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Notes

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NOTES

*Evidence*ADMISSIBILITY OF CONVICTION, FROM WHICH AN APPEAL IS PENDING,
TO TEST CREDIBILITY OF DEFENDANT IN CRIMINAL CASES

As a general rule, the credibility of a witness in a criminal as well as a civil suit may be impeached by evidence of a previous conviction of crime.¹ The courts, however, are in disagreement as to the admissibility, in order to test credibility, of evidence of a prior conviction from which an appeal is pending. Since the majority of cases in which this question has arisen have involved criminal prosecutions in which a defendant has waived his constitutional immunity from testifying against himself,² the scope of this note is necessarily directed towards a consideration of the problems involved in these cases.

A defendant, by waiving his constitutional immunity and taking the stand in his own behalf, occupies the position of an ordinary witness and subjects himself to the usual experiences of one serving in that capacity.³ In most jurisdictions it is a common practice to impeach the credibility of a witness by showing upon cross examination his prior conviction for a criminal offense.⁴ In many jurisdictions the witness' prior conviction may be shown by his admissions upon cross-examination, or by introducing the record of his conviction;⁵ while in still other jurisdictions, the prior conviction may only be proved by the record itself.⁶ Notwithstanding the various procedural requirements, the admissibility in evidence of this prior conviction for this purpose is generally upheld.⁷ However, when an appeal from this prior conviction is pending, its admissibility or non-admissibility presents a more delicate problem. The purpose of this discussion is to examine the present conflict in the law concerning this problem.

¹ See 3 WIGMORE, EVIDENCE § 987 n. 1 (3d ed. 1940) (Supp. 1949).

² ". . . nor shall [any person] be compelled in any criminal case to be a witness against himself. . . ." U. S. CONST. AMEND. V. (substantially embodied in the various state constitutions, with two exceptions: Iowa and New Jersey). See 8 WIGMORE, EVIDENCE § 2252 n. 3 (3d ed. 1940) (Supp. 1949); 3 WEARTON, CRIMINAL EVIDENCE § 1122 (11th ed. 1935).

³ 8 WIGMORE, EVIDENCE § 2275 *et seq.* (3d ed. 1940) (Supp. 1949); 3 WEARTON, CRIMINAL EVIDENCE §§ 1144-46, 1383 (11th ed. 1935).

⁴ 3 WIGMORE, EVIDENCE §§ 980, 981 (3d ed. 1940) (Supp. 1949); 4 WIGMORE, EVIDENCE § 1270 (3d ed. 1940) (Supp. 1949); 3 WEARTON, CRIMINAL EVIDENCE §§ 1320, 1375 (11th ed. 1935); 28 R. C. L., *Witnesses* § 212 (1929).

⁵ See note 4 *supra*.

⁶ *Ibid.*

⁷ See Notes, 6 A. L. R. 1608 (1920); 25 A. L. R. 339 (1923); 103 A. L. R. 350 (1936); 161 A. L. R. 233 (1946).

The case of *Newcomb v. State*⁸ furnishes a good illustration of the issues involved. In that case, evidence of the defendant's previous conviction in another county of automobile larceny was objected to as "incompetent, irrelevant and immaterial," when elicited upon cross-examination to affect his credibility. The reason urged upon the court was that such conviction was then on appeal. The court held that it was not error to admit the evidence, and in fact considered its admission most relevant. The court relied upon its decisions in *Manning v. State*,⁹ and *Porter v. State*.¹⁰ In the latter case it was stated:¹¹

This court has held in the case of *Manning v. State*, 7 Okl. Cr. R. 367, 123 Pac. 1029 [1912], that: "where defendant takes the witness stand in his own behalf, he may be asked if he has ever been convicted of a felony or of any offense showing want of moral character. The purpose of this evidence is to affect his credibility as a witness by showing that he has been convicted of a felony or of any offense indicating a want of moral character. The fact that an appeal is pending from such conviction will not render such evidence inadmissible. It is the verdict of the jury upon such accusation that affects the credibility of the witness."

While there are decisions in other states announcing a contrary doctrine, to the effect that a conviction is not final until the appeal is decided, and that while such appeal is pending it cannot be shown that the defendant was convicted of such former offense, for the purpose of affecting the credibility of the defendant or for any other purpose, we think the law as announced in the *Manning Case* is supported by the weight of authority and the better reasoning.

I.

Weight of Authority

In *People v. Rogers*,¹² the defendant was convicted of a felony involving the possession of a dangerous weapon. On appeal, counsel for the defendant argued that it was error for the trial court to overrule his objection to the following question put by the prosecutor in an attack upon the defendant's credibility: "One week ago last Friday you were convicted of the crime of robbery with a gun, were you not?" The objection was based on the fact that an appeal from the conviction referred to was then pending. The court dismissed this argument with the remark that the defendant offered no evidence to prove that any appeal was pending—and that even if he had, his objection would not have been sustained. The court stated:¹³

⁸ 23 Okla. Crim. 172, 213 Pac. 900 (1923).

⁹ 7 Okla. Crim. 367, 123 Pac. 1029 (1912).

¹⁰ 20 Okla. Crim. 355, 202 Pac. 1039 (1922).

¹¹ *Id.*, 202 Pac. at 1041.

¹² 112 Cal. App. 615, 297 Pac. 924 (1931).

¹³ *Id.*, 297 Pac. at 926.

Defendant having offered himself as a witness, the cross-examiner had the right to show that the witness had been convicted of a felony. The question related solely to the defendant as a witness and his credibility as a witness. The defendant having voluntarily testified in his own behalf, it was competent for the prosecution to show, either by his cross-examination or by the record of the judgment, that he had theretofore been convicted of a felony . . . Since such evidence of conviction is only for purposes of impeachment and goes only to the matter of credibility of the witness, we see no reason why the mere pendency of an appeal should affect the question of admissibility of the impeaching evidence.

The words of this California court amply illustrate the prevailing view. Other jurisdictions in which the point has been raised and which are in substantial accord with the view of the California court are the Court of Appeals for the Seventh Circuit,¹⁴ Alabama,¹⁵ Iowa,¹⁶ Nebraska,¹⁷ Ohio,¹⁸ Oklahoma,¹⁹ Utah²⁰ and Washington.²¹

The point was again raised in a later California case,²² wherein the defendant was convicted of robbery. On appeal, the defendant maintained that the prosecutor's reference to a prior conviction for murder was not proper for impeachment purposes, because the appeal from that conviction was pending at the time of trial and had, since that time, been reversed. The appellate court held that notwithstanding these facts, the reference was not error, even though the conviction in the murder case was thereafter reversed.

In the recent case of *United States v. Empire Packing Co. et al.*,²³ the prosecution, in a trial before the court without a jury, was permitted to cross-examine the defendant as to a former conviction, in order to test his credibility, over the objection of the defendant's

¹⁴ *United States v. Empire Packing Co. et al.*, 174 F. (2d) 16 (7th Cir. 1949), *cert. denied*, 337 U. S. 959, 69 S. Ct. 1534 (1949).

¹⁵ *Latikos v. State*, 17 Ala. App. 655, 88 So. 47 (1921); *Viberg v. State*, 138 Ala. 100, 35 So. 53 (1903).

¹⁶ *Hackett v. Freeman*, 103 Iowa 296, 72 N. W. 528 (1897); *Dickson v. Yates et al.*, 194 Iowa 910, 188 N. W. 948 (1922).

¹⁷ *Shaffer v. State*, 124 Neb. 7, 244 N. W. 921 (1932).

¹⁸ *In re Abrams*, 36 Ohio App. 384, 173 N. E. 312 (1930).

¹⁹ *James v. State*, 64 Okla. Crim. 174, 78 P. (2d) 708 (1938) (not involving verbal cross-examination); *Treadway v. State*, 30 Okla. Crim. 239, 235 Pac. 929 (1925); *Williams v. State*, 26 Okla. Crim. 180, 223 Pac. 193 (1924); *Newcomb v. State*, *supra* note 8; *Porter v. State*, *supra* note 10; *Manning v. State*, *supra* note 9.

²⁰ *State v. Crawford*, 60 Utah 6, 206 Pac. 717 (1922); *cf. Buckley v. Francis*, 78 Utah 606, 6 P. (2d) 188, 191 (1931).

²¹ *State v. Martin*, 176 Wash. 637, 30 P. (2d) 660 (1934); *State v. Johnson et al.*, 141 Wash. 324, 251 Pac. 589 (1926).

²² *People v. Braun*, 14 Cal. (2d) 1, 92 P. (2d) 402 (1939). *See People v. Hamilton et al.*, 188 P. (2d) 817, 831 (1948) (dissenting opinion); *cf. People v. Clapp*, 67 Cal. App. (2d) 197, 153 P. (2d) 758, 760 (1944). *See* 28 CALIF. L. REV. 222 (1940).

²³ *See* note 14 *supra*.

counsel. The fact that an appeal from the defendant's prior conviction for income tax evasion was then pending did not render the cross-examination improper. The court held that, "Unless and until the judgment of the trial court is reversed, the defendant stands convicted and may properly be questioned regarding said conviction solely for the purpose of testing credibility."²⁴ This was the view taken in the early case of *Hackett v. Freeman*,²⁵ where it was held that an appeal from a prior conviction does not affect the judgment, which stands until modified or reversed, although the right to execute it may be suspended; consequently, the prior conviction can be shown as bearing upon the credibility of the defendant.²⁶

In *State v. Martin*,²⁷ the defendant on cross-examination denied a previous conviction, whereupon the state offered the record of such conviction to impeach defendant's credibility. However, it also appeared on the face of the record that an appeal had been taken and was pending. The court held that the record of the defendant's conviction was competent proof of the falsity of his denial of conviction and was properly admitted to impeach his credibility. The court distinguished the present rule from the rule with regard to the non-admissibility in evidence of a prior conviction from which an appeal is pending, in cases involving enhanced penalty statutes.²⁸

II.

Minority View

The Texas case of *Ringer et al. v. State*²⁹ involved an appeal from convictions for felonies. The bill of exceptions stated that while one of the defendants was on the witness stand he was asked by the prosecutor, and required to answer, over the objection of his attorney, whether he had been previously convicted of receiving and concealing stolen property. It was further alleged that the prior conviction, being then on appeal, was not at such time a final conviction. The court held that the objection should have been sustained, and that the admission of this evidence constituted error, stating: "We have heretofore held that the asking of such a question under similar

²⁴ *Id.*, 174 F. (2d) at 20.

²⁵ See note 16 *supra*.

²⁶ This rule is to be distinguished from that applied by Iowa courts which have held that during the pendency of an appeal a conviction for felony cannot be regarded as grounds for a divorce. See, e.g., *Vinsant v. Vinsant*, 49 Iowa 639 (1878); *Rivers v. Rivers*, 60 Iowa 380, 14 N. W. 774 (1883).

²⁷ See note 21 *supra*.

²⁸ See *Joyner v. State*, 158 Fla. 806, 30 So. (2d) 304, 305 (1947) (citing jurisdictions upholding the rule). See Note, 153 A. L. R. 1159 (1944).

²⁹ 137 Tex. Crim. 242, 129 S. W. (2d) 654 (1938).

circumstances was reversible error."³⁰ The court cited earlier Texas cases³¹ and quoted the following language from one of them:³²

In this case . . . the conviction of the appellant had been appealed from, and . . . the matter was then pending in this court. It is settled that such appeal suspended the judgment, and that it was in no sense final. Whatever might be the rule, if the judgment of conviction had been final, it would seem necessarily to follow that, in case of conviction, where an appeal had been taken, this fact of conviction in another case should not be used against an appellant. If it were not the rule, then if the state in any manner had once secured a conviction, right or wrong, whether subject to reversal or not, and whether ultimately reversed or not, until such action had been taken, the illegal conviction could be used before the jury, not only for the purpose of discrediting the defendant, but as well as original evidence of his guilt. This is not the law.

These Texas cases are representative of the minority holding with reference to the instant problem.³³ Other jurisdictions in which this point has been raised, and which are in substantial accord with the minority proposition, are the Court of Appeals for the District of Columbia Circuit,³⁴ Kentucky³⁵ and Missouri.³⁶

The case of *Foure v. Commonwealth*³⁷ presents a slightly different aspect of the problem. This case involved the cross-examination of a witness who had been convicted of a felony as an accomplice of the defendant. Upon taking the witness stand on behalf of the defendant, he was asked and required to answer certain questions regarding his prior conviction for purposes of impeachment, although it was shown that an appeal was then pending in his case. This was one of the errors relied upon by the defendant as grounds for a reversal. The court stated that an appeal in a criminal case suspended the judgment, and that consequently the latter did not become final until the appeal was determined. It was reasoned that, should the witness' case be reversed on appeal, followed by an acquittal at the final trial, it could ". . . not be contended that on a subsequent trial he could

³⁰ *Id.*, 129 S. W. (2d) at 656.

³¹ *Ward v. State*, 117 Tex. Crim. 333, 36 S. W. (2d) 1024 (1931); *Jennings v. State*, 55 Tex. Crim. 147, 115 S. W. 587 (1909).

³² *Jennings v. State*, 55 Tex. Crim. 147, 115 S. W. 587, 588 (1909).

