

January 1958

Recent Case Notes

Kennet Hobbs

Jerry Moss

Kenneth B. Kramer

Allen Butler

Recommended Citation

Kennet Hobbs et al., Note, *Recent Case Notes*, 12 SW L.J. 381 (1958)
<https://scholar.smu.edu/smulr/vol12/iss3/7>

This Case Note is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

RECENT CASE NOTES

Constitutional Law — Due Process — State Jurisdiction Over Foreign Insurance Corporations

D, a Texas insurance corporation, agreed to assume the obligations of *X*, an Arizona corporation, which included a life insurance policy on *A*, a resident of California. *A* accepted *D*'s offer to re-insure on the same terms, and thereafter mailed premium payments to *D*'s Texas office. This was the only policy issued by *D* or *X* to a California resident, and neither corporation had solicited business nor had agents in that state. Upon *A*'s death *D* refused to pay the claim. *P*, the beneficiary, obtained a California judgment against *D* under a state law providing for service of process by registered mail on foreign insurance companies issuing policies to residents of California. Texas courts refused to enforce the judgment, holding that service of process outside of California gave that state's courts no jurisdiction over *D*. *Held*: The issuance of a single insurance policy by a foreign corporation to the resident of a state provides the necessary minimum contacts with that forum to sustain its jurisdiction over the insurer without violating due process of law as guaranteed by the fourteenth amendment. *McGee v. International Life Ins. Co.*, 355 U.S. 220 (1957).

Jurisdiction of state courts to render in personam judgments is based upon a concept of physical power over the defendant; thus, jurisdiction may not be obtained over a non-resident by service of process outside the forum. *Pennoyer v. Neff*, 95 U.S. 714 (1877). A corporation is considered a resident of the state under whose laws it is incorporated. *Railroad Co. v. Koontz*, 104 U.S. 5 (1881). Since corporations exist only as legal entities, courts have experienced difficulty in determining when non-resident corporations are operating sufficiently within the state so that assertion of jurisdiction over them will not violate the right to due process guaranteed by the fourteenth amendment. U.S. CONST. amend XIV, § 1. Early cases held that a state could not subject a foreign corporation involuntarily to the jurisdiction of its courts. See, e.g., *Clair v. Cox*, 106 U.S. 350 (1882). However, the Supreme Court has gradually extended the limits within which state jurisdiction over such corporations may be asserted without denying due process. 18 FLETCHER, PRIVATE CORPORATIONS § 8636 (rev. vol. 1955). This extension of jurisdiction has been upheld on various theories, e.g., that carrying on of corporate activities within the state implied consent to be sued there,

Ex parte Shollenberger, 96 U.S. 369 (1877); that corporate activity caused it to be "present" within the state for jurisdictional purposes, *International Harvester Co. v. Kentucky*, 234 U.S. 579 (1913); that the corporation was "doing business" within the forum, *Washington ex rel. Bond & Goodwin & Tucker v. Superior Court*, 289 U.S. 361 (1933). Usually under these various tests an isolated act or contract within a state did not subject the corporation to its jurisdiction, *Phelps v. Jesse French & Sons Piano Co.*, 65 S.W.2d 374 (Tex. Civ. App. 1933), unless the transaction indicated the intent of the company to continue business within the state, *Pitzer v. Stifel Nicolaus Co.*, 143 Neb. 394, 9 N.W.2d 495 (1943). In 1945, however, the above standards were rejected and the present rule was established that so long as proper notice is given, due process requires only that the defendant have certain "minimum contacts" within the state so that "maintenance of the suit does not offend the traditional notions of fair play and substantial justice." *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945). This doctrine has been applied to uphold state jurisdiction over a corporate defendant that made only one contract (not insurance) with a resident of the state, *Compania De Astral, S.A. v. Boston Metals Co.*, 205 Md. 237, 107 A.2d 357 (1954), and over a defendant committing only one tort within the forum, *Smith v. Twin State Improvement Co.*, 116 Vt. 569, 80 A.2d 664 (1951). See also *Perkins v. Benguet Consol. Mining Co.*, 342 U.S. 437 (1952).

Under the "consent," "presence," and "doing business" tests, foreign insurance corporations were held subject to state jurisdiction where they solicited business through agents within the state, collected premiums locally, sent claim adjusters into the state, insured property within its borders, or when a sizeable part of the company's total volume of business was done with residents of the forum. For a collection of cases see Annot., 44 A.L.R.2d 416 (1955). Applying these tests where all transactions with the insured were by mail and where the insurance contract became binding only upon its acceptance at the company's home office, an early case held that a corporation was not considered to be "doing business" in the policyholder's state, since the contract had been executed elsewhere. *Minnesota Commercial Men's Ass'n v. Benn*, 261 U.S. 140 (1923). Since the *International Shoe Case*, *supra*, such mail order operations have been held to provide sufficient minimum contacts with the forum to justify the assertion of jurisdiction over the insurer, either to enjoin its activities for failure to comply with a state license act, *Traveler's Health Ass'n v. Virginia*, 339 U.S. 643 (1950), or to permit

suit on a claim by the insured, *Parmalee v. Iowa State Traveling Men's Ass'n*, 206 F.2d 518 (5th Cir. 1953). Consistently with the application of the minimum contacts doctrine in other types of business transactions, a few courts have ruled that issuance of one policy by mail to a resident is sufficient, under appropriate statutes, to give the state jurisdiction over the foreign corporation. See, e.g., *Zacharakis v. Bunker Hill Mut. Ins. Co.*, 281 App. Div. 487, 120 N.Y.S.2d 418 (1953).

