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## Recent Case Notes

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## RECENT CASE NOTES

### Conflict of Laws—Full Faith and Credit— Local Public Policy

*P* recovered judgment against *D* in a Vermont court for the alienation of affections of *P*'s husband. The tort was primarily committed in New York, but was unenforceable there due to a statute which provided: "No act . . . done within this State shall operate to give rise either within or without this state, to any cause of action abolished by this article." *P* then sued in a New York court for judgment on the Vermont judgment and recovered. *D* appealed on the theory that the full faith and credit clause of the United States Constitution does not require a state to enforce a foreign judgment based on a cause of action which violates its manifest public policy. *Held*: As there is no constitutional question regarding the validity of the New York statute outlawing causes of action for alienation of affections, the appeal is dismissed and the Vermont judgment is accorded full faith and credit. *Parker v. Hoefler*, 1 N.Y.2d 873, 136 N.E.2d 709 (1956).

Article IV, § 1 of the United States Constitution provides that "Full faith and credit shall be given in each state to the . . . judicial proceedings of every other state." Pursuant to this, Congress has directed that every state must allow judgments of the courts of sister states ". . . the same full faith and credit . . . as they have by law or usage in the courts of such State from which they are taken." 28 U.S.C. §§ 1738, 1739 (1948). See *Hampton v. McConnel*, 4 U.S. (3 Wheat.) 207 (1818). But for a judgment to be entitled to full faith and credit, it is an absolute necessity for the original court to have had actual jurisdiction of both the subject matter of the suit and the parties thereto, *Milliken v. Meyer*, 311 U.S. 457 (1940), and the defendant may resort to evidence *aliunde* the record to prove that jurisdiction of either the subject matter or parties is lacking. *McDonald v. Mabee*, 243 U.S. 90 (1917).

Equally well established law under the full faith and credit clause is the general rule that if it is a valid judgment sued upon, the court in which the second judgment is sought may not look to the merits of the original decision, but must enforce it no matter how gross the error of fact or law upon which it is based. *Fauntleroy v. Lum*, 210 U.S. 230 (1908); *Roche v. McDonald*, 275 U.S. 449 (1927). And see *Christmas v. Russell*, 72 U.S. (5 Wall.) 290 (1866). Further,

it is a well-established conflict of laws rule that the law of the place where the tortious injury occurred will govern when the suit is brought in a sister state. *Young v. Masci*, 289 U.S. 253 (1933); *Loucks v. Standard Oil Co.*, 224 N.Y. 99, 120 N.E. 198 (1918); RESTATEMENT, CONFLICT OF LAWS § 378 (1934). It might be thought that the operation of these two rules would be in conflict if there is rendered a valid foreign judgment based upon an erroneous interpretation of the substantive law of the place where the "tort" occurred, for it is fundamental that if no cause of action existed in the state where the "tortious" act happened, usually there cannot be a correct recovery in a sister state even though that jurisdiction does recognize a cause of action. *Kansas City Southern Ry. Co. v. Phillips*, 174 Ark. 1019, 298 S.W. 325 (1927); *Howard v. Howard*, 200 N.C. 574, 158 S.E. 101 (1931); *Ewell v. Cardinal*, 53 R.I. 469, 167 Atl. 533 (1933). Nevertheless, the full faith and credit clause controls and the valid foreign judgment must be enforced, even though it is based on a mistake of law and is against the statutory public policy of the forum. *Fauntleroy v. Lum*, *supra*. However, there are a few situations which will permit a state to refuse enforcement of a foreign judgment, *viz.*: where the foreign court lacked jurisdiction (treated above); where the judgment is procured by certain types of fraud, or is penal in nature; or where the local judicial machinery will not accommodate the judgment in question. See STUMBERG, CONFLICT OF LAWS 111 (2d. ed. 1951).

The last mentioned "exception" has arisen in two situations: (1) where procedural jurisdiction of the local courts does not encompass the relief sought, and (2) where the local judicial machinery is incompetent to enforce the foreign judgment. As to the former, if a local court of general jurisdiction lacks the power to adjudicate issues between the parties, the full faith and credit clause does not require the state to provide a competent court. See *Anglo-American Provision Co. v. Davis Provision Co.*, 191 U.S. 373 (1903), where it was held that New York courts of general jurisdiction lacked the power to hear cases where all parties were foreign corporations not doing business in New York. But a state may not defeat the full faith and credit clause in favor of its own public policy merely by limiting the jurisdiction of its courts, if the limitation goes only to the merits of the case. *Fauntleroy v. Lum*, *supra*; *Hughes v. Fetter*, 341 U.S. 609 (1951); *Angel v. Bullington*, 330 U.S. 183 (1947); *Bröderick v. Rosner*, 294 U.S. 629 (1935). Further, the limitation is ineffective as to foreign judgments unless it is solely of a procedural

nature which deprives the court of power to act in that general type of case. *Anglo-American Provision Co. v. Davis Provision Co.*, *supra*. A statute which purports to deprive the court of jurisdiction to render a judgment on a foreign judgment (based upon a cause of action the substantive merits of which violate the state's public policy) will not negative the effect of the full faith and credit clause. *Kenney v. Supreme Lodge of the World, Loyal Order of Moose*, 252 U.S. 411 (1920).

As to the second situation where the exception has arisen, *i.e.*, where the local judicial machinery is inadequate, the full faith and credit clause does not dictate that new procedures must be adopted to enforce foreign judgments. *Masci v. Young*, 109 N.J.L. 453, 162 Atl. 623 (1932), *aff'd*, 289 U.S. 253 (1933), *supra*; *Mertz v. Mertz*, 271 N.Y. 466, 3 N.E.2d 597 (1936); *Weidman v. Weidman*, 274 Mass. 118, 174 N.E. 206 (1931) (full faith and credit denied in equity where only the law courts had power over that subject matter).

It is evident from the above that the statutes, case law, and public policy of each state are almost at the mercy of the interpretation and construction accorded it by courts of sister states. To counteract the undesirable enforcement of erroneous foreign judgments, some courts have allowed the local judgment debtor a cause of action against the resident plaintiff who goes to another state and recovers judgment, possibly erroneous, which is enforced locally under the full faith and credit clause. For example, where wages due a Texas resident from his railroad employer were garnished in California (garnishment of wages due is illegal in Texas), the Texas resident was allowed to recover damages for wrongful garnishment, thus indirectly vindicating this Texas public policy and discouraging future infractions. *Hall's Clothing Co. v. Ramirez*, 184 S.W.2d 296 (Tex. Civ. App. 1944) *error dismissed*.

In the principal case, the public policy of New York was clearly violated, for the alienation of affections of P's husband did not constitute an actionable tort in New York where the act primarily occurred, and it follows that the correct conflict of laws rule would require judgment in another state to be for D, regardless of the law of the state where the suit is brought. Nevertheless, New York courts, bound by the mandate of the full faith and credit clause, were forced to give effect to the erroneous Vermont judgment. Perhaps a state desiring to protect its more important public policies from abusive violations under the full faith and credit clause, can

do so constitutionally by creating a cause of action in favor of the resident held liable under such a foreign judgment. This would be a more effective remedy in practice than that now available, *viz.*: certiorari to the United States Supreme Court for reversal of the erroneous foreign judgment. Otherwise the courts of sister states, by applying erroneous conflict of laws principles, are in effect making law for one another.

