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CIVIL LIABILITY FOR MISSTATEMENTS IN DOCUMENTS FILED UNDER SECURITIES ACT AND SECURITIES EXCHANGE ACT

THE Securities Act of 1933[1] and the Securities Exchange Act of 1934[2] represent two related steps in the formulation of a program of governmental supervision over corporate activities. The Securities Act, also known as the "truth in securities" act, was intended to insure disclosure of all relevant information concerning securities issued after the passage of the Act.[3] It made no provision, however, for obtaining and publicizing information about securities already outstanding or for continuing accurate information during the life of new issues.[4] The Securities Exchange Act, in addition to its objects of restricting market speculation[5] and preventing manipulative practices,[6] comple-

1. 48 STAT. 74, 15 U. S. C. A. § 77(a) et seq. (1933), as amended by P. L. No. 291, 73d Cong., 2d Sess. (1934) tit. II.

2. P. L. No. 291, 73d Cong., 2d Sess. (1934) tit. I, hereinafter called "the Exchange Act."

3. Douglas and Bates, *The Federal Securities Act of 1933* (1933) 43 YALE L. J. 171, 172.

4. Tracy and MacChesney, *The Securities Exchange Act of 1934* (1934) 32 MICH. L. REV. 1025, 1049.

5. Exchange Act §§ 7, 8. See *Hearings before Committee on Banking and Currency on S. R. 56 and S. R. 97*, 73d Cong., 1st Sess. (1933) 6465; 78 CONG. REC. 7703 (1934).

6. Exchange Act §§ 9, 10. See *Hearings before Committee on Banking and Currency on S. R. 56 and S. R. 97*, 73d Cong., 1st Sess. (1933) 6465, 6466; 78 CONG. REC. 7704, 7705 (1934).

ments the earlier Act by provision for securing information regarding securities already issued similar to that required as to new issues by the Securities Act,[7] and by provision for continuing publicity during the lives of both old and new issues.[8] The function of the disclosure required by the Acts is twofold: to prevent fraudulent transactions by turning on them "the white light of publicity"[9] and, by revealing all material facts about a security, to afford investors an opportunity for a fair appraisal of its worth.[10] As one means[11] of compelling disclosure, the acts impose civil liabilities[12] for misstatements in certain types of informational documents[13] which issuers and others must file with the Federal Securities and Exchange Commission.[14] The civil liabilities, in turn, have a dual purpose: compensation of injured investors and prevention of conduct and transaction which would cause losses and create a need for compensation.[15] Since the Acts are partial substitutes for a comprehensive system of control over finance, compensation must assume secondary importance.

I. Reliance, Causation, Measure of Damages

Securities Act. The Securities Act, under Section 11, imposes civil liability for untruths in the registration statement.[16] Actions for damages may be maintained by any purchaser in case "any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading."[17] Prior to the 1934 amendments, the theory of liability under Section 11 was that of recission.[18] The Act departed, however, from the common-law action of recission by abolishing the requirement of privity and by allowing any person who acquired

7. Exchange Act § 12; Securities Act § 7, Schedules A and B.

8. Exchange Act § 13.

9. 78 Cong. Rec. 7925 (1934).

10. 78 Cong. Rec. 7704 (1934); Douglas and Bates, *supra* note 3, at 172.

11. Section 24, Securities Act, and Section 32, Exchange Act provide criminal penalties for wilful violations of any provisions of the Acts, or any rules or regulations made thereunder, or for wilful misstatements in documents filed with the Commission. See MacIntyre, *Criminal Provisions of the Securities Act and Analogies to Similar Criminal Statutes* (1933) 43 Yale L. J. 254.

12. Securities Act § 11; Exchange Act § 18.

13. See p. 469 *infra* for discussion of description of the documents that must be filed under the Acts.

14. The Commission was established by Section 4 of the Exchange Act. P. L. No. 291, 73d Cong., 2d Sess. (1934) tit. II, § 210, which transferred to the Commission the functions of the Federal Trade Commission under the Securities Act of 1933.

15. Shulman, *Civil Liability and the Securities Act* (1933) 43 Yale L. J. 227, 253.

16. A registration statement is required by Section 5. Its contents are prescribed by Sections 6 and 7 and Schedules A and B.

17. Securities Act § 11 (a).

18. Frankfurter, *The Federal Securities Act: II* (1933) 8 (2) Fortune 53, 103. In common-law recission, the buyer need only prove that the seller made a false representation about a material fact. It was immaterial that the seller honestly believed the statement to be true, or that the falsehood did not cause the fall in value. Recission at common law

the security to sue the persons named[19] in the Act. Liability under Section 11 differed from that in the common law action of deceit[20] by not requiring reliance, causation, and scienter, which had imposed so difficult a burden of proof on investors as virtually to preclude recovery.[21] On the other hand, Section 11 (a) retained several defenses familiar to the common-law deceit action. The defendant could still show: that the plaintiff had failed to establish that the statement was untrue or misleading; that the untruth related not to "fact" but to "opinion"; that the fact was not material.

The measure of damages under the Act as originally drawn was somewhat uncertain. The sole restriction was found in the provision that the amount recoverable should not exceed the price at which the security was offered to the public.[22] If the plaintiff chose to tender back the security, he could recover the amount paid, up to the offering price. If he sold and sued for damages, the Act apparently allowed him to recover the difference between the price at which he bought and the price at which he sold, so long as this amount did not exceed the offering price.[23] The section was interpreted extrajudicially to mean that damages must be limited to the difference between the offering price and the price at which the plaintiff sold.[24] Although reasonable in view of the purpose of the section, viz., to put those who sold and those who rescinded on the same footing, such an interpretation was not required by the language of the Act.

Under the 1934 amendments to the Securities Act, Section 11 is no longer founded on the theory of recission. The requirement of proof by the plaintiff that he has relied on the misstatement, one of the "elements" of the common-law deceit action, has been added to Section 11(a). The plaintiff's right to recover, if he bought after the issuer has made available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration, is now conditioned on proof that he relied on the untrue statement or that he relied on the registration statement and did not know of the omission in the statement. The omission of reliance under the original section was considered desirable during the early life of the security, since, during that period, the registration statement would be an important conditioner of the market and thus would affect buyers as much as if they had actually read the statement.[25] But after that time other factors would have supplanted the registration statement in affecting the market, and

was available, however, only between the buyer and his immediate vendor. See Shulman, *supra* note 15, at 231-233.

19. See p. 470 *infra*.

20. For statements of the elements of the action of deceit and negligence, and collections of cases, see: HARPER, TORTS (1933) §§ 76, 221, 222; Bohlen, *Misrepresentation as Deceit, Negligence, or Warranty* (1929) 42 HARV. L. REV. 733; Green, *Deceit* (1930) 16 VA. L. REV. 749; Shulman, *supra* note 15, at 233; Williston, *Liability for Honest Misrepresentation* (1911) 24 HARV. L. REV. 415.

21. Shulman, *supra* note 15, at 229 et seq.

22. Securities Act § 11 (g).

23. See Douglas and Bates, *supra* note 3, at 175.

24. Fed. Trade Comm. Release No. 45, Sept. 22, 1933, 133 C. C. H. § 7525.

25. 78 CONG. REC. 10186 (1934).

the conclusive presumption of reliance was then perhaps less justified.[26] The new clause was added in recognition of the fact that the price of a security purchased after the issuance of an earning statement is likely to be predicated on that statement rather than on the information contained in the registration.[27] The amendment may seem to weaken the investor's position, but probably will not do so to any great degree, as reliance is always implicit in the question of materiality.[28] Thus it is unreasonable to assume reliance if the misstatement concerns an immaterial or trivial fact. Furthermore, the plaintiff need not prove reliance during at least the first year after registration; and even subsequent to that period the difficulty of establishing reliance is not unsurmountable, for the plaintiff can do so without proving that he actually read the statement which he alleges has misled him.[29] And he can probably be depended upon to testify that he did rely on the untruth or omission. Moreover, Congress departed even further from the original recission theory by injecting into Section 11(e), in addition to reliance, the requirement of causal connection between the untruth and the loss.[30] Although the burden of proving lack of causal connection is rested on the defendant, the result of allowing any inquiry into causal relation will be to plunge courts into an extremely complicated administrative problem and to provide defendants with a talking point which may serve to obscure the real issues. Whether the decline in market value of a security was due to economic factors or to a false statement made, perhaps, many months before will be impossible to prove in almost every instance. And, assuming that the plaintiff purchased in reliance on the misstatement and that he would not have purchased but for the misstatement, *his* loss is caused by the misstatement even though the decline in the value of the security may be occasioned by an entirely extraneous cause.

Section 11(e), as amended, has eliminated the remedy of recission and has established more definite rules for the measurement of damages. The purchaser may recover the difference between the amount paid (not to exceed the offering

26. See Douglas and Bates, *supra* note 3, at 176.

27. 78 CONG. REC. 10186, 10284 (1934).

28. Thus, the Federal Trade Commission, in Release No. 137, Mar. 23, 1934, 133 C. C. H. § 7591, defined a "material" fact as "a fact which if it had been correctly stated or disclosed would have deterred or tended to deter the average prudent investor from purchasing the security." This is much the same definition as that used by English courts. See Broome v. Speak, [1903] 1 Ch. 586, aff'd [1904] A. C. 342. "Reliance," at common law, connotes action by the plaintiff reasonably induced by the defendant's representations. See HARPER, op. cit. *supra* note 20, § 225; Green, *supra* note 20, at 762, 766; Shulman, *supra* note 15, at 249.

29. Securities Act § 11(a).

30. Securities Act § 11(e): "if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion or all of such damages shall not be recoverable." It was stated by Baldwin B. Bane, in behalf of the Federal Trade Commission, in Release No. 45, Sept. 22, 1933, 133 C. C. H. § 7525, that even before the amendments, "trading losses" were not recoverable.

price) and (1) the value at the time of suit or (2) the price at which he sold before bringing action, if he did sell at that time, or (3) the price at which he sold the security after suit but before judgment, if he chose to sell then, provided such damages are less than the difference between the price paid (not to exceed the offering price) and the value at the time of suit. The meaning of "value" is open to question, but it seems patent that this refers to market value on the exchange or on the over-the-counter market. It has nevertheless been suggested that a showing that actual value differs from market value should be permitted.[31] But no inquiry into actual value is allowed in case the plaintiff has sold the security before suit; and to permit such an inquiry if the plaintiff chooses to retain the security would constitute an unreasonable and pointless discrimination.

Securities Exchange Act. Liability arises under Section 11 of the Securities Act only from untruths in the registration statement.[32] Section 18(a) of the Securities Exchange Act, on the other hand, imposes liability for misleading statements in a variety of documents required to be filed with the Federal Securities and Exchange Commission.[33] These include registration statements for securities listed on national securities exchanges,[34] periodical reports by the issuers of such securities,[35] statements filed by directors, officers, and owners of more than ten per cent of the stock of the issuer as to their holdings,[36] and any registration statements or documents which the Commission may require concerning securities either traded on over-the-counter markets[37] or granted unlisted trading privileges on an exchange.[38] A cause of action is given, under Section 18(a), against "any person who shall make or cause to be made any statement in any application, report or document filed pursuant to this title or any rule or regulation thereunder which statement was at the time and in the light of the circumstances under which it was made false or misleading[39] with respect to any material fact." The action may be maintained by any person who had no knowledge that the statement was false or misleading and "who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance."

The investor who bases his suit on Section 18(a) must prove that he relied on the misstatement, and is afforded no exemption from this requirement during

31. Legis. (1934) 48 HARV. L. REV. 107, 114, 115. This suggestion appears to be a false deduction from the "tort measure" of damages in deceit cases, which allowed damages equal to the difference between the purchase price and the *actual value* of the stock at the time of transfer. See *infra*, p. 463.

32. See *supra* note 16.

33. For more complete discussion of these documents, see *infra* p. 469 et seq.

34. Exchange Act § 12(a)-(e).

35. Exchange Act § 13.

36. Exchange Act § 16(a).

37. Exchange Act § 15.

38. Exchange Act § 12(f).

39. Unlike Section 11 of the Securities Act, this section does not expressly include omissions to state material facts required to be stated in order to make the statement not misleading. But the House Conference Managers declared that "a statement obviously may be misleading because of a material omission." 78 CONG. REC. 10262 (1934).

any period subsequent to the filing of the document containing the untruth or omission. Although the question of reliance tends to merge with that of materiality,[40] the insertion of this provision nevertheless will create serious administrative difficulties, will provide for defendants an excellent talking point in litigation, and may result in denial of compensation to many injured purchasers. It would seem that the investor who purchases after the filing of the misleading document might well have been relieved of the necessity of proving reliance during a short period after the filing of the registration and reports required by the Act. The information in these documents, in the hands of market analysts, investment services, and experienced investors, will materially affect the market for a time after they are released. Hence the purchaser, even though entirely ignorant of the contents of the document, may be as much affected by any misleading statements it may contain as if he had been fully aware of the representation.

In the case of an investor who purchased before the filing of the statement containing the untruth and who is thereafter forced to sell by the extinguishment of his margin or other circumstances, the reliance requirement may have a far more serious consequence than merely to provide the defendant with a strong talking point. Since the plaintiff did not sell in reliance on the misrepresentation, but was forced to do so by other causes, he will be precluded from any recovery, even though the decline in price was due solely to the misstatement. Furthermore, as the Exchange Act omits the provision of the Securities Act[41] that reliance may be proved without a showing that the plaintiff read the statement, the defrauded investor may find it necessary to prove that he actually read the document. Such a result seems unlikely, however, since, in view of the publicity provisions of the Exchange Act, documents filed may be deemed representations to the public at large.[42]

The Securities Exchange Act has incorporated a causation requirement. Section 18(a) allows recovery by any person who in reliance on a misleading statement "shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance." Suppose the plaintiff, in reliance on a misstatement contained in a document previously filed, purchases a security for $100 and later sells, after the price has fallen to $10. The section permits recovery for damages "caused by such reliance." If the investor in the case supposed did rely on the misstatement in buying the security, and would not have purchased otherwise, his loss may be said to have been caused by his reliance, whatever factors may have caused the decline in price. If this interpretation is adopted, it will be sufficient if the plaintiff proves that he bought in reliance on the untruth and that the untruth had some effect on the price. Proof of the exact amount of the decline in price which was caused by the untruth will then be unnecessary. Similarly, in the case of one who purchases before the filing of the document and sells in reliance on the misstatement, the cause of the damage is apparently the

40. See note 28, *supra*.

41. Securities Act § 11(a).

42. Cf. Emerson v. Detroit Steel & Spring Co., 100 Mich. 127, 58 N. W. 659 (1894). See Legis. (1934) 48 HARV. L. REV. 107, 110; 4 SUTHERLAND, DAMAGES (4th ed. 1916) § 1170.

misstatement which induces the sale. But Section 18 is even more susceptible of another interpretation. The section may have been intended to impose on plaintiffs, in cases such as that supposed, the onus of proving causal connection between the untruth and the decline in price.[43] Plaintiff must prove that he purchased or sold "at a price which was affected by" the misstatement. If the plaintiff's loss is considered to be caused by his reliance, it is immaterial whether or not the untruth had any effect on the price, and this requirement can serve no useful purpose. Hence, it would seem to have been inserted in order to compel a showing of relationship between the untruth and the subsequent decline in price. If such is the case, the investor and the court will be confronted with the same problems of proof as under the Securities Act.

The Exchange Act specifies no rules for the measurement of damages.[44] If the first view of the causation requirement should prevail, in the case of purchase in reliance on the misstatement, the measure of damages provided by the Securities Act[45] probably will be used, viz., recovery of the difference between the price paid and the price received on sale,[46] or between the price paid and the market value at the time of suit, if the security is not sold. These rules provide the only effective means of ascertaining the loss caused by the reliance, and are administratively simple. They may be used even if the second interpretation of the causation requirement is adopted, but most of their advantages will be eliminated by an inquiry into the causal connection between the misstatement and the depreciation in value. Adoption of the stricter view of causation will, however, encourage the use of one of the common law measures of damages, since the element of causation as between the false-

43. This hypothesis seems reasonable in view of the attack, in the hearings, on the damage provisions of the original Fletcher-Rayburn Bill (see note 44, *infra*) on the ground that they allowed recovery for losses occasioned by a decline in price which was not caused by the misstatement. See, for example, *Hearings before House Committee on Interstate and Foreign Commerce on H. R. 7852 and H. R. 8720,* 73d Cong., 2d Sess. (1934) 226, 489. The bill when reported to Congress had been altered to include the requirements that the misstatement must have affected the price of the security, a provision which theretofore had not appeared. See 78 CONG. REC. 7708 (1934). It is probable that this clause was inserted to satisfy the critics of the act and was intended to compel the showing of a causal relation between the untruth and the fall in value which caused the plaintiff's loss.

But even if the foregoing assumption as to the intent of Congress is unwarranted, it is probable that judicial interpretation will attach this connotation of causation to Section 18(a), since the common-law actions of deceit and negligence required proof of linkage between the damage and the misconduct. See HARPER, op. cit. *supra* note 20, §§ 65, 226.

44. The original Fletcher-Rayburn Bill, S. B. 2693, and H. R. 7852, provided a definite measure of damages. In the case of purchase, the damages were to be not less than the difference between the purchase price and the lowest market price during 90 days preceding and 90 days following the purchase. In case of sale, the damages were to be not less than the difference between the price received on sale and the highest price within 90 days preceding and 90 days following the purchase. See *Hearings before Committee on Interstate and Foreign Commerce on H. R. 7852 and H. R. 8720,* 73d Cong., 2d Sess. (1934) 10.

45. Securities Act § 11 (e). See p. 459, *supra.*

46. See Hotaling v. A. B. Leach & Co., 247 N. Y. 84, 159 N. E. 870 (1928), in which the difference between the purchase price and the price at which plaintiff sold his security was used as a measure of recovery.

hood and the fall in price is inherent in them. The so-called "tort measure,"[47] adopted by the United States Supreme Court,[48] the New York Court of Appeals[49] and the English courts,[50] limits recovery to the difference between the price paid and the actual value of the security at the time of purchase. This measure has been justified on the ground that it restricts the defendant's liability to losses caused by the misrepresentation, in that it prevents the plaintiff from recovering trading losses or depreciation caused by some fortuitous circumstance.[51] Use of this rule will raise, however, an almost insoluble problem of proof by forcing an examination of the financial condition of the issuer, to determine the asset value of the security at the time of purchase. The difficulties involved in evaluating a share of stock in terms of the assets, tangible and intangible, of a large corporation, which itself may be but one unit in a complicated structure of holding companies, are apparent.[52] In addition to adducing convincing proof of value at the trial, the investor before suit will be forced to determine to his satisfaction the "actual value" of his securities, in order to determine whether it will be profitable to bring action. Since he must post a bond to cover attorneys' fees and other costs if required by the court[53] suit will be advisable only if sufficient recovery is assured to reimburse him for the amount of the bond. The objections to the use of the "tort measure" apply with equal force to the "contract-warranty measure," which allows recovery of damages equal to the difference between the value as represented and the actual value at the time of purchase.[54] Although phrased differently, both measures will in fact allow the same recovery in securities cases under the Act; for the "represented value" of the warranty measure will actually be the market value at the time of purchase.

In case the investor purchases a security before the filing of a document and later sells in reliance on a misstatement it contains, neither the Security Act measure nor the common law measures of damages will be useful, since they are predicated on the assumption of *purchase* in reliance on a misstatement. In the case of sale, the simplest measure would be the difference

47. 2 SEDGWICK, DAMAGES (9th ed. 1912) §§ 777-781; 4 SUTHERLAND, op. cit. *supra* note 42, § 1172.

48. Smith v. Bolles, 132 U. S. 125 (1889).

49. Reno v. Bull, 226 N. Y. 546, 124 N. E. 144 (1919). But cf. Hotaling v. A. B. Leach & Co., 247 N. Y. 84, 159 N. E. 870 (1928) cited note 46, *supra*.

50. Derry v. Peek, 14 App. Cas. 337 (1889); McConnell v. Wright [1903] 1 Ch. 546.

51. Legis. (1934) 48 HARV. L. REV. 107, 116.

52. For an excellent illustration of these difficulties, see Hotaling v. A. B. Leach & Co., 247 N. Y. 84, 159 N. E. 870 (1928), in which the New York Court of Appeals recognized that valuation of the corporation's assets and of the plaintiff's bond was impossible.

53. Exchange Act § 18(a). "In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant." A similar provision is found in Section 11(e) of the Securities Act. The purpose of these sections is the prevention of "blackmail suits" by plaintiffs and "purely contentious litigation on the part of the defendant." 78 CONG. REC. 10264 (1934).

