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NOTES AND COMMENTS

Constitutional Law—Equal Protection—Admission of Negroes to State Universities.

P, a negro citizen of Missouri, sought admission to the Law School of the University of Missouri, there being no state-supported law school for negroes within the state. Upon his being refused admission purely on the basis of color, the State of Missouri, on the relation of *P*, brought mandamus proceedings against the registrar and curators of the university to compel them to admit *P* to the Law School. The Supreme Court of Missouri[1] refused to grant the petition for man-

[1] State *ex rel.* Gaines v. Canada, 113 S. W. (2d) 783 (Mo. 1937).

damus on the ground that the statutory provision[2] for payment by the state of tuition for the legal education of negroes in recognized schools outside the state afforded the equality of treatment guaranteed by the Fourteenth Amendment. On certiorari, the United States Supreme Court reversed the judgment.[3] In the absence of other and proper provision for his legal training within the state, such training being afforded the white citizens of the state, *P* must be admitted to the University of Missouri; and the out-of-state scholarship arrangement will not suffice as a substitute for the right to receive the use of the facilities maintained within the state.

Though the Thirteenth, Fourteenth, and Fifteenth Amendments to the Federal Constitution were aimed directly at the freedom of the negro from race oppression and discrimination,[4] the courts have recognized the problems of practical consequence which grow out of the presence of the two races, and have upheld segregation for many purposes. On the theory that no unconstitutional discrimination exists when each race is denied the use of facilities provided for the other, it has been settled that a state may, through statutes or constitutional provisions, provide for the establishment of separate schools for the races,[5] provided such separate facilities are equal or reasonably equal.[6] It then becomes a judicial question to determine whether the facilities offered meet this standard. The decision in the principal case indicates that a state, in order to satisfy this requirement, must maintain at its negro universities facilities for instruction

[2] Mo. Rev. Stat. (1929) §§9618, 9622.

[3] Missouri *ex rel.* Gaines v. Canada, 305 U. S. —, 59 Sup. Ct. 232, 83 L. ed. Adv. Ops. 207 (1938), *petition for rehearing denied,* 305 U. S. —, 59 Sup. Ct. 356, 83 L. ed. Adv. Ops. 320 (1939).

[4] Slaughter-House Cases, 16 Wall. 36, 21 L. ed. 394 (U. S. 1873); Strauder v. West Virginia, 100 U. S. 303, 25 L. ed. 664 (1879).

[5] Gong Lum v. Rice, 275 U. S. 78, 48 Sup. Ct. 91, 72 L. ed. 172 (1927); Lehew v. Brummel, 103 Mo. 546, 15 S. W. 765 (1890); People *ex rel.* King v. Gallagher, 93 N. Y. 438 (1883); see Plessy v. Ferguson, 163 U. S. 537, 544, 16 Sup. Ct. 1138, 1140, 41 L. ed. 256, 258 (1896).

[6] "Equality and not identity of privileges and rights is what is guaranteed to the citizen. . . ." People *ex rel.* King v. Gallagher, 93 N. Y. 438, 455 (1883). The mere fact that some colored pupils have farther to travel to reach a colored school than any white child must travel to reach a white school does not necessarily constitute a deprivation of equal advantages. Dameron v. Bayless, 14 Ariz. 180, 126 Pac. 273 (1912); Roberts v. Boston, 5 Cush. 198 (Mass. 1849); Lehew v. Brummel, 103 Mo. 546, 15 S. W. 765 (1890). But *cf.* United States v. Buntin, 10 Fed. 730 (C. C. Ohio 1882). Where the pupils belonging to the different races are unequal in number, it is not necessary that the buildings provided be identical in respect to size and cost. Reynolds v. Board of Education, 66 Kan. 672, 72 Pac. 274 (1903). Differences in the length of school terms and the proportionate number of teachers are grounds for holding that the facilities are not equal. Lowery v. School Trustees, 140 N. C. 33, 52 S. E. 267 (1905); Jones v. Board of Education, 90 Okla. 233, 217 Pac. 400 (1923). Where similar courses of study are not available to both races, it is held that there are not equivalent educational facilities. Pearson v. Murray, 169 Md. 478, 182 Atl. 590, 103 A. L. R. 713 (1936); Jones v. Board of Education, *supra.*

in every branch of learning taught in the universities which it maintains for white students. If, through segregation, a member of one race is denied the enjoyment of facilities "equal" to those enjoyed by members of the other race, even though the denial takes place pursuant to state statutes or constitutional provisions, the statutes or constitutional provisions must fail as regards the rights so denied, and mandamus will lie to compel the school authorities to admit otherwise qualified colored persons into public schools maintained for the white race.[7] Nor can this denial of equal protection be upheld merely because the right denied is sought by a single individual of the excluded race. The right is a personal one; and it is as an individual that he is entitled to the equal protection of the laws.

In *Pearson v. Murray*[8] the Supreme Court of Maryland held inadequate a statutory provision for a certain number of scholarships to enable negroes to attend colleges outside the state in order to pursue studies offered to the white citizens but not to the colored citizens within the state, on the ground that since not enough scholarships were provided to afford this opportunity to all possible applicants, and since greater expense to students would be involved in attending the out-of-state institutions than in attending the state university, the facilities were not equal. The Supreme Court of Missouri, when the principal case was before it, sought to distinguish the decision in Maryland upon the grounds: first, that in Missouri there is a "legislative declaration of a purpose to establish a law school for negroes at Lincoln University whenever necessary or practical", but there is no comparable provision in Maryland; and second, that, "pending the establishment of such a school, adequate provision has been made for the legal education of negro students in recognized schools outside of this State."[9] The United States Supreme Court brushed aside these distinctions, however, when it held that the right protected is the right to enjoy equal advantages and opportunities *within* the state regardless of the adequacy of the provisions for out-of-state education or of their temporary nature.

It has been held[10] that where the state has not required the segregation of the races in the schools, a colored student cannot be denied admission to a public school, even though special schools for colored

[7] Prior to the decision to this effect in the principal case it was so held in Piper v. Big Pine School District, 193 Cal. 664, 226 Pac. 926 (1924); Pearson v. Murray, 169 Md. 478, 182 Atl. 590 (1936); State v. Duffy, 7 Nev. 342 (1872); (1936) 21 St. Louis L. Rev. 260.

[8] 169 Md. 478, 182 Atl. 590 (1936).

[9] State *ex rel.* Gaines v. Canada, 113 S. W. (2d) 783, 791 (Mo. 1937).

[10] People v. Board of Education, 101 Ill. 308 (1882); People v. Mayor of Alton, 193 Ill. 309, 61 N. E. 1077 (1901); People v. School Board, 161 N. Y. 598, 56 N. E. 81 (1900). *Contra:* Roberts v. Boston, 5 Cush. 198 (Mass. 1849).

persons have been established. This is met, however, by a showing that segregation is required under the entire statutory scheme of the state on the subject of education. This is a question of state law,[11] and the United States Supreme Court will be bound by the decision of the state court.[12]

Although North Carolina's constitutional[13] and statutory[14] provisions segregating the races for educational purposes do so only with regard to "children" in the "public schools"; and although no decision of the North Carolina Supreme Court appears to have extended the application of these provisions to higher education, it would seem that the court could find the legislative intent to segregate the races for the purpose of higher education through an examination of the statutes relating to the educational institutions of the state. The Negro Agricultural and Technical College of North Carolina is "established for the colored race",[15] the Woman's College of the University of North Carolina is an "institution for the education of young women of the white race",[16] and the Cherokee Indian Normal School of Robeson County provides for instruction to "persons of the Indian race".[17]

State-supported colleges and universities do, in many instances, extend the privileges of education they afford to persons from other states, but they are under no obligation to do so.[18] The question arises

[11] State *ex rel.* Gaines v. Canada, 113 S. W. (2d) 783, 785 (Mo. 1937).

[12] See Missouri *ex rel.* Gaines v. Canada, 305 U. S. —, —, 59 Sup. Ct. 232, 234, 83 L. ed. Adv. Ops. 207, 208 (1938).

[13] ". . . And the children of the white race and the children of the colored race shall be taught in separate public schools; but there shall be no discrimination in favor of, or to the prejudice of, either race." N. C. CONST. art. IX, §2.

[14] N. C. CODE ANN. (Michie, 1935) §5384.

[15] *Id.* §5826. [16] *Id.* §5833. [17] *Id.* §5847.

[18] Clause 1, Section 2, of Article IV of the Constitution of the United States secures to the citizens of each state the privileges and immunities of citizens in the several states, but this protection has been confined ". . . to those privileges and immunities which are, in their nature, fundamental; which belong, of right, to the citizens of all free governments; and which have, at all times, been enjoyed by the citizens of the several states which compose this Union. . . ." Corfield v. Coryell, 6 Fed. Cas. No. 3,230 at 551 (C. C. E. D. Pa. 1823); see Paul v. Virginia, 8 Wall. 168, 180, 19 L. ed. 357, 360 (U. S. 1869); Ward v. Maryland, 12 Wall. 418, 430, 20 L. ed. 449, 452 (U. S. 1871); Slaughter-House Cases, 16 Wall. 36, 75, 21 L. ed. 394, 408 (U. S. 1873); *Ex parte* Chin King, 35 Fed. 354, 356 (C. C. D. Ore. 1888); 1 COOLEY, CONSTITUTIONAL LIMITATIONS (8th ed. 1927) 46, n. 4. The privilege of attending a public educational institution in another state would not seem to be a privilege belonging, of right, to the citizens of all free governments. The reasoning applied in McCready v. Virginia, 94 U. S. 391, 396, 24 L. ed. 248, 249 (1877), in which case the State of Virginia was upheld in its denial to persons not citizens of the state of the privilege of planting oysters in the soil covered by her tidewaters, would seem, by way of analogy, applicable here. The court there held that ". . . the right thus granted is not a privilege or immunity of general but of special citizenship. It does not 'belong of right to the citizens of all free governments,' but only to the citizens of Virginia, on account of the peculiar circumstances in which they are placed."

The privileges and immunities clause of the Fourteenth Amendment to the Federal Constitution has been held to secure to the citizens of each state freedom from impairment by the state of privileges or immunities arising out of United

whether, when this privilege has been extended to non-resident white persons, it must also be extended to non-resident colored persons without discrimination on the basis of race or color. Although the privilege accorded to the youth of the state of attending the public schools, is not a privilege or immunity guaranteed to the citizens of other states,[19] and is not a privilege or immunity of a citizen of the United States as such,[20] it would seem that a state's discrimination against a non-resident purely on the basis of color would be prohibited by the equal protection clause of the Fourteenth Amendment.[21] The term "within its jurisdiction" in that clause has been said to limit the application of the clause to ". . . persons who are physically present within the territorial jurisdiction of the State, the protection of whose laws they invoke".[22] This requires that state legislation shall treat alike all persons brought under subjection to its laws.[23] It may be argued that the privilege of education having been extended to one non-resident, then all non-residents who come in person into the state to seek entrance into its universities are thus entitled to freedom from arbitrary discrimination by the state merely on the basis of their race or color. Thus one who has an earnest desire to attend a school in another state probably would not find it too inconvenient to present himself within the borders of that state and there demand freedom from discrimination.

However faultless the decision in the principal case may be in follow-

States citizenship, that is, such as are granted or secured by the Constitution and laws of the United States. McPherson v. Blacker, 146 U. S. 1, 13 Sup. Ct. 3, 36 L. ed. 869 (1892); Duncan v. Missouri, 152 U. S. 377, 14 Sup. Ct. 570, 38 L. ed. 485 (1894); Twining v. New Jersey, 211 U. S. 78, 29 Sup. Ct. 14, 53 L. ed. 97 (1908); Maxwell v. Bugbee, 250 U. S. 525, 40 Sup. Ct. 2, 63 L. ed. 1124 (1919); Prudential Ins. Co. v. Cheek, 259 U. S. 530, 42 Sup. Ct. 516, 66 L. ed. 1044 (1922); Hamilton v. Regents of the University of California, 293 U. S. 245, 55 Sup. Ct. 197, 79 L. ed. 343 (1934); Colgate v. Harvey, 296 U. S. 404, 56 Sup. Ct. 252, 80 L. ed. 299 (1935); Breedlove v. Suttles, 302 U. S. 277, 58 Sup. Ct. 205, 82 L. ed. 252 (1937). But the privilege of receiving an education at the expense of the state is not one belonging to those upon whom it is conferred because they are citizens of the United States. Ward v. Flood, 48 Cal. 36 (1874); Kennedy v. Miller, 97 Cal. 429, 32 Pac. 558 (1893); Civic Center Ass'n v. Railroad Commission, 175 Cal. 441, 166 Pac. 351 (1917); Piper v. Big Pine School District, 193 Cal. 664, 226 Pac. 926 (1924).

