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Case Notes

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CASE NOTES

VALIDITY OF AGREEMENTS BY BANK TO REPURCHASE BONDS SOLD BY IT AS AFFECTED BY PUBLIC POLICY.—A decision was rendered by the Illinois Supreme Court in the case of *Knass et al.* v. *Madison and Kedzie State Bank et al.*[1] which may result in substantial benefit to bank depositors and cestuis of trust funds, victims of the over-optimistic attitude of a few years ago of certain Illinois banks as to the stability and permanence of the then current real estate values. The court construed, for the first time, a statute fifty-four years old, as authority for holding null and void as against public policy a bank's agreement to repurchase at par or slight discount, real estate mortgage bonds which it had sold. Having decided that such a contract was in contravention of public policy, the court, naturally, held it unenforceable by any remedy.

This decision distinguishes, if it does not overrule, *Wolf* v. *National Bank of Illinois*,[2] the case which for forty-three years has been cited as authority for a long line of decisions of the Illinois appellate courts, uniformly adverse to the banks, in cases where these agreements have been before the Illinois courts.

It appears to have been the practice of the Madison and Kedzie State Bank to invest heavily in securities on its own account and also to undertake the sale of such bonds on behalf of the issuing real estate corporation. The bank appears to have charged a commission on such sales. The repurchase agreement was to the effect that the bank would repurchase the bonds "at any time after one year at 99, and after three and one-half years at par if desired." Some repurchases were made, but after October, 1929, the bank refused to be bound by the terms of the agreement or to take back bonds which had been purchased from it, when requested to do so.

For reasons not essential to this discussion, the action was brought by bill in equity for specific performance. In view of the ground on which the court placed its decision, the form of action is immaterial. If such contracts are held to contravene public policy, even the remedy in quasi-contract is not available. The only result of this form of action, as against an action predicated upon the theory of recission, was to let in the defense of ultra vires. This defense was held ineffective in the courts below, but the Supreme Court reversed the lower courts on this point before going still further to apply the police power.

If the contract were merely ultra vires, the instant case

[1] 354 Ill. 554, 188 N. E. 836 (1933—Rehearing denied, 1934).

[2] 178 Ill. 85, 52 N. E. 896 (1899).

would no longer be authority for denial of recovery, even in this form of action, for, during the pendency of this case, the "Business Corporation Act" was passed. This act eliminates the defense of ultra vires in Illinois[3] in cases where business corporations are parties. However, since the court went beyond ultra vires to the ground of public policy, the authority of the principal case is not impaired by the corporation act.

In preparation for the application of the statute which, in its opinion, brings the agreement before it within the scope of the police power, the court lays down a broad doctrine of public policy, but it uses no language inconsistent with that which has been expressed and applied in cases already decided, as may be seen from the following quotation:

"Public policy is a principle of law which holds that no one may lawfully do that which has a tendency to injure the public or be against the public good.[4] Banks are quasi-public institutions. Their well-being concerns not only the stockholders, but the depositors and public at large. Contracts are against public policy when they tend to injure the public. Agreements such as are here involved fall within that category. Recent experience, so general as to afford the basis of judicial notice, has shown that contracts not within the powers conferred on banks and which so jeopardize the safety of bank deposits as to result in their loss, tend to produce widespread injury to the public, and may properly be held void though there be found no specific statutory prohibition against them." The qualification in the concluding phrase is obiter dictum, but it may become significant in a possible contingency which will be discussed later.

The court found statutory authority for the application of its doctrine of public policy to condemn the agreement before it in section 4 of "An Act for the protection of bank depositors," approved June 4, 1879, and incorporated into the statutes as a

[3] L. 1933, p. 308; Cahill's Ill. Rev. Stat., 1933, Ch. 32, sec. 8. Under this statute, ultra vires may be asserted only by the plaintiff (or the prosecution) in the following cases: (a) In a proceeding by a shareholder to enjoin the doing of unauthorized acts or the transaction or continuation of unauthorized business; (b) In a proceeding by the corporation, whether acting directly or through a receiver, trustee or other legal representative, or through shareholders in a representative suit, against the officers or directors of the corporation for exceeding their authority; (c) In a proceeding by the State to dissolve the corporation, or in a proceeding by the State to enjoin the corporation from the transaction of unauthorized business.

[4] Although no authority is cited by the court, this definition is that of Greenhood (Greenhood, The Doctrine of Public Policy, 2), who cites it as per Lord Brougham in Egerton v. Earl Brownlow, 4 H. L. C. 1 (1853). Page also uses this definition (Page, The Law of Contracts, sec. 326), and it is adopted as the definition of the court in People v. Gas Trust Co., 130 Ill. 268 (1889), where the court cites Page.

part of the Criminal Code.[5]

The public policy aspect of the principal case appears to present three questions:

(1) Is the court sound in its concept of the doctrine of public policy?