The principal case affirms the application of the minimum contacts doctrine in the *Parmalee Case*, *supra*, as to the issuance of policies by mail to residents of the state. It also represents an extension of this doctrine, for here there was no actual issuance of a policy by the defendant, but mere assumption of obligations under a policy issued by another corporation. Such assumption in effect was held to be included in the terms "issuance and delivery" used in CAL. INS. CODE §§ 1610, 1611 (1953), which provides for appointment of the Commissioner of Insurance as agent for claims arising out of policies issued to residents by foreign corporations. More important, however, the case clearly holds that the issuance (or assumption) of a single insurance policy provides the necessary minimum contacts to subject the insurer to jurisdiction, regardless of the absence of continuous business activities within the state, *Atlas Mut. Benefit Ass'n v. Portscheller*, 43 Del. 298, 46 A.2d 643 (1945), or the fact that the contract was not executed within the forum, *Anderson v. Service Life Ins. Co.*, 221 S.W.2d 398 (Tex. Civ. App. 1949).

The extension of the minimum contacts doctrine in the principal case is apparently sound. It seems neither just nor logical to deny such resident recourse against the insurer through local courts merely because the insurer has not dealt with other residents of the state. Clearly, the only alternative a foreign company now has to being subjected to the jurisdiction of the courts of a particular state is simply to have no contact whatsoever with its residents. Because of the nature of the insurance business, however, foreign insurers frequently will be unable to avoid these minimum contacts. For example, the principal case would seem to indicate that, with proper notice, state A's courts could assert jurisdiction over a foreign corporation which issued a policy to the insured while he was a resident of state B, but who has since become a resident of state A. As jurisdiction depends not on evidence of the insurer's intent to operate within the forum, but on whether it did in fact have some contact

with the resident, the insurer probably cannot avoid amenability to suit in some distant state by the simple expedient of issuing no policies to its residents.

Kennett Hobbs

Corporations — Securities Act of 1933 — Failure to Register Non-exempt Securities

Plaintiff stockholders of Monroe Paper Products Co. sought to invalidate a trust formed under a voting trust agreement executed by certain other stockholders of Monroe, alleging failure to register non-exempt securities in accordance with registration provisions of the Securities Act of 1933. Defendant directors and voting trustees admitted failure to register the trust certificates ("securities" within the act), but asserted other defenses. The federal district court of Michigan declared the trust "voidable" for failure to register the trust certificates. *Held, reversed and remanded*: The issue of *trust validity* cannot be divorced from certain factual issues not decided by the court below. *Knapp v. Kinsey*, 249 F.2d 797 (6th Cir. 1957). (The opinion in the instant case seems to approve *sub silentio* the district court's conclusion that failure to comply with registration provisions of the Securities Act renders a voting trust *voidable*. *Kinsey v. Knapp*, 154 F. Supp. 263 (E.D. Mich. 1957). This note is limited to an examination of that conclusion and does not comment upon the factual issues to be determined upon remand.)

The purpose of the Securities Act of 1933, 48 STAT. 74, 15 U.S.C. §§ 77(a)-77(aa) (1952), is protection of investors contemplating the purchase of securities. *Frost & Co. v. D'Alene Mines*, 312 U.S. 38 (1941); *Otis & Co. v. SEC*, 106 F.2d. 579 (6th Cir. 1939); Loss, *SECURITIES REGULATION* 120 (1951). This is accomplished largely through compulsory filing with the Securities and Exchange Commission of registration statements relating detailed information concerning security issues. 48 STAT. 77 (1933), 15 U.S.C. §§ 77(e)-77(g); BALLANTINE, *CORPORATIONS* § 372 (rev. ed. 1946). Civil liability is imposed where the registration statement is materially misleading or defective, 48 STAT. 82 (1933), 15 U.S.C. § 77(k), where securities are sold through material misrepresentations, or where there is failure to register securities. 48 STAT. 82 (1933), 15 U.S.C. § 77(l); Shulman, *Civil Liability and the Securities Act*, 43 Yale L.J. 227 (1933). The exclusive remedies provided under § 77(l) (§ 12 of the act) are recovery of

"consideration paid," or damages if the investor no longer owns the security.

Judicial construction of § 12 remedies has centered on the phrase "consideration paid." Investors seeking redress have not been limited to a money judgment. Thus, suit to rescind and secure restitution of consideration in kind was sustained in *Deckert v. Independence Corp.*, 311 U.S. 282 (1940), and where stock was given in exchange for voting trust certificates, recovery of such stock as "consideration paid" was allowed in *Corporation Trust Co. v. Logan*, 52 F. Supp. 999 (Del. 1943). Ancillary expenses incurred in the purchase of an unregistered security, *Whittaker v. Wall*, 226 F.2d 868 (8th Cir. 1955), and initial payments plus subsequent expenditures of an investor pursuant to a purchase contract, *Wall v. Wagner*, 125 F. Supp. 854 (Neb. 1954), are also recoverable. Thus, the phrase "consideration paid" has been liberally construed with an eye to restoring investors to their status prior to investment.

The *Deckert* case, *supra* at 288, states that § 12 prescribes the "legal consequences" of conduct proscribed by the act, not the form of action or procedure the claimant is to employ. Assuming voidability to be a "legal consequence," the instant decision's tacit approval of the district court's conclusion of voidability is not warranted by the language of § 12, either expressly or, it is thought, by implication. With the single possible exception of *Whittaker v. Wall*, *supra*, where the court by dictum termed unregistered securities "void," cases construing the "consideration paid" clause do not sustain such a position. These cases deal with the express language of § 12; the instant case, however, departs from statutory language to add a legal consequence of its own making.

The possible consequences of such a doctrine are conjectural at best, *e.g.*, whether judicial declaration of voidability is prerequisite to the enforcement of rights, whether an issuer who refuses to return investors' stock received in exchange for "voidable" securities would be liable for conversion, and whether investors not party to a suit, but holding similar securities, may take advantage of a judicial declaration of voidability. It seems clear that noncertificate holders and non-investors in general are not within the scope of Securities Act relief; whether relief should properly extend to investors who *knowingly* purchase unregistered securities seems extremely doubtful.