The equal protection of the laws, as guaranteed by the Fourteenth Amendment, requires that a law must deal alike with all of a given class within the jurisdiction to which the law is applicable. See Sims v. Rives, 84 F. (2d) 871, 878 (App. D. C. 1936). But even when a non-resident comes within the jurisdiction of a state, a classification as between residents and non-residents in the use of the schools supported by the state would seem to be a permissible classification. No decision of the Supreme Court has been found on this point.

[19] See note 18, *supra*.

[20] See note 18, *supra*.

[21] U. S. CONST. Amend. XIV, §1.

[22] State v. Travelers' Ins. Co., 70 Conn. 590, 600, 40 Atl. 465, 467 (1898); see Yick Wo v. Hopkins, 118 U. S. 356, 369, 6 Sup. Ct. 1064, 1070, 30 L. ed. 220, 226 (1886).

[23] Minneapolis & St. L. Ry. v. Beckwith, 129 U. S. 26, 29, 9 Sup. Ct. 207, 208, 32 L. ed. 585, 586 (1889).

ing the lines of judicial interpretation under the equal protection clause, it nevertheless, as is observed in the dissenting opinion, presents problems of great practical difficulty to those states which seek to segregate the races for the purpose of higher education. Those states which have, as a result of the paucity of the demands for higher education among its negro residents, provided for out-of-state[24] instruction, as well as all other states, will now be compelled either to admit negroes to their state universities or to build separate negro universities within their borders. If the latter course is followed, it will be necesary, in order to assure complete and continuous segregation of the races, to provide and maintain at such negro universities facilities for instruction in every branch of learning taught in the universities maintained for white students, because the previous lack of demand for the use of such facilities by negro residents or provisions for establishment of the facilities within a reasonable time after demand have been repudiated by the Court as factors to be considered in determining the equality of the facilities. The only other choice open to a state, if segregation is to continue, is to abolish the state universities and thereby disadvantage her white citizens without improving the opportunities of the colored citizens.[25]

FRANK THOMAS MILLER, JR.

Constitutional Law—Escheat of Deposits in State and National Banks.

Plaintiff, Attorney General of the State of Michigan, sued defendant, receiver of an insolvent national bank located in the state, to compel him to turn over certain unclaimed bank deposits in his hands in accordance with a Michigan statute providing that bank deposits of all persons who have had no dealings therewith, in the nature of entries or withdrawals, for a period of seven years shall escheat to the state if no heirs of the missing depositor can be found, such depositor being presumed to be dead.[1] The court held that the state statute was applicable to national banks and granted plaintiff's

[24] The following statutes provide for out-of-state instruction to negroes when educational facilities available to white citizens within the state are not provided for negroes: KY. STAT. ANN. (Carroll, 1936) §4527-81; MD. ANN. CODE (Flack, Supp. 1935) art. 77, §214A; Md. Laws 1935, c. 577; Md. Laws 1937, c. 506; MO. REV. STAT. (1929) §9622; Mo. Laws 1933, p. 87; Mo. Laws 1935, pp. 113-114; Mo. Laws 1937, p. 73; OKLA. STAT. ANN. (1938) tit. 70, §1591; Tenn. Acts 1937, c. 256; VA. CODE ANN. (Michie, 1936) §1003 1(b); W. VA. CODE ANN. (Michie, 1937) §1894.

[25] Segregation could be successfully effectuated in private schools; for a private educational institution can lawfully exclude colored pupils, and, in so excluding them, it violates no right secured by the Fourteenth Amendment. State *ex rel.* Clark v. Maryland Institute, 87 Md. 643, 41 Atl. 126 (1898); Booker v. Grand Rapids Medical College, 156 Mich. 95, 120 N. W. 589 (1909).

[1] MICH. COMP. LAWS (1929) §13464.

claim thereunder, refusing to allow defendant to raise the general question of the constitutionality of the statute on the ground that not the bank's rights, but those of the depositors, would be violated if the statute denied due process of law.[2]

As a general proposition, it has been held that national banks are subject to the laws of the state in which they are located insofar as they are not thereby incapacitated as agencies of the Federal Government, and provided no positive law of the United States is thereby contravened.[3]

There are two general types of statutes dealing with the problem of escheat of unclaimed bank deposits. The first type applies only to bank liquidation proceedings and usually provides that deposits remaining unclaimed for a certain number of years after a final order of distribution has been entered in winding-up proceedings shall escheat to the state.[4] The applicability of such statutes to national banks has not been directly passed upon, although in Arkansas it was held that a state statute providing that such funds be deposited in trust for the missing depositors[5] was inapplicable to national banks, as distribution of their assets in liquidation is governed by federal laws.[6] This objection, if a sound one, should apply to all escheat statutes of the type under consideration, as it is settled that national banks are not subject to state liquidation statutes, and, in case of insolvency, their assets must be disposed of as provided by Congress.[7] On the other hand, such a statute might be considered as merely designating the successor in title to the deposit and not as providing for a type of distribution in conflict with federal law. Much may be said in favor of each view, but, because of the fact that the federal statutes make no provision for disposal of deposits unclaimed by their owners after the bank has been liquidated, it would seem that payment to the state as the successor of the depositors is a practical method of

[2] Starr v. Schramm, 24 F. Supp. 888 (E. D. Mich. 1938).

[3] First Nat. Bank v. Kentucky, 9 Wall. 353, 19 L. ed. 701 (U. S. 1869); McClellan v. Chipman, 164 U. S. 347, 17 Sup. Ct. 85, 41 L. ed. 401 (1896); Clement Nat. Bank v. Vermont, 231 U. S. 120, 34 Sup. Ct. 31, 58 L. ed. 147 (1913); First Nat. Bank of St. Louis v. Missouri, 263 U. S. 640, 44 Sup. Ct. 213, 68 L. ed. 486 (1924); Lewis v. Fidelity & Deposit Co., 292 U. S. 559, 54 Sup. Ct. 848, 78 L. ed. 1425 (1934).

[4] HAWAII REV. LAWS (1935) §6638; OHIO GEN. CODE ANN. (Page, 1937) §710-106; OKLA. STAT. ANN. (Supp. 1938) tit. 6, §162o, UTAH REV. STAT. ANN. (1933) §7-2-17. N. M. STAT. ANN. (Courtright, Supp. 1938) §13-150a (expressly provides that it is applicable only to state banks).

[5] ARK. DIG. STAT. (Crawford & Moses, 1921) §726.

[6] England v. Hughes, 141 Ark. 235, 217 S. W. 13 (1920).

[7] First Nat. Bank of Chicago v. Selden, 120 Fed. 212 (C. C. A. 7th, 1903); Steele v. Randall, 19 F. (2d) 40 (C. C. A. 8th, 1927); Fiman v. South Dakota, 29 F. (2d) 776 (C. C. A. 8th, 1928), *cert. denied*, 279 U. S. 841, 49 Sup. Ct. 254, 73 L. ed. 987 (1928); Spradlin v. Royal Mfg. Co., 73 F. (2d) 776 (C. C. A. 4th, 1934); 2 MORSE, BANKS AND BANKING (6th ed. 1928) §250.

disposal and does not violate any federal law. If such a statute does not interfere with liquidation, the other constitutional problems raised are not substantially different from those raised by the second type of escheat statute to be considered.

The second type of statute usually provides that after a stated number of years in which the depositor has made no deposits to or withdrawals from his account, his deposit shall escheat to the state. The procedure for the accomplishment of this result is set out and provision made for the publication of notice of such proceedings to possible claimants of the deposit.[8] To a certain extent the question of the validity of such statutes presents the same problems with reference to both national and state banks.

The first of these problems is whether such a statute results in the deprivation of property without due process of law.[9] A California statute providing for escheat of deposits unclaimed after twenty years[10] was upheld as applied to state banks by the United States Supreme Court on the grounds that a state has dominion over intangible property within its borders; that, from the standpoint of the bank, no tontine right exists to retain unclaimed deposits; and that, from the standpoint of the depositor, the statutory proceedings do not violate due process since they are proceedings *in rem,* and notice thereof given by publication is sufficient.[11] Although the court thus effectively disposed of procedural due process, substantive due process was not considered, at least with regard to depositors. Other cases, however, have held that these statutes constitute no violation of substantive due process, because the state has, by virtue of its sovereign power, the right to take over property abandoned for a long period of time and to direct what shall be done with it, and unclaimed bank deposits are within the category of abandoned property.[12] In cases such as these, the right of the bank to raise the defense of a denial of due process might be questioned, as the depositor and not the bank is the party injured by such denial. However, this objection seems adequately an-

[8] ALASKA COMP. LAWS (1933) §2903; ARIZ. REV. CODE ANN. (Struckmeyer, 1928) §266; CAL. CODE CIV. PROC. (Deering, 1937) §1273; N. C. CODE ANN. (Michie, Supp. 1937) §5786(1); ORE. CODE ANN. (1930) §11-1215; PA. STAT. (Purdon, 1936) tit. 27, §282; WIS. STAT. (1937) §220.25. Such statutes should not be confused with those providing that the state take over and hold unclaimed deposits for the depositors, who may reclaim them at any time. HAWAII REV. LAWS (1935) §4236; LA. GEN. STAT. ANN. (Dart, 1932) §534; MASS. ANN. LAWS (1933) c. 168 §42, Nelson v. Blinn, 197 Mass. 279, 83 N. E. 889 (1908).

[9] U. S. CONST. Amendment XIV, §1.

[10] CAL. CODE CIV. PROC. (Deering, 1937) §1273.

[11] Security Savings Bank v. California, 263 U. S. 282, 44 Sup. Ct. 108, 68 L. ed. 301 (1923).

[12] Germantown Trust Co. v. Powell, 265 Pa. 71, 108 Atl. 441 (1919); Greenough v. Peoples' Savings Bank, 38 R. I. 100, 94 Atl. 706 (1915). *Contra:* Louisville School Board v. Kentucky, 86 Ky. 150, 5 S. W. 739 (1887).

swered by the theory upon which the issue was raised in *Security Savings Bank v. State of California*:[13] that, while payment to the state under a valid law would relieve the bank of liability to the depositor, if the statute were invalid as a denial of due process, the bank would not be protected by it in an action against it by the depositor, and would be forced to pay the amount of the deposit to him, although it had previously been paid to the state in accordance with the statute.[14] In the principal case, the court refused to allow the receiver of the bank to raise the question of the validity of the statute on this theory, reasoning that as the receiver of a national bank is an agent of the United States, he would be protected if he complied with a state statute which was later found to be unconstitutional.[15] However, in cases where the bank, and not the receiver, is the party from whom the deposit is sought to be collected, it should be allowed to raise the defense, as it may be subjected to double payment, as above indicated, if the statute violates due process.

Another problem which concerns the application of these statutes to both state and national banks is whether there is an impairment of the obligation of contracts.[16] A deposit in a bank creates a debtor-creditor relationship between the bank and the depositor, the bank ordinarily being answerable to the depositor for the amount of the deposit upon demand.[17] In the *Security Savings Bank* case, the Supreme Court held that the California statute did not impair the obligation of the contract between a state bank and its depositors.[18] But as to national banks, the court in an earlier case held the same statute invalid as an interference with the bank-depositor relationship contrary to the intent of Congress.[19] It is true that the terms of the agreement of either national or state banks with their depositors might seem to be altered by the application of such statutes, but it has been said that when the owner has apparently abandoned the deposit, this amounts to a termination of the contract, and the escheat power of the state becomes operative on abandoned property rather than on a sub-

[13] 263 U. S. 282, 44 Sup. Ct. 108, 68 L. ed. 301 (1923).

[14] See Security Savings Bank v. California, 263 U. S. 282, 284, 44 Sup. Ct. 108, 109, 68 L. ed. 301, 305 (1923); FIELD, THE EFFECT OF AN UNCONSTITUTIONAL STATUTE (1935).

[15] Starr v. Schramm, 24 F. Supp. 888 (E. D. Mich. 1938).

[16] U. S. CONST. Art. I, §10.

[17] Atlantic Gypsum Co. v. Federal Nat. Bank of Boston, 76 F. (2d) 59 (C. C. A. 1st, 1935); Hernandez v. First Nat. Bank of Omaha, 125 Neb. 199, 249 N. W. 592 (1933); New Hampshire v. Peoples' Nat. Bank, 75 N. H. 28, 70 Atl. 542 (1908).

[18] Security Savings Bank v. California, 263 U. S. 282, 44 Sup. Ct. 108, 68 L. ed. 301 (1923).