54. Bohlen, *supra* note 20, at 736; SUTHERLAND, op. cit. *supra* note 42, § 1171. This measure of damages is said to give plaintiff "the benefit of his bargain."

between the market price at the time of filing the document and the price at which the plaintiff later sold. However, recovery might be limited to the difference between the actual value at the time of sale and the price received, or between the sale price and the highest price for which the security sold within a reasonable time after the plaintiff discovered the misstatement.[55]

Serious problems will arise in connection with securities which are registered under both the Securities Act and the Exchange Act.[56] If each registration statement contains a misstatement of a material fact, an injured investor apparently has the option to sue under either Act. He probably will elect to bring action under the Securities Act, in view of the comparatively lighter burden of proof which he must sustain in order to recover under Section 11 of that act. If he does recover, and subsequently brings suit under the Exchange Act, the person sued will probably seek to introduce the prior judgment to show that the plaintiff has already been compensated for his loss, and hence has suffered no damage through the misleading statement in the document filed in compliance with the Exchange Act. Such a contention would seem reasonable,[57] since the plaintiff was occasioned but one loss, even though both misstatements may have contributed to it. However, if the misstatements in the two registrations are of such different natures that the defendant in the earlier action is enabled to reduce the plaintiff's recovery by showing that all or most of the loss was caused by the untruth in the Exchange Act document,[58] the plaintiff in the suit under the latter act should not be precluded from recovering the balance of his loss. Again, the Exchange Act, unlike the Securities Act, does not limit damages to the price at which the security was offered to the public.[59] Under the Securities Act, if the offering price was $100, and the plaintiff purchased at $150 and later sold at $50, his

55. Cf. SEGWICK, op. cit. *supra* note 47, at 843 (the difference between actual value at the time of the sale and price received on sale). The difference between the highest market value within a reasonable time after the plaintiff learns of the misrepresentation and the price received on sale is similar to the measure of damages used by the Supreme Court of the United States and the New York courts in cases of conversion by stockbrokers of customers' securities. See Galigher v. Jones, 129 U. S. 193 (1889); Mayer v. Monzo, 221 N. Y. 442, 117 N. E. 948 (1917); MEYER, THE LAW OF STOCKBROKERS AND STOCK EXCHANGES (1931) 554 et seq. Aside from administrative difficulties, this measure seems reasonable. It allows the plaintiff a reasonable time to determine whether he will repurchase the stock, and, if the price has risen within that time, permits him to recover the amount he would have lost by the repurchase.

56. SEE SECURITIES FOR WHICH REGISTRATION STATEMENTS MUST BE IN EFFECT, *infra* p. 465.

57. It is arguable, however, that the registration statements required by the two acts are entirely distinct and that the mere fact that the plaintiff has been compensated for a loss caused by a misstatement under one Act has no bearing on his right of recovery for a misstatement in a document filed under the other Act.

58. Securities Act § 11(e) provides that the plaintiff's recovery shall be reduced by any amount which the defendant proves to have resulted from any cause other than the misstatement or omission of a material fact in the registration statement filed under that Act.

59. Securities Act § 11(g). The measures of damages under Section 11 (e) restrict damages to the difference between the price paid, *not to exceed the offering price,* and the price received on sale or the market value at the time of suit.

recovery would be limited to $50.[60] In a subsequent suit under the Exchange Act, he may be able to recover the remainder of his actual loss.

II. SECURITIES FOR WHICH REGISTRATION STATEMENTS MUST BE IN EFFECT

Securities Act. Section 11 of the Securities Act imposes liability for misstatements in the registration statement. The filing of a statement is enforced by Section 5(a) which provides that it shall be unlawful to use the mails or any instrumentality of interstate commerce to transmit any offer to buy or sell any security, or to carry any security for which a registration statement is not in effect. But there are, apart from the exemption of all securities sold or offered to the public prior to July 27, 1933,[61] numerous exemptions from the operation of Section 5(a). Most of these relate to types of securities;[62] others relate to types of transactions. The 1934 amendments have left substantially unaltered the exemptions of securities issued by national or state banks whose business is supervised by a banking commissioner and substantially confined to banking,[63] by charitable institutions,[64] by common carriers subject to Section 20(a) of the Interstate Commerce Act,[65] by receivers and trustees in bankruptcy,[66] and by building and loan and similar associations.[67] The exemptions of short term commercial paper[68] and of insurance policies issued by corporations under governmental supervision[69] have also been retained.

Section 3(2) has been amended to exempt certificates of deposit for certain types of exempt securities, such as those issued by the United States, the states and other governmental subdivisions, and by state and federal instrumentalities.[70] The major changes in exemptions effected by the amendments

60. This suppositious case would fall within the second measure of damages set forth in Section 11(e), viz.: the difference between the price paid, not to exceed the offering price, and the price received on sale before suit.

61. Securities Act § 3(a) (1). But this exemption does not apply to any new offering of such security by an issuer or underwriter subsequent to the sixty-day period after the passage of the Act. As to what is a "new offering," see Douglas and Bates, *supra* note 3, at 184.

62. The definition of a security has been changed by the addition to Section 2(1) certificates of deposit, fractional undivided interests in oil, gas, and other mineral rights and "any interest commonly known as a 'security.'" This was intended to force registration of inscribed shares [78 CONG. REC. 10263 (1934)] but may serve to prevent protective committees from evading the necessity of registering certificates of deposit by utilizing powers of attorney. See Legis. (1934) 34 COL. L. REV. 1348, 1349.

63. Securities Act § 3(a) (2). The amendments have extended exemption to securities issued by District of Columbia banks, which were inadvertently omitted from the original section, and to securities guaranteed by banks. 78 CONG. REC. 10264 (1934).

64. Securities Act § 3(a) (4). "Person" has been substituted for "corporation."

65. Securities Act § 3(a) (6).

66. Securities Act § 3(a) (7).

67. Securities Act § 3(a) (5).

68. Securities Act § 3(a) (3).

69. Securities Act § 3(a) (8).

70. The amendments have broadened the class of public instrumentalities by eliminating the dubious qualification that the instrumentality must be one exercising an essential governmental function and have substituted "person" for "corporation" acting as an instrumentality of the United States.

are brought about by the addition of Paragraphs 9, 10, and 11 to Section 3(a). Paragraph 9, formerly a part of Section 4(3), exempts "any security exchanged by the issuer with its existing security holders exclusively where no remuneration is paid or given directly or indirectly for soliciting such exchange."[71] Paragraph 10 is also derived from former Section 4(3), but in considerably altered form. Section 4(3) covered the issuance of securities to the existing security holders or creditors of a corporation in the process of a bona fide reorganization under court supervision. Paragraph 10 exempts securities issued in exchange in whole or part for "securities, claims, or property interests . . . where the terms and conditions of such issuance and exchange are approved [by any court or by any other governmental agency authorized to grant such approval] . . . after a hearing on the fairness of such terms and conditions at which hearing all persons to whom it is proposed to issue securities in such exchange shall have the right to appear. . ." This paragraph serves to exempt securities issued in real estate reorganizations, which would have been denied exemption under Section 4(3).[72] It also seems to make certain that certificates of deposit will not be exempt unless the terms of their issuance are first approved by a court or administrative agency.[73] The Commission has intimated that court approval of the deposit agreement would be sufficient to exempt the certificates.[74] Further, Paragraph 10 will exempt new securities issued on completion of the reorganization proceedings provided that the protective committees do not secure the exclusive right to appear at the hearings.[75]

The foregoing exemptions in Section 3(a), Paragraphs 9 and 10, are modifications of those formerly contained in Section 4(3), which apparently exempted only the issuance of these classes of securities, and not subsequent transactions in them.[76] By the transfer to Section 3, the securities themselves are made

71. Prior to the amendments, the type of "remuneration" contemplated was not specified. As it now stands, this paragraph will exempt only securities issued in small reorganizations, where there is no necessity for paying commissions for solicitation.

72. Statement of House Conference Managers, 78 CONG. REC. 10264 (1934).

73. § 77 B(h) of the Bankruptcy Act—[P. L. No. 296, 73d Cong., 2d Sess. (1934)] may seem to exempt all securities, including certificates of deposit, issued in connection with a reorganization under that section. "All securities issued pursuant to any plan of reorganization confirmed by the court in accordance with the provisions of this section, including . . . all certificates of deposit representing securities of or claims against the debtor which it is proposed to deal with under any such plan, shall be exempt from all the provisions of the Securities Act of 1933, approved May 27, 1933, except the provisions of section 24 thereof as applied to willful violation of said section 17."

However, the Commission has indicated that this section requires court confirmation of a plan of reorganization as a condition to exemption of deposit certificates. Since solicitation of deposits normally takes place before court approval, certificates of deposit will be denied exemption under the section. See Legis. (1934) 34 COL. L. REV. 1348, 1351, 1352.

74. See Legis. (1934) 34 COL. L. REV. 1348, 1353.

75. Statement of House Conference Managers, 78 CONG. REC. 10264 (1934). Such securities will also be exempt if issued on a completion plan of reorganization under Section 77 B(h) of the Bankruptcy Act. See note 73, *supra*.

76. However, even before the amendments, the Commission declared that exemption of issuance under Sections 4(3) and 5(c) was equivalent to exemption of the securities

exempt. For similar reasons, Section 3(a)(11) has been taken from former Section 5(c). Section 3(a)(11) exempts securities which are part of an issue sold only to persons resident within a single state or territory, where the issuer is incorporated and/or does business within that state or territory. This exemption may relieve many small corporations from the necessity of registering their securities, since distribution of such issues is likely to be confined to a single state. The Act allows a quantitative as well as a geographical exemption. Section 3(b) vests in the Commission discretionary authority to exempt issues, the public offering price of which is less than $100,000.[77]

The final exemptions from Section 5(a), those which allow certain types of transactions to be carried on without the filing of a registration statement are: transactions by any person not an issuer, underwriter, or dealer;[78] transactions by an issuer not involving a public offering;[79] and various types of dealers' transactions.[80]

Securities Exchange Act. Under the Exchange Act, the determination of what securities must be registered is much simpler than under the Securities Act. The two acts define "security" in almost identical terms,[81] but the exemptions provided by the Exchange Act are narrower. The express exemptions[82] include securities issued or guaranteed by the Federal government, the states, municipalities, and their agencies and instrumentalities, "such securities issued or guaranteed by corporations in which the United States has a direct or indirect interest as shall be designated for exemption by the Secretary of the Treasury," and finally, such securities as the Commission may exempt, in the public interest, "which may include, among others, unregistered securities, the market for which is predominantly intrastate."[83] The Exchange Act fails to exempt many of the kinds of securities exempted by the Securities

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themselves under Section 3. Release No. 97, Dec. 28, 1933, 133 C. C. H. § 7561.

77. In Release No. 182, June 29, 1934, 133 C. C. H. §§ 5791-5803, the Commission extended exemption, on certain conditions, to various types of securities whose offering price was less than $100,000.

78. Securities Act § 4(1). Protective committees are within the definition of "issuer." Section 2(4); Fed. Trade Comm. Release No. 97, Dec. 28, 1933, 133 C. C. H. § 7562.

79. Securities Act § 4(1). Formerly, transactions not involving a public offering were exempt only if no underwriting was involved. See 78 CONG. REC. 10264 (1934). An offering to existing security holders of a single issuer is a "public offering." Fed. Trade Comm. Release No. 97, Dec. 28, 1933, 133 C. C. H. § 7559. Thus, the issuance of deposit certificates is a "public offering" and not exempt under Section 4(1).

80. For detailed discussion of these exemptions, see Douglas and Bates, *supra* note 3, at 187, 206-210.

81. Securities Act § 2(1); Exchange Act § 3(a)(10).

82. Exchange Act § 3(a)(12).

83. The Commission's power to exempt under this section of the Exchange Act is much broader than the power granted by the Securities Act, which allows the Commission to exempt, in the public interest, only securities whose aggregate offering price is less than $100,000. Section 3(a)(12) of the Exchange Act provides that the commission may "by such rules and regulations as it deems necessary or appropriate in the public interest or for the protection of investors, either unconditionally or upon specified terms and conditions or for stated periods," exempt any security "from the operation of any one or more provisions of this title which by their terms do not apply to an 'exempted

Act.[84] The presumable reason for not exempting certain of these, such as insurance policies, securities issued by receivers and by bankruptcy trustees, and those of building and loan associations, is the improbability that they would ever be traded on an exchange. Others, such as reorganization securities, whose original issuance is exempt on account of the safeguard of court supervision,[85] are perhaps not exempted by the Exchange Act because of the desirability of continuing publicity during the subsequent life of the security. Similarly, securities of common carriers subject to Section 20 of the Interstate Commerce Act, whose issuance is exempt because of the supervision of the Interstate Commerce Commission, are not exempt from the Exchange Act.[86] The Exchange Act differs from the Securities Act in failing to include in the exempt class certificates of deposit for the exempt securities of governmental units and instrumentalities.[87] This difference has not been explained. If it is thought desirable to exempt from registration the original issuance of such certificates, it seems to follow that the exemption should continue, even though they are traded on an exchange or over-the-counter market.

The Exchange Act, in effect, divides securities, other than those exempt, into four classes for the purpose of registration. In the first class are those securities listed on a national securities exchange; these may not be traded in on an exchange by any member, broker, or dealer, "unless a registration is effective as to such security for such exchange."[88] In recognition of the enormity of the administrative task of examining registration applications for all securities now listed, the Commission is authorized to permit securities listed on an exchange at the time the registration of the exchange becomes effective, to be registered until July 1, 1935, without complying with the registration requirements of Section 12.[89] In the second class are securities admitted

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security' or to 'exempted securities.'" Among the provisions which do not apply to exempted securities are Section 12 (registration), Section 13 (reports by issuers), and Section 16(a) (reports by officers, directors, and principal stockholders).

Under the authority conferred by this section, the Commission has exempted from Sections 13 and 16, on application for temporary registration by an exchange, listed securities whose issuers are in reorganization under Section 77 B of the Bankruptcy Act, or are in receivership or bankruptcy, or are foreign governments or corporations. Rule J E 3, 135 C. C. H. 5233. Securities granted unlisted trading privileges on application by an exchange have been exempted from Sections 12, 13, and 16, until June 1, 1936, on condition that copies of all reports of the issuer be filed with the Commission. Rule J F 4, 135 C. C. H. § 5244. Listed securities granted temporary registration are exempt from Section 13, on condition that the issuer file copies of all financial reports with the exchange and the Commission. Rule K C 1, 135 C. C. H. § 5271.

84. See pp. 465-467, *supra.*

85. Feldman, *The New Federal Securities Act* (1934) 14 B. U. L. REV. 1, 26.

86. But Section 13(b) of the Exchange Act allows such carriers to file duplicates of the documents filed with the Interstate Commerce Commission in lieu of the documents required by Sections 12 and 13 "in respect of the same subject matter."

87. Securities Act § 3(a)(2).

88. Exchange Act § 12(a). Unissued securities may be registered only in accordance with the rules of the Commission. Section 12(d).

89. Exchange Act § 12(e). Rules J E 1, 135 C. C. H. § 5231, and K C 1, 135 C. C. H. § 5271 have been promulgated to carry this section into effect. These regula-

to trading on an exchange but not listed. The Commission may prescribe terms for the continuance until June 1, 1936, of unlisted trading privileges to which the security was admitted prior to March 1, 1934.[90] If the security was listed on a national securities exchange on March 1, 1934, the Commission may extend unlisted trading privileges on another exchange until July 1, 1935.[91] The Commission is directed by the act to make a study of trading in unlisted securities and report to Congress in 1936.[92] Presumably, permanent provisions will be enacted as a result of this study. For securities in the third class, those for which an over-the-counter market is maintained, the Act makes no specific provision. But the Commission is given power to promulgate such regulations for over-the-counter markets as are necessary to afford investors protection comparable to that provided in the case of national securities exchanges.[93] The regulations, among other matters, may provide for the registration of securities for which brokers and dealers create an over-the-counter market. Liability under Section 18 will be imposed for misstatements in any registration statements or reports which the Commission may require. The final group of securities, those which are not listed or traded in on an exchange or market, are apparently not regulated by the Exchange Act. Thus, the myriad of small corporations whose securities are bought and sold locally need not file registration statements and reports. The small issuer is exempted from registration of new issues by Section 3(a)(11) of the Securities Act, if original distribution occurs within the state where the corporation carries on its business or is incorporated.

It is evident that many more securities must be registered under the Exchange Act than under the Securities Act. The Securities Act applies only to new securities; the Exchange Act to those already outstanding as well as to those that may be issued after its enactment. The exemptions allowed by the Exchange Act are fewer; as to those not expressly exempt, the only securities concerning which information is not required are those not listed or traded in on an exchange or over the counter. From issuers of all other securities, the Commission has authority to demand registration, under the provisions relating to listed securities or under its broad authority to regulate over-the-counter markets and the trading of unlisted securities.

III. Documents Required to Be Filed

In addition to a registration statement, the Exchange Act requires various other kinds of documents to be filed with respect to securities within its pur-

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tions provide for the filing of applications for temporary listing, and for the filing of reports. Liability under Section 18 will arise for misstatements in these documents.

90. Exchange Act § 12 (f)(1). Rule J F 1, 135 C. C. H. § 5241, requires that any exchange wishing to continue such unlisted trading privileges must file an application with the Commission.

91. Exchange Act § 12 (f)(2). Rule J F 2, 135 C. C. H. 5242, issued pursuant to this section, is similar to Rule J F 1, cited note 90 *supra*.

92. Exchange Act § 12(f).

93. Exchange Act § 15 forbids brokers and dealers to create a market or to use any facility of a market, by use of the mails or any instrumentality of interstate commerce, in violation of the rules and regulations of the Commission.

view. Section 13[94] provides that every issuer of a registered security must file: such information as the Commission may require to keep current the information contained in the registration statement;[95] annual reports, certified, if required by the Commission, by independent public accountants;[96] such quarterly reports as the Commission may prescribe.[97] Section 16(a)[98] requires every director and officer of the issuer of any registered equity security, and the beneficial owner of more than ten per cent of any class of any registered equity security, to file at the time of registration or within ten days after he becomes such a director, officer, or owner, a statement as to his holdings in the equity securities of the issue. Thereafter monthly statements as to changes in ownership must be filed, if, in fact, any change has occurred. Under this section, underwriters or deposit committees holding more than ten per cent of a registered stock apparently must file statements of their ownership. Since it applies to beneficial owners, the report requirement cannot be evaded by holding through a dummy, corporate or otherwise. In theory, at least, liability under Section 18 might attach for misleading statements in the registration statements which must be filed by national securities exchanges,[99] or in the reports which may be demanded from brokers, dealers, exchange members, and persons extending credit.[100] But in view of the reliance and causation requirements of Section 18(a) the likelihood of recovery for untruths in such documents is remote.

IV. Parties Liable

Issuers. The liability imposed upon an issuer by the Securities Act in its original form was almost absolute. The issuer was allowed only the defenses:[101] that there was no untruth or omission, that the untruths or omissions did not relate to material facts, that the person suing knew of the untruth or omission at the time of purchase, or that the statute of limitations had run.[102] The 1934 amendments, relaxing that strict liability somewhat, offer two additional defenses: if the plaintiff purchased the security after the release of an earning statement for the twelve months' period after issuance, that the plaintiff failed to prove reliance;[103] and that all or part of the plaintiff's damages resulted

94. For securities exempted from Section 13 by the Commission, see rules cited note 83, *supra.*

95. Exchange Act § 13(a)(1).

96. Exchange Act § 13(a)(2).

97. Exchange Act § 13(a)(2).

98. See note 83, *supra,* for exemptions from this section.

99. Exchange Act § 6.

100. Exchange Act § 17(b). These reports must be made to the Federal Reserve Board.

101. Securities Act § 11.

102. Section 13 originally provided that actions to enforce liability under Section 11 must be brought within two years after the discovery of the untruth or omission or after the discovery should have been made in the exercise of reasonable diligence, and within ten years after the security was bona fide offered to the public. As amended, Section 13 requires actions to be brought within one year after discovery and within three years after the public offering.