³³ *Cf. Jones v. State*, 32 Tex. Crim. 135, 22 S. W. 404 (1893) (witness is not disqualified when prior conviction is pending on appeal); *Bowles v. State*, 67 Tex. Crim. 578, 150 S. W. 626 (1912); *Grant v. State*, 87 Tex. Crim. 19, 218 S. W. 1062 (1920). *Contra: Ritter v. The Democratic Press Co.*, 68 Mo. 458 (1878). See *Chandler, Attacking Credibility of Witness By Proof of Charge or Conviction of Crime*, 10 TEX. L. REV. 257 (1932).

³⁴ *Campbell v. United States*, 176 F. (2d) 45 (D. C. Cir. 1949).

³⁵ *Crawford v. Commonwealth*, 242 Ky. 458, 46 S. W. (2d) 762 (1932); *Foure v. Commonwealth*, 214 Ky. 620, 283 S. W. 958 (1926).

³⁶ *State v. Shelton*, 314 Mo. 333, 284 S. W. 433 (1926) (involving witness other than defendant).

³⁷ See note 35 *supra*.

be impeached by showing such conviction, and during the pendency of the appeal it cannot be determined what the final judgment will be.”³⁸ This same reasoning was relied on in a later Kentucky case³⁹ in which the court was faced with a similar situation. The court in this case reasoned that under such circumstances it was highly prejudicial to the defendant to have placed before the jury the fact that his accomplice had been previously convicted when such conviction was pending appeal.

The recent case of *Campbell v. United States*⁴⁰ was ‘one of first impression in the District of Columbia Circuit. The defendant had been found guilty by a jury of assault with intent to commit rape, and also of simple assault. After testifying on his own behalf, the defendant was asked and required to answer whether he had ever been previously convicted of a crime. On appeal, he alleged as reversible error the fact that he was required to answer and disclose a previous conviction of petit larceny from which conviction an appeal was then pending. The court said:⁴¹

. . . it seems to us wholly illogical and unfair to permit a defendant to be interrogated about a previous conviction from which an appeal is pending. If the judgment of conviction is later reversed, the defendant has suffered, unjustly and irreparably, the prejudice, if any, caused by the disclosure of the former conviction. We therefore hold that the pendency of an appeal prevents the prosecution from proving a previous conviction for impeachment purposes; and that the District Court erred in admitting evidence concerning Campbell’s [defendant’s] conviction when his appeal therefrom had not been determined.

The court stated, however, that it was not *reversible* error, since it was doubtful that the jury gave more than the slightest weight to this evidence.

Conclusions

The foregoing examination of cases indicates that there is a decided division of authority with respect to this problem. The primary issue involved is clearly defined, namely, the admissibility in evidence of a prior conviction from which an appeal is pending, when such evidence is introduced to affect the credibility of the defendant in a criminal action. The causes of conflict between the two lines of decisions can be narrowed to: first, the various courts’ interpretation of the legal effect of a conviction from which an appeal has been taken; second, the public policy of the forum as to what constitutes a fair trial.

The majority view is based on the proposition that the conviction does not lose its finality until the subsequent reversal is perfected on

³⁸ *Id.*, 283 S. W. at 962.

³⁹ *Crawford v. Commonwealth*, note 35 *supra*.

⁴⁰ *Campbell v. United States*, note 34 *supra*.

⁴¹ *Id.* at 47.

appeal. Where a jury has found the defendant guilty, any previous presumption of innocence is destroyed, and the conclusion reached by an impartial tribunal indicates a want of moral character which is sufficient to affect the defendant's credibility.

The proposition advanced by the minority of jurisdictions is that the conviction from which an appeal is taken is not final, but is merely suspended pending the outcome of the appeal. The perfecting of the appeal is a condition precedent to the finality of the conviction. Thus the conviction in suspension is inadmissible to affect the credibility of the defendant.

Aside from the strictly legal bases upon which the opposing views ostensibly rest in these cases, certain policy considerations are also involved. The majority view would seem to be based upon the supposition that so long as evidence of a prior conviction from which an appeal is pending is of probative value in determining the defendant's credibility, such evidence should be admitted. The policy behind the minority view, on the other hand, is that of affording a maximum of protection to the accused who elects to testify. Since the policy of the minority view encourages the defendant to take the stand, it can be argued that the jury is able to arrive at perhaps a fairer and more accurate verdict than if the defendant chose not to testify.

Nevertheless, the probative value of the evidence in these cases, which is admitted *solely* for purposes of testing a defendant's credibility, weighs heavily against the varying possibility of undue influence upon the minds of the jurors. Of course, it must be emphasized that the existing possibility of undue influence should be guarded against by the courts, and evidence of a prior conviction from which an appeal is pending should be cautiously admitted only to test credibility, and then in the light of the reason and experience of the court in exercising its discretionary powers.

The problem of maintaining a proper balance between the adequate protection of society as a whole, and the rights of the individual defendant in a criminal action is raised by these cases. It should be obvious that, under our system of law, the great differences in the evidence admissible, and the degree of proof required in criminal cases are safeguards which greatly favor the accused. These protective measures, however, were not designed to enable a party to escape the consequences of his acts, but rather to prevent the conviction of innocent parties. Because the evidence in these cases is allowed only to test credibility, it would not seem that such evidence is violative of the special protections afforded the accused in a criminal case. The rationale of the courts favoring the majority view would seem well expressed in the words of the late Justice Holmes, who stated: "At the present time in this country there is more danger that crimi-

nals will escape justice than that they will be subject to tyranny.”⁴² It would be well for those who favor the minority view, and who argue that it is “wholly illogical” that the evidence in these cases be admitted, since the prior conviction may be reversed on appeal, to remember that “the life of the law has not been logic; it has been experience.”⁴³

Benedict R. Danko

Sales

EFFECT OF MISREPRESENTATIONS INDUCING SALES CONTRACTS

When one person is persuading another to enter into a sales contract, he generally makes representations in order to induce the sale. It is with a particular category of these representations that this article is concerned: namely, those representations which are false and without which the injured party never would have entered into the contract. Since the Uniform Sales Act does not purport to deal with this question to any considerable extent,¹ the rules of common law and equity apply.

Misrepresentations may either enter into and become a part of the contract, or may relate only to the inducements to enter the contract.² It is essential that this distinction be made at the outset, because there is necessarily a marked difference between the proof required to show misrepresentation in the inducement of the sales contract and that required to prove a breach of warranty.³ This distinction becomes important when the parties to a written sales contract become involved in litigation, and one of the parties wishes to show that he was fraudulently induced into the contract by introducing parol evidence of the other's misrepresentations. It is evident that if he confuses inducement by misrepresentation with breach of warranty, he will be estopped by the parol evidence rule from showing any warranties other than those contained within the written terms of the contract.⁴ It is generally held that all prior and contemporaneous oral agreements are merged in written contracts covering the same matter, and

⁴² *Kepner v. United States*, 195 U. S. 100, 134, 24 S. Ct. 797, 49 L. Ed. 114 (1924).

⁴³ HOLMES, *THE COMMON LAW* 1 (1881).

¹ Uniform Sales Act § 73, 1 UNIFORM LAWS ANN. 447 (1931); 3 WILLISTON, SALES § 623 (Rev. ed. 1948).

² *In re Barnet Mfg. Co.*, 11 F. (2d) 873 (Mass. 1926).

³ *Martin v. Shoub*, 62 Ind. App. 586, 113 N. E. 384 (1916).

⁴ *Schmitt v. William G. Johnston Co.*, 136 Pa. Super. 213, 7 A. (2d) 131 (1939).

breach of the oral promise does not constitute fraud.⁵ On the other hand, if the party alleging misrepresentation realizes his position and proceeds on the theory of misrepresentation in the inducement, he will be allowed to offer parol evidence that the seller misrepresented the article of sale, and that he was thereby induced to enter into a contract he would otherwise not have made. The rule that parol agreements shall not be received to alter or add to the terms of a written contract does not apply when fraud in the inducement is the issue.⁶ An attempt to restrict the remedy of one party for the other party's fraudulent inducements by reducing the agreement to writing is ineffectual in most jurisdictions.⁷ Actionable fraudulent misrepresentations are not so merged in a written instrument procured by this means that they may not be made the basis of a suit to set aside or rescind a written instrument,⁸ or the basis of a defense to an action brought on the instrument,⁹ or the basis of an action for damages.¹⁰

Although it is well settled that a party to a written contract can introduce oral evidence to show that he was fraudulently induced to enter into the agreement, what is the result when the instrument contains a clause which disclaims liability for any representations other than those in the written instrument? Disclaimer clauses take varying forms, but persons fraudulently induced to execute a written contract by oral misrepresentations may show such fact in evidence, even though the written contract contains a recital that all representations between the parties are contained therein, and that there are no verbal representations at variance with it.¹¹ It is generally accepted that clauses which state that the buyer agrees to take "as is,"¹² "sound or unsound,"¹³ "as demonstrated,"¹⁴ "with all its faults,"¹⁵ and such statements as "the writing is the entire agreement,"¹⁶ "verbal statements made prior to the signing of the contract are not binding,"¹⁷ etc., have no effect where fraud is the basis of the action.

⁵ Meyer v. Weber, 233 Mo. App. 832, 109 S. W. (2d) 702 (1937).

⁶ Kimbrough v. Adams, 65 Ga. App. 563, 16 S. E. (2d) 96 (1941); Bates v. Southgate, 308 Mass. 170, 31 N. E. (2d) 551 (1941); Bakke v. Keller, 220 Minn. 383, 19 N. W. (2d) 803 (1945).

⁷ Lyman v. Romboli et al., 293 Mass. 373, 199 N. E. 916 (1936).

⁸ Harris et al. v. Delco Products, Inc., 305 Mass. 362, 25 N. E. (2d) 740 (1940).

⁹ *Ibid.*

¹⁰ Bucyrus-Erie Co. et al. v. Smith et al., 168 S. W. (2d) 896 (Tex. Civ. App. 1942).

¹¹ Miller v. Troy Laundry Machinery Co., 178 Okla. 313, 62 P. (2d) 975 (1936).

¹² Wolford et ux. v. Freeman et ux., 150 Neb. 537, 35 N. W. (2d) 98 (1948).

¹³ West v. Anderson, 9 Conn. 106 (1831).

¹⁴ Mooney v. Cyriacks, 15 Cal. 70, 195 Pac. 922 (1921).

¹⁵ Smith v. Richards, 13 Pet. 26, 10 L. Ed. 42 (1839).

¹⁶ Stanard Tilton Milling Co. v. Mixon, 243 Ala. 309, 9 So. (2d) 911 (1942).

¹⁷ National Theatre Supply Co. v. Rigney, 130 S. W. (2d) 258 (Mo. App. 1939).

A typical case of misrepresentations inducing a sales contract is the California case of *Ferguson v. Koch*.¹⁸ It illustrates the distinction between those representations which become warranties and those which remain mere fraudulent inducements to enter the contract; it is a good example of the application of the parol evidence rule as discussed above; and it displays the court's treatment of disclaimer clauses. In the *Ferguson* case, the parties entered into a contract whereby Ferguson agreed to sell and Koch agreed to buy "as is" a Reo truck chassis, year model 1916. The sales contract stated that the chassis was sold "as is" due to the fact that certain parts belonging to the chassis were not attached thereto. The written agreement also stated that the motor was in very good condition. Koch refused to make the payments agreed upon, and in an action by Ferguson to recover the purchase price, Koch defended on grounds of fraud in the inducement. The evidence revealed that in the negotiations leading up to the written contract Ferguson had represented the chassis to have a two and one-half ton capacity, and the motor to be of the same type as that installed by the Reo Company in its new cars for the year 1925. In fact, the chassis had a three-quarter ton capacity and the motor was the type used by the company in the year 1917 for passenger automobiles. It should be noted that none of these representations were a part of the sales contract, and that the defendant was not endeavoring to make them a part of the contract. Koch proceeded on the ground that he was fraudulently induced to enter the contract by these misrepresentations, and that he should therefore be allowed to prove them by parol evidence, notwithstanding his agreement to buy the truck "as is." In denying the plaintiff relief, the court held that the defendant could introduce parol evidence to prove the fraudulent inducement even though he agreed to buy "as is."

The remedies of a party who has been induced into a sales contract by misrepresentation merit examination. On the discovery of the misrepresentation, the injured party may choose one of two major alternatives: he may either affirm or disaffirm the contract. If he chooses to affirm the contract, he may either sue for damages in an action in deceit or its equivalent, or wait until he is sued upon the contract, and then counterclaim. If he disaffirms the contract, he will be said to have rescinded it. He may then bring an action at law to rescind and to recover what he has paid. He may defend an action brought against him on the contract by setting forth the misrepresentation and rescission as a defense. He may, in certain cases, bring an action in equity for rescission.¹⁹

In electing his remedy, the injured party will be guided by the circumstances prevailing at the time he realizes that he did not

¹⁸ 204 Cal. 342, 268 Pac. 342 (1928).