*Morton L. Susman*

### Evidence—Admissibility of Confessions—Effect of Illegal Detention

*D* and two other suspects were arrested at 2:30 p.m. and taken to police headquarters in the District of Columbia. Sometime after 9:30 p.m., *D* confessed to the crime of which he was suspected. The police then attempted for the first time to contact a magistrate with whom they could file charges against *D*. *D* contended that the confession was illegal and inadmissible as evidence since it was procured during illegal detention, inasmuch as the federal officers did not take him before a committing magistrate without unnecessary delay. *Held*: A delay of seven hours before filing charges is not unreasonable and does not give rise to an illegal detention where the prisoner is one of three suspects, since the police should not be required to file charges until they develop some justification for them; further, a confession must have been obtained as a result of the delay to be inadmissible. *Mallory v. United States*, 236 F.2d 701 (D.C. Cir. 1956), *cert. granted*, 352 U. S. 877 (1956).

The Federal Rules of Criminal Procedure provide that "An officer making an arrest . . . shall take the arrested person without unnecessary delay . . ." before a committing magistrate and that ". . . a complaint shall be filed forthwith." FED. R. CRIM. P. 5 (a). This rule was construed by the Supreme Court to impose on federal officers a positive legal duty to commit promptly; a breach of that duty will cause a detention thereafter to be illegal and a confession obtained during that period inadmissible if the circumstances surrounding the detention and disclosure show physical or psychological coercion which is a flagrant disregard of the procedure prescribed by Congress. *McNabb v. United States*, 318 U.S. 332 (1942); *cf. United States v. Mitchell*, 322 U.S. 65 (1944). The *McNabb* rule was later expanded in effect by the Court's statement that such a confession was inadmissible whether or not it was the result of torture, physical or psychological. *Upshaw v. United States*, 335 U.S. 410 (1949). This ap-

parently made illegal detention *alone* enough to cause a confession to be barred. See Comment, *Admissibility of Confessions Obtained During Illegal Detention*, 3 Sw.L.J. 452 (1949). However, a confession is admissible if the detention which preceded it was lawful, even though the confession be followed by an illegal detention. *United States v. Mitchell*, *supra*. Further, a confession made to one crime while the suspect is being legally detained in connection with another crime is admissible, even though the prisoner has not been committed for the crime to which he confesses. *United States v. Carignan*, 342 U.S. 36 (1950).

Seemingly, the Court in this case has reverted to the *McNabb* rule and ignored the *Upshaw* interpretation by saying that the confession must have been produced by the detention to be inadmissible. This accords with previous holdings of the same court, as, e.g., *Pierce v. United States*, 197 F.2d 189 (D.C. Cir. 1952), *cert. denied*, 344 U.S. 346 (1952), in which it was held that the *Upshaw* case did not overturn the principle that an ". . . illegal detention before presentment to a committing magistrate, standing alone and without more, does not invalidate a confession made during its continuance, unless the detention produced the disclosure." This same court held in *Akowskey v. United States*, 158 F.2d 649 (D.C. Cir. 1946), that where the prisoners were within close proximity to persons authorized to commit but nevertheless were taken to police headquarters, the detention was illegal and any subsequent disclosure inadmissible as evidence.

Thus, it is seen that the federal courts for the District of Columbia have re-interpreted the *Upshaw* rule. Other circuits have circumvented the rule by allowing the federal trial courts a large amount of discretion in determining whether or not the delay in arraignment was necessary in the circumstances, recognizing that if the delay was not unreasonable, the detention would not be illegal and the *Upshaw* rule would not be applicable. See, e.g., *White v. United States*, 200 F.2d 509 (5th Cir. 1952); *United States v. Leviton*, 193 F.2d 848 (2d Cir. 1952), *cert. denied*, 343 U.S. 946 (1951). At least one circuit has expressly refused to follow the holding that the timing of the confession and commitment is controlling. *Haines v. United States*, 188 F.2d 546 (9th Cir. 1951), *cert. denied*, 342 U.S. 888 (1951). Texas accords with the principal case, holding that a failure to carry an accused before a magistrate vitiates a confession only when there is some casual connection between the failure and the subsequent confession. *Walker v. State*, 286 S.W.2d 144 (Tex. Crim. 1955), *cert. denied*, 350 U.S. 931 (1956).

The foregoing decisions indicate that the federal courts have been reluctant to follow the *Upshaw* rule in its strict sense. Instead, they have seized upon explanatory language in the *Upshaw* case to give effect to a less stringent requirement, saying that it is not the time of arraignment that makes the detention illegal and the confession inadmissible, but rather the circumstances of the case. The District of Columbia court has gone even further, holding that the illegal or unnecessary detention must produce the disclosure to render it inadmissible as evidence. It is apparent that these courts feel that a breach of the duty to commit promptly does not justify a complete vitiation of a confession. However, the federal courts do apply either the *McNabb* or *Upshaw* rule in instances where the arresting officers have verged on a violation of due process in their methods of securing a disclosure from a prisoner. The result is that the rule of the *Upshaw* case now occupies a curious position, being used only when the courts wish to reach a desired result but seemingly do not choose to base their decision on due process.

The *Upshaw* rule has been criticized by writers, Comments, 27 N.C.L. Rev. 552 (1949), 23 So. Calif. L. Rev. 63 (1949), and ignored, repudiated, or confined to its facts by the federal courts. However, it may well be that the Court in the *Upshaw* case, where the detention was for thirty hours, recognized the difficulty faced by an accused in proving that his confession was tortured from him so as to violate due process of law or that the disclosure was caused as a direct result of the detention. If this was the reason for the decision, the Court will be faced with the problem in this case of determining whether a detention of only seven hours should bar the disclosure without a showing of coercion. The difficulty of proving wrongful acts by officers in securing the confession is the same, whether the defendant be held seven hours or thirty hours. These considerations could well be the basis for a re-affirmation of the *Upshaw* case and the application of the principle to these facts, even though the period of detention was of a shorter duration.

*Eugene L. Smith*

### Evidence—Dead Man's Statute—Interested Parties

In 1948, Dr. Howard Ditto agreed with James Ditto to render medical care to the latter, payment for which would be by the estate of James Ditto upon his death. James Ditto died in 1953, and Dr. Ditto presented a bill to the independent executor who refused to

pay it. Thereafter, Dr. Ditto gratuitously assigned the claim to his wife as her separate property, whereupon she assigned the claim to the Ditto Investment Company, a corporation owned by her. The Company brought this action upon the claim and offered Dr. Ditto's testimony. *Held*: Article 3716 did not disqualify Dr. Ditto from testifying as to his agreement with James Ditto, because he had assigned his claim and had no actual interest in it. *Ditto Investment Co. v. Ditto*, 293 S.W.2d 267 (Tex. Civ. App. 1956).

Article 3716, commonly referred to as the Dead Man's Statute, provides that "[i]n actions by or against executors . . . in which judgment may be rendered for or against them as such, neither party shall be allowed to testify against the others as to any transaction with, or statement by, the testator . . . ; and the provisions of this article shall extend to and include all actions by or against the heirs or legal representatives of a decedent arising out of any transaction with such decedent." TEX. REV. CIV. STAT. ANN. (1926). Thus, in order for the statute to exclude testimony the action must be one contemplated by the statute, the testimony offered must be as to a "transaction" with the deceased, and the party seeking to testify must be a party within the meaning of the statute.