[19] First Nat. Bank of San Jose v. California, 262 U. S. 366, 43 Sup. Ct. 602, 67 L. ed. 1030 (1923).

sisting contract.[20] In a federal case in which the validity of an Alaska escheat statute was upheld as to national as well as state banks, the court attempted to draw a distinction between the Alaska and California statutes based on differences in wording. The latter statute provided for escheat of deposits unclaimed for twenty years, there being no mention of the depositor's death intestate;[21] the former provided that deposits of persons who have died intestate and without heirs shall escheat to the territory but that seven years' absence in which the depositor has not been heard from shall give rise to a presumption of death, his deposit then being subject to escheat if no heirs can be found.[22] In the opinion of the court, the California statute might result in the escheat of the deposit of a living person, which would constitute a serious interference with the bank-depositor relation, while the Alaska statute would not in law have this result since the depositor is presumed to be dead.[23] However, this distinction seems purely superficial as the working result of both statutes is almost identical. Under both, after the lapse of the statutory period, proceedings, of which notice by publication must be given, must be instituted to have the deposit escheated, and until the termination of such proceedings, the depositor or his heirs may reclaim the deposit; but after that time, the right of reclamation is barred.[24] Under either statute, the deposit of a person actually living might be escheated, even though under the Alaska statute that person is presumptively dead. But on the abandoned property theory, the owner need not be dead to entitle the state to take over the property.[25]

As applied to national banks, these statutes present additional problems. National banks may not be subjected to state legislation in contravention of any positive federal legislation, nor may such state legislation hinder them in the performance of their duties as federal agencies.[26] The first of these considerations may be disposed of, as there is no federal legislation dealing with disposal of unclaimed bank deposits and no federal escheat except of lands owned by aliens in the

[20] Germantown Trust Co. v. Powell, 265 Pa. 71, 108 Atl. 441 (1919); see Provident Institute for Savings v. Malone, 221 U. S. 660, 664, 31 Sup. Ct. 661, 663, 55 L. ed. 899, 903 (1911).

[21] CAL. CODE CIV. PROC. (Deering, 1937) §1273.

[22] ALASKA COMP. LAWS (1933) §2903.

[23] See Alaska v. First Nat. Bank of Fairbanks, 22 F. (2d) 377, 379 (C. C. A. 9th, 1927).

[24] Alaska v. First Nat. Bank of Fairbanks, 41 F. (2d) 186 (C. C. A. 9th, 1930); Matthews v. Savings Union Bank & Trust Co., 43 Cal. App. 45, 184 Pac. 418 (1919); California v. Savings Union Bank & Trust Co., 186 Cal. 294, 199 Pac. 26 (1921).

[25] Brooklyn Borough Gas Co. v. Bennett, 154 Misc. 106, 277 N. Y. Supp. 203 (Sup. Ct. 1935); Pennsylvania v. Dollar Savings Bank, 259 Pa. 138, 102 Atl. 569 (1917); Germantown Trust Co. v. Powell, 265 Pa. 71, 108 Atl. 441 (1919).

[26] See note 3, *supra*.

territories and of veterans' relief compensation.[27] As for the second, the Oregon statute providing for escheat of unclaimed deposits[28] was held valid as applied to national banks on the ground that such a statute did not hinder the banks in the performance of their functions.[29] This decision is probably no longer law by reason of the conflicting decision of the United States Supreme Court already mentioned. That court suggested that to subject national banks to state escheat statutes would result in a loss of their ability to obtain deposits,[30] but it is difficult to see how this loss would result from a statute, which, by its terms, applies to competing state banks as well. Another objection is that the assets of the bank will be depleted by payment of the deposit to the state, but, as was pointed out in the Oregon case, such payment also releases the bank from its corresponding liability to the depositor, and the ratio of assets to liabilities is not changed.[31] On the other hand, there is the broader consideration of the intent and purposes of Congress in setting up the national banking system, one purpose being to create a system of banks throughout the nation to be as independent as possible of state restrictions.[32] It was said that the application of state escheat statutes to national banks would violate this purpose, but, inasmuch as Congress has made no provision for unclaimed deposits in national banks and there is no general federal escheat,[33] such a restriction does not seem to be in conflict with any intent of Congress. Moreover, as the majority of depositors

[27] American Loan & Trust Co. v. Grand Rivers Co., 159 Fed. 775 (C. C. W. D. Ky. 1908); see Klein v. Brodbeck, 15 F. Supp. 473, 474 (E. D. Pa. 1934); *In re* Escheat of Moneys in Custody of U. S. Treasury, 322 Pa. 481, 484, 186 Atl. 600, 602 (1936); 29 STAT. 619 (1897), 8 U. S. C. A. §75 (1926); 44 STAT. 792 (1926), 38 U. S. C. A. §451 (1928).

[28] ORE. CODE ANN. (1930) §11-1215.

[29] Oregon v. First Nat. Bank of Portland, 61 Ore. 551, 123 Pac. 712 (1912). The Pennsylvania statute providing for escheat of unclaimed bank deposits, though constitutional as applied to state banks, is inapplicable to national banks as they are not "organized or doing business under the laws of the commonwealth" within the provision of the statute. PA. STAT. (Purdon, 1936) tit. 27, §282, Germantown Trust Co. v. Powell, 265 Pa. 71, 108 Atl. 441 (1919), Columbia Nat. Bank v. Powell, 265 Pa. 85, 108 Atl. 445 (1919).

[30] See First Nat. Bank of San Jose v. California, 262 U. S. 366, 368, 43 Sup. Ct. 602, 603, 67 L. ed. 1030, 1035 (1923).

[31] See Oregon v. First Nat. Bank of Portland, 61 Ore. 551, 561, 123 Pac. 712, 716 (1912). Payment to the state under a valid statute releases a bank from liability to the depositor for the amount of the deposit. Louisville & N. R. R. v. Deer, 200 U. S. 176, 26 Sup. Ct. 207, 50 L. ed. 426 (1905); Security Savings Bank v. California, 263 U. S. 282, 44 Sup. Ct. 108, 68 L. ed. 301 (1923). N. C. CODE ANN. (Michie, Supp. 1937) §5786(1) expressly provides for this release from liability.

[32] First Nat. Bank of San Jose v. California, 262 U. S. 366, 43 Sup. Ct. 602, 67 L. ed. 1030 (1923); see Easton v. Iowa, 188 U. S. 220, 229, 23 Sup. Ct. 288, 290, 47 L. ed. 452, 456 (1903).

[33] American Loan & Trust Co. v. Grand Rivers Co., 159 Fed. 775 (C. C. W. D. Ky. 1908); see Klein v. Brodbeck, 15 F. Supp. 473, 474 (E. D. Pa. 1934); *In re* Escheat of Moneys in Custody of U. S. Treasury, 322 Pa. 481, 484, 186 Atl. 600, 602 (1936).

of a national bank are likely to be citizens of the state in which it is located, it is not unreasonable that their property should be devoted to state purposes when they have apparently abandoned it. However, as the United States Supreme Court has held these statutes invalid as applied to national banks, until this decision is overruled it is difficult to see how this result may validly be accomplished.

ELIZABETH SHEWMAKE.

Mortgages—Deeds of Trust—Creditor's Action for Damage to the Security.

In return for a loan of $4,500, *S* gave *P* his note for that amount secured by a deed to certain lands. This transaction took place on November 7, 1925, and the security deed was registered shortly thereafter. In 1935 *S*, whose debt to *P* was then in default, sold the timber growing on the said lands to *X*, who entered upon the property, cut the timber, and sold it to *D*. *P* foreclosed his deed and bid in the property for $1,000. He then sued *D* in trover for the value of the timber severed from the land. *D* demurred to the complaint, which set forth the facts above. *Held*, demurrer sustained because *P* was neither the true owner nor was he in possession at the time of the alleged conversion.[1]

In some jurisdictions a mortgagee is allowed to maintain trover or its equivalent under the codes of civil procedure against the mortgagor,[2] a third party,[3] or purchasers from either who have notice of the mortgage,[4] for property severed from the mortgaged premises without the consent of the mortgagee. As the plaintiff in trover must have had immediate right to possession,[5] only the so-called "title states" in which the mortgagee has legal title and with it right to possession[6] ordinarily allow him to prosecute this action when he had no actual possession.[7] However, a mortgagee in possession in a "lien state"

[1] Federal Land Bank of Columbia v. St. Clair Lumber Co., 199 S. E. 337 (Ga. 1938).

[2] Frothingham v. McKusick, 24 Me. 403 (1844); Harris v. Haynes, 34 Vt. 220 (1861).

[3] Baker-Matthews Lumber Co. v. Bank of Lepanto, 170 Ark. 1146, 282 S. W. 995 (1926); Fitzgerald v. Chicago Mill & Lumber Co., 176 Ark. 64, 3 S. W. (2) 30 (1928); Frothingham v. McKusick, 24 Me. 403 (1844); Burrill Nat. Bank v. Edminister, 119 Me. 367, 111 Atl. 423 (1920); Searle v. Sawyer, 127 Mass. 491 (1879); Wilbur v. Moulton, 127 Mass. 509 (1870); Harris v. Haynes, 34 Vt. 220 (1861).

[4] Baker-Matthews Lumber Co. v. Bank of Lepanto, 170 Ark. 1146, 282 S. W. 995 (1926); Fitzgerald v. Chicago Mill & Lumber Co., 176 Ark. 64, 3 S. W. (2d) 30 (1928); Burrill Nat. Bank v. Edminister, 119 Me. 367, 111 Atl. 423 (1920).

[5] Harris v. Haynes, 34 Vt. 220 (1861); SHIPMAN, HANDBOOK OF COMMON-LAW PLEADING (3d ed. 1923) 102.

[6] 3 JONES, LAW OF MORTGAGES (8th ed. 1928) §849.

[7] *Id.* at §850.

should be able to succeed on the strength of his possession.[8] In states where the mortgage is considered a mere lien before maturity of the debt but the mortgage is given right to possession after default in payment by the mortgagor,[9] a number of courts allow the mortgagor to bring trover for property severed from the premises after default.[10] The measure of damages in trover is the value of the property severed from the mortgaged premises.[11] The mortgagee must give credit upon the mortgage debt for the money he recovers.[12]

In addition to trover, some jurisdictions where the mortgagee has title and the right to possession of the mortgaged property allow him to maintain the action of trespass *quare clausum fregit,* or its modern equivalent, against the mortgagor or third parties for injuries to that property.[13] The courts spell out the possession necessary to maintain trespass *quare clausum fregit* by saying that, since the mortgagee has the immediate right to possession, he is constructively in possession of the property;[14] and, even if the mortgagor is actually occupying the land, they either say that his possession is that of the mortgagee,[15] or that he is a mere tenant at will.[16] As only those who have a right to possession can maintain this action[17] it would seem that a mortgagee who waived this right could not succeed; but one who rightfully acquired possession, even in a lien state, should be able to bring the action on the strength of his possession. Also, a few courts which hold that the mortgagee has the right to possession after default allow him to maintain trespass for injuries done to the mortgaged property after default.[18] The usual measure of damages is the difference in the value

[8] Possession is usually held to be sufficient in an action of trover. SHIPMAN, HANDBOOK OF COMMON-LAW PLEADING (3d ed. 1923) 102. Besides, a mortgagee in possession in a lien state has the right to remain in possession, Fee v. Swingly, 6 Mont. 596, 13 Pac.. 375 (1887); (1928) 7 TEX. L. REV. 170.

[9] Federal Land Bank of New Orleans v. LeFlore County, 170 Miss. 1, 153 So. 882 (1924); Harris v. Haynes, 34 Vt. 220 (1861).

[10] See note 9, *supra.*

[11] Tennessee Coal and Iron and R. R. Co. v. Jourdan, 221 Ala. 106, 128 So. 132 (1930); Alliance Trust Co. Ltd. v. Greydon Bank, 162 La. 1062, 111 So. 421 (1927); Wilbur v. Moulton, 127 Mass. 509 (1878).

[12] Barron v. Paulling, 38 Ala. 292 (1862); Guthrie v. Kahle, 46 Pa. St. 331 (1863); 2 JONES, LAW OF MORTGAGES (8th ed. 1928) §854.

[13] Stowell v. Pike, 2 Me. 387 (1819); Frothingham v. McKusick, 24 Me. 403 (1844); Leavitt v. Eastman, 77 Me. 117 (1885); Page v. Robinson, 64 Mass. 99 (1852); Pettingill v. Evans, 5 N. H. 54 (1829); Sanders v. Reed, 12 N. H. 558 (1842); Harris v. Haynes, 34 Vt. 220 (1861).

[14] Stowell v. Pike, 2 Me. 387 (1819); Page v. Robinson, 64 Mass. 99 (1852); Pettingill v. Evans, 5 N. H. 54 (1829).

[15] Stowell v. Pike, 2 Me. 387 (1819).

[16] Pettingill v. Evans, 5 N. H. 54 (1829).