It is seriously doubted whether such a doctrine would appreciably expand investors' remedies under § 12 as liberally construed in the "consideration paid" cases; however, the seller's position will be

considerably weakened if persons other than innocent purchasers are allowed to rely on the doctrine. In addition, a "voidability doctrine" may give rise to new forms of action or procedure, *e.g.*, an action for conversion; such actions, although based on "legal consequences" not within § 12, would seem to be for the enforcement of rights which the Securities Act was designed to protect.

Jerry Moss

Criminal Law — Federal Courts — Double Jeopardy

D was indicted in the District of Columbia on two counts; the first for arson and the second for *first degree* murder, the latter offense being defined by statute as killing another in perpetrating arson, whether with or without purpose to kill. The trial court erroneously charged the jury on *second degree* murder, defined as killing another "with malice aforethought," except where done in perpetrating arson, in which event the offense is *first degree* murder. The jury found *D* guilty of arson under count one and of *second degree* murder under count two, the convictions carrying respectively sentences of one to three and five to twenty years' imprisonment. *D* accepted his conviction of arson under count one but secured a new trial under count two on the ground that there was no evidence of malice aforethought to sustain the conviction of murder in the *second degree*. When on retrial *D* was again charged with *first degree* murder he pleaded former jeopardy under the fifth amendment of the Federal Constitution. His plea was overruled and he was found guilty as charged and given a mandatory death sentence. *Held*: Where a defendant has been placed in jeopardy on a greater and a lesser offense [*first degree* murder and *second degree* murder], conviction of the lesser implies acquittal of the greater and discharge of the jury without rendering a verdict on the greater ends initial jeopardy, so that upon retrial at the defendant's request the fifth amendment prohibits again charging him with the greater offense. *Green v. United States*, 355 U.S. 184 (1957) (5-4 decision).

Where a defendant is charged with a greater offense, such as murder, but is convicted of a lesser, such as manslaughter, the question arises on retrial as to whether resubmitting the murder charge will illegally place the defendant in jeopardy a second time for the same offense. Federal courts prior to the instant decision have permitted retrial on the greater offense. *Bryan v. United States*,

175 F.2d 223 (5th Cir. 1949), *aff'd*, 338 U.S. 552 (1950); *United States v. Harding*, 26 Fed. Cas. 131, No. 15301 (C.C.E.D. Pa. 1846). *But see In re Bennett*, 84 Fed. 324 (N.D. Cal. 1897). Nineteen state jurisdictions follow this result while seventeen states hold contrary. *Green v. United States*, *supra* at 216 n.4. Cases allowing retrial on the greater offense generally follow either the waiver theory or the theory of continuing jeopardy. The waiver theory infers that an appellant waives his plea of former jeopardy on the greater offense by seeking retrial of his conviction of the lesser. By questioning the legality of his conviction on the lesser count the defendant throws open the entire record so that a final judgment free from substantial error can be rendered. *Trono v. United States*, 199 U.S. 521, 533 (1905) (5-4 decision); *Harris v. United States*, 237 F.2d 274 (8th Cir. 1956); *Morlan v. United States*, 230 F.2d 30 (10th Cir. 1956). The continuing jeopardy theory regards the entire controversy between the accused and the state as one continuous proceeding, from initial indictment to final appeal, with the result that retrial on the greater offense is simply a continuation of the original jeopardy. *Kepner v. United States*, 195 U.S. 100, 134 (1904) (dissenting opinion); *State v. Carabetta*, 106 Conn. 114, 137 Atl. 394 (1927); *State v. Lee*, 65 Conn. 265, 30 Atl. 1110 (1894).

The issue of retrial on the greater offense first reached the United States Supreme Court in *Trono v. United States*, *supra*. In that case a four-justice "majority" opinion held that the defendant had waived his plea of former jeopardy on the greater crime when he appealed his conviction of the lesser. The four dissenting justices vigorously attacked the decision and the waiver theory on which it was based. *Trono v. United States*, *supra* at 535. While Mr. Justice Holmes concurred in the majority decision (but not the opinion), it is significant that one year earlier he had criticized the waiver theory and urged adoption of the theory of continuing jeopardy. *Kepner v. United States*, *supra*. In the instant case the majority discounted *Trono* as authority under the fifth amendment on the ground that it was decided under the Philippine Bill of Rights Act, 32 STAT. 692 § 5 (1902), and asserted that this act, although using language taken almost verbatim from the first eight amendments to the Constitution, was designed to carry to the Philippines only some of the constitutional rights which apply in the continental United States. *See also Green v. United States*, *supra* at 197; *Downes v. Bidwell*, 182 U.S. 244 (1901).

The majority in the principal case rejected both the continuing

jeopardy and waiver theories. It found two events in the first trial which laid a basis for the defendant's plea of former jeopardy, which plea he could not legally be coerced into waiving: (1) When the jury convicted him of the lesser offense it *impliedly acquitted* him of the greater. (2) When the court discharged the jury without his consent and without obtaining a verdict on the greater charge his *initial jeopardy ended* at that point. Under either (1) or (2) submission of the greater charge in subsequent proceedings placed him in an illegal second jeopardy.

Mr. Justice Frankfurter says in his dissent that the majority overturned standard procedure in lower federal courts and dismissed *Trono* as authority under the fifth amendment despite its former acceptance by the Court. *Green v. United States*, *supra* at 205, 215. For examples of cases in which *Trono* was accepted see *Brantley v. Georgia*, 217 U.S. 284 (1910); *Burton v. United States*, 202 U.S. 344, 378 (1906); *Jones v. State*, 109 So. 265, *cert. dism.*, 273 U.S. 639 (1926).

