SMU Law Review

Volume 12 | Issue 2 Article 5

1958

Recent Case Notes

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Recommended Citation

Dennis Trent, et al., *Recent Case Notes*, 12 Sw L.J. 230 (1958)
https://scholar.smu.edu/smulr/vol12/iss2/5

RECENT CASE NOTES

Constitutional Law — Civil Rights — Extraterritorial Operation of Bill of Rights Guaranties

Petitioner, the wife of an American serviceman, was tried and convicted by a United States court-martial in England for the murder of her husband whom she was accompanying in that country. While in confinement in a federal jail in this country, she filed a petition for a writ of habeas corpus, alleging that she was not subject to court-martial jurisdiction because art. 2(11) of the Uniform Code of Military Justice, which purported to confer such jurisdiction, was unconstitutional on the grounds, inter alia, that it deprived her of her constitutional right as an American citizen to trial by jury. *Held*: A court-martial in time of peace for a capital offense committed by military dependents accompanying American servicemen abroad is unconstitutional even though such jurisdiction is conferred pursuant to an executive agreement between this nation and the nation where the offense is committed because no agreement with a foreign nation can override the restraints imposed on the actions of this nation by the Constitution. *Reid v. Covert*, 354 U.S. 1 (1957).

The primary issue involved in the instant case was the extent to which the Bill of Rights protects American citizens abroad when the United States government attempts to act upon them. The leading case on the question has been *In re Ross*, 140 U.S. 453 (1891), where it was broadly stated that "the Constitution can have no operation in another country." *Id.* at 464. In that case Ross, an American seaman, had murdered a fellow seaman aboard an American vessel while it lay at anchor in the harbor of Yokohama, Japan. Ross was tried and convicted by an American consular court established in Japan pursuant to treaties between the United States and Japan which provided that Americans committing offenses in Japan should be tried by the American consul. The Supreme Court there refused to issue a writ of habeas corpus on the grounds that certain constitutional safeguards, *viz.*, the fifth and sixth amendments, did not protect Ross outside the United States. The principle to be drawn from the *Ross* case is that the Constitution has no application to the acts of the United States government except within its territorial limits. See Comment, 32 TEXAS L. REV. 58 (1953).

The reasoning relied on to reach this result begins with the premise that any extraterritorial action by the United States is necessarily dependent on consent of the nation in which the United States seeks to act. Since the treaties with Japan provided for consular trial of American citizens committing offenses, it was reasoned that the United States could act in no other way. A subsequent case dealing with the question of the extraterritorial application of the United States Constitution is *Dorr. v. United States,* 195 U.S. 138 (1904), where the distinction was made between fundamental and non-fundamental rights. The *Dorr* case arose in an unincorporated territory of the United States; the Court applied the rule that fundamental rights of American citizens follow and shield them from the actions of their government wherever the government may attempt to act upon them. Non-fundamental rights may be abrogated by treaty or congressional action when the United States operates in an unincorporated territory. The *Dorr* case limits the *Ross* case by holding that the Constitution does have extraterritorial application, at least to the extent of unincorporated territories of the United States.

Mr. Justice Black, writing for the four-justice opinion of the Court, summarily disposed of the distinction between fundamental and non-fundamental rights on the ground that it is illogical to categorize constitutional rights into one class or the other. The case concludes that the Constitution operates extraterritorially to the extent that the United States itself operates extraterritorially. The Court arrived at this conclusion by reasoning that the government of the United States is a creature of the Constitution, *Ex parte Quirin,* 317 U.S. 1 (1942); *Graves v. New York,* 306 U.S. 466 (1939); *Ex parte Milligan,* 4 Wall 2 (1866); *Martin v. Hunter,* 1 Wheat 304 (1816), and therefore its power can come from no other source. The only way the United States can act is under the authority of the Constitution and in accordance with all the limitations imposed by the Constitution. *Marbury v. Madison,* 1 Cranch 137 (1803); *Hawaii v. Mankichi,* 190 U.S. 197 (1903) (dissenting opinion). Hence the protections of the Bill of Rights extend to American citizens whenever and wherever the United States reaches out to punish them.

The principal case indicates that the Court has abandoned previous cases in formulating a constitutional doctrine on the subject. However, there was no clear majority supporting any of the opinions. Only eight justices took part in the case. Four justices adhered to the broad principle that all constitutional rights operate abroad; two justices limited their holdings to capital cases, Mr. Justice Frankfurter on the ground that the facts before the Court did not require a broader holding than that military dependents may not be tried in time of peace for capital offenses by courts-martial. But a fair reading of his opinion leaves the conclusion that he would side with the four-justice opinion when the broader question of the general application of Bill of Rights guaranties extraterritorially arose. Mr. Justice Harlan concurred with the four-justice opinion on the narrow ground of capital offenses, leaving the clear implication that in at least certain non-capital cases he would sustain court-martial jurisdiction. Thus it appears that the four-justice opinion announcing the broad principle of complete extraterritorial application of constitutional rights will be the law of the country should the question arise. Two justices dissented, saying that court-martial jurisdiction was constitutional on the basis of Congress' power to make all laws necessary and proper for the regulation of our armed forces.

If the conclusion reached by the four-justice opinion is followed, certain practical problems will be encountered. For a nation such as ours, with large numbers of its citizens accompanying our armed forces in many countries of the world, the problem of having to assure every constitutional safeguard to those citzens is well-nigh insurmountable. The situation could be met under existing law by leaving punishment of the offender to the country in which the offense is committed or by bringing the offender to this country to stand trial under art. III, § 2 of the Constitution. Neither of the two possibilities is wholly acceptable; under the first there is the possibility of an act which would be a crime against our government but not against the nation where committed, *e.g.*, selling our military secrets. Thus there would be no machinery with which to punish the offender. Under the second possibility there is, among others, the problem of transporting foreign witnesses to this country. Another possibility which comes to mind is the requirement of a waiver of the right to a trial by jury as a condition precedent to permitting the dependents to live on the military reservations abroad. But it is doubtful whether waiver of a constitutional right could be made a condition to the enjoyment of a privilege granted by the government. If our government is to act at all, the only solution which could effectively meet all the problems would be a constitutional amendment permitting summary proceedings of some kind against American citizens committing offenses abroad.

Dennis Trent

Municipal Corporations — Tort Liability — Street Obstructions

Plaintiff, while operating a motorcycle, struck a rope which had been stretched across a street by defendant city to protect school children from traffic. There was nothing to warn of the rope's presence. *Held*: A municipality which negligently allows obstructions to remain in its streets will be held liable if a citizen in the exercise of due care is injured as a consequence. *Crow v. San Antonio,* —Tex.—, 301 S.W.2d 628 (1957).