¹⁹ *Davis et al. v. Gifford*, 182 App. Div. 99, 169 N. Y. S. 492 (1918).

receive exactly what he had bargained for; that is, when he becomes dissatisfied with what he has received and discovers that it does not measure up to the other party's representations, upon which he relied and by which he was induced to enter into the contract. The same remedy will not be available to the injured party under all circumstances. There is an important distinction, which will determine which remedy he should pursue, between an intentionally false representation and one made innocently. His choice will also be affected by the time at which the particular action is brought. As a general proposition, where the representation is intentionally made, and where the other elements of fraud are present, the courts will grant the injured party relief, either by way of rescission at law or in equity, or by an action at law for damages,²⁰ the success of the latter remedy being affected only by the time at which the action is brought. Where the false representation is innocently made, however, the courts differ as to the type of relief which will be afforded the injured party.

In an action for damages, the vast majority of jurisdictions require that the misrepresentation be either intentionally made, or made with such recklessness and disregard for the truth of the fact and the possible injury to the other party as to imply the necessary intent.²¹ On the other hand, some courts hold that intentional misrepresentation is not essential to recovery in an action for damages.²² The merits of either view must be considered in connection with the measure of damages rule applicable in the particular jurisdiction. The "out of pocket" and the "loss of bargain" rules²³ are the two prevalent standards.

In a jurisdiction which follows the majority view as to intent but which applies the "out of pocket" rule of damages,²⁴ the wrongdoer, except in instances where exemplary damages can be proved against him, will at worst be made to sell or receive the article in exchange for its actual value. He therefore is not required by law to compensate the party injured as a result of his intentional, wrongful conduct. The other extreme is reached in a jurisdiction which applies the "loss of bargain" rule and which does not require an intentional

²⁰ *Ibid.*

²¹ *Kountze et al. v. Kennedy*, 147 N. Y. 124, 41 N. E. 414 (1895).

²² *Aldrich et al. v. Scribner*, 154 Mich. 23, 117 N. W. 581 (1908); *Paul v. Cameron*, 127 Neb. 510, 256 N. W. 11 (1934).

²³ "Out of pocket" rule—The difference between the value of what the buyer has given and the value of what he has received. "Loss of bargain" rule—The difference between the actual value of what he has received and the value that he would have had if it had been as represented. PROSSER, TORTS § 90 (1941). For a discussion of the two rules, see *Wood v. Dudley*, 188 App. Div. 136, 176 N. Y. S. 494 (1919).

²⁴ See, e.g., *Emery v. Third National Bank of Pittsburgh*, 308 Pa. 504, 162 Atl. 281 (1932).

misrepresentation.²⁵ Here, in effect, the party making the misrepresentations is held to strict liability for all material statements made. In allowing damages, the court penalizes such a party in every instance without considering the element of fault.

The better view would appear to be that of those jurisdictions which require intent and which apply the "loss of bargain" rule as a measure of damages.²⁶ Here the defrauding party is properly penalized for the tort committed, and such a penalty may possibly be effective as a deterrent to his fraudulent conduct in the future. In addition, the injured party has been compensated for his injury. While it is true that this is in effect an application of a rule of damages based on contract law in a case where the basis of recovery is actually in tort, such a technical inconsistency appears immaterial, especially since the damage to the injured party was the result of his entering into the contract.

If the injured party chooses to disaffirm and thus rescind the contract, he must tender back all that he has received under it; i.e., the parties must be placed in the status quo — in the position they occupied prior to the contract. When the one party rescinds, he is in effect saying to the other party: "You have induced me to enter into this contract by fraud. I offer you what I received. Give me back that which you received, or, if that be impossible, pay me its value."²⁷ The controversy over the requirement that there be an intentionally false representation in actions for damages is not as pronounced where the remedy sought is rescission, and most courts will grant relief even where the misrepresentation is innocent.²⁸ It would seem that this is a fair and equitable distinction. By allowing rescission for innocent misrepresentation, the courts place the parties in the status quo; the injustice which might have resulted to the injured party is prevented, while the other party is not penalized to any extent — he is in substantially the same position as before entering into the contract. However, some courts still persist in requiring the misrepresentation to be fraudulent, i.e., intentionally made.²⁹

Because a sales contract, like any other contract which is induced by a misrepresentation, is not void but only voidable, if nothing is done by the injured party to disaffirm the contract it is not avoided, and the rights of the parties will be fixed by the agreement.³⁰ The

²⁵ See, e.g., *Aldrich et al. v. Scribner*, 154 Mich. 23, 117 N. W. 581 (1908).

²⁶ See, e.g., *Luedke et al. v. Pauly Motor Truck Co.*, 182 Wis. 346, 195 N. W. 853 (1923).

²⁷ *Wood v. Dudley*, 188 App. Div. 136, 176 N. Y. S. 494, 497 (1919).

²⁸ *Cannon et al. v. Chadwell*, 25 Tenn. App. 42, 150 S. W. (2d) 710 (1940), citing *RESTATEMENT, CONTRACTS* § 476, comment *b* (1932).

²⁹ *In re Barnet Mfg. Co.*, 11 F. (2d) 873 (Mass. 1926).

³⁰ *Wrightsmen v. Brown*, 181 Okla. 142, 73 P. (2d) 121 (1937).

right to sue for damages, which is based on the assumption that the transaction is affirmed, does not require prompt action by the injured party,³¹ the statute of limitations being the only general deterrent to excessive delay. There is the further possibility that the delay will tend to show that no fraud was perpetrated. Setting aside a contract induced by misrepresentation, on the other hand, is an alternative right based on equitable principles, and the desired remedy must therefore be sought with reasonable promptness after the misrepresentation is discovered. The injured party may be found guilty of laches if he has delayed and such delay has been prejudicial to the other party. What constitutes a reasonable time will be determined by the circumstances in each case.³²

A question arises as to the injured party's remedy in damages where the misrepresentation is discovered while the contract is wholly executory. Should the one who made the false representations be held liable for damages which the other party could have avoided by disaffirmance? It has been held that no damages should be recoverable under such circumstances.³³ It is difficult to see the reasonableness of such a rule in a jurisdiction where the measure of damages is the "out of pocket" rule. If the courts in these jurisdictions were to allow the injured party to recover damages in spite of the fact that he could have avoided them, they would be doing no more than putting the party in the same position, pecuniarily, that he was in before entering into the contract. To say that because he should have rescinded when he discovered the misrepresentation, he cannot later have his damages, would not seem to be a valid reason for denying the remedy. It is possible that the injured party may be willing to go through with the sale regardless of the misrepresentations. For example, he may desire the object of the sale at its actual value.

On the other hand, in jurisdictions where the "loss of bargain" rule is applied in an action for damages, it seems reasonable not to allow a party damages which he could have avoided, for under this measure of damages it is more advantageous for the defrauded party to execute the contract and then sue for damages than to rescind the contract while it is still wholly executory. Actually, in this situation, the defrauded party is temporarily damaging himself so that he can later recover. For example, *A* agrees to buy a horse from *B*, who represents the horse to be sound when in fact it is unsound. The sale price is \$500, the represented value is \$700, and the actual value is \$300.

³¹ See *Ellis et ux. v. Jones et al.*, 121 Cal. App. 325, 8 P. (2d) 933 (1932) where it was held that eighteen months delay was not a bar to an action for damages.

³² *Brown et al. v. Young*, 62 Ind. App. 364, 110 N. E. 562 (1915); *Roberts v. James*, 83 N. J. L. 492, 85 Atl. 244 (1912).

³³ *McCabe et ux. v. Kelleher*, 90 Ore. 45, 175 Pac. 608 (1918).

While the contract is still executory, *A* learns of the misrepresentation. If *A* chooses to execute the contract and then sue for damages, he will receive, under the "loss of bargain" rule, the difference between the actual value (\$300) and the value that he would have had if the horse had been as represented (\$700). By completing the contract, *A* obtains a horse worth \$300 for \$100. The result is that *A* has intentionally caused himself damage to his ultimate advantage. Such conduct should be discouraged, rather than encouraged. Of course, regardless of the rule applied in the jurisdiction, the injured party should be allowed to recover any compensatory damages that resulted from the misrepresentation and which he could not have prevented by rescission.

When the agreement is substantially executed when the fraud is discovered, the general rule is that the defrauded party can complete the action required by the contract and then sue for damages,³⁴ although the completion of the contract is not necessary in order to maintain such an action. If the latter course is chosen, the injured party is not required to return any benefit received, since there is no necessity of placing the parties in the status quo. However, the benefit received and retained will be offset against the damages recoverable. In addition, he may recover for any consequential damages that may have resulted.³⁵

Another situation arising in some cases is that existing where the defrauded party discovers the fraudulent inducement after he has wrongfully breached the contract. In such a case, the breach of contract seems to have no effect on the remedy allowed. It is generally held that the defrauded party may assert the fraud as a defense when sued upon the contract, and may demand rescission;³⁶ or if he has lost his right to rescind because of delay or inability to restore what he has received, he may counterclaim for damages,³⁷ although he will be held to liability on the contract; or he may bring an action for damages.³⁸ The recent case of *Martinelli & Co. v. Siegel Co.*³⁹ is illustrative of this problem. In that case Martinelli contracted to buy a carload of grapes from Siegel, "f.o.b. shipping point acceptance final." On their arrival, Martinelli refused to accept the grapes because of their decayed condition, and so notified Siegel. He later learned that Siegel had misrepresented the condition and location of the grapes, and that he had concealed a prior rejection of the shipment by another con-

³⁴ *Sell v. Mississippi River Logging Co.*, 88 Wis. 581, 60 N. W. 1065 (1894).

³⁵ RESTATEMENT, TORTS § 549 (1938).

³⁶ *Martinelli & Co. v. Siegel Co.*, 176 F. (2d) 98 (1st Cir. 1949); 3 WILLISTON, SALES § 648 (Rev. ed. 1948).

³⁷ *May v. Loomis et al.*, 140 N. C. 350, 52 S. E. 728 (1905).

³⁸ 5 WILLISTON, CONTRACTS § 1526 (Rev. ed. 1936).

³⁹ 176 F. (2d) 98 (1st Cir. 1949).

signee because of the decay. When sued on the contract, Martinelli asserted the defense of fraud. The court said:⁴⁰

. . . if Siegel's fraud . . . gave Martinelli the right to reject the shipment . . . we think Martinelli did not lose that right by reason of its rejection of the shipment before it discovered the fraud which had been practiced upon it. This is for the reason that fraud in the inception of a contract, although it does not render the contract void, renders it voidable at the election of the person defrauded, with the result that if the defrauded party to a contract breaks it before he discovers the fraud, he may nevertheless assert the fraud as a defense as soon as he discovers it, and demand rescission on that account when sued for breach of contract. 3 Williston on Sales (Rev. Ed.) § 648. See also 5 Williston on Contracts (Rev. Ed.) § 1526, in which it is said "The fact that the defrauded party has broken the contract before discovery of the fraud will not deprive him of his right to damages for the fraud in inducing him to enter into it; . . . nor will it prevent the exercise of his power of avoidance. . . ."

Conclusions

It may be said that in any case where a party seeks relief for injury caused by a misrepresentation which induced him to enter into a sales contract, a variety of factors must be taken into consideration. Where all the elements of fraud are present, the answers are relatively simple, since the courts have always stood ready to grant relief to a person injured by another's intentional, wrongful conduct. Where the misrepresentation is innocent, however, a just solution is much more difficult. This is evident from the basic issue underlying all cases of this type, i.e., the extent to which the parties to a sales contract should be held liable for statements made in negotiations leading up to the contract, wherein both parties, each to the knowledge of the other, are attempting to make a favorable bargain. While no unqualified answer to such a question is possible because of the many and various elements involved in each particular fact situation, it would appear that the courts lean towards an imposition of strict liability on the party making the false statements.

Patrick F. Coughlin

William J. O'Connor

⁴⁰ *Id.* at 100.

*Taxation*TREATMENT OF REPAYMENTS OF FUNDS RECEIVED UNDER
A CLAIM OF RIGHT

Since surtaxes are proportioned according to the amount of income received during the taxable year,¹ it is to the taxpayer's advantage to report receipts which are in dispute in the year in which his total income from other sources will be the lowest. As a corollary to this, when repayments of taxes paid upon such receipts are made in a later year, it will be to the taxpayer's advantage to obtain a reduction, pro tanto, in the year in which his income from other sources is the greater.² The Internal Revenue Code seeks to prevent any such alternative in reporting income by providing that "The amount of all items of gross income shall be included in the gross income for the taxable year in which received . . .,"³ unless under section 41 such amounts may properly be accounted for as of a different period. Section 41 provides that the accounting should clearly reflect income.

With regard to repayments, the Code provides that all deductions shall be taken as of the year in which they were "paid or incurred" or "paid or accrued," unless ". . . in order to clearly reflect the income the deductions or credits should be taken as of a different period."⁴ The courts prior to 1932 were in conflict as to the year in which payments received under a dispute were to be taxed.⁵

In 1932 the Supreme Court, in *North American Oil Consolidated v. Burnet*,⁶ laid down a rule which supposedly settled the point. This holding is the basis for what has been referred to as the claim of right doctrine. In this case the court stated:⁷

¹ INT. REV. CODE § 12(b).

² The following example will illustrate this advantage: In 1948 X received \$6,000 in dividends from the A Corporation. His net taxable income from other sources in that year was \$20,000. At that time, Y was contesting X's ownership of the stock. This contest was ended in 1949, when X's income from other sources was \$14,000. Assume first that X was successful in this contest. If he reports these dividends in the year in which his right to them was finally determined, his tax on them would be \$2,640. However, if he reported these dividends as income in 1948, his tax on them would be \$3,062.40. Now assume that the taxpayer, having reported the dividends in the year of receipt, lost the contest in 1949 and had to repay the dividends. If a refund is allowed for the 1948 tax, the tax saving would be \$3,062.40 (returning X to the status quo); whereas, if X is only allowed a deduction in the year of repayment, the saving is only \$2,024.

