NORTH CAROLINA LAW REVIEW

Volume 37 | Number 3 Article 5

4-1-1959

Notes and Comments

North Carolina Law Review

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Recommended Citation

North Carolina Law Review, *Notes and Comments*, 37 N.C. L. Rev. 317 (1959).
Available at: http://scholarship.law.unc.edu/nclr/vol37/iss3/5

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NOTES AND COMMENTS

Admiralty—Limitation of Liability—Vessel Cast Ashore by Act of God

In the recent case of *Wong v. Utah Home Fire Ins. Co.*,[1] a federal district court denied a petition for limitation of liability where a private vessel had been cast by a tidal wave onto the plaintiff's property. The defendant insurance company declared the boat a total loss, refused to let the boat owner accept an offer he had for removal, took an assignment of salvage rights, and thereafter made attempts to sell the hulk. Upon defendant's refusal to remove the wreck, plaintiff landowner brought an action for removal and for trespass damages resulting from the failure to remove. Defendant's petition for limitation was denied upon procedural grounds;[2] however, this Note will be limited to the substantive issue of the right to limit liability where a vessel is cast ashore by an Act of God.

Limitation of liability is a federally created right[3] over which the admiralty courts have exclusive jurisdiction.[4] Basically, it enables a shipowner to limit his liability to the value of his ship and pending freight[5] after the complained of incident,[6] where, without privity or knowledge[7] of the owner, his vessel causes personal injury or property damage to another. This limitation is permitted even though the shipowner may be fully indemnified through insurance for the loss of his vessel.[8] Although the original purpose of the limitation doctrine was to foster the commerce and business of the sea,[9] it is now settled that the

[1] 167 F. Supp. 230 (D. Hawaii 1958).

[2] The defendant had failed to comply with Admiralty Rule 51, 28 U.S.C. § 2073 (1952) and 49 STAT. 1480 (1936), 46 U.S.C. § 185 (1952), requiring the petitioner to pay into court, or transfer to a trustee, the minimum value of his interest in the vessel.

[3] REV. STAT. §§ 4283-89 (1875), 46 U.S.C. §§ 183-89 (1952).

[4] Langes v. Green, 282 U.S. 531 (1931); *In re* Great Lakes Transit Corp., 63 F.2d 849 (6th Cir. 1933); The Aloha, 56 F.2d 647 (W.D. Wash. 1932).

[5] Pending freight refers to the earnings of the voyage. The Black Eagle, 87 F.2d 891, 894 (2d Cir. 1937).

[6] City of Norwich v. Norwich & N.Y. Transp. Co., 118 U.S. 468 (1886); The C. F. Coughlin, 25 F. Supp. 649 (W.D.N.Y. 1938).

[7] "The privity or knowledge that excludes the operation of this section must be actual, in the sense of knowledge or authorization, or immediate control of the wrongful acts or conditions, or through some kind of personal participation in them." The Oneida, 282 Fed. 238, 241 (2d Cir. 1922). For a discussion of this term and its applicability, see GILMORE AND BLACK, ADMIRALTY §§ 10-20 to -26 (1957).

[8] City of Norwich v. Norwich & N.Y. Transp. Co., 118 U.S. 468 (1886); The Pere Marquette 18, 203 Fed. 127 (E.D. Wis. 1913).

[9] Moore v. American Transp. Co., 65 U.S. (24 How.) 1 (1861).

privilege extends to the owners of pleasure yachts and other water craft.[10]

The doctrine of limitation of liability is equally applicable whether the damages are consummated on land[11] or on navigable waters, and regardless of the location of the ship causing the damage.[12] The courts have reasoned that the exercise of the privilege is no longer dependent on whether the tort is maritime or nonmaritime, but rather is a privilege given to all shipowners ipso facto, and it is not required that the plaintiff's cause of action be grounded in admiralty for the shipowner to avail himself of this privilege.[13]

Since the privilege of limitation is available to all shipowners, there would appear to be no question of its availability to a defendant whose ship had been negligently navigated or cast upon a plaintiff's property causing damages thereon. Defendant would, of course, be liable for the trespass damage, *but only* to the extent of his limited liability so long as the trespass was without privity or knowledge. However, once the unabandoned vessel is on plaintiff's property and there has been an unheeded demand for removal, defendant is precluded from limiting his liability for damages occurring after the demand because the damages are now caused with privity or knowledge of the owner.[14]

The preceding background has involved situations where there was an existing liability on the boatowner, and the question was whether this should have been a limited liability. Since it is generally accepted that there is no liability for the Acts of God,[15] and since the initial damages in the principal case were caused by an Act of God, it is clear that there was no liability on the boatowner for the original damage. Thus the question presented by *Wong* is whether there is a liability

[10] Petition of Liebler, 19 F. Supp. 829 (W.D.N.Y. 1937); 49 STAT. 1480 (1936), 46 U.S.C. § 188 (1953).

[11] Richardson v. Harmon, 222 U.S. 96 (1911) (barge collided with the abutment of a railroad drawbridge). The Irving F. Ross, 8 F.2d 313 (D. Mass. 1923) (ashes from a barge impaired the flow of a factory's drainage pipes).

[12] In two relatively recent cases the vessels were in winter storage, on land, and caused injuries when they exploded while agents of the owners were performing maintenance on them. In the Matter of Colonial Trust Co., 124 F. Supp. 73 (D. Conn. 1954); The Trim Too, 39 F. Supp. 271 (D. Mass. 1941).

[13] BENEDICT, AMERICAN ADMIRALTY § 116 (6th ed. 1940).

[14] *In re* Pennsylvania R.R., 48 F.2d 559 (2d Cir.), *cert. denied,* 284 U.S. 640 (1931). In this case a barge which had negligently broken loose washed ashore and was causing damage to a boardwalk. The barge owners, although still claiming title, made no effort to remove the barge for four days after notice was given to them, and the court held that they consequently had lost the right to limit liability.

[15] In Louisville Ry. v. Sweeney, 157 Ky. 620, 163 S.W. 739 (1914), it was said that one who trespasses upon another and inflicts an injury is liable for the injury unless caused by the Act of God or produced by causes beyond his control. "A tornado lifts A's properly constructed house from A's land and deposits it on B's land. This is not a trespass." RESTATEMENT, TORTS § 158, comment *e*, illustration (2) (1934).

arising after knowledge of the results of this Act of God, and if so, can it then be limited.[16]

It has been held that an owner of goods may abandon them when they have been cast onto another's property by an inevitable accident.[17] It has likewise been held that the landowner has the right to remove goods so placed on his property, and that upon the chattel owner's *reclaiming* them there arises an implied contract to pay for the cost of such removal.[18] In *Livezey v. Philadelphia*,[19] a case similar to the principal case, but one in which the right to limit liability was not at issue, the position was taken that even for a failure to remove after notice it was not essential to immunity that the chattel owner or his vendee should abandon their interest in the chattel. In that case a bridge had washed onto the plaintiff's land as a result of a flood, and the court, in recognizing that there was an assertion of a claim to the property, said that neither the chattel owner nor his vendee could create a liability for a wrong which they had not committed, and for the consequences of which they could not have been made originally to answer.

The court in the principal case, by dictum, took a position diametrically opposed to the *Livezey* case and indicated that an abandonment would have been necessary to immunity from a subsequent trespass liability. It was reasoned that the defendant had exercised such dominion and control over the wreck that its claim for abandonment could not be sustained, and that it had become a purchaser of the wreck in its then existing condition. It seems to follow that the defendant, with full knowledge of the surrounding circumstances, assumed a duty of removal and consequent responsibility for the trespass damages resulting from the failure to remove. Thus it appears that the defendant assumed the subsequent liability with privity or knowledge as to bar the right to limit liability.

[16] The duty and obligation of a shipowner to remove sunken or wrecked vessels from *navigable waters* is specifically covered by a federal statute and has no apparent bearing to the problem at hand. The Wreck Act, 30 STAT. 1152 (1894), 33 U.S.C. § 409 (1953). This act provides that when a vessel is sunk or wrecked in navigable waters the owner shall mark it, and must maintain such marks until the sunken craft is removed or abandoned; a failure to prosecute immediate removal will be construed as an abandonment. In Petition of Highlands Nav. Corp., 29 F.2d 37 (2d Cir. 1928), the vessels in question had sunk by a pier in navigable waters without fault of the owner. A city ordinance required shipowners to remove such sunken or abandoned vessels or else the city would do it and assess the costs against the owners. It was held that the Wreck Act recognized the right of abandonment given by the general maritime law and that the owner intending to abandon could not be held liable for the cost of raising after abandonment. *Accord*, City of Newark v. Mills, 35 F.2d 110 (3d Cir. 1929), *cert. denied*, 281 U.S. 722 (1930); The Central States, 9 F. Supp. 934 (E.D.N.Y. 1935).

[17] Forster v. Juniata Bridge Co., 16 Pa. 393 (1851). See also, Annot., 41 A.L.R. 1015 (1926).

[18] Tome v. DuBois, 73 U.S. (6 Wall.) 548 (1867). See also, Annot., 55 Am. Dec. 508 (1886).

[19] 64 Pa. 106 (1870).

There is an appalling lack of authority on the problem of whether there can be a subsequent liability on an owner of chattels cast ashore by an Act of God. Regardless of how this problem is resolved it does not appear that the case will be ripe for a limitation of liability. If there is a subsequent liability the defendant will be faced with privity or knowledge; if there is not a liability there is no cause to limit.[20]

WALTON K. JOYNER

Corporations—Corporate Action for Mismanagement Precluded Where Sole Stockholder Has No Standing in Equity to Sue

Park Terrace, Inc. v. Burge,[1] a recent case of first impression, has added a third decision to the *Park Terrace* litigation.[2] In the present case the two defendants had been original shareholders of Park Terrace, Inc. The capital structure of the corporation provided that one class of stock would be called "preferred." All the shares of this class were held by the Federal Housing Administration.[3] In addition there were two other classes of stock, Class A and Class B. The Class B

[20] "The doctrine of limitation of liability presupposes that a liability exists which is to be limited, but if no liability exists, there is nothing to limit." In the Matter of Cherokee Trawler Corp., 157 F. Supp. 414, 419 (E.D. Va. 1957).

[1] 249 N.C. 308, 106 S.E.2d 478 (1959). Action was commenced on November 3, 1953.

[2] The first case, Lester v. McLean, 242 N.C. 390, 87 S.E.2d 886 (1955), involved a claim of alleged fraud raised by McLean as a defense to an action brought by the two defendants in the principal case to recover the purchase price of the Class A stock. The court found that there had been no fraud and rendered judgment against McLean.

The second case, Park Terrace, Inc. v. Phoenix Indem. Co., 241 N.C. 473, 85 S.E.2d 677 (1955), *remanded on rehearing*, 243 N.C. 595, 91 S.E.2d 584 (1956), concerned an action brought by the corporation against a building construction company owned by the two defendants in the principal case for alleged failure to build the housing in accordance with FHA specifications. On rehearing the court handed down a unique opinion stating that the legal entity of the corporation was suspended when the number of stockholders was reduced to less than three. This decision was widely criticized. Latty, *A Conceptualistic Tangle and the One- and Two-Man Corporation*, 34 N.C.L. REV. 471 (1956). After this decision the North Carolina Legislature enacted a statute which provided that the existence of a corporation was not impaired by the acquistion of all the shares by one or two persons. N.C. GEN. STAT. § 55-3.1 (Supp. 1957). N.C. Sess. Laws 1957, ch. 550, § 3½, in referring to the amending act, provides: "This Act shall not affect adjudicated rights." In light of this provision, it seems possible to argue that the legal entity of Park Terrace, Inc. was suspended for all purposes by the decision in Park Terrace, Inc. v. Phoenix, *supra*, and thus that the "corporation" would have no standing to bring this present action. However, it is submitted that § 3½ was included only to preclude relitigation by the "corporation" against Phoenix, and was not intended to affect its status with respect to other rights. Thus, Park Terrace, Inc. would be deemed to have had "uninterrupted existence and to have possessed uninterrupted capacity to act as a corporation" in all respects, limited only by the fact that the corporation's rights have been adjudicated as against Phoenix.

[3] In this manner FHA could step in and control the corporation in the event of default in the mortgage which it insured. Upon payment of the mortgage debt, the preferred stock could be redeemed at any time by the corporation.

stock was called common stock, but in fact it was set up with the characteristics of preferred.[4] Under the charter the Class A was the only true common stock, and it was given exclusive voting privileges.[5] Each of the defendants owned one third of the A stock, and both of them were directors of the corporation. The remaining A stock was held by another party who was the third director. In 1950,[6] the two defendants also held all the outstanding shares of Class B stock, the subscription price of which had never been fully paid. Pursuant to a unanimous vote by the directors, the corporation repurchased and cancelled all the outstanding B stock for an amount in excess of the original par value subscription price.[7] Circumstances indicated that the payment of this price was against the best interests of the corporation. Subsequently, in 1951, McLean inspected the corporate properties and purchased all of the Class A common stock.

This action was brought in the name of the corporation to recover the entire amount paid to defendants for repurchase of their B stock. Plaintiff alleged that the defendants, as former directors, had breached their fiduciary duty to the corporation. No creditors' rights were involved. FHA, the preferred stockholder, was not a party to this action and had never complained of any of the defendants' activities.[8] At the close of the plaintiff's evidence, the defendants' motion for nonsuit was granted. On appeal, the court affirmed. The court held that where, for several reasons, the sole shareholder is prohibited from bringing a derivative action, the corporation itself may not maintain the

[4] The Class B stock was given preferences both as to liquidation and to dividends, while it was deprived of any voting rights.

[5] These voting rights were subject, however, to the right of FHA to assume exclusive voting control should the corporation ever be in default in its mortgage payments.

[6] The facts in this case arose under the old North Carolina Corporation Act. However, there appears to be no change in the new act that would modify the rationale of the principal case. Logically, then, a similar cause of action arising after July 1, 1957, would be treated in the same manner.

[7] The repurchase price paid by the corporation was $221,000. This was $27,558 more than the par value of the stock. See Park Terrace, Inc. v. Burge, 249 N.C. 308, 311, 106 S.E.2d 478, 480 (1959). In their brief, defendants claim that the price paid to them was not excessive because they had given the corporation land appraised at a value of $60,000 in return for stock with a par value of only $23,660; also because the construction company owned by defendants had made two voluntary reductions in the contract price for the buildings totalling $146,774. Brief for Appellee, p. 10. However, it is interesting to note that defendants, acting as directors, refused to repurchase for an offered price of $500 the 70,151 shares of B stock (par value of $70,151) which had been given to the architect in partial payment for his services. Subsequently, defendants individually bought the stock for $500, and these shares were included in the stock which was later sold to the corporation for a price in excess of par value. These facts point to the underlying philosophical problem involved in the *Park Terrace* litigation, *i.e.*, the intrinsic difficulty of applying a corporation act, designed to regulate large widely held corporations, to a small close corporation.

[8] The record of the trial court discloses that FHA was at all times informed as to the stock transactions and financial status of the corporation. Record, pp. 48-53.

cause of action in its own name since all proceeds recovered by it would inure to the benefit of the ineligible shareholder.[9]

In disregarding the separate corporate entity, the court relied heavily upon the leading case of *Home Fire Ins. Co. v. Barber*,[10] which sets forth the following doctrine:

> When a corporation comes into equity and seeks equitable relief, we ought to look at the substance of the proceeding, and, if the beneficiaries of the judgment sought have no standing in equity to recover, we ought not to become befogged by the fiction of corporation individuality, and apply the principles of equity to reach an inequitable result.[11]

It appears from the decision in the principal case that the *Home Fire* doctrine has been unequivocably adopted in this jurisdiction. It becomes important, therefore, to examine the conditions which rendered the sole shareholder in the principal case so devoid of any standing in equity that suit by the corporation was precluded in order to prevent his indirect participation in the recovery. These conditions were: (1) McLean was not a stockholder at the time of the transaction on which the claim is based, (2) he had obtained his shares by voluntary purchase and not by operation of law, (3) the stock that McLean held was "guilty" stock, the former owners of which had participated in the alleged wrong. In addition to these three disqualifying factors, the action was not brought by the corporation for the benefit of creditors or for the purpose of asserting or endeavoring to protect a title to property, but solely as a suit in equity as the representative of its sole stockholder.[12]

It is a well established rule that one who was not a stockholder at the time of the transaction of which he complains has no standing to bring a derivative action in the federal courts.[13] This limitation, known

[9] At the outset of its opinion, the court stated: "Therefore, the plaintiff corporation had no stockholders with voting rights other than those who as officers and directors authorized the purchase by the corporation of the B stock from these defendants. Consequently, it would seem that neither the plaintiff corporation nor the holders of the A stock could thereafter attack the validity of the transaction unless the corporation in doing so was acting in behalf of creditors." 249 N.C. at 312, 106 S.E.2d at 481. This would imply that no wrong had ever been done to the corporation. However, the court did not decide the case on this ground, but based its decision upon the rationale that the lack of equitable standing on the part of the sole shareholder precluded suit in the corporate name regardless of the merits of the question as to whether or not the corporation had ever been wronged.