Generally, a municipality is not liable for torts arising out of the negligent performance of a governmental function, *Houston v. Shilling*, 150 Tex. 387, 240 S.W.2d 1010 (1951), but is liable for torts committed during the performance of a proprietary function, *Fort Worth v. Wiggin,* 5 S.W.2d 761 (Tex. Comm. App. 1928). Here, as elsewhere, the difficulty lies not in stating the general principle applicable, but in the application of that principle to concrete facts. In Texas, a municipality is not liable for damages caused by the negligent regulation of traffic, for such regulation is a governmental function. *Baker v. Waco,* 129 S.W.2d 499 (Tex. Civ. App. 1939). Consequently, Texas courts have held that a municipal corporation is not liable if it negligently operates, or fails to operate, its system of traffic lights. *Parson v. Texas City,* 259 S.W.2d 333 (Tex. Civ. App. 1953) *error ref.; Baker v. Waco, supra.* Nor is a municipality liable for its failure to install a master switch to turn traffic lights red when streets are needed as emergency fire lanes. *Presley v. Odessa,* 263 S.W.2d 293 (Tex. Civ. App. 1952). However, the construction and maintenance of streets is a proprietary function, and the municipality is liable for damages which result from the negligent performance of such a function. *Port Arthur v. Wallace,* 141 Tex. 201, 171 S.W.2d 480 (1943). Thus, the courts have found liability where bumps in a street directly contributed to a collision between an automobile and a fire truck, *Port Arthur v. Wallace, supra,* and where the municipality failed to warn properly of a hole which its employees had dug in a street, *Houston v. Cundiff,* 191 S.W.2d 133 (Tex. Civ. App. 1945) *error ref. n.r.e.* And in *Gabbert v. Brownwood,* 176 S.W.2d 344 (Tex. Civ. App. 1943) *error ref.*, the court held that a city may be liable for its failure to place a barrier or light to warn against unsafe places in streets.

In the recent case of *Austin v. Schmedes,* 154 Tex. 416, 279 S.W.2d 326 (1955), the municipal corporation was held liable for an injury arising out of a collision, the proximate cause of which was failure by the municipality to provide directing signs for traffic at the site of extensive street repairs. While recognizing that a municipality is under no duty to regulate traffic, the Supreme Court held it obligated to erect signs at street improvements. "The fact that the performance of the duty [to repair] requires an incidental regulation of traffic does not detract from the duty or change the character of the function which gave rise to the danger." *Id.* at 422. This case and the principal opinion, when considered together, are complementary. In *Austin*, the theory of liability was that the failure to regulate traffic was incidental to the main proprietary activity at the time of the accident; in the instant decision, the theory of liability is that the performance of the governmental function of regulating traffic gave rise incidentally to the proprietary duty to keep the streets free from obstructions (or to warn of their presence). In either case, the basis of liability is ostensibly the negligence of the municipal corporation in its performance of a proprietary function; yet in *Austin*, the Court imposed the duty to perform a governmental function, while in the principal case it imposed a duty to perform a governmental function non-negligently.

As the dissent suggests, the effect of the principal decision may be limited to the negligent placing of obstacles in a street for the purpose of regulating traffic; if future decisions do not impose this limitation, the result of the principal holding may be extended to all cases in which both proprietary and governmental functions are combined in varying degrees. Under either theory, the principal decision represents a departure from previous Texas law. The Court announced in the *Shilling* case, *supra*, that it would henceforth apply the doctrine of governmental immunity strongly against the municipality; but the principal opinion, while announcing this doctrine, ignored it in favor of the proprietary function doctrine which it applies to a situation previously thought exclusively governmental. The result is to leave unclear the path which the Court will follow in deciding cases of this nature. It is not improbable that future decisions, while recognizing the doctrine of governmental immunity, will interpret its application out of existence; there is at least a hint of such a tendency in the instant decision. A more satisfactory approach would be to abolish the archaic distinction between proprietary and governmental functions and hold a municipality liable when it is negligent.

Allen Butler

Oil and Gas — Lease Assignments — Assignee's Duty to Protect the Override

Rees transferred an oil lease to Briscoe under an assignment in which Rees expressly reserved the usual $\frac{1}{8}$th overriding royalty. He did not require the payment of a cash consideration, however; nor did the assignment provide for an extension of the override to renewal leases. *Prior* to its expiration, Briscoe secured a renewal of this lease from the lessor, making no mention of the overriding royalty. Rees, with full knowledge of the renewal, waited three years and then brought this suit for equitable relief on the theory that when Briscoe obtained the renewal he was acting in a fiduciary capacity and hence that Rees was entitled to have Briscoe's second lease impressed with a constructive trust of the override. The trial court rejected this theory and rendered judgment for Briscoe. *Held, judgment reversed.* A fiduciary relationship exists where there has been a special confidence reposed in one who in equity is bound to act in good faith, and whether or not the trust or confidence is justifiably reposed in another depends on the circumstances of each case. *Rees v. Briscoe,* —Okla.—, 415 P.2d 758 (1957).

Ordinary contract principles require that the assignee should be bound to his assignor by a duty to perform all the covenants of the original lease in addition to any express obligations found in the assignment itself. *Phoenix Oil Co. v. Mid-Continent Petroleum Corp.,* 177 Okla. 530, 60 P.2d. 1054 (1936). Thus, if the assignment expressly provides that the override will extend to renewals, the assignee is under a contractual duty to recognize the override in subsequent leases. *Probst v. Hughes,* 143 Okla. 11, 286 Pac. 875 (1930). By the same theory, however, the agreement to pay the overriding royalty is held to be a covenant that runs with the lease and not with the land; hence, in the absence of an express provision otherwise, a termination of the lease will normally extinguish the overriding royalty. *Wier v. Glassell,* 216 La. 828, 44 So. 2d 882 (1950); *Rogers Nat'l Bank v. Prewitt,* 231 S.W.2d 487 (Tex. Civ. App. 1950) *error ref.* These cases do not settle completely the question presented by the instant case, however, *viz.,* when may the assignee permit a termination of the lease *and* secure a renewal to the exclusion of the overriding royalty? See *Walker, Oil Payments,* 20 TEXAS L. REV. 259 (1942).

If any duties exist beyond those expressed in the assignment, the courts have encountered difficulty in determining their nature and scope. See 3 SUMMERS, OIL AND GAS §§ 541-53 (perm. ed. 1954). Attempting to define the assignee's duty to the holder of the overriding royalty, a recent Texas decision was cast in terms of negligence, *i.e.*, the assignee may not permit a negligent destruction of the override without incurring liability. *Whitson Co. v. Bluff Creek Oil Co.*, —Tex.—, 293 S.W.2d 488 (1956). It seems apparent that duties defined in terms of actions at law for damages are unsatisfactory to an assignor whose assignee has secured a renewal lease and has recovered therefrom valuable oil production. Thus, the assignor frequently seeks equitable relief on the theory that the assignee violated a relation of trust and confidence by taking the second lease and that such lease should be impressed with a constructive trust of the override. 3 SUMMERS, OIL AND GAS § 554 (perm. ed. 1954). In these cases, the "general rule" is stated that the mere assignment creates no such fiduciary relationship (fiduciary and confidential apparently being used synonymously). *Robinson v. Eagle-Picher Lead Co.*, 132 Kan. 860, 297 Pac. 697 (1931); *Montgomery v. Phillips Petroleum Co.* 49 S.W.2d 967 (Tex. Civ. App. 1932) *error ref.* Probably, these cases do no more than establish the rule that where the asignee acts in *good faith* in permitting a termination of the lease he should be treated like any third party in securing a second lease, because other cases may be found where equity has imposed a constructive trust of the override when the assignee in good conscience should not retain a benefit from the transaction, a result based on conduct of the assignee subsequent to the assignment. *Cf. Phillips Petroleum Co. v. McCormick*, 211 F.2d 361 (10th Cir. 1954); *Hivick v. Urschel*, 171 Okla. 17, 40 P.2d 1077 (1935).

