Journal of Accountancy

Volume 69 | Issue 1 Article 13

1-1940

Institute Examination in Law

Spencer Gordon

INSTITUTE EXAMINATION IN LAW

By Spencer Gordon

[Note.—The following answers to questions set by the board of examiners of the American Institute of Accountants at the examination of May, 1939, 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.*]

EXAMINATION IN COMMERCIAL LAW

May 12, 1939, 9 A.M. to 12:30 P.M.

GROUP I

No. 1 (10 points):

X, a dealer, makes numerous sales to Y, and at the end of each calendar month X sends Y an itemized statement. Some, but not all, of the charges by X bear interest. Because of unsettled disputes, a few of the items listed on the statement of April 30, 1939, had been billed for over five years. Y is about to make a payment on account. Has Y the right to compel X to apply this payment to items of principal or interest specified by Y, at the time of payment? Or has X the right to apply this payment as X desires, (a) if Y specifies the application, (b) if Y does not specify? If X has a right to apply the payment as X desires, within what time should he exercise it, and what notice if any should X give Y concerning the application made by X?

Solution:

Y may require that X apply Y's payment to the items specified by Y at the time of the payment. By the weight of authority, a debtor has the right to designate to what items his payments should be applied. It is important that a debtor should have this right, because by exercising it he can force a creditor to take some action on items which would soon be barred by the statute of limitations. If the debtor does not specify the items against which he wishes his payment applied, the creditor may apply the payment as he sees fit. In that case the creditor X must make his choice within a reasonable time. Under the circumstances set forth in this question, the creditor X should give notice by showing on the next monthly statement to Y the disposition which he has made of the previous payment.

No. 2 (10 points):

F, G, and H on March 15, 1939, agree orally to begin business in corporate form on May 1, 1939, and they retain a lawyer who prepares the certificate of incorporation which they execute on April 3, 1939. On April 10, 1939, F takes this certificate for delivery to the lawyer, but he inadvertently fails to deliver it. During the month of April, 1939, G and H sign a lease for office space and make various other contracts, all in the name of the proposed corporation. The lawyer inferred that the matter of the proposed incorporation had been dropped and he did nothing further with respect to it. Can F, G, and H be held personally liable on the lease and the other contracts made in April? If so, would they be held jointly, severally, or jointly and severally liable?

Solution:

F, G, and H can be held personally liable on the lease and other contracts made in April. The liability would be joint and several, as is the case with partners. The failure to file a certificate of incorporation would prevent the formation of a *de jure* corporation, and by the weight of authority it would be held to prevent the formation of a *de facto* corporation. In order to gain the freedom from personal liability accorded to the share-

holders of a corporation, there must at least have been a fairly complete compliance with the ordinary requirements of incorporation. The filing of a certificate is such a requirement, and it would therefore probably be held that no *de facto* corporation had been formed, despite the use of the corporate name in the signing of the lease and contracts. F would be personally liable, as well as G and H, even though his name did not appear on the contracts, because he was engaged with the other two in a joint business enterprise.

No. 3 (10 points):

When and in what circumstances may a general agent renounce his agency and terminate his relationship with his principal without incurring liability to the principal?

Solution:

A general agent, like any other agent, may renounce his agency without incurring legal liability only when such action violates no contractual obligation of the agent to his principal. Agency is a fiduciary relationship based upon contract; and if the contract provides that the agent shall serve for a certain period of time, the agent may not terminate his services before that time without being liable in damages to his principal. If the agency is indefinite in duration, the agent may renounce upon giving reasonable notice. Because the ordinary agency involves personal services a court usually will not order specific performance of the contract of agency; but the agent must respond in damages to his principal for any breach of the contract.

No. 4 (10 points):

Black made and delivered a legally valid promissory note, entirely in his own handwriting, payable at "No. 22 Mira Vista Ave.," which was his residence. The note was transferred several times by endorsement, and someone without authority added "People's Trust Co." in printed characters on the face of the note directly under the handwritten designated place of payment. Thereafter, but prior to maturity, Brown acquired the note by purchase for value and without actual knowledge of the alteration. At maturity, Brown presented the note at the People's Trust Company, which was not at the stated address, and the note was not paid. Can Brown recover from Black on this note?