[17] See note 13, *supra.*

[18] Federal Land Bank of Columbia v. Jones, 211 N. C. 317, 190 S. E. 479 (1937).

of the property before and after the trespass,[19] the mortgagee being required to account for the amount recovered as in trover.[20]

A great majority of the jurisdictions allow a mortgagee or a creditor under a deed of trust to maintain an action in the nature of waste against the mortgagor or against third parties for injuries to the mortgaged property.[21] Since this action is for the injury to the security of the creditor and not for an invasion of proprietary interests in the land, he need not have either title or right to possession in order to succeed.[22] It is usually unnecessary to allege or prove that the mortgagor is insolvent,[23] although there is authority to the contrary.[24] However, most of the courts require as a condition precedent to recovery that the plaintiff prove that the injury impaired the security value of the mortgaged property.[25] A minority of the courts require the creditor to prove that the injury rendered the property *inadequate* as security for his debt;[26] and a few of them, on the theory that the creditor is not injured until the foreclosure sale fails to raise enough money to pay his debt, refuse to allow the action unless the creditor has first obtained a deficiency judgment;[27] but the majority allow the action to be brought before default or foreclosure and recovery of a deficiency

[19] Craft v. Craft, 209 Ala. 226, 95 So. 901 (1923); Bourneman v. Milliken, 123 Me. 488, 124 Atl. 200 (1924). However, where the trespasser has severed and taken away property some courts allow the mortgagee to recover the value of that property. Stowell v. Pike, 2 Me. 387 (1819); Page v. Robinson, 64 Mass. 99 (1852).

[20] Barron v. Paulling, 38 Ala. 292 (1862); 2 JONES, LAW OF MORTGAGES (8th ed. 1928) §853.

[21] Hammer v. R. C. Hoffman Const. Co., 63 F. (2) 372 (C. C. A. 7th, 1933); Sloss-Sheffield Steel & Iron Co. v. Wilkes, 231 Ala. 511, 165 So. 764 (1936); Atlantic C. L. Ry. v. Rutledge, 122 Fla. 154, 165 So. 563 (1935); Bates v. Humboldt County, 277 N. W. 715 (Iowa 1938); Taylor v. Federal Land Bank of New Orleans, 162 Miss. 653, 138 So. 596 (1932); Vbrial v. Schildhauer, 130 Neb. 433, 265 N. W. 241 (1936); Cottle v. Wright, 140 Misc. 373, 251 N. Y. Supp. 699 (Sup. Ct. 1931); Toledo v. Brown, 130 Ohio St. 513, 200 N. E. 750 (1936).

[22] Bates v. Humboldt County, 277 N. W. 715 (Iowa 1938); *In re* Braddock Ave., Borough of Queens, City of New York, 251 App. Div. 669, 297 N. Y. Supp. 301 (2d Dep't 1937); Toledo v. Brown, 130 Ohio St. 513, 200 N. E. 750 (1936); 1 JONES, LAW OF MORTGAGES (6th ed. 1904) 700.

[23] Toledo v. Brown, 130 Ohio St. 513, 200 N. E. 750 (1936).

[24] Gardner v. Heartt, 17 N. Y. 231 (1846).

[25] Hammer v. R. C. Hoffman Const. Co., 63 F. (2d) 372 (C. C. A. 7th, 1933); Sloss-Sheffield Steel & Iron Co. v. Wilkes, 231 Ala. 511, 165 So. 764 (1936); Atlantic C. L. Ry. v. Rutledge, 122 Fla. 154, 165 So. 563 (1935); President & Directors of Manhattan Co. v. Mosler Safe Co., 284 N. Y. Supp. 145 (Sup. Ct. 1935); Toledo v. Brown, 130 Ohio St. 513, 200 N. E. 750 (1936). Accord: Nielsen v. Heald, 151 Minn. 181, 186 N. W. 299 (1922).

[26] Guaranty Savings & Loan Ass'n v. Springfield, 113 S. W. (2d) 147 (Mo. 1938); *In re* Braddock Ave., Borough of Queens, City of New York, 251 App. Div. 669, 297 N. Y. Supp. 301 (2d Dep't 1937); Liebermann, Loveman & Cohn v. Knight, 153 Tenn. 268, 283 S. W. 450 (1926).

[27] King v. Silgo Furnace Co., 190 S. W. 368 (Mo. 1916); Guaranty Savings & Loan Ass'n v. Springfield, 113 S. W. (2d) 147 (Mo. 1938); see Hammer v. R. C. Hoffman Const. Co., 63 F. (2d) 372, 374, (C. C. A. 7th, 1933).

judgment.[28] The minority view seems to deprive the mortgagee of the benefit of his bargain. He has contracted to have certain property as security for his debt, not to have only so much of that property as a court may consider adequate to secure him. Also, if he is forced to wait until he forecloses and obtains a deficiency judgment before suing, he may find that the wrongdoer meanwhile has become hopelessly insolvent or has left the jurisdiction.

The measure of damages in an action in the nature of waste is usually said to be the difference in the value of the property before and after the injury.[29] Some of the jurisdictions, where the injury is occasioned by the taking away or destruction of specific property such as timber, minerals, or fixtures, allow as damages the value of the property taken away or injured;[30] and one case, where fixtures had been removed, permitted recovery on the basis of replacement cost.[31] The mortgagee is almost universally required to account to the mortgagor for the money recovered, and where there is a deficiency judgment he is not allowed to recover more than the amount of such judgment.[32] If he has received full payment of his debt his cause of action disappears.[33]

The mortgagor may recover full damages for injury to the mortgaged property.[34] The wrongdoer is usually allowed to plead a recovery by the mortgagor in bar of a subsequent suit by the mortgagee[35] and to plead a former recovery by the mortgagee in mitigation of damages in a suit by the mortgagor.[36]

The holder of a security instrument such as a deed of trust, mortgage, or security deed may, in a great many jurisdictions and even in Georgia, enjoin the commission of waste, or trespass in the nature of waste, on the security provided he proves that its value will be im-

[28] Hammer v. R. C. Hoffman Const. Co., 63 F. (2d) 372 (C. C. A. 7th, 1933); President & Directors of Manhattan Co. v. Mosler Safe Co., 284 N. Y. Supp. 145 (Sup. Ct. 1935); Toledo v. Brown, 130 Ohio St. 513, 200 N. E. 750 (1936).

[29] Atlantic C. L. Ry. v. Rutledge, 122 Fla. 154, 165 So. 563 (1935); Corral v. Edmondson, 41 S. W. (2d) 64 (Tex. 1931).

[30] Cottle v. Wright, 140 Misc. 373, 251 N. Y. Supp. 699 (Sup. Ct. 1931).

[31] Cedar Avenue Building & Loan Ass'n v. McLaughlin, 69 Pa. Super. 73 (1918).

[32] Atlantic C. L. Ry. Co. v. Rutledge, 122 Fla. 154, 165 So. 563 (1935); Taylor v. Federal Land Bank of New Orleans, 162 Miss. 653, 138 So. 596 (1932); Cottle v. Wright, 140 Misc. 373, 251 N. Y. Supp. 699 (Sup. Ct. 1931); Planters' Bank v. Lummus Cotton Gin Co., 132 S. C. 16, 128 S. E. 876 (1925).

[33] Sloss-Sheffield Steel & Iron Co. v. Wilkes, 231 Ala. 511, 165 So. 764 (1936).

[34] Hamilton v. Griffin, 123 Ala. 600, 26 So. 243 (1899); Abney v. Austin, 6 Ill. App. 49 (1880).

[35] 2 JONES, LAW OF MORTGAGES (8th ed. 1928) 131.

[36] Elvins v. Delaware & A. Tel. Co., 63 N. J. L. 243, 43 Atl. 903 (1899); 1 JONES, LAW OF MORTGAGES (6th ed. 1904) 701.

paired by the alleged waste.[37] This relief is usually given whether or not the mortgagor or wrongdoer is insolvent and whether or not the particular jurisdiction deems the mortgagee the holder of a mere lien or the possessor of legal title.[38]

In some jurisdictions a deed given for security purposes is held to be a mortgage.[39] However, in Georgia, where a mortgage is said to be a mere lien,[40] there is a statute declaring that a security deed shall not be deemed a mortgage and that the grantee in such an instrument shall hold the legal title until he has received full payment.[41] In spite of the fact that the statute gives the holder of a security deed title,[42] the Georgia courts have refused to allow him to bring any action for injuries to the property covered by the deed.[43] If they wished to deny him the right to bring an action in the nature of waste they should still allow him to bring trover or trespass *quare clausum fregit*, because he has the legal title and, in the absence of any agreement to the contrary, the right to possession of the property.[44] The legislators intended to create a new type of security instrument which they expressly declared was not to be construed to be a mortgage.[45] However, the Georgia court in the principal case simply disregarded the provision giving the grantee legal title, ignored the probable intent of the legislature, and refused to give the holder of the legal title any cause of action for injuries to his property. This seems to be both unfair to the grantee and unwise social policy.

J. NATHANIEL HAMRICK.

Mortgages—Deeds of Trust—Validity of Conveyances of Equity of Redemption to Mortgagees.

P's debt to *D* was secured by a deed of trust. Having conveyed his equity of redemption to *D*, *P* brought an action to have the conveyance set aside, relying on a presumption of fraud or undue influence which he contended attaches to a conveyance of an equity of redemp-

[37] Small v. Slocumb, 112 Ga. 279, 37 S. E. 481 (1900); G. H. Ponder & Co. v. Mutual Ben. Life Ins. Co., 165 Ga. 366, 140 S. E. 761 (1928); Darby v. Mutual Ben. Life Ins. Co., 165 Ga. 516, 141 S. E. 410 (1928); Harris v. Bannon, 78 Ky. 568 (1880); Collins v. Rea, 127 Mich. 273, 86 N. W. 811 (1901); Adams v. Corriston, 7 Minn. 456 (1862); Vbrial v. Schildhauer, 130 Neb. 433, 265 N. W. 241 (1936); Sweeny v. Tabor, 191 S. E. 295 (W. Va. 1937); Taylor v. Collins, 51 Wis. 123, 8 N. W. 22 (1881); 1 JONES, LAW OF MORTGAGES (6th ed. 1904) §684.

[38] 1 JONES, LAW OF MORTGAGES (6th ed. 1904) §684.

[39] *Id.* §241.

[40] Vason v. Ball, 56 Ga. 268 (1876); Carter v. Gunn, 64 Ga. 651 (1879).

[41] GEORGIA CODE (1933) §67-1301.

[42] *Ibid.*

[43] Boswell v. Ivie, 31 Ga. App. 807, 122 S. E. 97 (1924); Scottish American Mortgage Co. v. King Lumber & Oil Co., 35 Ga. App. 524, 134 S. E. 140 (1926); Mills Lumber Co. v. Milan, 184 Ga. 455, 194 S. E. 911 (1938).

[44] GEORGIA CODE (1933) §67-1301; 1 JONES, LAW OF MORTGAGES (6th ed. 1904) §702.

[45] GEORGIA CODE (1933) §67-1301.

tion to a creditor under such circumstances. *Held,* a demurrer to the complaint was properly sustained. There is no trust or fiduciary relationship between the trustor under a deed of trust and the *cestui que trust.* Therefore, there is no presumption of fraud or undue influence when the trustor conveys the equity of redemption to the *cestui.*[1]

In North Carolina, as between mortgagees with power of sale and their mortgagors,[2] and possibly as between all mortgagees and mortgagors,[3] a well established rule, like that which governs the dealings of persons standing in a fiduciary relation, requires that, in order that a conveyance of an equity of redemption be held valid, the mortgagee must prove that no unfair advantage was taken of the mortgagor in the transaction. In almost all jurisdictions it seems to be agreed that a court of equity will scrutinize such a transaction carefully and will not allow a conveyance of the mortgagor's interest to the mortgagee to stand unless the conveyance is fair.[4] However, there is no uniformity among other jurisdictions as to whether the burden of proving fairness or the lack of fairness rests upon the mortgagee or the mortgagor.[5] In North Carolina and elsewhere it is safe to as-

[1] Murphy v. Taylor, 214 N. C. 393, 198 S. E. 382 (1938). For an earlier discussion of this problem consult (1928) 6 N. C. L. REV. 340.

[2] Whitehead v. Hellen, 76 N. C. 99 (1877); Hall v. Lewis, 118 N. C. 509, 24 S. E. 209 (1896); Pritchard v. Smith, 160 N. C. 79, 75 S. E. 803 (1912); Cole v. Boyd, 175 N. C. 555, 95 S. E. 778 (1918); Jones v. Williams, 176 N. C. 245, 96 S. E. 1036 (1918).