The dissent in the principal case argued that the effect of the court's decision is to establish the rule that the mere assignment of an oil and gas lease creates a fiduciary relationship and that an overriding royalty will extend to all future leases whether provided for in the assignment or not. It would seem from the majority opinion that this position is unsound, for there are numerous facts which contributed to the decision. The greatest single factor which distressed the court was the lack of a cash consideration for the assignment. Even if this fact does not provide a basis for an equitable remedy, other contributing factors called for such relief. The most notable of these were (1) Briscoe's full performance of other lease agreements, (2) an alleged oral promise that Briscoe would drill on the present lease, and (3) Rees' testimony that he in fact reposed confidence and trust in Briscoe that the override would be protected in the event of a renewal. Surely, it would not be argued that Briscoe acted in good faith in permitting a termination since he secured the renewal lease *prior* to the termination date. It seems clear that the instant case falls within that class applying ordinary equitable principles to solve similar problems as represented by the Oklahoma case of *Hivick v. Urschel, supra.*

Although Rees could have solved the problem by a simple expression in the assignment, obviously he did not intend a gift of the lease to Briscoe. "If a pigeon hole need be found for future cases where the assignor does not bargain for a cash consideration, it may be found in the sweeping concept of joint venture." Note, 7 OIL AND GAS REP. 1464 (1957). In the present case, there was no joint venture in the sense of a mining partnership since Rees was to stand no further expense, which is usually an essential factor. CRANE, PARTNERSHIPS § 687 (2d ed. 1952). It was a joint venture, however, in that one party provided something of value and the other party undertook to make it mutually profitable. 2 THORNTON, OIL AND GAS § 687 (Supp. 1956). Joint adventurers, in dealing with the common property, undoubtedly owe each other fiduciary obligations, precluding either from dealing with the property in such a way as to injure the other's interest. *Smith v. Bolin,* 261 S.W.2d 352 (Tex. Civ. App. 1953), rev'd on other grounds,—Tex. —, 271 S.W.2d 93 (1954).

Admittedly, the lack of clarity in the court's opinion could be used to justify the position taken by the dissent in the instant case. Probably, however, this case stands only for the proposition that a breach of confidence will cause a constructive trust to arise, dependent on the facts of each case. If any implied rights and duties exist between the overriding royalty holder and the owner of the working interest, they are yet to be defined by the courts.

Elton R. Hutchison

Procedure — Trial — Incomplete Verdict

P brought action for the wrongful death of his wife, alleging negligence on the part of *D*. The jury's verdict found *D* negligent and damages sustained by *P*, but failed to answer the special issue inquiring if *D*'s negligence was the proximate cause of the death of *P*'s wife. Upon receipt of the verdict the trial judge read it aloud and, no objection being voiced, received the verdict and discharged the jury. The trial court rendered judgment for D. *Held, judgment affirmed*: The right to have the jury pass upon all material issues is waived if no objection is made to the court's accepting the verdict and discharging the jury where the verdict contains a material issue which is unanswered; *and* under rule 279 it will be presumed that the trial court answered the issue in such manner as to support the judgment. *Boyer v. Gulf, C. & S.F. Ry.*, 306 S.W.2d 215 (Tex. Civ. App. 1957) *error ref. n.r.e.*

The rule has long been established in Texas that when a cause has been submitted on special issues, the verdict must contain a finding on all material disputed issues necessary to support the judgment on the verdict. *Texas Employers' Ins. Ass'n v. Frankum,* 145 Tex. 658, 201 S.W.2d 800 (1947) (unresponsive answer); *Powers v. Standard Acc. Ins. Co.*, 144 Tex. 415, 191 S.W.2d 7 (1945); *Panhandle & S.F. Ry. v. Sutton,* 125 Tex. 401, 81 S.W.2d 1005 (1933); *Tillman v. Mahaffy,* 252 S.W.2d 255 (Tex. Civ. App. 1952) *error ref. n.r.e.; Cox v. Clay,* 237 S.W.2d 798 (Tex Civ. App. 1950) *error ref. n.r.e.* When the verdict does not contain such findings, the court is not authorized to enter a judgment upon the verdict for either party. *Panhandle & S.F. Ry. v. Sutton, supra;* 3 McDONALD, TEXAS CIVIL PRACTICE § 15.03 (1950); SPEER, SPECIAL ISSUES § 462 (1932). The opinion in the instant case assumes this rule was changed by *Lewis v. Texas Employers' Ins. Ass'n,* 151 Tex. 95, 246 S.W.2d 599 (1952), as one writer has suggested, 31 TEXAS L. REV. 325 (1952).

In the *Lewis* case, involving workmen's compensation, the jury found total incapacity but failed to answer a special issue concerning partial incapacity. The Court expressly recognized the rule of *Panhandle & S.F. Ry. v. Sutton, supra,* but said that the facts of the *Lewis* case concerned preserving the error for appeal. It is significant that in the *Lewis* case the Court indicated that since total incapacity was found, the issue of partial incapacity was material only to the defendant, and in affirming the judgment of the trial court for the plaintiff said, "in this situation, where the verdict is not conflicting and *finds facts which support all the elements necessary for a judgment,* the error is not preserved unless brought to the trial judge's attention in time to have the jury reconsider and complete their verdict." *Lewis v. Texas Employers' Ins. Ass'n, supra* at 99, 246 S.W.2d at 601. (Emphasis added.)

In the *Lewis* case, and the only two cases which it expressly overruled, *Texas Employers' Ins. Ass'n v. Horn,* 75 S.W.2d 301 (Tex. Civ. App. 1934) and *Traders & Gen. Ins. Co. v. Patton,* 92

S.W.2d 1083 (Tex. Civ. App. 1936) *error dism.* (both holding error was not waived), issues concerning partial incapacity were not answered; however, the issues which *were* answered found all facts necessary to support the judgment for plaintiff (*viz.*, all elements of plaintiff's cause of action). In the instant case, the trial court entered judgment for the defendant, not because facts or issues were *found* by the jury which would entitle the defendant to judgment (*e.g.*, jury finding defendant was not negligent or if negligent that it was *not* the proximate cause of death), but because an issue was *not* answered which was essential to a judgment for the plaintiff. It has been suggested that where issues necessary to support a judgment are not answered by the jury "the court can not render judgment without usurping in part the functions of the jury, and thereby render judgment infringing a right guaranteed by the constitution and laws." *Moore v. Moore,* 67 Tex. 293, 296, 3 S.W. 284, 285 (1887); see also *Patterson v. U.S.,* 4 U.S. (2 Wheat.) 88 (1817); Annot., 76 A.L.R. 1137 (1932). The Court in the *Lewis* case recognized this when it said, "the issues answered by the jury support each element of plaintiff's cause of action establishing liability . . . therefore, the trial judge did not usurp the function of the jury in violation of the Constitution." *Lewis v. Texas Employers' Ins. Ass'n, supra* at 98, 246 S.W.2d at 600. Thus, "it is not essential to the validity of a verdict that all the issues submitted be answered, if those that are answered compel rendition of the judgment entered." *Williams v. Patterson,* 170 S.W.2d 269, 270 (Tex. Civ. App. 1943); see also *Rawls v. Holt,* 193 S.W.2d 536 (Tex. Civ. App. 1945) *error ref. w.o.m.; Rainey v. Jones,* 146 S.W.2d 794 (Tex. Civ. App. 1941) *error dism., judgm. cor.* It seems to be established that where there is a fatal conflict in the verdict, the parties cannot waive the conflict and a judgment entered upon such a conflict must be set aside. *Little Rock Mfg. Co. v. Dunn,* 148 Tex. 197, 222 S.W.2d 985 (1949).