Solution:

Brown cannot recover from Black on this note. The purported change in place of payment amounted to a material alteration of the note, according to the express provisions of the negotiable-instruments law, and the same law provides that the effect of a material alteration is to relieve from liability on the note all parties to the note prior to the alteration who did not assent to the alteration.

Brown was not a holder in due course even though he purchased the note before maturity as he was charged with constructive notice of the alteration, partly because the name of the bank appeared in printed letters (and thus was different from the body of the handwritten note) and partly because if the address given were the address of the bank the name of the bank would appear above the address. Brown was therefore put on notice that the note was irregular, and he would not receive the protection given to a holder in due course.

No. 5 (10 points):

Define partnership and state and explain briefly the more important legal characteristics of one.

Solution:

"A partnership is an association of two or more persons to carry on as co-owners a business for profit," according to the definition of a partnership set forth in the uniform-partnership act. Among the more important characteristics of a partnership are: (1) the relationship between partners is based on a contract; (2) each partner is an agent for each of the other partners within the apparent scope of the partnership business; (3) the relationship between the partners is a fiduciary relationship of trust and confidence; (4) each partner is personally liable for all of the debts of the partnership; (5) a partnership implies the sharing of profits and losses of the enterprise; (6) no new partner can be admitted to the partnership without the consent of all partners; and (7) the death or retirement of one partner automatically dissolves the partnership.

GROUP II

No. 6 (10 points):

X purchases on credit an automobile, for which the cash price was $2,100, and agrees to pay $2,400 for it at a date six months after the date of purchase. He makes a payment of $100 on account and takes possession of the automobile. On the assumption that the legal rate of interest was 6 per cent can X successfully attack the validity of the contract on the ground of usury?

Solution:

X cannot successfully attack the validity of the contract on the ground of usury, because usury applies only to the lending of money, and on the facts of this case, credit was extended but there was no loan of money. Considerations other than the interest return on the amount of the indebtedness—such as possible market fluctuations, need for current funds, etc.—may have properly prompted a lower cash price.

No. 7 (10 points):

A collection agency, incorporated under the laws of Missouri, makes a written contract in New York with a New York client, which recites that the collection agency "has executed and attested these presents at the City of St. Louis, to be effective from the date the acceptance is received at the office of the company at St. Louis, Mo." The agency has an active bank account in New York and it maintains an office there where it has a staff of salesmen. It is listed in building and telephone directories in New York and it deposited the client's check in its New York bank account. The agency had not qualified, as a foreign corporation, to do business in New York. Would it be permitted to maintain an action against its client in the New York courts?

Solution:

The collection agency, being a foreign corporation, would not be permitted to maintain an action in the New York courts because the corporation has not qualified to do business in New York, yet has engaged in business within the state. I am assuming that the New York statute, like most state statutes, forbids the bringing of an action in the state courts by a foreign corporation which is doing business in the state unless certain fees have been paid and certain papers filed. The employment of a staff of salesmen in New York, presumably engaged in making collections, would constitute doing business in the state, although the maintenance of an office and a bank account in the state would not necessarily establish that the corporation was doing business within the state. The fact that the contract with the client purported to have been made in Missouri does not establish that the agency was doing only an interstate business subject to the protection of the commerce clause.

No. 8 (10 points):

State and illustrate by brief examples the difference between a contract of sale and a contract for work, labor, and services, and explain the importance, legally, of differentiating between them.

Solution:

A contract of sale is a contract whereby the seller agrees to transfer title to goods to the buyer for a consideration called the price. The emphasis is upon the passage of title to goods.

In a contract for work, labor, and services, the emphasis is upon the labor performed rather than upon the passage of title to goods. Some courts hold that a contract for special goods not ordinarily manufactured by the seller is a contract for services rather than for the sale of goods. The principal importance of distinguishing between these contracts is that different provisions of the statute of frauds apply to them. A contract of sale must be in writing if the price of the goods sold is over a specified minimum. A contract for work, labor, and services must be in writing if it is not to be performed within a stated period of time, usually a year, specified in the local statute.