The majority apparently regarded first degree murder as the greater offense because it carried a more severe penalty than did second degree murder, but it is doubtful that severity of punishment was a proper test to use in the instant case. Ordinarily the *severity of the punishment* increases along with the *elements of the crime*, as in murder compared with manslaughter, but under the peculiar facts of this case the punishment becomes more severe without reference to additional elements of the crime, *viz.*, malice aforethought. The jury's verdict that the defendant was guilty of second degree murder was necessarily a finding that he killed the victim and the conviction of arson under the first count added the only other element of first degree murder required by the statutes, since no evidence of any other cause of death was introduced at the trial. *Green v. United States*, 218 F.2d 856, 857 (D.C. Cir. 1955). Viewed from this standpoint, the defendant actually appealed to the Court from an implied conviction of first degree murder, not acquittal. *Green v. United States*, 355 U.S. 184, 215. This same peculiarity of the facts weakens the alternative basis for the decision, namely, that discharge of the jury without obtaining a verdict on the first degree charge ended the defendant's initial jeopardy as to that "separate and distinct offense." *Green v. United States*, *supra* at 191, 194 n.14. There was no need for a verdict on the first degree charge because the defendant, under the verdicts rendered, already stood convicted of every element of that offense.

The dissenting opinion draws a parallel to the case of *Stroud v. United States*, 251 U.S. 15 (1919). In that case a jury found the defendant "guilty of murder in the first degree without capital punishment" and on retrial a second jury found him "guilty of murder in the first degree" without qualification. The Court upheld the imposition of the death sentence on retrial. Judged strictly by the severity of punishment test, the retrial in that case was a second jeopardy. The Court held, however, that because the first jury had found the defendant guilty of the *offense* as charged, the plea of former jeopardy was without merit. Similarly, the jury in the instant case necessarily found the defendant guilty of every *element* of first degree murder but through ignorance or disregard of the statutes called the offense by another name carrying a lesser punishment. It is difficult to agree with the majority's holding in the principal case that under these circumstances the fifth amendment prohibits retrial on the greater offense.

Kenneth B. Kramer

Federal Courts — Equity Jurisdiction — Probate

P brought suit in federal district court, alleging diversity of citizenship grounds for jurisdiction. P sought to have a testamentary trust declared invalid for fraud and undue influence, for having too indefinite a purpose, and for creating a perpetuity; he also alleged that certain provisions of the will were revoked by a later missing will or codicil. Finally, P sought to have himself declared the only heir of the testatrix and, as such, entitled to all property not disposed of by will. D moved to dismiss for want of jurisdiction since the action was essentially a proceeding to contest a will and thus within the exclusive jurisdiction of the state probate court. *Held*: A suit to set aside a will for fraud and undue influence is, by the law of Oregon, a suit in rem which retains the character of probate proceedings, and federal courts have no jurisdiction to entertain such an action; thus, since a court of equity will not do justice by halves, the court, in its discretion, will not hear those matters alleged in the petition over which the court does have jurisdiction. *Jackson v. Portland Nat'l Bank*, 153 F. Supp. 104 (D. Ore. 1957).

The equity jurisdiction of federal courts, U.S. CONST. art. III, § 2, cl. 1, extends to the administration of the judicial remedies which had been devised and were being administered by the English Court of Chancery at the time of the American Revolution. *Atlas*

Life Ins. Co. v. W. I. Southern, Inc., 306 U.S. 563 (1939). Thus, although jurisdiction over wills and probate matters as such is neither included nor excepted from the grant of judicial power to the federal courts, 62 STAT. 930, 28 U.S.C. § 1332; *cf. Ellis v. Davis*, 109 U.S. 485 (1883), they have no jurisdiction to probate a will or administer an estate because the equity jurisdiction of the Chancery Court in 1789 did not extend to probate matters. *Markham v. Allen*, 326 U.S. 490 (1945). Furthermore, it is clear that it is not within the jurisdiction of a federal court of equity to set aside a will or the probate thereof or to administer upon the estates of decedents in rem. *Sutton v. English*, 246 U.S. 199 (1917); *Farrell v. O'Brien*, 199 U.S. 89 (1904). But federal courts may entertain equity jurisdiction in order to hear and establish claims of creditors, heirs, and legatees against a decedent's estate, *Markham v. Allen*, *supra*; *Waterman v. Canal-Louisiana Bank Co.*, 215 U.S. 33 (1909); *Ingersoll v. Coram*, 211 U.S. 335 (1908); *Byers v. McAuley*, 149 U.S. 608 (1892), and any claims so established must take their places and share in the estate as administered by the probate court; they cannot be enforced by direct process against the estate itself.

It is well settled that federal equity jurisdiction is not subject to limitation or restraint by state legislation establishing courts of probate and giving them jurisdiction over similar matters. *Waterman v. Canal-Louisiana Bank Co.*, *supra*. However, rights created and remedies provided by the statutes of the states to be pursued in the state courts of general jurisdiction may be enforced in the federal courts either at law or in equity as the nature of the right or the remedy may require. *Burn v. Mann*, 151 Fed. 145 (8th Cir. 1906). Consequently, it has been held that if state law, either statutory or customary, gives citizens the right, in an action or suit *inter partes*, to question at law the probate of a will or to assail probate in a suit in equity, the federal courts in administering the rights of citizens of other states may enforce such remedies. *Sutton v. English*, *supra*; *Farrell v. O'Brien*, *supra*; *Gaines v. Fuentes*, 92 U.S. 10 (1875); *Foster v. Carlin*, 200 F.2d 943 (9th Cir. 1952); *Richardson v. Green*, 61 Fed. 423 (9th Cir. 1894). The action or suit *inter partes*, however, must relate to independent controversies and not to mere controversies which may arise on an application to probate or a mere method of procedure ancillary to the original procedure. *Farrell v. O'Brien*, *supra*. Therefore, in the instant decision, had the law of the state admitted of a plenary suit or action *inter partes* in which the plaintiff might set aside the will on grounds of fraud,

undue influence, or a later inconsistent will, the federal court would have had jurisdiction to determine those matters; such a suit, however, was not provided by the applicable state law. See *In re Anderson's Estate*, 157 Ore. 365, 71 P.2d 1013 (1936). The district court, then, finding itself without jurisdiction to determine issues raised with respect to the validity of the will, refused to hear that part of the case over which it had jurisdiction, *viz.*, the testamentary trust provisions of the will and the determination of the plaintiff's status as heir of the testatrix.

