Court overruled these decisions and granted the lessee-assignor a depletion allowance in Palmer v. Bender, it used a new phrase, "sufficient economic interest," apparently to signify the immateriality of the legalistic question of title to the oil in place, and not to establish any new criterion of an undefined economic interest. The real criterion advanced was the acquisition and retention of some interest in the oil in place and the securing of an income from the extraction of that oil.

The principal case would seem to read into the phrase "economic interest" a content not intended by the Palmer decision and to give it some indefinite meaning totally divorced from any idea of return of capital assets. Since the vendor of the wet gas was granted a depletion allowance of 27\% of the proceeds of all gas extracted, with the necessary result that the value of the capital assets depleted will be returned in their entirety to him, no allowance can logically be granted the vendee on the theory of a return of the value of capital assets depleted by severance. The vendee was merely a purchaser of the gas already severed, and acquired no interest in the gas in place. This is made evident by the fact that the purchaser would be

12. Helvering v. Twin Bell Oil Syndicate, 293 U. S. 312 (1934). 40 Stat. 1067, Rev. Act of 1918 § 214(a) (10) (individuals); § 234(a) (9) (corporations) and all subsequent Revenue Acts provide for an equitable apportionment of deductions between lessor and lessee.


15. 287 U. S. 551 (1933).

16. Id. at 557.

17. In Signal Gasoline Corp. v. Comm'r of Int. Rev., 66 F. (2d) 866 (C. C. A. 9th, 1933), the court laid down the doctrine that a purchaser of wet gas had an interest in the gas in place because of his contract duty to aid in the production of the gas he was to buy by creating a vacuum within the wet gas line. The validity of such a position is doubtful [see Hurley v. United States, 10 F. Supp. 365 (N. D. Okla. 1935); and Bankline Oil Co., 33 B. T. A. 910, 916 (1936)], and would seem to confuse contract duties and rights in surface land with rights in minerals. In the principal case the court realized that the situation was distinguishable on the facts since the taxpayer was under
granted no allowance whenever the fair market value declines to or below the contract price. Apparently the court has invented a peculiar type of capital asset which appears and disappears with the rise and fall of the fair market value of wet gas. The taxpayer is deemed to have an interest in the assets represented by the gas in place when the market is high, but no interest in those assets when the market is low, even though he purchase the same quantity of gas at both times.

As a favorable contract expires, or the quantity of gas reserves diminishes, the purchaser is the loser in the sense that profits tend to diminish or may cease altogether, but that fact is in no wise related to the concept of depletion. Indeed, any theory supporting the deductions granted would be similar to the distinctly different concept of amortization of the value of favorable contracts for the purchase of coal, services, and leaseholds by yearly deductions from the purchaser’s taxable income of an amount equal to the value of the contract divided by its duration in years. However, in every such instance the amortized value of the contract was a definite investment paid for the contract by way of assignment, whereas in the principal case there was no such investment and the amount sought to be amortized under the misnomer of depletion was not the value of the contract, which it resembles in some respects, but in reality was an annual unearned increment of profit. In other fields there has been no policy of exempting unearned profits from taxation. Yet the principal case would seem to reverse that policy by partially excluding the unearned increment from taxation. Such an extension of tax exemption would mean an appreciable loss of revenue to the government and would create difficulties necessarily accompanying the process of valuing commodities which have no organized market. The importance of these objections becomes apparent when it is realized that the theory of the principal case, if carried to its logical conclusion, is applicable to all profitable mineral and timber purchase contracts.

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18. For a general discussion of this subject see 2 Paul and Mertens, Law of Federal Income Taxation (1934) §20.64 et seq.; (1932) 32 Col. L. Rev. 387.
22. Where property has been bought below its fair market value and later sold at a profit, the increment of profit between cost and fair market value at the time of purchase is taxable as income unless the taxpayer can prove it to be a gift from the original vendor. E. L. Jacobs, 20 B.T.A. 529 (1930); R. A. Otto, 19 B.T.A. 889 (1930); see G. Wildy Gibbs, 28 B.T.A. 18, 20 (1933); J. F. Frindible, 16 B.T.A. 187, 192 (1929).
23. The apparent misapplication of the depletion concept caused an exemption of only 27½% of the increment of profit.
Fictitious Payee Checks in the Conflict of Laws *

An Illinois corporation sued in a New York court to recover from its various New York drawees amounts debited to its account on checks drawn to the order of fictitious payees. A dishonest employee in plaintiff's Chicago office had procured the issuance of these checks allegedly without the company's knowledge by submitting to the checking department vouchers on which he had substituted the name of the fictitious payee for the names of the intended payees. After endorsing the checks to himself in the name of the fictitious payee, and then endorsing them in his own name, the employee deposited the checks in Chicago banks which forwarded them to New York correspondents. The drawees paid out the proceeds to the latter and debited plaintiff's account accordingly. The court assumed that by the law of New York the banks would have been liable for payment on a forged indorsement to an order instrument, for the New York courts consider a check made out to a fictitious payee a bearer instrument only when its fictitious character was known to the actual drawer.1 Illinois law, on the other hand, regards checks drawn to a fictitious payee with the knowledge of either drawer or his employee as bearer instruments, with the result that indorsement is superfluous and consequently the drawee banks are not subjected to the responsibility of one who has honored a forged indorsement.2 After rehearsing the confusion of New York authorities on the conflict of laws question thus presented,3 the court adopted the rule of the Restatement that the negotiability of a mercantile instrument is determined by the law of the place of contracting,4 which in this case was Illinois, and that therefore the checks were bearer instruments, and the banks were entitled to debit the drawer's account.5

While the uniform legislation on negotiable instruments has lessened the number of conflict of laws questions pertaining to bills and notes,6 statutory and judicial variations still occasion thorny conflicts problems. Their solution


2. ILL. REV. STAT. (Smith-Hurd, 1935) ch. 98, § 29(3), which was passed at the instance of the American Banking Association following the decision in U. S. Cold Storage Co. v. Central Mfg. District Bank, 343 Ill. 503, 175 N. E. 825 (1931). Similar provisions exist in only two other states, IDAHO CODE ANN. (1932) § 26-109(3); MONT. REV. CODES ANN. (Anderson & McFarland, 1935) § 8416(3); and England, BILLS OF EXCHANGE ACT § 7(3).