The court in the instant case supports its decision with the additional reason that under rule 279, TEX. RULES CIV. PRO. (1941), the unanswered issue on proximate cause will be presumed to have been answered by the court in such a manner as to support the judgment, citing *Little Rock Mfg. Co. v. Dunn, supra,* as authority. Rule 279 by its express terms applies only to *omitted* issues. See *Bradley v. McKinzie,* 226 S.W.2d 458 (Tex. Civ. App. 1950); *Dakan v. Humphreys,* 190 S.W.2d 205 (Tex. Civ. App. 1947). If an issue is submitted, even incorrectly, this prevents the application of rule 279. *Texas & N.O. Ry. v. Barham,* 204 S.W.2d 205

(Tex. Civ. App. 1947). In *Little Rock Mfg. Co. v. Dunn, supra,* the defendant's special issue concerning proximate cause was submitted conditionally upon an affirmative answer to the preceding issue on contributory negligence. The Court reasoned that since the jury had been instructed to answer the proximate cause issue only in the event they answered the preceding issue in the affirmative, when the jury answered the preceding issue in the negative, the issue on proximate cause was not submitted for their consideration, being in effect an *omitted* issue. In the principal case the issue on proximate cause was also submitted conditionally upon an affirmative answer to the preceding issue; however, in this case the preceding issue was answered in the affirmative making the issue on proximate cause necessarily a *submitted* issue.

The result of the instant case may be justified inasmuch as the plaintiff expressly stated that he did not complain of the incomplete verdict but instead contended proximate cause was found by the jury in the "damage issue." It is believed, however, that the reasoning of the court on the points discussed is not supported by the authorities upon which it relies. Application of the rule of the *Lewis* case, where the issues answered supported the judgment rendered, to the facts of the instant case, where answered issues did not support the judgment, is certainly an extension of that decision. It may be argued that the findings of the jury in the principal case were not sufficient to form the basis of any judgment on the verdict, and that in entering judgment on the verdict the court usurped the function of the jury, thus raising constitutional questions. It would seem that if the parties cannot waive the error of entering judgment on a verdict containing a fatal conflict, they should not be held to waive the error of entering judgment on a verdict which does not contain findings necessary to support the judgment. The writer believes the holding of the court in the principal case that the unanswered issue will be presumed to have been answered by the trial court in such manner as to support the judgment is clearly an erroneous application of rule 279 and of the holding in *Little Rock Mfg. Co. v. Dunn.* As rule 279 pertains only to issues that are *omitted,* and since the reasoning of the *Dunn* case is that the unanswered issue was in effect omitted, there seems to be no basis to use either as authority where issues are submitted to the jury but are not answered. Upon either basis for the decision in the instant case, the fact remains that the judgment was based upon controverted facts found by the court and not by the jury.

Marshall J. Doke, Jr.

Taxation — Net Operating Loss Carry-Over — Continuity of Enterprise

Taxpayer corporation was formed by merger of seventeen separate corporations each owned by the same individuals and each engaged in the same type of business. Attempt was made to carry over pre-merger net operating losees of three of the constituent corporations and deduct them from the post-merger income attributable to the successor business. *Held*: The net operating loss carry-over deduction is not available following such corporate reorganization since there is no continuity of business enterprise. *Libson Shops v. Koehler*, 353 U.S. 382 (1957).

The 1939 code and prior revenue acts contained no specific enactments respecting net operating loss carry-overs after corporate reorganizations. The courts were forced to look to the general carry-over provisions in the statutes and construe the phrase "the taxpayer" to determine if a loss carry-over would be allowed under Int. Rev. Code of 1939, § 122 (b) (2) (c), 64 STAT. 937, 938. Comment, 23 GEO. WASH. L. REV. 549 (1955). Judicial interpretations became uncertain and frequently contradictory. See H.R. REP. No. 1337, 83d Cong., 2d Sess. 41 (1954).

The general rule was stated that the net operating loss could be carried forward or back solely by the entity which sustained the loss, so that a carry-over would be allowed only when the old and the new corporations were operating under the same charter. *New Colonial Ice Co. v. Helvering*, 292 U.S. 435 (1934). This principle was applied in holding that a successor could not carry back a net operating loss to a period before the reorganization because the predecessor could no longer be in existence when the successor's loss was sustained. *Standard Paving Co. v. Commissioner*, 13 T.C. 425 (1949), *aff'd*, 190 F.2d 330 (10th Cir.,), *cert. denied*, 342 U.S. 860 (1951). A corporation which retained its original charter and thus met the continuity of form test could use its carry-over benefits even though it changed the name of the company and the line of merchandise. *Alprosa Watch Co. v. Commissioner*, 11 T.C. 240 (1948); *Northway Securities Co. v. Commissioner*, 23 B.T.A. 532 (1931). The result of looking at the legal form of the transaction rather than equitable considerations was that some taxpayers gained valuable loss carry-overs by manipulations of corporate form, while others acting under less astute advice lost any carry-over benefits. For an analysis of how loss corporations have been used to gain tax benefits, see Comment, 23 GEO. WASH. L. REV. 549 (1955); Arent, *Tax Aspects of Buying Loss Corporations Under the 1954 Code,* 33 TAXES 955.

A qualification of the corporate form theory appeared in *Stanton Brewery v. Commissioner,* 176 F.2d 573 (2d Cir. 1949), where the court indicated there was an exception in the event of a statutory merger and held that a surviving corporation was a "union of component organizations which absorbed the rights and privileges, as well as the obligations of its constituents," so that after a merger, a corporation would be entitled to the carry-over benefits, even though the corporation which sustained the loss technically was no longer in existence. The theory was that after a merger, both corporations continued their existence within the framework of the surviving corporation. Following the *Stanton Brewery* decision, at least in statutory merger cases, the courts began to look at the substance rather than the form of reorganizations to determine if carry-overs would be allowed. *Newmarket Mfg. Co. v. United States,* 233 F. 2d 493 (1st Cir. 1956), *cert. denied,* 353 U.S. 983 (1957); *Koppers Co. v. United States,* 134 F. Supp. 290 (Ct. Cl. 1955), *cert. denied,* 353 U.S. 983 (1957). But this qualification met with criticism, *California Casket Co. v. Commissioner,* 19 T.C. 32, 39 (1952), and was applied only where the loss corporation was acquired through a statutory merger, *Gramm Trailer Corp. v. Commissioner,* 26 T.C. 689 (1956).