(2) Does the statute in question declare a public policy?

(3) Does the agreement in question fall within the class of contracts which are declared null and void by the statute?

For purpose of analysis, the first question may be considered according to whether contracts of banking institutions are so charged with a public interest that they fall within the ambit of public policy; and whether the test, "a tendency to injure the public or to be against the public good," is too broad, as an attempt to bring within the scope of the police power interests not included within the ambit of its protection.

The quasi-public nature of banking institutions has been settled by a long line of decisions in all jurisdictions. It is too well recognized to require citation of authorities, although *Wedesweiler* v. *Brundage*[6] and *People* v. *Mueller*[7] may be mentioned as recent Illinois cases in which the state's right to control banking activities is recognized.

To lay down a general rule for determining what public interests are included within the protection of the police power, as against the rights of individuals, is impossible. Such attempt is met at the outset by the situation well expressed by Mr. Justice Holmes in *Hudson County Water Company* v. *McCarter*,[8] where the eminent justice said:

"All rights tend to declare themselves absolute to their logical extreme. Yet all in fact are limited by the neighborhood of principles of policy which are other than those on which the particular right is founded, and which become strong enough to hold their own when a certain point is reached. The limits set to property by other public interests present themselves as a branch of what is called the police power of the state. The boundary at which the conflicting interests balance cannot be determined by any general formula in advance, but points in the

[5] L. 1879, p. 113; Smith-Hurd's Ill. Rev. Stat., 1931, Ch. 38, sec. 64. This section of the Criminal Code provides that: "It shall not be lawful for any savings bank, individual or individuals doing banking business, banking company, or incorporated bank receiving savings deposits, or deposits of trust funds, to assume the payment of, or to become liable for, or to guarantee to pay the principal of, or interest on, any bonds, notes or other evidence of indebtedness of, for, or on account of any person or persons, company or incorporation; and in any assumption, liability or guarantee, whereby such deposits or trust funds could be jeopardized or impaired, shall be null and void."

[6] 297 Ill. 228, 130 N. E. 520 (1921).

[7] 352 Ill. 124, 185 N. E. 239 (1933).

[8] 209 U. S. 349, 52 L. Ed. 828 (1908).

line, or helping to establish it, are fixed by decisions that this or that concrete case falls on the nearer or farther side. . . . It is sometimes difficult to fix boundary stones between the private right of property and the police power when . . . we know of few decisions that are very much in point. . . . This public interest is omnipresent wherever there is a state, and grows more pressing as population grows."

This language well expresses the fallacy of any attempt at rigid classification of the public interests to be protected under the doctrine of public policy. For instance, to define these interests as those of public health, public safety, and public morals, raises the question of the extent of these interests. "In order to maintain the balance at the proper boundary," under stress of economic and population changes, we may have to enlarge our usual concepts of health, safety, and morals until they include the entire scope of the greater interest properly designated as the "public good" or the "public welfare," of which health, safety, and morals are elements.

From this viewpoint, the language of the court in the principal case becomes of especial significance: "Recent experience, so general as to afford the basis of judicial notice, has shown that contracts not within the powers conferred on banks and which so jeopardize the safety of bank deposits as to result in their loss, tend to produce widespread injury to the public." So long as the entire conflict produced by the ultra vires contract is confined to that between private rights—the right of the bank's stockholders to be protected from unauthorized acts of officers and directors, on the one hand, and the right of the other contracting party to restitution of benefits conferred in reliance on such a contract, on the other—public policy is not interested, and the court will decide the case *ex aqueo et bono*. But when the facts and circumstances of the case, in view of "experience so general as to afford the basis of judicial notice," bring into the conflict a third and public interest, the situation changes. In this case, the public interest was the right of the public to security of its bank deposits—an essential element of its right to be safe against such calamities as bank failures, tending to "produce widespread injury to the public." Whether we designate this interest as "public safety," "public good," or "public welfare," the point has been reached where the rights of individuals may no longer "declare themselves absolute to their logical extreme."

The eminent justice was not announcing a new doctrine when he stated that the boundary at which the conflicting interests balance can not be determined by any general formula in advance. In 1824, Mr. Justice Burrough laid down his celebrated dictum that public policy "is a very unruly horse, and when

once you get astride it, you never know where it will carry you."[9] In 1887, Justice Kekewich, in *Davies* v. *Davies*,[10] said: "Public policy does not admit of definition and is not easily explained.[11] One thing I take to be clear, and it is this—that public policy is a variable quantity; that it must vary and does vary with the habits, capacities, and opportunities of the public; that it cannot have been the same when Chief Justice Tindal decided *Horner* v. *Graves*,[12] in 1831, as it was when Chief Justice Parker decided *Mitchel* v. *Reynolds*,[13] in 1711; that it must have changed, and did change between 1831 and 1869 when Vice-Chancellor James decided *Leather Cloth Company* v. *Lorsont*,[14] and if there had not been a further change before Lord Justice Fry decided *Rousillon* v. *Rousillon*,[15] in 1880, it must have occurred ere now."

