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Institute Examination in Law

By Spencer Gordon

[The following answers to the questions set by the board of examiners of the American Institute of Accountants at the examinations of May, 1927, have been prepared at the request of The Journal of Accountancy. These answers have not been reviewed by the board of examiners and are in no way official. They represent merely the personal opinions of the author.—*Editor*, The Journal of Accountancy.]

EXAMINATION IN COMMERCIAL LAW

May 20, 1927, 9 A. M. to 12:30 P. M.

Answer ten questions and no more—three on negotiable instruments; three on contracts; two on federal income tax, and one each on partnership and corporations.

Give reasons for all answers.

CONTRACTS

No. 1. Prepare a simple contract with the essential elements arranged in separate paragraphs. Point out the essential elements.

Answer:

Contract between A and B dated July 15, 1927: A promises to sell to B 1,000 dozen Gillette Safety Razor blades at fifty cents a dozen, to be delivered at B's factory August 1, 1927. B promises to buy from A 1,000 dozen Gillette Safety Razor blades at fifty cents a dozen, payment to be on delivery at B's factory August 1, 1927. (Signed) A. B. This contract contains consideration on both sides, to wit, the promise to sell and the promise to buy. The terms of the contract relating to subject matter, date, price and payment are definite and certain. Contract has a lawful object.

No. 2. How may a seller ship goods to a purchaser, retaining title in himself until the purchase price is paid? How is title then passed when the purchaser makes payment?

Answer:

A seller may ship goods to a purchaser retaining title in himself until the purchase price is paid by consigning the property to his own order with directions to notify the purchaser and by sending to a bank where the purchaser is situated a draft with endorsed bill of lading attached and instructions requiring payment of the draft before the bill of lading is delivered. Upon payment of the draft and delivery of the bill of lading to the purchaser, title passes to the purchaser.

No. 3. On May 1, 1927, Shearman signed and sealed a formal written offer to sell to Allen at any time on or before May 15, 1927, certain merchandise at a specified price. On May 5, 1927, Shearman wrote Allen that the offer was canceled and withdrawn. Upon receipt of that letter on May 6, 1927, Allen formally accepted the offer and thereafter sued to enforce the contract. What decision would you render in the action?

Answer:

At common law Allen could recover. A seal imports consideration, and as every offer is a promise, it follows that if a seal is put upon an offer it becomes a binding promise. Shearman, therefore, could not revoke his offer and it remained outstanding when Allen accepted. In many states the common-law effect of seals has been changed by statutes so that the decision will be otherwise.

No. 4. What is the effect on a contract where a party to it (a) is declared a bankrupt and receives a discharge in bankruptcy; (b) makes a general assignment for the benefit of creditors? What, if any, is the distinction between the two cases?

Answer:

I shall attempt to answer this question only from the viewpoint of whether the contract may be enforced against the bankrupt assignor; otherwise I would have to write a book: A. After a bankrupt receives a discharge, contracts made before bankruptcy ordinarily can not be enforced against him. The bankruptcy ordinarily operates as an anticipatory breach of the contract. The cause of action arising from such a breach is a provable debt and is therefore extinguished by the discharge. B. An assignment for the benefit of creditors does not affect the contractual rights between the assignor and third persons not parties to the instrument of assignment and who have not expressly or impliedly assented thereto. It does not ordinarily operate per se as a breach thereof.

NEGOTIABLE INSTRUMENTS

No. 5. Is the following a negotiable instrument?

Topeka, Kansas,
Jan. 10, 1927.

To *George W. Brown*, Topeka, Kansas:

Pay to the order of Fred L. Jones $2,000 on account of contract between you and the undersigned.

(Signed) JAMES A. SMITH.

Accepted
(Signed) GEORGE W. BROWN.

Answer:

This is a negotiable instrument. Under the uniform negotiable instruments law an unqualified order to pay is unconditional, though coupled with an indication of the particular account to be debited with the amount.

No. 6. What must a negotiable instrument not contain? What are the exceptions to this rule?

Answer:

A negotiable instrument must not contain an order or promise to do any act in addition to the payment of money. But the negotiable character of an instrument otherwise negotiable is not affected by a provision which

First. Authorizes the sale of collateral securities in case the instrument be not paid at maturity; or,

Second. Authorizes a confession of judgment if the instrument be not paid at maturity; or,

Third. Waives the benefit of any law intended for the advantage or protection of the obligor; or,

Fourth. Gives the holder an election to require something to be done in lieu of payment of money.

But nothing in this section shall validate any provision or stipulation otherwise illegal.