4. RESTATEMENT, CONFLICT OF LAWS (1934) § 336.


For purposes of discussion, almost fifty contemporaneous memorandum decisions by the same court in cases brought by the same plaintiff against a number of its New York drawees and dealing with similar transactions, have been consolidated. N. Y. L. J., July 3, 1937, p. 35, col. 4 et seq. The court's brief statement of facts has been amplified by uncontroverted material from the memoranda of the parties.

6. See generally Buschmann, Some Conflict of Laws Problems Pertaining to Bills and Notes (1933) 8 IND. L. J. 213.
is complicated by the variety of conceptual approaches that may logically be applied, and by the absence of compelling factors of social policy to direct a choice. In the principal case, the court, by assuming that the controlling issue was the negotiability of the instruments, availed itself of the authorities holding that the proper law to determine negotiability is the law of the place of contracting. Although in ordinary contracts, the ascertainment of the place of contracting is comparatively easy, the multiplicity of contracts which may be implied from checking transactions permits divergent results. Where the liability of the drawer or indorser to a holder is in issue, it is relatively simple to fix the place of contracting at the spot where the check is delivered. But here the drawees claim the right to debit the drawer’s account, and the question relates not to the liability on the checks, but to the mutual obligations of banks and a customer who draws a check in connection with a checking account. Hence the place of contracting might be viewed not as the state where a particular check happens to be drawn or negotiated, but where the original agreement to conduct a checking account was made. This might be either New York or Illinois. Or, on the other hand, the drawing of each check might be regarded as the acceptance by the drawer of an offer of a loan by the drawee: in this event Illinois would be the place of contracting.

A different result might be reached by taking the approach that the question directly involved here is not one of the validity of any contract but rather one of performance, i.e., whether payment of the fictitious payee checks by the drawee banks discharged their contractual obligations to the drawer customer arising out of the opening of the checking accounts. Since

7. Obviously, if the law governing the transactions views the checks as order instruments made out to a fictitious payee, since the payee is ex hypothesi fictitious, valid endorsements would be impossible, and the checks would therefore be non-negotiable. See Prince, *Forgery in the Law of Bills and Notes* (1935) 5 *Brooklyn L. Rev.* 1.


12. This analysis would distinguish the decisions adopting the lex loci contractus as involving the liability of drawer or indorser to subsequent holders and the availability of defenses. Amsinck v. Rogers, 189 N. Y. 252, 82 N. E. 134 (1907); Hyatt v. Bank of Kentucky, 8 Bush 193 (Ky. Ct. App. 1871); Hemenlotter v. DeOrvananos, 114 Misc. 333, 186 N. Y. Supp. 488 (Sup. Ct. 1921). Even where these issues are involved, many authorities apply the lex loci solutionis. Comment (1928) 37 *Yale L. J.* 893, 895.
questions relating to the performance of a contract are governed by the law of the place of performance, the law of New York, where the checks were honored, should control the issue.

Another approach, often applied in similar situations, would treat the problem as a question of title to the negotiable instruments as chattels. Under this doctrine, the drawee bank may debit the drawer's account when it has paid to a holder intended by the drawer or to a person who has acquired bona fide title under the Negotiable Instruments Law. The problem is whether the recipient of the money had title at the time of the transfer, and this should be determined by application of the lex res sitae. When the check is payable to a fictitious person, title is passed by a mere delivery if it is considered a bearer instrument; but if the check is deemed an order instrument, a valid endorsement is necessary and a forgery will not pass title. Since the transfers in the instant case occurred in Illinois, when the dishonest employee deposited the checks, it may be argued that the law of that state governs the validity of these transfers, and since the checks are bearer instruments under Illinois law, their delivery to the Illinois banks passed good title and the drawees could legitimately debit the drawer's accounts. While this type of analysis may be no less arbitrary than the approach in contractual terms, it apparently affords a more tangible basis for decision in situations complicated by an abundance of implied contracts. That this analysis may lead to highly artificial results, however, is illustrated by the case where one of the fictitious payee checks was deposited for collection and the other cashed immediately. It might be argued under one line of authorities that when the check is left for collection the forwarding bank acts as the agent of the depositor and title is passed not in Illinois, but in New York. Therefore the transfer of title must be governed by New York law. But if the bank paid out directly to the depositor, it became the

13. 2 Beale, Conflict of Laws (1935) 1268 et seq.
14. See cases cited in Lorenzen, Cases on Conflict of Laws (4th ed. 1937) 547, n. 73; Lorenzen and Heilman, The Restatement of the Conflict of Laws (1935) 83 U. of Pa. L. Rev. 555, 575; Comment (1928) 37 Yale L. J. 803. Although the location of the drawer at the time he draws a particular check may often be fortuitous, the location of the drawee is constant. See Buschmann, op. cit. supra note 6, at 222.
16. Lorenzen, Conflict of Laws Relating to Bills and Notes (1919) 47.
19. The opinion in the principal case is silent as to the depositor's exact procedure. Most of the memoranda submitted to the court state that the checks were deposited for collection. Defendant's memorandum in the Central Hanover Bank & Trust case, supra note 5, however, states (p. 2) that one of the checks was deposited for collection in one Illinois bank and the other was cashed at another Illinois bank.
and title was transferred in Illinois. The result would be to protect the New York bank when the Illinois bank acted as "purchaser" but to deprive it of protection when it acted as "agent." This distinction would be unrealistic since the Illinois bank, after having collected the proceeds, paid them over to the dishonest employee.

The more fundamental problem suggested by the instant case is the proper allocation of the risk of losses upon fictitious payee checks. Between bank and large scale employer, there is little preference on the basis of ability to insure: banks may and do insure against such losses; business enterprises sometimes secure fidelity insurance. The real problem is whether vicarious liability should be expanded to include employer responsibility for the employee's personal fraud or whether the traditional liability of banks for payments on forgeries should be extended to all fictitious payee checks. Intrastate dealings may consistently be governed by local policy. But where interstate transactions are complicated by divergent attitudes, courts may, by the skillful manipulation of conflict of laws concepts, individualize each case and allot the risk in their discretion.

MISMANAGEMENT CLAIMS IN RAILROAD REORGANIZATIONS *

Reorganization of a railroad or other large enterprise affords a signal opportunity to scrutinize the conduct of a normally self-perpetuating management, and to determine whether executives are fit to retain their positions. Receivers and trustees, as officers of the court, have always been charged with a duty to make investigations, uncover previous acts of mismanagement, and prosecute the culprits for the benefit of the estate. Section 77 of the


22. Corporate structure, especially when there is complicated departmentalization, multiplies opportunities for the kind of fraud that occurred in this case. Since the employee is usually defrauding his employer and acting beyond the scope of his authority, it is a mere legalism to impute his knowledge to the drawer-employer. However, the policy of encouraging free negotiability and the employer's position of control may well militate in favor of increased liability.