[10] 67 Neb. 644, 93 N.W. 1024 (1903).

[11] *Id.* at 669, 93 N.W. at 1033.

[12] When the corporation sues upon legal titles or rights, the distinction of entities is observed, but when it sues upon equities of the whole body of stockholders the courts look to their equities. FLETCHER, PRIVATE CORPORATIONS § 41 (perm. ed. 1931).

[13] This rule was originally established to prevent collusive transfers in order to get a corporate controversy into a federal court on the ground of diversity of citizenship. DOBIE, FEDERAL PROCEDURE § 175 (1928); 25 VA. L. REV. 100 (1938).

as the contemporaneous ownership rule, was inaugurated by the federal courts in the case of *Hawes v. Oakland*,[14] and has since been enacted into Federal Rule of Civil Procedure 23(b).[15] A number of states have passed similar statutes,[16] and several states have adopted the rule by way of decisional law.[17] North Carolina has sometimes been included in this latter classification by text writers.[18] However, this would seem to be erroneous since the precise question has never been directly passed on in this jurisdiction.[19]

In some states the rule is well settled that a stockholder may bring a derivative action even though he purchased his shares after the transaction complained of.[20] It is not certain as to which is the majority view because many of the cases in which the contemporaneous ownership rule is said to apply have rested upon fundamental principles of equity,[21] and the shareholder could have been precluded from maintaining the suit—because of participation, acquiescence, estoppel or laches—without relying on the theory that the shareholder was barred merely because his stock was purchased subsequent to the alleged wrong.

One New York case[22] has gone so far as to extend the contemporane-

[14] 104 U.S. 450 (1881).

[15] Authorities have held that rule 23(b) is procedural rather than substantive. FLETCHER, PRIVATE CORPORATIONS § 5943 (perm. ed. 1943).

[16] *E.g.*, 24 CALIF. CORP. CODE § 834; 4 DEL. CODE ANN. tit. 8, § 327 (1953); N.J. STAT. ANN. § 14:3-16 (Supp. 1958); PA. STAT. ANN. tit. 12, § 1321 (1953).

[17] Boldenwick v. Bullis, 40 Colo. 253, 90 Pac. 634 (1907); News-Journal Corp. v. Gore, 147 Fla. 217, 2 So. 2d 741 (1941); Alexander v. Searcy, 81 Ga. 536, 8 S.E. 630 (1889); Goldberg v. Ball, 305 Ill. App. 273, 27 N.E.2d 575 (1940); Clark v. American Coal Co., 86 Iowa 436, 53 N.W. 291 (1892); Jepsen v. Peterson, 69 S.D. 388, 10 N.W.2d 749 (1943); Pitcher v. Lone Pine Surprise Consol. Min. Co., 39 Wash. 608, 81 Pac. 1047 (1905).

[18] Sykes, *Right of Stockholder To Attack Transactions Occurring Prior to His Acquisition of Stock*, 4 MD. L. REV. 380, at 381 (1940).

[19] The derivative action involving this problem, Moore v. Mining Co., 104 N.C. 534, 10 S.E. 679 (1889), was ultimately decided on the grounds that the party seeking to bring the action was not shown to be a bona fide stockholder and was also charged with laches.

In the principal case the court quotes as follows from the *Home Fire* decision: '[A] purchaser of stock cannot complain of prior acts and management of the corporation. . . .' 249 N.C. at 314, 106 S.E.2d at 482. However, this can only be construed as dictum, and it appears that purchase of the stock subsequent to the wrong was of no more than secondary importance among the several circumstances which precluded suit by the corporation because of the lack of equitable standing on the part of the sole shareholder.

[20] Parsons v. Joseph, 92 Ala. 403, 8 So. 788 (1891); Just v. Idaho Canal & Improvement Co., 16 Idaho 639, 102 Pac. 381 (1909); Mason v. Carrothers, 105 Me. 392, 74 Atl. 1030 (1909); Forrester v. Mining Co., 21 Mont. 544, 55 Pac. 229 (1898); North v. Union Sav. & Loan Ass'n, 59 Ore. 483, 117 Pac. 822 (1911); Roberson v. Draney, 53 Utah 263, 178 Pac. 35 (1919); Bank of Mill v. Elk Horn Coal Co., 133 W.Va. 639, 57 S.E.2d 736 (1950).

[21] *E.g.*, Boldenwick v. Bullis, 40 Colo, 253, 90 Pac. 634 (1907) (transferor had participated in the wrong, and laches); Alexander v. Searcy, 81 Ga. 536, 8 S.E. 630 (1889) (acquiescence and laches); Home Fire Ins. Co. v. Barber, 67 Neb. 644, 93 N.W. 1024 (1903) (transferor had participated in the wrong).

[22] Capital Wine and Spirit Corp. v. Porkrass, 277 App. Div. 184, 98 N.Y.S.2d 291 (1st Dep't 1950), *aff'd without opinion*, 302 N.Y. 734, 98 N.E.2d 704 (1951).

ous ownership rule to bar a suit by the corporation itself. This decision has been severely criticized.[23] The concurring opinion[24] of the presiding justice seems to have based the result of the decision upon the more logical ground that the sole shareholder had bought the corporation on the basis of disclosed assets, and to permit the corporation to sue under these circumstances would be inequitable in that it would allow the shareholder to recover more than he had bargained and paid for. It seems very doubtful whether stock ownership acquired subsequent to the wrong, by itself, should be sufficient reason to justify disregarding the corporate entity when the corporation is suing in its own name to recover for prior mismanagement.[25]

The second disqualifying factor—that McLean obtained his stock through voluntary purchase after inspection of the corporation property, rather than by operation of law—appears to be of much greater significance. Concerning this, our court stated: "To allow the plaintiff corporation to recover the consideration it paid to the defendants for the B stock would, in substance, allow the present stockholders of the plaintiff corporation to recover an amount in excess of the sum M. P. McLean, Jr., paid these defendants . . . ."[26] The true nature of his right and remedy was an individual action against the transferors of the stock for misrepresentation, or for breach of guarantee.[27] Such a claim had already been litigated and decided against McLean.[28] The courts should not allow a stock purchase grievance between the transferor and the transferee to be litigated in the corporate name merely because the grievant has acquired the controlling interest in the corporation. There has been no other case in North Carolina presenting this situation. However, the courts which have had occasion to pass upon this question have held in accord with the principal decision, that the shareholder is not entitled to avail himself of the corporation to secure for himself, through that medium, more than he bought.[29]

The fact that the stock purchased by McLean was "guilty" stock which had participated in the alleged wrong appears very important in the court's decision. This factor is closely related to the stock purchase grievance discussed above. It is well settled that a shareholder

This involved a New York statute, N.Y. GEN. CORP. LAW § 61, which is similar to FED. R. CIV. P. 23(b).

[23] Note, 36 CORNELL L.Q. 740 (1951); Comment, 65 HARV. L. REV. 345 (1951); Comment, STAN. L. REV. 151 (1950); Comment, 2 SYRACUSE L. REV. 166 (1950).

[24] Capital Wine and Spirit Corp. v. Porkrass, 98 N.Y.S.2d at 297 (Peck, J., concurring opinion).

[25] Authority cited note 22 *supra*.

[26] 249 N.C. at 313, 106 S.E.2d at 482.

[27] Capital Wine and Spirit Corp. v. Porkrass, 98 N.Y.S.2d 291 at 297 (1st Dep't 1950).

[28] Lester v. McLean, 242 N.C. 390, 87 S.E.2d 886 (1955).

[29] Matthews v. Headley Chocolate Co., 130 Md. 523, 100 Atl. 645 (1917); Home Fire Ins. Co. v. Barber, 67 Neb. 644, 93 N.W. 1024 (1903).

who himself has participated in the alleged wrongful conduct cannot thereafter attack it;[30] and, generally, subsequent purchasers of stock stand in no better position than their transferors.[31] Thus, the great weight of authority is to the effect that the transferee cannot sue if he has acquired his title from a shareholder who participated or acquiesced in the wrong.[32] However, where the shareholder was an innocent purchaser for value who had no notice of such participation or consent by his transferor, such an action has been allowed.[33] There is no mention in the principal decision whether or not McLean was aware of the circumstances surrounding the repurchase of the B stock. Presumably, he had access to all the financial records prior to his purchase of the corporation. It seems unlikely that any claim could be made that he did not have either actual or constructive notice. If the transferee of all the outstanding stock is barred from bringing an individual action because he has purchased "guilty" stock from the transferor, it would be clearly a perversion of justice to allow him to recover through use of the corporate form.[34]

It should be noted that the decision in the principal case has no effect upon the rights of creditors. The court emphasized the fact that creditors are in a protected category and would have had the right to enforce the payment of the original subscription price by way of a creditor's bill in equity.[35]

The result achieved in the principal case seems analogous to those decisions which prevent an individual from doing business as a corporation in a field in which he had personally agreed not to compete,[36] or which refuse to allow a corporate recovery on a fire insurance policy where the sole shareholder had deliberately set fire to the property in order to collect the insurance.[37] The decisions in these and all similar cases are founded on the basic premise that a shareholder should not

[30] Diamond v. Diamond, 307 N.Y. 263, 120 N.E.2d 819 (1954); FLETCHER, PRIVATE CORPORATIONS § 5862 (perm. ed. 1943).

[31] Russell v. Louis Melind Co., 331 Ill. App. 182, 72 N.E.2d 869 (1947); FLETCHER, PRIVATE CORPORATIONS § 5866 (perm. ed. 1943).

[32] *Ibid.*

[33] Parsons v. Joseph, 92 Ala. 403, 8 So. 788 (1891). See also Continental Sec. Co. v. Belmont, 83 Misc. 340, 144 N.Y. Supp. 801 (Sup. Ct. 1913).

[34] Matthews v. Headley, 130 Md. 523, 100 Atl. 645 (1917).

[35] 249 N.C. at 313, 106 S.E.2d at 481. The court cited N.C. GEN. STAT. § 55-65 (1950), which provides that holders of unpaid stock are liable for so much of the full amount of the shares as is needed to satisfy creditors. Under the new act the comparable section is N.C. GEN. STAT. § 55-53 (Supp. 1955), which would cover situations arising after July 1, 1957.

[36] Beal v. Chase, 31 Mich. 490 (1875); Kramer v. Old, 119 N.C. 1, 25 S.E. 813 (1896); A. Booth & Co. v. Siebold, 37 Misc. 101, 74 N.Y. Supp. 776 (Sup. Ct. 1902).

[37] Meily Co. v. London & L. Fire Ins. Co., 142 Fed. 873 (E. D. Pa. 1906), *aff'd*, 148 Fed. 683 (3rd Cir. 1906); D. I. Felsenthal Co. v. Northern Assur. Co., 284 Ill. 343, 120 N.E. 266 (1918); Kirkpatrick v. Allenania Fire Ins. Co., 102 App. Div. 327, 92 N.Y. Supp. 466 (Sup. Ct. 1905), *aff'd*, 184 N.Y. 546, 76 N.E. 1098 (1906).

be allowed to profit in his corporate capacity when he is guilty of some wrong, or is under some obligation, which would prevent him from so profiting in his individual capacity.[38]

It is submitted that the result and the rationale of the principal case are to be commended as a desirable advancement in North Carolina corporation law. Certainly the ultimate effect of this decision is in line with the traditional principle that equity will look to the substance of the proceeding rather than to the form. The courts have consistently utilized their power to disregard the corporate entity where the sole shareholder seeks to use his inside position to work fraud or injustice.[39] The totality of the circumstances in this case clearly establishes that the sole shareholder had no equitable standing. Any contrary result would have had the effect of erecting a statutory shield behind which individuals with "unclean hands" could enforce their disqualified claims in equity.

SHERWOOD H. SMITH, JR.

Domestic Relations—Alimony Without Divorce and Absolute Divorce Based on Same Grounds

A wife in Missouri obtained a decree of separate maintenance on the ground of statutory desertion. Five years later she brought an action for absolute divorce based on the same ground. Her husband interposed as a defense the doctrine of election of remedies. *Held,* since an action for absolute divorce is not inconsistent with an action for separate maintenance based on the same ground, but is rather an action for further relief, the doctrine of election of remedies is not applicable. Consequently, the wife was granted an absolute divorce.[1]

Ordinarily there is no ban on successive divorce actions unless the doctrine of res judicata may be invoked as a bar thereto.[2] For a subsequent action to be precluded it must appear that a court of competent jurisdiction rendered a final decree on the merits in a prior action in which the same relief was sought.[3] Under this doctrine a decree of separate maintenance would not be a bar to a subsequent action for absolute divorce because the two remedies are not the same.[4] However, grounds litigated or questions determined in the separate maintenance proceeding are res judicata in a subsequent action for absolute divorce.[5] Thus, as of its date, a decree in favor of a wife in an action for separate

[38] Taylor v. Standard Gas & Elec. Co., 306 U.S. 307, 332 (1939).

[39] Pepper v. Litton, 308 U.S. 295 (1939); FLETCHER, PRIVATE CORPORATIONS § 41 (perm. ed. 1931).

[1] Prough v. Prough, 308 S.W.2d 294 (Mo. 1957).

[2] Meegan v. Meegan, 60 R.I. 131, 197 Atl. 221 (1938).

[3] Bidwell v. Bidwell, 139 N.C. 402, 52 S.E. 55 (1905).

[4] Jenkins v. Jenkins, 125 Cal. App. 2d 109, 269 P.2d 908 (1954)

[5] Gordon v. Gordon, 59 So. 2d 40 (Fla. 1952).

maintenance establishes her as the innocent and the husband as the guilty party.[6]

In a few instances the question has arisen as to whether the doctrine of election of remedies bars the plaintiff in a prior support action from maintaining an action for absolute divorce.[7] This question may arise, as in the principal case, where the husband has been guilty of misconduct for which the wife may obtain an absolute divorce or separate maintenance and she elects to sue for the latter and subsequently initiates an action for absolute divorce. The general rule in such cases is that the doctrine of election does not apply since the two remedies are not inconsistent inasmuch as they have different objects and effects.[8] A decree awarding the wife separate maintenance affords her only partial relief whereas a decree granting her absolute divorce amounts to exaction of the full remedy.[9] Thus, the result reached by the Missouri court in the instant case appears to be in line with the weight of authority.

While the problem before the court in the principal case has never arisen in North Carolina[10] the laws of this state provide a perfect setting for it to rear its troublesome head. North Carolina, like Missouri, allows a wife to sue for alimony without divorce (another name for separate maintenance) when her husband has been guilty of misconduct for which the wife may obtain an absolute divorce.[11] Thus, when the husband commits adultery, for example, the wife has two courses of action which she may pursue initially, an action for alimony without divorce or an action for absolute divorce.[12] If she elects to sue for absolute divorce she may not obtain alimony.[13] Therefore, she may elect to sue for alimony without divorce in order to receive continued support from her wrongdoing husband. If she then waits two years and seeks an absolute divorce on the grounds of two years separation,

[6] Jenkins v. Jenkins, 125 Cal. App. 2d. 109, 269 P.2d 908 (1954).
[7] *Id.*
[8] *Id.;* Kunze v. Kunze, 153 Minn. 5, 189 N.W. 447 (1922).
[9] Jenkins v. Jenkins, 125 Cal. App. 2d 109, 269 P.2d 908 (1954).
[10] Perhaps the reason for this was stated by the court in the principal case where it opined that its inability to find a similar case in Missouri might be due to the fact "that in most instances the husband—loser in the suit for separate maintenance,—is content, if not highly pleased, to exchange that status for absolute divorce." Prough v. Prough, 308 S.W.2d 294, 297 (Mo. 1957).
[11] N.C. GEN STAT. § 50-16 (Supp. 1957).
[12] The latter is not immediately available, however, since in her complaint for absolute divorce the wife must allege that to her knowledge the "facts set forth therein as grounds for divorce have existed . . . for at least six months prior to filing the complaint." N.C. GEN. STAT. § 50-8 (Supp. 1957). There is no such time requirement in the case of alimony without divorce and the wife can properly institute such action as soon as the grounds are discovered. N.C. GEN. STAT. § 50-16 (Supp. 1957); Cunningham v. Cunningham, 234 N.C. 1, 65 S.E.2d 375 (1951).
[13] Livingston v. Livingston, 235 N.C. 515, 70 S.E.2d 480 (1952).

she will have her divorce but will lose her continued support.[14] But, suppose she initially sues for alimony without divorce on the ground of adultery. Then, immediately after obtaining her alimony decree, she brings an action for absolute divorce using the same adultery as her ground. Would our court not grant the divorce? Since the weight of authority appears to indicate that the divorce would not be defeated because of the doctrine of res judicata or the doctrine of election of remedies, and since there does not appear to be anything in our statutes or case law to prevent this procedure, it is surprising not to find a case among our supreme court decisions discussing this possibility. This is especially surprising since this procedure, if allowed, would afford the injured wife a means of getting around our questionable policy[15] of not allowing the wife any alimony in an action for absolute divorce.