The principal case met the first of the three requirements inasmuch as it was an action against an executor. The test of the second requirement, *i.e.*, a transaction with the deceased, has been held to be whether the facts present a situation by which, as a basis for a cause of action, one person can derive impressions or information from the conduct, condition or language of the deceased. *Andreades v. McMillan*, 256 S.W.2d 477 (Tex. Civ. App. 1953) *error disp.* Thus an oral contract, such as that in the instant case, has been held to be a transaction with the deceased. *Madero v. Calzado*, 281 S.W. 328 (Tex. Civ. App. 1926).

The word "party" as used in the statute includes parties of record, all parties enumerated in the statute, and those who have an actual and direct interest in the subject matter of the transaction. *Ragsdale v. Ragsdale*, 142 Tex. 476, 179 S.W.2d 291 (1944); *Simpson v. Brotherton*, 62 Tex. 170 (1884). The criterion of an actual and direct interest is whether the witness will be bound by the judgment to be rendered under the pleadings. *Corbell v. Kogg*, 188 S.W.2d 905 (Tex. Civ. App. 1945) *error ref.* Former parties who have parted with all of their interest before the suit is filed are not incompetent, and this is true even though a witness conveyed his interest in the estate of the deceased primarily to remove his disability.



*May v. Brown*, 144 Tex. 350, 190 S.W.2d 715 (1945); *Turner v. Hodges' Estate*, 219 S.W.2d 522 (Tex. Civ. App. 1949) *error ref. n.r.e.* If, however, the conveyance of the claim against the deceased was simulated in order to circumvent the statute when, in fact, the actual ownership or beneficial interest in the claim remained in the grantor, the witness so acting has been held to possess such an interest as to constitute him a party within the statute. *Sheffield v. Leech*, 221 S.W.2d 789 (Tex. Civ. App. 1949); *Ragsdale v. Ragsdale*, *supra*. In the case at hand, the court found the conveyance to be a valid one, and that Dr. Ditto had no such interest to bar his testimony.

The plaintiff in the principal case, a corporation, was a "person," having power to own property within the purposes outlined in its charter and possessing all rights that a natural person may have in actions for or against it. *Port Arthur Trust Co. v. Muldrow*, — Tex.—, 291 S.W.2d 312 (1956); *Pittsburg Water Heater Co. of Texas v. Sullivan*, 115 Tex. 417, 282 S.W. 576 (1926). Ownership of property is in the corporation as such and not in the stockholders. *Rogers-Hill and Co. v. San Antonio Hotel Co.*, 23 S.W.2d 329 (Tex. Comm. App. 1930). This rule applies although the property (chose in action in the principal case) was received by assignment from a stockholder; further, the stockholder is not a necessary party to a suit by the corporation on such chose in action. *Lottman Bros. Manufacturing Co. v. Houston Waterworks Co.*, 38 S.W. 357 (Tex. Civ. App. 1896). The Dead Man's Statute does not apply to officers or employees of a corporation because they are not parties to actions by or against corporations. *Thompson v. McAllen Federated Woman's Building Corporation*, 273 S.W.2d 105 (Tex. Civ. App. 1954) *error disp.*; *San Antonio Light Pub. Co. v. Moore*, 101 S.W. 867 (Tex. Civ. App. 1907) *error ref.* Thus, had the testimony of Dr. Ditto's wife been offered in the principal case, she probably would have been qualified to testify.

It is submitted that the present decision correctly observed the controlling legal precedents; furthermore, by allowing collection of what appears to be a legitimate claim it is, at least to this extent, a desirable application of the law. Nevertheless, according to Texas community property law, *i.e.*, that revenue from the wife's corporate investments is community property, it would seem that Dr. Ditto, although not having an interest sufficient to constitute him a party under the statute, did have a direct interest in the outcome of the suit. Yet, through assignment, he has substantially accom-

plished a result which the law probably would have denied had he proceeded directly against the estate. Such a result serves to illustrate the inconsistencies which arise under the present interpretation of the Dead Man's Statute. It would seem that uniformity may be obtained only by proper legislative action. See Ray, *The Dead Man's Statute—A Relic of the Past*, 10 Sw.L.J. 390 (1956).

R. W. Calloway

### Family Law and Community Property—Putative Marriage—Division of Property

Certain realty was acquired in the name of W2 during her putative marriage to H. Upon H's death, W2 brought an action against W1 and H's heirs to determine title to the property. *Held*: A putative marriage entered in good faith by both parties establishes a "putative community," and any property acquired during such marriage will be distributed by giving an undivided one-fourth interest therein to both the legal and the putative wife, and the remaining undivided one-half interest to the husband or his heirs. *Prince v. Hopson*, —La.—, 89 So.2d 128 (1956).

A putative marriage arises when at least one of the two parties to a purported ceremonial or common law marriage has acted in good faith and in ignorance of existing impediments which render it unlawful. *Smith v. Smith*, 1 Tex. 628 (1846); *Hupp v. Hupp*, 235 S.W.2d 753 (Tex. Civ. App. 1950) *error ref. n.r.e.* The interests of innocent parties in property acquired during the putative marriage are now recognized by a majority of states, although justified on such diverse principles as partnership, *King v. Jackson*, 196 Okla. 327, 164 P.2d 974 (1945); resulting trusts, *Titus v. Titus*, 151 Kan. 824, 101 P.2d 872 (1940); community property, *Union Bank and Trust Co. v. Gordon*, 116 Cal. App.2d 681, 254 P.2d 644 (1953); or equity, *Fowler v. Fowler*, 97 N.H. 216, 84 A.2d 836 (1951).

The principal case was controlled by LA. CIV. CODE ANN. art. 117 (West 1952), which is a literal translation of Article 201 of the French Civil Code; therefore, the Court turned to the French commentators for aid in interpreting the statute. According to the interpretation of the commentators, the statute affords the putative wife all of the rights of a legal wife; hence, the putative wife is entitled to one-half of all of the property acquired during the putative marriage. Since the putative marriage does not terminate the legal marriage, the legal wife is entitled to the same one-half

of the property. The two claims with regard to the same property being equal in nature, the only equitable division that could be effected would be to split the property acquired during the putative marriage and give each wife one-fourth. This interpretation of the statute is referred to as the "Putative Wife Doctrine."

The law in Texas is settled as to the interest of the husband and the legal and putative wives in property acquired during the putative marriage. Assuming the property would ordinarily have a community character, the putative wife receives an undivided one-half interest in the property, and the husband and legal wife have a community estate in the remainder. *Routh v. Routh*, 57 Tex. 589 (1882); *Mathews v. Mathews*, 292 S.W.2d 662 (Tex. Civ. App. 1956); *Morgan v. Morgan*, 21 S.W. 154 (Tex. Civ. App. 1892). Although the Texas division thus differs from that of Louisiana, the Texas courts often have purported to follow the "Putative Wife Doctrine" in holding that the putative wife has the rights of a lawful wife as to all property acquired during the putative marriage. *Barkley v. Dumke*, 99 Tex. 150, 87 S.W. 1147 (1905). Although this language was denounced as early as 1910, *Ft. Worth & R.G.R. Co. v. Robertson*, 103 Tex. 504, 131 S.W. 400 (1910), the proposition continues to appear from time to time. *Cameron v. Cameron*, 103 S.W.2d 464 (Tex. Civ. App. 1937). The *Robertson* case rested the property division squarely on partnership principles and refused to allow the putative wife an interest in property acquired without contribution on her part.