The Supreme Court distinguished the instant case from the *Stanton Brewery* decision by requiring a continuity of enterprise, *i.e.,* only the same trade or business which produced the loss can take advantage of it. Thus the theory that a loss carry-over is allowed following a statutory merger now appears limited to cases where the successor is carrying on substantially the same business without regard to continuity of ownership or corporate charter. The Court rationalized that with the possible exception of *E. & J. Gallo Winery v. Commissioner,* 227 F.2d 699 (9th Cir. 1955), the continuity of enterprise has been present in cases following the *Stanton Brewery* decision. *Cf. Newmarket Mfg. Co. v. United States, supra; Koppers Co. v. United States, supra.*

The Court pointed out that it was not ruling on the situation where a single corporation retained its charter, although the enterprise was changed, such as *Alprosa Watch Co. v. Commissioner, supra;* and it further said that it was ruling just on those cases under the 1939 code. However, the Court's broad language has caused much concern among tax practitioners because of possible far-reaching effects if extended beyond the facts of this case. Arent, *Current Developments Affecting Loss Corporations*, 35 TAXES 956 (1957). It would seem that had this case been decided under the 1954 code, the loss carry-over to the surviving corporation would have been allowed because the owners were the same before and after the merger. INT. REV. CODE OF 1954, § 382(b)(3). It is now feared that the Commissioner may attempt to extend the main opinion to change the standards in the 1954 code. Although such an extension would clearly contradict the legislative purpose of the code, H.R. REP. No. 1337, 83d Cong., 2d Sess. 41 (1954), lawyers feel such an extention might be upheld by the courts because of their instinctive dislike for the carry-over provisions, *cf. Woolford Realty Co. v. Rose*, 286 U.S. 319 (1932), and the fact that such deductions are narrowly construed against the taxpayer, see *Deputy v. DuPont*, 308 U.S. 488 (1940). The provisions in the 1954 code are clear as to when carry-overs will be allowed, INT. REV. CODE of 1954, §§ 381, 382, 269, and any superimposed continuity of enterprise test would only create confusion and injustices. Arent, *Current Developments Affecting Loss Corporations*, 35 TAXES 956 (1957).

It is difficult to understand why courts have been inclined to believe that loss carry-overs are inherently wrong. There is substantial economic basis for the carry-over provisions, for then a taxpayer is better able to average a fluctuating income of several taxable periods and pay his tax on some sort of equitable basis. As the stockholders in the instant case were the same after the merger as before, and were the very persons who sustained the loss, it would seem that they should be entitled to the carry-over benefits as a matter of economic right. The Court reasoned that the companies had elected to forego any carry-over benefits by choosing not to file a consolidated return before the merger, but that if such a return had been filed the same taxpaying enterprise would have been involved and there would exist a continuity of the business enterprise. This reasoning is faulty because the companies were not entitled to file a consolidated return and consequently could have made no election before the merger. Arent, *Current Developments Affecting Loss Corporations*, 35 TAXES 956 (1957). Although the case seems to rationalize decisions under the 1939 code, by regarding a continuity of business enterprise as the essential element in case following the *Stanton Brewery* decision, it can only be hoped that the Commissioner does not try to apply this principle to cases arising in other than this particular situation. Such an extension would clearly distort the obvious legislative intent in the carry-over provisions of the 1954 code.

Robert G. Chappell

Torts — Immunity of Charitable Institutions — Respondeat Superior

Nurses in *D*'s charitable hospital negilgently failed to remove linens from *P*'s bedding which had been stained with an inflammable antiseptic solution while *P* was being prepared for an operation. When the surgeon touched the operative area with an electric cautery, the solution ignited and the surgeon doused the area with water before continuing the operation. A subsequent examination revealed burns on *P*'s body. *Held*: The rule granting immunity from liability to charitable hospitals for an employee's negligence occurring during the performance of a "medical" act is abandoned, and the doctrine of respondant superior will be the proper test to govern such liability in New York. *Bing v. Thunig*, 2 N.Y.2d 656, 143 N.E.2d 3 (1957).

A slight majority of jurisdictions, including Texas, grant a charitable institution immunity from liability for its employees' negligence resulting in injury to beneficiaries of its services. *Wattman v. St. Luke's Hospital Ass'n*, 314 Ill. App. 344, 41 N.E.2d 314 (1942); *Steele v. St. Joseph's Hospital*, 60 S.W.2d 1083 (Tex. Civ. App. 1933); *Baylor University v. Boyd*, 18 S.W.2d 700 (Tex. Civ. App. 1929) (hospital); *Schau v. Morgan*, 214 Wis. 334, 6 N.W.2d 212 (1942) (hospital). The minority viewpoint (allowing recovery) finds growing support in recent decisions, some of which expressly limit recovery to a paying patient only. *Wheat v. Latter Day Saints Hospital*, 297 P.2 1041 (Idaho 1956); *Mississippi Baptist Hospital v. Holmes*, 214 Miss. 906, 55 So. 2d 142 (1951), *aff'd on rehearing*, 56 So. 2d 709 (1952); *Avellone v. St. John's Hospital*, 165 Ohio St. 467, 135 N.E.2d 410 (1956); *Sessions v. Thomas D. Dee Memorial Hospital Ass'n*, 94 Utah 460, 78 P.2d 645 (1938); PROSSER, TORTS 787 (2d ed. 1955). As a rule the immunity defense does not bar recovery by employees of the charity, *Hotel Dieu v. Armendarez*, 210 S.W. 518 (Tex. Comm. App. 1919), nor by "strangers" to the charity's services (as distinguished from beneficiaries), *Walker v. Memorial Hospital*, 187 Va. 5, 45 S.E.2d 898 (1948);

but Texas courts have extended the doctrine to bar "strangers." *Southern Methodist University v. Clayton*, 142 Tex. 179, 176 S.W.-2d 749 (1944); *Scott v. Wm. M. Rice Institute*, 178 S.W.2d 156 (Tex. Civ. App. 1944) *error ref.* Beneficiaries may overcome the immunity defense by proving that administrators of the charity were negligent in the selection or retention of employees, *Enell v. Baptist Hospital*, 45 S.W.2d 395 (Tex. Civ. App. 1931) *error ref.*, or in Texas and a few other jurisdictions by proving failure to provide safe equipment for proper medical treatment, *Medical & Surgical Memorial Hospital v. Cauthorn*, 229 S.W.2d 932 (Tex. Civ. App. 1949) *error ref. n.r.e.* A collection of cases indicating the vast number of conflicting results may be found in Note, 32 N.C.L. Rev. 129 (1953).

Theories justifying the immunity doctrine are varied. The trust fund doctrine treats a charity's assets as a trust fund which the donor intended exclusively for charitable purposes and bars diversion of funds to pay tort judgments because of the conflict which would result with such intention, and also because of the public interest in preserving charities. *Eads v. Young Men's Christian Ass'n*, 325 Mo. 577, 29 S.W.2d 701 (1930). The argument that one who accepts a charity's benefits thereby impliedly waives the right to bring a tort action has also been advanced. *Wilcox v. Latter Day Saints Hospital*, 59 Idaho 350, 82 P.2d 849 (1938). Other courts allow immunity on broad public policy grounds aimed, as the trust fund doctrine, at protecting society's interest in maintaining such institutions. *Weston's Adm'x v. Hospital of St. Vincent*, 131 Va. 587, 107 S.E. 785 (1925). For a critical analysis of the various immunity theories, see *Georgetown University v. Hughes*, 130 F.2d 810 (D.C. Cir. 1942); Comment, 9 U. Pitt. L. Rev. 253 (1948). The Texas approach is set out in *Southern Methodist University v. Clayton, supra*, approving the non-applicability of respondeat superior and a modified trust fund theory, both based on public policy grounds.