³ INT. REV. CODE § 42.

⁴ *Id.*, at § 43.

⁵ Compare: *Commissioner v. Brown*, 54 F. (2d) 563 (1st Cir. 1931); *Ivan A. Greenwood*, 22 B. T. A. 1187 (1931), with *James M. Butler*, 19 B. T. A. 718 (1930); *Ford v. Commissioner*, 51 F. (2d) 206 (6th Cir. 1931).

⁶ 286 U. S. 417, 52 S. Ct. 613, 76 L. Ed. 1197 (1932).

⁷ *Id.*, 286 U. S. at 424.

If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.

While this case caused bitter dispute among the authorities,⁸ it was not an entirely novel treatment of such receipts. In *Board v. Commissioner*,⁹ the Court of Appeals for the Sixth Circuit held that although there was some dispute as to the taxpayer's claim to an amount received, it was nevertheless the duty of the taxpayer to report it in the year in which it was received.

The claim of right doctrine is intended to facilitate the administration of the taxing statutes.¹⁰ Judge Learned Hand, in *National City Bank of New York v. Helvering*,¹¹ argued that the Government should not be forced to take sides in a private controversy, nor should the collection of the revenues be delayed until the claimants have adjusted their rights; hence the taxing authorities, as a practical matter, look to possession as prima facie ownership, if the possessor claims ownership and his present disposition of the funds is unrestricted. There is also the "bird-in-the-hand" reason that if taxability is delayed until the dispute as to the receipts is resolved, the taxpayer may be insolvent.¹²

In addition to the objection that this doctrine can lead to injustice in some cases,¹³ the further objection has been raised that it is not in accord with standard accounting practice.¹⁴ Accountants argue, with much logic, that income should not be recognized until the right to receive and retain it becomes certain.¹⁵

As can be seen from the holding of the *North American Oil Consolidated* case, there are two conditions which must exist before income can be considered taxable upon receipt: the taxpayer must claim the receipts as his own and there must be no restriction on their distribution. The claim of right doctrine, therefore, has been held not to apply when funds are received by one as agent for another;¹⁶ when

⁸ See Magill, *When Is Income Realized?*, 46 HARV. L. REV. 933 (1933); Montgomery, *Accounting and the Concept of Income* in LECTURES ON TAXATION 55 (1932).

⁹ 51 F. (2d) 73 (6th Cir. 1931).

¹⁰ See *Penn v. Robertson*, 115 F. (2d) 167, 175 (4th Cir. 1940).

¹¹ 98 F. (2d) 93, 96 (2d Cir. 1938).

¹² See *Alamitos Land Co.*, 40 B. T. A. 353, 364 (1939) (dissenting opinion), *rev'd.*, 112 F. (2d) 648 (9th Cir. 1940).

¹³ *Blum v. Helvering*, 74 F. (2d) 482 (D. C. Cir. 1934).

¹⁴ Montgomery, *supra* note 8, at 55.

¹⁵ Magill, *supra* note 8, at 946 *et seq.*

¹⁶ *Commissioner v. Turney*, 82 F. (2d) 661 (5th Cir. 1936); *but cf.* *Chicago, R. I. & P. Ry. Co. v. Commissioner*, 47 F. (2d) 990 (7th Cir. 1931) (overcharges of fares taken into income); *Boston Consol. Gas Co. v. Com-*

the claim has no real foundation;¹⁷ when funds are received but a right to the amount is asserted to exist in a third party;¹⁸ where the taxpayer does not actually receive the funds, as in those instances where an escrow agent is interposed;¹⁹ or when there is an absolute liability to repay when received.²⁰ However, the courts have unanimously applied the claim of right doctrine when the two necessary elements are present.²¹

In spite of this harmony among the courts concerning the treatment of receipts,²² some disagreement exists with respect to the treatment of repayments.²³ When reimbursements are made during the

missioner, 128 F. (2d) 473 (1st Cir. 1942) (unclaimed deposits); J. R. Knowland, 29 B. T. A. 618 (1933).

¹⁷ Commissioner v. Turney, 82 F. (2d) 661 (5th Cir. 1936). *But see* National City Bank of New York v. Helvering, 98 F. (2d) 93 (2d Cir. 1938); Commissioner v. Wilcox, 327 U. S. 404, 66 S. Ct. 546, 90 L. Ed. 752 (1946) (wherein the Court seemed to add to the claim of right doctrine by saying that embezzlers were not taxable since there was no bona fide "legal or equitable claim," which must be present). See also, Clay Sewer Pipe Ass'n. v. Commissioner, 139 F. (2d) 130 (3d Cir. 1943).

¹⁸ Commissioner v. Brown, 54 F. (2d) 563 (1st Cir. 1931), *cert. denied*, 286 U. S. 556, 52 S. Ct. 639, 76 L. Ed. 1290 (1932) (wool dealers not required to treat as taxable that amount which they held pursuant to regulations of War Industries Board for later distribution to growers).

¹⁹ See, e.g., Merten E. Farr, 11 T. C. 552 (1948) (amount placed in escrow pending final determination of Federal Government tax lien on property sold, held not constructively received); Estate of Margaret McAllen Fairbanks, 3 T. C. 260 (1944); Sara R. Preston, 35 B. T. A. 312 (1937); H. L. Mulliner, P-H 8 B. T. A. Mem. Dec. ¶ 39,164 (1939). See 2 MERTENS, LAW OF FEDERAL INCOME TAXATION § 12.105 (1942), for a complete discussion of income held in escrow.

²⁰ Commissioner v. Smucker, 170 F. (2d) 147 (6th Cir. 1948), *affirming*, P-H 16 T. C. Mem. Dec. ¶ 47,265 (1947) (pursuant to agreement, officers of corporation paid back bonus in same year as received, as paid-in surplus to aid in expansion program). *But cf.* Soreng v. Commissioner, 158 F. (2d) 340 (7th Cir. 1946) (agreement with third party, but with final result to be acquisition of sole ownership by petitioners).

²¹ Haberkorn v. United States, 173 F. (2d) 587 (1948); Alamitos Land Co. v. Commissioner, 112 F. (2d) 648 (9th Cir. 1940); Griffin v. Smith, 101 F. (2d) 348 (7th Cir. 1938); Renwick et al. v. United States, 87 F. (2d) 123 (7th Cir. 1936).

²² For an exhaustive discussion of receipts under a "claim of right," see 2 MERTENS, LAW OF FEDERAL INCOME TAXATION § 12.103 (1942); Plumb, *Income Tax on Gains and Losses in Litigation*, 26 CORN. L. Q. 16 (1940); Magill, *When Is Income Realized?*, 46 HARV. L. REV. 933 (1933).

²³ Compare Greenwald v. United States, 57 F. Supp. 569 (Ct. Cls. 1944), with Haberkorn v. United States, 173 F. (2d) 587 (6th Cir. 1949). Compare Knight Newspapers, Inc. v. Commissioner, 143 F. (2d) 1007 (6th Cir. 1944), with St. Regis Paper Co. v. Higgins, 157 F. (2d) 884 (2d Cir. 1946). The conflict as to treatment of refunds of prior year's expenses was recently resolved. See Bartlett v. Delaney, 173 F. (2d) 535 (1st Cir. 1949), *cert. denied*, U. S., 70 S. Ct. 59 (1949), which overruled E. B. Elliott Co., 45 B. T. A. 82 (1941). The *Elliott* case held that such refunds could be added to the income of the year in which the corresponding deduction was taken. In overruling this case,

same taxable year in which the income is received, they are consistently treated as a reduction for that year.²⁴ It is when such repayments are made in a subsequent year that the dispute arises.²⁵ A dictum in the *North American Oil Consolidated* case formulated the general rule that such repayments are deductible in the year made.²⁶ In the majority of cases which have been decided since this dictum, the courts have held that repayments in a later year are not to be treated as reducing the former year's taxes.²⁷ In *McDuffie v. United States*,²⁸ the petitioner sought a refund from the previous year's tax as the result of having had to repay certain proceeds received from the United States. The refund was not allowed, and the petitioner's only remedy was held to be the taking of a deduction for the year in which the repayment was made. The same result was reached in *Grand Central Public Market v. United States*,²⁹ which involved bonus payments by a prospective subtenant to the tenant-taxpayer, with an agreement that they should be repaid if the property could not be delivered.³⁰ The district court decided that such payments were received under a claim of right, and that the deductions for repayments in a subsequent year could be taken only in that year. The petitioner attempted to show that the bonus was received under a trust, pending the delivery of the property involved, and that a special fund was actually set up; but such evidence was ignored by the court.

Two recent cases — a Court of Appeals case and a Tax Court decision — follow this strict interpretation of the *North American Oil*

the court in the *Bartlett* case compelled the taxpayer to treat such refunds of prior year's expenses as income when received. But a contrary result would be reached when the original payment was in the form of a tax which was later declared unconstitutional. INT. REV. CODE § 128; see also, 5 MERTENS, THE LAW OF FEDERAL INCOME TAXATION § 27.04 n. 50 (Supp. 1949).

²⁴ Willis W. Clark, 11 T. C. 672 (1948); *Huntington-Redondo Co.*, 36 B. T. A. 116 (1937); *Albert W. Russel*, 35 B. T. A. 602 (1937); *Guy Fulton*, 11 B. T. A. 641 (1928) (all involving factual situations in which readjustments took place within the year and the funds repaid were held not includible in gross income). *But cf.* *Leicht v. Commissioner*, 137 F. (2d) 433 (8th Cir. 1943) (involving an agreement to return part of rents, the agreement being made after receipt. The court held that when funds are received under a claim of right, the taxpayer cannot thereafter relieve himself of the tax by an attempt to alter his legal status). *Ruben Simon*, 11 T. C. 227 (1948) (repayment did not actually take place in the same year, but an attempt was made to show an agreement to repay).

²⁵ See note 23 *supra*.

²⁶ 286 U. S. 417, 424, 52 S. Ct. 613, 76 L. Ed. 1197 (1932): "If in 1922 the Government had prevailed, and the company had been obliged to refund the profits received in 1917, it would have been entitled to a deduction from the profits of 1922, not from those of any earlier year."

²⁷ See note 21 *supra*.

²⁸ 19 F. Supp. 239 (Ct. Cls. 1937).

²⁹ 22 F. Supp. 119 (S. D. Cal. 1938).

³⁰ *Id.* at 125. The court states that the Government acts "... upon the presumption that all contracts will be observed and not broken. . . ."

Consolidated case. In *Haberkorn v. United States*,³¹ petitioner had received a bonus in 1942 which he reported for income tax purposes in that year. It was later discovered by the paying corporation that this bonus was excessive, due to a miscalculation in computing corporate net income. In 1945 petitioner paid back the excess and filed a claim for a refund against his 1942 tax payment. The Court of Appeals refused the claim for refund, stating that the appellant "... should claim deductions for the amount of the bonus he was required to repay in the years in which such repayments were made."³²

In *Ruben Simon*,³³ the petitioner and his brother had organized a partnership for the purpose of leasing land to a corporation which was also owned by them. The rent charged was determined to be excessive and was partially disallowed as a deduction in the corporation's 1943 tax return. (This, of course, was not determined until after the close of the tax year.) Upon learning the acceptable rental, the partners lowered the rate and in addition paid back to the corporation the amount disallowed. They then sought a refund for the year in which the excess rental was charged. The partners attempted to avoid a strict application of the *North American Oil Consolidated* case by showing that they had entered into a conditional agreement prior to the end of the tax year to refund any excessive rental to the corporation. The Tax Court held that no refund would be allowed.

A strict application of the *North American Oil Consolidated* case to refunds produces inequitable results for at least two important reasons. First of all, not all items which are taxed as receipts are allowable as deductions under the Internal Revenue Code. Second, the taxpayer may not have sufficient income in the later year to take advantage of this deduction or to enjoy the same surtax saving as he would have enjoyed in the earlier year.³⁴ Nor can it be argued that the necessities of the proper administration of the tax laws will support the strict view. The efficiency of the Bureau of Internal Revenue would not be affected adversely by allowing a claim for refund in those cases which would involve substantial injustice to the taxpayer.

Prior to the *North American Oil Consolidated* case, more weight was given to these considerations, and the courts consistently allowed the refund from the prior year's taxes. The theory most often used by the courts in allowing the taxpayer to avoid liability for funds

³¹ 173 F. (2d) 587 (6th Cir. 1949).

³² *Id.* at 588.

³³ 11 T. C. 227 (1948).