103. Securities Act § 11(a).

not from the untruth or omission but from other causes.[104] Lack of knowledge, reasonable ground for belief, and reasonable investigation are, however, still not available as defenses.[105]

Not all those burdened with an issuer's liability are corporate issuers. Section 15 makes jointly and severally liable with the issuer every person who through stock ownership, agency, or otherwise controls any person liable under Section 11. Although the meaning of "control" is uncertain, majority stockholders and dominant minority groups no doubt fall within the definition of such controlling persons. The liability of a controlling person is not, however, as severe as the liability of the issuer.[106] The controlling person is relieved from liability if he sustains the burden of proving that he "had no knowledge of or reasonable ground to believe the existence of the facts by reason of which the liability of the controlled person is alleged to exist." This provision, added by amendment, avoids the predication of liability on mere control without knowledge of the issuer's statements. Section 11 imposes liability on another type of non-corporate issuer, protective committees issuing certificates of deposit,[107] which presumably derive no profit from the issuance. The members of such committees are relieved from personal liability as issuers by Section 2(4) as amended. But they may be personally liable under Section 15 as persons in control of the issuing committee,[108] or as those in control of a corporation issuing new securities pursuant to a plan of reorganization, or of the officers or directors of such a corporation.[109]

The Exchange Act offers issuers more avenues of escape than are open to them under the Securities Act. In addition to the defenses[110] of truth, want

104. Securities Act § 11(e).

105. Section 11(b), which extends these defenses to other parties liable, expressly excludes issuers from its provisions.

106. But those liable as "controlling persons" may be denied the right of contribution against other persons liable under Section 11. Section 11(f) provides that "every person who becomes liable to make payment under *this* section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment." The controlling person is not liable under that section, but under Section 15.

107. With respect to certificates of deposit, "the term 'issuer' means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued." § 2(4).

A protective committee, although not an issuer, except as to deposit certificates, may be liable under Section 15, for misstatements in the registration statement filed for new securities issued pursuant to a completed reorganization plan, in view of the control it may exercise over the corporate issuer or its officers or directors. This will, of course, be true only if the securities are not exempt under Section 3(a)(10) of the Securities Act or Section 77 B (h) of the Bankruptcy Act.

108. Technically, such a result would be proper, since Section 2(4) relieves members from personal liability *as issuers*, while under Section 15, they would not be held as issuers but as *controlling persons*. But this would seem a nullification of the obvious intent of Congress in amending § 2(4). See note 116, *infra*.

109. The same considerations would apply here as in the case where the committee itself is sought to be held as a controlling person. See note 107, *supra*.

of materiality, the running of the time limit on actions,[111] and the failure of the plaintiff to prove reliance and causation, the issuer is not liable if he can prove that he acted in good faith and had no knowledge that the statement was false or misleading. And Section 20(a) of the Exchange Act, which makes controlling persons jointly liable with those controlled is somewhat differently worded than Section 15 of the Securities Act, although the purpose of the two sections is the same. Under the Exchange Act, the "controller" is given the defense that "he acted in good faith and did not directly or indirectly *induce* the act or acts constituting the violation or cause of action." This phrasing would seem to make recovery against majority stockholders and other controlling persons more uncertain than under the Securities Act. "Induce" denotes more than mere passive control. The controlling person probably will be able to argue more convincingly that he did not "induce" the making of a false statement than that he had "no reasonable grounds to believe" in the existence of the falsity.[112] The Exchange Act, by its definition of "issuer," places an issuer's liability on protective committees.[113] Unlike the Securities Act,[114] it fails to insulate members of committees from personal liability.[115] This seems difficult to explain. If it is desirable to exempt committee members from personal liability on the original issuance of certificates of deposit,[116] consistency would require that similar provision be made in the event of subsequent registration of the certificates on an exchange.

Directors and Officers. The Securities Act requires a majority of the board of directors or those performing similar functions, and the principal executive, accounting and financial officers to sign the registration statement.[117] They,

110. Exchange Act § 18(a).

111. "No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued." § 18(c).

112. Some "controlling persons" can be held directly liable as issuers under the Exchange Act, since they may be said to "have caused to be made" the statement within the meaning of Section 18(a). This will eliminate the defense of non-inducement, which is afforded those sought to be held under Section 20(a).

Controlling persons liable under Section 20(a) of the Exchange Act may be unable to recover contribution under Section 18(b), since the right is granted only against those liable under that section. Cf. note 106, *supra*. But if they are held under Section 18(a) as persons who "caused a statement to be made," contribution will be allowed.

113. Exchange Act § 3(8). The definition is identical with that under Section 2(4) of the Securities Act. They may also be liable as controlling persons. See note 107, *supra*.

114. Securities Act § 2(4).

115. The members of protective committees may be subjected to liability as controlling persons under the Exchange Act as well as under the Securities Act. See discussion, notes 108 and 109, *supra*.

116. "The basis for the application of absolute liability under Section 11 to the issuer of securities is the principle that one should not retain the fruits of an unfair bargain. In the case of a trust or committee, it is the trust or committee, rather than the trustees or members, which profits from the bargain. Consequently the latter should not have the issuer's liability." Statement of House Conference Managers, 78 CONG. REC. 10263 (1934).

117. Securities Act § 6(a)

together with others who do not sign, such as directors, partners, those performing similar functions, and those named with their consent as about to become directors or partners, are subjected to liability for untruths in the statement.[118] With regard to any part of the registration statement either not purporting to be made on the authority of an expert nor on the authority of a public document or official statement,[119] or made on his own authority as an expert,[120] any of the foregoing persons is not liable if he can sustain the burden of proof that after reasonable investigation he had reasonable ground to believe and did believe that the statement was true and contained no material omission. As regards statements purporting to be made on the authority of an expert other than the defendant himself, or purporting to be statements of official persons or copies of public documents, the person sued must prove only that he had no reasonable ground to believe and did not believe that the statements were untrue or contained omissions of material facts.[121] The standard of reasonableness of investigation and belief demanded by the Securities Act is that "of a prudent man in the management of his own property."[122] The earlier version which required the care "of a person occupying a fiduciary relationship" was changed to avoid a supposedly unfortunate psychological effect.[123] There seems to be no substantial difference between

118. Securities Act § 11(a). Any of the persons enumerated in this section are not liable if they can prove that before the effective date of the registration statement they resigned from or ceased to act in the capacity described in the registration statement and advised the commission and the issuer of this action. § 11(b) (1). If the part of the registration statement with respect to which his liability is asserted became effective without the knowledge of the person sued, he is relieved from liability if he sustains the burden of proof that on becoming aware of the fact, he acted and notified the commission, as under Section 11(b)(1), and in addition, gave reasonable public notice that such part of the registration statement became effective without his knowledge. § 11(b)(2). Directors who do not sign and underwriters would seem to be the only persons affected by this section.

119. Securities Act § 11(b)(3) A.

120. Securities Act § 11(b)(3) B.

121. Securities Act § 11(b)(3) C and D. Before the amendments, the defendant, as regards such statements, was required to prove that he had reasonable ground to believe, and did believe that the statements were true and that there was no omission to state a material fact. The amendments apparently were intended only to restate the existing provisions, in order to avoid an unfortunate psychological effect. See 78 Cong. Rec. 8669, 10264 (1934). But it is possible that the amendments have lessened the burden of proof imposed by these sections as originally enacted. Thus, if the person sued for damages caused by an untruth in a part of the statement purporting to be made on the authority of an expert had no knowledge or reason to believe that the statement was either true or false, he would seem to be in a better position to prove that he had no knowledge or belief that the statement was untrue than he would be to prove that he had knowledge or a reasonably grounded belief that the statement was true. Prior to the amendments, Section 11(b)(3) C and D seemed to require proof of active belief or knowledge of the truth of the statement; under the present provisions, mere lack of any knowledge or belief is apparently sufficient to relieve the defendant from liability.

122. Securities Act § 11 (c).

123. See 78 Cong. Rec. 8669, 10264 (1934).

the two versions, as the amendment coincides with the American Law Institute's definition of the duty of a fiduciary.[124] The directors and officers subject to liability under Section 11 may also be liable under Section 15, as persons who control the issuer.[125] But it is doubtful whether the control they exercise is the type of "control" contemplated by Section 15, since application of this section would nullify the elaborate defenses provided by Section 11.

The Securities Exchange Act, in contrast to the Securities Act, does not enumerate the classes of persons liable for misstatements.[126] Consequently, it fails to provide for individuals subject to liability a standard of responsibility related to their particular opportunities for investigation. The Exchange Act, instead, imposes a blanket liability on all persons "who shall make or cause to be made any statement" in any document filed under the Act which is false or misleading.[127] No provision is made for the signing of the registration statement or periodical reports by officers or directors. Hence, it is impossible to predict what persons may be held "to have made or caused to be made" any particular statement. A majority of the board of directors, if they authorized the filing of the statement, and the principal financial and executive officers will probably be liable. In any event, Section 20 (b) precludes the use of "dummies" to evade liability, by prohibiting the doing of an unlawful act through or by means of another person.[128]

The standard of conduct established for officers and directors who may fall within Section 18 of the Exchange Act is, at least verbally, less stringent than that provided for directors and officers under the Securities Act. The Exchange Act dispenses with the notions of reasonable investigation and reasonable grounds for belief, and relieves defendants from liability if they acted in good faith and had no knowledge of the falsity of the statement.[129] The inclusion of this defense, which is the same as the strictest formulation of the scienter requirement of the common-law deceit action,[130] may enable the negligent or even the intentionally dishonest director or officer to escape liability entirely. It must be conceded that whatever instruction concerning the scienter element the law may provide, the result in any given case depends on the infinite

124. RESTATEMENT, TRUSTS (Draft T. No. 2, 1931 § 169. "The trustee is under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property; and if the trustee has greater skill than a man of ordinary prudence, he is under a duty to exercise such skill as he has."

125. If directors and officers are liable under Section 15, they may be denied a right of contribution under Section 11(f) against other persons who may be liable. See note 106, *supra.*

126. The Fletcher-Rayburn Bill, as originally introduced, specified that directors, officers, and accountants should be among those liable. See § 17(a), H. R. 7852, 73d Cong., 2d Sess. (1934), *Hearings before Committee on Interstate and Foreign Commerce on H. R. 7852 and H. R. 8720,* 73d Cong., 2d Sess. (1934) 10. The House Conference Managers stated that this clause was stricken out as superfluous. See 78 CONG. REC. 10262 (1934).

127. Exchange Act § 18(a).

128. This same result will be brought about by Section 15 of the Securities Act.

129. Exchange Act § 18(a).

130. See Green, *supra* note 20; Shulman, *supra* note 15, at 234.

variables of the personal judgments of court and jury. But the difference in connotation of "knowledge" and "reasonable belief" seems sufficient to produce different results under similar fact situations.

Experts. The Securities Act provides for the certification of parts of registration statement and of reports and valuations used in connection with the registration statement by experts such as accountants, engineers, and appraisers.[131] If the expert's written consent to the use of his name as certifier is filed with the statement,[132] he is liable for untruths occurring in the portions so certified,[133] unless he can prove that he had, after reasonable investigation, reasonable grounds to believe, and did believe that the statements were true and contained no material omission.[134] The Exchange Act provisions relating to experts authorize the Commission to require the balance sheets[135] and profit and loss statements[136] contained in the registration statement, and the annual reports of issuers of registered securities,[137] to be certified by independent public accountants. The consent of these experts is not required. Thus, the only way for the accountant to avoid the risk of personal liability is to refuse to certify corporate reports. But no honest and capable firm of accountants is likely to be forced out of business by fear of liability, as the risks are not unduly severe. Under the Exchange Act the accountant is liable only for untruths in the parts of the documents which he certifies.[138] And in contrast to the expert under the Securities Act, the accountant, by Section 18 (a) of the Exchange Act, like issuers, officers and directors, may avail himself of the broad defenses of good faith and lack of knowledge as to the false or misleading statements.

Underwriters. The circumstances which create liability on the part of "underwriters,"[139] and dealers who may be held to be "underwriters,"[140] under the Securities Act have been exhaustively discussed elsewhere.[141] The 1934 amendments regarding reliance,[142] causation[143] and burden of proof[144] have

131. Securities Act § 7. Also included as an expert is any other person "whose profession gives authority to a statement made by him."

132. The Commission may waive the filing of the written consent, in the case of experts who are named as having prepared or certified a report or valuation used in connection with the registration statement, if filing is deemed to be impractical or to involve undue hardships on the issuer. Securities Act § 7.

133. Securities Act § 11(a) (4).

134. Securities Act § 11(b) (3) B.

135. Exchange Act § 12(b) (1) I.

136. Exchange Act § 12(b) (1) J.

137. Exchange Act § 13(a) (2).

138. The expert is liable under Section 18(a) only for false or misleading statements which he "makes or causes to be made."

139. The definition of "underwriter" under Section 2(11) includes many persons not previously considered to be underwriters. Thus the term includes originating houses, principal underwriters, members of selling syndicates, and members of selling groups.

140. See Douglas and Bates, *supra* note 3, at 203.

141. Douglas and Bates, *Some Effects of the Securities Act upon Investment Banking* (1933) 1 U. OF CHI. L. REV. 283; Douglas and Bates, *supra* note 3, at 198-205.

142. Securities Act § 11(a).

143. Securities Act § 11(e).

144. Securities Act § 11(b)(3) C and D.

altered the "underwriter's" liability[145] to the same degree as that of others who are liable on the registration statement. The amendment to Section 11 (e) limits the damages for which the underwriter might be liable to the total price at which the securities underwritten by him were offered to the public, "unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting."[146] The purpose of this amendment was to eliminate the fear that previously had existed that the "underwriter" might be liable in damages for the whole issue, no matter how small his participation.[147] But the added clause creates new uncertainties. It is impossible to determine what sort of "benefit" the section contemplates, or who "other underwriters similarly situated" may be.[148]

The Securities Exchange Act nowhere uses the term "underwriter." The sole risk of liability to which any of the groups classed as "underwriters" by the Securities Act are subjected under the Exchange Act is the danger of being held as a person who makes or causes a misstatement to be made,[149] or as a "controlling person."[150] Such "control" may be present in the case of an originating house which is in a position to dictate to the issuing corporation or its officers and directors, or which is manager of a protective committee. This risk is, however, more remote than the direct liability imposed on all "underwriters" by Section 11 (a) (5) of the Securities Act.

V

The civil liability provisions of the Exchange Act, while analogous to those of the Securities Act, are much less rigorous. The original draft of the Fletcher-Rayburn Bill was far more drastic than the Act as eventually passed.[151] The bill provided for liabilities similar to those of the Securities Act. The explanation for the gradual modification of the bill seems to have been fear on the part of Congress, carefully nurtured by corporate executives and exchange officials, that penalties as severe as those of the Securities Act would impel corporations to withdraw old issues from listing[152] and force directors and

145. Section 11(a)(5) of the Securities Act makes liable every underwriter with respect to the security registered. The underwriter may, of course, be liable as a person controlling the issuer or its officers and directors. § 15. Contribution may in such case be denied. Cf. note 106, *supra*.

146. Securities Act § 11(e).

147. See 78 CONG. REC. 8669 (1934).

148. As an example of these difficulties, suppose the originating house acts as manager for a syndicate and receives a premium for its services. It may be said that this was a benefit in which other "underwriters" did not share in proportion to their respective interests. But were there any other underwiters "similarly situated," or is the syndicate manager sui generis?

149. Exchange Act § 18(a).

150. Exchange Act § 20(a).

151. For text of this bill, see *Hearings before Committee on Interstate and Foreign Commerce on H. R. 7852 and H. R. 8720*, 73d Cong., 2d Sess. (1934) 1-15.

152. *Hearings before Committee on Banking and Currency on S. Res. 84*, 72d Cong.,

officers to resign.[153] In the hearings before House and Senate committees, opponents of the measure constantly reiterated that the Securities Act had stifled "honest business" and that the Exchange Act, in its original form, would paralyze corporate financing still more.[154]

There is perhaps a greater necessity for heavy liabilities in the case of new, untried securities, offered by unknown issuers than in the case of some securities which have long been issued and established in the market.[155] But the motivating purpose of the civil liabilities provided by Section 18 of the Exchange Act is to compel disclosure of information hitherto unrevealed. The Act is intended not merely to compensate the investor for losses incurred, but to prevent occasions for the imposition of liability from arising.[156] The present liability provisions of the Act fall far short of providing adequately for the compensation of injured investors. Although recovery by them is contemplated, yet the heavy burden of proof, the uncertain measure of damages, the absence of any definitive statement as to what parties are liable, and the many defenses available to defendants, when coupled with the requirements of a cost bond[157] will effectively deter many investors from bringing action, and will defeat others, who are not deterred. For the same reasons the liability provisions of the Act as preventive measures, are not terrifying. But perhaps terrification is unnecessary and unwise. Prevention may perhaps be sufficiently achieved, without the sacrifice of other values, by a threat which is real although its ultimate execution may be beset with many uncertainties.

1st Sess. *and on S. Res. 56 and S. Res. 97*, 73d Cong. 1st Sess. (1932-1934) 6939, 6996, 6997, 7085, 7220. It was asserted that securities of corporations in receivership or bankruptcy and foreign securities would not be registered under the Exchange Act, since the issuers would be unable to register or uninterested in registering. See id. at 6683, 6684, 7517. But Rule J E 2 of the Commission has allowed registration of these securities on application by the *exchange*. See 135 C. C. H. § 5232.

See *Hearings before Committee on Interstate and Foreign Commerce on H. R. 7852 and H. R. 8720*, 73d Cong., 2d Sess. (1934) 260, 261, 273, 491, 673, 733, 742.

Even though directors might withdraw securities from listing, registration might still be required under the § 15, regulating over-the-counter markets. And directors would penalize themselves as well as the shareholders, and would be subject to great pressure by the latter group, in the event of withdrawal from listing.

153. See, for example, *Senate Hearings, supra* note 152, at 6965, 6968.

154. See especially, statements of Richard Whitney, *Senate Hearings, supra* note 149, at 6582 et seq.; *House Hearings, supra* note 152, at 151 et seq., 723 et seq.

155. But this distinction possesses no validity in the case of new issues of long-established firms, which also must be registered under the Securities Act.

156. See p. 457, *supra*.

157. Exchange Act § 18(a).

INFORMAL SETTLEMENT OF DECEDENTS' ESTATES

THE settlement of a decedent's estate usually involves conflicting interests.[1] Debtors of the estate are not always anxious to meet their obligations, and require an assurance that the person to whom they make payments has authority to accept them on behalf of the estate. Creditors desire a prompt payment of their claims, which may in some instances require first a collection of debts and liquidation of all or part of the assets. Beneficiaries likewise want outstanding assets speedily realized, but their interests naturally are opposed to those of the creditors since they suffer to the extent that creditors' claims are allowed.[2] And finally, the beneficiaries may disagree among themselves as to distribution.[3] The furnishing of an impartial administration that will protect these conflicting interests, preserve order, and secure reasonable, prompt settlement is a function of the familiar courts of probate.[4] These courts handle in a single proceeding the complex ministerial questions that arise in the settlement of an estate.[5] After a petition invoking its jurisdiction, a probate court may[6] appoint an administrator or executor who acquires con-

1. See 2 WOERNER, THE AMERICAN LAW OF ADMINISTRATION (3d ed. 1923) § 199; Barry, *Modernizing the Law of Decedents' Estates* (1929) 16 VA. L. REV. 107.

2. Denton v. Meador, 268 S. W. 762 (Tex. Civ. App. 1925).

3. Koontz v. Koontz, 79 Md. 357, 32 Atl. 1054 (1894).

4. See generally 1 WOERNER, ADMINISTRATION 483, 513, 530. The courts variously called probate, ordinary, orphans, prerogative and surrogate courts, are usually courts of record with powers to punish for contempt, to compel obedience to their orders and decrees, and to control their own process, the jurisdiction being limited to the control of devolution of property upon the death of the owner.

5. "The functions involved in this office have a ministerial element superadded to that judicial quality . . . Such as the appointment of administrators, granting probate of wills in non-contentious cases, qualifying executors, fixing the amount and passing upon the sufficiency of bonds and sureties, receiving inventories, settlements, reports, etc., fixing the dividends to be paid to creditors, decreeing payment of legacies, ordering distribution of the residue etc. . . . which, if they occurred in ordinary courts of law or equity, would require the intervention of adjuncts—commissioners, auditors, referees, etc.—involving, aside from the question of inconvenience, delay, and cost, an incongruity in the duties of the office. Such being the logical basis and scope of courts having control of administrators and executors . . ." 1 WOERNER, ADMINISTRATION, 11, n. 2.