Notwithstanding language to the contrary in some Texas decisions, it is apparent that a putative wife does not have the rights of a lawful wife in Texas. A chose in action accruing to the husband as a result of personal injuries is community property, but it has been held that the putative wife may not maintain the action. *Ft. Worth & R.G.R. Co. v. Robertson*, *supra*. Nor does the putative wife have an action for the wrongful death of her husband under the Wrongful Death Statute or the Workmens' Compensation Laws. *Texas Employers Ins. Ass'n. v. Grimes*, 153 Tex. 357, 269 S.W.2d 332 (1954). The putative wife has no homestead rights, *Middleton v. Johnston*, 110 S.W. 789 (Tex. Civ. App. 1908) *error ref.*, and she can neither inherit the husband's separate property nor administer his estate. *Morgan v. Morgan*, *supra*; *Chapman v. Chapman*, 32 S.W. 564 (Tex. Civ. App. 1901). These cases are not in conflict with the partnership theory for in none of them did the putative wife contribute to the acquisition of the property. Furthermore,

none of the cases purporting to follow the Putative Wife Doctrine have reached a result different from that which would have been reached had they followed partnership principles, *i.e.*, none have involved property acquired other than by joint effort. The division arrived at has been the same regardless of the theory utilized. *Lee v. Lee*, 112 Tex. 392, 247 S.W. 828 (1923); *Morgan v. Morgan*, *supra*.

It is submitted that language in the Texas decisions to the effect that a putative wife has the rights of a lawful wife is meaningless, since the putative wife is afforded no rights whatsoever unless she has contributed to the acquisition of the property to which she is asserting a claim. If the Texas courts were following the Putative Wife Doctrine and the putative wife did have the rights of a lawful wife, the Texas division would necessarily be the same as that of Louisiana.

George B. Davis

### Liens—Sale Under Deed of Trust—Cancellation by Mortgagor's Administrator

The administrator of the estate of a deceased mortgagor of non-homestead real property brought suit to set aside a sale of the property made, after the mortgagor's death, under a power of sale in a deed of trust. There was no evidence of claims against the estate of higher priority than secured claims. *Held*: An administrator may set aside a deed of trust sale made within four years after the death of the mortgagor even though there is no evidence of debts of a higher priority. *Pearce v. Stokes*, —Tex.—, 291 S.W.2d 309 (1956).

The power of sale contained in a deed of trust is designed to assure the creditor of a swift mode of foreclosure without the delay and expense of a law suit, *Blackwell v. Barnett*, 52 Tex. 326 (1879), and because this power is coupled with an interest, it survives the death of the mortgagor. *Natali v. Witthaus*, 135 S.W.2d 969 (Tex. Comm. App. 1940); *Wiener v. Zwieb*, 105 Tex. 262, 141 S.W. 771 (1911). The process of estate administration also is designed to protect the interests of creditors in that it attempts to assure each creditor of the deceased fair consideration and prompt settlement. *Palfrey v. Harborth*, 158 S.W.2d 326 (Tex. Civ. App. 1942) *error ref.*; *Ryan's Administrator v. Flint and Chamberlain*, 30 Tex. 382 (1867). Although these safeguards usually operate independently of each other, under certain circumstances they may

come into conflict, and questions of precedence arise. Thus, it is generally held that administration suspends the power of sale and that a sale made by the mortgagee while administration is pending is void. *Robertson v. Paul*, 16 Tex. 472 (1856). On the other hand, the sale will be valid if there is no administration within four years of the mortgagor's death, *Wiener v. Zwieb, supra*, or if the estate is handled by an independent executor, *Smith v. San Antonio Joint Stock Land Bank*, 130 S.W.2d 1070 (Tex. Civ. App. 1939) *error ref.*, or if the sale is made after the expiration of four years from the date of the death of the grantor, no administration being opened on the estate of the deceased. *Heirs of Roger v. Watson*, 81 Tex. 400, 17 S.W. 29 (1891).

The mortgagee in the principal case contended that a sale made within four years of the death of the mortgagor may not be set aside at the instance of an administrator except upon proof that there are claims against the estate of higher priority than the secured debt of the mortgagee. This argument apparently had never been raised before in Texas, and the Court of Civil Appeals was of the opinion that the sale should be set aside *if* it interfered with the administration of the estate. *Stokes v. Pearce*, 285 S.W.2d 475 (1955). In holding that the administrator, unconditionally, may set aside the sale, the Supreme Court was governed by such considerations as the realization that administration is for the protection of all creditors, the fact that the purpose of a mortgage is security and not the acquisition of property, and the desire for greater certainty. Thus, the Court's ultimate decision was grounded on policy considerations; it was indicated that, as a result of the decision, mortgagees would be encouraged to pursue their remedy in an administration proceeding since they would be bound to know that any sale made after the death of the mortgagor and within four years thereof could be cancelled at the instance of an administrator should administration be opened.

The Court in the instant case was confronted with the age-old problem of two innocent parties, one of whom must suffer. Should the administration be effectuated and priority creditors protected, *e.g.*, funeral, last sickness, administration expenses, *Palfrey v. Harborth*, 158 S.W.2d 326 (Tex. Civ. App. 1942) *error ref.*, or should the mortgagee be protected in his power of sale? If the mortgagee is favored, the priority creditors may receive nothing or substantially less than they are due. However, the result of the present decision is that the mortgagee's power of sale is weakened con-

siderably. If there are priority creditors, the mortgagee likely will receive only partial payment. One should also consider the problem of a bidder at the foreclosure sale whose purchase will be subject to revocation for four years. See dissent in *Wiener v. Zwieb, supra*. Although the mortgagee may always open administration proceedings himself, thereby avoiding this problem, he will incur additional expenses by doing so. TEX. REV. CIV. STAT. (1925), PROBATE CODE, § 178(b); *Ragsdale v. Prather*, 132 S.W.2d 625 (Tex. Civ. App. 1939) *error ref.*

In summary, from the standpoint of policy there seems little to choose between a decision favoring the administrator or the mortgagee. It is submitted that the present decision is not objectionable since the curtailment of one or the other's rights is essential to certainty in the law.

*Marshall S. McCrea, Jr.*

### Oil and Gas—Construction of Instruments— After-Acquired Title

*P* owned an undivided 1/40th interest in a tract of land. Together with her relatives, who owned an undivided 8/40ths interest, *P* executed an oil and gas lease upon printed form to *D* which purported to convey *all* of the oil and gas and other minerals in the tract. The lease provided for an oil payment and a delay rental, each being equivalent to 9/40ths of the mineral interest. In addition, a royalty of 1/8th of the oil and gas produced from said land was reserved to the lessor. A warranty clause covering the entire tract was included, but the proportionate reduction clause had been marked out before the lease was signed. When the lease was executed, *D* and his associates owned 31/40ths of the mineral interest. *P* contended she was entitled, as royalty, to 1/72nd of the oil and gas produced. *Held: P* is entitled to 1/9th of 40/40ths of 1/8th on the oil produced from the land as provided for in the lease agreement rather than 1/40th of 1/8th as contended by *D*. *Gibson v. Turner*, —Tex.—, 294 S.W.2d 781 (1956), 6 OIL & GAS REP. 1212.

