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Institute Examination in Law

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The following answers to questions set by the board of examiners of the American Institute of Accountants at the examination of November, 1936, have been prepared at the request of The Journal of Accountancy. The 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

November 13, 1936, 9 A. M. to 12:30 P. M.

Reasons must be stated for each answer. Whenever practicable give the answer first and then state reasons. Answers will be graded according to the applicant's evident knowledge of the legal principles involved in the question rather than on his conclusions.

Group I

Answer all questions in this group.

No. 1 (10 points):

(a) Define usury.

(b) What is the general rule of law with respect to usury?

(c) What transactions usually are expected from the application of this rule?

(d) What are some of the subterfuges adopted in attempts to evade this rule?

Answer:

(a) Usury has been defined as:

"The reserving and taking, or contracting to reserve and take, either directly or by indirection, a greater sum for the use of money than the lawful interest."

(b) Usury is a purely statutory matter and its effect upon a transaction depends upon the terms of the applicable statute. Under some statutes usury renders the whole transaction void; under others the whole interest is rendered void; and under still others, only the interest exceeding the lawful rate is voided. Some statutes make the exaction of usury a criminal offense.

(c) Examples of transactions which are usually excepted from the usury rule:

1. Mistakes in calculating or other mistakes of fact made in good faith resulting in the lender's unintentionally charging or recovering more than the lawful rate.

2. Loan of chattels, not passing as money, to be returned with an increment of chattels of a similar kind.

3. Loan of stocks and other commercial securities; a loan of depreciated and fluctuating bank notes; a loan of stock converted into money, by arrangement to be replaced by other stock.

4. The sale, at a discount, of commercial paper, that has once been validly negotiated.
5. Purchase of an annuity.
6. A stipulation for the payment of costs of collection and attorney's fees, where the lawful interest rate is thereby exceeded, does not make the contract usurious.
7. Collecting interest in advance on a note by discounting it.
8. Collateral demand loans of more than a statutory minimum.
9. Personal loans of small amount payable within a short time where interest is computed on unpaid balance of principal due in regular instalments.

(d) Some of the subterfuges adopted in attempts to evade the usury rule are:

1. Misstating in the contract the amount of the loan or the rate of the interest.
2. Selling property to an applicant for a loan at an exorbitant price to be paid at a future day in order to enable the purchaser to sell it immediately for cash and thus obtain the money of which he is in need.
3. Compelling the borrower to sell to the lender property at an inadequate price, the lender reserving the right to compel repurchase at an increased price.
4. Return to the lender of part of the sum borrowed.
5. Extorting commissions, attorneys' fees, title examinations, etc., in excess of the value of services, in connection with a loan.
6. Compelling borrower to purchase property at an exorbitant price with part of the money loaned.
7. Compelling borrower to obtain the loan through a corporation in a state where a corporation is forbidden by law to plead usury.

No. 2 (10 points):

Answer the following questions on the assumption that the certificate of incorporation (charter) and the by-laws of the corporation contain no provision applicable to the question and that the matter is not covered by a local statute:

(a) Can the president of a corporation who is also a director vote on a resolution fixing his salary as president?

(b) Can a person have rights as a stockholder before a certificate for stock for which he has duly subscribed and paid has been issued to him?

(c) What is a proxy and who may give one?

(d) When funds are turned over to a trustee for the payment of outstanding mortgage bonds and the trustee has been named in the mortgage as the trustee for the bondholders, is the corporation relieved from liability on the bonds?

Answer:

(a) A director should not vote on a resolution fixing his salary as president, because he is interested in the outcome of the vote. By the better rule, if he does so the contract is void or voidable at the option of the corporation. In some jurisdictions the presence of an interested director may not be counted for the purpose of ascertaining whether or not a quorum was present even though the director did not vote on the resolution fixing his salary as president.

(b) The certificate is not the stock, but merely the written evidence of the stockholder's right as such. Therefore, a person can have rights as a stockholder before a certificate for stock for which he has duly subscribed and paid has been issued to him.

(c) A proxy is an authorization to a person to vote for and thus represent a stockholder. A person, under no disability, who is the record owner of stock at the time it is to be voted may give a proxy. A director can not give a valid proxy to another to vote as director.

(d) If the deed of trust provided for payment to the trustee, and such payment was duly made by the corporation, the bondholders would have to bear any loss occasioned by a default of the trustee in paying the bonds. The note holders are charged with knowledge of the terms of the deed of trust. They made the trustee their agent to collect their money and where one of two innocent parties must bear a loss, such loss is imposed upon the one whose conduct made the loss possible.

No. 3 (10 points):

A soap-manufacturing company gave a coupon with each cake of soap and advertised in every practicable way that it would give an adult's round-trip ticket to a specified amusement park for every 25 coupons presented. Plaintiff, a stamp and premium broker, duly presented 100,000 coupons and demanded 4,000 tickets. The manufacturing company refused to deliver the tickets.