During the past two or three years, many courts, including the United States Supreme Court, have shown a strong tendency to extend rather than to restrict the application of the police power. This appears most noticeably in cases such as *Home Building & Loan Association* v. *Blaisdell*,[16] and in other cases where moratory legislation to relieve the consequences of the recent collapse of our economic structure has been sustained against attack on constitutional grounds. The element of "emergency" has been somewhat stressed in these decisions. It is not necessary, however, to rely upon cases involving emergency legislation, where the court may have been affected by economic conditions of the past three or four years, for authority that "public good" and "public welfare" do not express concepts too broad for use in defining the interests included within the protection of the police power. Some of the earlier cases go even farther. Some of them specifically apply the police power to sustain legislation, not otherwise supportable as constitutional, for protection of bank depositors.

In *Manigault* v. *Springs*,[17] decided by the United States Supreme Court in 1905, Mr. Justice Brown defines the extent of the police power to include "promotion of the common weal" and protection of the "public comfort," then concludes: "It only remains to consider . . . whether the act of the general assembly . . . was a proper exercise of the police power of the state. Of this we have no doubt. Although it was not an exercise of that power in its ordinarily accepted sense of protecting

[9] Richardson v. Mellish, 2 Bing. 229 at p. 252 (1824).
[10] 36 Ch. Div. 359, 364 (1887).
[11] Citing Lord Brougham in Egerton v. Earl Brownlow, 4 H. L. C. 1 (1853).
[12] 7 Bing. 735 (1831).
[13] 1 P. Wms. 181 (1711).
[14] L. R. 9 Eq. 35 (1869).
[15] 14 Ch. Div. 351 (1880).
[16] 290 U. S. 398, 78 L. Ed. 413 (1934).
[17] 199 U. S. 473, 50 L. Ed. 274 (1905).

the health, lives, and morals of the community, it is defensible in its broader meaning of providing for the general welfare of the people. . . ."[18]

Ten years later, in *Chicago & Alton Railroad* v. *Tranbarger,*[19] Mr. Justice Pitney reiterated the same broad doctrine of the United States Supreme Court,[20] and stated as settled, the fact that the police power embraces regulations designed to promote the public convenience or the general welfare and prosperity, as well as those of the public health, morals or safety.[21]

In *Noble State Bank* v. *Haskell,*[22] Mr. Justice Holmes applied the public policy doctrine directly to the protection of bank depositors. This case questioned the constitutionality of the Oklahoma bank guaranty law. The law levied an assessment on each state bank for the purpose of creating a depositors' guaranty fund to secure the full repayment of deposits, in case it, or any other bank existing under the state laws, became insolvent. In sustaining the statute as a valid exercise of the police power of the state, the eminent justice said: "It may be said in a general way that the police power extends to all the great public needs.[23] It may be put forth in aid of what is sanctioned by usage, or held by the prevailing morality or strong and preponderant opinion to be greatly and immediately necessary to the public welfare."

In *Shallenberger* v. *First State Bank,*[24] the United States Supreme Court followed its previous decision in *Noble State Bank* v. *Haskell,* in reversing the decision of the United States District Court for the District of Nebraska,[25] which had held the Nebraska bank guaranty law unconstitutional. In *Assaria State Bank* v. *Dolley,*[26] the bank guaranty law of Kansas was upheld as a valid exercise of the police power of the state.

[18] The court cites Charles River Bridge v. Warren Bridge, 11 Pet. 420, 9 L. Ed. 773 (1837), as authority for the statement that while the police power is subject to limitations in certain cases, there is a wide discretion on the part of the legislature in determining what is and what is not necessary—a discretion which courts ordinarily will not interfere with.

[19] 238 U. S. 67, 59 L. Ed. 1204 (1914).

[20] Citing Atlantic Coast Line R. Co. v. Goldsboro, 232 U. S. 548, 558, 58 L. Ed. 721, 726 (1914), and cases there cited.

[21] Citing Lake Shore & M. S. R. Co. v. Ohio, 173 U. S. 285, 292, 43 L. Ed. 702, 704, 19 S. Ct. 465 (1899); Chicago, B. & Q. R. Co. v. Illinois, 200 U. S. 561, 592, 50 L. Ed. 596, 609, 26 S. Ct. 341, 4 Ann. Cas. 1175 (1906); Bacon v. Walker, 204 U. S. 311, 317, 51 L. Ed. 499, 502, 27 S. Ct. 289 (1907).

[22] 219 U. S. 104, 55 L. Ed. 112 (1911).