In construing the lease in question, under which the lessor over-conveyed and in which the proportionate reduction clause was marked out, the majority of the Court applied certain well-settled principles of legal instrument construction in determining the plaintiff's royalty interest. First, in a collateral attack on an unambiguous mineral lease or other written instrument the court may not make

a new instrument for the parties, nor may it refer to any source other than the instrument as written in order to ascertain the intention of the parties. *Texas Co. v. Parks*, 247 S.W.2d 179 (Tex. Civ. App. 1952) *error ref.*, 1 OIL & GAS REP. 555; *Clemmens v. Kennedy*, 68 S.W.2d 321 (Tex. Civ. App. 1934) *error ref.* Further, it has been held that Texas follows the "four corners" rule of construction. *Benge v. Scharbauer*, 152 Tex. 447, 259 S.W.2d 166 (1953), 2 OIL & GAS REP. 1350; *Murphy v. Dilworth*, 137 Tex. 32, 151 S.W.2d 1004 (1941). Third, there is nothing inconsistent in conveying all the minerals one may own in land and in a separate paragraph reserving a royalty interest, because a royalty interest is unlike an interest in the minerals in place. *Countiss v. Baldwin*, 151 S.W.2d 235 (Tex. Civ. App. 1941). Finally, the owners of mineral interests may make their fractional interest in royalties different from their fractional ownership of the mineral estate if they plainly express such an intention. This follows because an oil and gas leasehold estate is not synonymous with a royalty interest, and they may also be in a different quantum or amount. *Benge v. Scharbauer*, *supra*.

The defendant in the principal case contended that he was entitled to recover for the breach of warranty because of failure to receive the interest purportedly conveyed. It appears that there *was* a breach of warranty because of the lessors' inability to convey the interest which the deed purported to convey. However, it is well-settled that a cause of action for breach of a covenant of general warranty will not lie in the absence of an eviction. If the grantee is the owner of the outstanding interest, as in the instant case, there can be no eviction since legal eviction cannot be predicated upon the voluntary act of the grantee in evicting himself. *Schneider v. Lipscomb County National Farm Ass'n*, 146 Tex. 66, 202 S.W.2d 832 (1947); *Rancho Bonito Land and Livestock Co. v. North*, 92 Tex. 72, 45 S.W. 994 (1898). This same principle should apply to a mineral or royalty interest since they are regarded as realty in Texas. *Lockhart v. Williams*, 144 Tex. 553, 192 S.W.2d 146 (1946); *Stephens County v. Mid-Kansas Oil & Gas Co.*, 132 Tex. 160, 254 S.W. 290 (1923).

The dissenting opinion contended that the royalty interest of the plaintiff should be reduced, basing its opinion largely on *Dubig v. Peavy-Moore Lumber Co.*, 135 Tex. 503, 144 S.W.2d 878 (1940), a case which represented an extension of the doctrine of after-acquired title to a mineral estate reserved by the grantor. Classification of the doctrine as legal or equitable in nature has not been uniform. Some decisions treat it as an equity doctrine grounded on

principles of estoppel. *McKinnon v. Lane*, 285 S.W.2d 269 (Tex. Civ. App. 1955) *error ref. n.r.e.*, 5 OIL & GAS REP. 607; *Hanlon v. McLain*, 206 Okla. 227, 242 P.2d 732 (1952), 1 OIL & GAS REP. 862. Other cases hold that the title of a grantor, who has purportedly conveyed the title by a general warranty deed, passes to his grantee by operation of law immediately upon acquisition of such title by the grantee. Such cases would appear to treat the doctrine as a legal one. *Breen v. Morehead*, 126 S.W. 650 (Tex. Civ. App. 1910), *aff'd*, 104 Tex. 254, 136 S.W. 1047 (1911). Some states have statutes dealing with after-acquired title which also appear to make the doctrine one of law and not equity. See, *e.g.*, OKLA. STAT. ANN. tit. 16, § 17 (1951); ARK. STAT. ANN. § 50-404 (1947); KAN. GEN. STAT. ANN. § 67-207 (1949).

The courts have not been uniform on the question of what gives rise to the doctrine of after-acquired title. There is some authority to the effect that an estoppel arises from the assertion of ownership by the grantor in the covenant of warranty, express or implied, or in other recitals of ownership in the deed. *Talley v. Howsley*, 142 Tex. 87, 176 S.W.2d 158 (1944); *Clark v. Gauntt*, 138 Tex. 558, 161 S.W.2d 270 (1942). Other cases have held that the estoppel does not depend upon the obligation or presence of the covenant of warranty, but if the conveyance purports to transfer some certain estate the grantor will be estopped, irrespective of the presence of covenants, to assert that an estate did not pass by virtue of his deed. *Lindsay v. Freeman*, 83 Tex. 259, 18 S.W. 727 (1892); *Texas Pac. Coal and Oil Co. v. Fox*, 228 S.W. 1021 (Tex. Civ. App. 1921); *Lowry v. Carter*, 102 S.W. 930 (Tex. Civ. App. 1907) *error ref.* See Comment, *The Doctrine of After-Acquired Title*, 11 Sw. L.J., 217 (1957). Further, since a covenant of general warranty cannot operate by estoppel to vest in the grantee a greater interest than the deed itself would have conferred, *Chase v. Gregg*, 88 Tex. 552, 32 S.W. 520 (1895), it is doubtful that the courts would apply the doctrine of after-acquired title to an estate reserved in a mineral lease, because the estoppel arising from the doctrine is restricted to the estate purportedly conveyed and is not applied to a reserved estate. *Talley v. Howsley*, *supra*; *McKinnon v. Lane*, *supra*.

It is customary in the oil and gas industry for the lessee to take a full interest lease though he may know that the lessor owns less than the full mineral fee. The lessee is thus more certain to receive whatever interest the lessor may have and he may operate the premises as a single unit so that interior offset problems will be eliminated



and only one set of measuring tanks will be necessary in computing the lessor's royalty. The lessee protects himself from the possibility of having to pay a full 1/8th royalty on less than the entire mineral fee by means of the proportionate reduction clause. However, it is to be noted that the proportionate reduction clause does not operate to reduce the estate which the lessor purported to convey, nor does it nullify the warranty. *Klein v. Humble Oil and Refining Co.*, 126 Tex. 450, 86 S.W.2d 1077 (1935). The principal case points out the difficulty in which the lessee may find himself if he allows the proportionate reduction clause to be struck.

Since the royalty clause is contractual in nature and the deed does not purport to convey the right given by such clause, it is not affected by a breach of warranty because the warranty does not extend to the provisions in the deed as to the interest in royalties. *Benge v. Scharbauer, supra*. However, it appears that the lessee in the instant case could have recovered damages for the breach of warranty if the outstanding interest had been owned by someone other than himself. It is advisable that, to avoid problems with which the lessee was confronted in the instant case, lessees insist that the proportionate reduction clause be included in the lease. This clause would protect the lessee in the event the royalty clause provided that the lessor was entitled to more than his actual ownership, since the proportionate reduction clause has the effect of reducing the lessor's royalty interest to coincide with his actual ownership of the mineral fee.