6. In re McWhirter's Estate, 235 Ill. 607, 85 N. E. 918 (1908) (right of administration not inherent but statutory); Trent v. Griffy, 193 Ky. 124, 235 S. W. 22 (1921); In re Carter's Estate, 113 Okla. 182, 240 Pac. 727 (1925); Hart v. Hart, 170 S. W. 1071 (Tex. Civ. App. 1914); MD. ANN. CODE (Bagby, 1924) art. 93, § 31 (if relatives decline to administer, and creditors neglect to, "administration may be granted at the discretion of the court."); MO. STAT. ANN. (Vernon, 1932) c. 1, § 2 (probate court may refuse administration if estate is less than statutory amount allowed to widow etc.,); TEX. ANN. CIV. STAT. (Vernon, 1925) art. 3356 ("No administration upon any estate shall be granted unless there exists a necessity therefore, such necessity to be determined by the court hearing the application."); 2 WOERNER, ADMINISTRATION § 235; HORNER, PROBATE PRACTICE (3d ed. 1925) § 32. But cf. Welsh v. Manwaring, 120 Wis. 377, 98 N. W. 214 (1904) (statute providing for administration held mandatory); KAN. REV. STAT. ANN. (1923) c. 22, § 312 (if no creditors and no one seeking administration "and court is satisfied that the estate

trol over the property of the estate and undertakes its administration under the court's supervision.[7]

In spite of the obvious advantages in many instances of a formal probate court settlement of an estate, it cannot, however, be regarded as desirable in all possible circumstances. Such administration, to insure protection for all interests, is designed to secure full disclosure of all steps taken, and a court review of these details is necessary at the close of proceedings.[8] This inevitably entails considerable expense and delay. Yet on many occasions the settlement of an estate does not in fact involve conflicting interests.[9] This would appear to be true where the estate consisted entirely of property exempt from creditors' claims—such as statutory allowances for widow and children[10] or community[11] or homestead property;[12] where an estate has no debtors or

exceeds the value of $100" it shall select an administrator); N. C. CODE ANN. (Michie, 1931) § 3 (letters of administration must issue); OHIO GEN. CODE (Page, 1931) § 1509-3 (if no relatives seeking administration, the court shall commit administration to such other person as it deems fit).

7. See In re Mulford, 217 Ill. 242, 247, 75 N. E. 345, 346 (1905); Buchanan v. Bilger, 64 Tex. 589, 592 (1885); cf. Stewart v. Morrison, 81 Tex. 396, 17 S. W. 15 (1891).

8. In re Higgin's Estate, 15 Mont. 474, 39 Pac. 506 (1895); see In re Mulford, 217 Ill. 242, 75 N. E. 345, 346 (1905); cf. Deobold v. Opperman, 111 N. Y. 531, 684, 19 N. E. 94 (1888); Stewart v. Morrison, 81 Tex. 396, 17 S. W. 15 (1881).

9. Despite the requirements of administration, the majority of adults leave a negligible amount, and there is nothing to administer. From 1912 through 1923 in 24 counties in 13 states, a total of 184,958 adult deaths, only 43,512 estates went through the mechanics of probate administration. FEDERAL TRADE COMMISSION, NATIONAL WEALTH AND INCOME (1926) 58. Even in New York and Kings County, 1914-29, for example, of 933,794 deaths, 688,250 persons were of testamentary age but only 217,074 estates went through formal administration. From 1914 to 1929 inclusive in New York County there were 10.63% wills, 20.06% administrations, and 69.31% unadministered. Powell and Looker, *Decedents' Estates* (1930) 30 COL. L. REV. 919.

Courts may also refuse administration when an estate is small. Allen v. Foth, 210 Ky. 343, 275 S. W. 804 (1925); see In re Tangerman's Estate 226 App. Div. 162, 235 N. Y. Supp. 213, 216 (3d Dep't, 1929); and many statutes either exempt estates less than a certain amount or provide for summary administration. ARIZ. REV. CODE ANN. (Struckmeyer, 1928) § 4163 (less than $300); CAL. PROB. CODE (Deering, 1931) § 630 (estate less than $1000 and no real property); ME. REV. STAT. (1930) c. 76, § 1 (Estate less than $20); MONT. REV. CODE (1921) § 10149 (estate less than $3000, summary administration at court's discretion); OKLA. STAT. (1931) § 1229; S. D. COMP. LAWS (1929) § 3267 (personalty less than $750); cf. ILL. REV. STAT. (Smith-Hurd, 1933) c. 3, § 147 (estate less than $500); HAWAII REV. LAWS (1925) § 2501; N. D. COMP. LAWS ANN. (1913) 1788.

10. Williams v. Sykes, 154 So. 267 (Miss. 1934); Hastings v. Myer's Administrator, 21 Mo. 519 (1855); FLA. COMP. GEN. LAWS ANN. (1927) § 5589; GA. CODE ANN. (Michie, 1926) §§ 3930, 3931; IND. STAT. ANN. (Burns, 1926) § 3277; KY. STAT. (Carrol, Supp. 1933) § 3897-1; MO. STAT. ANN. (Vernon, 1932) c. 1, § 2; NEB. COMP. STAT. (1929) c. 30, § 332; NEV. COMP. LAWS (Hillyer, 1929) § 9704.

11. Wright v. Smith, 19 Nev. 143, 7 Pac. 365 (1885); cf. In re Anderson's Estate, 18 Ariz. 266, 158 Pac. 457 (1916); CAL. PROB. CODE (Deering, 1931) § 203; LA. CIV. CODE ANN. (Dart, 1932) art. 930; PHIL. ISLANDS CIV. CODE (Sinco and Capistrano, 1932) art. 1053, § 685.

12. Lester v. Stroud, 212 Ala. 635, 103 So. 692 (1925); Cohn v. Sanez, 211 S. W. 492

creditors, and the beneficiaries are in agreement as to[13] the value of the estate and the proportion due to each of them; and also where all claims are voluntarily settled,[14] with the debtors content to pay the beneficiaries directly and the beneficiaries not questioning the claims of creditors but paying them promptly. Under such circumstances there seems to be no need for the protective duties of account and approval, and hence no need to undergo the expense or delay of any probate administration whatsoever. But even when the settlement of an estate is thus apparently free from conflicting interests, there are several possible difficulties that may be encountered, either before or after distribution, when an attempt is made to omit formal administration.[15]

(Tex. Civ. App. 1919); Parker v. Miller, 258 S. W. 602 (Tex. Civ. App. 1924); FLA. COMP. GEN. LAWS ANN. (1927) § 5589; KANS. REV. STAT. ANN. (1923) § 22-108; S. D. COMP. LAWS (1929) § 3267; cf. Denton v. Meador, 268 S. W. 762 (Tex. Civ. App. 1925) (though homestead generally was exempt, the probate court allowed a lien upon it; held, that this could not be collaterally attacked, the presumption being conclusive in favor of judgment of the probate court).

13. Seive v. Steinreide, 8 Ky. L. 347, 1 S. W. 672 (1886); Howells v. McGraw, 97 App. Div. 460, 90 N. Y. Supp. 1 (1st Dep't 1904); FLA. COMP. GEN. LAWS ANN. (1927) § 5589 (sole heir and no debts; or agreement, and no debts owed by the estate); GA. CODE ANN. (Michie, 1926) § 3964 (heirs, distributees or legatees may prefer to settle without administration); KY. STAT. (Carroll, Supp. 1933) § 3897-2; ILL. REV. STAT. (Smith-Hurd, 1933) c. 3 § 18; cf. Tise v. Hicks, 191 N. C. 609, 132 S. E. 560 (1926) (family settlements favorites of the law); CAL. PROB. CODE (Deering, 1931) § 581 (after the time to file claims against an estate has gone, an administrator cannot recover possession from the distributees in possession).

Usually an agreement between the distributees requires all parties to be of legal age to make it valid. Kilcrease v. Shelby, 23 Miss. 161 (1851). Yet a guardian acting in good faith has been allowed to consent for his ward. Cotterell v. Coen, 246 Ill. 410, 92 N. E. 911 (1910); In re Beresford's Estate, 146 Misc. 140, 262 N. Y. Supp. 78 (Surr. Ct. 1932); KY. STAT. (Carroll, Supp. 1933) 3897-3; But cf. ILL. REV. STAT. (Smith-Hurd, 1933) c. 3, § 18.

14. Creditors and distributees may amicably adjust claims among themselves. Bull v. Hepworth, 159 Mich. 662, 124 N. W. 569 (1910); Roth v. Rubert, 176 Mich. 484, 142 N. W. 749 (1913); In re Booth's Estate, 146 Misc. 70. 261 N. Y. Supp. 397 (Surr. Ct., 1932).

15. See in re Lambrecht's Estate, 112 Wash. 645, 192 Pac. 1018 (1920) (dispute over computation of inheritance tax). In some states executor de son tort statutes render one who converts a decedent's estate to his own use liable to a subsequently appointed administrator or executor for the value of the property so converted and for any damages to the estate. IOWA CODE (1931) § 12059; MISS. CODE ANN. (1930) 1720; NEB. COMP. STAT. (1929) c. 30 § 321; N. C. CODE ANN. (Michie, 1931) § 4; ORE. CODE ANN. (1931) tit. 5 § 707; N. J. COMP. STAT. (1911) tit. 2260 § 3 (qualified); cf. ORE. CODE ANN. (1931) tit. 11 § 314. *Contra:* N. Y. CONS. LAWS (Cahill, 1930) tit. 13 § 112 (abolished).

Probate proceedings may be mandatory in some jurisdictions, in which event the need for them in a particular case is unimportant. See note 6, *supra*.

When the deceased has made a testamentary disposition, all parties in interest may ignore the will and join in an agreement which will supersede it. Apgar v. Connell, 79 Misc. 531, 140 N. Y. Supp. 705 (Sup. Ct. 1913); Phillips v. Phillips, 8 Watts 195 (Pa. 1839). *Contra:* In re Dardis' Will 135 Wisc. 457, 115 N. W. 332 (1908). Where the purpose is to defeat the rights of certain legatees or devisees, not parties to the agreement, the

The first, and perhaps the least serious, objection has to do with the transfer of title of property to the beneficiaries of the estate. Where an administrator or executor is necessary to the settlement of an estate, it is necessary that he be given complete power to deal with the property thereof.[16] As to realty this is usually done by permitting the administrator or executor to intercept the title of the heir or devisee should the personalty be insufficient to pay the debts.[17] But as to personalty, which is first applied against obligations of the estate, this is assured by the doctrine that legal title vests in the administrator or executor when appointed rather than in the beneficiaries, the title relating back to the time of the former owner's death.[18] The reason for the doctrine's application to personalty alone was largely historical, and apparently in some jurisdictions it is being extended to include realty as well.[17] The problem is essentially the same, however, regardless of the nature of the property involved. By such a doctrine the estate is protected against sale of property by other than an executor or administrator since no one else is able to pass title. Because of this fact, the failure to have an administrator or executor appointed might be ground for attack on a title otherwise derived. Yet such

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agreement is considered to be contrary to public policy and therefore void. Gergolz v. Gehrkens, 164 Cal. 596, 130 Pac. 8 (1913); Cochran v. Zachary, 137 Iowa 585, 115 N. W. 486 (1908); see 1 PAGE, THE LAW OF WILLS (2d ed. 1926) § 631.

16. "Ordinarily the entire title to personal property left by an intestate vests in the administrator of his estate . . . exceptions . . . should embrace these three fundamental facts: First, the absence of debts against the estate; second, the legal age of each of the heirs entitled to share in its distribution; and third, a unanimity among them as expressed by their agreement or acts to dispense with an administration." Griesel v. Jones, 123 Mo. App. 45, 55, 99 S. W. 769, 771 (1907).

17. Lester v. Stroud, 212 Ala. 635, 103 So. 692 (1925); Rippe v. Weiters, 96 Kans. 738, 153 Pac. 536 (1915). In some states the right to possession of the real estate is with the administrator. Lawson v. Kelly, 82 Tex. 457, 17 S. W. 717 (1891); Jameson v. Goodwin, 43 Okla. 154, 141 Pac. 767 (1914). But title, subject to this possessory right of the administrator, vests in the heirs at once. See Berry v. Howard, 26 S. D. 29, 127 N. W. 526 (1910); Merritt v. Daffin 24 Fla. 320, 329, 4 So. 806, 808 (1888); 2 WOERNER, ADMINISTRATION 1121.

In other states the administrator can take charge of the real estate but title is in the heirs and also the right to assert it until the administrator exerts his power of possession. Masterson v. Girard, 10 Ala. 60 (1846); Streeter v. Paton, 7 Mich. 341 (1859); State v. Probate Court, 25 Minn. 22 (1878); Leon v. Heath, 53 Neb. 707, 74 N. W. 274 (1898); CLEAVELAND, HEWITT AND CLARK, PROBATE LAW AND PRACTICE OF CONNECTICUT (1915) 232. But see English Administration of Estates Act 1925, Part II, § 9, 15 GEO. V. 894 (1925) (real and personal property shall vest in the probate judge until administration is granted, to the same extent as personal property vested in the ordinary). COMBINED REPORTS OF THE DECEDENT ESTATES COMMISSION (N. Y. State 1928-33). No. 69, p. 81, points out that more than three-fourths of the other states have a uniform system for selecting the intestate successors to real and personal property, but this does not determine the question of title during administration.

18. S. S. Pierce Co. v. Fiske, 237 Mass. 39, 129 N. E. 609 (1921); cf. Buder v. Franz, 27 F. (2d) 101 (C. C. A. 8th, 1928) (remainderman on death of life tenant gets property directly and no administration can be had); Murphree v. Griffis, 215 Ala. 93, 109 So. 746 (1926) (probate of will).

an objection is purely formalistic, and where an administration would have the sole function of providing a conduit for title, there is no reason why, by analogy to a dry trust, title should not be said automatically to vest in the distributees who have the equitable interest.[19] Therefore, whether the question is raised by a person seeking to administer an estate for his own benefit in the form of fees, or by a beneficiary who is anxious to have title adjudicated, the court should comply with a request by the beneficiaries that it refuse to appoint an administrator, which refusal should in itself provide an effective adjudication of title.[20]

A second objection to omitting formal administration of an estate evolves from the possibility of the subsequent appearance of creditor's claims. Non-appearance of such claims before distribution does not necessarily and finally determine their non-existence.[21] Unless there has been a proper notice of dissolution of the estate, there is a possibility of harm to creditors, whose protection is one of the primary functions of probate administration.[22] Moreover, a formal probate administration procedure serves to bar all non-reported creditor claims. Without such administration the possibility also exists that beneficiaries may be prejudiced by being subsequently compelled to pay debts in proportion to the availability of the beneficiaries rather than in proportion to their interests in the estate. But whether these contingencies are sufficient ground for probate administration should depend largely upon when the questions are raised and by whom; the mere fact of their existence alone is hardly an adequate reason.

They may be raised before the distribution of assets by a person attracted by the opportunity for possible fees. Such a person may have no interest in the estate, or may have such a slight interest as to render his need for protection hardly an important consideration.[23] His request for administration should have little weight if the other distributees oppose it and furnish security to the extent of any possible loss, and such distributees might even be permitted to forestall the request by previously providing for a public notice to creditors, thus raising a presumption that non-disclosure of claims indicates

19. Fretwell v. McLemore, 52 Ala. 124 (1875); Adamson v. Parker, 74 Ark. 168, 85 S. W. 239 (1905); Bell v. Farmers and Traders Bank, 188 Mo. App. 383, 174 S. W. 196 (1915); cf. Powell v. Pennock, 181 Mich. 588, 148 N. W. 430 (1914).

20. But see CLEAVELAND, HEWITT & CLARK, op. cit. *supra* note 17, at 208: "The only way which has been suggested to bar such rights [of creditors] is by the bringing of an application [for administration] and its refusal by the court. Whether such course will be efficacious to quiet title may perhaps be questioned."

21. See Bell v. Farmers and Traders Bank, 188 Mo. App. 383, 388, 174 S. W. 196, 197 (1915).

22. Waterhouse v. Churchill, 30 Colo. 415, 70 Pac. 678 (1902); cf. Gwinn v. Nubin, 9 Idaho 202, 72 Pac. 961 (1903); see 2 WOERNER, ADMINISTRATION 658: "The rights of creditors to the assets of a deceased person is the principal reason for requiring official administration and courts, therefore, sanction the disposition of the property of a decedent without the appointment of an administrator, where it is certain that no debts are owing."

23. In re Tangerman, 226 App. Div. 162, 235 N. Y. Supp. 213 (3d Dep't, 129).

non-existence.[24] Even the fact that the interest of the person advancing the request for administration was too slight to justify the proceeding might reasonably be urged in opposition. But a more valid contention in favor of administration might come from a person who is a substantial beneficiary of the estate. He can summon a very convincing argument that his interests as a distributee might later be subjected to serious impairment by creditors' claims. Under this contention, whether merely a pretext to gain administrator's fees or not—a fact that is difficult or impossible to determine—his position should nevertheless command a right to probate court protection,[25] in the absence of voluntary security for his interests by other beneficiaries. Because of the size of the interest this is hardly apt to be given.

After the estate has been informally distributed, the claims for administration may yet be advanced by the same persons, or in addition by a subsequently appearing creditor.[26] As to a person who has no interest in the estate, the previous presumption that there were no creditors would be strengthened by the passage of time and by their non-appearance.[27] Beneficiaries, from whom the request is more likely to come, would by their previous acceptance of a division of the estate have waived any right or estopped themselves from raising the question.[28] Only a subsequently appearing creditor could now raise a valid claim for probate proceedings, and his claim might be silenced by payment, or even denied, if to allow administration would clearly render no benefit to the creditor.[29] There is the further possibility that a creditor might, instead of requesting probate administration, pursue a court action against a particular beneficiary[30] who could then successfully claim adminis-

24. Bradley v. Raulerson, 66 Fla. 601, 64 So. 237 (1914).

25. See Griesel v. Jones, 123 Mo. App. 45, 56, 99 S. W. 769, 771 (1907) (heir cannot be coerced nor deprived of protection of administrator except by his consent).

26. Vuiellemont v. Consulin, 17 La. App. 661, 134 So. 419 (1931) (creditor was made the administrator, the estate being very small and there being over 200 heirs); Denton v. Meador, 268 S. W. 762 (Tex. Civ. App. 1925).

27. Waterhouse v. Churchill, 30 Colo. 415, 70 Pac. 678 (1902); cf. Tunnell v. Moore, 53 S. W. (2d) 324 (Tex. Civ. App. 1932).

28. Caldcleugh v. Caldcleugh, 158 Ark. 224, 250 S. W. 324 (1923); Riffe v. Walton, 105 Kans. 227, 182 Pac. 640 (1919).

29. In particular instances creditors have been refused administration where other means of collection seemed more suitable. Webb v. Thimble Bros., 143 Ky. 375, 136 S. W. 870 (1911) (creditor held lien on particular land, specifically mortgaged; held, that he could sue the other heirs directly); In re Carter's Estate, 113 Okla. 182, 240 Pac. 727 (1925) (creditor's petition for administration refused; there were no assets in the estate except a $20 watch, which was exempt as "wearing apparel"); Rogers v. Barbee, 32 S. W. (2d) 666 (Tex. Civ. App. 1930) (estate of about $60,000 unencumbered real estate, $60,000 personal property—cash in the bank, there being two heirs and one creditor,—the doctor of the deceased presenting a claim for $1,513. Since there were no conflicting rights of creditors and no interest of a widow or minor intruding, it was held that such a claim could be vindicated in a direct suit against the two heirs); cf. Cook v. Baker, 45 S. W. (2d) 161, 165 (Tex. Comm. of Appeals, Sec. B., 1932).

30. Cf. ILL. REV. STAT. (Smith-Hurd, 1933) c. 59 § 15 (Upon failure to have an administrator within a year, a separate suit or action may be maintained against the heirs or devisees on all the contracts and undertakings of such deceased).

tration on the ground of actual rather than probable or possible injury. The risk of a creditor's appearance is occasionally foreclosed by statutes that automatically bar such claims after a certain time,[31] or by other statutes rendering void any administration begun after a certain number of years.[32] The existence or non-existence of such statutes, and the condition of the records of the estate may well be determining factors to persons contemplating an informal estate settlement. When the transactions of a decedent are clear and easily understood, there should be little fear of informal settlement on this ground. When they are confused and uncertain, the risk is greater, and a formal administration is more desirable.

It is not necessarily true, however, that informal settlement of a decedent's estate should be allowed only where there are no conflicting interests. Probate proceedings, necessary where creditors are urging their claims and unnecessary where they are satisfied, may likewise be superfluous where the only existing conflict is that between debtors of the estate and its beneficiaries, or where disagreement over the proceeds exists only among the beneficiaries.