23. (1933) 3 Brooklyn L. Rev. 121; (1933) 27 Ill. L. Rev. 564. The imputation of knowledge is usually so artificial and fortuitous that convenience may better be served by holding the bank liable indiscriminately.


1. For a study of the difficulties encountered in attempting to oust an entrenched management, see BERLE AND MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

Bankruptcy Act,\(^3\) sought, as one of its objectives, to vitalize this purgatory power, which had rarely been exercised by the equity receiver.

Before resorting to the equity receivership, railroad executives usually created an atmosphere in which impending financial difficulties were made to appear as temporary setbacks encountered by an unfortunate management whose honesty and ability were unquestioned. To assist the company in consummating a reorganization with the least possible embarrassment, a sympathetic federal judge was usually prevailed upon to appoint a corporate official as receiver.\(^4\)

When this early practice was criticized as incompatible with the high trust impressed upon an officer of the court, reorganizers found it expedient to inject a degree of impartiality into the proceedings by the selection of an additional independent receiver.\(^5\) In actuality, however, the independent held a merely formal position; his reputation lent dignity to the receivership, but the scope of his activity was narrowly circumscribed.\(^6\) He had little personal knowledge of the corporation's affairs, and in view of the friendly nature of the proceedings, it is probable that he did not feel bound to conduct an inquiry into any but the most flagrant abuses, for the attendant publicity would have impeded reorganization by destroying the faith of the security-holders. Moreover, the pervasive control of the banker-management group\(^7\) over the receivership process made difficult any investigation of their stewardship, even were the independent so inclined.

Section 77, which replaces the receiver with a trustee, is the first legislative attempt to set standards governing his selection. Trustees are now appointed by the bankruptcy court, subject to the approval of the Interstate Commerce Commission.\(^8\) Since efficient maintenance of the property as a going concern requires knowledge of the problems and personnel of the enterprise, the statute permits nomination of a corporate officer, but an outsider, free from management affiliations, must be named to serve with him.\(^9\) Maximum limits of compensation are fixed by the Commission.\(^10\) In almost every case involv-
ing Class I property, the railroad president and an independent have been chosen.\textsuperscript{11}

It is difficult to evaluate the effect of 77 upon the utility of the independent trustee. Some activity is indicated by the two mismanagement suits which trustees have brought to date against officers, directors and bankers of the St. Louis-San Francisco\textsuperscript{12} and the Missouri Pacific.\textsuperscript{13} Neither of these cases, however, can definitely be ascribed to any change wrought by the new statute. The Frisco had been put into receivership prior to its filing under 77. As a result of procedural complications occasioned by unfriendly suits brought in both state and federal courts prior to the friendly receivership, an outside receiver acceptable to the hostile interests had been selected to serve alongside the president of the railroad.\textsuperscript{14} Both receivers have been retained as trustees under 77, and the unfriendly officer is responsible for the present litigation.\textsuperscript{15}

In the second action, which alleges improper transactions by the management group of the Missouri Pacific, the complaint has been but recently filed, and little is known about the background of the controversy.

Aside from suits brought by independent trustees other methods have been used to obtain retribution from an unfaithful management. Security holders have compelled prosecution of the more flagrant cases.\textsuperscript{16} Bondholders and stockholders of the Frisco instituted no less than five mismanagement suits, several of which were instrumental in precipitating reorganization and obtaining the appointment of a hostile receiver. The Reconstruction Finance Corporation, intervening as a secured creditor, succeeded in persuading the bankruptcy court to order that the trustee of the Missouri Pacific bring an action for recovery of payments made under the notorious Terminal Shares contract.\textsuperscript{17} Other government agencies have been enlisted to uncover hitherto unrevealed improprieties. The 1935 amendments to Section 77 authorized

achieved by the Commission may be contrasted with the failure of prior attempts to control expenses. See Comment (1931) 40 \textit{Yale L. J.} 974.

11. In at least four instances, three trustees have been selected.


13. In April, 1937, Guy A. Thompson, the trustee, filed suit in the Common Pleas Court of Cleveland against five directors and O. P. Van Sweringen's estate, alleging improper manipulation of the company's securities and misuse of funds. See (1937) 144 \textit{Comm. \& Fin. Chron.} 2836.


the court in its discretion to request investigations by the Interstate Commerce Commission,\textsuperscript{18} while congressional committees have been making independent inquiries. Meagre information at present available indicates that more misdeeds will probably be discovered by vigorous investigatory committees than by the Commission, accustomed as the latter is to routine examination. Shortly after the Commission revealed to the court that it possessed no information regarding mismanagement of the Missouri Pacific,\textsuperscript{19} hearings conducted by the Senate Interstate Commerce Committee revealed several questionable transactions by executives of the same railroad.\textsuperscript{20}

But since suits by security holders and government investigations will occur only sporadically, ultimate reliance must be placed upon the independent trustee.\textsuperscript{21} Selection of at least one independent is now mandatory, but there seems to be no statutory method of making him more competent than the outside equity receiver whom he replaces. 77's only innovation along this line is the requirement of Commission approval of all appointments, and the Commission's \textit{imprimatur} has been placed upon almost all of the court's nominees.\textsuperscript{22} Whether or not this precaution has improved the caliber of trustees, more has probably been accomplished by other provisions of 77 calculated to diminish banker-management control of the reorganization,\textsuperscript{23} and by the stimulation of aroused investor opinion.\textsuperscript{24} And while combined efforts of investors, public agencies and carefully selected trustees have resulted in few mismanagement suits, this fact is of little significance in appraising the utility of present methods, for it is possible that in most cases no basis for such suits exists. The main value of investigation lies not in the assets recovered, but in the corrective influence of vigorous policing upon an intrenched management.