The instant decision overrules *Schloendorff v. Society of New York Hospital*, 211 N.Y. 125, 105 N.E. 92 (1914), a leading case which held that doctors, nurses, interns, and persons of like status should be considered in law independent contractors although they are in fact salaried employees. This theory was based on the premise that professionals exercise an "independent calling" and thus are not under the control of the charity-employer. Later decisions have carried the theory to its logical end by holding a charity liable for the negligence of non-professional employees. The test, however, has shifted from whether the negligent employee is professional or non-professional to whether the negligence occurred during the performance of an "administrative" act, resulting in liability, or a "medical" act, resulting in immunity. *Berg v. New York Soc'y for Relief of Ruptured & Crippled,* 1 N.Y.2d 499, 136 N.E.2d 523 (1956); *Phillips v. Buffalo Gen. Hospital,* 239 N.Y. 188, 146 N.E. 199 (1924). The New York approach has been termed a "special application" of the respondeat superior doctrine, Feezer, "*The Tort Liability of Charities,*" 77 U. PA. L. REV. 191 (1928); however, the instant case assumes that New York courts have not applied respondeat superior, but have relied upon the test indicated above, *viz.*, whether the negligence occurred during an "administrative" or a "medical" act. The *Berg* and *Phillips* cases, *supra*, seem to support this position.

The result of the instant case places New York in the "full liability" category; but, because of the peculiar New York theory (justifying immunity only where the act is "medical") which is abandoned in the instant case, the reasoning behind the decision probably will be of little value as precedent in jurisdictions granting immunity on other grounds.

It seems clear that Texas law is firmly established in favor of immunity in the instances cited earlier and that Texas will apply stare decisis in all its vigor. See *Jones v. Baylor Hospital,* 284 S.W.2d 929 (Tex. Civ. App. 1955). The existence of liability insurance, which removes the objection that tort judgment execution hampers a charity's projects, was recently held not to affect a charity's immunity. *Baptist Memorial Hospital v. McTighe,* 303 S.W.2d 446 (Tex. Civ. App. 1958) *error ref. n.r.e.* A theory seldom advanced in other jurisdictions and as yet untested in Texas is breach of implied contract for non-negligent service. See *Tucker v. Mobile Infirmary Ass'n,* 191 Ala. 572, 68 So. 4 (1915). Therefore, if a case can not be brought within the established exceptions regarding negligent selection and retention of employees or failure to provide proper equipment, the chances for recovery by a beneficiary or even a stranger are slight in Texas. Legislation seems desirable to bring Texas within the modern and what is believed the sounder rule of "full liability" for charities.

Jerry Moss

Torts — Negligence — Reliance on Gratuitous Promise — Promissory Estoppel

P, while shopping in *D*'s store, was bitten by *D*'s cat. *D* promised to keep the cat penned up for fourteen days to determine if it were rabid. *D* however took no steps to confine the cat and it escaped. *P*, not knowing the condition of the cat, was thus forced to take anti-rabies injections as a precautionary measure. Later it was found that the cat was not diseased and the treatments taken by *P* were actually unnecessary. *P* was allergic to the serum and brought action for the ill effects suffered. *Held*: Though not liable for the original injury, *D*, by his promise, assumed a duty to use reasonable care to confine the cat and his failure to do so was the proximate cause of *P*'s injuries due to the injections. *Marsalis v. LaSalle*, 94 So. 2d 120 (La. App. 1957).

Negligence is usually defined as conduct which falls below the standard established by law for the protection of others against unreasonable risk of harm. RESTATEMENT, TORTS § 282 (1934). While liability for negligence in Louisiana stems from a statute, LA. CIV. CODE ANN. arts. 2315-16 (West 1952), the interpretation given these code provisions is in general agreement with common-law jurisdictions in that liability for negligence depends upon the existence and breach of a legal duty owed to a particular party, *Mills v. Heidingsfield*, 192 So. 786 (La. App. 1939). Further, as noted by the principal case, in the absence of a relationship between the parties which imposes some duty to act, one is under no legal obligation to assist persons injured or in peril, even if such assistance might be given without danger to the volunteer. *Buch v. Amory Mfg. Co.*, 69 N.H. 257, 44 Atl. 809 (1898). However, when such a volunteer intercedes and by affirmative conduct attempts to assist the person in peril, he is held to have assumed a duty to use reasonable care in so doing. *Wells v. McGehee*, 39 So. 196 (La. App. 1949); *Medical & Surgical Memorial Hospital v. Cauthorn*, 229 S.W.2d 932 (Tex. Civ. App. 1949). Generally if only a promise of assistance is made, no tort liability will ensue even though the plaintiff has relied upon the promise and suffered injury from such reliance. *Pizzolotto v. Sims*, 23 So. 2d 710 (La. App. 1945); *Houston Milling Co. v. Carlock*, 183 S.W.2d 1013 (Tex. Civ. App. 1944).

In such case, however, if the injured party can prove (1) that the promise was one reasonably expected to induce substantial reliance, (2) that there was such reliance and real injury as a result, and (3) that injustice cannot otherwise be avoided, recovery may be possible under the doctrine of promissory estoppel. RESTATEMENT, CONTRACTS § 90 (1932). Among other applications, promissory estoppel has been used to enforce gratuitous promises made and relied upon in bailment and agency relationships. *Brewer v. Universal Credit Co.,* 191 Miss. 183, 192 So. 902 (1940). Although considered a contract remedy, the absence of the requirement of consideration, *Rancher v. Franks,* 269 S.W.2d 926 (Tex. Civ. App. 1954), the use of such concepts as causation and foreseeable reliance, *Graddon v. Knight,* 138 Cal. App. 2d 577, 292 P.2d 632 (1956), and the fact that courts have occasionally allowed the recovery of "tort-type" damages, *Goodman v. Dicker,* 169 F.2d 684 (D.C. Cir. 1948), have tended to give the doctrine substantial tort overtones. Louisiana courts have specifically rejected the doctrine of promissory estoppel, *Ducote v. Oden,* 221 La. 228, 59 So. 2d 130 (1952), but one writer has noted that *culpa in contrahendo,* the same basic principle, has been applied by the courts in construing some articles of the Louisiana Civil Code, Schwenk, *Culpa In Contrahendo In German, French, and Louisiana Law,* 15 TUL. L. REV. 87 (1940).

The principal case is anomalous whether rationalized as tort law or considered as an application of the principles of promissory estoppel, framed in tort language. Considered in its tort aspect, the court held that the defendant's promise to confine the cat constituted an assumption of duty to assist the injured plaintiff, a duty which was breached by negligently allowing the animal to escape. However, the cases cited to support this position are clearly distinguishable because in them assumption of duty was created by affirmative conduct, *Carey v. Davis,* 190 Iowa 720, 180 N.W. 889 (1921); *Owl Drug Co. v. Crandall,* 25 Ariz. 322, 80 P.2d 952 (1938), while recovery here was based upon the very fact that the defendant did nothing. Also, the plaintiff here was neither helpless nor severely injured, and there was no emergency situation such as is usually present in such cases. Clearly, most jurisdictions dealing with the same facts would not have held that the defendant's breach of a promise to give assistance gave rise to tort liability, *cf. Long v. Patterson,* 198 Miss. 626, 22 So. 2d 490 (1945), notwithstanding that such liability was approved by the American Law Institute, RESTATEMENT, TORTS § 325, comment *a* (1934). However, it should be noted that in analogous situations a few courts have held the relationship of storekeeper-customer one which creates a duty to use reasonable care to prevent aggravation of the injury, even though, as here, the defendant was not held liable for the original injury. *L. S. Ayres & Co. v. Hicks,* 220 Ind. 86, 41 N.E.2d 195 (1942). By this view, the defendant in the main case would have been held liable even absent the promise.