[3] The decision in McLeod v. Bullard, 84 N. C. 516 (1881), indicates the rule is applicable to all mortgages. But the decision on rehearing, 86 N. C. 210 (1882), made it doubtful whether the rule was applicable to any mortgages except those with power of sale or those in the form of an absolute deed. At least two cases since this case recognize that there *may* be a distinction between mortgages with and without power of sale. Dawkins v. Patterson, 87 N. C. 385, 387 (1882); Cole v. Boyd, 175 N. C. 555, 559, 95 S. E. 778, 780 (1918). There are cases, however, which have applied the rule as between mortgagor and mortgagee without stating specifically whether the mortgage contained a power of sale. Shelton v. Hampton, 28 N. C. 216 (1845); Barnes v. Brown, 71 N. C. 507 (1874); McLeod v. Bullard, 84 N. C. 516 (1881); Harrelson v. Cox, 207 N. C. 651, 178 S. E. 361 (1934).

[4] Russell v. Southard, 12 How. 139, 13 L. ed. 927 (U. S. 1851); Alexander v. Rodriguez, 12 Wall. 323, 20 L. ed. 406 (U. S. 1870); Peugh v. Davis, 96 U. S. 332, 24 L. ed. 775 (1877); Stoutz v. Rouse, 84 Ala. 309, 4 So. 170 (1887); Bradbury v. Davenport, 114 Cal. 593, 46 Pac. 1062 (1896); Linnell v. Lyford, 72 Me. 280 (1881); Sheckell v. Hopkins, 2 Md. Ch. 89 (1851); Grannis v. Hitchcock, 118 Minn. 462, 137 N. W. 186 (1912); Remsen v. Hay, 2 Edw. Ch. 535 (N. Y. 1835); Wagg v. Herbert, 19 Okla. 525, 92 Pac. 250 (1907); Hall v. Hall, 41 S. C. 163, 19 S. E. 305 (1893); Hyndman v. Hyndman, 19 Vt. 9 (1845); Liskey v. Snyder, 56 W. Va. 610, 49 S. E. 515 (1904); notes (1895) 44 Am. St. Rep. 699, (1897) 55 Am. St. Rep. 105, (1897) 56 Am. St. Rep. 117, (1910) 131 Am. St. Rep. 926, L. R. A. 1916B 18, 446.

[5] For a general discussion of the burden of proof consult Johansen v. Looney, 31 Idaho 754, 176 Pac. 778 (1918); note L. R. A. 1916B 18, 447. The following cases place the burden of proving fairness on the mortgagee: Webb v. Globe Securities Co., 203 Ala. 226, 82 So. 476 (1919); Green v. Gilbert, 169 Ark. 537, 276 S. W. 8 (1925); Gassert v. Strong, 38 Mont. 18, 98 Pac. 497 (1908); Caro v. Wollenberg, 68 Ore. 420, 136 Pac. 866 (1913); Liskey v. Snyder, 56 W. Va. 610, 49 S. E. 515 (1904). The following place the burden of proving lack of

sume that the transaction will not be considered fair unless there is an absence of fraud, undue influence, or oppression.[6] There is diversity of opinion as to the significance that should be given to the consideration received by the mortgagor in determining the fairness of a transaction. Some of the courts seem to take the position that, if the mortgagee has not paid a price which the courts deem adequate, this fact alone is sufficient to vitiate the transaction;[7] others, however, indicate that the price paid is merely *evidence* bearing upon the issue of whether the conveyance was completely voluntary.[8] Where the former view is adopted, rules vary as to how low the price must be if the conveyance is to be avoided.[9]

In North Carolina the rule under discussion has been applied in a variety of situations in which a debtor has conveyed to the creditor his remaining interest in the property securing the debt, among them the following: where a mortgagee purchased the equity of redemption at a sale which he himself conducted pursuant to a power of sale, being authorized by the mortgagor to make such a purchase;[10] where

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fairness on the mortgagor: De Martin v. Phelan, 47 Fed. 761 (C. C. N. D. Cal. 1891); Richardson v. Curlee, 229 Ala. 505, 158 So. 189 (1934); Walker's Adm'x v. Farmers' Bank, 13 Del. 258, 10 Atl. 94 (Ch. 1887); O'Connor v. Schwan, 190 Minn. 177, 251 N. W. 180 (1933); Coates v. Marsden, 142 Wis. 106, 124 N. W. 1057 (1910); Melbourne Banking Corp. v. Brougham, 7 App. Cas. 315 (1882). Probably most of the cases that place the burden on the mortgagor are cases where the mortgagor claims he intended the deed of his equity of redemption as further security. See note L. R. A. 1916B 18, 454. But in North Carolina the burden of proving fairness falls upon the mortgagee regardless of whether the mortgagor's deed was intended as further security or as an absolute conveyance. Hall v. Lewis, 118 N. C. 509, 24 S. E. 209 (1896); Chilton v. Smith, 180 N. C. 472, 105 S. E. 1 (1920).

[6] Russell v. Southard, 12 How. 139, 13 L. ed. 927 (U. S. 1851); Alexander v. Rodriguez, 12 Wall. 323, 20 L. ed. 406 (U. S. 1870); West v. Reed, 55 Ill. 242 (1870); Hinckley v. Wheelwright, 29 Md. 341 (1868); see Odell v. Montross, 68 N. Y. 499, 504 (1877); McLeod v. Bullard, 86 N. C. 210, 215 (1882); Alford v. Moore, 161 N. C. 382, 386, 77 S. E. 343, 344 (1913); Cole v. Boyd, 175 N. C. 555, 558, 95 S. E. 778, 780 (1918).

[7] Russell v. Southard, 12 How. 139, 13 L. ed. 927 (U. S. 1851); Peugh v. Davis, 96 U. S. 337, 24 L. ed. 775 (1877); Bradbury v. Davenport, 114 Cal. 593, 46 Pac. 1062 (1896); De Laigle v. Denham, 65 Ga. 482 (1880); Pritchard v. Smith, 160 N. C. 79, 75 S. E. 803 (1912); see Cole v. Boyd, 175 N. C. 555, 560, 95 S. E. 778, 781 (1918); note L. R. A. 1916B 18, 451.

[8] West v. Reed, 55 Ill. 242 (1870); Bridges v. Linder, 60 Iowa 190, 14 N. W. 217 (1882); Hicks v. Hicks, 5 Gill & J. 75 (Md. 1832); Wachovia Loan & Trust Co. v. Forbes, 120 N. C. 355, 27 S. E. 43 (1897); see Niggeler v. Maurin, 34 Minn. 118, 125, 24 N. W. 369, 373 (1885); Hinton v. West, 207 N. C. 708, 716, 717, 178 S. E. 356, 360, 361 (1934).

[9] Russell v. Southard, 12 How. 139, 13 L. ed. 927 (U. S. 1851) ("less than others would have given" repudiated); Peugh v. Davis, 96 U. S. 332, 24 L. ed. 775 (1877) (less than would be deemed reasonable if the transaction were between other parties); De Martin v. Phelan, 47 Fed. 761 (C. C. N. D. Cal. 1891) (such inadequacy as would shock the conscience); Johansen v. Looney, 31 Idaho 754, 176 Pac. 778 (1918) (grossly inadequate); Scanlon v. Scanlon, 134 Ill. 630, 25 N. E. 652 (1890) (mere inadequacy).

[10] Jones v. Pullen, 115 N. C. 465, 20 S. E. 624 (1894). *Contra:* Dawkins v. Patterson, 87 N. C. 385 (1882).

the assignee of a mortgage purchased the equity of redemption;[11] and where a pledgee purchased the pledged property.[12] It has also been held that the rule was applicable where a mortgagor waived the provisions of a lease to the mortgagee;[13] and, in *Cole v. Boyd*,[14] it was held that a purchaser of the fee from the mortgagee who had bought the mortgagor's equity acquired no title because the title of his grantor was defective as a result of the presumption of fraud or undue influence practiced upon the mortgagor, the mortgage being on record at the time the deed was given by the mortgagee. On the other hand, no presumption of unfairness was recognized where a mortgage ran solely to a creditor, and a surety on the obligation purchased the equity of redemption from the mortgagor.[15]

The holding in the principal case to the effect that no presumption of unfairness attaches to a conveyance of an equity of redemption by the trustor under a deed of trust to the *cestui*, or creditor, is in accord with an earlier case, *Simpson v. Fry*;[16] but in a still earlier case the opposite result was reached.[17] The distinction thus made between the incidents of the mortgagor-mortgagee relation and those of the relation of trustor and *cestui* under a deed of trust does not appear to have been recognized in any other jurisdiction. On the contrary there are cases to the effect that a conveyance by trustor to *cestui* will be regarded with the same suspicion or will be surrounded with the same presumption of unfairness that applies to conveyances by mortgagors to mortgagees.[18] The validity of the North Carolina distinction depends upon whether the principles upon which the rule applicable to the mortgagor-mortgagee relationship is based are equally applicable to the trustor-*cestui* relation.

It is believed that the rule governing conveyances of equities of redemption by mortgagors to mortgagees is based upon one or more of the following: (1) the principles governing the relationship of settlor and *cestui que trust* under a real trust; (2) the principles governing persons in confidential or fiduciary relationships; and (3) a feeling that the mortgagor should be protected from an unfair bargain because the mortgagee is in a superior bargaining position.

A mortgagee in North Carolina occupies a position somewhat analogous to that of a trustee, as he is given legal title[19] to mortgaged

[11] Hall v. Lewis, 118 N. C. 509, 24 S. E. 209 (1896).
[12] Wachovia Loan & Trust Co. v. Forbes, 120 N. C. 355, 27 S. E. 43 (1897).
[13] Hines v. Outlaw, 121 N. C. 51, 27 S. E. 1006 (1897).
[14] 175 N. C. 555, 95 S. E. 778 (1918).
[15] Chilton v. Smith, 180 N. C. 472, 105 S. E. 1 (1920).
[16] 194 N. C. 623, 140 S. E. 295 (1927).
[17] Alford v. Moore, 161 N. C. 383, 77 S. E. 343 (1913).
[18] Thompson v. Mansfield, 84 Cal. App. 560, 258 Pac. 702 (1927); Cox v. Horner, 43 W. Va. 786, 28 S. E. 780 (1897).
[19] Cauley v. Sutton, 150 N. C. 327, 64 S. E. 3 (1909).

property, but only for the purpose of security. A *cestui* under a deed of trust does not have legal title. If purely legalistic considerations were to govern, some basis for the distinction between conveyances of equities of redemption under mortgages and under deeds of trust might be found in these technicalities of title. But the mortgagor-mortgagee relationship is not governed by the body of law applicable to real trusts.[20] Even if the rule as to conveyances of equities of redemption to mortgagees were influenced by that body of law, it is evident that the rule is based on other considerations as well. Otherwise, how could the rule be applicable to the assignee of a mortgage, the assignee having no title[21] to the mortgaged land and his rights to the property being substantially the same as those of a *cestui* under a deed of trust?[22] Or, how could the rule be applied to a pledgee, who is not usually treated as a real trustee?[23]

The case of *Simpson v. Fry*,[24] which was followed in the principal case, seemed to premise the rule as to mortgagors and mortgagees upon the existence of a fiduciary relation and to explain the distinction made with regard to conveyances from trustor to *cestui* under a deed of trust on the ground that no such relation exists between the latter parties. The elements that constitute a fiduciary relationship and the circumstances under which it may exist cannot be easily defined. However, it has been said that there is a fiduciary relationship ". . . wherever there exists such a confidence, of whatever character that confidence may be, as enables the person in whom the confidence or trust is reposed to exert influence over the person trusting him. . . . The relation and the duties involved in it need not be legal; it may be moral, social, domestic, or merely personal."[25] If anything can be gathered from the statements above, it would seem to be that the mere fact that legal title is placed in a mortgagee is not a fact which is necessary to the existence of a fiduciary relationship. Is the fact that a mortgagee is entrusted with a power of sale, while a *cestui* is not, sufficient to cause the former but not the latter to be a fiduciary? Such a distinction is purely technical; for, as a matter of fact, the *cestui* under a deed of trust for security purposes is entrusted with the *use* of the power of sale and can call upon the trustee to exercise it at any time when the debt is not paid. Does a debtor trust his creditor more because the latter happens to prefer one type of security transaction over another?

[20] 1 BOGERT, TRUSTS AND TRUSTEES (1935) §29.
[21] Collins v. Davis, 132 N. C. 106, 43 S. E. 579 (1903).
[22] See (1928) 6 N. C. L. REV. 340, 342.
[23] 1 BOGERT, TRUSTS AND TRUSTEES (1935) §30.
[24] 194 N. C. 623, 140 S. E. 295 (1927).
[25] 2 POMEROY, EQUITY JURISPRUDENCE (3d ed. 1905) §1747.