\textsuperscript{18} § 77c(9).
\textsuperscript{19} See ANNUAL REPORT OF THE INTERSTATE COMMERCE COMMISSION (1936) 46.
\textsuperscript{20} The Committee's investigation of railroad reorganizations began on Oct. 20 (N. Y. Times, Oct. 20, 1937, p. 33, col. 1), and revelations have been made intermittently from that time. See, \textit{e.g.}, N. Y. Times, Oct. 21, 1937, p. 33, col. 1.
\textsuperscript{21} The concentration of power in Commission and trustee may have a backwash effect of preventing other types of suits for mismanagement. In Meyer v. Kansas City So. Ry., 84 F. (2d) 411 (C. C. A. 2d, 1936), (1936) 36 Col. L. Rev. 1170, a derivative suit brought by a stockholder against bankers, officers and other railroads for mismanagement of the St. Louis-Southwestern, the customary appointment of a receiver was requested. The bill was dismissed on the ground, \textit{inter alia}, that no receiver need be appointed, since it was already the duty of the railroad's trustee under Section 77 to investigate mismanagement claims. So far as is known, however, the trustee has brought no suit.
\textsuperscript{22} But \textit{cf.} N. Y. Times, Nov. 10, 1937, p. 39, col. 4, reporting the Commission's refusal to ratify the appointment of a second trustee for the N. Y., Ontario and Western, on grounds of economy.
\textsuperscript{23} See Comment (1937) 47 YALE L. J. 247, 250.
\textsuperscript{24} A group of vociferous small investors headed by Prof. Charles A. Beard was instrumental in precipitating the current Congressional investigation of the Missouri Pacific's finances. See Hearings before Committee on Interstate Commerce on S. Res. 71, 74th Cong., 1st Sess. (1935) 2-38.
Jurisdiction of S. E. C. over Security Issue of a Corporation Temporarily Exempted under Public Utility Holding Company Act*

The Public Utility Holding Company Act of 19351 requires the Securities and Exchange Commission to exempt from its prohibitions and supervision those holding companies whose structure and activity comply with certain requirements, unless contrary to public interest.2 The filing of an application for exemption in good faith by a non registered company automatically exempts the applicant until the Commission has acted upon its petition.3 But a temporarily exempted company is faced with a perplexing problem, well illustrated in a recent case, if it embarks upon a course of action which may be subject to Commission approval should the Commission declare it registerable.4 An application for a permanent exemption was filed by the International Paper and Power Company. Before it had been passed upon, the Company decided to reorganize its capital structure by a plan which included the issuance of warrants to purchase common stock and preferred stock convertible into common. But as the Commission might decide that the Company comes within the Act before the common stock is issued and as its issuance might then be subject to approval by the Commission, the present value of the warrants and conversion rights would be impaired. The Company took what appeared to be the safest course: it applied to the Commission for help.

Its petition raised an interesting administrative problem, which the Commission proceeded to resolve by permitting the Company, for the purposes of this issue, to act as much like a registered company as possible. The Company applied for, and the Commission issued, a report “in the manner provided in Section 11(g)(2),”5 this being the procedure required of registered companies proposing reorganization to their stockholders.6 The plan having been accepted by the stockholders, the Commission exempted the issue from the necessity of approval under Section 7, which sets the standards for

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securities of registered companies. An order was issued exempting the Company, insofar as this issue was concerned, from Section 4(a), which forbids unregistered holding companies to distribute securities in interstate commerce, from Section 6(a), which similarly restricts registered companies unless Section 7 has been satisfied, and from all other applicable sections of the Act.

Several alternatives were available to both the Company and the Commission. The Company might have withdrawn its application for permanent exemption and registered. But as the Act expressly gives it the privilege of enjoying a temporary exemption until its claim is determined, it felt no duty to accept the other burdens of the Act. Conversely, the Commission might have passed upon the application for exemption immediately. But this procedure would have defeated the Commission's policy of subjecting such applications to careful scrutiny, both because in this manner only could the true nature of the Company's position be discovered and because the Commission does not wish to invite legal attack upon the constitutionality of the Act by precipitate action. The Company could, of course, have proceeded without Commission approval. It might have relied upon the argument that the common stock issued to meet the conversion rights and warrants is so closely identified with the conversion rights and warrants that it is to be deemed issued, for the purposes of the Act, when they are issued. Furthermore, it is arguable that from Section 6(b), which exempts from the Act stock issued to meet obligations outstanding on January 1, 1935, may be implied an intent to exempt all stock issued to meet obligations incurred prior to registration.

This independent action, or some other method of recapitalization, would appear to be the only course permitted by the Act in this situation. The Commission is given jurisdiction over registered companies and jurisdiction to determine whether or not a particular company need register. Since the International Paper and Power Company cannot claim the former, the Commission's power over the Company must result from the latter or not at all. But as the power of an administrative tribunal finds its outermost bounds in the limits of the statute conferring jurisdiction, and as the Act gives the Commission jurisdiction over those claiming exemption only in order to determine their status, it is difficult to see how a power to aid can be spelled

out of the jurisdiction to exempt. In fact, it can hardly be doubted but that
the language of the statute, taken baldly, affords no basis for the Com-
mmission's action. But this conclusion leads to harsh effects. Action without
Commission sanction is dangerous, and strict interpretation of the Act
would compel cautious companies temporarily exempt not to recapitalize
in this way, a compulsion stemming from no express provision of the
statute. Furthermore, only if the application for exemption is filed in good
faith, is the Company entitled to temporary exemption, and the Act makes
no provision for a separate determination of this requirement.

Basing its jurisdiction on the assumption that the temporary exemption
was unintentionally incomplete, the Commission searched for means within
the Act to fill what it considered a hiatus in the Act. This power it found
by reading Section 20(a), which authorizes it to issue “such rules and
regulations and such orders as it may deem necessary to carry out the
provisions of this title . . .,” with Section 3(c), permitting temporary
exemption. The Commission was careful to make the issuance of its order
conditional upon compliance with Sections 11(g) and 7, thus retaining con-
trol over the plan. And in issuing the order it declared the Company
had done all a registered company would do in respect to this issue and
that the stock would in fact comply with the pertinent clauses of Section 7
when issued. Inasmuch as the chief objectives of the Act are to integrate
the public utility system and to furnish some measure of protection to in-
vestors, it seems that from a practical point of view the Commission's action
fulfills the Act's intentions. Whether or not the Act intended that stock
issued pursuant to exempted warrants and conversion rights should also
be exempt, there would seem to be no Congressional intent to curtail the
issuance of stocks that do comply with the standards of Section 7.