*R. W. Calloway*

### Oil and Gas—Pollution of Subsurface Waters— Absolute Liability

P owned farm land on which he had a fresh water well. D, an oil company, in the operation of an oil well on neighboring property, constructed and maintained evaporation pits for salt water produced from the well. P's fresh water well became polluted by seepage from D's salt water evaporation pits. *Held*: D is absolutely liable for the pollution of the subsurface water supply which feeds P's well because of Rule 20 of the Railroad Commission. *Gulf Oil Corp. v. Alexander*, 291 S.W.2d 792, 6 Oil & Gas Rep. 457 (Tex. Civ. App. 1956) *error ref., n.r.e.*, —Tex.—, 295 S.W.2d 901 (1956).

Pollution of fresh water by the escape of waste products resulting from oil and gas production is a problem common to all jurisdictions

in which there is a large petroleum industry. In solving this problem, some jurisdictions employ a rule of strict liability based on either a controlling legislative enactment, *Franklin Drilling Co. v. Jackson*, 202 Okla. 687, 217 P.2d 816 (1950), or the rule of strict liability as announced in the leading English case of *Rylands v. Fletcher*, L.R. 1 Ex. 265 (1866), *aff'd* L.R. 3 H.L. 330 (1868). *Wendtlandt v. National Co-operative Refinery Ass'n*, 168 Kan. 619, 215 P.2d 209 (1950). This rule finds liability even in the absence of negligence for damages caused by the escape of a dangerous substance collected by the defendant on his land in connection with a *non-natural* use to which the defendant was putting his land. The doctrine of *Rylands v. Fletcher*, *supra*, has not found extensive acceptance in this country. PROSSER, "The Principle of *Rylands v. Fletcher*," SELECTED TOPICS ON THE LAW OF TORTS (1953).

Most jurisdictions require proof of specific negligence as a basis of liability for pollution caused by oil and gas production wastes. Jones, *Escape of Deleterious Substances: Strict Liability v. Liability Based Upon Fault*, 1 ROCKY MT. MINERAL L. INST. 163, 194 (1955). Texas is among these by virtue of the landmark case of *Turner v. Big Lake Oil Co.*, 128 Tex. 155, 96 S.W.2d 221 (1936), which expressly repudiated the doctrine of strict liability, except in the case of pollution of a public body of water which is specifically prohibited by TEX. PEN. CODE ANN. art. 698b (1948). The instant case announces a radical departure from the earlier Texas policy. Prior to the *Turner* case there was some confusion in Texas law on pollution of waters not public. Several early Civil Appeals decisions seemed to hold the oil well operator strictly liable under a theory of private nuisance; *e. g.*, *Teel v. Rio Brave Oil Co.*, 104 S.W. 420 (Tex. Civ. App. 1907). This would involve a finding that the defendant was making an unreasonable use of his property in causing injury to the plaintiff. *City of Temple v. Mitchell*, 180 S.W.2d 959 (Tex. Civ. App. 1944). However, today certainly the drilling and operation of oil and gas wells is a reasonable use of Texas property. *Cosden Oil Co. v. Sides*, 35 S.W.2d 815 (1931); *Turner v. Big Lake Oil Co.*, *supra*. It seems clear in the light of the *Turner* case that in the absence of negligence no theory of private nuisance will support a recovery for pollution caused by the escape of wastes. Further, it has been held that in these circumstances negligence will not be presumed nor will the doctrine of *res ipsa loquitur* apply. *Warren Petroleum Corp. v. Martin*, 153 Tex. 465, 271 S.W.2d 410 (1954).

The decision in the present case turns on the Court's interpretation

of Rule 20 of the Railroad Commission which reads as follows: "Fresh water, whether above or below the surface shall be protected from pollution, whether in drilling, plugging or disposing of salt water already produced." As the rule is stated, it is susceptible to at least two interpretations. It may be viewed as a directive to oil well operators that they must use reasonable care in protecting surface and subsurface fresh water from pollution caused from operation of their wells. This is in accord with the common law and would amount to a recognition by the Commission of the holding in the *Turner* case. Under this view there would be no liability without proof of negligence. The Court, however, assumed that the rule imposes absolute liability on the operator. It then relied on the case of *Peterson v. Grayce Oil Co.*, 37 S.W.2d 367 (Tex. Civ. App. 1931), *aff'd*, 128 Tex. 550, 98 S.W.2d 781 (1936), which stands for the proposition that the failure to comply with a standard of conduct imposed by a ruling of an administrative body may constitute actionable negligence. The *Peterson* case does not hold that the Commission has the power to create liability in an individual, although the breach of the duty imposed by the Commission in its ruling may give rise to liability on the basis of common law negligence. The interpretation given the rule by the Court in the present case defines no standard of conduct to guide the operator. It has the effect of creating a cause of action in the plaintiff regardless of fault in the defendant.

It is submitted that if the Court's interpretation of Rule 20 is the correct one, the Railroad Commission has exceeded the authority granted it by the legislature. *Ryan Corp. v. Pickens*, —Tex.—, 285 S.W.2d 201 (1955); see discussion notes, 6 Oil & Gas Rep. 460 (1956). The Commission is given the general powers of promoting conservation of oil and gas and prohibiting their waste as defined by the statutes. TEX. REV. CIV. STAT. ANN. art. 6008, 6014, 6029 (1949). It is specifically empowered to make rules "To require wells to be operated in such manner as to prevent injury to adjoining property." TEX. REV. CIV. STAT. ANN. art 6029(4) (1949). Nowhere is the Commission empowered to create liability as such. The Supreme Court, in affirming the decision on other grounds, expressly reserved its opinion of the position taken by the Court of Civil Appeals, so the question is yet to be finally decided. If the Supreme Court should find the Commission exceeded its authority in promulgating this rule, then the rule would be void. *Railroad Commission v. Rowan Oil Co.*, 152 Tex. 439, 259 S.W.2d 173 (1953).

In these times of drought, any loss of fresh water by pollution is

certainly to be viewed with concern, and every reasonable effort should be exercised by all to prevent this pollution. Perhaps it would be in the public interest for the oil industry to be held to a higher degree of care than that enunciated in the *Turner* case. This may have been in the mind of the Court when it rendered the decision in the present case. However, any remedy forthcoming should emanate from the legislature and not from an administrative body which is not charged with correction of the problem.

David M. Woolley

### Real Property—Adverse Possession—Tenant's Attornment to Owner

A tenant, after some six years adverse possession for his landlord, executed a formal tenancy agreement with the true record owner. Although the landlord was aware of the tenant's attornment to the owner, he did nothing except warn the tenant not to acknowledge again the title of the owner. After expiration of the Texas 10-year Statute of Limitations, the owner brought this suit in trespass to try title. *Held*: When both landlord and owner know of the tenant's attornment to the owner, and the landlord fails to remove the tenant, adverse possession is broken. *Kirby Lumber Corp. v. Laird*, 231 F.2d 812 (5th Cir. 1956).