The cases in jurisdictions other than North Carolina, for the most part, state the rule as to conveyances of a debtor's interest in the security to the security holder without giving reasons for it. But the tenor and language, if not the holdings, of some of the earlier cases suggest a principle which seems to underlie the rule.[26] The nature of this principle might be summarized as follows. According to a well-known rule developed early in the history of mortgage law, no stipulations or agreements, at the time of the execution of the mortgage contract, for the destruction or restriction of the equity of redemption would be enforced.[27] Conceivably, this same complete inability to contract away the equity of redemption could have persisted even after the original agreement; but, in order to save the mortgagor the costs of foreclosure, the mortgagor was given the power to sell his equity of redemption to the mortgagee after the execution of the mortgage.[28] However, for the same reason which led the courts to prohibit such contracts at the inception of the mortgage relation, this power to sell the equity of redemption to the mortgagee subsequently was conditioned upon the sale being in all respects fair.[29] And this reason, the one underlying both rules, the so-called "once a mortgage always a mortgage" rule and the rule under discussion, is that the mortgagee is in a bargaining position superior to that of the mortgagor.[30]

[26] See note 30, *infra*.

[27] 3 POMEROY, EQUITY JURISPRUDENCE (3d ed. 1905) §1193.

[28] Russell v. Southard, 12 How. 154, 13 L. ed. 934 (U. S. 1851); Stoutz v. Rouse, 84 Ala. 309, 4 So. 170 (1887).

[29] "It would be strange indeed, if the Court of Chancery which so carefully guards the equity of redemption from all restraints that parties may attempt to impose in the mortgage which creates it, or in any other contemporaneous deed, should thenceforth abandon it to the arts or influence of the mortgagee, who, having already a hold upon the property by the original contract, comes into every new transaction with the mortgagor with increasing advantage." Perkins v. Drye, 33 Ky. 170, 177 (1835). "A subsequent agreement that what was originally a mortgage shall be regarded as an absolute conveyance is open to the same objection (that is, the objection to such agreement in the mortgage itself) and will not be sustained unless fairly made, and no undue advantage is taken by the creditor." Bradbury v. Davenport, 114 Cal. 593, 600, 46 Pac. 1062, 1063 (1896).

[30] De Martin v. Phelan, 47 Fed. 761 (C. C. N. D. Cal. 1891); Goree v. Clements, 94 Ala. 337, 10 So. 906 (1891); Bowen v. Kraemer, 260 Ill. App. 454 (1931); Perkins v. Drye, 33 Ky. 170 (1835); Dougherty v. McColgan, 6 Gill & J. 275 (Md. 1834); Sheckell v. Hopkins, 2 Md. Ch. 90 (1851); Baugher v. Merryman, 32 Md. 185 (1869); Holdridge v. Gillespie, 2 Johns. Ch. 30 (N. Y. 1816); Shaw v. Walbridge, 33 Ohio St. 1 (1877); Hyndman v. Hyndman, 19 Vt. 9, 12 (1845) (". . . when the orator contracted to sell out his equity of redemption to his mortgagee, he is, in this court, entitled to very favorable consideration, on account of the unequal relations in which the parties stood at the time. The one was the superior and the other the dependent. The one had power and resources; the other had neither, but was sore pressed by necessity."); Ford v. Olden, L. R. 3 Eq. 461 (1867); see Bither v. Packard, 115 Me. 306, 315, 98 Atl. 929, 933 (1916). It is stated in 3 POMEROY, EQUITY JURISPRUDENCE (3d ed. 1905) 2370 that the reason behind the "once a mortgage always a mortgage"

If this be the basis for the rule restricting conveyances of the equity of redemption to the mortgagee, it is difficult to see why the rule should not be applied to conveyances to the *cestui* under a deed of trust. A *cestui que trust* is not allowed to destroy or restrict, contemporaneously with the execution of a deed of trust, the equity of redemption under it.[31] Why should he, any more than a mortgagee, be left unrestricted thereafter in his right to acquire the debtor's interest? He is not less able to take advantage of the mortgagor by use of his security. The threat of foreclosure exerts as much compulsion on the debtor as in the case of a mortgage. He is as much entitled to a deficiency judgment as the mortgagee. A sale foreclosing a deed of trust is as likely to bring a price much less than the value of the land as is a sale foreclosing a mortgage. The costs of foreclosure are at least as high in the case of a deed of trust as in the case of a mortgage with a power of sale. Debtors who give one type of security are just as ignorant, just as poor and distressed, and just as helpless as debtors giving the other type. It is hard to see any respect in which a mortgage is a greater instrument of oppression than is a deed of trust.

The distinction the North Carolina Supreme Court makes between mortgagees and *cestuis que trust* seems unwarranted, but it might be explained, perhaps, on the ground that the court regrets the restrictions imposed on mortgagees and seeks to limit their application.

WILLIAM R. DALTON, JR.

Municipal Corporations—Contracts—Power of Governing Body to Bind Its Successors.

The mayor and city council of Charlotte entered into a ten-year contract with *P* whereby the city was to place all the sludge from its sewage disposal plant upon drying beds to be constructed and maintained by the city. *P* agreed to remove the sludge and to pay the city therefor on a stated schedule according to tonnage; and, in reliance on the contract, it expended large sums of money in preparing to fulfill its obligations. The city performed its part of the contract for a few years, after which a subsequent council refused further performance, contending that, as the disposal of sewage was a governmental function, it was not bound by the contract of its predecessor in office. *P* sued for breach of the contract. *Held,* it was error to sustain the city's

rule is as follows: "this doctrine is based upon the relative situation of the debtor and the creditor; it recognizes the fact that the creditor necessarily has a power over his debtor which may be exercised inequitably; that the debtor is liable to the exertion of such power; and it protects the debtor absolutely from the consequences of his inferiority, and his own acts done through infirmity of will."

[31] Dotterer v. Freeman, 88 Ga. 479, 14 S. E. 863 (1891); Thompson v. Lewis, 182 App. Div. 556, 169 N. Y. Supp. 501 (2d Dep't 1918).

demurrer, as this contract did not deprive the former governing body or its successors of any discretion which, as a matter of public policy, should be left unimpaired.[1]

Thus the question of the extent to which a city council may bind its successors by contract again came to the forefront. The usual formula for solving this problem involves a classification of the powers of a municipal corporation into two groups: (1) proprietary or business powers, and (2) governmental or legislative powers. The orthodox rule is that the former, being merely for the private gain of the municipality, may be contracted away, while the latter, being the power of governing the people, must be passed to their chosen representatives unimpaired.[2] Hence, any agreement purporting to contract away a governmental power may be avoided by the city.[3]

Following this line of reasoning, the courts have almost uniformly held, in the absence of a statute to the contrary, that the making of contracts securing water supply,[4] gas supply,[5] electric power,[6] coal for lighting plant,[7] printing supplies,[8] and contracts for the removal

[1] Plant Food Co. v. Charlotte, 214 N. C. 518, 199 S. E. 712 (1938).

[2] Illinois Trust & Savings Bank v. Arkansas City, 76 Fed. 271 (C. C. A. 8th, 1896); Tempe v. Corbell, 17 Ariz. 1, 147 Pac. 754 (1915); Biddeford v. Yates, 104 Me. 506, 72 Atl. 335 (1908); Jenkins v. Henderson, 214 N. C. 244, 199 S. E. 37 (1938); see Valparaiso v. Gardner, 97 Ind. 1, 4 (1884); Maney v. Oklahoma City, 150 Okla. 77, 81, 300 Pac. 642, 646 (1931); 3 McQUILLIN, MUNICIPAL CORPORATIONS (2d ed. 1928) §§1271, 1356.

[3] Central Transportation Co. v. Pullman's Palace Car Co., 139 U. S. 24, 11 Sup. Ct. 478, 35 L. ed. 55 (1891); Jenkins v. Henderson, 214 N. C. 244, 199 S. E. 37 (1938); 3 McQUILLIN, MUNICIPAL CORPORATIONS (2d ed. 1928) §§1271, 1378, 1379. It should be noted that the courts generally hold that a person contracting with a municipal corporation is bound at his peril to know of the limitations of the power of its officers to contract, and is not entitled to any equitable consideration for loss sustained by him in erroneously relying upon an agreement which the officers had no authority to make. Dawson v. Dawson Waterworks, 106 Ga. 696, 32 S. E. 907 (1899); Folkers v. Butzer, 294 Ill. App. 1, 13 N. E. (2d) 624 (1938); Mealey v. Hagerstown, 92 Md. 741, 48 Atl. 746 (1901); 3 McQUILLIN, MUNICIPAL CORPORATIONS (2d ed. 1928) §1268. As to whether a city in such cases may be liable in quasi-contract for benefits derived, see Abbott Realty Co. v. Charlotte, 198 N. C. 564, 568, 152 S. E. 686, 688 (1930); 3 McQUILLIN, MUNICIPAL CORPORATIONS (2d ed. 1928) §1379.

[4] Denver v. Hubbard, 29 Colo. 529, 68 Pac. 993 (1902); Flynn v. Little Falls Elec. & Water Co., 74 Minn. 180, 77 N. W. 38 (1898); Atlantic City Water Works v. Atlantic City, 48 N. J. L. 378, 6 Atl. 24 (Sup. Ct. 1886); Eau Claire Dells Improvement Co. v. Eau Claire, 172 Wis. 240, 179 N. W. 2 (1920).

[5] Omaha Gas Co. v. Omaha, 249 Fed. 350 (D. Neb. 1914); Vincennes v. Citizens' Gaslight Co., 132 Ind. 114, 31 N. E. 573 (1892); New Orleans Gas Light Co. v. New Orleans, 42 La. Ann. 188, 7 So. 559 (1890); see Griffin v. Oklahoma Nat. Gas Corp., 37 F. (2d) 545, 548 (C. C. A. 10th, 1930).

[6] Mealey v. Hagerstown, 92 Md. 741, 48 Atl. 746 (1901); Tanner v. Auburn, 37 Wash. 38, 79 Pac. 494 (1905).

[7] Rockhill Iron & Coal Co. v. Taunton, 273 Fed. 96 (C. C. A. 1st, 1921).

[8] Liggett v. Kiowa County, 6 Colo. App. 269, 40 Pac. 475 (1895). *Contra:* Sheldon v. Commissioners of Butler County, 48 Kan. 356, 29 Pac. 759, 16 L. R. A. 257 (1892).

of garbage[9] is a proprietary function of the city, and, if fair and reasonable when made, will be enforced, even though extending over a long period of time. So, also, a lease of city property entered into by a city council was held good, though it did not begin to run until after the expiration of the councilmen's terms of office.[10]

On the other hand, the powers to levy taxes and assessments,[11] pass ordinances,[12] and abate nuisances[13] have been held to be governmental and may not be contracted away. The appointments of city attorneys,[14] city physicians,[15] and almshouse surgeons[16] have been said to terminate automatically with the term of office of the appointing board. An agreement by a town with an adjoining city that the latter could build and maintain a garbage plant within the town's limits, in return for cancellation of a debt owed by the town to the city, was held invalid on the ground that the town could not thus restrict itself by contract and, hence, gave no consideration to support the contract.[17] Likewise, where a city council made a contract for sprinkling its streets, such sprinkling being necessary to the maintenance of the streets, the court held that a governmental function was involved and that the contract was not binding beyond the tenure of office of the appointing board.[18]

Within this group of powers which cannot be contracted away also comes the general police power which is usually thought to include the power to provide and maintain sewage disposal facilities.[19] It is not entirely clear exactly how far this function continues to be governmental. Certainly it would continue so until the sewage reaches the septic tank. Would it also extend to the removal of the sludge after it had been placed on drying beds? It is on this point that the real controversy in the principal case centered. The city contended

[9] Marble v. Clinton, 9 N. E. (2d) 522 (Mass. 1937); Kelley v. Broadwell, 92 N. W. 643 (Neb. 1902); New York v. New York Disposal Corp., 100 Misc. 536, 166 N. Y. Supp. 963 (Sup. Ct. 1917).

[10] Biddeford v. Yates, 104 Me. 506, 72 Atl. 335 (1908).

[11] Westminster Water Co. v. Westminster, 98 Md. 551, 56 Atl. 990 (1904); Little Falls Elec. & Water Co. v. Little Falls, 74 Minn. 197, 77 N. W. 40 (1898); Bristol v. Dominion Nat. Bank, 153 Va. 71, 149 S. E. 632 (1929).

[12] New York, N. H. & H. Ry. v. New Rochelle, 29 Misc. 195, 60 N. Y. Supp. 904 (Sup. Ct. 1899); Born v. Pittsburgh, 266 Pa. 128, 109 Atl. 614 (1920).