There are, however, certain doctrinal difficulties in the rationale which
the Commission adopted. It has the power to exempt companies and subsi-
diaries completely or partially, but it has no power to exempt a particular
issue, even one of a registered company, from the requirements of Section 7.
nor consequently from Section 6(a). As the Commission cannot exempt
a registered holding company's issues from the necessity for approval. a

14. The Company may be declared registerable. If it is, the Commission may
consider the stock as not having been issued when the warrants and conversion rights
were issued. And if the Commission makes this determination, it may hold that the
stock does not comply with Section 7.


Release No. 770 (Holding Company Act), Aug. 3, 1937. Although the warrants and
conversion rights and the plan itself would as a matter of time be all exempt and
only the common stock contingently subject to Section 7, it is apparent from the
Section that compliance with its standards could only be discovered by passing on
the plan as well.

"The Commission . . . shall exempt any holding company . . . from any provision
or provisions of this title . . . " But cf. In the Matter of the Kansas Electric Power
L. J. 1058.
fortiori it would seem to have no power to exempt the issue of an unregistered company which has consented to assume the burdens of a registered company. As long as the Commission felt that it could not grant its approval, it would perhaps have been better for it to stop short of subjecting its action to such objection. It could have proceeded precisely as it did, but instead of issuing the order it might have merely advised the Company that, were the issue at some future date to become subject to Section 7, it would meet the Section's requirements. Such action would not constitute a reviewable order, and the company would have some measure of protection for the Commission probably would not reverse its position after the Company had acted in reliance upon it. This quasi-estoppel may in the last analysis be all the protection the Company has received under the present ruling. For should the Commission declare the Company registerable, and should the order be declared void by the courts—a matter which may depend upon the existence of one with sufficient interest to contest the order, the Commission will probably not deny its approval under Section 7 contrary to its present declaration.

EFFECT OF EXECUTIVE AGREEMENT ON THE STATUS OF CONFISCATION DECREES*

In the exchange of diplomatic correspondence between the United States and Russia which accorded recognition to Soviet Russia, an assignment was made by Russia to the United States of all claims against American nationals held by the Soviet Government. On the basis of this assignment, the United States brought suit to recover a deposit made prior to 1918 with the Belmont Bank of New York by a Russian corporation which had been dissolved and whose assets had been confiscated under Soviet decree. The

18. Section 24(a), 49 Stat. 834 (1935), 15 U. S. C. § 79x(a) (Supp. 1936) providing for review, reads: "Any person or party aggrieved by an order issued by the Commission . . . may obtain a review of such order in the circuit court of appeals . . . ." This would not be an order. And injunctions have traditionally been granted only where the administrative body makes or threatens more affirmative action. Spielman Motor Co. v. Dodge, 295 U. S. 89 (1935), Ex parte Young, 209 U. S. 123 (1908); see Ashwander v. Tennessee Valley Authority, 297 U. S. 288, 324 (1935); cf. Ex parte La Prade, 289 U. S. 444 (1933).

19. On Sept. 11, 1937, a stockholder filed a petition for review with the Circuit Court of Appeals for the First Circuit. But it is difficult to see how he has been injured by the order. For the stock could be issued whether the company were either exempt or registered since it complies with the requirements of the Act.

20. The Commission may have had some such consideration in mind when an application for rehearing was denied. In the Matter of the Application of International Paper & Power Co., S. E. C. Release No. 850 (Holding Company Act) Oct. 13, 1937.


District Court's decree dismissing the complaint for failure to state facts constituting a cause of action, affirmed by the Circuit Court of Appeals, was reversed by the Supreme Court of the United States.

This decision is apparently the first to hold that the Soviet decrees might affect property situated outside of Russia at the time of enactment. Although it has been conceded that a sovereign state's confiscation of private property within its own jurisdiction will be recognized by courts of other countries, it has been held consistently that confiscatory legislation will be granted no extraterritorial effect. In all previous cases the reason for refusing to give effect to Soviet decrees has been their opposition to the public policy of the forum, to which the comity ordinarily granted foreign laws must yield.

But the majority in the instant case reversed the lower court, which had based its decision on state public policy, upon the ground that an international compact overrides local laws and policies. If the agreement involved had been a treaty, made with the advice and consent of the Senate, there is little doubt but that it could override state law or state policy, for a treaty is

7. Ware v. Hylton, 3 Dall. 199 (U. S. 1796); Chirac v. Chirac, 2 Wheat. 259 (U. S. 1817); Hauenstein v. Lynham, 100 U. S. 483 (1879); see Crandall, Treaties, Their Making and Enforcement (2d ed. 1916) 247-250.
"the supreme law of the land." But even the treaty power, though unlimited by any provision of the Constitution, has its bounds; for courts and writers have intimated that a clearly colorable use of this power to effect a result opposed to other terms of the Constitution would be held invalid.

The status of an executive agreement made without congressional authorization or senatorial ratification, such as that involved in the instant case, is not so certain. Although there is no clause in the Constitution which directly confers upon the executive the power to make international agreements without the advice and consent of the Senate, a tradition, which has never been questioned, has long given him the power to do so in certain situations, such as those involving the settlement of claims of United States citizens against foreign governments, or of private claims. By implication at least, the instant case confirms the executive's power to make these compacts and at the same time holds that they are to have the same force as treaties in their supremacy over state law or policy. There is no suggestion, however, that executive agreements are to be permitted to override other provisions of the Constitution, for the reversal is without prejudice to claims of creditors based upon federal policy. This result may be desirable in preventing the states from embarrassing American relations with Russia by their refusal to recognize Soviet title because of emotional antipathy toward confiscation, but it is open to several objections. First, since the executive agreement did not specifically approve the confiscatory decrees, there would seem to be no federal policy to override state laws. And secondly, it is doubtful whether the Russian decrees purported to extend to property abroad; or if they did, whether the assignment itself was intended to cover claims acquired by confiscation.