That the better reasoning militates in favor of allowing an injured wife to maintain a subsequent action for absolute divorce on the same ground for which she has previously obtained alimony without divorce seems to admit of little doubt. The General Assembly has seen fit to authorize a wife both alimony and absolute divorce when her husband commits adultery. Nowhere have they indicated that they intended to deny one by granting the other. Moreover, as already indicated, whenever similar situations have arisen in other jurisdictions the courts have almost unanimously held that the wife may use the same ground for obtaining both forms of relief.

So long as the policy of this state is to deny alimony in actions for absolute divorce, but not to prevent an alimony decree previously obtained from surviving an absolute divorce except in certain instances,[16] it would appear desirable for our General Assembly to pass a statute making it clear that a wife who has grounds for both alimony without divorce and absolute divorce can obtain both remedies. This would resolve any uncertainty which presently exists and could be accomplished by simply adding to the statute providing for alimony without divorce (G.S. § 50-16) a provision to the effect that

> Any action initiated pursuant to, or judgment obtained under, the provisions of this section on grounds that would also constitute grounds for absolute divorce shall not bar the plaintiff in such action, or who obtains such judgment, from maintaining an action for absolute divorce on the same grounds.

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[14] N.C. GEN. STAT. § 50-11 (Supp. 1957).
[15] See Note, 36 N.C.L. REV. 203 (1958).
[16] N.C. GEN. STAT. § 50-11 (Supp. 1957).

Domestic Relations—Effect of Community Property Laws on Interpretation of "Gross Income" in North Carolina Alimony Without Divorce Award

In the recent case of *Kinross-Wright v. Kinross-Wright*,[1] the North Carolina Supreme Court was asked to interpret for the first time the term "gross income" as used in an alimony judgment. Plaintiff, a resident of North Carolina, had been granted an alimony without divorce award[2] to be paid by defendant, at that time a resident of Texas. The award provided that defendant was to pay $350 or 30% of his gross income, whichever was greater, to plaintiff each month for the support and maintenance of herself and their two children. Defendant was ordered to forward to plaintiff an authenticated copy of his federal income tax return for each taxable year thereafter. It was further provided that if defendant's gross income *"as shown on said tax return"*[3] exceeded the sum of $14,000, a sum equal to 30% of the excess over $14,000 divided by 12 was to be added to each monthly payment due plaintiff and children for the next twelve months. Two months after the alimony award, plaintiff was granted an absolute divorce on grounds of two years separation, without prejudice to the prior alimony award.[4] Almost immediately thereafter, defendant remarried and continued to live in Texas with his second wife. Defendant later filed a petition for modification and clarification of the alimony judgment. Plaintiff then filed a petition alleging that defendant's gross income had exceeded $14,000 and that he had failed to pay her 30% of the excess as ordered. Defendant contended that the term "gross income" as used in the alimony judgment did not include income which, under the Texas community property laws,[5] was the income and property of his second wife. It was this dispute, *inter alia,* which the North Carolina court was asked to decide.

[1] 248 N.C. 1, 102 S.E.2d 469 (1958).
[2] See N.C. GEN. STAT. § 50-16 (Supp. 1957).
[3] 248 N.C. at 3, 102 S.E.2d at 470. (Emphasis added.)
[4] N.C. GEN. STAT. § 50-11 (Supp. 1957), which provides in effect that a prior alimony award will be terminated by a subsequent absolute divorce obtained by the wife on the ground of separation for the statutory period (two years), was not applicable here since the alimony award was obtained in 1953 and the amendment did not become effective until January 1, 1956. See Yow v. Yow, 243 N.C. 79, 89 S.E.2d 867 (1955); Rayfield v. Rayfield, 242 N.C. 691, 89 S.E.2d 399 (1955).
[5] TEX. CONST. ANN. art. 16 § 15; TEX. REV. CIV. STAT. ANN. arts. 4613-14, 4619 (1951).

"The community property system has lived since the days of the rude tribes of Germany when the wives who shared the fighting were thought to be worthy of a share in the spoils. When Germanic Goths conquered and occupied Spain they carried the concept of community property with them to that nation, and one of the Gothic rulers of Spain, by statute, made community of matrimonial gains the general law of Spain. Spain, in turn, introduced the community property to the new world, and by this manner it became part of the law of Texas." TEX. CONST. ANN. art. 16, § 15, Interpretive Commentary at 102.

It is well settled under Texas law that a married person's legal gross income consists of only one-half of the total amount which he produces.[6] However, the North Carolina Supreme Court refused to give this meaning to the term "gross income," and instead concluded that the term as used in the alimony judgment meant gross income as interpreted under the North Carolina law. In reaching this conclusion, the court relied entirely on two cases from other jurisdictions—*Alexander v. Alexander*,[7] and *Arthur v. Arthur*.[8] These involved the construction of the terms "gross income" and "gross earnings," respectively, as used in separation agreements.[9]

In *Alexander*, the defendant was required by a separation agreement, approved by a divorce decree, to furnish a true and certified copy of his federal income tax return, and "if, as shown thereby *or otherwise established*, the defendant should have gross income [in excess of a specified amount] from whatever source derived [then the defendant was to pay a percentage of the excess to the plaintiff] . . . ."[10] The agreement had been executed in Missouri, a non-community property jurisdiction. Defendant thereafter remarried, moved to Texas, and then claimed that his gross income should be reduced by one-half in computing the amount due under the contract. It was held, under the particular circumstances, that the Texas law could not be invoked so as to reduce the payments.

In *Arthur*, the California court was called upon to interpret a separation contract, executed in New York, which provided that the defendant was to pay a certain percentage of his "gross earnings" to the plaintiff. Defendant later remarried and moved to the community property state of California.[11] It was apparent that the contract had not been executed in contemplation of defendant's future marriage, much less in contemplation of the possibility that defendant might subsequently move to a community property jurisdiction.[12] Further, no criterion

[6] The community property system is specifically recognized in the Texas Constitution and is set out in detail in the statutes of that state. These statutes clearly provide that any earnings of either husband or wife become community income, and that the wife's interest is equal to the husband's. Her interest in the community is properly characterized as a present vested interest equal and equivalent to that of her husband; one-half of the community income is therefore income of the wife. See TEX. CONST. ANN. art. 16 § 15; TEX. REV. CIV. STAT. ANN. arts. 4613-14, 4619 (1951). See also Hopkins v. Bacon, 282 U.S. 122 (1930); Wright v. Hays' Adm'r, 10 Tex. 130 (1848).

[7] 64 F. Supp. 123 (1945), *aff'd*, 158 F.2d 429 (1946), *cert. denied*, 330 U.S. 845 (1947).

[8] 147 Cal. App. 2d 252, 305 P.2d 171 (Dist. Ct. App. 1956).

[9] These are apparently the only reported cases in the United States which even remotely involve the *Kinross-Wright* situation.

[10] 64 F. Supp. at 125. (Emphasis added.)

[11] "In Louisiana, Texas, California, Arizona, Idaho, New Mexico, Nevada, and Washington, what is known as the 'community system of matrimonial gains' prevails." TIFFANY, REAL PROPERTY § 294 (new abr. ed. 1940).

[12] 147 Cal. App. 2d at—, 305 P.2d at 174.

was set forth in the contract whereby the meaning of "gross earnings" might be ascertained. With these factors in mind, the court held that "the word 'earnings' is used to indicate the amount produced, not that part only which may vest in defendant by virtue of the community property law."[13]

There are important distinctions between the *Alexander* and *Arthur* cases and the *Kinross-Wright* case. In the principal case, the judgment of the lower court expressly stated that the plaintiff's right to any increase in the amount of alimony being paid to her was to be determined by the amount of defendant's gross income "as shown on said tax return for the preceding year." There was nothing in the judgment which indicated that defendant's gross income was to be determined solely under North Carolina law. That the court meant defendant's gross income as shown on his tax return, whether it be determined under the laws of North Carolina, Texas, or some other state to which defendant might become subject, is the only interpretation to which the clear and simple language used by the lower court lends itself.

It is true that in the *Alexander* case the defendant was required to furnish plaintiff a copy of his tax return; however, the contract there clearly did not limit the amount of gross income to that amount as shown on the tax return. On the contrary, it was expressly provided that gross income might be "otherwise established." Under this broad language, together with the surrounding circumstances, the federal court was justified in ruling as it did.

Further, both the *Alexander* and *Arthur* cases involved contracts made and intended to be executed in states which did not have a community property system, and by parties, all of whom were residents of such states at that time. In neither case was it contemplated that the defendant would remarry and subsequently move to a community property state. In the principal case, however, defendant was already residing in Texas and had become subject to its community property laws at the time the final alimony judgment was rendered.[14] The record further indicates that the *Kinross-Wright* alimony suit was brought by plaintiff in contemplation of a subsequent absolute divorce from de-

[13] *Ibid.* In reaching this conclusion, the court stated: "[S]o far as plaintiff is concerned, his contracting a marriage with another woman thereafter and his removal to the State of California where such other woman had a vested interest in half of his earnings as community property are no different in effect than his execution of an assignment of one-half of such earnings to some finance company in consideration of a loan." *Ibid.*

[14] The original summons was issued February 13, 1952, at which time both plaintiff and defendant were residents of North Carolina. On March 5, 1952, an interlocutory order for subsistence and counsel fees was entered. In January of 1953, defendant moved his residence from North Carolina to Texas; therefore, when the cause came on for final hearing on September 3, 1953, and the final alimony decree was entered, defendant had been a legal resident of Texas for approximately nine months.

fendant; and that their marital difficulties had arisen from defendant's prolonged association with the woman whom he married within a month after the date of the absolute divorce. Thus, the parties must have known at the time of the alimony award that defendant intended to remarry and reside in Texas with his second wife after the absolute divorce was granted. It appears, then, that all parties must have contemplated that defendant's gross income as shown on his tax return would be determined under the Texas law rather than the North Carolina law, so long as defendant filed his income tax return as a resident of that state.

A careful reading of the *Alexander* and *Arthur* cases reveals that the court in each case reached its decision by applying the general rules of construction applicable to written instruments. The *Alexander* case plainly states: "[T]he question posed turns upon an interpretation of the phrase 'gross income' as the parties understood and used that term when they executed the contract."[15] In the principal case, the court was construing a judgment; but the rules of construction of written instruments also apply to the construction of judgments.[16] A judgment must be construed in the light of the situation of the court,[17] what the court had before it,[18] and the accompanying circumstances.[19]

If the North Carolina court had given effect to the apparent intention of the parties, based upon the surrounding circumstances, and to the plain language of the judgment, the term "gross income" might well have been construed in accordance with the operation of the Texas community property law. However, the court makes no mention of intention of the parties, and in following the holdings of the *Alexander* and *Arthur* cases states: "The reasoning in these two cases . . . appears to be sound, and may well be applied with approval to the factual situation in the instant case."[20] It is not certain whether the basis of the present decision is (1) that the court found the actual intent of the parties to be that North Carolina law was to control, notwithstanding

[15] 158 F.2d at 430.

[16] Decker v. Tyree, 204 Ky. 302, 264 S.W. 726 (1924); Perman Oil Co. v. Smith, 129 Tex. 413, 107 S.W.2d 564 (1937).

[17] Rinaldo v. Board of Medical Examiners, 123 Cal. App. 712, 12 P.2d 32 (Dist. Ct. App. 1932); *cf.* Bank of Union v. Redwine, 171 N.C. 559, 88 S.E. 878 (1916).

[18] Toms v. Holmes, 294 Ky. 233, 171 S.W.2d 245 (1943). The court's province is to construe contracts, not to make contracts for the parties, and neither court nor jury may disregard contracts expressed in plain terms and unambiguous language. See Belk's Dep't Store v. George Washington Fire Ins. Co., 208 N.C. 267, 180 S.E. 63 (1935); King v. Davis, 190 N.C. 737, 130 S.E. 707 (1925).

[19] Christiano v. Christiano, 131 Conn. 589, 41 A.2d 779 (1945). In construing a writing in order to determine the true intent of the parties, the following should be considered: the subject matter, the situation of the parties, and the circumstances at the time when the writing was executed. See Bank of Union v. Redwine, 171 N.C. 559, 88 S.E. 878 (1916).

[20] 248 N.C. at 12, 102 S.E.2d at 477.

the *apparent* intention of the parties, or (2) that, as a matter of public policy, where it is not otherwise clearly expressed to the contrary, an alimony award will not be diminished by the defendant's subsequent remarriage in a community property state.

It is submitted that the decision seems sound from the standpoint of public policy. Since the prime purpose of an alimony award is to provide support for a defendant's wronged wife and family, he should not, by the simple expedient of remarrying in a state where community property laws obtain, be allowed thereby to divest his first wife and family of a large part of their support.

Many variations of the *Kinross-Wright* situation might arise in the future. If the *Kinross-Wright* decision be considered as a judicial expression of public policy, it seems likely that the North Carolina court, in interpreting the term "gross income" in separation contracts or alimony judgments, will continue to disregard the community property laws of other states, absent a specific provision to the contrary.

ROBERT C. SOLES, JR.

Husband and Wife—Tenancy by the Entirety—Surviving Spouse's Right to Contribution on Paying Debt Secured by Mortgage on Entireties Property

H and W hold a house and lot as tenants by the entireties.[1] The property has a market value of $20,000. Part of this value is due to recent improvements on the property, for which H and W jointly executed notes and a mortgage. H dies when there is still $8,000 owing. W succeeds to the entire fee and petitions H's executors for $4,000, claiming that amount as H's share of the joint debt. Under these facts, the Supreme Court of Delaware recently held in *In re Keil's Estate*,[2] that the claim should be allowed.

The recovery was allowed on the principle of equitable contribution. The rationale of the principle is that where parties are under a common burden or liability, one joint debtor who pays the whole debt, or more than his share, is entitled, in equity, to contribution from his co-obligors.[3]

[1] "'Estates by the entireties are creatures of the common law created by legal fiction and based wholly on the common-law doctrine that husband and wife are one, and, therefore there is but one estate, and in contemplation of law, but one person owning the whole. . . . By reason of their legal unity by marriage, the husband and wife together take the whole estate as one person. Neither has a separate estate or interest in the land, but each has the whole estate. Upon the death of one the entire estate and interest belongs to the other, not by virtue of survivorship, but by virtue of the title that vested under the original limitation.'" Woolard v. Smith, 244 N.C. 489, 493, 94 S.E.2d 466, 469 (1956), quoting 4 THOMPSON, REAL PROPERTY § 1803 (perm. ed. 1940).

[2] —Del.—, 145 A.2d 563 (1958).

[3] 13 AM. JUR., *Contribution* § 3 (1938).

The *Keil* case, and other cases[4] in accord, hold that the right to contribution flows from the fact that both parties were primarily liable as joint makers of the notes, paying no attention to the characteristics of the tenancy under which the security property was held.

Lopez v. Lopez,[5] illustrates a line of authority[6] contra to the holding in the *Keil* case. There the Florida court disallowed the claim of the surviving entireties tenant, saying that the doctrine of equitable contribution applies only to prevent one debtor from having to bear more than his share of a common burden, or to prevent unjust enrichment of a non-paying debtor where his co-obligor paid the whole amount. Applying this standard, the court held that no common burden existed, because each was obligated for the whole debt, since each held the whole fee in the mortgaged property. The court further pointed out that there could be no unjust enrichment if the survivor were made to pay the entire debt, since the decedent's estate succeeded to no interest in the redeemed property.