[13] Wood v. Hinton, 47 W. Va. 645, 35 S. E. 824 (1900).

[14] See Wilmington v. Bryan, 141 N. C. 666, 672, 54 S. E. 543, 545 (1906).

[15] Jacobs v. Elmira, 147 App. Div. 433, 132 N. Y. Supp. 54 (3d Dep't 1911).

[16] Connelly v. Commissioners of Alms House of Kingston, 32 Misc. 489, 66 N. Y. Supp. 194 (Sup. Ct. 1900).

[17] Schwab v. Graves, 221 App. Div. 357, 223 N. Y. Supp. 160 (4th Dep't 1927); note (1927) 16 NAT. MUNIC. REV. 794.

[18] Tempe v. Corbell, 17 Ariz. 1, 147 Pac. 745 (1915). Accord: Jenkins v. Henderson, 214 N. C. 244, 199 S. E. 37 (1938).

[19] Weaver v. Canon Sewer Co., 18 Colo. App. 242, 70 Pac. 953 (1902); Stifel v. Hannan, 95 W. Va. 629, 123 S. E. 428 (1924); 4 McQUILLIN, MUNICIPAL CORPORATIONS (2d ed. 1928) §§1545, 1564. *Contra:* First Nat. Bank of Red Oak v. Emmetsburg, 157 Iowa 555, 138 N. W. 451 (1912).

that the function continued to be a governmental one until the sludge passed completely out of its possession and control. *P*, while admitting that the disposal of sewage was a governmental function, contended that a contract for the removal of the sludge was merely incidental thereto, involving only the proprietary or business powers of the city. Thus, no criticism of the traditional formula was offered by the litigants, but the issue, as drawn, was what result should be reached from its application to the facts of the particular case.

But the North Carolina Supreme Court discarded this governmental-proprietary test, implying that its strict application might lead to a different result from that reached. It pointed out that the line of demarcation between governmental and proprietary powers is none too sharply drawn "and is subject to change of front as society advances and conceptions of functions of government are modified under its insistent demands." The court further indicated that the mere fact that the general subject matter of sewage disposal belongs within the governmental field is no reason for holding that no detail of its administration may be contracted away, or that such a contract must be limited to the term of office of the contracting council. According to the court, the proper test for determining the validity of contracts of the type under consideration is "whether the contract itself deprives the governing body, or its successors, of a discretion which public policy demands should be left unimpaired." In applying this test, the court followed in the footsteps of the California court in *McBean v. Fresno*.[20] In that case the plaintiff had entered into a contract for five years with the City of Fresno whereby he agreed to take charge of the city's sewage after it left the city limits and dispose of it. The city later refused to perform, and the plaintiff sued. Without deciding whether there was a surrender of legislative power, the California court held that in all cases of extended contracts with a municipality there is no unreasonable restraint on the power of succeeding councils to contract when a party seeking enforcement sustains the burden of proving that the contract was entered into in good faith, that it was fair and just when made, and that there was a reasonable necessity for its execution. This appears to be but another way of saying that the plaintiff must show that enforcement of the contract would not be against public policy.

This public policy test appears on its face to be rather broad and perhaps uncertain in its application, but it seems to be the best test—in fact the only real one in any close case. It is quite natural in controversial cases to consider the subject-matter of a contract and the phase of municipal power involved. But there can be no good reason

[20] 112 Cal. 159, 44 Pac. 358 (1896).

why, before the validity of a contract may be determined, it must first be classed as one affecting governmental functions or proprietary ones, especially in view of the general confusion as to the class into which a particular function falls. It is believed that public policy is a primary consideration in every determination of the validity of a municipal contract. If the North Carolina court was more outspoken in its language than other courts, it was simply being more frank in applying the same test that is almost always applied, consciously or otherwise.

LAFAYETTE WILLIAMS.

Taxation—Income Derived from the Discharge of an Obligation at Less than Face Value.

In 1905 the petitioner owned and operated a small but profitable railroad, its property at that time being valued at $419,130. On January 1, 1906, petitioner leased all its property for a period of fifty years, the lessee to pay an annual rental of $25,000 for the first ten years and $30,000 for the remaining forty years, plus all taxes, operating expenses, etc. Petitioner, in accordance with the terms of the lease, issued $434,000 par value five per cent first mortgage bonds, the proceeds being used to refund a prior bond issue. The lease provided that the $21,700 annual interest on the bonds be deducted from the rent and paid to the trustee of the bonds, the remainder of the rent to be paid directly to the petitioner.

In October, 1932, petitioner purchased $19,000 par value of its bonds for $4,750, which it held in its treasury in order that it might collect the interest thereon. At the time this purchase was made, petitioner's assets consisted of $10,000 cash, $77,000 of its own bonds, and the railroad property subject to the lease. Its liabilities consisted of $500 in accounts payable and the $434,000 bond issue. The business carried on by the railroad had decreased until it amounted to practically nothing, although the property had not been revalued and still stood on the books at its 1905 valuation of $419,130.

The Board of Tax Appeals affirmed a ruling by the Commissioner of Internal Revenue to the effect that the difference between the price paid for the bonds and their par value constituted taxable income to the petitioner. On appeal to the circuit court of appeals, *held,* since the bonds were not retired and since there was no freeing of assets when the bonds were repurchased, no taxable gain accrued to the petitioner.[1]

The first ground of the decision, that the bonds were not retired, was sufficient to support the result reached, for any gain resulting

[1] Transylvania R. R. v. Commissioner, 99 F. (2d) 69 (C. C. A. 4th, 1938).

from the repurchase of bonds by the issuer at a discount arises by reason of the fact that an obligation has been extinguished at less than face value. Clearly there can be no taxable gain if there has been no discharge. The treasury regulations under the Revenue Act of 1932, which were involved in this case, provided, as did prior regulations,[2] that there not only be a purchase of its bonds by the issuing corporation, but also that they be retired before the difference between the purchase price and the face value would be treated as a taxable gain. The Board of Tax Appeals had at first held that "retirement" within the meaning of the regulations did not necessarily require cancellation.[3] A later case,[4] which was affirmed by the Circuit Court of Appeals for the Third Circuit in a memorandum decision,[5] stated that *retirement* was immaterial. Thereafter the Court of Appeals for the District of Columbia held that, under the regulations, retirement was necessary, but that what constituted retirement depended upon the intention of the purchaser; an intention to keep the indebtedness alive when the bonds were repurchased, however, must be clearly shown, for the "general rule is that where an indebtedness is in fact paid, evidence of it cannot be reissued for a new or different debt".[6] While the intention to retire the repurchased bonds is not capable of definite ascertainment in all cases, the intention not to retire was clear in the principal case where the taxpayer held the bonds in order to collect interest from the lessee under the terms of the lease.

The latest treasury regulations do not require that the bonds be retired,[7] but in their application it must be recognized that the essential factor is whether or not the debt represented by the bonds has been extinguished. If it has not there is no basis for treating the transaction as a taxable gain unless and until the taxpayer later resells the bonds so purchased, in which case there is a taxable gain in the amount of the difference between the cost of the repurchased bonds and the selling price. But if there is actually an extinguishment of the debt, that extinguishment is the event out of which the taxable gain, if any, arises. If the elimination of the requirement that the bonds be retired is regarded merely as making retirement no longer the exclusive

[2] U. S. Treas. Reg. 45, Art. 544; U. S. Treas. Reg. 62, Art. 545; U. S. Treas. Reg. 65, Art. 541; U. S. Treas. Reg. 69, Art. 541; U. S. Treas. Reg. 74, Art. 68; U. S. Treas. Reg. 77, Art. 68.

[3] Garland Coal & Mining Co., 28 B. T. A. 348 (1933); *cf.* Virginia Iron, Coal & Coke Co., 29 B. T. A. 1087 (1934) (income results in the year in which the bonds are cancelled and retired rather than the year in which they were purchased).

[4] Montana, W. & S. R. R., 31 B. T. A. 62 (1935).

[5] Montana, W. & S. R. R., v. Commissioner, 77 F. (2d) 1007 (C. C. A. 3d, 1935).

[6] Garland Coal & Mining Co. v. Helvering, 75 F. (2d) 663, 664 (App. D. C. 1935).

[7] U. S. Treas. Reg. 94, Art. 22(a)-18(c).

test for determining whether there has been an extinguishment of the debt, and attention is directed to the question whether the obligation has in fact been discharged, regardless of the form the extinguishment takes, then the new regulations will be given proper effect.

The second ground of decision was that there had been no freeing of assets of the debtor by the extinguishment of the debt and therefore no taxable income by the discharge of the debt at less than its face value. This point presents a difficult problem in income tax law. In 1926 the United States Supreme Court held, in *Bowers v. Kerbaugh-Empire Co.*,[8] that the discharge of a debt by payment in depreciated currency did not result in taxable gain because the money originally borrowed had been lost in the transaction in which it was used. Shortly thereafter, in *Independent Brewing Co.*,[9] the Board of Tax Appeals, basing its decision on the *Kerbaugh-Empire Co.* case, ruled that no taxable income was derived from the repurchase by the taxpayer of its own bonds at less than par value, in spite of a treasury regulation to the contrary,[10] for the financial condition of the taxpayer was such that "whether or not it will ever be able to pay the balance of them [its debts] is uncertain."[11] Citing these two cases as precedent, the Board of Tax Appeals for a number of years ignored both the treasury regulation and the circumstances in the two cases, and followed the flat proposition that a repurchase of bonds by the issuer at a discount does not result in taxable income.[12] In 1931, however, the Supreme Court gave effect to the treasury regulation and in *United States v. Kirby Lumber Co.*[13] decided that, under certain circumstances, income may be derived from such a repurchase. The *Kerbaugh-Empire*

[8] 271 U. S. 170, 46 Sup. Ct. 449, 70 L. ed. 886 (1926). For a discussion of the district court decision, see (1925) 25 COL. L. REV. 110; (1925) 34 YALE L. J. 334.

[9] 4 B. T. A. 870 (1926).

[10] U. S. Treas. Reg. 45, Art. 544. The same provision has appeared in all subsequent regulations: U. S. Treas. Reg. 62, Art. 545; U. S. Treas. Reg. 65, Art. 541; U. S. Treas. Reg. 69, Art. 541; U. S. Treas. Reg. 74, Art. 68; U. S. Treas. Reg. 77, Art. 68; U. S. Treas. Reg. 94, Art. 22.

[11] 4 B. T. A. 870, 874 (1926).

[12] New Orleans, T. & M. Ry., 6 B. T. A. 436 (1927); Houston B. & T. Ry., 6 B. T. A. 1364 (1927); Indianapolis Street Ry., 7 B. T. A. 397 (1927); National Sugar Mfg. Co., 7 B. T. A. 577 (1927); Petaluma & S. R. R. R., 11 B. T. A. 541 (1928); General Manifold & Printing Co., 12 B. T. A. 436 (1928); Douglas County Light & Water Co., 14 B. T. A. 1052 (1929); Eastern S. S. Lines, Inc., 17 B. T. A. 787 (1929); North American Mortgage Co., 18 B. T. A. 418 (1929); Kirby Lumber Co., 19 B. T. A. 591 (1930); American Tobacco Co., 20 B. T. A. 586 (1930); Houghton & Dutton Bldg. Trust, 20 B. T. A. 591 (1930); Boulevard Bldg. Co., 21 B. T. A. 864 (1930); Norfolk Southern R. R., 22 B. T. A. 302 (1931); Chicago & Northwestern Ry., 22 B. T. A. 1407 (1931); New York, C. & S. L. R. R., 23 B. T. A. 177 (1931); Terre Haute, Indianapolis & Eastern Traction Co., 24 B. T. A. 197 (1931); Consolidated Gas Co. of Pittsburgh, 24 B. T. A. 331 (1931); see American Seating Co., 14 B. T. A. 328, 337 (1928).

[13] 284 U. S. 1, 52 Sup. Ct. 4, 76 L. ed. 131 (1931), (1932) 32 COL. L. REV. 137, (1932) 45 HARV. L. REV. 744, (1932) 6 ST. JOHN'S L. REV. 415, (1932) 6 U. OF CIN. L. REV. 357.

Co. case was distinguished on its facts, the court saying that there the "transaction as a whole was a loss" while here "there was no shrinkage of assets".[14]

A situation somewhat analogous to the repurchase of bonds at less than face value is the forgiveness or cancellation in whole or in part of a debt owed by the taxpayer.[15] The Board of Tax Appeals, prior to the *Kirby* case, held that such a cancellation did not result in income to an insolvent taxpayer;[16] but, while the only cases decided involved insolvent taxpayers, both the board, by implication,[17] and the Circuit Court of Appeals for the Tenth Circuit, by affirmative statement,[18] recognized the fact that a distinction requiring a different result should be made in the case of a *solvent* debtor.