8. U. S. CONST. ART. VI, cl. 2.
10. See Corwin, The President's Control of Foreign Relations (1917) 116-125; Crandall, op. cit. supra note 7, at 102-140; Barnett, International Agreements without the Advice and Consent of the Senate (1905) 15 Yale L. J. 18, 63; Moore, Treaties and Executive Agreements (1905) 20 Pol. Sci. Q. 385; Comment (1937) 46 Yale L. J. 647, 660.
12. The exercise of the Presidential power to make foreign agreements as authorized under an act of Congress has been challenged, on the ground that there has been an improper delegation of power. Field v. Clark, 143 U. S. 649 (1892). But the examination will not be as strict as in regard to a delegation of power over internal matters. See United States v. Curtiss-Wright Export Corp., 299 U. S. 304, 315-316 (1936).
The concurring judges arrived at the same result by another approach, which is interesting as a first attempt in this country to limit the content of public policy with reference to foreign confiscation decrees. Since the substance of public policy has seldom been defined, it has been recognized that unless checked it may be applied destructively to interfere with the normal play of private international law. Consequently, various rules have been formulated to limit its application in certain type situations.\(^5\) In this case, the Circuit Court of Appeals based its refusal to recognize the validity of the confiscation decrees upon the often-voiced public policy of New York against such decrees.\(^6\) The concurring justices in the Supreme Court, in reversing the order, intimated, however, that a moral distaste for confiscatory legislation is not sufficient reason for denying effect to a foreign confiscation decree.\(^7\) An affirmative desire to further some practical purpose seems to be necessary before a court may refuse to recognize the decrees, the minority suggesting that the intervention of other claimants, who were lacking in the instant case, would be adequate cause for invoking a public policy, state or federal, against them.\(^8\) While this opinion, therefore, seems contrary to a long line of American cases, it is distinguishable; for in all previous cases the claims of creditors,\(^9\) stockholders,\(^10\) or directors\(^11\) were furthered by refusal to recognize the Soviet decrees. In the instant case the decrees were invoked in an attempt to defeat Soviet title when no conflicting claims of creditors were involved.\(^12\)

Although the majority and minority are in accord as to the decision on the narrow question presented in this case, the dissimilarity of approach in

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15. See Lorenzen, Territory. Public Policy and the Conflict of Laws (1924) 33 YALE L. J. 736; Comment (1936) 45 YALE L. J. 1403, 1467.
16. See cases cited notes 5 and 6, supra. The Court also suggested that the Fifth Amendment of the Federal Constitution expressed a policy opposed to such claims. See United States v. Belmont, 85 F. (2d) 542, 544 (C.C.A. 2d, 1936).
17. Both the majority and the concurring opinion hold that there is no policy to protect the debtor from paying his debt, his interest being merely that of a custodian. See United States v. Belmont, 301 U. S. 324, 332 and 334 (1937).
18. The Government attempted to get around the situs rule by arguing that while New York law might govern the debtor’s duty to pay, Russian law determined the creditor’s right to receive. Brief for the United States, pp. 16-32, United States v. Belmont, 301 U. S. 324 (1937). The Court does not discuss this argument. But this point was decided adversely to the government in Moscow Fire Ins. Co. v. Bank of New York & Trust Co., 161 Misc. 903, 294 N. Y. Supp. 648 (Sup. Ct. 1937).
22. The Court was cognizant of the fact that some might later appear, for it had denied shortly before a motion to intervene made by a New York receiver. United States v. Belmont, 300 U. S. 641 (1937) No. 532.
each opinion presages future disagreement when creditors and stockholders
of the dissolved corporation intervene. The majority's rationalization depends
on the subordination of state policy to the national policy enunciated in the
executive agreement. Thus the Federal Constitution is the sole basis upon
which a claimant may attack the confiscation decrees. And it would seem
from the majority's ambiguous statement that the Constitution has no extra-
territorial effect except for American nationals,23 that the latter only are
protected by the Fifth Amendment. Foreign creditors and stockholders, un-
able to invoke the Amendment, will be remediless. Under the view of the
concurring judges, however, the status of intervenors will depend upon the
public policy expressed in the New York statute providing for the distri-
bution of assets of nationalized corporations to creditors and stockholders,24
and consequently both American and foreign creditors and stockholders may
present claims based thereon. And it would seem possible that in the
absence of a statute or of creditors and stockholders, the state itself, under
the common law doctrine of escheat,25 might have a sufficient interest upon
which to base a policy opposed to recognition of Soviet title.

JURISDICTION OVER FOREIGN CORPORATIONS UNDER BLUE SKY LAWS *

A COLORADO corporation, which had complied with the requirements of the
Minnesota blue sky law, sold stock in Minnesota to the plaintiffs. Alleging
a conspiracy to denude the corporation of its assets, the plaintiffs brought
suit in Minnesota for an accounting and reconveyance of assets. Personal
service was had upon both the individual defendants and the corporation to
which the assets had allegedly been transferred. An attempt was made to
obtain jurisdiction over the Colorado corporation by use of the substituted
service provision of the blue sky law. This section requires foreign corpora-
tions, as a prerequisite to selling stock in Minnesota, to appoint the chairman
of the securities commission as their agent for the purpose of accepting ser-
vice in all actions against the corporation "in relation to or involving any
transaction covered by this act."1 But the Minnesota Supreme Court held,
one judge dissenting, that the lower court had not obtained jurisdiction over
the Colorado corporation since the action constituted affirmance of the con-

24. N. Y. C. P. A. § 977(b). In spite of the fact that this statute specifically
states the Soviet decrees are not to be recognized, the concurring justices could find
no New York policy against recognizing them.
25. See Fletcher, Corporations (perm. ed. 1931) § 8586; (1937) 46 Yale L. J.
(1901).

*Zochrison v. Redemption Gold Corp., 274 N. W. 536 (Minn. 1937).
1. Minn. Stat. (Mason, 1927) § 3996-11. Even where the substituted service pro-
visions do not expressly limit the type of action in which they may be used, courts have
interpreted them to be available only in actions arising under the blue sky laws.
Dragon Motor Car Co. v. Storrow, 165 Minn. 95, 205 N. W. 694 (1925).
tract of sale and a waiver of the fraud upon which jurisdiction under the statute is founded.  

Since the plaintiffs wished to sue in Minnesota and since they had personal jurisdiction over all save the defendant Colorado corporation, they could have conceivably pursued one of several courses.  

A stockholder’s suit for reconveyance of assets might have been brought against the individual defendants, who allegedly were responsible for the fraud, and the transferee corporation alone, on the theory that the corporation, although a party defendant in such an action, is really the party suing and therefore need not be served at all. As an alternative, plaintiffs might have attempted to obtain jurisdiction over the Colorado corporation by serving the secretary of state on the theory that the sale of securities in the state comes within the concept of “doing business,” and that the corporation will therefore be deemed to have appointed the agent required by statute whether or not it has done so in fact.