[23] The eminent justice here cited Canfield v. U. S., 167 U. S. 518, 42 L. Ed. 260 (1897).

[24] 219 U. S. 121, 55 L. Ed. 117 (1911).

[25] 172 F. 999 (1909).

[26] 219 U. S. 121, 55 L. Ed. 123 (1911).

It appears, therefore, that specific application of the police power to protection of bank depositors, by whatever term the interest so protected is defined, has become *stare decisis* in the Supreme Court of the United States.

The reason for the failure of the Illinois courts to apply the police power, heretofore, to protection of bank depositors, by declaring null and void repurchase agreements of banks, must be sought elsewhere than in a narrow concept of the interests to be protected by the police power. The Illinois Supreme Court, by dictum and decision, has expressly adopted the doctrine of *Davies* v. *Davies,* heretofore cited, and subsequent cases which have recognized the fallacy of attempts to reduce public policy to any formulary definition. The reason for failure of such specific application will be discussed later, in considering the third main question presented by the principal case.

In *Zeigler* v. *Illinois Trust & Savings Bank,*[27] the contract under question was one between physician and patient, whereby the physician agreed to furnish medical attention to the patient as long as she should live. The consideration was $100,000, payable out of the patient's estate after her death. After the patient died, the personal representative of the decedent refused to perform the contract. The ground for refusal was that the agreement was an incentive to commission of crime and also a wager of the continuance of the patient's life, hence void as against public policy. In holding the agreement valid, the court said:

"There is no precise definition of public policy, and consequently no absolute rule by which a contract can be measured or tested to determine whether or not it is contrary to public policy. . . . The public policy of the State or of the nation is to be found in its constitution and its statutes, and when cases arise concerning matters upon which they are silent, then in its judicial decisions and the constant practice of the government officials."[28]

In *Brush* v. *City of Carbondale,* [29] it was held that whether or not a contract is against public policy is a question of law for the court to determine from all the circumstances of each case. In

[27] 245 Ill. 180, 91 N. E. 1041 (1910). This doctrine is reiterated practically verbatim in Steen v. Modern Woodmen of America, 296 Ill. 104, 129 N. E. 546 (1921), as ground for its decision that a contract waiving a constitutional or statutory right or an established rule of law is not void on the theory that it is against public policy, unless it is injurious in some way to the interests of society.

[28] In support of this statement of its doctrine, the court cites Bell v. Farwell, 176 Ill. 489, 52 N. E. 346 (1898); Harding v. American Glucose Co., 182 Ill. 551, 55 N. E. 577 (1899); and People v. Gas Trust Co., 130 Ill. 268, 22 N. E. 798 (1889). See also reference to the Gas Trust Co. case in footnote 4.

[29] 229 Ill. 144, 82 N. E. 252 (1907).

Union Trust & Savings Bank v. *Kinloch Long Distance Telephone Company,*[30] it was decided that a public service corporation—in this case a telephone company—owes a duty to the public, and it cannot, without the consent of the state, disable itself from performing any part of the functions which its charter authorizes it to perform. A contract so to disable itself was held to be a violation of its duty to the state, and void as against public policy. *Crichfield* v. *The Bermudez Asphalt Paving Company*[31] and *Thomas* v. *The First National Bank of Belleville*[32] could probably be brought under the classification of "contracts against public morality." Other Illinois cases where the police power has been applied have involved contracts in which the claim to illegality was based upon considerations of public health, safety, or morality.[33] None of them, however, contains language which appears to indicate that the court considered itself bound to limit the application of the police power to these interests.

Because the doctrine of public policy can not, apparently, be confined within narrow formulary limits; because there is so much principle and authority in support of the broad basis upon which the court, in the principal case, rests its doctrine of public policy; and because there is specific authority of the United States Supreme Court for application of the doctrine to the very question before the court, the first question presented would seem to require an affirmative answer—the court announces a sound general doctrine.

The second problem presented is one of statutory construction. Does the particular section of the statute which the court has applied to the contract declare a public policy?

In determining whether a particular statute evidences a legislative intent to declare a public policy, the historical background of the statute is important. By ascertaining the facts and circumstances which gave rise to the legislation in question, and the conditions which it was designed to remedy, we may determine whether such facts, circumstances, and conditions presented a proper case for the application of the police power. Mr. Justice Dunn, in delivering the opinion of the court in *People* v. *Gould,*[34] has given us the historical background of "An Act for the protection of bank depositors." This opinion also expressly recognizes this statute as an exercise, by the legislature,

[30] 258 Ill. 202, 101 N. E. 535 (1913).

[31] 174 Ill. 466, 51 N. E. 552 (1898).

[32] 213 Ill. 261, 72 N. E. 801 (1904).

[33] Beadles v. Bless, 27 Ill. 320 (1862); Goodrich v. Tenney, 144 Ill. 422, 33 N. E. 44 (1893).