The protection desired by a debtor alone is not such as to require a probate proceeding. Certainly when called to account by a beneficiary he ought not to defeat a recovery for the reason that there are or may be debts owed by the estate.[33] The claims are not related, and although before payment an estate's debtor may be subject to garnishment proceedings by its creditor, extinguishment of the debt to the estate removes the possibility. The same is true as to the claims of the beneficiaries against the debtor. To protect him-

31. COLO. ANN. STAT. (Mills, 1930) § 7905 (two years); KY. STAT. (Carroll, Supp. 1933) §§ 3897-4 (just claimant has five years to set aside agreement dispensing with administration); R. I. GEN. LAWS (1923) § 5608 (six years for real estate); Tunnell v. Moore, 53 S. W. (2d) 324 (Tex. Civ. App. 1932) (four years); Duvall v. Healy Lumber Co., 57 Wash. 446, 107 Pac. 357 (1910) (same as R. I. GEN. LAWS, *supra*); cf. Bauserman v. Blunt, 147 U. S. 647, 660 (1893).

32. COLO. ANN. STAT. (Mills, 1930) § 7904 (2 years); CONN. GEN. STAT. (1930) § 4909 (10 years); KY. STAT. (Carroll, 1930) § 3895 (20 years); ME. REV. STAT. (1930) c. 76, §§ 1, 2 (20 years); MASS. ANN. LAWS (1933) c. 193, § 4 (20 years); PA. STAT. ANN. (Purdon, 1930) tit. 20, § 342 (21 years).

33. See Merchants' National Bank of Muncie v. McClellan, 40 Ind. App. 1, 4, 80 N. E. 854, 855 (1907); Ricks v. Hilliard, 45 Miss. 359, 363 (1871): "If a presumption may be indulged that creditors are barred, or if a reasonable time has elapsed since the death of a decedent to give creditors a full opportunity to open an administration, or have it committed to the sheriff or public administrator, and they have failed to do so, a stranger, who is called to an account at the suit of the distributees, ought not to be permitted to defeat a recovery, for the reason that there are or may be outstanding debts. A recovery by them does not cut off creditors or put them in a worse predicament than they were before . . . inequitable to permit . . . defendant to set up the right which this stale creditor may or may not have, might or might not assert, to cut off the right of the distributee." Yet in all the cases permitting distributees to sue for assets of an estate, it is insisted by the courts that there be no creditors of the estate. Cases cited note 45, *infra*. See ILL. REV. STAT. (Smith-Hurd, 1933) c. 3 § 147 (In certain counties, in the case of estates less than $500, distributees may collect debts due the estate upon giving an affidavit); LA. CODE PRAC. (Dart, 1932) art. 113.

self fully it is only necessary that the debtor know that his payment does extinguish the debt, and the voluntary consent of all the beneficiaries should usually furnish this assurance.[34] But it may not be certain that all possible beneficiaries are known, and a debtor's natural reluctance may be augmented by the chance that other beneficiaries may appear later or that a subsequently appointed administrator might seek to collect from him.[35] The most probable consequence of a situation wherein a debtor is afraid to pay is a suit by the beneficiary to enforce payment.[36] Here the debtor could defend either on the ground that payment to the plaintiff would not be payment to the estate, or upon the ground that the plaintiff had no title upon which to base his suit. The first objection, though admittedly valid, could be solved by the court in which the suit was brought by a requirement that all the beneficiaries be parties to the suit, either as joint plaintiffs in a suit at law or as either plaintiffs or defendants in a suit in equity.[37] The second objection, directed at the plaintiff's title, has already been discussed and has received varied treatment by the courts. Where an executor or administrator has been unable or unwilling to press a claim, the equitable title of the beneficiaries has been said to be sufficient to permit them to sue,[38] in effect supplementing the probate administration. Even where there has been no probate administration some courts have permitted this, either requiring a bond for indemnity of the debtor,[39] or providing for notice by advertisement which is then deemed to make all interested parties sufficiently represented.[40] Others are reluctant to permit such suits and draw a distinction between collection by a beneficiary, where payment is voluntary, and collection through judicial proceedings. In Michigan, for example, the heirs may collect debts but may not sue for them,[41] and

34. Cf. Cotterell v. Coen, 246 Ill. 410, 92 N. E. 911 (1910).

35. Brown v. Baxter, 77 Kans. 97, 94 Pac. 574 (1908) (Debtor's fear of paying twice held a "fanciful apprehension." There were no appearing creditors in the eleven years from the death of the decedent, and there was no disagreement among the distributees). But see 2 WOERNER, ADMINISTRATION 656, for the rule that payment of a debt due the deceased to other than the legal executor or administrator will not protect the debtor against the demand of such representative, twenty-eight states and the District of Columbia being cited as so holding.

36. But see McBride v. Vance, 73 Ohio St. 258, 263, 76 N. E. 938, 939 (1905).

37. Salter v. Salter, 98 Ind. 522 (1884); cf. Gale v. Cory, 112 Ind. 39, 14 N. E. 362 (1887).

38. Moore v. Waldstein, 74 Ark. 273, 85 S. W. 416 (1905); Austin v. Snider, 17 Colo. App. 182, 68 Pac. 125 (1902); Hatton v. Howard Braiding Co., 47 R. I. 47, 129 Atl. 805 (1925); N. M. STAT. ANN. (1929) c. 47 § 127.

39. Kent v. Davis, 89 Ga. 151, 15 S. E. 457 (1892); KY. STAT. (Carroll, Supp. 1933) § 3897-2 (persons applying to court for permission to distribute without appointment of an administrator are required to give a bond double the amount of the personal estate, to protect any possible creditors who may apply within nine months of decedent's death); see Brashear v. Conner, 29 La. Ann. 347, 349 (1877); Conklin v. Alabama and Vicksburg Ry. Co., 81 Miss. 152, 32 So. 920, 162 (1902).

40. Roberts v. Garbett, 171 Atl. 241 (R. I. 1934); see Dabol and Johnson v. Field, 9 R. I. 266, 286 (1869).

41. Brobst v. Brobst, 190 Mich. 63, 155 N. W. 734 (1916).

in Missouri the heirs may collect bank deposits[42] while only an administrator may sue to recover proceeds of a sale of property.[43] It is hard to see why such a distinction should be drawn.[44] And in still other courts the distributees have not been so impeded, but have been permitted to sue in their own name for debts of the estate, although the courts continue to stipulate that there must be no creditors of the estate existing at the time.[45]

Where disagreement between the beneficiaries is the sole question, an equitable suit to compose their differences may, when available, be more convenient and less expensive.[46] Before distribution a disagreement may consist in a dispute as to who the beneficiaries are, and in what proportion they should share in the estate. It may obviously raise difficult questions that should be handled only through a probate court.[47] The problem raised by the Wendel will case in New York[48] is a notable example. There the administrative task of determining the identity of the beneficiaries was complicated by the appearance of

42. Bell v. Farmers and Traders Bank, 188 Mo. App. 383, 174 S. W. 196 (1915).

43. Hounson v. Moore, 18 Mo. App. 406 (1885).

44. Cf. Moore v. Smith, 121 Ga. 479, 49 S. E. 601 (1904); In re Riley's Estate, 92 N. J. Eq. 567, 113 Atl. 485 (1921).

45. Some states permit collection informally when the debts of an estate have been paid or agreements have been made to pay them: Metropolitan Life Insurance Co. v. Fitzgerald, 137 Ark. 366, 209 S. W. 77 (1919); Phillips v. Phillips, 163 Ga. 899, 137 S. E. 561 (1927); Bell v. Kelly, 54 F. (2d) 395 (E. D. Ill. 1931); Magel v. Milligan, 150 Ind. 582, 50 N. E. 564 (1898); Babbittt v. Bowen, 32 Vt. 437 (1859); cf. Allen v. Foth, 210 Ky. 343, 275 S. W. 804 (1925); Roberts v. Garbett, 171 Atl. 241 (R. I. 1934); Schoenwetter v. Shoenwetter, 164 Wis. 131, 159 N. W. 737 (1916). Other courts, less specific, permit collection informally "when there are no creditors." Teal v. Chancellor, 117 Ala. 612, 23 So. 651 (1898); Austin v. Snyder, 17 Colo. App. 182, 68 Pac. 125 (1902); Granger v. Harriman, 89 Minn. 303, 94 N. W. 869 (1903); Ricks v. Hilliard, 45 Miss. 359 (1871); Cox v. Yeazel, 49 Neb. 343, 68 N. W. 483 (1896); Hurt v. Fisher, 96 Tenn. 570, 35 S. W. 1085 (1896); Grant v. Poyas, 62 S. C. 426, 40 S. E. 891 (1902) (sole heir); cf. Wood v. Welmar, 104 U. S. 786 (1881); Haynes v. Harris, 33 Iowa 516 (1871); Richardson v. Cole, 160 Mo. 372, 61 S. W. 182 (1901); Catlin v. Huestis, 5 Ohio Circ. Dec. 23 (1895). *Contra:* McBride v. Vance, 73 Ohio St. 258, 76 N. E. 938 (1906). Still other courts permit distributees to sue, after an estate has once been settled, for unadministered assets. Hubbard v. Urton, 67 Fed. 419 (Circ. Ct. D. Nev. 1895); Sanders v. Moore, 52 Ark. 376, 12 S. W. 783 (1890); Jordan v. Hunnell, 96 Iowa 334, 65 N. W. 302 (1895).

46. 2 WOERNER, ADMINISTRATION § 201, names 24 states where, if there are no debts against an estate and distribution alone remains to be done, cases have been found not requiring administration. In addition, cf. Seive v. Steinrede, 1 S. W. 672 (Ky. 1886); Howells v. McGraw, 97 App. Div. 460, 90 N. Y. Supp. 1 (1st Dep't 1904); Tise v. Hicks, 191 N. C. 609, 132 S. E. 560 (1926); Commercial Savings and Loan Corp. v. Kemp, 149 Va. 68, 140 S. E. 113 (1927); Roberts v. Garbett, 171 Atl. 241 (R. I. 1934); Catlin v. Huestis, 5 Ohio Circ. Ct. 23 (1895) (executor dispensed with); Schoenwetter v. Schoenwetter, 164 Wis. 131, 159 N. W. 737 (1916) (family agreement; heirs could collect assets, but a creditor could demand administration).

47. Cf. Richardson v. Cole, 160 Mo. 372, 61 S. W. 182 (1901). But cf. In re Peterson's Estate, 137 Wash. 137, 241 Pac. 964 (1926).

48. In re Wendel's Will, 143 Misc. 480, 257 N. Y. Supp. 87 (Surr. Ct. 1932) (trial of the relationships of the claimants to the decedent in a will contest).

over 1500 claimants. Where the question is more simple, a court of equity would probably be perfectly able adequately to settle the dispute, even prior to settlement. After a settlement has been made, the previous assent[48] and reliance of others upon that assent would seem to prevent those who entered the original settlement from challenging it at all unless there had been fraud, accident or mistake.[49] In the absence of these factors, only strangers to the agreement, for instance an heir or next of kin appearing subsequently, would be entitled to demand an administration.[50] Such a claimant[51] may choose to make application to a probate court, asking for letters of administration for himself, or merely that letters of administration be granted. This the other beneficiaries would naturally oppose, first on the ground that the claimant was not in fact of the necessary degree of relationship to the deceased, and secondly on the theory that the costs of administration would be an unnecessary expenditure. Should a determination of the first objection result in favor of the claimant, it would be improbable that the probate court would allow the possessors of the estate to escape the expense of administration unless they were willing to pay the claim against them. Particularly would this be true where there was a dispute as to the amount of the property in the estate and the manner in which it should be distributed. But if the claimant does not seek administration, there is no reason why he should not be able successfully to petition a court of equity to declare his equitable title equal to the equitable title of the other beneficiaries. An argument by the defendant beneficiaries to the effect that a probate court is best qualified and should alone be permitted to determine the necessary issue of whether or not the claimant has a valid claim is not compelling, for nothing in the situation necessitates the use of the administrative machinery peculiar to courts of probate. Moreover, weight would probably be given to the fact that

49. Griffith v. Godey, 113 U. S. 89 (1885); Robert v. Parsons, 195 Ky. 274, 242 S. W. 594 (1922); Burgess v. Burgess, 130 S. C. 265, 126 S. E. 34 (1925).

50. Although an estate has been amicably settled by the parties interested, administrators have subsequently been appointed in some instances. Generally suits have arisen when administrators thus appointed have attempted to recover back the distributed property. The courts usually point out that a revesting of property in the administrator only to have him turn it back to the same parties is unnecessary. Though it is conceded that an administrator can be appointed, he is not permitted to recover against those with equitable title who are in possession, there being no debts against the estate. Richardson v. Cole, 160 Mo. 372, 61 S. W. 182 (1901); cf. Allen v. Foth, 210 Ky. 343, 275 S. W. 804 (1925).

When property is discovered after an estate has been formally administered, an administrator de bonis may be appointed, but often the appointment of such a representative is held to be a needless formality. The estate being settled, presumably there are no creditors needing protection, and the beneficiaries may be permitted to distribute the property among themselves. Pullis v. Pullis, 127 Mo. App. 294, 105 S. W. 275 (1907); Mo. STAT. ANN. (Vernon, 1932) § 47; see 1 WOERNER, ADMINISTRATION 606; cf. Sanders v. Moore, 52 Ark. 376, 12 S. W. 783 (1890).

51. "It has often happened that new or unknown distributees or creditors have appeared, demanded their portions or debts from the 'sole heir' who, without administration, took possession of and consumed the estate." Grant v. Poyas, 62 S. C. 426, 427, 40 S. E. 891, 893 (1902).

bringing suit in a probate court would not obviate the necessity of a later suit in equity by an administrator if the defendants in the probate action refused to pay. The problem in this and other disputes between the distributees is whether a court of equity would be able to give adequate protection to all interests, or in any event, protection as adequate as that offered by a probate administration; where this is possible,[52] a suit in equity can be used and the probate proceedings dispensed with.

UNIFORMITY AND THE RECOGNITION OF EX PARTE DIVORCES

COURTS and legal authorities agree that marriage, although created by the will of the parties, assumes an important social function "having to do with the morals and civilization of the people," and is subject to public control greater than other relations created by the will of the parties.[1] The marital status and its dissolution are accordingly regulated by the state in which the parties have their home, and a divorce granted by such a state in conformity with its laws is valid everywhere.[2] When husbands and wives separate, and having left the state of the marital domicil, establish separate homes in different jurisdictions, then if either petitions for a divorce and the other appears or is served within the state, the marital status is said to be within the control of the jurisdiction where the plaintiff is domiciled and a decree entitled to full faith and credit may be granted.[3] But when the parties are domiciled in dif-

52. Equity has furnished protection in several situations where administration has been omitted. See Griffith v. Godey, 113 U. S. 89, 93 (1885): "If the property is omitted by mistake or subsequently discovered, a court of equity may exercise its jurisdiction in the premises, and take such action as justice to the heirs . . . or . . . creditors . . . may require, even if the Probate Court might, in such case, open its decree, and administer upon the omitted property." See also Fretwell v. McLemore, 52 Ala. 124 (1875); People v. Abbott, 105 Ill. 588 (1883); Moore v. Brandenberg, 248 Ill. 232, 93 N. E. 733 (1910); Powell v. Pennock, 181 Mich. 588, 148 N. W. 430 (1914); In re Riley's Estate, 92 N. J. Eq. 567, 113 Atl. 485 (1921) (equity decreed direct to secondary next of kin, when next of kin of decedent died intestate before receiving his share of the ancestor's estate). In Hart v. Hart, 170 S. W. 1071 (Tex. Civ. App. 1914), it was pointed out that district courts have retained jurisdiction in suits for partition when there were no creditors of the estate, or on the ground that the property of the estate was insufficient to justify the expense of administration. In re Peterson's Estate, 137 Wash. 137, 241 Pac. 964 (1926), held that a dispute between the heirs could be settled in a suit between them and that the dispute would not give rise to an administration.

1. See Maynard v. Hill, 125 U. S. 190, 205 (1888); Andrews v. Andrews, 188 U. S. 14, 30, 31 (1903).

2. Atherton v. Atherton, 181 U. S. 155 (1901); see Haddock v. Haddock, 201 U. S. 562, 630 (1906); Beale, *Haddock Revisited* (1926) 39 HARV. L. REV. 417, 418.

3. Barber v. Barber, 21 How. 582 (U. S. 1858); Cheever v. Wilson, 9 Wall. 108 (U. S. 1869); Harding v. Harding 198 U. S. 317 (1905). The plaintiff must be domiciled within the state granting the decree. Cheely v. Clayton, 110 U. S. 701 (1884); Bell v. Bell, 181

ferent jurisdictions and the defendant spouse does not appear, there is some conflict as to the extent of a court's dominion over the marriage. Since an action for divorce is regarded as a suit quasi in rem, practically all courts grant a divorce to a petitioner domiciled within the state upon constructive service of the defendant spouse who is otherwise not subject to the jurisdiction of the court. Divorces thus secured are generally recognized by other states. But a few states, either because of different findings of fact, more rigorous moral standards or other reasons, sometimes refuse to recognize a divorce rendered by a sister state in such circumstances.[4] Thus where a wife has left her husband in New York, established a separate home in Ohio, and there secured an ex parte divorce valid in that state and most other states, such a divorce will not affect the marital status of the parties in New York. The latter state will consider the subsequent marriage of either spouse a meretricious relationship devoid of all the legal attributes of marriage.[5] Children born from such a marriage will be considered legitimate in perhaps all states other than New York where they will not be eligible to take as heirs of their natural fathers.[6]

In order to remedy these conditions which have been a source of indignation for both commentators and judges,[7] the American Law Institute's Restatement of the Conflict of Laws has offered a uniform rule.[8] The theory underlying this rule is that if a divorce be granted only under conditions which will entitle it to recognition everywhere, uniformity will be achieved. Its formula therefore states that a court shall have jurisdiction to grant an ex parte divorce when the plaintiff was justified in leaving the defendant spouse because of that spouse's misconduct, and has established a permanent residence in the state whose authority he or she invokes; and if these conditions be fulfilled, the di-

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U. S. 175 (1901); Streitwolf v. Streitwolf, 181 U. S. 179 (1901); Andrews v. Andrews, 188 U. S. 14 (1903); German Savings and Loan Society v. Dormitzer, 192 U. S. 125 (1904). Domicil is defined as residence within a particular state without present intention to leave. See Williamson v. Osenton, 232 U. S. 619, 24 (1914); Comment (1928) 37 YALE L. J. 649.

4. Borden v. Fitch, 15 Johns. 121 (N. Y. 1818); People v. Baker, 76 N. Y. 78 (1879); Williams v. Williams, 130 N. Y. 193, 29 N. E. 98 (1891); Winston v. Winston, 165 N. Y. 553, 59 N. E. 273 (1901); Olmsted v. Olmsted, 190 N. Y. 458, 83 N. E. 569 (1908); Fischer v. Fischer, 254 N. Y. 463, 173 N. E. 680 (1930); People v. Karlsloe, 1 App. Div. 571, 37 N. Y. Supp. 481 (1st Dep't, 1896); McGown v. McGown, 19 App. Div. 368, 53 N. Y. Supp. 1108 (1st Dep't, 1898); cf. Hubbard v. Hubbard, 228 N. Y. 81, 126 N. E. 508 (1920); see Rigney v. Rigney, 127 N. Y. 408, 412, 28 N. E. 405, 406 (1891); Matter of Haffner, 254 N. Y. 238, 172 N. E. 483 (1930). For other states following such a view, see note 35, *infra*.

5. People v. Baker; Winston v. Winston, both *supra* note 4; Kaiser v. Kaiser, 192 App. Div. 400, 182 N. Y. Supp. 709 (1st Dep't, 1920), aff'd, 233 N. Y. 524, 135 N. E. 902 (1922); cf. In re Degaramo's Estate, 86 Hun 390, 33 N. Y. Supp. 502 (4th Dep't, 1895).

6. Olmsted v. Olmsted, 190 N. Y. 458, 83 N. E. 569 (1908); Matter of Caltabellotta, 183 App. Div. 253, 171 N. Y. Supp. 82 (4th Dep't, 1918).

7. Goodrich, *Matrimonial Domicil* (1917) 27 YALE L. J. 49, 65; Greene, *The Enforcement of a Foreign Divorce Decree in New York* (1926) 11 CORN. L. Q. 141; McClintock, *Fault as an Element of Divorce Jurisdiction* (1928) 37 YALE L. J. 564; (1920) 5 CORN. L. Q. 174, 6.