Although ostensibly the principal case is based upon tort concepts, analysis would seem to indicate that liability of the defendant was actually determined by application of promissory estoppel principles, while the damages assessed were based upon tort law. The necessary elements for recovery on a promissory estoppel theory are present since the defendant's promise to confine the cat was one reasonably expected to induce reliance, *cf. Miller v. Lawlor,* 245 Iowa 1144, 66 N.W.2d 267 (1954), and there was actual reliance by the plaintiff in forbearing to take other action to cause the cat to be confined, see *Martin v. Dixie Planing Mill,* 199 Miss. 455, 24 So. 2d 332 (1946). As a result of this reliance, the plaintiff sustained a real injury in unnecessarily having to take anti-rabies injections and if injustice could not be otherwise avoided, *i.e.,* no other remedy was available, promissory estoppel would be the appropriate remedy. *Easton v. Wycoff,* 4 Utah 2d 386, 295 P.2d 332 (1956). Thus far in its development the doctrine has not been applied in personal injury cases, possibly because only the contract measure of damages is usually awarded in cases based upon promissory estoppel. *Sult v. Scadrett,* 119 Mont. 570, 178 P.2d 405 (1947). As a necessary corollary, even to recover out-of-pocket damages it would seem necessary to prove that the injury sustained was reasonably contemplated by the parties at the time the agreement was made. RESTATEMENT, CONTRACTS § 330 (1932). As applied to the principal case, promissory estoppel would only allow recovery for the expense of taking the injections while recovery for additional injuries suffered from complications due to the plaintiff's allergy to the serum would have been more questionable. But see *Eads v. Marks,* 39 Cal. 2d 807, 249 P.2d 257 (1952).

Although decided under the Louisiana Civil Code, the principal case seems firmly grounded in common-law doctrine and, if its reasoning is followed elsewhere, could have an impact upon both tort and contract law of other jurisdictions. While the case apparently turned on a misapplication of the usual tort rule that assumption of a duty to assist one in peril must be evidenced by affirmative conduct, it seems unrealistic to contend that such assumption cannot be as clearly evidenced by an express promise as by an act. The extension of the rule applied here would possibly have been of more weight had it been set forth in a jurisdiction where promissory estoppel was available as an alternative remedy and where there was no civil-law background. However, if the decision is recognized as actually being an application of promissory estoppel to a personal injury case, it may represent the first of a new class of cases to which that remedy will be applied *if* the courts are willing to allow recovery of tort-type damages as was done here. As the principal case falls within an area where contract and tort law merge, the elements necessary to recover for personal injury in either tort or promissory estoppel are strikingly similar, and apparently the intent or lack of intent of the parties to contract may eventually be the factor which determines the remedy applied.

Kennett Hobbs

Negotiable Instruments — Non-Existing Payee — Liability of Drawee*

John Greenlaw kept accounts, paid bills, served as secretary-treasurer, and was signing officer of the Southern Cotton Co. Unable to meet a personal obligation due one Shoemaker, Greenlaw signed a company check payable to "Johnathan Tearose," who was to Greenlaw's knowledge a non-existent person. After endorsing the check, Greenlaw cashed it at the drawee Fifth National Bank, where the company maintained an account. The company sued the bank for the amount of the check after discovering the fraud. *Issue*: Can the company recover the amount of the check from the drawee bank?

American Law

In the principal case, the indorsement of the payee's name was of course forged, and payment on a forged indorsement cannot ordinarily be charged against the drawer's account. NEGOTIABLE INSTRUMENTS LAW § 9(3). The courts have held that the payee is 2 So. 2d 76 (La. App. 1941); *Tolman v. American Nat'l Bank*, 22 R.I. 462, 48 Atl. 480 (1901). However, the drawer's account may be charged even where there is a forged indorsement if the drawer is estopped to deny its validity. NEGOTIABLE INSTRUMENTS LAW § 23. The drawer is estopped if he knew that the payee was fictitious and was thus, in effect, a party to the forged indorsement. Annot., 146 A.L.R. 840 (1943). Further, the drawee is not liable

* (*Editor's Note: Please turn to* Inter Alia *for the background of the following notes.*)

for paying on the forged indorsement if the instrument is "bearer" paper. *Prugh v. Linwood State Bank*, 241 S.W.2d 83 (Mo. App. 1951).

The Negotiable Instruments Law provides that an instrument is a bearer instrument when payable to a fictitious person and such fact was known to the "person making it so payable." NEGOTIABLE INSTRUMENTS LAW § 9(3). The Courts have held that the payee is fictitious if the person making the instrument so payable, with or without knowledge of the payee's existence or non-existence, does not intend the named payee to benefit from the instrument. *Norton v. City Bank & Trust Co.*, 294 Fed. 839 (4th Cir. 1923); *Seidman v. Camden Trust Co.*, 122 N.J.L. 580, 7 A.2d 406 (Sup. Ct. 1939); *Commonwealth v. Globe Indemnity Co.*, 323 Pa. 261, 185 Atl. 796 (1936).

The above stated propositions indicate that the drawee bank in the instant case is not liable to the drawer for paying on the forged indorsement *if* the fictitious character of the payee was known to the *person making it so payable.* Several tests have been devised by the courts to determine the identity of the person making an instrument "so payable." Under the "actual maker" or Kentucky rule, the fictitious character of the payee turns on the intent of the person *actually* drawing the instrument, whether the nominal maker or not. Thus, in *Mueller & Martin v. Liberty Ins. Bank*, 187 Ky. 44, 218 S.W. 465 (1920), where the drawer's official signing officer drew the instrument, his acts were held to be within the apparent scope of his authority and binding on the drawer. Under the "nominal maker" or Missouri rule, the "person making it so payable" is the person who will ultimately be charged on the instrument and such person is not bound by acts of an agent outside the scope of his apparent authority. *American Sash and Door Co. v. Commerce Trust Co.*, 332 Mo. 98, 56 S.W.2d 1034 (1932); *Globe Indemnity Co. v. First Nat'l Bank*, 133 S.W.2d 1066 (Mo. App. 1939); RESTATEMENT, AGENCY §§ 159, 173, 177 (1933). Although some courts have treated these two rules as *contra*, the Missouri rule seems to be complementary in saying that *absent* real or apparent authority, the bank is not protected. Annot., 74 A.L.R. 822 (1934).