Rather than adopt one of these alternatives, the plaintiffs elected to join the Colorado corporation as defendant and to obtain jurisdiction over it by serving the chairman of the securities commission. This type of substituted service is generally employed in suits where the purchaser of securities seeks damages or recission of the contract and recovery of the consideration.


3. If the plaintiffs had desired to recover a money judgment, they could have sued the Colorado corporation in Minnesota for damages or rescission, obtaining jurisdiction over the Colorado corporation by substituted service under the Minnesota blue sky law. Supplemental thereto, they might have brought a creditor’s bill against the fraudulent transferee to insure that sufficient assets would be restored to the defendant to meet their claims. Nye Odorless Incinerator Corp. v. Nye Odorless Crematory Co., 18 Del. Ch. 179, 156 Atl. 176 (1931); see Arnold and James, Cases on Trials, Judgments and Appeals (1936) 501.


6. Washington v. Superior Court, 289 U. S. 361 (1933), aff’d, 169 Wash. 638, 15 P. 2d) 600 (1932); Osage Oil & Refining Co. v. Inter-Pipe Co., 124 Okla. 7, 253 Pac. 66 (1926). Where, however, as may have occurred in the instant case, the cause of action arose without the state, this device, in absence of an actual appointment of an agent to be served, would probably not be successful Old Wayne Mutual Life Ass. of Indianapolis v. McDonough, 204 U. S. 8 (1907); Simon v. Southern Ry., 236 U. S. 115 (1914).

because of the seller's failure to comply with some provision of the blue sky law. A few courts have, however, gone further and sustained substituted service where the action was founded upon an affirmative misrepresentation which was not in violation of any provision of the act. While the plaintiffs in the instant case attempted to employ the substituted service provision to support a cause of action and a prayer for relief which are novel in such suits, this application of the provision appears to be well within the letter as well as the spirit of the Minnesota blue sky law. The sole prerequisite to jurisdiction is that the action relate to or involve a transaction covered by that law. And the acts alleged by plaintiff—a failure to disclose a labor lien in the registration statement filed with the Minnesota securities commission and a conspiracy to defraud the corporation of its assets by foreclosing that lien—were both subject to sanctions imposed by the Minnesota statute. They would seem to be all that is necessary to confer jurisdiction. The majority was swayed, however, more by the type of relief sought than by the acts on which the claim for jurisdiction was based, and it gave no categorical answer to the question of whether the fraud alleged could support the service upon the commissioner. The complaint was dismissed on the ground that the plaintiffs' suit had the effect of affirming the original sale of the securities and of waiving the fraud. Yet, as the dissenting justice clearly points out, although affirmance of an executory contract entails waiver of fraud, this result does not follow affirmance of an executed contract, such as the one involved in the instant case.

The majority was influenced by the fact that the relief sought was reconveyance of the assets to the defendant corporation. This should raise slight conceptual difficulties. True, such relief is usually granted in stockholders' suits where the plaintiff is not enforcing his own but the corporation's right. And, strictly speaking, the blue sky laws were intended to protect the pur-


11. MINN. STAT. (Mason, Supp. 1936) § 3996-9. Since this provision was not enacted until after these securities had been registered in Minnesota, there may be doubt if it may be given a retroactive effect.


14. See note 4, supra.
chase of stock and not the corporation. But this factor should not be conclusive in denying the plaintiffs the privilege of using substituted service; by interpreting the complaint as one seeking to enforce the contract as represented, the plaintiffs may be said to be enforcing their own right, a right which has been recognized by the issuance of injunctions restraining promoters from enforcing against the corporation liens concealed when securities were sold to the public. Whatever the style in which the complaint may be dressed, it is clear that the plaintiffs in this case were fundamentally interested in protecting their own interests.

**LIABILITY OF BANK FOR AIDING FIDUCIARY IN PURCHASE OF NON-LEGAL SECURITIES**

A recent New York case presents a novel application of the firmly-rooted doctrine that anyone knowingly aiding or participating in a breach of trust is jointly and severally liable with the trustee. An administratrix, holding as part of her husband's estate shares in the Bank of Italy and Bancitaly, which were not in the statutory list of "legal" investments for fiduciaries, wished to take advantage of an offer of Transamerica Corporation to accept those shares plus a cash consideration in exchange for shares in Transamerica. The latter were likewise non-legals. In September, 1929, her attorney turned in the certificates at a Bank of America office in New York, where a vice-president, who was also a vice-president of Transamerica, had been designated to receive stock exchanged by Eastern holders. The head of the customers' securities department of the bank, acting under general instructions from the vice-president, mailed the certificates to San Francisco, where they were cancelled by Bank of Italy, and Transamerica certificates issued in their stead. These were then sent back to Bank of America, which delivered them to the administratrix. Five years later, when the value of


1. Vance v. Kirk, 29 W. Va. 344, 1 S. E. 717 (1887); Blyth v. Faldgate, (1891) 1 Ch. 337.

2. 4 BOGERT, TRUSTS AND TRUSTEES (1935) § 898; RESTATEMENT, TRUSTS (1935) § 226.

3. N. Y. BANKING LAW § 254, as applied to administrators by N. Y. DECEDENT ESTATE LAW § 111.

4. The letter offering the exchange advised Eastern stockholders to "send or deliver their stock to Cavagnaro, Vice-President, Bank of America." Cavagnaro ordered the head of the customers' securities department to receive the stock to be exchanged, and to have some receipts printed: it is not clear for whom Cavagnaro professed to be acting. Record on Appeal, 150, 157-175, 183-202, 463-464.
these shares had fallen to a fraction of their original value, the administratrix brought suit against Transamerica and the National City Bank, successor to Bank of America, to recover the loss sustained by the estate. The New York Supreme Court awarded her judgments against both, on the ground that the transaction was not merely an exchange, but an illegal investment in which the defendants participated with knowledge of the plaintiff's fiduciary capacity obtained from the application for exchange of the securities.

The court, emphasizing the cash payment and the differences both in form and substance between the old corporations and Transamerica, viewed the transaction as one in which the administratrix had sold non-legals and improperly purchased others with the proceeds. In New York, where the investment statute is construed as permissive rather than mandatory, an acquisition of non-legals is not tortious. Nevertheless, it subjects the fiduciary and any third parties who are found to have participated to a risk of absolute liability for any loss from the investment, no matter what the cause. If the purchase was improper, Transamerica's liability as a participant seems unavoidable. It sold the stock to the administratrix in her representative capacity and knowingly received part of the trust res in violation of the cestui's right that it should not be dissipated in non-legal investments.