The two lines of authority can be summarized as follows: Where the survivor gets contribution the courts emphasize that it was a joint obligation, stressing the notes, and playing down the tenancy by the entireties in the mortgaged property. Courts that deny contribution emphasize the nature of the tenancy, and hold that the debt takes on similar characteristics, at least as between the debtors. Both lines of authority leave the liability of the parties to the mortgagee unchanged.

North Carolina first ruled on the question presented in the principal case in *Wachovia Bank and Trust Co. v. Black*,[7] where it was held, with no authority cited, that the survivor was entitled to contribution. The reason given was the same as that of the Delaware court in the *Keil* case, that "the unity of person is an incident of the estate, . . . it is not incident to the note."[8]

[4] Magenheimer v. Councilman, 76 Ind. App. 583, 125 N.E. 77 (1919); Cunningham v. Cunningham, 158 Md. 372, 148 Atl. 444 (1930); Nobile v. Bartletta, 109 N.J. Eq. 119, 156 Atl. 483 (Ct. Err. & App. 1931) (partly based on local rule that entireties tenants hold as tenants in common during their joint lives); Wachovia Bank and Trust Co. v. Black, 198 N.C. 219, 151 S.E. 269 (1929); *In re* Dowler's Estate, 368 Pa. 519, 84 A.2d 209 (1951) (vigorous dissent); Newson v. Shackleford, 163 Tenn. 358, 43 S.W.2d 384 (1931) (*Magenheimer* case, *supra*, relied upon, no contra authority coming to attention of court).

See Brown v. Hargraves, 198 Va. 748, 96 S.E.2d 788 (1957), where contribution was allowed against the estate of the deceased member of a joint tenancy with right of survivorship.

[5] 90 So. 2d 456 (Fla. 1956).

[6] Ratte v. Ratte, 260 Mass. 165, 156 N.E. 870 (1927); Robinson v. Bogert, 187 Misc. 735, 64 N.Y.S.2d 152 (1946); *In re* Dell's Estate, 154 Misc. 216, 276 N.Y.S. 960 (1935); Geldart v. Bank of N. Y. and Trust Co., 209 App. Div. 581, 205 N.Y.S. 238 (1924).

See also, *In re* Keil's Estate, (Mr. Justice Bramhall's dissent), —Del.—, 145 A.2d at 566; *In re* Dowler's Estate, (Mr. Justice Bells' dissent), 368 Pa. at 525, 84 A.2d at 211.

[7] 198 N.C. 219, 151 S.E. 269 (1929).

[8] *Id.* at 221, 151 S.E. at 270.

In *Underwood v. Ward*,[9] the North Carolina court seems to have considered the character of ownership of the security by holding that since the deceased's estate holds no interest in the mortgaged entireties property, the estate's liability to the widow for contribution is not such a claim as would qualify for preference as a secured claim under G.S. § 28-105[10] thus, the estate being insolvent, the widow had to share pro-rata with the general creditors.

In *Montsinger v. White*,[11] the husband alone had executed the note and mortgage and had later conveyed the property to himself and his wife as tenants by the entireties. After the husband's death the widow paid the entire debt, and filed a general claim against the deceased's insolvent estate. The court held that by paying the debt she became subrogated to the claim of the mortgagee. The mortgagee's rights under G.S. § 28-105 are limited to a general claim against the insolvent estate only to the extent of any deficiency resulting after he has first proceeded against the security. Since here the security was sufficient to satisfy the debt, the mortgagee would have had no right of action against the estate, thus the widow, being subrogated, had no such right.

Thus, in North Carolina the rather anomalous situation exists that where the survivor pays the *joint* debt he may receive contribution from the deceased's estate. If, on the other hand, he pays the deceased's *sole* debt, he is merely subrogated to the mortgagee's claim and if the decedent's estate is insolvent, can collect nothing unless the security is worth less than the amount of the debt.

The North Carolina court has not gone into the ramifications of the doctrine of equitable contribution in the entireties cases. The court, however, has generally cited with approval, American Jurisprudence's[12] statement: "In other words, when any burden ought, from the relationship of the parties or in respect of property held by them, to be equally borne and each party is *in aequali jure*, contribution is due if one has been compelled to pay more than his share. The doctrine is founded not upon contract, but upon principles of *equity*."[13] (Emphasis added.) Applying this equitable standard where the obligation is joint and one tenant dead, neither the "relationship of the parties" nor the nature of the security property ownership would seem to require that the "burden" be "equally borne." The entire equity of redemption, formerly owned by the marital unit, is now owned by the surviving spouse alone and the

[9] 239 N.C. 513, 80 S.E.2d 267 (1954).

[10] "The debts of the decedent must be paid in the following order: First class. Debts which by law have a specific lien on property to an amount not exceeding the value of such property. . . ."

[11] 240 N.C. 441, 82 S.E.2d 362 (1954).

[12] See note 3 *supra*.

[13] Nebel v. Nebel, 223 N.C. 676, 685, 28 S.E.2d 207, 213 (1943). See also Bunker v. Llewellyn, 221 N.C. 1, 18 S.E.2d 717 (1942).

decedent's estate has no interest in the security property. From the unjust enrichment standpoint, it seems that *equity* is not accomplished by allowing the windfall which results when the survivor redeems the whole mortgagor interest and is allowed to recover half the amount paid. Conversely, if contribution is not allowed there is no unjust enrichment because, having no further interest in the property, the decedent spouse's estate acquires no unpaid-for benefit. Granted that his estate is liable to the mortgagee jointly and severally with the survivor, this should not be the primary consideration in determining the liability of the parties as between themselves.

When a mortgagor pays off the secured indebtedness, he redeems his equity in the property.[14] When one of several joint mortgagors pays the whole debt, the other principal obligors must redeem their respective shares from the one who has paid the whole debt.[15] The amount of contribution that can be claimed against the obligors who have not yet paid is in direct proportion to the share in the security owned by each debtor.[16] Thus, the doctrine of contribution, in the case of tenants in common or their estates, works to prevent the unjust enrichment of those who did not share in the payment of the mortgage debt. But, in the case of tenants by the entireties, this doctrine causes unjust enrichment because the decedent's estate had nothing to redeem by contributing.

If X buys a house and executes a mortgage and notes for the purchase money, and gets his friend, Y, to sign the notes, as an accommodation party, we have a similar situation to that where one of the entireties tenants has died. Both X and Y are liable,[17] but as between the parties, if X is made to pay, since he got the entire benefit of the transaction, he cannot force Y to contribute.[18] Likewise, if Y is made to pay he would have a right of action for the whole amount against X since the entire benefit went to X.[19] Also, where X owns a fee subject to a mortgage, and sells his interest to Y, who assumes the mortgage, X becomes a surety for Y, who is primarily liable.[20] Y, who receives the entire benefit, cannot make X contribute, and if X is called upon by the mortgagee for payment, he can look to Y for reimbursement.[21] In the principal case situation the tenancy by which the mortgaged

[14] Riddick v. Davis, 220 N.C. 120, 16 S.E.2d 662 (1941); Stevens v. Turlington, 186 N.C. 191, 119 S.E. 210 (1923).

[15] Bain v. Howell, 247 Ala. 514, 25 So.2d 167 (1946); 86 C.J.S., *Tenancy in Common* § 61 (1954). *Cf.* Raynor v. Raynor, 212 N.C. 181, 193 S.E. 216 (1937).

[16] *Ibid.*

[17] Dry v. Reynolds, 205 N.C. 571, 172 S.E. 351 (1933).

[18] ". . . There is no obligation between the maker and the accommodation endorser that the latter shall pay the debt. . . ." First and Citizens Nat'l Bank v. Hinton, 216 N.C. 159, 160, 4 S.E.2d 332, 333 (1939).

[19] N.C. GEN. STAT. § 26-3 (1953).

[20] State-Planters Bank and Trust Co. v. Randolph, 207 N.C. 241, 176 S.E. 561 (1934).

[21] *Ibid.*

property was held results in the payor's receiving—as in the above illustrations—the benefit of his payment. Therefore, it would seem that equity would require that the nature of the security ownership, rather than the nature of the obligation, be the controlling factor and that contribution should not be allowed.

ROBERT L. LINDSEY

Sales—Implied Warranty of Title—When Cause of Action for Breach Accrues after Purchase of Precarious Title

In the recent case of *Henry Vann Co. v. Barefoot,*[1] plaintiff and defendants traded motor vehicles. Defendants' automobile had previously been used for illegal transportation of whiskey, and after the trade it was confiscated by federal agents. Plaintiff sued for the reasonable value of the vehicle it had traded to the defendants on the ground of total failure of consideration. *Held,* plaintiff had stated a cause of action for breach of an implied warranty of title, but that in order to recover it must prove that by legal proceedings the defendants' title to the vehicle was divested as of a time prior to the trade.

The Supreme Court, reversing the court below, held, inter alia, that plaintiff need not prove the offense which made the car subject to confiscation. Accordingly, there is left open the question whether if the offense prior to the trade had been proved, but not that the title of defendants had been divested by legal proceedings, plaintiff could have recovered. This necessarily depends on the answer to the following question: If the vendor has committed some act or knows of circumstances which make his title precarious,[2] and he fails to inform his purchaser of this fact, may the purchaser immediately sue him for breach of an implied warranty of title, or must he wait until he has been dispossessed?[3] In attempting to answer the hypothetical question posed, it is necessary to consider the scope of an implied warranty of title, and what constitutes a breach thereof.

Implied warranty of title is a well established doctrine in the United States. The seller of personal property is held to warrant impliedly

[1] 249 N.C. 22, 105 S.E.2d 104 (1958).

[2] The principle of transfer of a precarious title may be illustrated by this anecdote: John owes Robert ten dollars. John and Robert are riding together on a train. It is held up. The robbers are coming down the aisle of the car relieving the passengers of their purses. Just before the robbers get to them John hands Robert a bill and says, "Here is the ten dollars I owe you."

[3] It should be noted at this point that fraud of the seller inducing the sale of personal property may entitle the purchaser to rescind the contract and recover the consideration he has paid, even though the paramount title holder has not recovered the property nor the vendee suffered any actual damages. Case v. Hall, 24 Wend. 102 (N.Y. Sup. Ct. 1840). However, the difficulties of proof presented by this remedy would make it highly desirable from the buyer's point of view to be able to sue for breach of the implied warranty of title.

the title unless a contrary intention appears.[4] An implied warranty of title is, in substance, a warranty that the seller's title is perfect and free from all liens and incumbrances or partial defects.[5] Thus, where at the time of the sale the chattels were subject to forfeiture to the federal government for the illegal acts of the seller in violation of the revenue laws, the subsequent enforcement of such forfeiture has been held a breach of the seller's warranty of title.[6] This holding makes it apparent that the scope accorded the implied warranty of title covers the situation where the vendor knowingly and without disclosure has passed to the purchaser a precarious title later divested.

The question still remains as to when the cause of action arises for the breach of the implied warranty. A majority of the jurisdictions, including North Carolina, which have not adopted the Uniform Sales Act treat the warranty of title implied in every sale as similar to a covenant for quiet enjoyment, which goes to the possession rather than the title. It is not deemed broken for the purpose of an action on the breach until there has been an actual or constructive eviction of the purchaser by the paramount title holder.[7] "The seller is bound to protect the buyer from all evictions arising from circumstances anterior to the sale."[8] Thus in North Carolina an eviction is a condition precedent to the bringing of an action for breach of an implied warranty of title.[9] Under this rule it is manifest that the purchaser of a precarious title cannot maintain such action until his possession has been disturbed in some way by the paramount title holder.

A minority of the courts have held that there is an immediate breach of the implied warranty of title arising at the time of the sale, reasoning that the implied warranty of title to chattels is analogous to a covenant of seisin in a deed which is broken, if at all, immediately upon the delivery of the deed.[10] Thus, courts using this analogy have held that the breach occurred at the time of the sale. The result was that sometimes a purchaser lost both the purchase price and the goods because the statute of limitations had run before claim was made by the paramount title holder.[11] Fear of this possibility is apparently responsible for

[4] 1 WILLISTON, SALES § 218 (rev. ed. 1948).

[5] Martin v. McDonald, 168 N.C. 232, 84 S.E. 258 (1915); see also 1 WILLISTON, SALES § 218 (rev. ed. 1948).

[6] McKnight v. Devlin, 52 N.Y. 399 (1873); Henry Vann Co. v. Barefoot, 249 N.C. 22, 105 S.E.2d 104 (1958).

[7] Roberts v. Hill, 78 Ga. App. 264, 50 S.E.2d 706 (1948); Hodges v. Wilkinson, 111 N.C. 56, 15 S.E. 941 (1892); Wilson v. Tihcheff, 196 Okl. 243, 164 P.2d 396 (1945); see also 1 WILLISTON, SALES § 221 (rev. ed. 1948).

[8] Myers v. Smith, 27 Md. 91, 110 (1867).

[9] Hodges v. Wilkinson, 111 N.C. 56, 15 S.E. 941 (1892).

[10] Chancellor v. Wiggins, 4 Ky. (B. Mon.) 202, 39 Am. Dec. 499 (1843); Spillane v. Corey, 323 Mass. 673, 84 N.E.2d 5 (1949); Perkins v. Whelan, 116 Mass. 542 (1874); see also 1 WILLISTON, SALES § 221 (rev. ed. 1948).

[11] Chancellor v. Wiggins, *supra* note 9; Perkins v. Whelan, *supra* note 9.

insistence by the majority, including North Carolina, on eviction as a prerequisite to recovery.[12] Actually, neither rule adequately protects the purchaser. Under the majority rule he is denied any recourse against his vendor until he has been evicted, and under the minority rule he runs the risk of having his rights barred by the statute of limitations.

Under the Uniform Sales Act there is an implied warranty on the part of the seller that he has the right to *sell* the goods, and there is a further implied warranty that the buyer should have and enjoy quiet possession of the goods as against any lawful claims existing at the time of the sale.[13] The first warranty has been held to be separate and independent from the operation of the second one.[14] Thus, where the vendor at the time of the sale had in fact no title to the goods and therefore no right to sell them, the purchaser was given the right to proceed immediately against him even though there had been no eviction.[15] It would appear that the same result should follow in the case where the vendor had a precarious title to the goods. Apparently the Sales Act contemplates an implied warranty that the seller has the right to sell a good, clean title which is certainly something more than a precarious title. Thus under the Sales Act it could be argued that a purchaser of a precarious title without notice could sue his vendor immediately for breach of his implied warranty that he had the right to sell the goods notwithstanding the fact that there had been no eviction. If there is a breach of warranty by the seller, the Uniform Sales Act authorizes the buyer at his election to rescind the sale, offer to return the goods to the seller, and recover any part of the purchase price which has been paid.[16] Thus, apparently the purchaser of a precarious title would be able to recover the purchase price even though there had been no eviction. However, since the breach necessarily arises at the time of the sale, the statute of limitations may have run before the purchaser discovers the defect in his title. In such case, the purchaser would have to rely upon the implied warranty of quiet enjoyment, and would encounter the same obstacle under the Uniform Sales Act that he would under the North Carolina rule—namely, the requirement of an eviction before he may sue for the breach.

It is submitted that the purchaser of a precarious title should be allowed to sue on his warranty as soon as he discovers the nature of his title regardless of whether a claim has been asserted by a superior title holder. A purchaser is placed in a most undesirable position when he is denied the right to sue before eviction. The effect of such denial is to

[12] Gross v. Kierski, 41 Cal. 111 (1871); see also 1 WILLISTON, SALES § 221 (rev. ed. 1948).
[13] Uniform Sales Act § 13.
[14] Martin v. Coffman, 87 Ohio App. 398, 95 N.E.2d 286 (1949).
[15] *Ibid.*
[16] Uniform Sales Act § 69.

allow a vendor, who knows that he is going to lose or runs great risk of losing his goods, to pass this risk on to an innocent purchaser who must bear it until claim is asserted by the paramount title holder. To allow a vendor to pass on to an unknowing purchaser goods which he deems "too hot to handle" is unconscionable, and a remedy should be available at once. If plaintiff's right to recover the purchase price is delayed,[17] the dangers of the defendant disappearing or becoming judgment proof in the interim are imminent. Justice demands that he be given a remedy to recover the purchase price immediately upon discovering such fact.[18] The effect of allowing the purchaser to sue on his warranty at this time would be to afford him the adequate protection he needs against such bargains and in so doing would not subject him to the danger of having his action barred by the statute of limitations before he discovers the defect. The vendor would not be prejudiced by such action as he is protected against any false assertions made by the purchaser by the requirement that the purchaser must prove in his action the actual existence of a superior claim to the goods.[19]

The North Carolina Legislature might well consider abolishing the doctrine that an implied warranty of title is the equivalent of a covenant of quiet enjoyment. Disturbance of possession should not be the exclusive way in which breach of the warranty can be established. This appears to be the view adopted in the Uniform Commercial Code.[20] A comment on the applicable subsection states that it

> makes provision for a buyer's basic needs in respect to a title which he in good faith expects to acquire by his purchase, namely, that he receive a good, clean title transferred to him also in a rightful manner so that he will not be exposed to a lawsuit in order to protect it.
>
> . . . .