8. See Beale, *supra* note 2.

vorce shall be entitled to recognition in all other states under the full faith and credit clause of the Constitution.[9] It follows from this formula that the marital status of both spouses will be the same in all states. To achieve this end, however, it would sometimes be necessary that the Supreme Court should independently determine which of two diverse state decisions is correct. Thus where both parties have been granted divorces in different jurisdictions, and each court has found the other party to be guilty of misconduct, the spouse who received the first decree could claim protection under the full faith and credit clause, and an independent finding of fact would be necessary to determine which decree was valid, which invalid.[10]

The doctrine suggested by the Restatement has received no support from the Supreme Court since the Court has never taken this first step, namely to determine independently the conflicting findings of state courts. In *Haddock v. Haddock*,[11] which has been offered in support of this part of the Restatement,[12] the spouses separated immediately after the marriage in New York without ever establishing a matrimonial domicil.[13] Shortly thereafter the husband settled in Connecticut, where, after a few years of residence, he was granted a divorce on the ground of his wife's desertion. Since the defendant was in New York and not under the jurisdiction of the Connecticut court, she was served constructively through publication and by mail addressed to her last known address. Twenty-six years later, she brought suit in New York for separation and alimony. The husband pleaded the Connecticut decree in bar to the action, but the New York court refused to admit the evidence and held for the plaintiff. Appeal was taken to the United States Supreme Court which held, by a vote of five to four, that although the decision of the Connecticut court might be valid there, if need not be recognized in New York. Mr. Justice White, writing for the majority, apparently proceeded on the theory that the husband had deserted the wife, as found by the New York court.[14] There is, however, nothing to indicate that the Supreme Court made an independent finding of the facts. The majority does not claim to have done so. According to the record of the New York court and the statement of facts in the Supreme Court, the husband admitted only that he and his former wife had separated;[15] and Mr. Justice Brown notes in his dissenting opinion that "the testimony leaves it doubtful whether it was a case of abandonment or separation by mutual consent."[16] Consequently it is reasonably certain

9. § 119. The Restatement also states that a spouse may get a valid ex parte divorce if the other consented to the establishment of a separate home. There is no authority therefor, but a contrary dictum based on the old rule in regard to a wife's right to a separate domicil. Barber v. Barber, 21 How. 582, 595 (U. S. 1858); Haddock v. Haddock, 201 U. S. 562, 571 (1906).

10. In view of Beale's article, *supra* note 2, such an intepretation of the Restatement seems to be the only plausible one.

11. 201 U. S. 562 (1906).

12. See Beale, *supra* note 2.

13. 201 U. S. 562 at 606.

14. Id. at 577; McClintock, *supra* note 7, at 565.

15. 201 U. S. 562, at 562, 566.

16. Id. at 625.

that the Court did not independently decide the question of either party's misconduct.[17] If it be assumed therefore, that the Supreme Court thought it at all necessary to consider the fault of the spouses in order to determine which spouse retained the marital res and could have it adjudicated, the Court must have held merely that the New York finding of fact shall govern in determining whether New York need recognize the Connecticut decree. Were the contrary assumed, namely that the Supreme Court's own finding of fact was the basis of jurisdiction, it would have been necessary for the Court to declare the Connecticut decree invalid, because the plaintiff therein, being the party at fault, could not carry with him the marital "res," and could not give the Connecticut court jurisdiction to dissolve the marriage. But the Court specifically denied such a conclusion and inferentially admitted the validity of that decree in Connecticut.[18]

Atherton v. Atherton,[19] affirmed in *Haddock v. Haddock*, and later in *Thompson v. Thompson*,[20] further indicates that the fault resulting in the separation of the parties has never been determined by the Court. In that case, New York found that the wife who had been domiciled with her husband in Kentucky left him because of his cruelty, and established a bona fide domicil in New York. It accordingly refused recognition to an ex parte decree secured by the husband in Kentucky on the ground of her desertion. Despite the finding of the New York court, which was not denied, the Supreme Court held the Kentucky decree entitled to full faith and credit. It is obvious that if the Court had thought it necessary to determine which party's misconduct justified desertion by the other, the findings of the New York court could not have been ignored. Consequently, the Court did not attempt to settle the controversy in regard to jurisdiction by appealing to the facts themselves.[21] Unless this opinion, therefore, be held completely irreconcilable with *Haddock v. Haddock* that case cannot be interpreted to support the Restatement, which requires an independent review of the facts.[22]

It is very doubtful, moreover, whether misconduct necessary to justify separation is a jurisdictional fact which state courts must determine before granting an ex parte divorce, or deny in refusing recognition to such a decree of a sister state. The theory that fault is of relevance receives somewhat doubtful support from a few cases which were decided under the old common law rule

17. McClintock, *supra* note 7, at 566.

18. 201 U. S. 562, at 569, 572. The court cites Maynard v. Hill, 125 U. S. 190 (1888). See also the opinion of Mr. Justice Holmes in Haddock v. Haddock, 201 U. S. 562 at 629, 630. Beale would have this dictum overruled. Beale, *supra* note 2, at 420. For other discussions note Schofield, *The Doctrine of Haddock v. Haddock* (1906) 1 ILL. L. REV. 219; Peaslee, *Ex Parte Divorce* (1915) 28 HARV. L. REV. 457, 466; Note (1917) 2 CORN. L. Q. 335.

19. 181 U. S. 155 (1901).

20. 226 U. S. 551 (1913).

21. In fact the court clearly states that the Kentucky findings preclude the wife "from asserting that she left him on account of his cruel treatment." 181 U. S. 155, at 173. See Holmes, J. in Haddock v. Haddock, 201 U. S. 502, at 629.

22. There can be no doubt that the *Haddock* case overruled the premises on which the *Atherton* case was decided.

that by marriage, husband and wife became one person at law, and his domicil was also hers. In order to overcome this doctrine, a wife was permitted to establish a separate domicil for the purpose of suing for divorce when her husband's misconduct justified a separation.[23] But the present necessity of such proof of fault for a wife to have a separate domicil is most likely unnecessary in view of the decisions of some state courts,[24] and *Williamson v. Osenton*,[25] decided in 1914, in which Mr. Justice Holmes declared the notion that the wife's domicil was prima facie that of her husband's was an antiquated fiction which had lost its justification in fact. There the Court permitted a wife to acquire a separate domicil in a different state for the purpose of civil suit, before she had been granted a divorce. Moreover, the contrary view, that fault is a jurisdictional fact, is definitely opposed to the Supreme Court's decision of *Maynard v. Hill*.[26] In that case the allegations of the plaintiff, suing in the Oregon Court, declared that the husband, who received a divorce from the legislature of the territory of Oregon without any stated finding of fault, had deserted his wife in another state. A demurrer to the complaint was upheld by the territorial and Supreme Courts, and the attempt to impeach the divorce was unsuccessful. Since this decision obviates the possibility of attacking a divorce within the state granted, on the grounds suggested by the Restatement, the only other possibility is that the Supreme Court will require a state court substantially to deny the findings of fault made in favor of the plaintiff by a sister state, in order to refuse recognition to an ex parte divorce.[27]

The Court's position is best described, therefore, either as ignoring fault as an element of jurisdiction, or merely indicating when the courts may be guided by their own determinations of fact and principles of comity. Under these assumptions, the law is that where plaintiff was domiciled within the state and the defendant was not personally served and did not appear, the divorce is good in the state rendered. If that state also be the last one in which the parties were domiciled together, such a divorce is entitled to full faith and credit. And finally when the parties have both received divorces, the first of which was in a state other than the marital domicil, each state may rest on its own findings. Slight reflection moreover will lead one to conclude that the Supreme Court will continue its policy. Administrative difficulties, economy of time, the present interests of the court, and the impossibility of judging facts many years after they have occurred, will and should prevent the court from

23. Barber v. Barber, 21 How. 582 (U. S. 1858); Cheever v. Wilson, 9 Wall. 108 (U. S. 1869); Vischer v. Vischer, 12 Barb. 640 (N. Y. 1851); Beale, *supra* note 2, at 418, 424.

24. In Haddock v. Haddock, 201 U. S. 562, 630 (1906), Holmes, J., notes that the idea of a wife having a separate domicil from her husband is modern, and that she most likely has the same rights to domicil and divorce as her husband. Cf. Matter of Daggett, 255 N. Y. 243, 174 N. E. 641 (1931); see McClintock, *supra* note 7, at 570; articles cited in LORENZEN, CASES ON THE CONFLICT OF LAWS (1932) 687.

25. 232 U. S. 619 (1914).

26. 125 U. S. 190 (1888).

27 But even this seems highly improbable in view of *Maynard v. Hill*, which is at least partially opposed to such a course in that it regards the question of fault as irrelevant. See also discussion in the *Haddock* case, at 611.

ever assuming the task of untangling the complexities of marital disputes.[28] Furthermore, it would be necessary for the court to define its standards of fault, which it cannot do without slighting the moral precepts of some one jurisdiction.[29] As long as the Court, however, continues its present stand in regard to examining facts and requiring fault as an element of jurisdiction—and the fact that it has not decided a divorce case for twenty years is further evidence that it will—each state may do what it pleases with the exception of the situations in which the facts are those of *Atherton v. Atherton*,[30] where an ex parte decree secured by a husband in the state in which he and his wife had lived previous to their separation was held entitled to full faith and credit.

Similarly, with the exception of two states,[31] the rule suggested by the American Law Institute receives no support from the decisions of state courts. The majority of the states, following a rule approved by early treatises[32] and in *Atherton v. Atherton*, recognize as valid the ex parte decrees of sister states provided only that the plaintiff was domiciled in the state granting the divorce.[33] And in passing upon the question of domicil, the question of fault is of no consequence to these courts for the purpose of recognizing a divorce decree.[34] Thus it is possible for a spouse to leave the state of matrimonial domicil, establish elsewhere a bona fide residence, and there receive a decree which will receive recognition in the first state without a re-examination of fault. The result in such states is a uniformity generally thought highly desirable.

On the other hand the minority rule,[35] exemplified by New York, although contrary in attitude and result to the majority, also disregards fault as a jurisdictional fact. The higher appellate courts of New York have never recognized

28. In fact the Court has refused to determine which of two state courts had properly decided the question of plaintiff's domicil when the second court refused recognition to the divorce of the first court on the ground that the plaintiff had not established a bona fide domicil. Holmes, J., said in German Savings and Loan Society v. Dormitzer, 192 U. S. 125, 128 (1904), that if Washington had attempted to impeach the jurisdiction of the Kansas Court without evidence, such an evasion would not be upheld.

29. See McClintock, *supra* note 7, at 572 et seq.

30. Greene, *supra* note 7, at 158, points out that *Haddock v. Haddock* did not change the New York rule at all, contrary to the belief of Beale. See also McClintock, *supra* note 7, at 566.

31. Montmorency v. Montmorency 139 S. W. 1168 (Tex. 1911); cf. Perkins v. Perkins 225 Mass. 82, 87, 113 N. E. 841, 843 (1916). There has been no change in the policy of most states since *Haddock v. Haddock*. Kansas enacted a law recognizing all divorces. McCormick v. McCormick, 82 Kan. 31, 107 Pac. 546 (1910).

32. See Beale, *supra* note 2, at 419; McClintock, *supra* note 7.

33. See Peaslee, *supra* note 18, at 459; McClintock, *supra* note 7, at 571; note (1913) 11 MICH. L. REV. 508.

34. On the other hand, Nevada, Arkansas and Idaho grant divorces without discrimination. See particularly Squire v. Squire, 186 Ark. 511, 54 S. W. (2d) 281 (1932). For a good discussion of the method of obtaining a divorce in Reno, see Note (1933) 17 MINN. L. REV. 638.

35. The minority states are generally held to include North Carolina, South Carolina, Pennsylvania and New York. Peaslee, *supra* note 18, at 459; Beale, *supra* note 2, at 428.

an ex parte decree when the defendant was domiciled in New York at the time the divorce was granted unless the facts were exactly those of *Atherton v. Atherton*.[36] Some of the cases ignore the question of fault or innocence of the plaintiff in the first suit, and the facts stated do not make it possible to decide.[37] Others state facts sufficient to prove that the plaintiff was justified in leaving the other spouse, that he or she established a bona fide domicil in another state, and that a divorce was granted by a court of competent jurisdiction.[38] The Appellate Division has refused recognition even where the wife was held justified in leaving her husband in New York because of his misconduct, and the divorce procured in the state where she had established her domicil was granted on the grounds of adultery.[39] The stringency of this policy is subject to limitation in that only a few persons are permitted to attack the validity of a foreign decree.[40] Beyond that, a few hesitant dicta form the sole basis of

36. In the following cases the facts were exactly those of *Atherton v. Atherton*. Hammond v. Hammond, 103 App. Div. 437, 93 N. Y. Supp. 1 (1st Dep't, 1901); Hall v. Hall 139 App. Div. 120, 123 N. Y. Supp. 1056 (1st Dep't, 1910); Post v. Post, 149 App. Div. 452, 133 N. Y. Supp. 1057 (1st Dep't, 1912), aff'd, 210 N. Y. 607, 104 N. E. 1139 (1914); Schenker v. Schenker, 181 App. Div. 621, 169 N. Y. Supp. 35 (1st Dep't, 1918), aff'd, 228 N. Y. 600, 127 N. E. 921 (1920).

In the following cases although the defendant was said to be in New York, the domicil remained in the state which granted the divorce. Hunt v. Hunt, 72 N. Y. 217 (1878); In re Denick's Estate 92 Hun. 161, 36 N. Y. Supp. 518 (4th Dep't, 1895).

If the defendant was domiciled in a state other than New York, but one which would not recognize the divorce, New York will not recognize it. Ball v. Cross, 231 N. Y. 329, 132 N. E. 106 (1921); Dean v. Dean, 241 N. Y. 240, 149 N. E. 844 (1925); Matter of Caltabellotta, 183 App. Div. 753, 171 N. Y. Supp. 82 (4th Dep't, 1918); cf. Percival v. Percival, 106 App. Div. 111, 94 N. Y. Supp. 909 (2d Dep't, 1905), aff'd, 186 N. Y. 587, 79 N. E. 1114 (1906). But cf. Matter of Morrison, 52 Hun. 102, 5 N. Y. Supp. 90 (1st Dep't, 1889), aff'd, 117 N. Y. 638 (1889), 22 N. E. 1130. *Contra:* North v. North, 47 Misc. 180, 93 N. Y. Supp. 512 (1905), aff'd, 111 App. Div. 921, 96 N. Y. Supp. 1138 (2nd Dep't, 1906). This case was decided after *Atherton v. Atherton,* and before *Haddock v. Haddock*. It may be considered as overruled today by the *Haddock* case.

In *Atherton v. Atherton* it is noted that the New York view considered a divorce an action in personam to the extent that the defendant must appear in order that the divorce bind the defendant. 181 U. S. 155, 170 (1901). See also Thurber, *Foreign Divorce Decrees in New York* (1907) 10 BENCH AND BAR 82, 86 et seq.; Greene, *supra* note 7.

37. Cross v. Cross, 108 N. Y. 628, 15 N. E. 333 (1888); Starbuck v. Starbuck, 173 N. Y. 503, 66 N. E. 193 (1903); Ackerman v. Ackerman, 200 N. Y. 72, 93 N. E. 192 (1910); Kaiser v. Kaiser, 192 App. Div. 400, 182 N. Y. Supp. 709 (1st Dep't, 1920), aff'd, 233 N. Y. 524, 135 N. E. 902 (1922); Vischer v. Vischer, 12 Barb. 640 (N. Y. 1851); In re Degaramo, 86 Hun. 393, 33 N. Y. Supp. 502 (4th Dep't, 1895); Bailie v. Bailie, 30 App. Div. 461, 52 N. Y. Supp. 228 (1st Dep't, 1898); Tysen v. Tysen, 140 App. Div. 370, 125 N. Y. Supp. 479 (1st Dep't, 1910); Matter of Caltabellotta, 183 App. Div. 753, 171 N. Y. Supp. 82 (4th Dep't, 1918).

38. O'Dea v. O'Dea, 101 N. Y. 23, 4 N. E. 110 (1885); Percival v. Percival 106 App. Div. 111, 94 N. Y. Supp. 909 (2nd Dep't, 1905), aff'd, 186 N. Y. 587, 79 N. E. 1114 (1906); Berney v. Adriance, 157 App. Div. 628, 142 N. Y. Supp. 748 (1st Dep't, 1913); Gilson v. Airg, 181 App. Div. 761, 169 N. Y. Supp. 242 (1st Dep't, 1918).

39. Ransom v. Ransom, 125 App. Div. 915, 109 N. Y. Supp. 1143 (1st Dep't, 1908).

40. See Kelsey v. Kelsey, 237 N. Y. 520, 143 N. E. 726 (1927).

One who gets a divorce will not be heard to attack its validity. Starbuck v. Starbuck,

the belief that New York will in the future change its well established position.[41]

Nor is it apparent that courts ought to change their present positions in regard to fault, or that such a change would create greater uniformity. Under the majority rule the divorce of a sister state is recognized unless the plaintiff was not domiciled within the state which granted the decree. Therefore unless the plaintiff's domicil can be effectively attacked, the marital status of both parties remains the same in all jurisdictions when the defendant is domiciled within a state following the majority rule. The Restatement, however, urges that misconduct be considered a jurisdictional fact which other states may review, and thereby adds to the number of elements on which two courts may differ. An obvious difficulty with such an attempt to obtain uniformity is that the courts may decide the facts of a particular case differently especially when neither, as is sometimes the case, has both spouses before it. Moreover the use of the word "misconduct" without definition in the Restatement cannot overcome the conflict which would result from the different views held as to what facts are necessary to justify one spouse in leaving the other. Greater uncertainty and decreased uniformity would thus be the probable consequence of its adoption.[42] It is said that uniformity would be achieved if the Supreme Court settled the criteria of fault, and resolved the contradictory state findings of fact.[43] But that Court has refused to arbitrate in such a fashion in the past; it is moreover undesirable that the Court enter such a controversy, for reasons previously stated, and because definitions of fault are generally so vague as to create further litigation rather than certainty, which is perhaps more desirable than uniformity.

Even if it be assumed that the Restatement would achieve its purpose if

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173 N. Y. 503, 66 N. E. 193 (1903); Brown v. Brown, 242 App. Div. 33, 272 N. Y. Supp. 877 (4th Dep't, 1934); Nathan v. Nathan, 150 Misc. 895, 270 N. Y. Supp. 551 (Sup. Ct. 1933). *Contra:* Todd v. Kerr, 42 Barb. 317 (N. Y. 1864).

If in reliance on a void decree gotten by either spouse, the wife remarries, and later brings an action for separation and alimony, or seeks dower rights from the estate of her second husband, the invalidity of the divorce and the second marriage have been held an adequate defense. Starbuck v. Starbuck, *supra;* Lefferts v. Lefferts, 263 N. Y. 631, 188 N. E. 229 (1933); Fischer v. Fischer, 254 N. Y. 463, 173 N. E. 680 (1930); Bell v. Little, 204 App. Div. 234, 197 N. Y. Supp. 674 (4th Dep't, 1923), aff'd, 237 N. Y. 519, 143 N. E. 726 (1923). If the second husband seeks an annulment on the ground of a previous undissolved marriage of his wife, he must prove that the divorce was void, that the defendant in the suit remained in New York or some other state which would not recognize the decree, that he did not aid the acquisition of such a divorce, and that he was a citizen of New York at the time the divorce was granted. Hubbard v. Hubbard, 228 N. Y. 81, 126 N. E. 508 (1920); Schenker v. Schenker, 181 App. Div. 621, 169 N. Y. Supp. 35 (1st Dep't, 1918); Beischer v. Beischer, 226 App. Div. 454, 235 N. Y. Supp. 652 (4th Dep't, 1929); cf. Ball v. Cross, 231 N. Y. 329, 132 N. E. 106 (1921); Greene, *supra* note 7 at 159 et seq. But cf. O'Dea v. O'Dea, 101 N. Y. 23, 4 N. E. 110 (1885).

41. Dean v. Dean, 241 N. Y. 240, 244, 149 N. E. 844, 845 (1925); Lefferts v. Lefferts, 263 N. Y. 131, 135, 188 N. E. 279, 280 (1933).