5. Plaintiff's own liability would not bar her from suing in a representative capacity. Wetmore v. Porter, 92 N. Y. 76 (1883).

6. Plaintiff and her son are the beneficiaries of the estate; as to her distributive share, there might be an estoppel because she consented to the investment. See 4 BOGERT, TRUSTS AND TRUSTEES (1935) § 941. Also, defendants probably have a right to apportion the loss and sue her for contribution; see (1936) 3 U. of CHI. L. REV. 675.

7. Transamerica, a holding company, was formed to acquire not only the shares of Bank of Italy and Bancitaly, but also many other ventures. Cf. Mertz v. Guaranty Trust Co., 247 N. Y. 137, 159 N. E. 888 (1928). Even where the trustee is directed to retain certain non-legal securities, he cannot invest in holding company stocks offered in exchange. Hewitt v. Hewitt, 113 N. J. Eq. 299, 166 Atl. 528 (Ch. 1931).

8. Both Bank of America and Transamerica, however, might contend that they had a right to assume that the plaintiff was mindful of her duty to dispose of any non-legal stocks held by the estate within a reasonable time [In re Hamersley's Estate, 180 N. Y. Supp. 887 (Surr. Ct. 1920); Comment (1930) 79 U. of PA. L. REV. 77], and that she made the exchange only to take advantage of the readier marketability of Transamerica. Cf. RESTATEMENT, TRUSTS (1935) § 231(f). For purposes of discussing the general significance of the decision, however, this note will assume the validity of the court's finding that there was a new illegal investment.

9. N. Y. DECEDENT ESTATE LAW § 111 ("An executor, administrator, trustee . . . may invest"). N. Y. DOMESTIC RELATIONS LAW § 85, as recently amended, makes the list mandatory for guardians. N. Y. LAWS 1936, c. 848.


11. Knowledge of plaintiff's fiduciary capacity put Transamerica on inquiry as to her investment powers. See 4 BOGERT, TRUSTS AND TRUSTEES (1935) § 897.

12. The liability of the transferee with notice seems rarely to have been invoked to recover trust funds used in wrongful purchases of stock. Dunnegan Grove Cemetery v. Farm and Home Savings and Loan Assoc., 93 S. W. (2d) 95 (Mo. App. 1936); cf. Pink v. Title Guar. and Trust Co., 298 N. Y. Supp. 544 (Sup. Ct. 1937) (subordinate interests in mortgages); Bonham v. Coe, 249 App. Div. 428, 292 N. Y. Supp. 423 (4th Dep't 1937) (farm exchanged for apartment house).
cordingly, it can be required as a constructive trustee either to return the trust fund if identifiable, or to reimburse the estate for the loss sustained.\(^{13}\) Bank of America, however, received no compensation\(^{14}\) or other tangible benefit\(^{15}\) from the transaction and was held liable only because it performed the physical act of transfer with constructive knowledge of its impropriety. In some respects, its rôle as intermediary resembles that of a stockbroker, who bears the liability of a participant for permitting trustees to speculate with trust money.\(^{16}\) But since the broker receives a commission, and is often inclined to induce disastrous speculation by the fiduciary,\(^{17}\) his motivation is hardly similar to the disinterested attitude of the bank in the instant case. More analogous is the liability of the transfer agent of a corporation, which registers transfers of stock on the books of the company and issues new certificates to the transferees.\(^{18}\) Though lack of registration does not ordinarily affect the title of the transferee as against the transferor, the transfer agent is none the less liable if it knowingly registers a transfer in breach of trust; to protect the interests of beneficiaries it must assume the risk of correctly determining the trustee's power of sale.\(^{10}\) This duty of inquiry has been modified by statute in many states,\(^{20}\) but the liability for registration with actual knowledge of breach remains as an example of participation by one having only a minor part in the wrongful transaction.

If there is sound policy behind the requirement that transfer agents supervise sales of stock by fiduciaries, that same policy would seem to require that banks buying securities for fiduciaries be subjected to the same standard of care. Where the investments of executors, administrators, and guardians are limited by statute, as in New York, the bank's only duty would be to prevent deviations from the statutory list.\(^{21}\) Since most transactions are of

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14. Cash payments made by plaintiff represented: (a) the increase in value of Transamerica between the time the exchange was offered and her acceptance; (b) the price of a half-share (§82), so that she would get an even number. (Record on Appeal, 165-167).
15. Bank of America was controlled by Transamerica; this accounts for its undertaking gratuitously the task of forwarding the stock to be exchanged. The court, however, dismissed the confusing questions of agency arising from this relationship. Stark v. National City Bank, 161 Misc. 51, 57, 58, 291 N. Y. Supp. 884, 891, 892 (1936).
17. See (1937) 46 Yale L. J. 1085, 1089, n. 29.
20. Section 3 of the Uniform Fiduciaries Act was recently enacted by New York [N. Y. Laws 1937, c. 344]; it imposes liability on the transfer agent only when there is actual knowledge of breach, or knowledge of facts amounting to bad faith. The Uniform Act has been adopted by 15 states. 9 Uniform Laws Ann. 146.
21. Some states have no specific list for this class of fiduciaries, but the investment statutes for savings banks can usually be followed. In others, however, which have no lists at all, the intermediary, even after inquiry, would face considerable risk. For
local origin, this burden would be less onerous than that of the transfer agent, who registers transfers of fiduciaries throughout the country. More burdensome would be imposition of a duty upon banks to investigate trustees' powers of investment under trust instruments of varying, and sometimes ambiguous, terms. But banks which choose to perform the functions of brokers can safeguard their interests either by requiring the fiduciary to prove his authority to purchase or, in any event, by demanding adequate compensation for assuming the risks incident to dealing with fiduciaries.

a collection of the statutes, see McKinney, Trust Investments (2d ed. 1927) and 4 Bogert, Trusts and Trustees (1935), ch. 30. In other states, it would be necessary merely to ask the fiduciary to produce a court order. Aside from statutes forbidding investments without a court order, there are occasional provisions allowing a trustee to obtain one for his own protection. See McKinney, supra.

22. In addition to investigating the propriety of the deal, banks in New York might take the precaution of exacting a contract of indemnity from the fiduciary. Such a contract, though seemingly against public policy, was upheld in Delafield v. Barret, 270 N. Y. 43, 200 N. E. 67 (1936).