³⁴ In many of the cases in which the taxpayer is attempting to have the repayment treated as a reduction of the former year's tax, no mention is made of the injustice that will otherwise result. Nevertheless, it does not seem that the results would have been substantially the same or the taxpayer would not voluntarily have elected to pursue an expensive litigation.

received and later repaid was the constructive trust doctrine. In *Carey Van Fleet*,³⁵ the court held that legal fees received under a mutual mistake of fact were impressed with a trust in favor of the payor and were not taxable upon receipt. In *Benjamin Paschal O'Neal*,³⁶ the same reasoning was applied to the case of liquidating dividends received by a stockholder who later was assessed for past taxes of the corporation. Similarly, in *Eakins v. United States*,³⁷ earnings were distributed in proportion to holdings of stockholders, under an agreement to return the same in the event of an additional assessment of war and excise taxes. The Government refused to allow this sum to be deducted as salaries, assessing the additional taxes. The court decided that the amount returned pursuant to this agreement was not income, but a loan or advance to the petitioner, who was entitled to a refund of the tax paid thereon. The court reasoned that a decision for the respondent would have been inequitable. No mention was made of treating the repayment as a deduction when paid.

In *National City Bank of New York v. Helvering*,³⁸ a 1938 case, the court abandoned this doctrine. In that case the taxpayer alleged that illicit bonus receipts were not his property, and that, as a constructive trustee, he could not be taxed thereon. The court ignored this argument and reasoned that the taxpayer should be taxed as the owner, regardless of the infirmity. A more direct attack on the constructive trust doctrine was made in *Saunders v. Commissioner*.³⁹ In this case, by way of dicta, it was inferred that a court's determination that the funds were held by the taxpayer as constructive trustee would not relieve the funds from original tax liability.⁴⁰ In *Commissioner v. Alamitos Land Co.*,⁴¹ the taxpayer claimed that money paid it in satisfaction of a judgment, where there was a possibility of reversal on appeal, should be treated in the nature of a trust fund and therefore not taxable. The court, however, refused to apply the constructive trust doctrine.

While the majority of the courts subsequent to 1932 have neglected to apply the constructive trust doctrine,⁴² courts recently have shown more favor towards it.⁴³ At least one court mentions the fact that it has been influenced to apply this doctrine because of the equities

35 2 B. T. A. 825 (1925).

36 18 B. T. A. 1036 (1930).

37 36 F. (2d) 961 (E. D. N. Y. 1930).

38 98 F. (2d) 93 (2d Cir. 1938). For numerous cases considering the illegality of receipts, see Note, 154 A. L. R. 1276, 1279 (1945).

39 101 F. (2d) 407 (10th Cir. 1939).

40 *Id.* at 409.

41 112 F. (2d) 648 (9th Cir. 1940).

42 See notes 21 and 23 *supra*.

43 *Knight Newspapers, Inc. v. Commissioner*, 143 F. (2d) 1007 (6th Cir. 1944); *Hall C. Smith*, 11 T. C. 174 (1948).

involved. In *Knight Newspapers, Inc. v. Commissioner*,⁴⁴ the Court of Appeals for the Sixth Circuit held that a dividend received by the petitioner under a mistake of fact was thereby impressed with a constructive trust and the dividend would therefore be treated as if never received. In this case the petitioner had received a dividend in the form of a credit to his liability account, which dividend on later computation was found not to have been declared in accordance with the provisions of the preferred stock indenture. The entry was reversed in a subsequent year, and petitioner sought a refund on the taxes paid. The court stated that the incentive for making this exception to the claim of right doctrine was that a penalty in the form of an exorbitant surtax would have resulted if the taxpayer had not been permitted to make the reduction in the prior period.⁴⁵ However, in *St. Regis Paper Co. v. Higgins*,⁴⁶ the Court of Appeals for the Second Circuit, in considering an almost identical factual situation, arrived at a contrary conclusion. The court did, indeed, assume the existence of a constructive trust, and recognized the injustice to the taxpayer,⁴⁷ but nevertheless determined that the funds were received under a claim of right and must be taxed.

A recent decision following the constructive trust doctrine is *Hall C. Smith*.⁴⁸ There the Tax Court stated that the fact that the petitioner would be liable in equity, as transferee:⁴⁹

. . . can mean only that he received the transferor's assets (the excessive compensation) impressed with a trust in favor of the Government's claim against the transferor for unpaid taxes. The petitioner held the funds not for himself, but for the creditors of the transferor.

The case therefore appears to extend the doctrine not only to cases involving a mistake, but to all cases where the taxpayer is liable in equity to make repayment. In so far as the rule of this case would apply to instances where no substantial difference would result from treating the repayment as a refund in the year of receipt, rather than as a deduction in the year of repayment, it would seem to be too broad.

The Court of Claims in two recent cases has adopted the mistake of fact doctrine in situations where the courts had formerly applied the constructive trust doctrine. In *Greenwald v. United States*,⁵⁰ the petitioners, filing on the cash basis, paid taxes in 1934, 1935 and 1936 on income received during those years. Large portions of such income were bonus payments made by the employer-company on the basis of their net income. Because of the falsification of the company's

⁴⁴ 143 F. (2d) 1007 (6th Cir. 1944).

⁴⁵ *Id.* at 1011.

⁴⁶ 157 F. (2d) 884 (2d Cir. 1946).

⁴⁷ *Id.* at 885.

⁴⁸ 11 T. C. 174 (1948).

⁴⁹ *Id.* at 177.

⁵⁰ 57 F. Supp. 569 (Ct. Cls. 1944).

records, these bonus payments were excessive, and upon discovery of this fact the excess was repaid in 1938 and 1939. The court allowed petitioner a refund on the tax paid in 1935 and 1936 (the statute of limitations having run on the 1934 tax). Again the motive of the court in reaching the decision was the prevention of the injustice which would result to the taxpayer from a denial of the refund. The court stated: "Where . . . one pays income taxes upon income which he physically receives, but which he is not allowed to keep, the Government's retention of the tax is essentially unjust."⁵¹ The court's failure to mention the possibility of treating the repayment as a deduction in the taxable year of repayment was probably the result of the fact that, as a practical matter, such a treatment would have been of little benefit to the taxpayer.

Following the *Greenwald* case, the Court of Claims, in *Gargaro v. United States*,⁵² allowed another refund for overpayments of tax, resulting from an overstated bonus. In this case, however, the bonus was misstated as a result of the Reconstruction Finance Corporation's subsequent renegotiation of a contract with the company involved. The reasoning of the court warrants mention. The court stated that, for the Government's insistence ". . . upon keeping taxes paid to it by a taxpayer . . . when in fact he received it only by reason of an honest mistake, and was obliged to and did give it back and got no benefit from it, there is nothing to be said morally."⁵³ The court further stated that the only reasons why the Government should retain the tax would be that the law was plainly so written, or because a fairer interpretation of what was an unclear law would throw the public revenues into serious confusion.⁵⁴ However, the court contended that the law was not clear, citing *Commissioner v. Wilcox*,⁵⁵ where an embezzler was not taxed on the funds taken, though used and spent by him. The court went on to consider the claim of right doctrine, but concluded that it did not apply, because the mistake "neutralized" that claim. The reasoning of the court in this respect appears to be merely an attempt to avoid the strict and inequitable results which would flow from adherence to this doctrine.

The dissent, after conceding that a contrary conclusion did not seem just, pointed out that there was no mistake involved, but only the contingency that a future event might occur, i.e., the renegotiation of the contract by the Government. As far as anyone knew or could have ascertained at the time income was computed, the amount was

⁵¹ *Id.* at 573.

⁵² 73 F. Supp. 973 (Ct. Cls. 1947).

⁵³ *Id.* at 974.

⁵⁴ *Id.* at 975.

⁵⁵ 327 U. S. 404, 66 S. Ct. 546, 90 L. Ed. 752 (1946).

correct. While this case is therefore distinguishable from the *Greenwald* case, it seems to be a warranted extension of the principles contained therein because of the hardship which would otherwise result to the taxpayer.

Conclusions

Application of the claim of right doctrine to receipts when there is either an existing dispute as to their ownership, or a contingency that they will later have to be repaid, seems necessary for the proper administration of the taxing statutes. However, a strict application of this doctrine and the accompanying dictum to repayments is very often unconscionable. As has been indicated, some of the courts have narrowed the application of the *North American Oil Consolidated* case, in certain instances, to prevent a disproportionate tax burden upon funds which the taxpayer was not allowed to keep. Nevertheless, the examples of an equitable approach to this problem are in the minority.

The solution of this predicament does not appear to require legislative action, since section 43 of the Internal Revenue Code permits the taxpayer to use that method of reporting his receipts which will most accurately reflect his actual income. Taxing the taxpayer for receipts he is later forced to return, without allowing a compensating refund in the year received, obviously is not an accurate reflection of his income for that period. A consideration of this fact by the courts should induce them to restrict the application of the claim of right doctrine whenever it would cause substantial oppression to the taxpayer.⁵⁶ It does not appear that such a relaxation of a strict and inequitable doctrine will detract from the effectiveness of the tax laws. Efficiency in the administration of the Internal Revenue Code need not be inconsistent with equitable treatment of the taxpayer.

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Trade Regulations

THE NON-SIGNER CLAUSE OF FAIR TRADE ACTS: CONSTITUTIONALITY AND THEORY OF ENFORCEMENT

As the trade and business world has grown to its present vast proportions, a perhaps inevitable concomitant has been the development of an increasing variety of unsocial and unethical business practices. To check these abuses as they arise, American law has taken strong

⁵⁶ See note 2 *supra*.

measures, among which are the unfair practices acts, anti-discrimination acts, anti-trust laws, and fair trade acts. To the layman all these mean generally the same thing — governmental regulation;¹ to the businessman they represent the common enemy of assertedly unwarranted interference with business activities. Appealing to legal terminology, the businessman maintains that they are unconstitutional.

It is the purpose of this article to examine only one class of these legislative measures — a class designed both to promote the particular welfare of individual competitors by protecting their property interests, and to secure economic stability to the public by preventing disastrous price warfare. This particular genus of legislation consists of what are popularly termed fair trade acts.

The avowed intent of such statutes is the prevention of unfair competition² and the protection of the good will³ enjoyed by the owner of a trade-name or brand.⁴ These ends are accomplished by the statutory enforcement of resale price contracts. These contracts are freely entered into between the owners of branded or trade-named (not necessarily copyrighted) commodities sold in open competition, and the distributors and retailers of such commodities. The typical contract provides a schedule of minimum or fixed prices which the distributor may not undercut. It may provide for subsequent contracts to be entered into by the distributor and his vendees providing for resale price restrictions on such vendees. It should be noted that such contracts would be enforced at common law.⁵ However, the impact of the fair trade acts extends much further. The prices established by resale price contracts are made binding upon all parties selling the branded commodity who have knowledge of the contract, whether parties to it or not. This enforcement is made possible by the much controverted device of the non-signer clause.⁶

¹ See Life Magazine, Mar. 6, 1950, p. 30.

² Ray Kline, Inc. v. Davega-City Radio, Inc., et al., 168 Misc. 185, 4 N. Y. S. (2d) 541 (1938); Borden Co. v. Schreder, 182 Ore. 34, 185 P. (2d) 581 (1947).

³ Old Dearborn Distributing Co. v. Seagram-Distillers Corp., 299 U. S. 183, 57 S. Ct. 139, 81 L. Ed. 109 (1936); Calvert Distilling Co. v. Brandon, 24 F. Supp. 857 (W. D. S. C. 1938).

⁴ A discussion of the intent of such statutes is contained in Part II of this note.

⁵ Dr. Miles Medical Co. v. Park & Sons Co., 220 U. S. 373, 31 S. Ct. 376, 55 L. Ed. 502 (1911).

⁶ "Wilfully and knowingly advertising, offering for sale or selling any commodity at less than the price stipulated in any contract entered into pursuant to this chapter, whether the person so advertising, offering for sale or selling is or is not a party to such contract, is unfair competition and is actionable at the suit of any person damaged thereby." CAL. BUSINESS AND PROFESSIONS CODE § 16904 (1944).

It is with this clause that this article is concerned. Two aspects will be separately considered: the constitutionality of the clause, and the theory of its enforcement.

I.

Constitutionality

The modern fair trade acts, the conception of which dates back to August 21, 1933, when the first non-signer clause was enacted,⁷ have met with concerted and vigorous opposition throughout their entire existence.⁸ The advocate of unrestrained price competition has consistently deemed resale price maintenance an unequivocal infringement upon his constitutional rights. Two traditional theories support his contention: the *laissez faire* concept of unrestrained competition as an essential of the capitalistic system; and the traditional American desire for freedom from governmental interference of any sort. Moreover, his position is supported by the common law rule that price competition, unless engaged in with malicious intent, is not unlawful, civilly or criminally.⁹ Armed with these persuasive doctrines, the advocate of unrestrained price competition may readily appeal to those members of the judiciary whose philosophy embraces such doctrines. Attacks upon resale price maintenance are founded primarily upon the prohibitions of the Fourteenth Amendment. Unconstitutionality is variously asserted on the grounds that the acts are an unfair interference with the operation of private business;¹⁰ that they interfere with the commercially sanctioned free alienation of property;¹¹ that they favor one group over another;¹² that they interfere with the right of freedom of contract;¹³ and that they result in a deprivation of the full and free use of one's property.¹⁴

The initial attack on the non-signer clause was made in California, the state in which the clause originated. There the state supreme

⁷ The renowned section 1½ amendment to the California fair trade act passed as: Cal. Laws 1933, c. 260. The clause is now found in: CAL. BUSINESS AND PROFESSIONS CODE § 16904 (1944).