(a) Can plaintiff compel delivery of the tickets?
(b) If not, what remedy, if any, has plaintiff?

Answer:

(a) Since the plaintiff has an adequate remedy at law (recovery of money damages in the amount of the retail value of the tickets) specific performance should not be allowed.

(b) The plaintiff may recover the retail value of the tickets. The defendant allowed its offer to remain unrestricted when it should have known that quite a number of coupons were unredeemed, so it should not be allowed to object to the quantity of coupons presented by the plaintiff. Nor should the defendant object that the plaintiff is a coupon broker, and not the actual user of the soap, since the offer could readily have been restricted to users of the soap. The purchase of the soap was the consideration for the promise of the defendant.

No. 4 (10 points):

It is a rule applied by courts that "where one claimant has two funds to which he may resort to answer his demand, and another claimant has an interest in only one of such funds, he (the latter) can compel the former to take satisfaction out of the fund in which the latter has no lien."

(a) Can this properly be classified as a rule of the common law?
(b) If not, how would you classify it?

Answer:

(a) This rule is known as the doctrine of "marshaling assets." It can not be properly classified as a common-law rule.

(b) It is properly classified as an equitable doctrine. In some jurisdictions the doctrine is recognized by force of statutes, but such statutes are merely declaratory of the general equity rule.

No. 5 (10 points):

Benson for ten years had held a full-life non-cancellable accident and health policy issued by the Accident Company which provided that all annual premiums must be paid in advance at the home office of the company. The premium for each year had been duly paid by Benson's check mailed to the home office and accepted by the company. Prior to the premium due date in 1936, Benson duly mailed to the company his check for the proper amount, having funds in his bank sufficient to cover it, this check being enclosed in a properly addressed and stamped envelope with a return address, and being mailed in ample time to reach the company's home office one day before the due date. This check was not received by the company nor was it cashed by any one or returned to Benson. The day after the premium was due, the company cancelled the policy and duly notified Benson. Can Benson compel the Accident Company to reinstate the policy by offering a duplicate check immediately upon his receipt of the notice of cancellation?

Answer:

It was not negligent for Benson to rely on the mail, a reliable public agency, as a method of transmission, especially when the mail had been used in a course of dealings between the parties. Benson should therefore be allowed to compel the reinstatement of the policy, since a remedy at law would be inadequate.

Group II

Answer any five questions in this group. No credit will be given for additional answers, and if more are submitted only the first five will be considered.

No. 6 (10 points):

An investment company sold certain bonds to Clark but refused to take Clark's check in payment although Clark offered the check in time to enable the vendor to have it certified before delivery of the bonds. Clark refused to give a check already certified, but by agreement between the parties the vendor delivered the bonds to a bank in which the vendee had a balance sufficient to cover the purchase price and accepted that bank's cashier's check, and the bank immediately delivered the bonds to the vendee. Thereafter, but before the cashier's check could be cashed, the bank failed. Can the vendor recover the purchase price from the vendee?

Answer:

The vendor can not recover the purchase price from the vendee.

The vendor had the right to demand cash but in lieu thereof he accepted the cashier's check, and it is to be inferred that he took the check in satisfaction of the vendee's liability, especially when the cashier's check was taken after a refusal to take the vendee's check unless it had been certified. The very kind of payment that would have preserved the liability of the vendee was refused.

No. 7 (10 points):

An infant, twenty years of age, authorized his agent to purchase certain bonds, the agent knowing the infancy of his principal. The agent purchased the bonds, disclosing the name of his principal but not disclosing the fact of infancy. The vendor did not know that the principal was an infant and the agent had every reason to believe that the vendor was ignorant of this fact. Upon reaching the age of twenty-one, the infant disaffirmed the purchase, returned the bonds and all interest received thereon, and was reimbursed for the purchase price. Is the agent legally responsible to the vendor?

Answer:

The agent is legally responsible to the vendor.

An agent impliedly warrants that his principal is legally competent, but he does not warrant that his principal has full contractual capacity any more than he warrants that his principal is solvent. Thus, an agent for one not of legal age is not *necessarily* liable if the infant avoids the obligations of the contract. However, in this case the agent had every reason to believe that the vendor was ignorant of the fact of infancy, and under these circumstances the agent was under a duty to disclose the infancy.

No. 8 (10 points):

Four negotiable promissory notes, payable respectively one, two, three and four months after date, were executed as a part of one transaction; also, as a part of the same transaction, the maker and the payee executed a written agreement which provided that upon default in any one of the notes the remaining ones should immediately become due. Hobbs, to the knowledge of the payee, signed the second and third notes as an accommodation indorser but without either actual or constructive knowledge of the acceleration agreement. The maker defaulted on the first note and thereupon the payee declared all four notes payable and duly notified all indorsers on the first note, of which Hobbs had no knowledge. On the day when the second note matured according to its face, the second note was presented for payment, the maker failed to pay it, and Hobbs was duly notified. Is Hobbs liable as indorser?