42. McClintock, *supra* note 7, at 572 et seq.

43. Beale, *supra* note 2.

adopted, it is worth considering whether a state following a view such as New York should be swayed by the advantages of uniformity. The justification generally urged in favor of uniformity is that bastardy and adultery by operation of law, a result frequently reached under the New York rule, are unfortunate conditions, and therefore should be eliminated. No doubt unnecessary and hardly justifiable injury has been inflicted by the decisions of New York and other states who refuse recognition to ex parte divorces.[44] Yet if once the emotional and moral aura be removed from words such as bastardy and adultery much of the criticism of their position loses its cogency. The problem in many cases becomes one of interest in decedent estates. Since the law at least in New York is almost always predictable, some of the difficulty created when a wife is refused dower,[45] and children the right to take as heirs of their natural fathers[46] may be avoided by will or antenuptial agreements. Some effects of non-recognition still remain; a prior wife of the decedent spouse can assert her right of dower in New York property.[47] The evil, however, of such a claim by a wife who never defended against the action for divorce by the decedent, is not easily demonstrated. Some inequity still exists when the husband of a second marriage is allowed to have the marriage annulled because of the invalid divorce of his wife. Yet such actions have been curtailed by the courts which refuse the second husband the right to attack the decree of his wife in the absence of certain conditions.[40]

The basis of the Institute's Restatement, and the theory of the English and American law of divorce recognition has been that the state of domicil has a paramount interest in the marital status because the state must protect the morals of its people.[48] When two states acquire an interest in the same marriage, the problem has been one of division of interest, and all criticisms of the New York attitude and of *Haddock v. Haddock* have proceeded on the theory that these views do not conform to the proper laws of division expressed by the legal concepts of domicil and an action in rem.[49] The consequences have been thought to be socially undesirable because, among other reasons, proper respect is not given to the interest of states in the status of a marriage which according to the precepts of the conflict of laws has its situs within a particular state.[50] However there is no moral necessity in such a position; nor is it at all certain that morality and civilization would be affected if a different theory were ac-

44. People v. Baker, 76 N. Y. 78 (1879); Berney v. Adriance, 157 App. Div. 628, 142 N. Y. Supp. 748 (1st Dep't, 1913).

45. Kerr v. Kerr, 41 N. Y. 272 (1869); Matter of Kimball, 155 N. Y. 62, 49 N. E. 331 (1898); Bell v. Little, 204 App. Div. 234, 197 N. Y. Supp. 674 (1st Dep't, 1923), aff'd, 237 N. Y. 519, 143 N. E. 726.

46. Baylis v. Baylis, 207 N. Y. 446, 101 N. E. 176 (1913).

47. Kerr v. Kerr, 41 N. Y. 272 (1869).

48. GOODRICH, CONFLICT OF LAWS (1927) § 122; Beale, *supra* note 2, at 424 et seq.

49. GOODRICH, op. cit. *supra* note 48, § 127; Beale, *Constitutional Protection of Decrees for Divorce* (1906) 19 HARV. L. REV. 586; Greene, *supra* note 7; Harper, *The Validity of Void Divorces* (1930) 79 U. OF PA. L. REV. 158.

50. Beale, *supra* note 49; Goodrich, *Matrimonial Domicil* (1917) 27 YALE L. J. 49; Peaslee, *supra* note 18.

cepted. It is said that in Roman Law divorce was a personal action.[51] And New York, considered a particularly severe state in regard to the recognition of ex parte divorces, has never declared as invalid the decree of a sister state where both parties appeared, even though they were both domiciled in New York.[52] Certainly both these views ignore the theory of state interest, but they have not been shown to be unethical or contrary to the best interests of society.

In order better to determine whether any of the variety of theories is superior, much more than criticism based on legal concepts and doubtful hypotheses in regard to the importance of state interest is necessary.[53] Whether any rule which recognizes divorces gotten without the knowledge of the defendant is better than one which requires the presence of both parties, cannot be determined on the basis of a few decisions. It may well be that general recognition of ex parte divorces under the majority rule, or the more limited recognition under the rule of the Restatement, is socially superior although in some cases the absent party is deprived of an opportunity to defend. On the other hand, perhaps New York's general refusal to recognize foreign divorces unless both parties appear is superior in terms of social consequences despite the fact that it ignores the concept of domicil and occasionally produces unfortunate results. Neither of these problems are easily settled, but intelligent criticism cannot be made by evaluating particular views in terms of uncriticised legal premises. For successful evaluation, statistics describing social fact are necessary, since cases reaching appellate courts hardly mirror the actual problem.[53] In the absence

51 GOODRICH, loc. cit. *supra* note 48. Beale has pointed out that countries governed by Roman-Dutch law have no requirement of domicil. Beale, *supra* note 49, at 589.

52. Gould v. Gould, 235 N. Y. 14, 138 N. E. 490 (1923), considered the leading case, held that the plaintiff need not be domiciled in the state which granted the decree. This case, however, was not as unusual as it was generally thought to be. A decree granted by a foreign state in which neither party was domiciled was recognized in Kinnier v. Kinnier, 45 N. Y. 535 (1871), on the theory that full faith and credit must be given to such decrees. See Jones v. Jones, 108 N. Y. 415, 15 N. E. 707 (1888); Strauss v. Strauss, 122 App. Div. 729, 107 N. Y. Supp. 842 (1st Dep't, 1907); Rupp v. Rupp, 156 App. Div. 389, 141 N. Y. Supp. 484 (2nd Dep't, 1913); Tiedemann v. Tiedemann, 172 App. Div. 819, 150 N. Y. Supp. 851 (1st Dep't, 1916). More recent decisions have sometimes disregarded the question of recognition, but have not permitted the divorce to be attacked. Guggenheim v. Wahl, 203 N. Y. 390, 96 N. E. 726 (1911); Scheinwald v. Scheinwald, 231 App. Div. 757, 246 N. Y. Supp. 33 (2nd Dep't, 1930); Schneider v. Schneider, 232 App. Div. 711, 249 N. Y. Supp. 131 (2nd Dep't, 1931); Matter of Pratt, 233 App. Div. 200, 251 N. Y. Supp. 424 (4th Dep't, 1931); Borenstein v. Borenstein, 151 Misc. 160, 20 N. Y. Supp. 688 (Sup. Ct. 1934). However the concept of domicil has been used in New York to declare an ex parte decree void. Kerr v. Kerr, 41 N. Y. 272 (1869); Hoffman v. Hoffman, 46 N. Y. 30; Winston v. Winston, 165 N. Y. 553, 59 N. E. 273 (1901); Lefferts v. Lefferts, 263 N. Y. 131, 188 N. E. 279 (1933). See Greene, *supra* note 7; Harper, *supra* note 49, at 166, 176; Thurber, *supra* note 36.

53. The beginnings of more realistic attitude will be found in MARSHALL AND MAY, THE DIVORCE COURT (1932-1933).

of adequate knowledge, all ethical and quasi-ethical criticism is ineffectual.[54]

MOTIONS FOR BONDHOLDERS' LISTS IN NEW YORK

The restrictive covenants[1] which are almost universally present in corporate indentures under which corporate bonds have been issued and sold to the public have made the stockholder the watch-dog of the corporate treasury. The bondholder's interest in corporate affairs is expressible, ordinarily, only through the trustee of the indenture, his recognized agent. But when reorganization of the corporation becomes necessary the individual bondholder must be consulted.[2] Such necessary consultation usually commences with a newspaper announcement of the formation of a "Bondholders' Protective Committee" with which all bondholders are urged to deposit their bonds. Shortly thereafter the committee announces a "Plan of Reorganization" and the consultation has ended, to be reopened only if the bondholders have among their number a litigiously-minded individual. His efforts to organize an opposition "Bondholders' Committee" and to promulgate a counter "Plan of Reorganization" require, however, a knowledge of the identity of the bondholders; they must be circularized and persuaded to join the opposition committee and to withdraw the bonds previously deposited. But the right of a bondholder to secure the names and addresses of his fellow bondholders is by no means certain to be conceded by the courts. The cases in the courts of New

54. See HOLMES, COLLECTED LEGAL PAPERS (1921) 187: "For the rational study of the law the black-letter man may be the man of the present, but the man of the future is the man of statistics and the master of economics. It is revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV. It is still more revolting if the grounds upon which it was laid down have vanished long since, and the rule simply persists from blind imitation of the past."

For a sharp criticism of those who would tell us what ought to be on the basis of some logical demonstration see 1 CHARLES S. PEIRCE, COLLECTED PAPERS (1932) 339 et seq. It is unfortunate that modern legal criticism, even by "Realists," shows little recognition of Peirce's analysis.

For a discussion of some of the methodologic problems raised by the approach taken here, see Cook, *The Logical and Legal Bases of the Conflict of Laws* (1924) 33 YALE L. J. 457, and the articles and treatises cited therein.

A knowledge of social fact is a necessary condition; but is not to be mistaken for a sufficient condition.

1. A usual covenant prevents suit on the indenture or on the bond by an individual bondholder unless the holders and owners of twenty-five percent of the outstanding bonds have requested the trustee of the indenture to sue and the request has been refused. Such covenants generally have been strictly enforced. Lidgerwood v. Hale & Kilburn Corp., 47 F. (2d) 318 (S. D. N. Y., 1930); Batchelder v. Council Grove Water Co., 131 N. Y. 42, 29 N. E. 801 (1892); Greene v. New York United Hotels, Inc., 236 App. Div. 647, 260 N. Y. Supp. 405 (1st Dep't, 1932).

2. Reorganizations are usually effected by reducing the interest on the bonds and by altering the sinking fund requirements, or by otherwise affecting the original contract between the bondholder and the debtor corporation.

York[3] illustrate the absence of established doctrine which makes this right a doubtful one indeed. The New York Appellate Division[4] has upheld both the grant[5] and the denial[6] of the right, but in so doing has rendered no opinions to guide the determination of the circumstances under which a bondholders' list may be obtained. Similarly, the decisions below which have not been appealed are of little assistance; motions for bondholders' lists[7] have been granted[8] and denied[9] on almost identical facts. Indeed, this uncertainty has caused resort, in the S. W. Strauss & Co. litigations, to the appointment of a receiver or referee with access to the list of bondholders as a means by

3. The reported cases seem to be confined to New York although there probably are unreported cases in other jurisdictions. Only one case was found reported elsewhere. Firebaugh v. Traff, 353 Ill. 82, 186 N. E. 526 (1933).

4. With exception of the Appellate Division decisions, most of the cases herein discussed are unreported.

5. Bergelt v. Roberts, 144 Misc. 832, 258 N. Y. Supp. 905 (Sup. Ct. 1932) aff'd 235 App. Div. 777, 258 N. Y. Supp. 1086 (1st Dep't, 1932); discussed in (1932) 32 COL. L. REV. 1435; (1932) 19 VA. L. REV. 517; (1933) 46 HARV. L. REV. 713; (1933) 42 YALE L. J. 984. Hartford v. Commonwealth Bond Corporation, Levy, J., Spec. I, N. Y. Co., June 20, 1932, aff'd 236 App. Div. 776, 258 N. Y. Supp. 1026 (1st Dep't, 1932); Bank of Manhattan Trust Co. v. Silrap Construction Co., 238 App. Div. 801, 263 N. Y. Supp. 367 (2d Dep't, 1933). The presiding justice of the First Department recently intimated to counsel that the order granting a bondholders' list in Marx v. Merchants' National Properties, Inc., Valente, J., Spec. I, N. Y. Co., May 18, 1933, would be affirmed on appeal and counsel for the defendants therefore abandoned the appeal and complied with the order.

6. Sullivan v. St. Louis-San Francisco Ry., Cohn, J., Spec. I, N. Y. Co. Dec. 12, 1932, aff'd 238 App. Div. 826, 262 N. Y. Supp. 967 (1st Dep't, 1933) (motion to compel an admission of possession of a bondholders' list, but treated by the court and counsel as a motion for the list itself).

7. Motions under the authority of Section 328 of the New York Civil Practice Act to compel an admission of possession of a bondholders' list and a disclosure of the person to whom the list has been furnished may be treated as motions for the list itself. Prior to the enactment of the Civil Practice Act the admission of the fact of possession or control of documents was a necessary prerequisite for an order requiring their production. King v. Leighton, 58 N. Y. 383 (1874).

8. Adler v. S. W. Straus & Co. Inc., Black, J., Spec. I, N. Y. Co., N. Y. L. J. Aug. 8, 1932, at 480, col. 4 (motion to compel admission of possession of a bondholders' list); Sun Life Insurance Co. v. S. W. Straus & Co. Inc., N. Y. L. J., Sept. 21, 1932, at 1039, cols. 3-5; Marx v. Merchants' National Properties, Inc., Valente, J., Spec. I, N. Y. Co., May 18, 1933 [the motion had previously been denied by Frankenthaler, J., 148 Misc. 6, 265 N. Y. Supp. 163 (Sup. Ct. 1933)]; Continental Bank & Trust Co. v. Webster Investing Corp., Walsh, J., Spec. I, N. Y. Co., June 6, 1933; People, etc. v. S. W. Straus & Co. Inc., Lockwood, J., Add'l Spec. I, Kings Co., Jan. 15, 1934 (Roosevelt Committee).

A motion to restrain the use of a bondholders' list was granted in Cohen v. S. W. Straus & Co. Inc., Collins, J., Spec. I, N. Y. Co., Aug. 4, 1932 [accompanied by the opinion reported as Bergelt v. Roberts, 144 Misc. 832, 258 N. Y. Supp. 905 (Sup. Ct. 1932)].

9. Industrial & Realty Finance Corp. v. S. W. Straus & Co. Inc., Walsh, J., Spec. I, N. Y. Co., July 1, 1932 (motion to restrain use of list); Silverman v. S. W. Straus & Co. Inc., Schmuck, J., Spec. I, N. Y. Co., July 30, 1932; Empire Trust Co. v. Bim's

which the complaining bondholder may reach his fellow investors under the supervision of the court.[10]

Contemplated corporate reorganizations are responsible for all the reported applications for bondholders' lists. The dissatisfied bondholder usually has only a small investment in the corporation but is represented by a vigilant and diligent attorney.[11] He complains,[12] in the reported cases, that the bankers[13] for the debtor corporation, or the officers and directors of the debtor corporation, have organized a hand-picked "Bondholders' Protective Committee"[14] for the purpose of protecting not the bondholders but themselves

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Realty Corp., Dunne, J., Spec. I, Queens Co., N. Y. L. J. Nov. 23, 1932, at 2323, cols. 3, 4; Block v. Pierce, Butler & Pierce Manufacturing Co., Carew, J., Spec. I, N. Y. Co., March 22, 1933; O'Connell v. Stanley, Frankenthaler, J., Spec. I, N. Y. Co., May 5, 1933; Marx v. Merchants National Properties, Inc., 148 Misc. 6, 265 N. Y. Supp. 163 (Sup. Ct. 1933) (the motion was however subsequently granted by Valente, J., Spec. I, N. Y. Co. May 18, 1933). A Federal court sitting in New York has similarly held. In re International Match Corp., 59 F. (2d) 1012 (S. D. N. Y. 1932) discussed in (1932) 32 COL. L. REV. 1435; (1933) 46 HARV. L. REV. 713; (1933) 42 YALE L. J. 984.

10. Harrigan v. Pounds, 147 Misc. 666, 264 N. Y. Supp. 363 (Sup. Ct. 1933), rev'd on other grounds 239 App. Div. 1, 265 N. Y. Supp. 676 (1st Dep't, 1933), noted in (1933) 43 Yale L. J. 330; People etc. v. S. W. Straus & Co. Inc., Lockwood, J., Spec. I, Kings Co., June 3, 1933 (Butler Hall); People v. S. W. Straus & Co., Inc., 149 Misc. 38, 267 N. Y. Supp. 227 (Sup. Ct. 1933) (Spingsley Realty Corp. mortgagor petitioned to have receiver send plan to bondholders); People v. S. W. Straus & Co. Inc., N. Y. L. J. Oct. 27, 1933, p. 1481, cols. 1-5 (Lockwood, J. N. Y. Sup. Ct., Spec. I, Kings Co.) (Two Park Ave. Corp., mortgagor, petitioned to have receiver send plan to bondholders), discussed in (1934) 47 HARV. L. REV. 529; People etc. v. S. W. Straus & Co. Inc., Lockwood, J., N. Y. Sup. Ct., Spec. I, Kings Co., Nov. 16, 1933; People etc. v. S. W. Strauss & Co. Inc., Matter of Pounds et al, Schneider v. S. W. Strauss & Co. Inc., N. Y. L. J. Nov. 23, 1934, at 1980, col. 4. Compare Section 39 of the Bankruptcy Act, 30 STAT. 555 (1898), 11 U. S. C. A. § 67 (1926), and In re International Match Co. 59 F. (2d) 1012, 1013 (S. D. N. Y. 1932) (bankruptcy receiver could obtain bondholders' list from the protective committee).

11. Cf. comment of Commissioner Eastman, "From observation in the past the security holders knew . . . that a fight against reorganization managers behind Wall Street intrenchment is an uphill struggle against heavy odds." Chicago, Milwaukee & St. Paul Reorganization, 131 I. C. C. 673, 703 (1928).

12. Perhaps his "complaint" is manufactured for the purpose of obtaining a bondholders' list since the court will not entertain requests for preliminary relief, such as applications for bondholders' lists, unless made in a pending action.

13. The domination which these bankers of the debtor corporation exercise over its reorganization is rendered absolute by their exclusive profession or ready access to the bondholders' list. See e.g., Lowenthal, *The Railroad Reorganization Act* (1933) 47 HARV. L. REV. 18, 46-48; Carey & Brabner-Smith, *Studies in Realty Mortgage Foreclosures* (1933) 28 ILL. L. REV. 1, 5-7; (1933) 42 YALE L. J. 984.

14. See Harrigan v. Pounds, 147 Misc. 666, 677, 678, 264 N. Y. Supp. 363, 374, 375 (Sup. Ct. 1933) [". . . the fact remains that they (members of the independent Bondholders' Committee) have permitted themselves, as a committee, to become part of a plan which is not for the benefit of the bondholders . . . Whatever, therefore, the gentlemen of this committee may be individually, as a committee they are not independent in any proper sense, but committed in fact, perhaps without being fully aware

alone.[15] He asks that the names and addresses of his fellow investors be made available to him so that he may appraise them of the inequalities of the proposed plan of reorganization and of the self-serving purposes of the so-called "Bondholders' Protective Committee." He is then opposed by distinguished counsel who point with scorn to his small investment and frequently rest their opposition upon variations of the accusation that the litigation is only a strike suit and the complaining bondholder a professional trouble maker.[16] Invariably the motion papers contain the accusations and counter accusations which follow when the "outsider" attacks the "insider." Why a bondholder, even if he owns but a single bond, is considered an "outsider" desirous of "horning in,"[17] apparently has never been answered by those opposing an application for a bondholders' list.

The dissenting bondholder's rights are not, however, formally decided upon those grounds. Nor is it pertinent that access to the list would constitute a publication of the names of the customers of the bankers who originally sold or underwrote the bonds[18] or a disclosure of information by the paying agent of the debtor corporation, in violation of a federal revenue statute.[19] These

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of it, to an inequitable and manipulated scheme."] DEWING, FINANCIAL POLICY OF CORPORATIONS (1926) 955; TRACY, CORPORATE FORECLOSURE, RECEIVERSHIP AND REORGANIZATION (1929) 13: "Such a Committee (Protective Committee) is ordinarily a self appointed body, initiated by the bankers who originally underwrote the issue of bonds, the members being chosen, so far as it is practicable, from the holders of substantial blocks of bonds outstanding".

15. The charge is not peculiar to these times of stress. See United Water Works v. Omaha Water Co., 164 N. Y. 41, 44, 58 N. E. 58, 59 (1900).

16. Counsel for several banks and financial houses make frequent use of a remark attributed to Governor Lehman: "Too often . . . opposition has been inspired by persons who are actuated solely by motives of personal gain and who hope by means of obstruction to force an unfair advantage for themselves." These insinuations have had effect upon the courts. In Bank of Manhattan Trust Co. v. Ellda Corp., 147 Misc. 374, 383, 265 N. Y. Supp. 115, 123 (Sup. Ct. 1933), the court remarked: "While justice is blind, it can still hear, and rumors concerning the activities of minority certificate holders objecting for selfish reasons have grown disturbingly persistent."

17. The Appellate Division brief of the Protective Committee in Hartford v. Commonwealth Bond Corp., 236 App. Div. 776, 258 N. Y. Supp. 1026 (1st Dep't, 1932), says of the order granting a motion for a bondholders' list: " . . . the order is a serious matter for the defendant-appellant Commonwealth Bond Corporation, because it . . . affords the plaintiff information from the defendant's files which it (plaintiff) may use in an endeavor to disrupt a plan of reorganization . . ."

18. Hartford v. Commonwealth Bond Corp., Levy, J., Spec. I, N. Y. Co., June 20, 1932, aff'd 236 App. Div. 776, 258 N. Y. Supp 1026 (1st Dep't, 1932); Silverman v. S. W. Strauss & Co., Inc., Schmuck, J., Spec. I, N. Y. Co., July 30, 1932; cf. People ex rel. Venner v. New York Life Ins. Co., 111 App. Div. 183, 97 N. Y. Supp. 465 (1st Dep't, 1906) (policy holder of mutual life insurance company refused inspection of company files for disclosure of names and addresses of other policy holders because files contained other confidential information).