⁸ See, e.g., FTC, REPORT OF THE FEDERAL TRADE COMMISSION ON RESALE PRICE MAINTENANCE (1945).

⁹ RESTATEMENT, TORTS § 768 (1939); PROSSER, TORTS 1020-22 (1941); Carpenter, *Interference with Contract Relations*, 41 HARV. L. REV. 728, 768 (1928).

¹⁰ Shryock v. Ass'n. of United Fraternal Buyers, Inc., 3 CCH TRADE REG. SERV. § 25150 (1938), *rev'd. on other grounds*, 135 Pa. Super. 428, 5 A. (2d) 581 (1939).

¹¹ Coty, Inc., of New York v. Hearn Dept. Stores, Inc., 158 Misc. 516, 284 N. Y. S. 909 (1935).

¹² Liquor Store, Inc., et al. v. Continental Distilling Corp., Fla., 40 So. (2d) 371 (1949).

¹³ Max Factor & Co. v. Kunsman, 5 Cal. (2d) 446, 55 P. (2d) 177 (1936).

¹⁴ Doubleday, Doran & Co. v. R. H. Macy Co., 158 Misc. 267, 284 N. Y. S. 533 (1935), *aff'd.*, 269 N. Y. 272, 199 N. E. 409, 103 A. L. R. 1325 (1936).

court, reversing a lower court decision, held the clause constitutional.¹⁵ Contemporaneously, similar test cases involving such clauses were argued in Illinois and New York. The Illinois act was held constitutional,¹⁶ but the New York act was found to be unconstitutional, on the grounds that the non-signer clause amounted to indirect legislative price fixing, which was beyond the power of the legislature, in respect to goods not affected with the public interest.¹⁷ Appeals were taken from the California and Illinois decisions to the United States Supreme Court.

Thereupon, in the famous case of *Old Dearborn Distributing Co. v. Seagram-Distillers Corp.*,¹⁸ a unanimous Court, speaking through Mr. Justice Sutherland, sustained the validity of the non-signer clause, stating that the means employed were reasonably adapted to a legitimate legislative end: the protection of "the property — namely, the goodwill — of the producer, which he still owns."¹⁹ The secondary purpose, it was added, was to protect the general public from injurious price cutting.

The Court conclusively overthrew all opposing arguments. It first disposed of the contention that the clause constituted an unlawful delegation of power to private persons to control the disposition of property of others, on the theory that such other persons had acquired the property with knowledge of the resale price restrictions. Secondly, the Court held that the clause was not so arbitrary as to amount to a denial of due process. The restriction did not deal with a "commodity alone, but with a commodity plus the brand or trade-mark . . .," symbolizing good will.²⁰ "And good will is property in a very real sense, injury to which . . . is a proper subject for legislation."²¹ Finally, the Court declared that it was not within its province to determine whether the legislative purpose was for the common good; since it was a "fairly debatable" question, the legislature was the sole judge.

This decision has established the law. New York explicitly changed its position to conform with the Supreme Court's decision.²² New Jersey upheld the constitutionality of its act, the court stating that the "decision is a complete answer to every argument advanced against

¹⁵ Max Factor & Co. v. Kunsman, 5 Cal. (2d) 446, 55 P. (2d) 177 (1936).

¹⁶ Seagram-Distillers Corp. v. Old Dearborn Distributing Co., 363 Ill. 610, 2 N. E. (2d) 940 (1936); Joseph Triner Corp. v. McNeil, 363 Ill. 559, 2 N. E. (2d) 929 (1936).

¹⁷ See note 14 *supra*.

¹⁸ 299 U. S. 183, 57 S. Ct. 139, 81 L. Ed. 109 (1936).

¹⁹ *Id.*, 299 U. S. at 193.

²⁰ *Id.*, 299 U. S. at 194.

²¹ *Ibid.*

²² Bourjois Sales Corp. v. Dorfman, 273 N. Y. 167, 7 N. E. (2d) 30 (1937).

the statute.”²³ The ultimate result of the *Old Dearborn Distributing Co.* case has been the enactment of similar statutes in forty-seven jurisdictions.²⁴ However, these statutes have not been free from vigorous and continuing attacks.

In 1940, Wisconsin's fair trade act was challenged²⁵ as an unlawful delegation of legislative power to private individuals. Following the reasoning of the Illinois Supreme Court,²⁶ the court overthrew this contention, holding that the act does not attempt to fix, or delegate to others the right to fix, the price at which a commodity must be sold; furthermore, such an act does not take effect upon any authority other than the legislative branch of the state government, being complete in and of itself when passed, even though it comes into actual operation only when a manufacturer or wholesaler elects to avail himself of it. In like manner Maryland answered the same objection,²⁷ holding that its act was not an attempt to delegate price fixing authority, but merely permitted designated persons to contract with respect thereto, as they saw fit.

Strong attacks have proceeded on the theory that fair trade contracts restrain competition and promote monopoly.²⁸ This contention seems to overlook the salient requirement that the fair trade goods must be “in free and open competition,” and further that they are imposed upon “vertical” rather than “horizontal” lines. Obviously, there cannot be competition between the producer and his distributing retailer; and as between the producer and his actual competitors, the contract prices must be set to meet their competition. There is no restraint of true horizontal competition; consequently, the acts do not engender monopoly.

The contentions of unconstitutionality propounded in the *Old Dearborn Distributing Co.* case — invalid exercise of the police power, interference with freedom of contract, denial of equal protection of the laws, and deprivation of due process of law through an improper delegation of power — had been repeated with decreasing frequency in the state

²³ *Johnson & Johnson et al. v. Weissbard et al.*, 121 N. J. Eq. 585, 191 Atl. 873 (1937).

²⁴ Forty-five states, Hawaii, and Puerto Rico. Texas, Missouri, Vermont, and District of Columbia have resisted enactment. For a complete listing, see P-H LABOR GUIDE ¶ 22,121 (1947).

²⁵ *Weco Products Co. v. Reed Drug Co.*, 225 Wis. 474, 274 N. W. 426 (1937).

²⁶ *Joseph Triner Corp. v. McNeil*, 363 Ill. 559, 2 N. E. (2d) 929 (1936).

²⁷ *Goldsmith v. Mead & Johnson Co.*, 176 Md. 682, 7 A. (2d) 176 (1939).

²⁸ This contention was dismissed by *Eli Lilly & Co. v. Saunders*, 216 N. C. 163, 4 S. E. (2d) 528 (1939); *Goldsmith v. Mead & Johnson Co.*, 176 Md. 682, 7 A. (2d) 176 (1939); *Miles Laboratories, Inc. v. Seignious*, 30 F. Supp. 549 (E. D. S. C. 1939); *Miles Laboratories, Inc. v. Owl Drug Co.*, 67 S. D. 523, 295 N. W. 292 (1940); *Sears et al. v. Western Thrift Stores of Olympia, Inc.*, et al., 10 Wash. (2d) 372, 116 P. (2d) 756 (1941).

courts until April 5, 1949, when the Florida Supreme Court declared the Florida fair trade act unconstitutional.²⁹ During the period between the decision in the *Old Dearborn Distributing Co.* case and the recent Florida case, no court had declared a fair trade act invalid on any *substantive* constitutional grounds.³⁰ The Florida court declared that one group of property owners cannot claim additional personal advantages beyond their rights as part of the general public. The police power may not be invoked to secure personal advantages, but is restricted to matters affecting the public morals, health or safety. The court stated that:³¹

When a statute is brought into question resting upon the police power, the courts have power and the duty to inquire whether it is within constitutional limits . . . The legislature is the judge of the wisdom of the regulation but the court may say whether the act is within constitutional limits. It is particularly a judicial question whether the legislative act is for a private or public purpose.

The court concluded that the act was arbitrary, unreasonable and violative of the right to own and enjoy property, and that the sovereign power of the state cannot be given to one group to be exercised upon another. Unlike New York, which bowed to the United States Supreme Court in this matter,³² the Florida court said in effect that, while the Supreme Court of the United States was supreme with respect to the Federal Constitution, the Florida court was supreme with respect to the Florida constitution. Although the Florida constitution contains provisions similar to the Fourteenth Amendment of the Federal Constitution, the court was construing the Florida constitution, not the Fourteenth Amendment, and hence owed only passing respect to the Supreme Court's decision. This court did exactly what the Supreme Court in the *Old Dearborn Distributing Co.* case said the courts cannot do: that is, determine whether an act is for the public or private

²⁹ *Liquor Store, Inc., et al. v. Continental Distilling Corp.*, Fla., 40 So. (2d) 371 (1949).

³⁰ *Burroughs Wellcome & Co. v. Johnson Wholesale Perfume Co.*, 128 Conn. 596, 24 A. (2d) 841 (1942); *Pepsodent Co. v. Krauss Co., Ltd.*, 200 La. 959, 9 So. (2d) 303 (1942); *Goldsmith v. Mead & Johnson Co.*, 176 Md. 682, 7 A. (2d) 176 (1939); *Weco Products Co. v. Sam's Cut-Rate, Inc., et al.*, 296 Mich. 190, 295 N. W. 611 (1941); *Johnson & Johnson et al. v. Weissbard et al.*, 121 N. J. Eq. 585, 191 Atl. 873 (1937); *Eli Lilly & Co. v. Saunders*, 216 N. C. 163, 4 S. E. (2d) 528 (1939); *Miles Laboratories, Inc. v. Seignious*, 30 F. Supp. 549 (E. D. S. C. 1939); *Miles Laboratories, Inc. v. Owl Drug Co.*, 67 S. D. 523, 295 N. W. 292 (1940); *Sears et al. v. Western Thrift Stores of Olympia, Inc., et al.*, 10 Wash. (2d) 372, 116 P. (2d) 756 (1941); *Weco Products Co. v. Reed Drug Co.*, 225 Wis. 474, 274 N. W. 426 (1937) (except the exemption of cooperatives from the operation of the act).

³¹ *Liquor Store, Inc., et al. v. Continental Distilling Corp.*, Fla., 40 So. (2d) 371, 374 (1949).

³² *Bourjois Sales Corp. v. Dorfman*, 273 N. Y. 167, 7 N. E. (2d) 30 (1937).

good.³³ Such a determination, according to the *Old Dearborn Distributing Co.* case, is the prerogative of the legislature. A dissenting opinion, in the Florida case, reiterated what is perhaps the most frequent criticism of the modern judiciary:³⁴

Courts are not permitted to strike down a statute because it fails to square with their individual social or economic philosophies or theories, neither can we consider the question of public policy, wisdom or lack of wisdom or other motives which may address themselves to the legislative department of our government.

Upon analysis, it appears that the ultimate determination of the court was that the legislature's exercise of the police power, in enacting the fair trade act, was not for a valid purpose. It admitted that in a debatable situation it is for the legislature to determine whether the police power may properly be invoked. This admission the court peremptorily dismissed by its declaration, previously noted, that it is "particularly a judicial question whether the legislative act is for a private or public purpose."³⁵ Thus the court established itself as supreme arbiter in questions of whether legislative enactments in economic matters are within the purview of the general welfare. Had the court been dealing with a subject primarily involving personal rights, its sweeping declaration would have had colorable validity. But this subject involved primarily economic matters, where in all controversial problems the legislative determination is given broadest scope.³⁶ It is not for the courts to "legislate," by taking a different position than that adopted by the legislature, and by declaring the acts of the legislature unconstitutional.³⁷ That is exactly what the Florida court has done by determining that the general welfare has not been served by the fair trade acts. And it patently admits that a dispute exists by attempting to predicate its conclusions³⁸ upon an argumentative report of the Federal Trade Commission.³⁹

The constitutional attack on fair trade acts has not been restricted to their substantive quality. Often courts have found reasons to invalidate the acts on procedural grounds, which merely postpones

³³ *Old Dearborn Distributing Co. v. Seagram-Distillers Corp.*, 299 U. S. 183, 57 S. Ct. 139, 81 L. Ed. 109 (1936).

³⁴ *Liquor Store, Inc., et al. v. Continental Distilling Corp.*, Fla., 40 So. (2d) 371, 393 (1949).

³⁵ *Id.*, 40 So. (2d) at 374.

³⁶ *Buck v. Kuykendall*, 267 U. S. 307, 45 S. Ct. 324, 69 L. Ed. 623, 38 A. L. R. 286 (1925).

³⁷ It must be noted that the Florida legislature was not to be defeated. It promptly passed a new fair trade act, to meet the court's objections, on June 1, 1949, less than two months after the court rendered its decision. See 2 CCH 1949 TRADE REG. SERV. ¶ 7083.

³⁸ *Liquor Store, Inc., et al. v. Continental Distilling Corp.*, Fla., 40 So. (2d) 371, 375 (1949).

³⁹ FTC, REPORT OF THE FEDERAL TRADE COMMISSION ON RESALE PRICE MAINTENANCE (1945).

the "day of reckoning." Nevertheless, this has been done and is continuing to be done. For example, the Florida court, in an early case, declared that state's act to be void⁴⁰ because the title failed to represent completely the contents of the act. The title did not indicate that it applied to one who was not a party to the fair trade agreement, although the act itself explicitly applied to non-signers.