[17] The plaintiff in suing for breach of warranty would more than likely seek rescission as his remedy rather than damages. "Logically his recovery, if his action is tried before he has been evicted, should be based on the chance of his being subsequently deprived of the benefit of what he has bought. Such a measure of damage is, however, so speculative as to be difficult of practical application." 1 WILLISTON, SALES § 221 (rev. ed. 1948).

[18] A buyer has been held entitled to rescind on the ground of mutual mistake when ties sold were, without the knowledge of either party, in danger of destruction by forest fire at the time of the sale. Richardson Lumber Co. v. Hoey, 219 Mich. 643, 189 N.W. 923 (1922). If mutual mistake is a ground for rescission when the existence of the goods is precarious, breach of warranty of title should be a ground when the title is precarious.

[19] Jordan v. Van Duzee, 139 Minn. 103, 165 N.W. 877 (1917); Martin v. Coffman, 87 Ohio App. 398, 95 N.E.2d 286 (1949).

[20] UNIFORM COMMERCIAL CODE § 2-312. Warranty of Title and Against Infringement; Buyer's Obligation Against Infringement.

(1) Subject to subsection (2) there is in a contract for sale a warranty that
   (a) The title conveyed shall be good, and its transfer rightful; and
   (b) the goods shall be delivered free from any security interest or other lien or incumbrance of which the buyer at the time of contracting has no knowledge.

> The warranty of quiet possession is abolished. Disturbance of quiet possession, although not mentioned specifically, is one way, among many, in which the breach of the warranty of title may be established.

The view advocated in this note, that the warranty of title is violated when the title conveyed is unsound although the buyer is not yet disturbed by adverse claimants, is adopted in the Code in connection with a particular situation. The Code specifies that "a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like. . . ."[21] A comment states that "this section rejects the cases which recognize the principle that infringements violate the warranty of title, but deny the buyer a remedy unless he has been expressly prevented from using the goods. Under this Article 'eviction' is not a necessary condition to the buyer's remedy since the buyer's remedy arises immediately upon receipt of notice of infringement; it is merely one way of establishing the fact of breach." If this be sound law as to merchants when a title is invalid by reason of infringements, it would appear to be sound law generally where the title is invalid by reason of other infirmities.

BAILEY PATRICK, JR.

Taxation—Depreciation—Useful Life, Salvage Value and Capital Gains Under the Declining Amount Depreciation Methods of the 1954 Code

The Internal Revenue Code of 1954 authorizes taxpayers in business to compute a reasonable allowance for depreciation by means of liberalized, declining amount methods in addition to the ordinary straight line method.[1] However, section 167(c) expressly provides that these liberalized methods "shall apply only in the case of property (other than intangible property) . . . with a *useful life* of 3 years or more . . . ." (Emphasis added.)[2]

[21] UNIFORM COMMERCIAL CODE § 2-312 (3).

[1] INT. REV. CODE OF 1954, § 167. Section 167(b) provides:

> For taxable years ending after December 31, 1953, the term "reasonable allowance" as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under any of the following methods:
> (1) the straight line method,
> (2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),
> (3) the sum of the years-digits method, and
> (4) any other consistent method productive of an annual allowance. . . .

[2] Section 167(c) has other limitations on the use of the liberalized methods of depreciation, not pertinent to this Note, which in effect require that such

In *Hertz Corp. v. United States*,[3] a recent district court decision, a thorough analysis was made of some of the most common issues of depreciation—useful life and salvage value. In 1954, 1955, and 1956, the taxpayer, an automobile rental agency, had held and used some of its automobiles an average period of 26 months. The average economic life of these vehicles for business purposes was four years. On the basis of this latter period, taxpayer sought to depreciate the vehicles under the declining balance method. The Commissioner disallowed the use of this method because the taxpayer had held the vehicles for only 26 months—a period less than the three-year period prescribed by section 167(c). Furthermore, the Commissioner disallowed declining balance depreciation deductions on trucks, even though the taxpayer had held the trucks more than three years, contending that taxpayer had taken depreciation beyond a reasonable salvage value.[4]

Taxpayer contended that it was entitled to use the method, urging that the useful life of the vehicles extended over the entire business life of four years, regardless of the holding period.[5] Further, taxpayer contended that no salvage value need be estimated and accounted for under the declining balance method, other than the residual sum inherent therein.

The specific issues before the court were: (1) whether it was the intent of Congress to change the meaning of "useful life" when enacting the 1954 Code; (2) if so, whether such new definition may be retroactively applied from the time of its appearance in the 1956 regulations; and (3) whether salvage value is inherent in the declining balance method or must be accounted for as required under the 1956 regulations.[6]

The court, after a review of legislative history and pertinent case law, concluded that taxpayer could not use the declining balance method for those vehicles held by it for less than three years, because Congress intended "useful life" to mean the life of the asset in the hands of taxpayer. However, it was held that the deficiency assessments of the Commissioner could not be applied retroactively to years before the promulgation of the asserted regulations of 1956, due to the fact that the taxpayer was justified in relying upon the Commissioner's acquiescence in the meanings of "useful life" and "salvage value" as those asserted by the taxpayer. Also, the court allowed the taxpayer to

tangible property shall have been completed or originally acquired after December 31, 1953.

[3] 165 F. Supp. 261 (D. Del. 1958).

[4] See generally Treas. Reg. §§ 1.167(a)-1(a), (c) (1956).

[5] Certified public accountants testified on behalf of the taxpayer that "useful life" has consistently meant, and still means, the economic life of the asset in whatever hands; and that the useful life of automobiles used for business purposes is four years. 165 F. Supp. at 265.

[6] 165 F. Supp. at 266.

depreciate the qualifying trucks down to the inherent residuum without accounting for salvage value as defined under the new regulations.[7]

As the court admitted, the problems raised are not only "interesting and novel, but also difficult of approach."[8] Perhaps an acceptable approach would be to show why depreciation assumes greater importance today than mere accounting procedure, how this importance led to the problems raised in the principal case, and how the court there deviated from the purpose of the 1956 regulations in holding salvage value to be inherent in the declining balance method.

Taken literally, "depreciation" is the converse of "appreciation," and means a decrease in value not necessarily due either to use or lapse of time. Here, the word is used to reflect, not the literal meaning, but the statutory language, *i.e.*, the amortization of long-term costs by periodic deductions of a "reasonable allowance for . . . exhaustion, wear and tear (including a reasonable allowance for obsolescence) . . . ."[9]

One authority concludes from an examination of early accounting literature in England that the idea of depreciation was recognized at the time of the American Revolution and related to the assignment of long-term plant costs to the various accounting periods.[10] Today, however, the concept of "depreciation" has come to mean more than mere accounting procedure. This is true because of the occurrence of two events: (1) the steady decline of the dollar's purchasing power, and (2) the enactment of the Internal Revenue Code of 1954. The former has induced business to seek a process whereby higher replacement costs can be anticipated in part from revenues to supplement the inadequate allowances of amortization—more specifically, depreciation. The 1954 Code appeared to give business such a process by way of the liberalized, declining-amount depreciation methods found under section 167, and the

[7] "On this latter point, both the Commissioner in the past and Congress presently are in complete agreement, and the intent of Congress being clear, I conclude that salvage value other than that which is inherent in the method is not a factor in determining depreciation under the declining balance theory of depreciation." 165 F. Supp. at 275.

[8] 165 F. Supp. at 266.

[9] INT. REV. CODE OF 1954, § 167(a). In United States v. Ludley, 274 U.S. 295 (1927), Mr. Justice Brandeis set out the general formula as follows:

"The amount of the allowance for depreciation is that sum which should be set aside for the taxable year, in order that, at the end of the *useful life* of the plant in the business, the aggregate of the sums set aside will (with *salvage value*) suffice to provide an amount equal to the original cost." (Emphasis added.) *Id.* at 300.

See also Even Realty Co., 1 B.T.A. 355 (1925); 4 MERTENS FEDERAL INCOME TAX § 23.33 (1954).

[10] In 1764, the following entry was made in an expense report for maintaining and preserving the canal from Forth to Carron Water: "I suppose in 20 years time many of the locks will want new gates, all of which will gradually fail in a few years after. I, therefore, suppose them all made at the end of 20 years and, therefore, 72 locks at 60 pounds per lock . . . 4,320 pounds." Perry Mason, *Illustrations of the Early Treatment of Depreciation*, 8 ACCOUNTING REV. 209, 210 (1933).

preferential capital gains treatment afforded certain business assets under section 1231.[11] These declining-amount methods allow the taxpayer to depreciate high initial costs against present sales so as to reduce taxable income and thereby gain a temporary advantage.[12] Probably the primary purpose of the declining-amount methods is to keep American industry modern by encouraging firms to retire plant assets before such assets became absolutely obsolete.[13] The declining balance method used by the taxpayer in the principal case was one of these methods.[14]

To the tax-conscious taxpayer who could take advantage of the declining-amount methods and the capital gain benefits of section 1231, an obvious opportunity to avoid taxes by converting ordinary income into capital gains presented itself. Even with the requirement of a three-year useful life as a condition precedent to the use of the declining-amount methods, the taxpayer, assuming that "useful life" was the period of economic usefulness of the asset, proposed to take the largest depreciation deductions allowable and then sell the assets after a one or two year holding period—a period during which the asset would be useful to him, but less than the economic life of the asset.[15] Obviously, since

[11] INT. REV. CODE OF 1954, § 1231. Section 1231(a) allows capital gain treatment, under specific circumstances, of "recognized gains on sales or exchanges of property used in trade or business." Section 1231(b) defines the term "property used in the trade or business." It includes, *inter alia*, non-inventoriable property which is held for more than six months and is depreciable under § 167.

[12] Most businessmen and accountants agree that the two basic objectives of a sound depreciation policy are: (1) to incur the lowest possible long-term tax costs, and (2) to achieve the maximum conservation of working capital. Inasmuch as depreciation generally does not affect the volume of sales, it is obvious that any change in working capital must come from the postponement of tax payments. This is the function of those liberalized methods of depreciation found under § 167(b) of the 1954 Code. Though the tax is merely deferred, a permanent advantage is derived from the *use* of the increased working capital. See generally Reynolds, The Impact of the Choice of Base and Method of Amortization, May 1957 (unpublished thesis in University of North Carolina Main Library).

[13] 165 F. Supp. at 272. H. R. REP. No. 1337, 83rd Cong., 2d Sess. 24 (1954), contains the following:

> More liberal depreciation allowances are anticipated to have far-reaching economic effects. The incentives resulting from the changes are well-timed to help maintain the present high level of investment in plant and equipment. The acceleration in the speed of the tax-free recovery of costs is of critical importance in the decision of management to incur risks. The faster write-off would increase available working capital and materially aid growing businesses in the financing of their expansion. For all segments of the American economy, liberalized depreciation policies should assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living. *Ibid.*

[14] See note 1 *supra*.

[15] The use of the 200 percent declining balance rate in case of short-lived properties would result in extremely fast write-offs. For example, in the case of an asset with a 2 year service life, the doubling of the 50 percent straight line rate would be equivalent to *expensing* the cost in the year of acquisition. These properties would retain substantial value and could be resold subject to capital gains rates.

To prevent unrealistic deductions and resulting tax avoidances, your committee has provided that the liberalized methods be made available only with

"useful life" was assumed to be the entire business life of the asset, "salvage value" was understood to be that residual or scrap value remaining after the business life was exhausted; and the taxpayer only accounted for salvage value in this manner, if at all.[16] Thus, in view of the relatively high market demand for used assets and the rapid depreciation of initial cost, it can be seen that these assets brought a price substantially higher than scrap value. The taxpayer obtained 1231 treatment on the gains realized,[17] causing revenue losses which the Treasury sought to combat by various methods.

These methods of attack by the Treasury were basically as follows: (1) asserting that the assets sold by taxpayer were items of inventory, and therefore not qualified for capital gain treatment under section 1231; (2) seeking to readjust useful life and salvage value, either by lengthening useful life so as to reduce the depreciation rate per annum or by increasing salvage value so as to reduce the amount of depreciation allowable; or (3) asserting that "useful life" was meant to be that period during which the asset was in the hands of the individual taxpayer, and "salvage value" to be the estimated value of the asset at time of disposition. It was on the basis of this third method that the 1956 regulations sought to prevent the tax avoidances and resulting revenue losses mentioned.

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respect to assets with *useful lives of 3 or more years.* (Emphasis added.) S. Rep. No. 1622, 83rd Cong., 2d Sess. 29 (1954).

[16] Koelling v. United States, 57-1 U.S. Tax Cas. ¶ 9453 (E.D. Neb. 1957); 4 Mertens Federal Income Tax § 23.28 (1954) ("as a matter of practice salvage value is sometimes ignored").

[17] Int. Rev. Code of 1954, §§ 1221, 1231.

To illustrate this idea assume that an automobile agency starts business in 1954 with 200 cars costing $300,000. If it depreciates these cars on a three-year basis and takes 66⅔% depreciation in the first year (twice the straight line rate) as allowed under the Code, its depreciation expense in 1954 would be $200,000. Assuming revenue of $500,000 and expenses other than depreciation of $300,000, net taxable income would be zero. Then suppose that the cars are sold at the end of the first year for $200,000; there would be a capital gain of $100,000. The total tax would be only $25,000. Comparatively, if the straight line method were followed, there would be, under the same facts, $125,000 ordinary income. The tax bill on this income at the corporate tax rate would be $59,500. The following schedule illustrates the difference:

Corporate Profit and Loss	Declining Balance	Straight Line
Ordinary Income	$500,000	$500,000
Expenses:		
Depreciation (*adjusted for salvage value)	$200,000	$ 75,000*
Other	300,000	300,000
Total	$500,000	$375,000
Taxable Ordinary Income	-0-	$125,000
Tax on Ordinary Income (corporate rates)	-0-	$ 59,500
Capital Gains	$100,000	-0-
Tax on Capital Gains (25%)	$ 25,000	-0-
Total Tax	$25,000	$ 59,500

In *Philber Equipment Co. v. Commissioner,*[18] new automobiles were leased for one or two years to taxpayer's customers and then sold upon termination of the leases. The Commissioner contended that the automobiles were inventoriable goods held principally for sale to the customers in the ordinary course of business and, therefore, that the gains received from the sales could not qualify for capital gain treatment under section 1231. The court of appeals reversed the judgment of the lower court in favor of the Commissioner upon the theory that the acquisition, use, and disposition of the vehicles were consistent with the *business purpose* of vehicle rentals. It was held that the gains from the sale of such assets qualified for 1231 treatment.[19]

In *Pilot Freight Carriers, Inc.,*[20] the taxpayer was depreciating its tractors over a period of four years, and its trailers over a period of five years. These vehicles were disposed of after average holding periods of 33 and 38 months, respectively. The Commissioner contended that the useful lives of the assets were being *understated* by the taxpayer because it (taxpayer) was receiving amounts upon disposition of the assets greatly in excess of their adjusted bases at time of sale. The Commissioner determined tax deficiencies computed on the basis of a useful life of *five* years for the tractors and *six* years for the trailers. The court held that the useful lives were correctly stated by the taxpayer. The Commissioner was not allowed to assert an understatement of salvage value because the issue had not been framed in his pleadings; but since salvage value cannot be redetermined unless useful life is also redetermined,[21] the omission probably did not weaken the Commissioner's case.