When the equitable relief asked for is partly within and partly without federal jurisdiction, the federal courts have exercised discretion in either hearing or dismissing the case. *Cf. Waterman v. Canal-Louisiana Bank Co.*, *supra*; *Haines v. Carpenter*, 91 U.S. 254 (1901); *Underground Elec. Ry. v. Owsley*, 176 Fed. (2d Cir. 1909). As stated in the instant opinion, suits were pending before the proper state courts, and state procedure provided adequately for any relief to which the plaintiff might be entitled; furthermore, adherence to the rule of comity required that the suit be dismissed. In view of these considerations, therefore, the instant decision was clearly correct.

Allen Butler

Insurance — Automobile Liability Policy — Employees Exclusion

As part compensation for his employees, *D* agreed to furnish rides in his truck to those who wished them from a nearby town to the cotton fields and then back to town at the end of the working day. Two employees were injured when *D*'s truck overturned while transporting them back to town after work. *D* had automobile liability insurance subject to an exclusionary clause which stated that the insurance did not cover injuries to employees while engaged in *D*'s employment. *Held*: Employees are covered by their employer's auto liability insurance while being transported to and from work by the insured employer as part of their compensation because they are not engaged in employment within the meaning of the exclusionary clause, such clauses being strictly construed against the insurer. *Southern Farm Bureau Cas. Ins. Co. v. Bohls*, 304 S.W.2d 534 (Tex. Civ. App. 1957) *error ref. n.r.e.*

It is a settled rule of insurance law that language of a policy which is ambiguous should be construed strictly against the in-

insurance company. *Providence Washington Ins. Co. v. Proffitt*, 150 Tex. 207, 239 S.W.2d 379 (1951). However, this proposition does not qualify the basic principle which is applicable to all contracts (that to control is the intention of the contracting parties). *Burns v. American Nat'l Ins. Co.*, 280 S.W. 762 (Tex. Comm. App. 1926).

As a guide in determining cases such as the present one, courts often have been urged to adopt the same tests for determining whether the employee is within the scope of his employment as are applied in cases construing workmen's compensation statutes, because the statutes, see, e.g., TEX. REV. CIV. STAT. ANN. art 8306 (1925), and the policy provisions in the ordinary insurance cases, see, e.g., *B & H Passmore Metal & Roofing Co. v. New Amsterdam Cas. Co.*, 147 F.2d 536 (10th Cir. 1945), contain similar language. Under workmen's compensation statutes, recovery is permitted only if the injuries were "sustained in the course of employment"; and in the ordinary insurance case, recovery is denied if the injuries were sustained while the "employee was engaged in the employment of the insured." In the leading case of *B & H Passmore Metal & Roofing Co. v. New Amsterdam Cas. Co.*, *supra*, a divided court held that cases construing similar provisions in workmen's compensation laws are inapplicable to the construction of insurance contracts, because insurance contracts must be construed strictly against the insurer, whereas workmen's compensation statutes are to be construed liberally. However, the Fourth Circuit, in *Lumber Mut. Cas. Ins. Co. v. Stukes*, 164 F.2d 571 (4th Cir. 1947), cited but refused to follow the *Passmore* case, stating simply that distinctions in the law are to be avoided and therefore holding that workmen's compensation decisions are controlling authority in ordinary auto liability insurance cases such as the present one. It is now generally accepted that the Fourth, Fifth and Eighth Circuits are committed to the *Stukes* view. *State Farm Mut. Automobile Ins. Co. v. Braxton*, 167 F.2d 283 (4th Cir. 1948); *State Farm Mut. Automobile Ins. Co. v. Brooks*, 136 F.2d 807 (8th Cir. 1943); *Johnson v. Aetna Cas. and Surety Co.*, 104 F.2d 22 (5th Cir. 1939).

The federal rule, outside of the Tenth Circuit, may be stated thus: Where an employer is under an obligation, either expressed or implied, to transport an employee to and from his place of work, such employee, while being so transported by the employer, is engaged in his employer's employment. *Hartford Acc. & Indemnity Co. v. Hudson*, 124 F. Supp. 666 (E.D. Ky. 1954). In an exhaustive analysis of the problem and perhaps the best considered opinion on this subject, the Oregon Supreme Court in *I-L Logging Co. v.*

Manufactures & Indemnity Exchange, 202 Ore. 277, 273 P.2d 212 (1953), stated, after considering the *Passmore* and *Stukes* cases, ". . . the fact remains that [insurance] policies such as the one before us are intended to grant employers no protection for injuries to their employees. The controlling issue is, when does an employee lose his identity as such an employee and become absorbed in the general public. Until he has cast off his role as [an] employee and [has] become merged in the general public, the policy affords his employer no protection against mishaps which may befall him."

The principal case may commit the Texas courts to the minority rule of the *Passmore* decision. One previous Texas case held that an employee is not engaged in the employment of his employer when he rides casually in his employer's vehicle and where such transportation is not a condition of the employment contract. *Republic Cas. Co. v. Obregon*, 290 S.W.2d 267 (Tex. Civ. App. 1956) *error ref. n.r.e.* But, where such transportation was a part of the contract of employment, it was held that an employee riding between his actual place of work and his employer's central station was an employee engaged in the work, business, trade, or profession of his employer. *Wichita Falls v. Travelers Ins. Co.*, 137 S.W.2d 170 (Tex. Civ. App. 1940) *error disp., judgm. cor.*

The facts of the principal case fall between the *Obregon* and *Wichita Falls* cases, because in *Obregon* the employer owed no duty to furnish transportation. Whereas in *Wichita Falls* there was an obligation to provide transportation, but such transportation was merely back to the employer's central station. In the principal case the relationship was more casual than in *Wichita Falls*, since here the transportation was taking the employees home; but even so, there was a definite obligation to provide transportation. The court ruled in line with the *Obregon* decision, though that case was not cited.