In 1949, the Illinois Supreme Court held Illinois' mandatory fair trade act void because it attempted to amend the liquor control act and the fair trade act by reference to their title.⁴¹ In this instance reference by title was prohibited by Illinois statute.⁴²

Until the 1949 Florida decision, the constitutionality of the fair trade acts' "non-signer clause" seemed well settled.⁴³ This is not to deny that there has been uninterrupted opposition to the acts by large segments of the merchandising world. The leader of the opposition has been the Federal Trade Commission, whose periodic reports have attempted to show that these contracts have been used as a means to increase the prices of branded commodities, free from governmental interference. The Florida court has been convinced by this reasoning. Whether other courts will follow, displacing the Supreme Court's ruling in the *Old Dearborn Distributing Co.* case, is an open question. It is submitted that so long as a bona fide controversy exists, so long as the economic philosophy indicated in the *Old Dearborn Distributing Co.* case is not clearly arbitrary, the question is one exclusively of legislative determination and is not open for the courts' decision.

II.

Theory of Enforcement

The merest cursory perusal of the law, in a broad sense of the term, manifests endless differences and confusion in its rules, principles, standards and philosophy. No part of the law is immune from this condition; but of all the phases of the law, possibly the one in the greatest state of flux and uncertainty is that of business regulation. The reasons for this are numerous: (1) the swifter rate of change in the economic sphere than in the legal; (2) the conflict between common law and statutory enactment; (3) the inability of either the courts or the legislature accurately and comprehensively to anticipate

⁴⁰ *Bristol-Myers Co. v. Webb's Cut Rate Drug Co., Inc.*, 137 Fla. 508, 188 So. 91 (1939).

⁴¹ *Illinois Liquor Control Commission v. Chicago's Last Liquor Store, Inc.*, ... Ill., 88 N. E. (2d) 15 (1949).

⁴² ILL. REV. STAT. c. 43, §§ 94-194, 196-204 (1947); ILL. REV. STAT. c. 121½, §§ 188-91 (1947); ILL. CONST. Art. 4, § 13.

⁴³ Another recent decision, holding the Mississippi fair trade act unconstitutional, is *Sheaffer Pen Co. v. Barrett et al.*, (Chancery Court, 1st Jud. Dist. of Hinds County, Miss., 1949).

future developments in the business world; (4) divergent economic theories upon which the courts and legislatures act; (5) the wide discrepancy between business practice and test-tube economic theory. The composite result in many cases has been haphazard, piecemeal legislation and narrow, inconsistent judicial decisions.

This situation permeates the law concerning the non-signer clause of the fair trade acts. The purpose of the clause is to permit enforcement of fair trade contracts against non-contracting parties who have knowledge of the contract. But now, seventeen years after the enactment of the first non-signer clause,⁴⁴ and after forty-seven jurisdictions⁴⁵ have passed identical or similar provisions, not a single case has been found that has comprehensively analyzed the basic jurisprudential principle or principles upon which this clause is enforced, nor a single jurisdiction whose decisions can be consistently classified under the theory of enforcement announced by its courts.

Theories of enforcement suggested include: prevention of tortious interference with contractual relations;⁴⁶ creation of an equitable servitude running with the chattel;⁴⁷ prevention of unfair competition;⁴⁸ protection of good will;⁴⁹ and recognition of a "statutory right."⁵⁰ The rampant confusion is exemplified by a decision⁵¹ which gallantly attempted to predicate enforcement, expressly or impliedly, upon at least three theories, the ramifications of each being mutually exclusive. The incongruity, it must be reiterated, does not arise only through variances in different jurisdictions, or even between courts, but often in the same court and even in the same case.

The two principal theories⁵² upon which every aspect of enforcement is attempted to be predicated are the doctrines of tortious interference with contractual rights⁵³ and of imposition of equitable

⁴⁴ See note 7, *supra*.

⁴⁵ See note 24, *supra*.

⁴⁶ *Max Factor & Co. v. Kunsman*, 5 Cal. (2d) 446, 55 P. (2d) 177 (1936).

⁴⁷ *Joseph Triner Corp. v. McNeil*, 363 Ill. 559, 2 N. E. (2d) 929 (1936); *Johnson & Johnson et al. v. Weissbard et al.*, 121 N. J. Eq. 585, 191 Atl. 873 (1937); *Eli Lilly & Co. v. Saunders*, 216 N. C. 163, 4 S. E. (2d) 528 (1939).

⁴⁸ *Ray Kline, Inc. v. Davega-City Radio, Inc.*, 168 Misc. 185, 4 N. Y. S. (2d) 541 (1938); *Borden Co. v. Schreder*, 182 Ore. 43, 185 P. (2d) 581 (1947).

⁴⁹ See, e.g., *Old Dearborn Distributing Co. v. Seagram-Distillers Corp.*, 299 U. S. 183, 57 S. Ct. 139, 81 L. Ed. 109 (1936); *Calvert Distilling Co. v. Brandon*, 24 F. Supp. 857 (W. D. S. C. 1938).

⁵⁰ *Miles Laboratories, Inc. v. Seignious*, 30 F. Supp. 549, 556 (E. D. S. C. 1939); *Burstein v. Charline's Cut Rate*, 126 N. J. Eq. 560, 10 A. (2d) 646 (1940).

⁵¹ *Port Chester Wine & Liquor Shop, Inc. v. Miller Bros. Fruiterers, Inc.*, 281 N. Y. 101, 22 N. E. (2d) 253 (1939), *affirming*, 253 App. Div. 188, 1 N. Y. S. (2d) 802 (1938).

⁵² 2 *MARKETING LAWS SURVEY* xlii (State Price Control Legislation) (1940).

⁵³ For thorough discussions of the doctrine, see *Carpenter, Interference with Contract Relations*, 41 *HARV. L. REV.* 728 (1928); *Sayre, Inducing Breach of Contract*, 36 *HARV. L. REV.* 663 (1923).

servitudes upon chattels.⁵⁴ The purpose of this discussion is to attempt to show that neither of these theories can be consistently applied to coincide with the purpose, nor even the letter, of the fair trade laws. Furthermore, an attempt will be made to clarify the principles upon which the courts, though not expressly and perhaps not consciously, have seemingly acted, and to discover an underlying theory of enforcement, if one exists.

The rule of liability for tortious interference with contractual rights has been stated thusly:⁵⁵

. . . a *prima facie* tort exists where there is any damaging interference with a contractual relation either by inducing the promisor to break the contract or to abandon the relation, or by doing an act either for the purpose of such interference or with knowledge that such interference will result, or according to respectable authority under such circumstances that a reasonably prudent person would know that such interference is likely to result.

If any of these conditions exist, liability will result unless the defendant can show that "justification" for his interference exists.⁵⁶ Whether such justification⁵⁷ does exist depends upon the correlative interests of the interferor, of the contracting parties, and of society in the preservation of the integrity of contracts.

Rephrased, tort liability exists if one proximately causes injury to another by interfering with his contractual relations, if such interference is direct (whether intentionally or negligently caused), and the object of the interference is either malicious or calculated to secure the injured party's contractual rights or advantages to the interferor's benefit. Under this definition, liability would exist if it could be shown that a non-signer's refusal to comply with the minimum or fixed prices of the fair trade contract proximately induced a breach of the contract. As to the producer-owner of the trade-name, the breach may occur in two ways: other retailing contractors may, first, breach their contracts by selling below the fixed or minimum price, or, second, may refuse to continue their purchase commitments with the producer. Liability upon the latter grounds seems rather unsubstantial, in respect to the requirement of proximate interference. When another retailer sues, if liability is to be sustained, it must be upon the theory of interference with the fair trade contract by price competition. But price competition, unless carried on with malicious intent, is a justified interference

⁵⁴ See Chafee, *Equitable Servitudes Upon Chattels*, 41 HARV. L. REV. 995 (1928).

⁵⁵ Carpenter, *Interference with Contract Relations*, 41 HARV. L. REV. 728, 744 (1928).

⁵⁶ *Id.* at 745.

⁵⁷ For a general definition of "justification" see Bohlen, *Incomplete Privilege to Inflict Intentional Invasions of Interests of Property and Personality*, 39 HARV. L. REV. 307, 314 (1926).

with a competitor's contract.⁵⁸ Unless an exception is to be made to this general rule, enforcement cannot be based upon tortious interference. Might not enforcement be predicated upon grounds of unfair competition by the competing retailer? This possibility will be examined later herein.

An examination of the cases will illustrate that the doctrine of tortious interference cannot be applied as the underlying principle of enforcement, even though several cases have expressly adopted this doctrine,⁵⁹ and others have been construed as having so held.⁶⁰ These courts apparently have failed to distinguish between unfair competition and tortious interference, and consequently have not considered who brought the suit—the owner of the brand-name or the retailer.

Under this doctrine, a suit by a non-signatory against another non-signatory could not be sustained, as there cannot be any direct interference with a contractual relation; but suits involving only non-signatories have been allowed.⁶¹

Nor is suit by a retailer precluded because the owner of the trade or brand-name has not actively enforced the contractual restrictions,⁶² as would be required under the tortious interference theory. In such case, the contract has been breached as to its implied condition that the trade-name owner will enforce the fair trade prices against all competitors of the contracting party; this implied condition is deemed to be a part of the consideration supporting the contract by some courts.⁶³ If the contract is already breached, there can be no action for an outsider's interference with it; yet, such actions by the retailer are allowed. Nor can the contention subsist that a different part of a severable contract is involved; the interference involves the same condition of the

⁵⁸ RESTATEMENT, TORTS § 768 (1939); PROSSER, TORTS 1020-22 (1941); Carpenter, *Interference with Contract Relations*, 41 HARV. L. REV. 728, 758 (1928); 1 NIMS, UNFAIR COMPETITION AND TRADE MARKS 482 (4th ed. 1947).

⁵⁹ See, e. g., *Max Factor & Co. v. Kunsman*, 5 Cal. (2d) 446, 55 P. (2d) 177 (1936).

⁶⁰ *Port Chester Wine & Liquor Shop, Inc. v. Miller Bros. Fruiterers, Inc.*, 281 N. Y. 101, 22 N. E. (2d) 253 (1939), *affirming*, 253 App. Div. 188, 1 N. Y. S. (2d) 802 (1938); *Shryock v. Ass'n. of United Fraternal Buyers, Inc.*, 135 Pa. Super. 428, 5 A. (2d) 581 (1938).

⁶¹ *Burstein v. Charline's Cut Rate*, 126 N. J. Eq. 560, 10 A. (2d) 646 (1940); *Weisstein v. Peter Corbyon Liquor Store, Inc.*, 174 Misc. 1075, 22 N. Y. S. (2d) 510 (1940).

⁶² *Seagram-Distillers Corp. v. Nussbaum Liquor Store*, 166 Misc. 342, 2 N. Y. S. (2d) 320 (1938); *Calvert Distillers Corp. v. Stockman*, 26 F. Supp. 73 (E. D. N. Y. 1939); *Magazine Repeating Razor Co. v. Weissbard*, 125 N. J. Eq. 593, 7 A. (2d) 411 (1939); *Gillette Safety Razor Co. v. Green*, 167 Misc. 251, 3 N. Y. S. (2d) 822 (1938), *aff'd. without opinion*, 258 App. Div. 723, 15 N. Y. S. (2d) 142 (1939); *Automotive Electric Service Corp. v. Times Square Stores Corp.*, 175 Misc. 865, 24 N. Y. S. (2d) 733 (1940).

⁶³ See, e. g., *Houbigant Sales Corp. v. Woods Cut Rate Store*, 123 N. J. Eq. 40, 196 Atl. 683 (1937).

contract—that the retailer after agreeing not to sell below the minimum price is to be protected from underselling by his competitors.

To seek an injunction for violation, the producer or owner of the trade-name need not have contracted directly with any retailer.⁶⁴ He may have contracted with a wholesaler or jobber, who agreed not to sell except upon establishment of resale prices with his vendee-retailers. A suit by the producer, who has not had contractual relations with other retailers, cannot be based upon tortious interference, as there is no contract with the retailer with which to interfere, and any interference with the wholesaler-producer contract is too remote to create liability.

A few cases have held that a single contract is sufficient to place the non-signer clause in operation.⁶⁵ As tortious interference requires that there be proximate interference with the contract, there could not reasonably be any proximate interference with that single contract by another retailer underselling in another community far removed from the location of the signing retailer.

Finally, a syllogistic argument may be made against the tortious interference theory as the true basis of liability. New York courts have held that the enforcement of the non-signer clause is upon tortious interference. *Port Chester Wine and Liquor Shop, Inc. v. Miller Bros. Fruiterers, Inc.*,⁶⁶ is generally cited as adopting this doctrine, although the court's reasoning is not without ambiguity. But in that very case, the court stated that the non-signer clause of the act "created a new cause of action."⁶⁷ However, the tort doctrine already existed. Consequently, something other than the tort doctrine must have been the basis upon which relief was given. This conclusion is substantially fortified by the established common law,⁶⁸ which prior to the enactment of the non-signer clauses refused to apply the doctrine of tortious interference against underselling non-signers of resale price contracts. Relief was refused on the joint grounds that the contracts tended to spawn monopoly and that bona fide price competition could not be characterized as wrongful.

⁶⁴ *Calvert Distillers Corp. v. Nussbaum Liquor Store*, 166 Misc. 342, 2 N. Y. S. (2d) 320 (1938); *Calvert Distillers Corp. v. Stockman*, 26 F. Supp. 73 (E. D. N. Y. 1939).