It can be seen that in seeking to prevent the taxpayer from realizing a substantial capital gain in the *Pilot* case and in seeking to prevent taxpayer from obtaining capital gain treatment altogether under section 1231 in the *Philber* case, the Commissioner was taking inconsistent positions. In the *Pilot* case, the Commissioner was seeking to prevent a capital gain by extending the useful lives of the assets beyond those periods estimated by the taxpayer. In the *Philber* case, the Commis-

[18] 237 F.2d 129 (3d Cir. 1956).

[19] *Accord,* Davidson v. Tomlinson, 165 F. Supp. 455 (S.D. Fla. 1958); Lynch-Davidson Motors, Inc. v. Tomlinson, CCH 1958 STAND FED. TAX REP. ¶ 9738. Taxpayer, an auto dealer, was held entitled to depreciation and capital gains treatment on various cars and trucks that were set aside from its used car business and used for company purposes. They were not properly includible in inventory since they were not held primarily for sale in the ordinary course of business.

[20] 25 P-H Tax Ct. Mem. 195 (1956).

[21] Treas. Reg. § 1.167(a)-1(c) provides in part:

> [S]alvage value shall not be changed at any time after the determination made at the time of acquisition merely because of changes in price levels. However, if there is a redetermination of useful life under the rules of paragraph (b), salvage value may be redetermined based upon facts known at the time of such redetermination of useful life.

sioner was apparently acquiescing in the useful lives of the assets, and allowing the gains realized, but asserting that such gains could not qualify for capital gain treatment.[22] These positions of the Commissioner were also inconsistent with his later position based on the 1956 Regulations where he sought to prevent the realization of a 1231 gain on the sale of such assets by defining "useful life" as *that period during which the asset was used by the individual taxpayer* and not as the business life of the asset.

Before the appearance of the 1956 Regulations, the taxpayer relied on the business community's definitions of the concepts of "useful life" and "salvage value."[23] Such reliance appeared justified since Congress, while recognizing the need for such concepts, has never announced an official explanation of either term.[24] The courts apparently construed the terms in the same manner as did the taxpayer; and the Commissioner, as illustrated by such cases as *Pilot*,[25] acquiesced in the community-developed meanings, *viz.*, just as "useful life" was considered that period for which the asset was functionally usable, "salvage value" was understood to mean that residual or scrap value which naturally remained after the asset was physically exhausted. Probably the most affirmative position towards definition taken by the Treasury, before the 1956 regulations, appeared in Bulletin "F." There the government listed such factors as wear and tear, decay or decline from natural causes, and "various forms of obsolescence attributable to the art, economic changes, inventions, and inadequacy to the growing needs of the trade or business" as important in the determination of the useful life of

[22] This contention of the Commissioner is clearly inconsistent with congressional intent as manifested by § 1231(b), expressly providing for capital gain treatment of certain depreciable assets. See note 11 *supra*. *Cf.* INT. REV. CODE OF 1954, § 179 (added by Technical Amendments Act of 1958, § 204), where businesses (not including trusts) may elect to write off 20% of the cost of tangible personal property in the year of acquisition, *in addition to* the regular depreciation on the balance. However, this additional 20% allowance is limited to tangible assets with a remaining useful life of at least 6 years.

[23] See note 16 *supra* and accompanying text.

[24] Although the terms were not given definition, the Treasury has utilized them from an early date. Treas. Reg. 45, art. 161 (1919) provided: "A reasonable allowance for depreciation is that amount which should be set aside for the taxable year [so that] . . . the aggregate of such amounts for the *useful life* of the property in the business will suffice, with the *salvage value*, at the end of such useful life to provide in place of the property its cost. . . ." (Emphasis added.) Article 165 of the same regulation provided that the "capital sum to be replaced should be charged off over the useful life of the property." See also Treas. Reg. 118, § 39.23(*l*)-1 (1953); Treas. Reg. 111, § 29.23(*l*)-1 (1942).

[25] See also Dorothy Caruso, 23 T.C. 836 (1955); Wier Long Leaf Lumber Co., 9 T.C. 990 (1947), *rev'd on other grounds*, 173 F.2d 549 (5th Cir. 1949); Norris Lumber Co., 7 CCH Tax Ct. Mem. 728 (1948); General Sec., Inc., 11 P-H B.T.A. Mem. 219 (1942), *aff'd per curiam*, 137 F.2d 201 (6th Cir. 1943) (taxpayer used cars for one or two years—depreciation allowed on basis of three-year useful life); Terminal Realty Corp., 32 B.T.A. 623 (1935); American Refrigerator Transit Co., 31 B.T.A. 465 (1934); Merkle Broom Co., 3 B.T.A. 1084 (1926) (automobiles exchanged within two years of purchase; court held that the proper rate of depreciation was 25%, over a *four year period*).

property in the trade or business. But nowhere in the Bulletin appear definitions of "useful life" and "salvage value."[26] The taxpayer, therefore, established depreciation policies based upon the accelerated methods of depreciation when they first became available under Section 167(b) of the 1954 Code, and in some instances, since it was understood that "useful life" meant the economic life of the assets, these methods were also applied to assets that were *held* for less than three years by the taxpayer.

Probably the first public notice of the coming change in the definitions of "useful life" and "salvage value" appeared when the Assistant to the Secretary of the Treasury, Laurens Williams, submitted a letter to Representative Thomas B. Curtis of Missouri. This letter appeared in the *Congressional Record* on June 16, 1955, and stressed the definitions of "useful life" and "salvage value" as they were to later appear in the new Regulations. The following is an excerpt from that letter:

> [U]seful life . . . is not the full, normally inherent useful life of the property. It is rather, the useful life of the property determined in accordance with the practice of the particular *taxpayer in his trade or business* or in the production of income. If a taxpayer has no consistent practice regarding the disposition of depreciable property, the estimated useful life of his depreciable assets should be determined in the light of experience in the taxpayer's business or industry. (Emphasis added.)[27]

Then, in 1956, the Treasury Regulations were issued defining "useful life" and "salvage value." The relevant depreciation provisions, set forth in section 1.167(a)-1, state that a reasonable allowance (for depreciation) is "that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan, so that the aggregate of the amounts set aside, *plus the salvage value,* will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property . . . . An asset shall not be depreciated below a reasonable salvage value under *any* method of computing depreciation . . . . The allowance shall not reflect amounts representing a mere reduction in market value." (Emphasis added.)

Section 1.167(a)-1(b) provides that the useful life "is the period over which the asset may reasonably be expected to be *useful to the taxpayer* in his trade or business . . . ." And, finally, section 1.167(a)-

[26] INT. REV. BULL. "F" (1920, rev. 1942), contained such information and statistical data as then constituted the best available indication of Internal Revenue practice and the trend of official opinion in the administration of the pertinent provision relating to determination of deductions for depreciation and obsolescence. The text was revoked in part by Rev. Rul. 90, 91, 1953-1 CUM. BULL. 43, 44, in which the IRS announced its general policy, *still in effect,* not to disturb depreciation deductions, and to propose adjustments only where there was a clear and convincing basis for a change. In 1955, the IRS announced that the remainder of the text was revoked. 1955-8 CUM. BULL. 53.

[27] 101 CONG. REC. 8570 (1955).

1(c) provides that "salvage value is the amount (determined at time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business . . . ." (Emphasis added.)

Obviously this change in policy was not well received by such taxpayers as the plaintiff in the *Hertz* case. They argued that the 1956 Regulations were not in accord with the intent of Congress,[28] that Congress understood the former definitions to be correct and contemplated the continued use of such former meanings, and that any change in these meanings would be a change in policy, requiring Congressional action.[29] On the other hand, the government argued that Congress left such definitive action to the Treasury under its interpretative powers, that the new regulations merely defined "useful life" and "salvage value" in more detail, and that there was actually no change in their definitions.[30]

The courts in the few cases decided under the 1956 Regulations seemed to uphold the authority of the Treasury to make such definitions, but took a modified position as to when the definitions were to become effective. This was because the statute of limitations had not run on the taxable years for which the Commissioner was seeking to assess deficiencies, and because the Commissioner had taken inconsistent positions before the 1956 Regulations and had long acquiesced in the practice followed by the taxpayer.[31] Courts generally do not favor retroactive laws,[32] nor the retroactive application of administrative regulations in-

[28] In *Hertz*, the court referred to extensive revenue hearings held by Congress during which the Treasury submitted reports to the Ways and Means Committee and the Senate Finance Committee warning against revenue losses through the benefits of capital gains treatment of profits from the sale of assets subject to accelerated depreciation. Also, when Congress limited the taking of capital gains in connection with the rapid amortization of emergency facilities, it did not see fit to limit capital gains upon the sale of assets used in the trade or business. 165 F. Supp. at 273. See H. R. Rep. No. 1337, 83rd Cong., 2d Sess. 25 (1954); S. Rep. No. 1622, 83rd Cong., 2d Sess. 29 (1954); *cf.*, Int. Rev. Code of 1954, §§ 168, 1238.

[29] "While it is true that a regulation by a department of Government addressed to and reasonably adapted to the enforcement of an Act of Congress, the administration of which is confided to such department, has the force and effect of law if it be not in conflict with express statutory provision, yet the power to enact regulations is not power to alter the law and the regulations have no power to amend or change existing statutory provisions." St. Louis Co. v. United States, 134 F. Supp. 411, 414 (D. Del. 1955).

[30] The Commissioner's argument could be supported by the fact that Congress set up a standard of "reasonable allowance for depreciation." Thus, it would not be a delegation of legislative power to permit the Treasury, a legislative agency, to make rules that best *define* what is reasonable. Maryland Cas. Co. v. United States, 251 U.S. 342 (1920).

[31] Evans v. Commissioner, CCH 1959 Stand. Fed. Tax Rep. (59-1 U.S. Tax Cas.) ¶ 9208 (9th Cir. Jan. 26, 1959), *reversing and remanding* 26 P-H Tax Ct. Mem. 156 (1957); Hertz v. Commissioner, 165 F. Supp. 261 (D. Del. 1958); Koelling v. United States, 57-1 U.S. Tax Cas. ¶ 9453 (E.D. Neb. 1957).

[32] Nichols v. Collidge, 274 U.S. 531 (1927); Schwab v. Doyle, 258 U.S. 529 (1922).

terpreting laws in such a manner as to be inconsistent with prior practice.[33]

In the recent case of *Evans v. Commissioner*,[34] the Commissioner asserted the new Regulations as he did in the principal case. The taxpayer was in the auto-leasing business. During the taxable years of 1951 and 1952, taxpayer leased all of his automobiles through a corporation owned by his son. The leased vehicles were returned to taxpayer at the termination of the leases, usually within 15 months of their original purchase, and then were immediately sold. The vehicles were to be depreciated on the basis of a four-year useful life period and taxpayer made no provision for salvage value. The Commissioner redetermined the depreciation on the basis of a useful life of 17 months and a salvage value of $1,325 for each vehicle, using as authority subsections 1.167(a)-1(b) and 1.167(a)-1(c) of the new regulations.[35]

The Tax Court held that "the automobiles which it (taxpayer) leased to U-Drive, Inc. for short-term, had a useful life of 15 months and a salvage value of $1,375."[36] Upon appeal by the taxpayer, the court of appeals reversed because the regulations asserted by the Commissioner and upheld by the Tax Court had been retroactively applied. The court relied on the *Hertz* case where it was stated:

> [T]axpayers had a right to file their returns in reliance upon the Commissioner's long-continued interpretation of his own regulations. Here a new regulation has been promulgated defining the term 'useful life' pursuant to a statute which *for the first time* has employed the term and where the intention of Congress is clearly contrary to the interpretation, as evidenced by conduct and frequent pronouncements, which the Commissioner has given it in the past. Common justice requires it be given a prospective construction only. (Emphasis added.)[37]

The court implied that the new regulations would be given effect prospectively.[38]

[33] Woodworth v. Kales, 26 F.2d 178 (1928); *cf.* Gasper v. Commissioner, 225 F.2d 284 (1955).

[34] Evans v. Commissioner, *supra* note 31.

[35] In the notice of deficiency directed to the petitioner, the Commissioner stated: "It has been determined that the average useful life of the automobiles used in *your* business based on *your* actual experience was not in excess of seventeen months and the average salvage value of said automobiles at the end of their useful life in your business was not less than $1,325. . . ." (Emphasis added.) *Id.* at 71, 399.

It is interesting to note that the Commissioner abandoned his contention that the taxpayer should not be allowed to treat the income from the sales as capital gain. As to this, the court remarked: "The Commissioner's abandonment of this approach was probably influenced by the decision of Philber Equipment Corp. v. Commissioner." *Ibid.*

[36] CCH 1959 STAND. FED. TAX REP. ¶ 9208 at 71, 392.

[37] 165 F. Supp. at 275.

[38] The court also allowed capital gain treatment to the taxpayer on the basis of *Philber*.

CONCLUSION

It appears reasonable to predict from *Philber,* and other more recent cases dealing with similar facts,[39] that any substantial gains realized by way of extraordinary circumstances from the sale of depreciable assets will be afforded capital gain treatment under section 1231, but that such gains will no longer be obtainable through a depreciation policy based upon the *economic* life of the asset because of the new definitions found under the 1956 Regulations. However, it seems clear from the principal case and the *Evans* case that the new regulations shall not be applied retroactively to years before their promulgation. The taxpayer, relying on the long-continued practice and position of the Commissioner in measuring useful life by the physical or economic life of the deprecable asset, cannot be retroactively assessed for an overstatement of depreciation based on the functional life of the asset.

In all probability, the taxpayer must look for a prospective application of "useful life" to mean the life of the asset in the taxpayer's individual trade or business. "Salvage value" will mean the estimated value of the asset to be realized at the time of its disposition.

However, it should be noted that, under the holding of the principal case, the taxpayer using the declining balance method need not account for salvage value as the estimated realizable value of the asset at time of disposition. The effect of such a holding, upon close analysis, is that a capital gain concession results in favor of the taxpayer using the declining balance method which is not available to taxpayers using any of the other methods of depreciation allowed by the Code.[40] This is because, under all other methods, salvage value must be deducted before arriving at depreciable basis.[41] Thus, under the other methods, the only capital gain possible is the difference between the estimated value and the price actually realized.

For illustrative purposes, assume that two taxpayers each acquire an asset at the cost of $3,000, intending to use it in the business for a period of four years. Taxpayer *A* uses the declining balance method. Taxpayer *B* uses the straight line method (any other method could also

[39] See note 19 *supra.*

[40] See note 1 *supra.* Such concession is based on the assumption that taxpayer holds the asset for more than the three years required by section 167(c), but less than the full business life, so that a substantial disparity will result between the price at time of disposition (salvage value, under the new regulations) and the inherent residual balance, the former exceeding the latter.

[41] Tres. Reg. § 1.167(a)-1(c) (1956) provides that "salvage value must be taken into account in determining the depreciation deduction either by a reduction of the amount subject to depreciation, or by a reduction in the rate of depreciation. . . . See, however, section 1.167(b)-2(a) for the treatment of salvage under the declining balance method."

Treas. Reg. 1.167(b)-2(a) provides that "while salvage value is not taken into account in determining the annual allowances under this method, in no event shall an asset (or an account) be depreciated below a reasonable salvage value."

apply here). Both expect to sell the asset at the end of the four-year period for an estimated price of $1,000. Assume, further, that the new concepts of "useful life" and "salvage value" under the 1956 Regulations are in effect, and that the principal case is available for precedent. Taxpayer *A,* by using the declining balance method, need not account for salvage value in arriving at his depreciable basis; taxpayer *B* must subtract his salvage value ($1,000) in arriving at the depreciable basis of his asset.

The comparative schedule is as follows:

ACCOUNTING	TAXPAYER *A* DECLINING BALANCE	TAXPAYER *B* STRAIGHT-LINE
Cost of Asset	$3,000	$3,000
Less Estimated Salvage Value	-0-	1,000
Depreciable Basis	$3,000	$2,000
Depreciation:		
1st year	$1,500	$ 500
2nd year	750	500
3rd year	375	500
4th year	187.50	500
Total Depreciation	$2,812.50	$2,000
Basis at Time of Sale (cost less deprn.)	$ 187.50	$1,000
Selling Price (after 4 yr period)	1,000.00	1,000
Long Term Capital Gain	$ 812.50	$ -0-
Tax at 25% (maximum)	203.13	-0-
Net Gain After Taxes	$ 609.37	$ -0-
add Recovery on Remaining Basis	187.50	1,000
add Recovery via Depreciation Deductions	2,812.50	2,000
Total Recovery on Investment	$3,609.37	$3,000
deduct Original Investment	3,000.00	3,000
Recovery Beyond Original Cost (available for replacement)	$ 609.37	$ -0-

Thus, taxpayer *A,* entitled to use the declining balance method because the useful life of the asset in his hands met the three-year condition imposed by section 167(c), was able to compensate for the declining purchasing power of the dollar by recoupment of more than the original cost of the asset and provide funds to meet the expected higher replacement cost of another asset.[42] Under the holding of the principal case, taxpayer *A* is allowed to depreciate beyond the estimated value at time of disposition (salvage value, under the new regulations) down to the

[42] See note 11 *supra.*

inherent residual value at the end of the useful life.[43] In all probability, this residual value will be a great deal smaller than the estimated value at the time of disposition; especially where the useful life is relatively short so that general obsolescence does not come into play to any appreciable degree.