No. 7. A note payable to Moore or order is endorsed "Pay to Neil Bartlett for collection" over Moore's signature. It is then endorsed "Pay to Fred Downs" over Bartlett's signature. Downs collects the amount of the note from the maker. To whom does the money belong?

Answer:

The money belongs to Moore. The first negotiation being by restrictive endorsement operates as notice to all persons that the endorser has not parted with title to the instrument but merely constituted the endorsee his agent for collection, and any subsequent holder taking the instrument from the endorsee will be liable as trustee for the real owner when the proceeds are collected.

No. 8. Give an example of a case in which a holder with notice is a holder in due course.

Answer:

A holder who derives his title through a holder in due course and who is not himself a party to any fraud or illegality affecting the instruments has all the rights of such former holder in respect of all parties prior to the latter. This rule is necessary to protect the first holder in due course. Otherwise, the value of the instrument in his hands would be impaired.

CORPORATIONS

No. 9. X insured certain buildings owned by him with Y Fire Insurance Company against damage by windstorm or tornado, paying the required premium therefor. While the policy was in force the buildings were damaged by wind. When X sought to recover the amount of his damages the company contended as a defense that wind or tornado insurance was not within the scope of its charter powers and that the policy was therefore void. Was such defense good?

Answer:

The defense is not good. The corporation having received the benefits of the contract will not be excused on the plea of ultra vires where the contract is not wrong per se. Although X might have guessed that the Y Fire Insurance Company was for fire insurance only and had no power to give wind or tornado insurance, this would not necessarily be so, and it would impede business too much to require persons dealing with corporations to learn the exact extent of their corporate powers.

No. 10. What is a corporation *de facto?* a corporation *de jure?*

Answer:

Where there is a statute authorizing the formation of a corporation and there is an effort in good faith to organize a corporation thereunder and corporate functions are assumed and exercised, the organization becomes a corporation de facto although some of the requirements of the statute may not have been complied with. As a general rule the legal existence of such corporation can not be inquired into collaterally but can only be questioned by the state. A

corporation de jure is one where all the essential requirements of the statute have been complied with. It is a corporation in law as well as in fact and has a right to corporate existence even as against the state.

PARTNERSHIP

No. 11. A decides to go into a retail business and to enable him to do so B and C lend A the sum of $10,000 for one year under an agreement in which A agrees to pay to B and C as interest on such loan 5 per cent. of the net profits of the business for one year. Subsequently the X Company, which has sold goods to A, brings suit against A, B and C as copartners, for the unpaid purchase price. Does X corporation recover against B and C?

Answer:

The corporation can not recover from B or C since they are not partners of A. An agreement to lend money to a person engaged in business under an agreement whereby interest is to be paid equal to five per cent. of the net profits of the business for one year does not make the parties partners. The absence of any right of control which is an incident of partnership would indicate that no partnership was intended, as would the fact that the $10,000 was to be returned at the end of the year and the further fact that there was no agreement on the part of B and C to share in losses.

No. 12. What risks would you deem to be important for careful consideration before you would enter into copartnership with another?

Answer:

The risk of financial loss in entering into an ordinary partnership is practically unlimited. Each partner is personally and individually liable for the entire amount of all partnership obligations whether arising from contract or tort. The individual property of a partner may be taken to satisfy the partnership debt. One partner may bind the partnership to obligations which will result in losses to the other partner. One partner or an employee may commit torts which will result in losses to the other partner. Among the risks that I would consider important for careful consideration would be the capacity, honesty, record, health, age, family connections, associations, religion, nationality, color, appearance and disposition of my proposed partner.

INCOME TAX

No. 13. In 1925 A, a stock broker, has income (after deduction of personal exemptions) of $7,000, but he has suffered a loss of $40,000 in the stock market so that his return for 1926 shows a net loss of $33,000. Can such net loss be used as a deduction from A's gross income in returns for any years subsequent to 1925?

Answer:

If trading in stocks was the trade or business regularly carried on by A, the net loss may be carried into subsequent years. But if the stockbroker's regular business was only to buy and sell for customers on commission (which is the ordinary legitimate business of a "stockbroker" as distinguished from a "trader") no net loss would be allowed which could be used as a deduction in subsequent years.

No. 14. The W Company owns a large loft building, part of which it occupies and the balance of which is leased to various tenants under 5-year leases begin-

ning January 1, 1926. In 1926 the company paid out $25,000 to real-estate brokers as their commissions for securing the tenants and for the making of the leases. Is the sum so paid out a proper deduction for income-tax purposes for the year 1926? If not, how is such sum deductible?

Answer:

This is not a proper deduction for income-tax purposes for the year 1926. The sum should be capitalized and spread over the term of the lease, deducting $5,000 each year of the five-year term.