⁶⁵ *Revlon Nail Enamel Corp. v. Charmley Drug Shop*, 123 N. J. Eq. 301, 197 Atl. 661 (1938); *Pazen v. Silver Rod Stores*, 129 N. J. Eq. 128, 18 A. (2d) 576, reversed on other grounds, 130 N. J. Eq. 407, 22 A. (2d) 237 (1941); or only a few contracts, *Calvert Distillers Corp. v. Nussbaum Liquor Store, Inc.*, 167 Misc. 342, 2 N. Y. S. (2d) 320 (1938).

⁶⁶ 253 App. Div. 188, 1 N. Y. S. (2d) 802 (1938), *aff'd.*, 281 N. Y. 101, 22 N. E. (2d) 253 (1939).

⁶⁷ 253 App. Div. 188, 1 N. Y. S. (2d) 802, 805 (1938).

⁶⁸ *Dr. Miles Medical Co. v. Park & Sons Co.*, 220 U. S. 373, 31 S. Ct. 376, 55 L. Ed. 502 (1911). However, note Justice Holmes' famous dissent.

An equitable servitude⁶⁹ is a restriction placed upon the use of property, inhering in the ownership of the property. It does not attach to the property itself. Its enforcement is based upon the equitable doctrine that one should not be allowed to violate the terms of a contract concerning property which he owns, when he acquired the property with notice of such restricting contract, or did not take the property as a bona fide purchaser for value. The doctrine of equitable servitudes originally applied only to land, but has been applied to chattels to a limited extent.⁷⁰ The extension of the doctrine to chattels has been resisted uninterruptedly from the outset,⁷¹ predominantly upon the contentions that normal commercial usage demands that chattels be freely alienable; that the analogy to servitudes upon land is not valid; that such restrictions tend to create monopoly; and that, apart from the interference with the regular operation of the business world, the enforcement of such restrictions by the courts is impractical.

At first glance, one might readily subscribe to this doctrine as the true basis for the enforcement of the non-signer clause. It allows the producer of the chattel to control it after it has left his ownership in one important aspect of the use to which the chattel may be put—the price at which it may be resold.

Upon perusal of the cases, however, it becomes evident that this theory cannot subsist. Although a majority of the cases hold that a retailer or distributor who acquires the goods without notice of the fair trade contract cannot be held to the terms of the contract,⁷² the better reasoned holdings enforce the non-signer clause if the knowledge of the contract is acquired before re-sale.⁷³ This certainly coincides with the exact terms of the typical statutory clause, which provides that “willfully and knowingly advertising, offering for

⁶⁹ For an excellent discussion of the principles of equitable servitudes, see Clark, *The Assignability of Easements, Profits & Equitable Restrictions*, 38 YALE L. J. 139, 152-64 (1928).

⁷⁰ Chafee, *Equitable Servitudes on Chattels*, 41 HARV. L. REV. 945 (1928).

⁷¹ “And so it is if a man be possessed of a lease for years, or of a horse, or of any other chattel real or personal, and give or sell his whole interest or property therein, upon condition that the donee or vendee shall not alien the same, the same is void, because his whole interest and property is out of him, so as he hath no possibility of a reverter, and it is against trade and traffic, and bargaining and contracting between man and man. . . .” CO. LITR. *26.

⁷² *James Heddon's Sons v. Callender*, 29 F. Supp. 579 (Minn. 1939); *Lentheric, Inc. v. Weissbard*, 122 N. J. Eq. 573, 195 Atl. 818 (1937); *Seagram-Distillers Corp. v. Seyopp Corp.*, 2 N. Y. S. (2d) 550 (1938); *Oneida Ltd. v. Macher Watch Co.*, 99 N. Y. L. J. 1706 (S. Ct. Apr. 8, 1938); see *Old Dearborn Distributing Co. v. Seagram-Distillers Corp.*, 299 U. S. 183, 57 S. Ct. 139, 81 L. Ed. 109 (1936).

⁷³ *Barron Motors v. May's Drug Stores, Inc.*, 227 Iowa 1344, 291 N. W. 152 (1940); see *Calvert Distillers Corp. v. Stockman*, 26 F. Supp. 73 (E. D. N. Y. 1939); *Calvert Distillers Corp. v. Nussbaum Liquor Store*, 166 Misc. 342, 2 N. Y. S. (2d) 320 (1938).

sale or selling any commodity" at less than the contract price is the basis for the cause of action. That such construction implements the purpose of the statutes is not open to question. But if this construction is placed upon the non-signer clause, enforcement cannot be upon the principle of equitable servitude, which unequivocally demands that notice of the restriction be had *before acquisition* of the goods.

Nor does the restriction inhere in the ownership of the chattel. If that were so, the fair trade contract prices would be unremittingly enforced against anyone who acquired or held the goods with notice of the contract prices, with the standard exceptions of change of condition or inequitable conduct of the plaintiff.

If the restriction inhered in the ownership of the chattel, the removal of an identifying label would be of no effect. But the legislatures of at least sixteen states⁷⁴ have expressly provided that the statute does not apply where the identifying trade-name or other symbol has been removed. Furthermore, powerful dicta⁷⁵ supports this view. To the same effect are the converse statutory provisions⁷⁶ and judicial holdings⁷⁷ that include within the operation of fair trade contracts products sold from vending machines that identify the product by its trade-name.

What then is the basis for the enforcement of the non-signer clause? Does any consistent principle underlie its enforcement, or is there merely a right created by statute? It is submitted that there is not one basic theory applicable to all the cases, but two theories, and that the answer to the question of which theory applies in a given case depends upon who seeks to enforce the contract restrictions against the non-signatory.

Apparently a tremendous part of the confusion and uncertainty has been caused by the failure to distinguish between the respective rights of action of the owner of the trade-name, and the retailer or other distributor attempting to enforce the fair trade contract. In the abortive attempts to "peg" the enforcement of the clause upon one theory, this essential difference between the position of the owner of the brand and that of the distributor of the branded product has been the source of the confusion. Just as the interests of the trade-

⁷⁴ 2 MARKETING LAWS SURVEY xxxviii (State Price Control Legislation) (1940).

⁷⁵ Old Dearborn Distributing Co. v. Seagram-Distillers Corp., 299 U. S. 183, 57 S. Ct. 139, 81 L. Ed. 109 (1936).

⁷⁶ Effective in at least eight states: California, Maine, Massachusetts, Nevada, New Jersey, Oregon, Utah and Washington.

⁷⁷ Broadway Arthur Garage, Inc. v. Coliseum Motors, Inc., 100 N. Y. L. J. 814 (S. Ct. Sept. 23, 1938), 3 CCH TRADE REG. SERV. ¶ 25,158; Schumer v. Easar Gas Stations, Inc., 100 N. Y. L. J. 1125 (App. Div. Oct. 13, 1938), 3 CCH TRADE REG. SERV. ¶ 25,161.

name owner and of the distributor are different, so are the underlying principles protecting them.

An oft-quoted paragraph in the landmark *Old Dearborn Distributing Co.* case⁷⁸ categorically epitomizes the interest of the owner of the trade-name: it is his good will, evidenced by his trade-mark, brand or name. There is no authority seriously disputing this proposition, although some courts⁷⁹ and writers⁸⁰ have tended to confuse the protection of good will of the producer with the prevention of unfair competition. The tort of unfair competition cannot apply; there is no competition between the producer as such and the distributors of his product.⁸¹ Good will, however, may obviously be affected by price-cutting, and is a property interest⁸² in the strictest sense of the word—an interest which the law will fully protect.⁸³

Before proceeding further, the tort of unfair competition⁸⁴ should be scrutinized. Being a comparatively new tort, it is as yet scarcely definable. Predominantly, it is a residual classification embracing those acts involving business relations which the law presently deems so unjust that they should result in liability. It connotes the idea of preventing one from taking a "free ride" on the name, product or activities of another.⁸⁵ It involves the concept of "unjust enrichment."⁸⁶ The United States Supreme Court has said that, "Unfair competition . . . has been held to apply . . . to misappropriation of what equitably belongs to a competitor."⁸⁷ Nevertheless, it is impossible to construct an inclusive definition at the present state of the law. The inconsis-

⁷⁸ 299 U. S. 183, 193, 57 S. Ct. 139, 81 L. Ed. 109 (1936).

⁷⁹ See, e.g., *Caron Corp. v. Wolf Drug Store*, 40 F. Supp. 103, 105 (N. J. 1941).

⁸⁰ See, e.g., 2 NIMS, UNFAIR COMPETITION AND TRADE MARKS § 300 (4th ed. 1947).

⁸¹ Competition in its proper connotation cannot exist between vertical operators, even though they deal in the same commodity. It is submitted that the misuse by a retailer of a trade-name may better be termed "unfair business practices." It hardly could be unfair competition where competition does not exist.

⁸² *Metropolitan Bank of New York v. St. Louis Dispatch Co.*, 149 U. S. 436, 446, 13 S. Ct. 944, 37 L. Ed. 799 (1893); *Old Dearborn Distributing Co. v. Seagram-Distillers Corp.*, 299 U. S. 183, 194, 57 S. Ct. 139, 81 L. Ed. 109 (1936); *Eli Lilly & Co. v. Saunders*, 216 N. C. 163, 4 S. E. (2d) 528 (1939).

⁸³ 1 NIMS, UNFAIR COMPETITION AND TRADE MARKS §§ 13, 16 (4th ed. 1947).

⁸⁴ See Chafee, *Unfair Competition*, 53 HARV. L. REV. 1289 (1940); Callmann, *What Is Unfair Competition*, 28 GEO. L. J. 585 (1940); CALLMANN, UNFAIR COMPETITION, AMERICAN BAR ASSOCIATION, GENERAL PRACTICE SERIES (1946).

⁸⁵ See Note, *The Monopoly Concept of Trade-Marks and Trade-Names and "Free Ride" Theory of Unfair Competition*, 17 GEO. WASH. L. REV. 112 (1948).

⁸⁶ Callmann, *He Who Reaps Where He Has Not Sown: Unjust Enrichment in the Law of Unfair Competition*, 55 HARV. L. REV. 595 (1942).

⁸⁷ *Schechter Poultry Corp. v. United States*, 295 U. S. 495, 531-32, 55 S. Ct. 837, 79 L. Ed. 1570 (1935).

encies of the rulings are frustrating.⁸⁸ Unfair competition includes, among other acts, false advertising, trade-mark infringement, piracy of "un-copyrightable" and "un-patentable" product styles and business methods, disparagement of a competitor or his product, unlawful acquisition of trade secrets—in short, any competitive activity which the law considers unethical enough, or sufficiently inimical to the public welfare, to warrant imposition of civil liability for injury caused thereby. Among such activities is the violation of a fair trade contract by a distributor, signatory or not, in respect to his competitor. The civil remedy also allows relief to the horizontal competitor. Although it is a residual classification, the prevention of unfair competition seems to be the only theory which will embrace all the decisions enforcing the non-signer clause in suits by competing retailers. It explains the otherwise anomalous situations illustrated in the succeeding paragraphs:

It allows a non-signatory to bring suit for violation of the terms of a fair trade contract.⁸⁹ Such a suit cannot be sustained on contract principles nor on the theory of protection of good will.

It explains the ability of a retailer to bring suit against a non-signer who has violated a fair trade contract, but who could resist the producer's attempt to enforce it because the producer had not diligently enforced the restrictions,⁹⁰ or had acted inequitably towards the non-signer by refusing to sell to him at all⁹¹ or on the same terms as those granted to other distributors.⁹² These cases indicate the separate existence of rights of enforcement in the owner of the good will and in the competing retailer. They exemplify the right of the retailer to be protected from unfair competition.

The statutes verify this conclusion. The non-signer clauses explicitly state that the knowing violation of the terms of a fair trade contract is "unfair competition." That it is so considered is borne out by the statutory exceptions to the selling of fair-traded commodities at less than their contract price. These exceptions include: closing out sales, sales in pursuance of judicial order, sales of damaged and deteriorated goods and sales by governmental agencies.⁹³ In all these

⁸⁸ CALLMANN, UNFAIR COMPETITION, AMERICAN BAR ASSOCIATION, GENERAL PRACTICE SERIES (1946).

⁸⁹ *Burstein v. Charline's Cut Rate*, 126 N. J. Eq. 560, 10 A. (2d) 646 (1940).

⁹⁰ *Wilson Distributing Co., Inc. v. Stockman*, 11 N. Y. S. (2d) 51 (1939); *Magazine Repeating Razor Co. v. Weissbard*, 125 N. J. Eq. 593, 7 A. (2d) 411 (1939); *Automotive Electric Service Corp. v. Times Square Stores Corp.*, 175 Misc. 865, 24 N. Y. S. (2d) 733 (1940).

⁹¹ *Lentheric, Inc. v. Weissbard et al.*, 122 N. J. Eq. 573, 195 Atl. 818 (1937).

⁹² *Gillette Safety Razor Co. v. Green et al.*, 167 Misc. 251, 3 N. Y. S. (2d) 822 (1938), *aff'd. without opinion*, 258 App. Div. 723, 15 N. Y. S. (2d) 142 (1939).

⁹³ For an excellent comparative chart of the exemptions in the various states, see 2 CCH 1949 TRADE REG. SERV. ¶ 7012.