A third class of cases turns essentially on general agency principles. For example, in *Goodyear Rubber Co. v. Wells Fargo Bank*, 1 Cal. App. 2d 694, 37 P.2d 483 (1934), the defrauding employee, general manager of the drawer's branch office, caused the checks to be issued by the drawer's home office on the basis of information supplied by the employee. The employee was authorized to and did co-sign the instruments. After pointing out that the drawer or maker and the "person making it so payable" can be different persons, the court held that where an independent fraud is perpetrated on the principal, the principal will not be charged with the agent's knowledge, but the principal will be liable for the acts of his agent when done within the scope of his apparent authority. Finally, there are those cases following no clear-cut rule. In two cases involving false claims submitted to the home office of an insurance company by branch claims personnel, *Liberty Mut. Ins. Co. v. First Nat'l Bank,* 151 Tex. 12, 245 S.W.2d 237 (1951), and *Republic Nat'l Bank v. Maryland Cas. Co.,* 184 S.W.2d 496 (Tex. Civ. App. 1946), the courts held the checks in question were not bearer instruments. In the first case the court reasoned that since only the employee had knowledge of the payee's fictitious character, the drawer was not bound. In the second the same result was reached on the ground that the employee had no authority to approve payment, only to deliver checks. Both cases would have been decided differently under the Missouri rule or the *Goodyear* case, *supra,* but seem correct under the Kentucky approach.

Britton suggests that American courts have become confused as to the proper understanding of "person making it so payable" through failure to recognize the *two* problems arising under § 9(3), *viz.,* whether the named payee is fictitious (intent being a proper issue here) and, secondly, whether the drawee may charge the account of the drawer for payment on the instrument, such charge being proper where the person who caused issuance of the check was an agent of the drawer acting within the scope of his apparent authority. BRITTON, BILLS AND NOTES § 149 (1943). The California courts are substantially in accord with this view; the Kentucky rule, however, concerns itself only with the first problem and does not apply agency principles, a step which would seem essential to proper analysis.

Sixteen states, including Missouri, have amended § 9(3) to read: "When it is payable to the order of a fictitious or non-existing person or to a living person not intended to have any interest in it and such fact was known to the person making it so payable or was known to his employee or other agent who supplies or causes to be inserted the name of such payee . . . ," thereby eliminating the confusion. 5 UNIFORM LAWS ANN. 128. This statutory modification, which has been recommended by the American Banking Association, has the effect of making Britton's suggested second issue turn on whether the instrument was issued in the normal course of the drawer's business, rather than on agency principles. Such modification would, it is believed, bring American law substantially in line with the Canadian Bills of Exchange Act, CAN. REV. STAT. c. 15, § 21(5) (1952).

Thus, as a result of statutory amendment or of application of agency principles to § 9(3) as unamended, the overwhelming majority of American jurisdictions hold that where the drawer's agent causes a check to be issued payable to a fictitious payee and where such act was within the agent's apparent authority, the instrument is a bearer instrument and a paying bank may charge the drawer's account.

In the instant case, application of any of the above rules would, it is believed, result in a decision that the drawer can not recover from the drawee. Kentucky, Missouri, and those states with the amended statute would reach the result since the employee was the signing officer of the drawer. The agency analysis of Britton and the California courts is satisfied since the act was committed within the scope of the agent's apparent authority. Even such anamolous jurisdictions as Texas would concur since the acts of a corporation's officers done within the scope of their apparent authority, though a fraud on it, would bind the corporation to third parties.

Robert Keegan and Gordon Jackson

CANADIAN LAW

Codification of the Canadian law of bills, notes and cheques is found in the Bills of Exchange Act. first passed in 1890, CAN. REV. STAT. c. 15 (1952), and modelled on the British Bills of Exchange Act, 1882, 45 & 46 VICT., c. 61. Since § 21(5) of the Canadian act (which is applicable in the instant case) and § 7(3) of the English act are identical, the Ontario Court of Appeals has indicated that House of Lords' decisions construing § 7(3) are binding on Canadian courts. *Harley v. Bank of Toronto,* [1938] Ont. 100, 2 D.L.R. 135 (1938). This statement should be taken with some reservation now that the Supreme Court of Canada is the final court of appeal for Canada; but even though English decisions are not technically binding now, they must still be treated with great respect.

Assuming that the cheque in the instant case was payable to Tearose or to order in accordance with general business practice, the drawee bank could have obtained no rights against the drawer if there were an actual Tearose in existence who had been intended as payee, and who had endorsed the cheque, CAN. REV. STAT. c. 15, §§ 60(3), 165 (1952); nor could the bank recover from the drawer money paid on a forged endorsement. CAN. REV. STAT. c. 15, § 49(1) (1952). However, § 21(5) of the act provides that where the payee is fictitious or non-existent, a bill (and consequently a cheque, CAN. REV. STAT. c. 15, § 165 (1952)) may be treated as payable to bearer and negotiable on delivery. CAN. REV. STAT. c. 15, § 60(2). Even if there were an actual Johnathan Tearose, the cheque would be regarded as payable to bearer, since the signer (Greenlaw) never *intended* Tearose as payee. *Vagliano Bros. v. Bank of England*, [1891] A.C. 107. As Lord Herschell stated in the *Vagliano Bros.* case, *supra*, at p. 153, " . . . where the name inserted as that of payee is so inserted by way of pretense only, it may . . . be said that the payee is a feigned or pretended, or in other words, a fictitious person."

Analogous to the instant case is *Clutton v. Attenborough & Co.*, [1897] A.C. 90, where a clerk induced his company to sign a cheque payable to George Brett, a name invented by the clerk; it was held that the cheque was payable to a non-existent person and thus to bearer. A chief difference between the *Clutton* case and the principal case is that the Attenborough official who signed the cheque in the *Clutton* case had actual authority to do so (although misled by the clerk's misrepresentations), whereas Greenlaw had authority to sign cheques only to discharge the company's obligations, not his personal obligations. He thus exceeded his actual authority.

However, the company in effect said to the bank that cheques signed by Greenlaw, the signing officer, are the company's cheques, making the bank liable for failure to honour them. *Marzetti v. Williams*, 1 B. & Ad. 415 (1830). It would seem that Greenlaw acted within the apparent scope of his authority, and it is well settled in Canadian jurisprudence that a principal is liable for the acts of an agent done within the apparent scope of his authority since the principal has the better means of knowing what type person his agent is, and since the principal should bear the risk of the agent's exceeding his authority where the principal is to benefit from the agent's exercise of delegated powers. *Craig v. Sauve*, 1 D.L.R. 72 (1940), citing Collins, M. R., in *Hamlyn v. John Houston & Co.*, 1 K.B. 81 (1903) at pp. 85-86. For these reasons, it is believed that Southern Cotton Co. should not recover the amount of the cheque.

Robert Webster

COMMENT

Although it would appear from the wording of the Bills and Exchange Act that only one problem need be resolved, that the payee be fictitious or non-existent, while the Negotiable Instruments Law has the further requirement that such fact be the intention of the person making it so payable, the apparent differences disappear upon an application of the two statutes to a particular set of facts. In Canada, in order to ascertain whether a payee is fictitious, a determination must be made of the intent of the party causing such person to be named as payee, for there is no other method to determine whether the named payee was intended to have an interest in the instrument. In the United States, the existence of such intent is an express requirement of section 9(3) of the Negotiable Instruments Law. It would appear that in both Canada and the United States that upon proof of the intention that the payee be fictitious, the instrument is then payable to bearer.