No. 9 (10 points):

A testamentary trustee received from the executor of testator's will shares of stock in a corporation and subsequently he purchased additional shares of the same stock. Thereafter the corporation issued and the trustee received rights to subscribe to new stock of the same character. What principles and rules of law should the trustee have in mind when he decides what to do about these rights?

Solution:

In most jurisdictions a trustee is not permitted to invest trust funds in stock unless the will gives such power. Assuming that the will so provides, the trustee should be guided by the following considerations: The trustee has a duty to conserve the principal of the trust estate, and must use the judgment of a reasonable man in his fiduciary position in determining whether or not to exercise the stock rights. Under the decisions of most states if the stock itself is principal, the rights arising out of the stock are also said to belong to the principal of the trust rather than to the income. Any gain on a sale of stock rights is an increase in principal and not of income, notwithstanding its taxability under income-tax statutes; and any loss on a sale of rights is chargeable to principal. The trustee must keep careful records to enable him to determine the basis for gain or loss on the subsequent sale or other disposition of any of the new stock.

No. 10 (10 points):

Define purchase-money mortgage and give a brief example showing circumstances in which one normally would be given. Which party in the sale becomes the mortgagee? What, briefly, are the rights and remedies of each party?

Solution:

A purchase-money mortgage is a lien on real estate given by the purchaser of the real estate to the seller thereof as security for the payment of the balance of the price. For example, X sells land to Y for $15,000, Y paying $5,000 in cash and giving a purchase-money mortgage for $10,000 as security to X for the payment of the balance.

The seller of the real estate becomes the mortgagee.

The mortgagor, in some states, continues to have title to the mortgaged real estate, but this title is subject to a lien to the extent of the secured debt. In other states, the mortgagee has title to the property while the mortgagor has a reversionary interest conditional upon payment of the amount for which the mortgage was given as security. The mortgagor may give other mortgages subsequent to the prior lien of the purchase-money mortgage, and he may sell the land subject to these mortgages. The mortgagor has the right to have the mortgage canceled when he pays to the mortgagee the debt for which the mortgage is the security. If the mortgagor fails to pay the mortgage debt at its maturity, he has an equity of redemption which enables him, within a time specified by statute, to reacquire the property by the payment of the debt interest and other charges.

The mortgagee has a personal claim against the mortgagor for the mortgage debt, and if the mortgagor does not pay it at maturity, the mortgagee has the right through foreclosure proceedings to have the land sold and the debt paid out of the proceeds.

No. 11 (10 points):

During a time of financial stress, the clearing house committee in a certain city promised a banker in that city and the United States Comptroller of the Currency that, if the banker would accept the presidency of a certain bank, the committee would protect the depositors of that bank and prevent the bank's failure.

(a) What is the relation between a bank and its depositors?
(b) Was the above promise subject to the statute of frauds?
(c) If your answer to (b) is in the affirmative, what provision in said statute applied to this promise?

Solution:

(a) The relation between a bank and its depositors is that of debtor and creditor. The bank is the debtor and each depositor is a creditor of the bank.
(b) The promise would not be held to be subject to the statute of frauds as the promise was not a promise made to a creditor to answer for the debt of another.
(c) The provision of the statute of frauds which might have been considered applicable would have been the one requiring a written contract for a special promise to answer for the debt, default, or miscarriage of any other person.

No. 12 (10 points):

A sole proprietor is occupying office space under a legally valid lease which will not expire until three months from today. He is in arrears for four months' rent and is about to

vacate the premises. He is in arrears also for the rent of two rooms which he occupies without a lease in a hotel. What principles of law are involved in determining his right, upon immediately vacating both premises, to remove all of his property therefrom?

Solution:

The principles involved are those concerning liens as security for the payment of rent. The landlord of the office building has no lien at common law although certain states by statute give a landlord a lien on the chattels of his tenant, and it is also sometimes held that a lien may be created by express provisions of the lease. At common law, however, the landlord has the right of distress for unpaid rent, and so may seize certain chattels and hold them until the rent is paid. The hotel has an innkeeper's lien and may prevent the removal of any property belonging to the occupant of the rooms until the rent has been paid.