Taxpayer *B*, having to estimate a reasonable salvage value as the expected price for the asset upon disposition, was confined to realize only the return of his original investment; and the increased cost of his replacement must be obtained from retained earnings or future income, after taxes at the ordinary rate. He gets no concession from the use of section 1231 other than those incidental capital gains which might result from the difference between estimated and actual salvage value.

Assuming that the inherent salvage value in the declining balance method is a "reasonable salvage value," it is obvious from the illustration, *supra*, that business will find it more lucrative to maintain a depreciation policy based on this method. The probable consequence is a mass exodus by industry from the other depreciation methods and a shift to the declining balance method.

That this is obviously not what Congress intended is evidenced by the fact that other methods were enacted without any indication of discrimination in favor of the declining balance method.[44] It may well be that Congress intended to grant taxpayers in industry extra benefits through the use of the accelerated depreciation methods; but to grant the concession allowed by the court in the principal case only to the declining balance method would result in the relative obsolescence of the other methods allowed under section 167(b) of the 1954 Code.

It is submitted that the *Hertz* case will not be followed on its specific holding that salvage value is inherent in the declining balance method and that the taxpayer need not cease depreciation at the point where the depreciated basis reaches the estimated value of the asset at the time of disposition.[45] It seems likely that the provisions of the new regulations relating to the definitions of "useful life" and "salvage value" will be upheld in toto, limited only by the requirement that they be given prospective effect.

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[43] That the court found such residual sum to be a "reasonable salvage value," although not clearly so stated, may be inferred from two facts. First, the issue of "reasonable salvage value" was asserted by the Commissioner; and, second, the court nevertheless decided in favor of the taxpayer. 165 F. Supp. at 274.

[44] See note 2 *supra*.

[45] It is possible that other courts, by a "stretch of the legal imagination," could construe this latter holding to mean that although the taxpayer does not have to account for salvage value other than that inherent in the method, he will have to stop the depreciation process upon reaching an adjusted basis equal to the estimated value of the asset at time of disposition. This is what section 1.167(b)-2(a) of the 1956 Regulations requires. Since the Commissioner was asserting this very section, it would appear difficult for the courts to give such construction to the holding.

Workmen's Compensation—Latent Injuries and the Period of Limitations on Filing Claims

When it is undisputed that an industrial accident arising out of and in the course of employment proximately results in a disabling injury, and the claim for compensation is filed within a reasonable time after the disability, few would doubt that an award favorable to the claimant should issue. Where the injury is latent or progressive, however, and does not manifest itself until long after the accident, an otherwise meritorious claim may be denied under a provision like G.S. § 97-24(a) which forever bars the right to compensation unless a claim is filed with the Industrial Commission within two years *after the accident.*[1] In *Whitted v. Palmer-Bee Co.,*[2] for example, a case involving the old one year limitation period, the claimant was involved in an apparently trivial accident and sustained a very slight injury to his right eye by a flying sliver of metal. The incident was reported to the employer promptly, but no claim for compensation was made as the employee returned to the job almost immediately. Some eighteen months later, however, a cataract developed in the right eye and the claimant totally lost the sight of the eye. The North Carolina Supreme Court held that the employee's failure to file claim within one year after the *accident* forever barred his right to compensation.[3] In other words, the limitation period began running on the date of the accident against a claim which had not at that time matured, and when the claim did mature some eighteen months later, it was held to be already barred.

A result more in keeping with the remedial purposes of workmen's compensation legislation is possible, indeed, is usual, where the limitation period is dated not from the time of the *accident,* but from the time of the *injury.*[4] In *Hughes v. Industrial Comm'n,*[5] where the seemingly

[1] N.C. GEN. STAT. § 97-24(a) (1958) provides: "The right to compensation under this article shall be forever barred unless a claim be filed with the Industrial Commission within two years after the accident, and if death results from the accident, unless a claim be filed with the Commission within one year thereafter." (The 1955 amendment enlarged the period for filing claims from one to two years.)

[2] 228 N.C. 447, 46 S.E.2d 109 (1948). The *Whitted* case distinguished Hardison v. Hampton, 203 N.C. 187, 165 S.E. 355 (1932) which had held that Form No. 19, to be filed with the Commission by the employer upon the occurrence or knowledge of an injury, constituted a "claim" within the intendment of G.S. § 97-24(a). At the time of the *Whitted* decision, however, Form No. 19 had been amended and contained a statement on its face that it was filed in compliance with G.S. § 97-92 *only* and was not the employee's claim for compensation. See Lilly v. Belk Bros., 210 N.C. 735, 188 S.E. 319 (1936).

[3] *Accord,* Wilson v. Border Queen Kitchen Cabinet Co., 221 Ark. 580, 254 S.W.2d 682 (1953); Gavigan v. Visiting Nurse's Ass'n, 125 Conn. 290, 4 A.2d 923 (1939); Rutledge v. Sanders, 181 Kan. 369, 310 P.2d 950 (1957).

[4] The "accident" contemplated by workmen's compensation legislation is any untoward event which results in some injury to the workman. It should be pointed out that in any accident giving rise to a right to workmen's compensation there will always be some traumatic or "injuring" effect at the precise moment of the accident although the employee may be unaware of it. It is the premise of this

trivial accident occurred in December, 1953, it was not until October, 1954 that "traumatic sinovitis, left wrist" was discovered. Claim for compensation was made more than twenty-one months after the accident. The Arizona court, while holding the claim timely as against a one year period of limitation which ran from the time of the *injury,* said that the employee could not have been expected to make a claim for compensation at the time of the accident, for the injury was not then compensable, and that consequently the statute of limitations did not begin to run until the injury became manifest.[6]

Summarization of the statutes, in respect to their claim period dates, is difficult because of considerable variety and rather frequent amendment. However, it appears that of the some fifty workmen's compensation statutes in effect in this country at least twenty-six clearly date the claim period from the time of the "accident."[7] Most of the remaining

Note, however, that when the injury is latent and its full extent is essentially unknowable until some time after the accident that produced it, the statute of limitations should not begin to run until the employee knows or has reason to know that he suffers from a compensable injury.

[5] 81 Ariz. 264, 304 P.2d 1066 (1956).

[6] *Accord,* Hartford Acc. & Indem. Co. v. Industrial Comm'n, 43 Ariz. 50, 29 P.2d 142 (1934) (cancer developed more than two years after the accident); Acme Body Works v. Koepsel, 204 Wis. 493, 234 N.W. 756 (1931) (cataract resulted more than six years after the accident).

[7] ALA. CODE tit. 26, § 296 (1940) (claim must be filed within one year from the time of the accident); ARK. STAT. § 81-1318 (Supp. 1957) (two years from the date of the accident; formerly ran from the date of the "injury" but amended in 1948); CAL. LAB. CODE § 5405 (one year from the date of the "injury," but § 5411 defines the date of the "injury" as the date of the "accident"); COLO. REV. STAT. ANN. § 81-13-5 (1954) (six months after the injury, but § 81-13-6 provides that any disability beginning more than five years after the *accident* is conclusively presumed not to be due to the accident; the latter section has been held to be a rule of evidence and not a statute of limitations. Industrial Comm'n v. Weaver, 81 Colo. 191, 254 Pac. 444 (1927)); CONN. GEN. STAT. § 31-168 (1958) (one year from the date of the accident); DEL. CODE ANN. tit. 19, § 2361 (Supp. 1958) (two years from the accident); GA. CODE ANN. § 114-305 (1956) (one year after the accident); IDAHO CODE ANN. § 72-402 (1949) (one year after the date of the accident); ILL. ANN. STAT. ch. 48, § 161 (Smith-Hurd 1950) (six months after the accident); IND. ANN. STAT. § 40-1224 (1952) (two years after the "occurrence of the accident"; formerly two years after the injury, but amended in 1947); KAN. GEN. STAT. ANN. § 44-520a (Supp. 1955) (120 days after the accident); KY. REV. STAT. § 342.185 (1959) (one year from the date of the accident); ME. REV. STAT. ANN. ch. 31, § 33 (Supp. 1957) (in no event to exceed two years from the date of the accident); MD. ANN. CODE art. 101, § 39 (1957) (sixty days after the date of the "accidental injury," but an amendment in 1957 provides that unless claim is made within eighteen months "from the date of the accident" the claim is completely barred); MINN. STAT. ANN. § 176.151 (Supp. 1958) (not to exceed six years from the date of the accident); MONT. REV. CODES ANN. § 92-601 (1949) (twelve months from the date of the "happening of the accident"); N.H. REV. STAT. ANN. § 281:16 (Supp. 1957) (ninety days from the occurrence of the accident); N.J. REV. STAT. § 34:15-51 (1959) (two years after the accident); N.M. STAT. ANN. § 59-10-74 (Supp. 1957) (one year after the accident "causing injury"); N.Y. WORKMEN'S COMP. LAW § 28 (two years after the accident); N.C. GEN. STAT. § 97-24(a) (1958) (two years after the accident); ORE. REV. STAT. § 656.274 (1955) (not later than one year after the accident); PA. STAT. ANN. tit. 77, § 602 (Supp. 1957) (sixteen months after the accident); S.C. CODE § 72-303 (1952) (one year

twenty-four date it from the time of the "injury."[8] In at least one of the "accident" type statutes[9] there are provisions which soften the effect somewhat in the case of latent or inherently unknowable injury caused by accident. Massachusetts,[10] Texas,[11] and Nevada[12] appear at first glance to have "accident" type statutes using the accident as a beginning point for the limitation period; but in each statute there are such broad grounds of excuse for "good cause," "mistake," and the like, that they are for all practical purposes in accord with the better rule that dates the limitation period from the time of the "injury."[13] Although there has been some legislative amendment equating "injury" with "accident,"[14] and, indeed, some successful judicial activity to that effect even under an "injury" type statute,[15] there would appear to be

after the accident); UTAH CODE ANN. § 35-1-99 (1953) (three years from the date of the accident); VA. CODE ANN. § 65-84 (1950) (one year after the accident); WIS. STAT. § 102.01(2) (1957) (limitation period starts on "date of the injury," but "date of the injury" is defined as the "date of the accident"). It should be pointed out that these provisions relate only to claims for accidental *injury*. If the claim is based on accidental *death* the limitation periods invariably begin on the death and not at the time of the accident.

[8] ARIZ. REV. STAT. ANN. § 23-1061 (1956); FLA. STAT. ANN. § 440.19 (1952); IOWA CODE ANN. § 85-26 (1949); MICH. STAT. ANN. § 17.165 (Supp. 1957); MISS. CODE ANN. § 6998-18 (1952); MO. ANN. STAT. § 287.430 (1949); N.D. REV. CODE § 65-0501 (1943); OHIO REV. CODE ANN. § 4123.84 (1953); OKLA. STAT. ANN. tit. 85, § 43 (1951); R.I. GEN. LAWS ANN. § 28-35-57 (1956) (two years after the "occurrence or manifestation of the injury"); S.D. CODE § 64.0611 (1939); TENN. CODE ANN. § 50-1003 (1955); WASH. REV. CODE § 51.28.050 (1952); W. VA. CODE ANN. § 2540 (1955); WYO. COMP. STAT. ANN. § 72-160 (Supp. 1957).

[9] LA. REV. STAT. § 23:1209 (1950): "[W]here the injury does not result at the time of, or develop immediately after the accident, the limitation shall not take effect until the expiration of one year from the time the injury develops, but in all such cases the claim for payment shall be forever barred unless the proceedings have been begun within two years from the date of the accident." Despite the provision for latent injuries, the claim still must be filed within two years after the date of the *accident*. See MALONE, LA. WORKMEN'S COMPENSATION § 77 (Supp. 1955).

[10] MASS. ANN. LAWS ch. 152, § 49 (1957) provides that failure to make claim within the prescribed six months after the "occurrence of the injury" will not bar proceedings for compensation if the late filing was occasioned by "mistake or other reasonable cause, or if it is found that the insurer was not prejudiced by the delay."

[11] TEX. REV. CIV. STAT. ANN. art. 8307, § 4a (1956) provides in part: "For good cause, the Board may, in meritorious cases, waive the strict compliance with the foregoing limitations as to notice, and the filing of claims before the Board."

[12] NEV. REV. STAT. § 616.500(6) (1957) also allows the Nevada Industrial Commission to waive the strict claim requirement where "for some sufficient reason" the claim could not have been made.

[13] 2 LARSEN, WORKMEN'S COMPENSATION § 78.42(a) (1952).

[14] CAL. LAB. CODE § 5411 provides: "The date of the injury, except in cases of occupational disease, is that date during the employment on which occurred the alleged incident or exposure, for the consequences of which compensation is claimed." Similarly, WIS. STAT. § 102.01(2) (1957) defines the "date of the injury" as the "date of the accident." See note 7 *supra*.

[15] Graham v. J. W. Wells Brick Co., 150 Tenn. 660, 266 S.W. 770 (1924). The court stated that "while the terms 'accident' and 'injury' are not synonymous, the accident produced the injury and in point of time they were concurrent. [T]he legislature . . . fixed the date of the injury at the date of the accident and not at some remote time thereafter when the injured employee became definitely satisfied that he was disabled as a result of the accident." 150 Tenn. at 667, 266 S.W. at

overwhelming judicial agreement that under a limitation period dating from the time of the "injury" no claim for compensation arises until the injury results in disability, or in some other overt manner becomes apparent to the claimant.[16]

It is submitted that the harsh result indicated under an "accident" type statute like North Carolina's is the product of a failure to keep in mind the benevolent purposes of workmen's compensation legislation, and to a reluctance to interpret the "claim" for compensation in latent injury cases so as to effectuate those purposes. To say that the limitation period begins to run from the time of the "accident" and not from the time of some compensable injury is to say in those cases where the accident and the injury are not coeval that it begins to run before a claim or a cause of action has really accrued.[17] In common law negligence cases, of course, the cause of action for damages for personal injuries accrues from the time the negligence operates harmfully on the plaintiff, that is, at the time of the accident, and usually the plaintiff's knowledge that any of his rights have been violated is deemed immaterial.[18] But in workmen's compensation the right to compensation is predicated not on negligence but on the sound policy that the expense of industrial injury, however faultlessly incurred, should be distributed to the public

772. The case in effect was overruled, however, in Ogle v. Tenn, Eastman Corp., 185 Tenn. 527, 206 S.W.2d 909 (1947) and it may be safely said that today Tennessee is an "injury" jurisdiction. An interesting example of judicial vacillation on the "accident" versus "injury" problem is to be found in the Oklahoma cases. In Brown & Root, Inc. v. Dunkelberger, 196 Okla. 116, 162 P.2d 1018 (1945), the Oklahoma court had held that the statute of limitations did not begin to run against the filing of a claim for compensation until the disability arising from the injury became apparent to the employee. Three years later, however, in Tulsa Hotel v. Sparks, 200 Okla. 636, 198 P.2d 652 (1948) the Oklahoma court adopted a strict construction policy and in effect overruled the salutary holding of the *Dunkelberger* case.

[16] Salt Lake City v. Industrial Comm'n, 93 Utah 510, 74 P.2d 657 (1937). This decision reversed a line of cases based on Utah Consol. Mining Co. v. Industrial Comm'n, 57 Utah 279, 194 Pac. 657 (1920), which had applied a general statute of limitations and dated it from the accident. (Regrettably, however, the sound holding of the *Salt Lake City* case is now itself legislatively overruled by an amendment to the Utah compensation statute which dates the period from the time of the accident. UTAH CODE ANN. § 35-1-99 (1953). Applying the new amendment, the Utah court in McKee v. Industrial Comm'n, 115 Utah 550, 206 P.2d 715 (1949) said that the claimant's right to compensation was forever barred notwithstanding the fact that he obtained no competent medical diagnosis of his work-caused injury until three years after the accident and had no knowledge of his latent condition until that time.)