The main objection to the court's reasoning is that it relies too greatly on the canon of insurance construction which requires strict construction against the insurer, and too little on the cardinal principle of construction of all contracts which is the intent of the parties is to control. The court admits that the employees at the time of the injury were "within the course of employment" within the meaning of the workmen's compensation statutes. Thus it is reasonable to assume that it was the intent of the contracting parties to exclude such injuries since the employees could qualify for workmen's compensation. It also seems very likely that the intent of the parties was to have their insurance policy provide

no coverage for employees who were not yet "merged in the general public." If this was the intent, then the result of the principle case is clearly wrong. Not only did the court ignore this intent, but it refused to consider any intent whatsoever. Consideration of intent would seem imperative to a proper determination of the case.

Larry L. Gollaber

Oil and Gas — Mineral Deed — Four Corners Rule

P executed a mineral deed to Caldwell, under whom D claimed. The granting clause defined the conveyed interest as an "undivided 1/64 interest in the minerals." This interest was made subject to a prior oil and gas lease, but included 1/8th of any royalties (*i.e.*, a 1/64th royalty) and 1/8th of any money rentals payable by the lessee. One eighth of any money rentals which might be paid to extend the lease were to be paid to the grantee, Caldwell. The deed further provided that when the first lease terminated, the grantee would own "1/8 of the *lease interest* and all future rentals." The deed concluded by stating that the grantee owned "1/8 of 1/8 of all the oil, gas, and other minerals and a 1/8 interest in all future rents." P executed a subsequent lease after the first oil and gas lease had terminated. Thereafter P claimed a 63/64th mineral interest while D claimed a 1/8th mineral interest. *Held*: Under the four corners rule of construction, the deed conveyed a 1/8th interest in all minerals. *Garrett v. Dills Co.*, —Tex.—, 299 S.W.2d 904 (1957).

An instrument of conveyance which is ambiguous should be construed in the grantee's favor and taken as conveying to him the largest possible estate within the words of conveyance. *Hoffman v. Magnolia Petroleum Co.*, 273 S.W. 828 (Tex. Comm. App. 1925). However, this rule should be considered in conjunction with the four corners rule of construction, which is often stated as follows: The strictness of ancient rules for construing deeds and like instruments has been relaxed as it is now well settled that all parts of the instrument will be given effect when possible, and the actual intention of the parties will be gathered from the whole instrument without reference to matters of mere form, relative position of descriptions, technicalities or arbitrary rules. *Harris v. Windsor*, —Tex.—, 294 S.W.2d 798 (1956); *Sun Oil Co. v. Burns*, 125 Tex. 549, 84 S.W.2d 442 (1935).

Generally, mineral deeds convey the same proportionate interest

in the royalty that is conveyed in the minerals. *Jones v. Bedford*, 56 S.W.2d 305 (Tex. Civ. App. 1932) *error ref.* (Dissent by Hickman, C. J., who wrote the opinion of the Court in the principal case). Without specific stipulation as to royalties in a mineral deed, the conveyed interest would carry with it, by operation of law, the right to a pro rata share of the royalties. *Richardson v. Hart*, 143 Tex. 392, 185 S.W.2d 563 (1945). A single deed can convey one set of interests in the absence of a lease, another set of interests under a designated lease, and still another set of interests under a future lease. *Woods v. Sims*, 154 Tex. 59, 273 S.W.2d 617 (1955). However, if the parties intend to convey a different interest in the royalties than is conveyed in the minerals, then such an intent must be expressed. *Benge v. Scharbauer*, 152 Tex. 447, 259 S.W.2d 166 (1953); *Humble Oil & Refining Co. v. Harrison*, 146 Tex. 216, 205 S.W.2d 355 (1947).

The deed form used by the parties in the principal case has been construed by Texas courts on several occasions. In *Richardson v. Hart*, *supra*, the deed conveyed an undivided 1/16th of 1/8th mineral interest and a 1/16th of 1/8th of the royalties produced under an existing lease. The Court held that the grantee received 1/16th of 1/8th of the 1/8th royalty (or 1/1024th of all the oil produced). The *Richardson* case is distinguishable from the principal case on two grounds: first, the *Richardson* deed did not attempt to convey any interest in the grantor's possibility of reverter in the determinable lease interest, and second, the *Richardson* deed used the same fractions throughout. Although no court has decided precisely what the term "lease interest" means, many have merely assumed that it refers to the right to execute a subsequent oil and gas lease and to receive the benefits thereunder. Such a case is *Tipps v. Bodine*, 101 S.W.2d 1076 (Tex. Civ. App. 1937) *error ref.*, where the deed purported to convey a 1/16th mineral interest subject to an oil and gas lease but including 1/2 of the royalties payable by the lessee. It also conveyed, after the lease terminated, 1/2 of the lease interest. The court held that the grantee received 1/2 of the royalties under a subsequent lease. Although the reasoning in that case is far from convincing, the facts and holding are exactly in point. See Meyers and Williams, *Hoffman v. Magnolia Petroleum Co.: A Further Comment*, 35 TEXAS L. REV. 363 (1937) expanding Williams, *Hoffman v. Magnolia Petroleum Co.: The "Subject-To" Clause in Mineral and Royalty Deeds*, 30 TEXAS L. REV. 395 (1952); see also Note, 17 TEXAS L. REV. 346 (1939). One case, however, has held that the phrase "lease interests and all

future events" refers only to the money bonuses paid by the oil and gas lessee to the lessor. *Porter v. Shaw*, 12 S.W.2d 595 (Tex. Civ. App. 1928). This case can easily be distinguished from the principal case, for the mineral deed in *Porter* recited that it was subject to an oil and gas lease; but actually there was no lease in existence, and the spaces in the form concerning the lease were left blank. Under these facts it is obvious why the court did not decide that the term "lease interests" referred to all the benefits from a subsequent lease.