Answer:

By entering into the acceleration agreement the maker and the payee changed the nature of the maker's obligation without Hobbs' knowledge. The agreement was not effective as to Hobbs, and there is no attempt to enforce it against him, but he should be relieved from liability to the payee on his endorsement of the note because he has been prejudiced by the change in the obligation of the maker. Hobbs had a right to go against the maker in the event that he was forced to pay the note. This right which he would have had against the maker has become less valuable because of the lapse of time between the maker's default and the date of the notice to Hobbs.

No. 9 (10 points):

The authorized common stock of a corporation is 10,000 shares, of which 8,000 are issued and outstanding. The board of directors had authorized the retention of 2,000 shares to meet conversion rights of preferred stockholders, which expire in 1940. The president of the corporation, who has held that office for five years, makes a written contract with the corporation for his services during the next five years and as part of his compensation he is given an option to subscribe immediately for 1,000 shares of common stock at a specified price above par. Is the contract valid as to this option?

Answer:

The validity of the option depends upon (1) the terms of the conversion agreement between the corporation and the preferred stockholders, and (2) whether or not a preëmptive right is recognized as to stock which has been authorized but is unissued.

If the conversion agreement gives the preferred stockholders an absolute right to demand 2,000 shares of stock, an option, given to the president of the corporation (who must be presumed to know of the rights of the preferred stockholders) which, if exercised, would make it impossible for the corporation to perform, is invalid.

Apart from the rights of the preferred stockholders, the option given the president is invalid if the common or preferred stockholders have a preëmptive right to authorized but unissued stock. (There is a conflict of authority as to whether or not they have such a preëmptive right.)

No. 10 (10 points):

Holland, Jones and Kerr were partners doing business as note brokers under the name of Holland & Co. The partnership was duly dissolved May 1, 1936, Kerr being named as liquidating partner. On May 20, 1936, Kerr procured and sold to Martin a note purporting to be made by the Acme Corporation and dated May 19, 1936. This transaction was conducted in the name of Holland & Co. and Martin, who had no actual knowledge that that partnership had been dissolved, gave Kerr a check to the order of Holland & Co. in payment of the purchase price and accepted from Kerr a guaranty of the signature on the note signed "Holland & Co." Kerr indorsed the check in the name of Holland & Co. and deposited it in his own bank account. The Acme Corporation note proved to be a forgery. Against whom has Martin any rights?

Answer:

Kerr as liquidating partner could only bind the other partners by such acts as were proper to consummate the liquidation. The purchase of the Acme Corporation's note by Martin after dissolution and the subsequent giving of a guaranty of the signature on that note in the name of the partnership do not appear to have been transactions essential to the winding up of the partnership affairs. They were transactions by which new obligations were created, and a liquidating partner after dissolution can not bind the partnership to new obligations unless the person with whom he deals was entitled to and did not receive notice of the dissolution. Since by hypothesis the partnership was "duly dissolved" it is assumed that there were no persons entitled to notice of dissolution who did not receive it. Martin may therefore recover only from Kerr, or from his own bank (which paid the check on a forged endorsement of the payee's name).

No. 11 (10 points):

For what purposes may an action at law or in equity be brought in the name of a corporation against one or more of its directors or officers? State each purpose separately and specify the remedy or relief to be sought (e. g., damages or injunction).

Answer:

(a) Damages at law:

1. For neglect or failure of officers to perform their duties in the management and disposition of the funds and property committed to their charge.

2. For the value of any property which officers or directors have acquired to themselves, or transferred to others, or lost, or wasted, by or through any neglect of or failure to perform their duties.

(b) In equity to enjoin:

1. Threatened transfer of property in violation of law.

2. Injury to the goodwill of the corporation or from engaging in a rival business.

No. 12 (10 points):

In 1930, John Adams orally promised his brother Henry that he would advance to Henry all cash needed by Henry to enable the latter to take a university course in accountancy, obtain a certificate as a C. P. A. and equip an office for the public practice of accountancy. Henry orally agreed to repay these advances out of the first fees collected by him in his practice as a C. P. A. John made these advances, amounting in total to $6,000, and Henry completed the course, became a C. P. A. in 1935, and began to practise as such. After collection of his first fees, Henry refused to repay any part of the advances, relying upon the statute of frauds.

(a) Upon what provision in the statute of frauds did Henry rely?

(b) Does the statute of frauds bar a recovery by John?

Answer:

(a) Henry relies on the provision that an agreement not to be performed within a year of the making thereof must be in writing.

(b) In my opinion the statute bars recovery. A university course in accounting requires more than one year, and the possibility that a genius could do it in less than a year should not be taken into consideration. There is, however, at least one decision holding that in such a case an action may be maintained for money had and received.