[17] Salt Lake City v. Industrial Comm'n, note 16 *supra*, at 513, 74 P.2d at 658.

[18] Shearin v. Lloyd, 246 N.C. 363, 98 S.E.2d 508 (1957); Butler v. Bell, 181 N.C. 85, 106 S.E. 217 (1921). *But see* Saffold v. Scarborough, 91 Ga. App. 628, 86 S.E.2d 649 (1955), to the effect that the general rule in negligence cases that the cause of action accrues and that the statute of limitations runs from the moment of injurious impact should not apply to that type of negligence case involving inherently unknowable harm. The Georgia court said that in such a case the statute of limitations should not begin to run until the plaintiff had reason to know he had a cause of action. *Cf.* Bradt v. United States, 221 F.2d 325 (2d Cir. 1955).

as a cost of production.[19] Consequently, the negligence rules are inapplicable to workmen's compensation legislation. As the Utah court said in *Salt Lake City v. Industrial Comm'n*:[20]

> The compensation act . . . imposes a duty on employers to pay compensation to employees who suffer disability or loss from an injury by accident arising out of or in the course of employment. Not until there is an accident and injury and disability or loss from the injury does the duty to pay arise. *A mere accident does not impose the duty to pay.* Accident plus injury therefrom does not impose the duty to pay. But accident plus injury which results in disability or loss gives rise to the duty to pay. (Emphasis added.)

To be compared with the Utah court's cogent analysis of the nature of a claim for compensation made in an "injury" jurisdiction is that of the Pennsylvania Superior Court in the case of *Lewis v. Carnegie-Illinois Steel Corp.*[21] There a solution of muriatic acid and water was accidentally splashed into the employee's eye, but no serious injury or disability resulted until more than four years later when the claimant lost the sight of the eye as a direct result of the original accident. Applying a one year period of limitation dating from the time of the accident, and holding the claim barred, the court made this curious statement:

> A claim for personal injury arises simultaneously and is complete with the happening of the accident. . . . The statutory limitation . . . applies to the cause of action (the splashing of muriatic acid into the left eye) and not to the extent of the injury (the loss of sight of that eye).[22]

It would doubtless come as a surprise to many workmen and employers in Pennsylvania to learn that upon the occurrence of any accident in the course of employment, however minor and however devoid of any disabling injury, there should exist a "cause of action" for workmen's compensation. The effect of such a strict interpretation of the limitation period for filing claims is to lift the latent injury case out of a statute that was intended to compensate workmen for injuries resulting in a loss of wages and to protect the public from the expense of providing for their care.[23]

The latent injury, traceable to a specific traumatic event which is isolable in point of time, is factually distinguishable from the similarly troublesome occupational disease which results slowly over a relatively

[19] Vause v. Vause Farm Equip. Co., 233 N.C. 88, 63 S.E.2d 178 (1951).
[20] 93 Utah 510, 513, 74 P.2d 657, 658 (1937).
[21] 159 Pa. Super. 226, 48 A.2d 120 (1946).
[22] *Id.* at 228, 48 A.2d at 121.
[23] Baltimore Steel Co. v. Burch, 187 Md. 209, 49 A.2d 542 (1946).

long period of time because of repeated exposure to a particular hazard.[24] The factual distinction is exemplified in the hernia cases. If the hernia follows as a result of a single definite "accident" it is an "accidental hernia," whereas if it develops as a result of certain types of lifting over a long period of time it may be an "occupational hernia." But aside from the factual difference, there would seem to be little difference in legal principle. The Maryland court,[25] in construing a "date of the disability" limitation provision applicable both to occupational diseases and to accidental injuries, said that in the case of occupational disease the statute of limitations would begin to run "from the time the employee . . . knew or had reason to believe that he was suffering from an occupational disease and that there was a causal connection between his disability and occupation."[26] The same court used much the same reasoning in an accidental injury case,[27] saying that in such event the limitation period does not begin to run until "it becomes or should become reasonably apparent to a workman that he has a compensable disability."[28] The point is that the legislatures and courts have come to recognize the inherently unknowable character of the occupational disease in its earlier stages, and generally rather liberal claim periods for that category of disability have been provided.[29] Even in many of those jurisdictions where the limitation period on accidental injuries dates from the time of the accident, there are to be found separate provisions allowing claims for occupational disease to be filed within a certain period after "disability," "first symptom," "diagnosis," "manifestation," etc.[30] For example, G.S. § 97-58 provides that claims for occupational disease may be filed within one year from "death, disability, or disablement, as the case may be."[31] The North Carolina Supreme Court, in construing this section, has said that the legislature did not intend to require employees suffering from compensable occupa-

[24] Rathjen v. Industrial Comm'n, 233 Wis. 452, 289 N.W. 618 (1940).

[25] Consolidation Coal Co. v. Porter, 192 Md. 494, 64 A.2d 715 (1949).

[26] *Id.* at 506, 64 A.2d at 721.

[27] Gracie v. Koppers Co., 213 Md. 109, 130 A.2d 754 (1957).

[28] *Id.* at 114, 130 A.2d at 757.

[29] See generally, 100 C.J.S., *Workmen's Compensation* § 468 (8)b (1958).

[30] Compare VA. CODE ANN. § 65-84 (1950), requiring that a claim for an accidental injury be filed with the Commission within one year after the accident, *with* VA. CODE ANN. § 65-49 (Supp. 1958), allowing a claim for occupational disease to be filed within one year after the claimant experiences a distinct manifestation, or a diagnosis is made, whichever shall first occur, of an occupational disease.

[31] N.C. GEN. STAT. § 97-58(a) (1958). The term "disability" is defined as an incapacity to earn the wages which the employee was receiving at the time of the injury in the same or any other employment. G.S. § 97-2(i). The term "disablement" as it is applied to cases of asbestosis and silicosis means the actual incapacitation by either disease to earn the wages which the employee was receiving "at the time of his last injurious exposure to asbestosis or silicosis, but in all other cases of occupational disease 'disablement' shall be equivalent to 'disability'. . . ." G.S. § 97-54.

tional disease to diagnose their own condition, or to file a claim for compensation before they know they have such a disease or run the risk of having their claim barred by the statute of limitations.[32] The operative factors in a claim for compensation based on an occupational disease in North Carolina, therefore, are disability and an awareness of the incidence of the particular disease. The employee suffering from an occupational disease[33] does not stand the risk of losing his right to compensation until he knows or has reason to know that he actually suffers from the disease. But the employee who sustains a latent or progressive injury in an industrial accident, an injury as inherently insidious in many instances as an occupational disease, stands to lose forever his right to compensation unless the injury becomes apparent within two years after the accident. It is submitted that notwithstanding the *factual* distinction between occupational disease and accidental injury in their inception, their development is essentially the same, and the same legal principles should apply. For in either event no amount of diligence on the part of the employee would avail until his condition became manifest.

The purpose of a limitation period on filing claims for compensation is the same as for any other statute of limitations: to protect the person to be charged from stale or fraudulent claims that are too old or too doubtful to be successfully investigated and defended.[34] It has been argued that if an employer is to be open to claims filed several years after the occurrence of the accident the very purpose of the limitation period will be defeated.[35] The argument may be simply illustrated. An employee is involved in an accident in the course of his employment and experiences a slight twinge of pain in the back. But if there is any serious injury he is completely unaware of it. Then months or even years later while working around his house he lifts a heavy bag of cement and "slips" a disc. The workman remembers the employment-connected accident but no one else does. To answer the argument, it may be pointed out that there are actually two distinct limitation periods in most statutes[36] with which the employee must comply: The first is the period for giving *notice* of the accident to the employer, and the second is the period for filing *claim* with the particular agency or court for compensation. G.S. § 97-22 requires that written notice of the accident be given to the employer within thirty days after its occurrence,

[32] Huskins v. United Feldspar Corp., 241 N.C. 128, 84 S.E.2d 645 (1954); Duncan v. Carpenter, 233 N.C. 422, 64 S.E.2d 410 (1951).

[33] See N.C. GEN. STAT. § 97-53 (1958) where the compensable occupational diseases are enumerated.

[34] Butler v. Bell, 181 N.C. 85, 106 S.E. 217 (1921); Harris v. Traders & Gen. Ins. Co., 200 La. 445, 8 So. 2d 289 (1942). See 1 WOOD, LIMITATIONS OF ACTIONS § 4 (4th ed. 1916).

[35] See 2 LARSEN, *op. cit. supra* note 13, § 78.42(b).

[36] HOROVITZ, WORKMEN'S COMPENSATION 247 (1944).

unless reasonable excuse for late notice is made to the satisfaction of the Industrial Commission.[37] The notice provision should certainly give the employer sufficient protection with respect to investigating the facts of the accident, minimizing the degree of the injury, and soliciting the statements of witnesses. And furthermore the "doubtful claim" argument has been satisfactorily met by Professor Larsen who points out that in any event the claimant must still prove his case, including the "arising out of" requirement and the exercise of due care in discovering the nature of his disability.[38] The ultimate question is whether the procedural purposes to be served by the "accident" type statute are so necessary as to justify their defeating a piece of purportedly protective and remedial legislation.

As the courts are too prone to apply the limitation provision under an "accident" statute by its strict letter, the obvious remedy lies with the legislature, although an occasional court will acknowledge that "justice and fairness" speak for a contrary conclusion.[39] However, at least one court[40] has assumed the task of carrying over into the adjective

[37] N.C. GEN. STAT. § 97-22 (1958). The "reasonable excuse" provision permits the excuse of waiver, or estoppel in not notifying the employer of the accident within the prescribed time. Yet the North Carolina court speaks of the limitation period for filing a *claim* for compensation as a condition precedent to the substantive right to receive compensation, and asserts that it is not an "ordinary" Statute of Limitations. Winslow v. Carolina Conference Ass'n, 211 N.C. 571, 191 S.E. 403 (1937). If that is true, there should be no question of waiver of the defense of late filing, or estoppel to assert it, or even fraud in causing the late filing, since the limitation period, if a condition precedent, would limit the *liability* and not the *remedy*, in which case it could not be construed on equitable considerations as analogous to waiver and estoppel. Simons v. Halcomb, 98 Conn. 770, 120 Atl. 510 (1923). Notwithstanding the North Carolina courts assertion that the limitation period is a condition precedent, and even jurisdictional to the right of the Commission to hear a claim, Wray v. Carolina Cotton & Woolen Mills Co., 205 N.C. 782, 172 S.E. 487 (1934), in other cases involving the claim period question the court has stated that, "It must not be understood that we hold an employer may not by his conduct waive the filing of a claim within the time required by law. The law of estoppel applies in compensation proceedings as in all other cases." Biddix v. Rex Mills, Inc., 237 N.C. 660, 75 S.E.2d 777 (1953). An allied problem, to which the same general principles of this comment relate, is that of a recurrence of an injury or a change of condition. G.S. § 97-47 provides that the Commission may review an award and on such review make an award ending, diminishing, or increasing the compensation previously awarded, but no such review can be made after twelve months from the date of the last payment of compensation. Medical or other treatment bills paid by the employer are treated as payments of compensation for the purposes of this section only. It has no relation to the filing of original claims under G.S. § 97-24(a). Payment of medical bills as allowed by G.S. § 97-25 (for the purpose of diminishing the severity of an injury) will not have the effect of an admission of liability by the employer or constitute a waiver of the necessity of filing timely claim with the Commission. Biddix v. Rex Mills, Inc., *supra*.

[38] 2 LARSEN, *op. cit. supra* note 13, § 78.42(b).

[39] Bergstrom v. O'Brien Sheet Metal Co., 251 Minn. 32, 86 N.W.2d 82 (1957). This was also recognized by Mr. Justice Denny in the *Whitted* case. "It may be regretted that we have no provision in our Workmen's Compensation Act to preserve and protect the rights of employees in cases like the one before us." Whitted v. Palmer-Bee Co., 228 N.C. 447 at 453, 46 S.E.2d 109 at 113 (1948).

[40] Keenan v. Consumers Public Power Dist., 152 Neb. 54, 40 N.W.2d 261 (1949).

law of workmen's compensation the beneficent qualities of the substantive, and has realized that the purposes of legislation involving a whole new area of claims and liabilities cannot be effectuated by a rigid interpretation of every word. The Nebraska court, faced with a latent injury problem and a straight "accident" type statute, held that the "literal limitation of the statute has no application where the injury is latent and progressive and the employee is without knowledge of the condition."[41] The court said that in such a case the action for compensation could be brought within one year from the time the claimant obtained knowledge of his condition.

An interpretation of a straight "accident" type statute as running from the time the employee knew or ought to have known that he had a compensable injury can be supported on various grounds.[42] In the first place, it could hardly be presumed that the legislature intended to defeat the purpose of the act by setting up a virtually impossible claim requirement in the case of latent injury, and certainly to the extent that meritorious claims are not awarded the purpose of the act is thwarted.[43] Further, the claim period section should be construed in such a way as to meet the typical coverage formula of "*injury* by accident, arising out of and in the course of employment."[44] Since an *injury* is certainly as important to the coverage formula as an *accident*, the word "accident" in the claim period section could be construed as meaning "accidental injury." Professor Larsen advocates this sensible construction, pointing out that an "accidental injury" is the very heart of the coverage formula.[45] Finally, the constitutionality of legislation that at once destroys common law rights for personal injuries sustained during the course of employment and prevents the right to compensation by a procedural road block such as an "accident" type limitation provision has been questioned,[46] especially if in the particular jurisdiction there exists a state constitutional provision, as in North Carolina, that purports to assure a legal remedy for every injury.[47] While the latter

[41] *Id.* at 57, 40 N.W.2d at 263.

[42] See, *e.g.*, Austin, *Essay on Interpretation*, in 2 JURISPRUDENCE 989 (5th ed. 1885). "Where a statute is remedial, and so entitled to a liberal construction, judicial *extensive* interpretation has always been recognized as *genuine* interpretation." (Emphasis added.)

[43] Mulhall v. Nashua Mfg. Co., 80 N.H. 194, 115 Atl. 449 (1921).

[44] As to the coverage formula, see Withers v. Black, 230 N.C. 428, 53 S.E.2d 668 (1949). *Cf.* Griffitts v. Humphrey, 199 Tenn. 528, 288 S.W.2d 1 (1955), expressly adopting the language of Salt Lake City v. Industrial Comm'n, 93 Utah 510, 74 P.2d 657 (1937) which is set out in the text at note 20 *supra*.

[45] 2 LARSEN, *op. cit. supra* note 13, § 78.42(d).

[46] *Ibid.*

[47] N.C. CONST. art. I, § 35: "All courts shall be open; and every person for an injury done him in his lands, goods, person, or reputation, shall have remedy by due course of law . . . ." As to the enactment of statutes in other jurisdictions abolishing civil actions for alienation of affections, criminal conversation, seduction, and breach of promise to marry, see, generally I VERNIER, AMERICAN FAMILY LAWS § 6 (1935). The constitutionality of such statutes generally has been

argument has considerable merit, it overlooks the fact that workmen's compensation is not predicated on negligence or any other historically actionable wrong, but creates a whole new statutory area of claims and liabilities that were non-existent at the common law. If it happened that in any particular case the accidental injury was caused by the negligence of the employer, denial of a remedy by way of the procedural bar might well violate such a constitutional guaranty.

The North Carolina court will presumably adhere to its strict construction policy, however, and if relief is to be had from the present straight "accident" type statute the General Assembly will probably have to provide it. The 1955 amendment, enlarging the claim period from one to two years after the accident, would at least prevent the harsh result of the *Whitted* case on its particular facts. But it is respectfully submitted that the claim period provision should be amended as follows:

N.C. GEN. STAT. § 97-24(a).—"The right to compensation under this article shall be barred unless a claim is filed with the Industrial Commission within two years from the date the employee knew or ought to have known the nature of his injury and its relation to the employment. If death results from such injury, claim must be filed with the Commission within one year after the death."

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upheld on the ground that the marriage contract results in a special relation created by the state, and thus subject to the state's control. Fearon v. Treanor, 272 N.Y. 268, 5 N.E.2d 815 (1936), *rehearing denied* 273 N.Y. 528, 7 N.E.2d 677, *appeal dismissed* 301 U.S. 667, *rehearing denied* 302 U.S. 774 (1937).