The mistake made by the parties in both the *Tipp*s and principal case was the rather common one of treating the lessor's retained interest in the minerals (subsequent to the usual oil and gas lease) as being merely 1/8th of the minerals. This view, of course, completely neglects the lessor's possibility of reverter in the 7/8th determinable fee. Hence, the granting clause in attempting to grant 1/8th of the lessor's retained interest, purported to convey 1/64th of the minerals. It appears that the Court under the guise of the four corners rule looked behind the deed, discovered the mistake, and then reformed the deed in a title suit. The Court in effect rewrote the granting clause by changing the interest conveyed from a 1/64th mineral interest to a 1/8th mineral interest. This illustrates the extent to which courts will go to find an instrument unambiguous. In so doing, this Court reached a proper result by correctly ascertaining the intent of the parties from an instrument which at first impression appeared to be ambiguous.

Larry L. Gollaber

Taxation — Oil and Gas — Sale of Carved-Out Production Payments

Lake, a corporation, assigned a \$600,000 carved-out production payment to its president in consideration for the cancellation of a debt in the same amount. Payments were dischargeable out of twenty-five per cent of the oil attributable to Lake's working interest, which resulted in the pay-out period extending to slightly more than three years. Lake reported this \$600,000 in its tax return as proceeds from the sale of property taxable at long-term capital gain rates. *Held*: The consideration received for the assignment of a carved-out production payment is taxable as ordinary income subject

to depletion. *Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260 (1958).

When considering the capital gain and loss provisions of the Internal Revenue Code, the same basic question always arises: Has there been a sale or exchange of property subject to capital gain treatment? Int. Rev. Code of 1939, § 117(a), 53 STAT. 50 (now INT. REV. CODE OF 1954, § 1221). Mineral interests are usually capital assets in the hands of the owner and thus, when sold or exchanged, the proceeds are accorded capital gain treatment. See H.R. REP. NO. 350, 67th Cong., 1st Sess. (1939); BEVERIDGE, *FEDERAL TAXATION OF INCOME FROM OIL AND GAS LEASES* §§ 27-42 (1948). While a production payment has been recognized to be an economic interest in the minerals in place entitling its owner to a specified fraction of production for a limited time, *Thomas v. Perkins*, 301 U.S. 655 (1937); *Lee v. Commissioner*, 42 B.T.A. 1217 (1940), *aff'd*, 126 F.2d 825 (5th Cir. 1942); BREEDING & BURTON, *TAXATION OF OIL AND GAS INCOME* § 2.07 (school ed. 1954), this does not provide the answer to the essential question involved in the principal case, *viz.*, whether for capital gain purposes, a production payment is to be treated as a mineral interest.

Under Texas decisions, it is well settled that production payments are real property and mineral interests as distinguished from rights to future income. *State v. Quintana Petroleum Co.*, 134 Tex. 179, 133 S.W.2d 112, 128 A.L.R. 843 (1939); *Tennant v. Dunn*, 130 Tex. 285, 110 S.W.2d 53 (1937); however, since state law as to the character or disposition of mineral interests is not binding for income tax purposes, *Burnet v. Harmel*, 287 U.S. 103 (1932), the Revenue Service has been free to emphasize the method of their creation rather than technical property considerations in deciding when, if ever, production payments are to be treated as mineral interests, see BREEDING & BURTON, *supra* at § 6.02; Comment, 10 Sw. L.J. 302 (1956).

The Commissioner has accepted the view that where a production payment is *retained* out of a larger mineral interest which has been assigned by the owner, the subsequent sale or exchange of this type of production payment will be treated as a capital transaction. G.C.M. 22730, 1941-1 CUM. BULL. 214; see Heard, *Income Tax Treatment of Production Payments*, EIGHTH ANNUAL INSTITUTE ON OIL AND GAS LAW AND TAXATION 563 (1957). Conversely, if it is the larger mineral interest which the owner retains and out of this he *carves* and assigns a production payment, the Commissioner initially ruled that where the pay-out period is of short duration

the assignment of this type interest would be treated as an assignment of future income and not as a capital transaction. G.C.M. 24849, 1946-1 CUM. BULL. 66; BREEDING & BURTON, *supra* at § 6.03. Reasoning by analogy to cases where taxpayers in fields other than oil and gas had attempted to deflect income to parties in lower surtax brackets by donative assignments of income, see, e.g., *Harrison v. Schaffner*, 312 U.S. 579 (1941); *Helvering v. Horst*, 311 U.S. 112 (1940), the Commissioner in 1950 rejected his initial position (that duration of the pay-out period is the test) and ruled instead that all *carved-out* production payments would be treated as mere assignments of future income. I.T. 4003, 1950-1 CUM. BULL. 10; see 1 P-H OIL AND GAS TAXES para. 116.2.

In one of the many cases decided subsequent to the Commissioner's 1950 ruling, the Fifth Circuit expressly rejected his analogy and treated the assignment as a capital transaction where the duration of the pay-out ranged from nine to thirteen years. *Caldwell v. Campbell*, 218 F.2d 567 (5th Cir. 1955), 4 OIL AND GAS REP. 305. Later, the same court reasoned that *Caldwell v. Campbell* would still be followed but that it is the "substantiality" of the interest assigned which determines the tax consequences and that a pay-out period of two years or less is "insubstantial." *Commissioner v. Hawn*, 231 F.2d 340 (5th Cir. 1956), 5 OIL AND GAS REP. 855. Compare this holding with G.C.M. 24849, *supra*. Cf. *Helvering v. Clifford*, 309 U.S. 331 (1940); *United States v. Shafito*, 246 F.2d 338 (4th Cir. 1957). While the *Caldwell* and *Hawn* cases are consistent when explained on the "substantiality" basis, the Seventh Circuit, citing the *Hawn* decision, cast considerable doubt as to the applicability of the "substantiality" test, by holding in *Commissioner v. Slagter*, 238 F.2d 901 (7th Cir. 1957) (where the pay-out was slightly less than eight years), that the lump-sum consideration received was merely a loan with the assignment of the carved-out production payment serving only as security.