[34] 345 Ill. 288, 178 N. E. 133 (1931).

of the police power of the state. It was section 1 of the act which was then before the court, but in their historical aspect and in recognition of the act as an exercise of the police power, the court's remarks apply to the entire act:

"At the time of the adoption of the constitution of 1870, many incorporated banks existed in Illinois, some under special laws enacted by the legislature, others under the act of 1851[35] to establish a general system of banking. . . . All of these banks and banking corporations, whether organized under the general Banking law of 1851 or under special statutes, were recognized by sections 2, 5 and 7 of article 11 of the constitution of 1870 and treated as validly organized corporations.[36] Besides the incorporated banking associations there were in the State many individuals and partnerships doing a banking business over whom the State exercised no supervision, and many national banks organized under the Federal laws and subject to the supervision of the Federal government. The act of 1851 provided in considerable detail for the security of the note holder . . . but no special provision for the security of depositors was made except to require a full statement of the bank's affairs as of the first Monday of January, April, July, and October to be transmitted to the Auditor and published in the nearest newspaper. Whether or not this section [Art. 11. sec. 5] repealed the Banking act of 1851 is not material, for that act was expressly repealed by the general Repealing act of the Revised Statutes (chap. 131, sec. 1, par. 172) which took effect on July 1, 1874.

"Thus the law stood, with no statute authorizing the organization of corporations with banking powers in Illinois, when the Thirty-first General Assembly on June 4, 1879, passed 'An act for the protection of bank depositors.' . . .

"It has been observed that in 1870 the banking business of this State was conducted by many so-called private banks which were not incorporated, by a number of incorporated banks having special charters, and by some banks incorporated under the Banking act of 1851. Any person who chose to, could become a private banker if he had a few thousand dollars of his own or could secure a few thousand dollars by borrowing or associating somebody with him as a partner who had the money. He was not required to report his assets and liabilities or the condition of his business to anyone and was not subject to the examination of any public officers as to his financial ability to respond to the demands of his depositors. Their dependence for the payment of their deposits was in the business ability, honesty and good fortune of the banker, and too often these failed them. Failures

[35] Laws of 1851, p. 163.

[36] The court here cites People v. Loewenthal, 93 Ill. 191 (1879).

were frequent and they were often disastrous. Therefore in 1879 the legislature, in the exercise of the police power, passed the act. . . . This act was passed, not as an amendment to the Criminal Code and not as an amendment to any act authorizing or creating a corporation with banking powers, but as an independent act to protect bank depositors. . . .

"This was the condition of the law when the Thirty-fifth General Assembly passed 'An act concerning corporations with banking powers,'[37] which was approved by the Governor on June 16, 1887. . . . At the November election, 1888, the act was approved by the vote of the people and became a law. . . .

"This act contained no penal provisions whatever. . . . Neither section 76 nor section 25a (as section 1 of the act of June 4, 1879, was then known) of the Criminal Code was referred to or affected by the act, but the officers of the banking corporations authorized by it became subject to these criminal laws, as were the officers of all other banks."

The title of the act, together with this historical background, would appear to be cogent evidence of the public policy intent of the legislature in enacting this statute. Its cogency is certainly strengthened by the express recognition of the act by the Illinois Supreme Court as an exercise of the police power.

The court, in the principal case, finds evidence of the intent of the legislature to declare contracts of the character before it void as against the public policy of the state in the fact that the statute was enacted, as its title indicates, for the protection of bank depositors. For its statement that its enactment was for the public generally and should be construed to carry out that purpose, the court finds authority in *People* v. *Tallmadge,*[38] another case in which section 1 of the act was before the court. In passing on the constitutionality of the act, the court thus construed its purpose:

"The purpose of the statute undoubtedly was to protect the public from being induced to deposit money, or property of like import, with insolvent bankers, and time and experience have demonstrated to us that there was ample reason, if not a real necessity, for such legislation. Ordinarily a penal statute should be strictly construed, and though this statute is penal in its nature yet it is one enacted for the benefit of the public generally and should receive a fair and reasonable construction."

Although the court in the Tallmadge case refers to the statute as "penal in its nature" and the statute appears as part of the Criminal Code, it is doubtful whether section 4 is penal, at least in the strict sense. Section 1, which was under considera-

[37] Laws of 1887, p. 89. This act was repealed by the act of 1919, (L. 1919, p. 224, Cahill's Ill. Rev. Stat., Ch. 16a, pars. 1-18).