19. Marx v. Merchants National Properties, Inc., Valente, J., Spec. I, N. Y. Co., May 18, 1933. The paying agent may obtain this information from the ownership certificates which the Internal Revenue Act requires of all who present interest coupons for payment.

arguments, seemingly advanced for lack of meritorious objection, have been entirely disregarded by the courts even when the motion against which they were urged was denied.[20] But the chief inquiry has been directed to finding a right-duty relationship between the petitioning bondholder and the party from whom the list is sought, or to finding sanction therefor in the procedural statutes. Thus where the list was sought from the established Bondholders' Protective Committee or from the trustee of the indenture under which the bonds were originally issued, or his successor, the issue of a fiduciary relationship was raised. The courts have failed to settle the question. The motion to compel the Protective Committee to disclose the bondholders' list to the dissenting bondholder has been granted on the ground that the Committee owed a fiduciary duty to all bondholders[21] and denied on the ground that no duty was owing to persons who had not deposited their bonds with the Committee.[22] The trustee has likewise been charged with a duty of complete disclosure of the information he held[23] and has been absolved from any such duty.[24] The procedural question of relevancy, materiality and necessity in the proof of the moving bondholder's claim against the guarantor of the bonds and the Protective Committee has been decisive in the cases where the list was sought from them; the courts have both found such relevancy, materiality and necessity[25] and have not.[26] Absence of a fiduciary relationship and a lack of relevancy, materiality or necessity have resulted in a denial of all motions thus far directed against the debtor corporation.[27] Subsumed, of course, was the issue of the existence of a duty owed by the

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INCOME TAX REGULATIONS 77, art. 765. Publication of any part of an income tax return or ownership certificate is subject to penalty. 44 STAT. 117 (1926), 26 U. S. C. A. § 1025 (1928). Cf. Rodgers and Groom, *Reorganization of Railroad Corporations Under Section 77 of the Bankruptcy Act* (1933) 33 COL. L. REV. 571, 592, 593. But that the return of a trustee shall be open to inspection by the beneficiary of a trust see INCOME TAX REGULATIONS 77, art. 421.

20. See cases cited in notes 18, 19, *supra.*

21. Bergelt v. Roberts, 144 Misc. 832, 258 N. Y. Supp. 905 (Sup. Ct. 1932) aff'd 236 App. Div. 777, 258 N. Y. Supp. 1086 (1st Dep't, 1932); Hartford v. Commonwealth Bond Corporation, Levy, J., Spec. I, N. Y. Co., June 20, 1932, aff'd 236 App. Div. 776, 258 N. Y. Supp. 1026 (1st Dep't, 1932); Clinton Trust Co. v. 142-144 Joralemon Street Corp., 237 App. Div. 789, 793, 263 N. Y. Supp. 359, 363 (2d Dep't, 1933); (1933) 43 YALE L. J. 330, n. 19.

22. In re International Match Corp., 59 F. (2d) 1012 (S. D. N. Y. 1932); Bank of Manhattan Trust Co. v. Ellda Corp., 147 Misc. 374, 265 N. Y. Supp. 115 (Sup. Ct. 1933).

23. Adler v. S. W. Straus & Co., Inc., N. Y. L. J. Aug 8, 1932, at 480, col. 4.

24. Silverman v. S. W. Straus & Co. Inc., Schmuck, J., Spec. I, N. Y. Co. July 30, 1932; cf. Firebaugh v. Traff, 353 Ill. 82, 186 N. E. 526 (1933).

25. Sun Life Insurance Co. v. S. W. Straus & Co. Inc., N. Y. L. J. Sept. 21, 1932 at 1039, cols. 3-5.

26. Sullivan v. St. Louis, San Francisco Ry., Colin, J., Spec., I, N. Y. Co. Dec. 12, 1932, aff'd 238 App. Div. 826, 262 N. Y. Supp. 967 (1st Dep't, 1933).

27. Ibid. (the motion was to compel the corporation to state whether it had a list); Marx v. Merchants National Properties, Inc., 148 Misc. 6, 265 N. Y. Supp. 163 (Sup. Ct. 1933).

corporation to the bondholder which could be likened to that owed a stockholder, but as coming into being with the bondholder's interest in the reorganization.[28] Yet it is apparent that despite the possible delineation of issues, the success or failure of the motion for a bondholders' list depends upon the ability of the moving party to arouse the sympathies of the judge before whom the motion is heard.[29] Only the manner of presentation of the particular situation and the economic theories of the judge can account for the conflicting decisions on identical facts.[30]

Not only is the bondholder who desires a list of the owners of the corporation bonds at the mercy of judicial discretion, but in order to obtain access to that discretion he must be prepared to face extended and costly litigation.[31] This is in sharp contrast to the position of a stockholder, who may obtain the names and addresses of the other stockholders of the corporation without court order[32] and without disclosing the reason for his interest in the identity of his fellow investors.[33] A judgment creditor of a corporation has a similar right.[34] The

28. See Bergelt v. Roberts, 144 Misc. 832, 838, 258 N. Y. Supp. 905 (Sup. Ct. 1932); (1932) 32 COL. L. REV. 1435; (1933) 46 HARV. L. REV. 713.

29. A similar situation arises with respect to the granting of preliminary injunctions under N. Y. C. P. A. § 878.

30. A study of the moving papers in the cases listed in notes 8 and 9, *supra*, permits of no other conclusion. The basic facts are identical in each of these cases. In Marx v. Merchants National Properties Inc., 148 Misc. 6, 265 N. Y. Supp. 163 (Sup. Ct. 1933), Valente, J., Spec. I, N. Y. Co. May 18, 1933, the same papers were presented to two judges, except that the trustee of the indenture under which the bonds had been issued, was added as a party defendant on the second application. The second application was granted and the list was supplied by the *debtor corporation* from which the list had been unsuccessfully sought on the first application. A similar situation arose in Industrial & Realty Finance Corp., v. S. W. Straus & Co. Inc., Walsh, J., Spec. I, N. Y. Co., July 1, 1932, where the second application was successfully made on papers almost identical with those in Sun Life Insurance Co. v. S. W. Straus & Co. Inc., N. Y. L. J., Sept. 21, 1933 at 1039, cols. 3-5.

31. Compare Section 437 of the New York Insurance Law, which gives to all holders of mortgages and participation certificates guaranteed and/or issued by any title company organized under the Insurance Law, the right to receive a bondholders' list upon demand, but subject to the approval of the Superintendent of Insurance. The demand must state in detail the reasons for the request. N. Y. Laws 1933, c. 453.

32. N. Y. STOCK CORP. LAW, (1923) §§ 10, 113. The stock book must be open to inspection during at least three business hours daily at the office of the corporation or of its transfer agent within the state. The statute did not create the right of inspection, but is merely declaratory of the common law. Matter of Steinway, 159 N. Y. 250, 53 N. E. 1103 (1899); (1933) 27 ILL. L. REV. 828. In England the holder of a registered bond has a statutory right to a list of the owners of all registered bonds. COMPANIES ACT (1929) § 73 (2) 19 and 20 GEO. 5, c. 23.

33. But the New York statute, *supra* note 31, limits the right of inspection to those who have been stockholders of record for at least six months. Inspection may be denied to a stockholder who, within five years preceding the application, has sold or offered for sale a stockholders' list. And by a recent amendment it was added ". . . that such inspection shall not be for the purpose of communicating with stockholders in the interest of a business or object other than the business of the corporation." N. Y. Laws 1933, c. 641. See also Note (1934) 34 COL. L. REV. 1308, 1310.

34. NEW YORK STOCK CORPORATION LAW, note 32, *supra*.

bondholder, however, must have a bona fide grievance against the party from whom the list is sought, apart from and in addition to his failure to obtain the list upon request.[35] The procuring of the list cannot be the sole stated objective of his suit.[36] Even if he believes himself to be more adept at reorganization than the officials of the debtor corporation and the handpicked committee of the bankers, he must stand by until the "insiders" have published their plans and solicited the bonds of his fellow investors. Then if he is able to point to specific inequities in the proposals of the "insiders" for which he has a definite remedy[37] he may commence his action and demand the names and addresses of his fellow bondholders. Meanwhile, of course, valuable time has been lost and the objecting bondholder is, in fact, endeavoring to "disrupt a plan of reorganization."

As indicated by subsequent events in a recent reorganization[38] much time, money and energy would be saved and many needless antagonisms avoided if bondholders were given an absolute right to a bondholders' list and were permitted to organize a truly "protective committee" as soon as a default by the debtor corporation seemed imminent. To permit bondholders to solicit the aid of their fellow investors after the debtor corporation has already been exposed to several unsuccessful attempts at "rehabilitation" is a gracious but useless gesture.[39] The granting of a bondholders' list at that late date is of little, if

35. Silverman v. S. W. Straus & Co., Inc., Schmuck, J., Spec. I, N. Y. Co., July 30, 1932; People, etc. v. S. W. Straus & Co. Inc. et al., Lockwood, J., Spec. I, Kings Co., April 14, 1933 (Von Glahn; Schultz).

36. It may however be the sole result. In Continental Bank & Trust Co. v. Webster Investing Corp., Walsh, J., Spec. I, N. Y. Co., June 6, 1933, a bondholder was granted a bondholders' list but denied the right to intervene in the action which was brought by a mortgagee to foreclose the mortgage under which the bonds were issued. Compare Empire Trust Co. v. Bim's Realty Corp., Dunne, J., Spec. I, Queens Co., N. Y. L. J. Nov. 23, 1932, at 2323 cols. 3, 4, a foreclosure action wherein an application for a bondholders' list was denied on the ground of immateriality. A similar result was reached in Firebaugh v. Traff, 353 Ill. 82, 186 N. E. 526 (1933).

37. People, etc. v. S. W. Straus & Co. Inc. et al., Lockwood, J., Spec. I, Kings Co., April 14, 1933 (Von Glahn; Schultz): "The sole basis upon which the movant claims a right to the list of bondholders is to make possible 'concerted action' on behalf of the bondholders. What kind of concerted action? None is asserted in the motion papers and none stated on the argument." People, etc. v. S. W. Strauss & Co. Inc., Matter of Pounds et al, Matter of 616 Madison Avenue First Mortgage Serial 6% Bonds, Lockwood, J., Add'l Spec. Term, Kings Co., Nov. 22, 1934: "It has been the policy of the courts consistently to deny motions for bondholders' lists until a proposed plan has been submitted and the court given an opportunity to examine it as to its fairness and equitableness"; People, etc. v. S. W. Strauss & Co. Inc., Matter of Pounds et al, Adams v. S. W. Strauss & Co. Inc., N. Y. L. J. Nov. 23, 1934, at 1980, col. 7 (Riegelmann, J.): "The motion for a list of names and addresses of the bondholders must be denied at this time for none of the parties have as yet proposed a definite plan."

38. Marx v. Merchants National Properties, Inc., 148 Misc. 6, 265 N. Y. Supp. 163 (Sup. Ct. 1933); id., Valente, J., Spec. I, N. Y. Co., May 18, 1933. After the motion was granted the moving bondholder's suggestions were adopted by the Protective Committee and reorganization became unnecessary.

39. See e.g., Matter of Nemerov, 149 Misc. 797, 804, 805; 268 N. Y. Supp. 588 (Sup. Ct. 1933).

any, assistance to the bondholders at large, the only result is to give the litigating bondholder a club which he may hold over the hand-picked Bondholders' Protective Committee,[40] a club which frequently may be purchased for cash. The other bondholders have already been solicited and have deposited their bonds with the company's or the bankers' committee and assets which should be conserved for all the bondholders have already been expended for useless "reorganization expenses."[41] If it is true that "what is best for the bondholders is the Court's paramount concern"[42] and if it is "the essence of good judgment . . . for lenders and borrowers to cooperate in the effort to permit the carrying on of sound business enterprises and properties"[43] the individual bondholder should not be prevented from conferring with his fellow investors until after the damage has been done and an inequitable plan of reorganization proposed and promulgated by a hand picked "Protective Committee."[44] Courts sitting barely a stone's throw from Wall Street should not ignore the factual situation by requiring the bondholder to travel down the same old path and to use the same old implements[45] when he seeks assistance and protection for his small investment.

To this end the courts should allow the free grant of bondholders' lists to any bondholder who applies in good faith, no matter who may possess the list. The legal rationalization does not raise insurmountable difficulties. It is true, attempts to establish a right-duty relation between the bondholder seeking disclosure and those holding the bondholders' list are for the most part too strained

40. He then becomes one of those "guerrillas who hang about the outskirts of reorganizations and endeavor to levy tribute as a condition of abating the nuisance of their presence." Payne, *The General Administration of Equity Receiverships of Corporations* (1922) 31 YALE L. J. 685, 699.

41. TRACY, CORPORATE FORECLOSURES, RECEIVERSHIP AND REORGANIZATION (1929) 6; "It seems equally clear that if a man holds a bond on which there has been a default in the payment of interest or principal or sinking fund he should not have to sit back without a remedy while the property securing his bond is, in his opinion, being dissipated through losses in operations." Carey and Brabner-Smith, *supra* note 13, at 241.

42. Bergelt v. Roberts, 144 Misc. 832, 838, 258 N. Y. Supp. 905 (Sup. Ct. 1932).

43. People etc. v. S. W. Straus & Co. Inc., 149 Misc. 38, 267 N. Y. Supp. 227 (Sup. Ct. 1933) (Springsley Realty Corp.).

44. A bondholder's right to oppose an inequitable plan *after* the Protective Committee has promulgated it has never been denied. In Clinton Trust Co. v. 142-144 Joralemon Street Corp., 237 App. Div. 789, 794, 263 N. Y. Supp. 359, 365 (2d Dep't, 1933), the proposed plan was remitted to the Special Term with instructions ". . . to withhold the entry of judgment decreeing a sale, and of confirmation thereof, until the grievances of the different bondholders can be heard and an opportunity afforded them to formulate a plan of reorganization of the mortgaged property which is fair and just. . . "

45. If the bondholder proceeds under N. Y. C. P. A. § 328, the bondholders' list must be shown to be relevant to the cause of action alleged in the complaint. If he proceeds under N. Y. C. P. A. § 324, the list must be shown to be material and necessary to the cause of action. Adler v. S. W. Strauss & Co. Inc., N. Y. L. J. Aug. 8, 1932, at 430, col. 4; Sullivan v. St. Louis, St. Paul & San Francisco Ry., Colin, J., Spec. I, N. Y. Co. Dec. 12, 1932, aff'd 238 App. Div. 826, 262 N. Y. Supp. 967 (1st Dep't, 1933); Empire Trust Co. v. Bim's Realty Corp., N. Y. L. J. Nov. 23, 1932, at 2323, cols. 3, 4. A sympathetic court, however, may find relevancy, or materiality and necessity, where none in fact exists.

and artificial[46] to form a certain basis for granting the motion; and so too are the attempts to spell out relevancy, materiality and necessity in a dispute between them.[47] But because the moving bondholder is a creditor whose investment has become endangered and because the corporate debtor is either "in cahoots" with or at the mercy of its bankers, its officers being either too indifferent or too weak to protest,[48] the individual bondholder must be given ample opportunity to participate in the reorganization in order to protect himself. To do this effectively he, like the others working for the reorganization, must be granted free access to the bondholders' lists. The courts' inherent power to prevent a threatened wrong by mandatory injunction before the damage has been done could hardly be used to better effect than when directed at divulging bondholders lists for the use of those engaged in attempting to prevent an inequitable reorganization and in giving to the bankers of the debtor corporation some wholesome and much needed competition.[49] The exercise of this power would of course comprehend all who might possess lists, viz., the corporation, the trustee, the opposing bondholders' committees, the underwriters, the selling agencies, the paying agencies, and any other outsiders who might have acquired the information. And it would take place in the earliest stages of the reorganization when the information is most useful. Nor are the objections availing that bankers who have to disclose such lists would be violating the Penal Law which forbids disclosure of customers' lists[50] and would be deprived of a business asset without due process of law. The penal statute

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Adler v. S. W. Straus & Co. Inc., *supra;* Sun Life Insurance Co. v. S. W. Straus & Co., Inc., N. Y. L. J. Sept. 21, 1932, at 1039, cols. 3-5.

46. *Cf.* (1932) 32 COL. L. REV. 1435; (1933) 46 HARV. L. REV. 713; (1933) 42 YALE L. J. 984. Only where the list is sought from the trustee under the indenture is there a clear right-duty basis between the parties. See (1932) 19 VA. L. REV. 517. But even in that event the right may be contingent upon misfeasance by the trustee. Silverman v. S. W. Straus & Co. Inc., Schmuck, J., Spec. I, N. Y. Co., July 30, 1932).

The possible claim has never been urged that, if the bondholder is bound by the 25 per cent clause in the indenture (see note 1, *supra*), he must, as a matter of right, be allowed access to the bondholders' list in order to get the requisite number of bondholders to join him in suit. Nor has the right against the bankers been attempted to be placed on a basis of their having seized a "corporate opportunity" the product of which, the bondholders' list, they ought to be made to disgorge for the benefit of the interested bondholders. Cf. Berle, *Promoters' Stock in Subsidiary Corporations* (1929) 29 COL. L. REV. 35, 36.

47. It has been suggested, however, that the disclosure of the bondholders' list is relevant, material or necessary where the courts are called upon to approve reorganization plans, since they must consider the number of assenting bondholders. (1934) 47 HARV. L. REV. 529, 530.

48. For a graphic portrayal of such weakness or indifference see LOWENTHAL, THE INVESTOR PAYS (1933).

49. When one faction of bondholders has access to the bondholders' list, it would seem that every other faction deserves the same privilege. In Rice v. Pounds, McGoldrick, J. Spec. I, N. Y. Co., Oct. 27, 1934, that reason was assigned for the granting of the motion for a bondholders' list although the opponents of the motion claimed that their plan was much superior to the one which the plaintiff sought to present to his fellow investors.

50. N. Y. PENAL LAW (1917) § 851 (6).

and the objection to customer list disclosure are directed solely to the prevention of rival business organizations obtaining private information. Here the disclosure is not in the interest of commercial rivalry but is motivated by the necessity to obtain information vital to and to be used solely in the protection of the bondholder's investment in the debtor corporation. The divulgence of a customers' list would seem to be a sacrifice which the bankers should be required to make, if by such revelation the bondholders are enabled to protect themselves and to prevent an inequitable reorganization. The chance is slight, moreover, that the disclosed list would reach commercial rivals if the moving bondholder is required to show good faith and if in his use of the list he is made responsible to the court. Certainly, the provisions for free disclosure of bondholders' lists in reorganizations registered under the Federal Securities Act do not accord such protection to the privacy of bondholders' lists.[51] If, however, for these reasons or any others the state courts fail to exercise their equity powers in favor of the individual bondholder, the example of the Federal government should be followed by the states and statutes should be passed giving the bondholder an absolute right to the bondholders' lists.[52]

EMILY MARX†

51. Section 7 of the Federal Securities Act provides that registration statements shall contain information and be accompanied by documents specified in Schedule A. Section 32 of Schedule A broadly authorizes the Securities and Exchange Commission to demand such information as it may deem necessary in case of certificates of deposit. Form D-1 provides for registration of certificates of deposit when bonds are first taken up by any committee Exhibit D of Form D-1 requires a list of names and addresses of persons to whom it is intended to send a call for deposits. Section 6 (d) of the Securities Act provides that any information in or filed with the registration statement shall be made available to the public under such regulations as the Commission may prescribe, and copies shall be furnished to applicants at such reasonable charge as the Commission may prescribe. [For text of the Act, forms and schedules see THORPE AND ELLIS, SECURITIES ACT MANUAL (1933); and see generally Legis. (1934) 34 COL. L. REV. 1348.] The Securities and Exchange Commission is also invested with similar powers by the Securities Exchange Act [P. L. No. 291, 73rd Cong., 2nd Sess. (1934) §§ 12(b) (1), 12(c), 24(b)] except that, if the party filing the information objects to public disclosure, the Commission may publish and distribute copies of the information only when disclosure is, in the judgment of the Commission, in the public interest. Actually, the Commission is now selling bondholders' lists at fifteen cents per page. Compare also Sections 77(c) and 77B(c) of the National Bankruptcy Act, wherein it is provided that in reorganizations carried out under these sections the debtor corporation or the trustee may be required to prepare a list of all known bondholders and creditors, to be open for inspection.

52. It is noteworthy that in 1932 such bills were proposed in Illinois and New York. Carey and Brabner-Smith, *supra* note 13, at 10. Legislative relief has recently been granted in New York to holders of guaranteed mortgage certificates issued by title and guaranty companies. N. Y. INSURANCE LAW § 437, *supra* note 31. But it came too late to enable certificate holders to protect their investments. Compare suggestion as to reorganizations in bankruptcy in Douglas, *Protective Committees in Railroad Reorganizations* (1934) 47 HARV. L. REV. 565, 587.

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