The pay-out period in the principal case was slightly more than three years. The Fifth Circuit determined that this was a "substantial" property interest for tax purposes, relying heavily on state law. *Commissioner v. P. G. Lake, Inc.*, 241 F.2d 71 (5th Cir. 1957). Consistent with the *Slagter* case, the Seventh Circuit clearly would have disagreed. The Supreme Court, neither accepting nor rejecting the "substantiality" test, nor expressly accepting the *Slagter* "loan-investment" theory, concluded that this assignment was a transparent device, citing *Harrison v. Schaffner* and *Helvering v.*

Horst, supra. The Court's reference to these cases is tantamount to holding that in the future all *carved-out* production payments will be treated as assignments of income, regardless of duration. Compare this holding with I.T. 4003, *supra*. Thus it would appear that the end has come to the long list of cases dealing with the total effect of an assignment of a *carved-out* production payment. See BREEDING & BURTON, *supra* at §§ 6.03-6.06; MILLER, OIL AND GAS—FEDERAL INCOME TAXATION 183 (3d ed. 1957); Heard, *Income Tax Treatment of Production Payments, supra*. Undoubtedly, however, the problem will arise again in at least two different contexts, one being a question of income timing and the other concerning the use of reversionary interests in tax planning.

In the usual "carried interest" arrangement, the owner of the working interest assigns all or a portion of the interest for a period of time, measured by the recoupment of costs by the assignee, at which time a portion, *e.g.*, one half, of the working interest previously assigned *reverts* to the assignor. BREEDING & BURTON, *supra* at § 2.08. In view of his position taken in I.T. 4003, *supra*, the Commissioner probably will argue from the *Lake* decision that one half of the original assignment is in the nature of a *carved-out* production payment since that portion of the interest reverts to the assignor and thus that one half of the advanced development costs will be treated as income to the assignor. Hence, it would seem advisable, whenever the use of a reversionary interest is contemplated, to secure an advance ruling. With respect to the question of income timing, if it is foreseen that fifty per cent of net income will be less than 27½ per cent of gross income for purposes of the depletion allowance, INT. REV. CODE OF 1954, § 613, the taxpayer may sell a *carved-out* oil payment and attempt to avoid the adverse effects of the fifty per cent net income limitation. BREEDING & BURTON, *supra* at §§ 16.14-16.15. As a tax avoidance device, this procedure necessarily depends upon two assumptions, *viz.*, that the sale results in ordinary income and that the realization is immediate. The *Lake* case clearly holds that there is ordinary income but the taxable year in which it is realized was not discussed. The Service has recognized that all of the income is realized in the year of sale, *i.e.*, the taxpayer's income is "bunched" into one year. 1 P-H OIL AND GAS TAXES para. 114.2. However, the court in *Commissioner v. Slagter, supra*, having once adopted a "loan-investment" theory, was forced to the conclusion that the income was taxable to the assignor only as it was accumulated and paid to the assignee since the lump sum

received by the assignor was only a "loan." Probably, the *Slagter* case was tacitly overruled by the *Lake* decision because *Lake* was reversed but not remanded as would have been necessary had the Court decided that the Commissioner was attempting to impose the tax in the wrong year. Thus, it would seem that the adverse effects of the fifty per cent net income limitation may still be avoided by this procedure, but otherwise, as a result of the instant case, the *carved-out* production payment in tax planning will be of little value. Compare the principle case with I.T. 3935, 1949-1 CUM. BULL. 39, where the Service holds that a gift of a carved-out oil payment is not a gift of a property interest. *Contra*, *Lester A. Nordan*, 22 T.C. 1132 (1954).

The holding of the principal case should not be too alarming since, due to factual distinctions, it has little or no effect on most collateral oil and gas transactions. Ruling substance over form, the Commissioner has taken the view that where the consideration for the assignment is pledged for use in further development there is in fact no sale at all, G.C.M. 22730, *supra*, and where the pay-out is so lengthy with respect to the depletable interest out of which it is carved that there is in effect an overriding royalty the consideration received will be treated as capital gain, G.C.M. 24849, *supra*. Further, if it is the taxpayer's entire interest which is assigned, the transaction will be treated as the sale of a capital asset, I.T. 4003, *supra*, and hence the well-known ABC or XYZ deal as it is commonly employed remains unaffected by the *Lake* decision since A assigns his entire interest to C. See *ABC or XYZ Private Ruling*, 6 OIL AND GAS TAX Q. 54 (1956); 1 P-H OIL AND GAS TAXES § 2011.1.

In reaching its conclusion, the Supreme Court undoubtedly was correct when it reasoned that the lump-sum consideration received by the taxpayer is nothing more than a substitute for what otherwise would be received at a future time as ordinary income. However, the sale of *any* mineral property involves the sale or anticipation of future income in the sense that had the sale not been made and had the oil been retained on a barrel-by-barrel basis, this same oil would have been taxed at normal rates when produced. In this respect, therefore, *Harrison v. Schaffner* and *Helvering v. Horst*, *supra*, should not be applied to the sale of mineral property because the taxpayer retains no income-producing "tree" as *Schaffner* and *Horst* seemingly would require. It may be that *carved-out* production payments are being used abusively, but, in view of the fact that mineral interests are recognized to come within the capi-

tal gain provisions of the Code, it would seem that their regulation should be left to Congress so as to produce a prospective effect, rather than a retroactive effect as did the *Lake* decision.

Elton R. Hutchison