[38] 328 Ill. 210, 159 N. E. 319 (1927).

tion in the Tallmadge case, is undoubtedly penal, but section 4, in the principal case, inflicts no penalty on those who, by its terms, are forbidden to enter into the class of contracts which it condemns. The fact is distinctly otherwise. Although it is the action of the bank which is declared unlawful, application of the "penalty" by declaring the agreement void, is the very result the bank is seeking to accomplish in order to avoid a heavy loss. However, a statute need not be penal in order to express a public policy, although the fact that it is penal often makes more certain its construction as so intended. Where the public policy object may be accomplished by a remedial statute, the law may be content, as between the parties, especially when they are *in pari delicto,* to inflict no specific penalty upon either party. It may "let the loss lie where it falls" so long as the public interest is protected. The object of section 4 is to avoid one of the causes which often leads to the necessity of applying the penalty of section 1. Section 1 merely inflicts a penalty upon the banker who receives deposits after his bank becomes insolvent. The purpose of section 4 is to prevent the insolvency by the removal of one of its frequent causes—assumption of the liability of a guarantor or surety.

Apparently, the second question presented also requires an affirmative answer. The court's construction of the statute which it applied to the contract before it, as expressing a legislative intent to declare a public policy, appears to be well supported.

Consideration of the third and final question—whether the agreement in the principal case comes within the class of contracts declared null and void by statute—will involve a discussion of previous Illinois decisions. Previous decisions, where agreements of banks to repurchase bonds sold by them have been involved, have uniformly required the banks to repurchase the bonds—usually at a heavy loss.

First, however, it may be well to consider the argument advanced that the bonds and repurchase agreements were not evidence of indebtedness of another, but were the obligations of the bank itself, and therefore that the statute would not apply. It is difficult to conceive on what ground these bonds could be considered obligations of the bank. A bank, of course, is liable for its indorsements on commercial paper, but these bonds were not commercial paper, nor could the repurchase agreements be considered as endorsements. Bearer bonds such as those in question pass from hand to hand without indorsement. Title passes by delivery, and no liability ever accrues to the holders unless, as in the principal case, such liability is voluntarily assumed by a vendee by execution of a collateral agreement such as was executed by the bank in this case.

Regardless of ownership, these bonds remain the obligations of the mortgagor. In entering into the agreement to redeem them, therefore, the bank was, in effect, guaranteeing to the purchaser the value of the mortgagor's obligations. In fact, the bank's obligation appears to have passed beyond the secondary liability of a mere guarantor, and to have more nearly approached the primary liability of a surety. A guarantor agrees to redeem if the principal obligor fails to do so. The bank's agreement was to redeem upon demand, without regard to any action of the mortgagor. The contract contained the additional element of certainty that redemption would not be called for except under circumstances which would involve loss to the bank. So long as the value of the bonds was more than that guaranteed by the bank, no purchaser would return them. The bank could not even mitigate its loss by calling for execution of the repurchase agreement when the market first started to decline. No matter how great the shrinkage of real estate values, redemption was entirely at the option of the purchaser. He could "hold on" waiting for a "turn of the market" until the termination of the period covered by the agreement, and then, by the exercise of his option, throw the entire loss upon the bank.

The nature of this agreement and its inherent danger to bank deposits and trust funds—especially in view of the large sums for which such real estate bond issues were "floated" and marketed through the banks during the "real estate boom"—would undoubtedly have been decisive of the case, except for the influence of *Wolf* v. *National Bank of Illinois*.[39] This case has been cited as primary authority in all previous cases, including the principal case in the Appellate Court, for permitting recovery against the banks on such repurchase agreements. Plaintiff, in the principal case, cited the Wolf case as authority for the contention that the agreement was not a repurchase contract, but a conditional sales contract—that the bonds were taken on condition that they might be returned—and that such a contract is enforceable.

In the Wolf case, the bank sold Wolf bonds of the Chicago Auditorium Association, considered staple bonds, with an agreement to repurchase on demand, either at the price sold or at par with interest. The receiver of the bank refused to accept the bonds on demand or recognize any obligation by reason of the repurchase agreement. Wolf brought an action at law for breach of the contract. The only defense offered was that the agreement was in contravention of the "Gambling in Futures

[39] 178 Ill. 85, 52 N. E. 896 (1899).

Act"[40] of Illinois, and therefore null and void as a gambling transaction. As against this defense, the court held that the contract, construed as a whole, was a conditional sale with the right reserved by the plaintiff to return the bonds. This construction was placed on the ground that the obvious intention of the parties was to make a conditional sale, the condition being that the bank should take the bonds back at the price paid, within a specified time, if the plaintiff desired to return them. In other words, the court held that the plaintiff had the right, during the stipulated time, to elect whether he would keep the bonds or return them, and in case he decided to return them, was entitled to his money back with interest.

The Wolf case can be distinguished from the principal case, if such distinction is important, by the fact that in the Wolf case the bank sold bonds to which it had acquired title, having purchased them for its own investment. In the principal case, the bank had never acquired title to the bonds, but appears to have been merely acting as a sales agent.