The cases decided since the *Kirby Lumber Co.* case are difficult to reconcile. There seems to be little doubt that there is no actual gain, and therefore no taxable income, where an insolvent obligor is discharged from his obligation, for he would have been unable to pay anyway.[19] And where the obligor is in good financial condition and has

[14] 284 U. S. 1, 3, 52 Sup. Ct. 4, 76 L. ed. 131, 133 (1931). But the proposition that income does not result where the "transaction as a whole" is a loss, where the entire transaction covers a period of several years, was apparently repudiated by the Supreme Court the year before *United States v. Kirby Lumber Co.* was decided. In Burnet v. Sanford & Brooks Co., 282 U. S. 359, 51 Sup. Ct. 150, 75 L. ed. 383 (1931), (1930) 43 HARV. L. REV. 962, the taxpayer entered into a dredging contract with the Federal Government. It suffered losses on the contract during 1913, 1914, 1915, and 1916, and brought suit against the Government for damages for breach of warranty as to the character of the material to be dredged. A recovery equal to the amount of the losses suffered was had in 1920, and the Court held this amount to be a taxable gain for that year.

[15] Yet another similar situation is the writing off of obligations for mere bookkeeping purposes, the obligations not being actually discharged. Where, for instance, uncollected wages are transferred to a profit and loss account after two or three years, it has been held that income resulted in the year the transfer was made, even though the obligation was not barred by the Statute of Limitations. Chicago, R. & I. Ry. v. Commissioner, 47 F. (2d) 990 (C. C. A. 7th, 1931); Charleston & W. C. Ry. v. Burnet, 50 F. (2d) 342 (App. D. C. 1931).

[16] Meyer Jewelry Co., 3 B. T. A. 1319 (1926); John F. Campbell Co., 15 B. T. A. 458 (1929), *aff'd*, 50 F. (2d) 487 (App. D. C. 1931); Simmons Gin Co., 16 B. T. A. 793 (1929) *aff'd*, 43 F. (2d) 327 (C. C. A. 10th, 1930); Eastside Mfg. Co., 18 B. T. A. 461 (1929); Progress Paper Co., 20 B. T. A. 234 (1930); Herman Senner, 22 B. T. A. 655 (1931); *cf.* Smith Insurance Service, Inc., 9 B. T. A. 284 (1927) (forgiveness of debt owed by corporation to stockholder held to be a gift rather than income); Ida L. Dowling, 13 B. T. A. (1928) (cancellation of debt owed by stockholder to corporation held to be payment of a dividend, and therefore taxable as income).

[17] Meyer Jewelry Co., 3 B. T. A. 1319, 1322 (1926); John F. Campbell Co., 15 B. T. A. 458, 459 (1929); Eastside Mfg. Co., 18 B. T. A. 461, 465 (1929); Progress Paper Co., 20 B. T. A. 234, 236 (1930); Herman Senner, 22 B. T. A. 655, 658 (1931).

[18] Commissioner v. Simmons Gin Co., 43 F. (2d) 327, 329 (C. C. A. 10th, 1930).

[19] Dallas Transfer & Terminal Warehouse Co. v. Commissioner, 71 F. (2d) 95 (C. C. A. 5th, 1934); E. B. Higley & Co., 25 B. T. A. 127 (1932); Towers & Sullivan Mfg. Co., 25 B. T. A. 922 (1932); Porte F. Quinn, 31 B. T. A. 142 (1934); Madison Ry., 36 B. T. A. 1106 (1937); *cf.* Lakeland Grocery Co., 36 B. T. A. 289 (1937), where it was held that income resulted from the cancella-

suffered no losses in the transaction in which the borrowed money was used, the discharge of the obligation seems clearly to be income.[20] But where the discharged obligor, while not actually insolvent, is in bad financial condition, or has lost the money borrowed so that the discharge of the obligation is really merely a "diminution of a loss", rather than an actual gain, the courts find it difficult to determine whether to apply the *Kirby* case or the *Kerbaugh-Empire Co.* case.

The first question to arise under the language of the *Kirby* case is what is meant by a "shrinkage of assets". Does it refer to all the assets owned by the taxpayer or only those purchased with the proceeds of the bonds and which perhaps are also security for the bonds? Whether the debt is secured by the particular assets or not, it is still a general obligation of the taxpayer and when it is discharged for less than its face value the debit entry on the taxpayer's books is eliminated, and this is done by the application of a less amount from the assets side than if the debt had been discharged by the full amount called for. The assets so freed from the claim of this debt are treated as taxable income. This is the view taken in *Consolidated Gas Co.*,[21] where the proceeds of the bonds were used in 1898 to start the taxpayer in the business of manufacturing and selling gas to consumers in Pittsburgh. At the time of the repurchase of the bonds in 1921 and 1922 the equipment used in the manufacture of gas had become almost entirely worthless because of the availability of natural gas. The Board of Tax Appeals held that there was no shrinkage of assets within the meaning of the *Kirby* case. There was a shrinkage in value of the particular assets acquired with the proceeds of the bonds, but otherwise the taxpayer was a solvent and going concern. In *B. F. Avery & Sons, Inc.*,[22] the board again refused to find a shrinkage of assets where notes given by the taxpayer were cancelled upon the discovery of the fact that the machinery for the purchase of which they were given

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tion of an insolvent taxpayer's debt because he became solvent immediately after, and as a result of, the cancellation; Walker v. Commissioner, 88 F. (2d) 170 (C. C. A. 5th, 1937), where solvency as of the time the debt is forgiven, rather than time when agreement to forgive is made, was held to be controlling.

[20] Helvering v. American Chicle Co., 291 U. S. 426, 54 Sup. Ct. 460, 78 L. ed. 891 (1934) (burden on taxpayer to show that the transaction was a loss); Garland Coal & Mining Co. v. Helvering, 75 F. (2d) 663 (App. D. C. 1935); Briarcliff Investment Co. v. Commissioner, 90 F. (2d) 330 (C. C. A. 5th, 1937); Woodward Iron Co., 24 B. T. A. 1050 (1931); Suncrest Lumber Co., 25 B. T. A. 375 (1932); B. F. Avery & Sons, Inc., 26 B. T. A. 1393 (1933); Twin Ports Bridge Co., 27 B. T. A. 346 (1932).

The obligation discharged must have been a liability which could have been deducted from gross income, however, for income to result. Commissioner v. The Rail Joint Co., 61 F. (2d) 751 (C. C. A. 2d, 1932) (where corporation issued dividend in the form of bonds and later repurchased some of the bonds at a discount, *held*, not income), (1933) 7 ST. JOHN'S L. REV. 366, (1933) 81 U. OF PA. L. REV. 777, (1933) 42 YALE L. J. 791.

[21] 24 B. T. A. 901 (1931).

[22] 26 B. T. A. 1393 (1932).

was defective, and held that such cancellation constituted income to the taxpayer. This might properly have been treated as a reduction in the purchase price.[23] In the principal case the court did not expressly say that there was a shrinkage of assets within the meaning of the *Kirby* case, but it stressed the fact that the railroad property—which was the only property owned by the taxpayer—had become almost valueless at the time the bonds were repurchased, and hence that no taxable gain was derived. This view is inconsistent with the *Consolidated Gas Co.* case if the chief consideration is the value of the particular assets acquired with the proceeds of the loan, but if the focal point is the net position of the taxpayer, as it seems to be, the two decisions are not contradictory.

The determination of when "the transaction as a whole" is a loss is also confusing. Under the holding in *Bowers v. Kerbaugh-Empire Co.* the "transaction" apparently includes the borrowing of the money, the investment of it in a losing enterprise, and the discharge of the obligation at less than face value. The *Kirby* case speaks of these three separate and distinct transactions as the "transaction as a whole" and the attempts of the courts to apply this language have led to varied results. In the *Consolidated Gas Co.* case the proceeds of the bond issue were employed in the acquisition of property which was used for many years in the business of the taxpayer, but which had become worthless at the time of the repurchase of the bonds. The board—looking, apparently, at the business of the taxpayer over a period of years—said that the repurchase of the bonds resulted in income because the "petitioner did not lose the money in an unsuccessful enterprise . . . and may never suffer any loss even though its properties had shrunk in value at the time when the bonds were repurchased."[24] In the principal case the entire property of the taxpayer was worthless at the time the bonds were repurchased, and the court stressed this fact. In *B. F. Avery & Sons, Inc.*, where the creditor cancelled part of the amount owed on the purchase price after it was discovered that the machinery was defective, the board held that the transaction as a whole did not result in a loss. This is explicable only on the assumption that the board was looking at the entire business operations of

[23] In Des Moines Improvement Co., 7 B. T. A. 279 (1927), the taxpayer employed a contractor to construct certain buildings, the contract providing that, upon the completion and acceptance of the buildings, the taxpayer should execute mortgages to the contractor totaling $45,000. The contractor ran short of cash before the completion of the buildings and induced the taxpayer to execute the mortgages in order that he might use them as collateral to facilitate the procuring of loans. He was unable to use them in this fashion, however. After completion and acceptance of the buildings, the contractor cancelled the mortgages upon payment by the taxpayer of $33,200 cash. The Board of Tax Appeals held this to be a reduction of the contract price, and not income.

[24] 24 B. T. A. 901, 905 (1931).

the taxpayer. In *Carlisle Packing Co.*[25] a corporation borrowed various sums over a period of years in order to continue in business. It continued to lose money each year. Finally it transferred $346,000 worth of its property to its creditor,[26] which cancelled $650,000 of the debt. The board held this to be taxable income. Apparently the taxpayer retained other properties, although the board opinion contains no statement of the financial condition of the taxpayer after the transfer.

It would seem that under the *Kerbaugh-Empire Co.* case, in which the money was lost in the performance of construction contracts by one of the taxpayer's subsidiaries, the test is whether the borrowed money was ear-marked and used in a particular enterprise even though this constituted only a part of the taxpayer's business operations.[27] Under this test, however, the *Consolidated Gas Co.* case and the principal case should have reached the same result, for in both cases the proceeds of the bond issue were employed in the acquisition of all the property used by the taxpayer in the general conduct of its business. And the result in *B. F. Avery & Sons, Inc.,* belies the test, for there the debt was incurred in the acquisition of particular pieces of machinery. Nor does the test explain the result in *Carlisle Packing Co.,* where the borrowed money was used to finance current business operations. Although the board and the courts speak in terms of "the transaction as a whole," they apparently consider only the net financial position of the taxpayer after the discharge of the obligation, and disregard the actual gain or loss in the particular transaction. The expression "the transaction as a whole" in the *Kirby Lumber Co.* case needs clarification if there is going to be an end to the confusion which now exists.

It is obvious from the many distinctions that no set rule can be formulated for determining when the discharge of an obligation results in income which will insure an equitable result in all cases. In addition to the points already mentioned, the rule in *Bowers v. Kerbaugh-Empire Co.* has further objectionable features. In the first place, if the transaction takes place over a number of years, and the discharge of the obligation takes place before it is completed, it is impossible to ascertain at the time whether the result is going to be a gain or a loss, and any decision must be a mere guess based on the circumstances of the particular case.[28] In the second place, the incurring

[25] 29 B. T. A. 514 (1933).

[26] The board has held that the discharge of a debt with property (in this case, stock of another corporation) costing less than the amount of the debt results in a taxable gain. Twin Ports Bridge Co., 27 B. T. A. 346 (1932).

[27] MAGILL, TAXABLE INCOME (1936) 225, 226.

[28] See Commissioner v. Coastwise Transportation Corp., 71 F. (2d) 104 (C. C. A. 1st, 1934), in which the court held that the repurchase of serial notes at a discount resulted in a gain, even though it was apparent that the taxpayer

and subsequent discharge of the obligation, and the use to which the money or property for which the obligation was incurred is put, may be entirely separate transactions. The gain or loss in each transaction should be determined separately and as of the date each takes place.[29] The law as it stands today leaves the taxpayer bewildered. Either a set rule should be adopted to the effect that the discharge of an obligation at less than face value results in income only where the debtor is clearly solvent, or else all rules and catch-phrases should be ignored[30] and gain or loss determined from a mathematical view of the circumstances in each individual case. Under the former alternative inequitable results will be reached in some cases, while under the latter the taxpayer will never actually know whether he has had a gain or a loss until the court has decided his particular case; but under the present situation both of these evils exist simultaneously, and one or the other should be eliminated.

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would eventually suffer a loss on the property for which the notes had been given in payment. This is apparently *contra* to the principal case.

[29] For a detailed discussion of this point, see note (1931) 40 YALE L. J. 960.

[30] The undesirability of throwing away all rules is obvious, but the cases discussed show clearly that any rule sufficiently broad to cover all situations would in fact be no rule at all.