It is well established in Texas that one may adversely hold land by means of a tenant, *Jack v. Dillon*, 25 S.W. 645 (Tex. Civ. App. 1894) *error ref.*; *Dawson v. Tumlinson*, 150 Tex. 451, 242 S.W.2d 191 (1951); and that the tenant's possession inures to the benefit of his landlord. *Harris v. Iglehart*, 113 S.W. 170 (Tex. Civ. App. 1908). Further, the tenant is estopped from denying his landlord's title. *American Nat. Bank of Beaumont v. Wingate*, 266 S.W.2d 934 (Tex. Civ. App. 1953) *error ref.* Thus, the tenant's acknowledgement of a third party's title, *e. g.*, acceptance of a lease, is ordinarily void as to the landlord unless the latter has granted permission to his tenant to make such attornment. *Carter v. Townsend*, 139 S.W.2d 641 (Tex. Civ. App. 1940) *error disp., judgm. cor.*; *Wiener v. Zweib*, 128 S.W. 699 (Tex. Civ. App. 1910), *aff'd* 105 Tex. 262, 141 S.W. 771 (1911), *rehearing denied* 105 Tex. 262, 147 S.W. 867 (1912). Nor is the continuity of the adverse possession interrupted by the tenant's attornment to a third party. *Powell Lumber Co. v. Nobles*, 44 S.W.2d 774 (Tex. Civ. App. 1931).

However, where the record owner of the property makes a lease with one found in possession, and the owner has no notice of the adverse claim of the tenant for his landlord, the adverse possession of the tenant for his landlord has been held to be interrupted. *Louisiana & Texas Lmbr. Co. v. Alexander*, 154 S.W. 233 (Tex. Civ. App. 1913). On the other hand, the owner who makes a lease with one found in possession has been charged with notice that the tenant has no authority from his landlord to recognize the owner's title and so interrupt adverse possession of his landlord. *Kimble v. Willey*, 204 F.2d 238 (8th Cir. 1953). In the latter case, the owner was given the burden of removing the tenant from possession. Failing to remove the tenant allowed adverse possession to continue despite the lease between the tenant and the true record owner.

In the principal case the burden of removing the tenant who acknowledged the record owner's title was placed on the landlord, the court reasoning that the law should range itself on the side of protecting rather than undermining ownership. Thus, between the true record owner of the land who had received acknowledgement of his title from the tenant in possession of the land and the landlord who did nothing after learning of his tenant's recognition of the owner's title, the principal case favored the owner. Apparently the landlord could have continued his adverse possession of the land by removing his disloyal tenant. *Coyle v. Franklin*, 54 Fed. 644 (5th Cir. 1893).

It is well settled that one in adverse possession in his own right who acknowledges a tenancy relationship to another destroys his adverse claim. *Boyles v. Red*, 227 S.W.2d 310 (Tex. Civ. App. 1950) *error ref.* If the principal case had allowed the adverse possession to continue, despite the attornment of the tenant to the true record owner, then the trespassing landlord would have been allowed to assert greater rights by use of a tenant than he could have asserted if he had personally been in possession and made the attornment. Such a view would give to the landlord-tenant relationship an "unqualified supremacy over all persons," as was done in the *Kimble* case, *supra*.

The landlord-tenant relationship is only a vehicle by which the landlord's open, hostile, and continuous claim of the owner's land is made. In the principal case this vehicle collapsed and, as to the owner, lost its hostility. It is submitted that there is no rational ground whatever upon which the court could have held that the owner's land was possessed adversely merely because the landlord desired that his tenant so hold.

Carroll Jarnagin

## Regulation of Business—Fair Trade—Integrated Distributors

Defendant corporation manufactures a line of trademarked drugs which it markets through independent wholesalers and through its own wholesaling division. Defendant's wholesaling division and manufacturing division are under separate management, but are part of the same corporation. In some areas defendant's wholesaling division is in direct competition with the independent wholesalers to whom its manufacturing division sells. Defendant entered into fair-trade agreements fixing resale prices with a number of independent wholesalers. The government brought a civil action for injunctive relief under the Sherman Anti-Trust Act. *Held*: Price fixing agreements are illegal per se, notwithstanding the fact that they are made by integrated manufacturer-wholesalers, if the effect is to fix prices between parties competing on the same functional level. *United States v. McKesson & Robbins*, 351 U.S. 305 (1956).

Under the Sherman Anti-Trust Act, "[e]very contract, combination in the form of a trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States" is illegal. 26 STAT. 209 (1890), 15 U.S.C. §1 (1952). The Supreme Court has interpreted this provision to mean that price fixing agreements are illegal per se regardless of their effect on interstate commerce. *United States v. Socony-Vacuum*, 310 U.S. 150 (1940). On the other hand, most of the states have enacted "fair-trade" acts which permit the vertical fixing of prices (*i.e.*, between a manufacturer and a wholesaler or between a wholesaler and a retailer) by the distributor of a branded or trade-marked product. See, *e.g.*, ILL. REV. STAT. c. 121½ § 188 *et seq.* (1955); OKLA. STAT. ANN. tit. 78 § 41 (1951); N. Y. GEN. BUS. § 369-a. The purpose of such acts is to protect the property interest of the distributor in the good will and prestige attached to his trademark. Such state statutes do not, however, give the vertical price fixing agreements immunity from the operation of the Sherman Act, and are illegal in the absence of approval by Congress. *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

This approval was granted by Congress in 1937 by the Miller-Tydings Act, 50 STAT. 693 (1937), 15 U.S.C. §1 (1952), which amended the Sherman Act by making resale price maintenance contracts entered into by manufacturers of branded or trade-marked products lawful if such contracts were authorized by state law. Since the early fair-trade statutes were binding only on contracting parties,

price cutting by nonsigners often thwarted the purpose of the acts. The states soon amended their statutes to make nonsigners, who had notice of the price-fixing contracts, liable in civil actions. See, e.g., ILL. REV. STAT. c. 121½ § 189 (1955); N. M. STAT. ANN. § 49-2-2 (1953); LA. REV. STAT. § 51:394 (1950); ARK. STAT. § 70:206 (1947). In 1951 the Supreme Court held that the Miller-Tydings Act exempted only consensual contracts or agreements from the prohibitions of the Sherman Act and that contracts seeking to bind nonsigners under state laws were thus illegal per se. *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U. S. 384 (1951). This decision prompted the McGuire Act, 66 STAT. 632, 15 U.S.C. § 45 (1952), with the result that the "non-signer" provisions of the typical state act now enjoy exemption from the Sherman Act. By virtue of the McGuire Act any price cutting distributor is subject to injunctive or damage proceedings for any departure from the fair trade price. ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 151 (1955).

Both the Miller-Tydings Act and the McGuire Act are restricted to those agreements in which the commodity affected is in "free and open competition with commodities of the same general class." Immunity from the Sherman Act was denied, however, to contracts entered into by "persons, firms, or corporations in competition with each other." Therefore, horizontal price fixing agreements between those on the same functional level of distribution (i.e., between a wholesaler and a wholesaler or between a manufacturer and a manufacturer) do not fall within the exemption of the Miller-Tydings Act and are illegal per se. *United States v. Frankfort Distilleries, Inc.*, 324 U.S. 293 (1945); *Bausch & Lomb Optical v. United States*, 321 U.S. 707 (1944).

Because the defendant in the principal case operated as a manufacturer and a wholesaler, the price maintenance agreements involved both vertical and horizontal aspects. It was the government's position that the price fixing agreements benefited the wholesaling division of the defendant just as if they had been made by that division because of the integrated character of the defendant's organization and that the agreements were thus horizontal and illegal. It would appear that the contentions of the government and the result reached by the Court are correct, in view of the Miller-Tydings specific exclusion of agreements between parties "in competition with each other." *United States v. Masonite Corp.*, 316 U.S. 265 (1942).