Whether or not the transaction in the Wolf case was properly held to be a conditional sale, or that in the principal case could properly be so held, would appear immaterial, in view of the ground upon which the principal case was decided. There is authority for the view that a sale on condition subsequent may properly be designated a conditional sale,[41] although the weight of authority is decidedly in favor of the view that the term "conditional sale" has acquired a special significance, and has come to mean a sale where the passage of title to property is subject to a condition, and that condition is precedent and not subsequent. This view is codified by the definition of a "conditional sale" in the Uniform Conditional Sales Act.[42] The minority view has been criticized[43] as unfortunate and tending to confusion.

Under the defense raised in the principal case, it is immaterial whether the transaction is designated as a "conditional sale," "sale on condition subsequent," "venté a reméré," "sale or return," or other technical term. The property sold by the bank was the obligation of the mortgagor. The condition subsequent was for the purpose of protecting the purchaser against depreciation in the value of the obligation; to remove, as to him, the speculative element and thus induce him to make the purchase. It may well be reasoned that such a condition subsequent is, in fact, a guarantee of the obligation of another and therefore

[40] Cahill's Ill. Rev. Stat., Ch. 38, par. 308 (Act of 1874).

[41] Hunt v. Wyman, 100 Mass. 198 (1868); Vent v. Duluth Coffee & Spice Co., 64 Minn. 307, 67 N. W. 70 (1896); Ophir Consolidated Mines Co. v. Brynteson, 143 F. 829 (1906).

[42] 2 U. L. A., Sec. 1 (1924).

[43] Bogert, Commentaries on Conditional Sales, 2a U. L. A., Sec. 4 (1924); see also Williston, Sales, 2d ed., secs. 270-272 (1924).

within the prohibition of the act of 1879—even though the transaction may be technically designated a "conditional sale."

Whether or not it was necessary to hold the contract in the Wolf case a conditional sale, in order to avoid declaring it a gambling contract, is immaterial to the purpose of this discussion. Our only interest is in the effect of the case on subsequent decisions. In the Wolf case, no question was raised of ultra vires or public policy, except on the question of gambling. The case, therefore, stands only as authority for this point and has no value as an authority where the "Act for the protection of bank depositors" is raised.

In *Freedman* v. *Madison and Kedzie State Bank,*[44] the action was at law on a repurchase contract identical with that in the principal case. The court sustained a recovery against the defense of ultra vires on the ground that a corporation for pecuniary profit has power to purchase its own bonds, and that a sale with an agreement to repurchase is only a conditional rather than an absolute sale. The fallacy of the argument that in such case the bank is "purchasing its own bonds," has already been indicated. The court cites *Wolf* v. *National Bank of Illinois* and other Illinois authorities,[45] but the Wolf case is the only one cited where a bank was involved. As to the Wolf case, the court said: "It is true . . . that the precise question of ultra vires was not raised in the briefs or considered in the opinion of the court; but as the parties to that suit were represented by able counsel, they would not have missed the point had it been deemed available." Apparently counsel for banks, usually very able, have been overlooking the significance of the act of 1879 for nearly half a century.

Regarding the possible effect of an act such as that of 1879, the court, in the Freedman case, said: "We are not cited to any statute which forbids expressly such contracts as was here made; and on the plainest principles we think defendent is estopped to set up that defense. Even if a statute expressly forbade it, there would remain the question of whether it was the intention of the legislature, by the enactment of the statute, to make such a contract wholly void as contrary to public policy."

The next agreement of this nature to come before the Illinois Appellate Court was *Awotin* v. *Atlas Exchange National Bank.*[46] To sustain the defense of ultra vires, the defense invoked the proviso of the National Banking Act limiting a national bank's

[44] 259 Ill. App. 519 (1931).

[45] Ward v. Johnson, 95 Ill. 215 (1880); Stewart v. Dodson, 282 Ill. 192, 118 N. E. 405 (1918); Roush v. Illinois Oil Co., 180 Ill. App. 346 (1913); Hills v. Hopp, 210 Ill. App. 365 (1919); Massachusetts Bonding & Ins. Co., v. The Phillips Co., 230 Ill. App. 38 (1923).

[46] 265 Ill. App. 238 (1932).

business of buying and selling investment securities to such buying and selling without recourse.[47] The court permitted a quasi-contractual recovery of the amount paid for the bonds plus accrued interest, "even if the agreement to repurchase could be considered ultra vires in view of the above subsection 7." The defense of "conditional sale" was also sustained on the authority of the Wolf case. The court quoted from that case, *inter alia:*

"Is it contrary to law or justice, or does it violate any rule of public policy, for a person to sell a horse, a cow, a promissory note or a bond for a specified sum and agree to take the article back within a given time for the same price? If it is, this contract might be condemned; otherwise not." Apparently the court, in the Wolf case and the Appellate Court in its subsequent quotation in the Awotin case, overlooked the fact that neither the Federal statute nor the act of 1879 is directed to the sale of horses or cows by banks, or of promissory notes or bonds by individuals.