It has been urged that even vertical price fixing agreements in-

evitably result in horizontal fixing of resale prices. Thus, if a manufacturer enters into agreements with wholesalers A, B, C, and D, requiring them to resell at a fixed price, the economic effect is the same as if A, B, C, and D, had entered into the agreement between themselves. Adams, *Resale Price Maintenances: Fact and Fancy*, 64 YALE L.J. 967, 970 (1955). From this reasoning it could be argued that it would not matter whether the manufacturer initiating the contract is integrated or non-integrated, since the ultimate effect is equivalent to a horizontal agreement. It has been argued further that integrated manufacturer-distributors should have as much right to protect the good will of their product as any other producer or distributor of a branded good. The interpretation of the statute in the principal case will force manufacturers to choose between the benefits to be derived from fair-trade agreements and the benefits to be derived from an integrated manufacture-distribution system. See Weston, *Resale Price Maintenance and Market Integration: Fair Trade or Foul Play?*, 22 GEO. WASH. L. REV. 658 (1954).

It would seem, however, that the integrated manufacturer-distributor was properly excluded from the immunity of the Miller-Tydings Act. In the final analysis, the wholesaling division of the defendant was in direct competition with those independent dealers with whom the defendant free-traded. The non-integrated manufacturer who enters into fair-trade agreements with independent wholesalers must base the resale price upon the average costs of distribution and the average margin of profits taken by independent distributors. Fulda, *Resale Price Maintenance*, 21 U. CHI. L. REV. 175 (1954). On the other hand, when an integrated manufacturer sets the fair-trade price on a product the potential profits of its wholesaling division may enter into the determination. The integrated manufacturer is also in position to protect an inefficient distribution system by setting resale prices at a level most advantageous to the wholesale outlet. *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 147-148 (1948). This ability to protect integrated wholesaling outlets and to take advantage of what amounts to horizontal price fixing is heightened by the non-signer provisions of the McGuire Act. Since the wholesaling outlet of a integrated manufacturer is likely to distribute only those products produced and fair-traded by its manufacturer, the fixing of resale prices by the manufacturer on all its goods will allow the integrated distributor to operate in an artificially maintained market.

Don M. Dean



### Taxation—Deductions—Interest Paid on Debentures

A parent corporation issued 5¼% debentures in 1930 in order to purchase all of the assets of a certain company, and then conveyed these assets to a subsidiary in return for all its capital stock. The parent suffered a large operating loss each year due to the high interest paid on the bonds, but until 1934 this loss was off-set against the subsidiary's profit by using the consolidated income tax return. In 1934 Congress repealed the statute that permitted the filing of consolidated returns. Thereafter, the subsidiary declared a \$30,000,000 dividend out of paid-in surplus, issued 6% debentures to the parent in that amount and from 1934 to 1938 deducted the interest paid on the debentures as an ordinary business expense. The parent's income during these years was increased in an amount equivalent to the interest paid by the subsidiary. The Commissioner disallowed the deduction, contending that the payments were actually dividends in disguise, and not interest on indebtedness. *Held*: Money paid to a sole stockholder as interest on debentures is deductible for income tax purposes as an ordinary business expense. *Kraft Foods Co. v. Commissioner*, 232 F.2d 127 (2d Cir. 1956).

Interest is compensation for the use of borrowed money, *Deputy v. DuPont*, 308 U.S. 488 (1940), and is a deductible business expense for income tax purposes. INT. REV. CODE OF 1954, § 163. A dividend constitutes a portion of the accumulated surplus or profits of the enterprise that is allocated to the stockholders in proportion to the amount of stock they own in the corporation. *Martindale v. Fiduciary Counsel*, 133 N.J. Eq. 408, 30 A.2d 281 (1934). Although the declaration of a dividend gives rise to a debtor-creditor relationship between the stockholder and corporation, it is not a deductible business expense for income tax purposes. The cases generally hold that money payments to security holders are deductible if the securities are evidence of a debt, but not if they represent ownership in the corporation. *Jordan Co. v. Allen*, 85 F. Supp. 437 (M.D. Ga. 1949). The nature of the securities in question must be decided on the facts in each case. *Commissioner v. T. R. Miller Mill Co.*, 102 F.2d 599 (5th Cir. 1939).

The instant case can be reconciled with the existing law by showing that there is a binding debt, and not a sham transaction. *Higgins v. Smith*, 308 U.S. 473 (1941). As in the principal case, a debt may be created by using money or assets originally paid in as equity or ownership in the corporation. *Lansing Community Hotel Corp. v.*

*Commissioner*, 14 T.C. 183 (1950), *aff'd* 187 F.2d 487 (6th Cir. 1951). A debenture dividend may operate as a corporate distribution and a simultaneous borrowing back. *Commissioner v. T. R. Miller Mill Co.*, *supra*. The securities in question in the principal case were simple conventional debt instruments, and not hybrids having characteristics of both debt and ownership certificates. There was a definite maturity date, *Jordan v. Allen*, *supra*; an unqualified promise to pay a fixed sum of money, *Staked Plains Trust Ltd.*, 2 T.C.M. 566 (1943), *aff'd* 143 F.2d 421 (1944); and an absence of voting rights or any participation in the management of the corporation. *John Kelley Co. v. Commissioner*, 326 U.S. 521 (1946). All of these characteristics have been held important in determining that securities in question in the respective cases were debt instruments and not evidence of ownership in the corporation.

The subsidiary complied with all of the legal requisites for creating a debtor-creditor relationship; the fact that the transaction was handled in this manner to reduce taxes is not grounds for declaring it invalid *per se*. *Superior Oil Co. v. Mississippi*, 280 U.S. 390 (1930). On the other hand, if the taxpayer complies with only the legal formalities and the transfer is without substance or business purpose, the Commissioner will disregard the form and treat the taxpayer as though there had been no transfer. *Gregory v. Helvering*, 293 U.S. 465 (1935). In the case at bar the Commissioner applied these principles and concluded that the transaction was in form only, but the court overruled his decision and held that the payments to the parent were interest on indebtedness and therefore deductible.

Had the dividend been declared and the bonds issued while the taxpayer still could file the consolidated return, the question of tax avoidance hardly could have been raised because the taxpayer would have gained no tax advantage at the time. Since the subsidiary did not declare the dividend until the parent had lost the privilege of using the consolidated return to off-set the parent's operating loss against the subsidiary's profit, there is strong evidence that the intent of the taxpayer, an important factor in these cases, was to maintain the tax advantage they had enjoyed while using the consolidated return. *Commissioner v. Meridian and Thirteenth Realty Co.*, 132 F.2d 182 (7th Cir. 1942).

It would seem that the decision could have been rendered either for the Commissioner or the Kraft Foods Company without ignoring or circumventing any of the principles of law involved, as the

question appears to be one of fact and definition. One of the Tax Court's functions is to ascertain the facts in each case, and since the Court of Appeals has the same jurisdiction over the Tax Court's findings of fact as it does over a District Court when a case is tried without a jury, INT. REV. CODE OF 1954, § 7482, it is submitted that the appellate court here should not have reversed the lower court's finding of fact unless it was *clearly erroneous*. FED. R. CIV. P. 52. The ruling in the instant case apparently indicates that if the deduction is to be disallowed, stronger evidence will be required to show that the taxpayer's transactions were without substance or business purpose and existed solely for the purpose of avoiding taxes.

*C. Wayne Litchfield*