The Awotin case also cites the Freedman case to the effect that a bank's agreement to repurchase bonds sold, on certain conditions, is a valid agreement; and as to the possible effect of a statute expressly prohibiting such an agreement.

The principal case appears to be the first in which section 4 of the act of 1879 was definitely presented to the Illinois Appellate Court. That court considered the defense of ultra vires settled by the Freedman case, stating that, while the act in question was not specifically called to its attention in that case, it was presented to the Supreme Court for consideration upon the application for certiorari, which was denied. It also cites the Awotin case as one where the defense of ultra vires was held unavailable. It also calls attention to *Madison and Kedzie Trust and Savings Bank* v. *Dean.*[48] In that case, the defendant in the principal case attempted to sustain a judgment by confession entered upon a note taken under circumstances substantially similar to those of the principal case. The motion to open the confession judgment had been denied in the court below, but was reversed and remanded by the Appellate Court. The case is reported in abstract only, but the court, in the principal case below, states that the statute was considered. The Appellate Court also cites *Hoffman* v. *Sears Community State Bank,*[49] also reported in abstract only, as one in which the statute in question as well as a number of cases which it was there insisted had not been called to the attention of the court in previous cases, received consideration.

[47] U. S. Rev. Stat., sec. 5136, subsec. 7.
[48] 263 Ill. App. 646 (1931).
[49] 269 Ill. App. 644 (1933).

Since the decision was rendered in the principal case, however, *Hoffman* v. *Sears Community State Bank* has gone to the Illinois Supreme Court on certiorari.[50] The Supreme Court followed its decision in the prncipal case, reversed the Appellate Court and held the bond repurchase agreement null and void as against public policy. The court said: "The contract in question, upon which the plaintiff bases his claim against the defendant, is similar to the contract of re-purchase considered by this court in *Knass* v. *Madison and Kedzie State Bank.*[51] The contract was there held to be prohibited by law and not enforceable against a banking corporation organized under the laws of this State. We see no reason to depart from the conclusion reached in that case and we adhere to the legal conclusion reached therein."

In the Hoffman case, it was argued that section 4 of the act of 1879 had been repealed by the general banking law of 1919,[52] being inconsistent with sections 1, 9 and 10 of the general Banking act, in that section 4 of the act of 1879 imposes a limitation on the powers of banks. The court, citing *People* v. *Gould,*[53] held that there was no inconsistency, when the object and purpose of the Banking act and of the provision of the Criminal Code are considered as a whole, and hence there was no repeal by implication.

It was further contended that section 4 of the act of 1879 is unconstitutional, being violative of section 5 of article 11 of the state constitution.[54] The court refused to pass on the constitutional question, on the ground that it had not been raised in the courts below and could not be raised, for the first time, in the Supreme Court.[55] It is doubtful if the act of 1879 is open to the constitutional objection raised. Even in the contingency that a subsequent case may reach the Supreme Court with this constitutional question properly raised, and the act should be declared unconstitutional, it is probable that the result would

[50] 356 Ill. 598, 191 N. E. 280 (1934).

[51] 269 Ill. App. 588 (1933).

[52] L. 1919, p. 224; Cahill's Ill. Rev. Stat. (1933), Ch. 16a, pars. 1, 9, 10.

[53] 345 Ill. 288, 178 N. E. 133 (1931).

[54] This section provides: "No State bank shall hereafter be created, nor shall the State own or be liable for any stock in any corporation or joint-stock company or association for banking purposes, now created, or to be hereafter created. No Act of the General Assembly authorizing or creating corporations or associations with banking powers, whether of issue, deposit or discount, nor amendments thereto, shall go into effect or in any manner be in force unless the same shall be submitted to a vote of the people at the general election next succeeding the passage of the same, and be approved by a majority of all the votes cast at such election for or against such law."

[55] The decision in People ex. rel. Carr v. Murray, 357 Ill. 326, 192 N. E. 198 (1934), may indicate a change in the attitude of the Illinois Supreme Court on this point.

be the same as in the principal case. Here, the dictum in the principal case, already referred to, becomes of significance in forecasting the probable decision. The court, in declaring its public policy doctrine, expresses the opinion that such contracts may properly be held void "though there be found no specific statutory provision against them." Strong expressions indicating a similar point of view are found in many of the decisions of this court already cited.

Heretofore, astute bond buyers have been able to avoid the speculative element from such purchases by buying through an Illinois bank. By securing from the bank a repurchase agreement, the speculative element has been thrown entirely upon the bank. It appears now, however, that the protection heretofore uniformly given to such contracts by the Illinois courts is at an end, and that the contrary point of view has become, or is well on its way to become, *stare decisis* in Illinois.

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