RECENT AMERICAN DECISIONS.

Court of Appeals of Kentucky.

THOMAS FARMER v. GREGORY & STAGG.

When an agreement is reduced to writing, and although not signed, is acted upon by the parties, parol evidence is not, in the absence of fraud or mistake, admissible to add to, vary or contradict its terms.

Where a warehouseman sells goods in his warehouse under a general authority to sell, given to him by the owner, the property passes and he may give a second warehouse receipt to the purchaser, notwithstanding there is a receipt still in the hands of the first owner. The Kentucky Warehouse Act of 1869, prohibiting the issue of a second warehouse receipt without the production of the first, does not apply to such a case.

ACTION to recover possession of goods described in a warehouse receipt. The facts of the case were as follows: Taylor issued to Gregory & Stagg, a warehouse receipt for certain barrels of whiskey. At the same time Gregory & Stagg entered into the following agreement with Taylor:

"We make advances in money or accept drafts for a commission of 2½ per cent., this to cover two renewals of four months' paper, making the commission 2½ per cent. per annum. The paper we take we discount at 10 per cent. per annum. When you can do better at home, we will accept your drafts, the amount per gallon or barrel for purposes of collateral to be agreed upon. Free goods we usually do not go beyond three-fourths the cash value, we to have one dollar per barrel on sales in bond of all goods advanced on, whether we sell, or you make sale, and 2½ per cent. on all tax-paid goods advanced on, sold by us or you. When required to guarantee sales, we charge 2½ per cent. commission on amounts so guaranteed; when sale is made of goods advanced on by us, and you do not require the guarantee, other goods can be placed in our hands, as collateral in their stead. We can carry, on the above terms all you want carried, and as long as it will pay you to carry."

This agreement was reduced to writing, but not signed by the parties. Afterwards Taylor sold the whiskey to Farmer and issued to him a warehouse receipt therefor, Farmer having no notice of the outstanding receipt to Gregory & Stagg. This action was afterwards brought by Farmer against Gregory & Stagg to recover possession of the whiskey, plaintiff claiming that the sale to him was made by Taylor under the above agreement.

The answer of Gregory & Stagg admitted that the agreement was entered into, but insisted that it did not authorize Taylor to sell and convey title to the whiskey covered by their receipt. The evidence showed that transactions under this agreement between Taylor and Gregory & Stagg, were had to the amount of at least $150,000, but that there was in the meantime, only one sale by Taylor of whiskey for which Gregory & Stagg held receipt. This last-mentioned sale by Taylor was sanctioned by Gregory & Stagg, accompanied with the suggestion that they preferred that, in the future, their approbation should be obtained by Taylor before making sale of whiskey for which they held receipts. This transaction was prior to the sale by Taylor to Farmer, but unknown to the latter.

On the trial defendant offered parol evidence to explain the above agreement, and this evidence was admitted by the court. A verdict was rendered for defendant, and judgment entered thereon, whereupon this appeal was taken.

J. & J. W. Rodman, for appellant.

W. P. D. Bush and *D. W. Lindsey*, for appellee.

The opinion of the court was delivered by

HINES, J.—Instruction No. 5, given by the court below, requires as a condition precedent to the liability of Gregory & Stagg, first that the jury shall find that Gregory & Stagg authorized Taylor to sell the whiskey; and second, that Gregory & Stagg authorized Taylor to issue a warehouse receipt therefor. It was error in the court to make the right of recovery depend upon the establishment of both these facts, when proof of the authority to sell carries with it, as an incident, the right to issue the warehouse receipt. The property in the whiskey, where the sale is made with the consent and by authority of the holder of the first receipt, passes to the purchaser, regardless of the fact of the issuing or surrender of receipts.

Section 7 of the Warehouse Act of 1869, does not apply to a case like this. That portion of the section forbidding the issuing of a second receipt without the production of the prior receipt accompanied by the written consent of the holder of the prior receipt, is in the interest of commerce and of the negotiability of such receipts and for the protection of the holder of the second receipt. It is

for the prevention of fraud, and not to encourage it, as would be the case if the holder of the first receipt were permitted to repudiate the oral authority, given to the original owner of the property, by which he obtains the money of an innocent purchaser for value who has been misled by the silence of the first receipt-holder, who permits the original owner to retain possession with every indicia of ownership. The holder of the first receipt who gives the oral authority to sell is as much estopped to deny the authority to sell and the title in the innocent purchaser as he could be if he had stood by in person and acquiesced in the sale without asserting claim. Any other construction would sanction and encourage combinations for the perpetration of frauds that would effectually defeat the beneficial purposes designed to be accomplished by the passage of the Warehouse Act.

The written evidence of the agreement between Taylor and Gregory & Stagg is entitled to as much consideration as if they had each signed it. The object of reducing the terms of a contract to writing is to make them certain, and the object of the signature is to identify the writing and to make manifest the fact of deliberation accompanying the consummation of the contract. These objects may be accomplished, as in this instance, by reducing the terms to writing, by delivery, acceptance, and the conduct of business under the agreement, as effectually as if the signatures of the parties were appended. The terms of a contract thus executed must be taken to speak the solemn agreement of the parties, and can no more be altered, added to or varied than any other written contract, which purports on its face to contain the whole of the agreement between the parties. If parol evidence were permitted, in the absence of an allegation of fraud or mistake, to effect it, the same evidence would be competent as bearing upon the same writing when signed by the parties entering into the agreement. If the writing appeared upon its face to be a loose or incomplete memorandum of an agreement, parol evidence would be competent, without alleging fraud or mistake, to show what the contract in fact was; but it is not such a memorandum, and the effect of the oral evidence admitted is to show that the terms used by the contracting parties did not express their meaning. It is true that Stagg testifies that the writing does not contain the whole of the agreement, and that it was not understood to authorize Taylor to sell whiskey for which Gregory & Stagg held warehouse receipts; but the same might be

said of every deliberately-written contract, and the conservative rule excluding parol evidence thereby effectually nullified.

The expression in the writing exhibited, "We to have one dollar per bbl. on sales in bond of all goods advanced on, whether we sell or you make the sale, and 2½ per cent. on all tax-paid goods advanced on, sold by us or you," taken in connection with the whole tenor of the instrument, manifestly makes it a dispositive document, which was intended to confer upon Taylor the authority to sell whiskey upon which advances have been made by Gregory & Stagg. As to the simple question of the authority to sell, the language is unequivocal and without ambiguity, and cannot, therefore, be contradicted, added to or varied without allegation and proof of mistake or fraud. The authority to sell being without limitation or condition, to permit parol evidence to establish that the sales were to be made upon condition that the permission of Gregory & Stagg should be first obtained, would be to make a new contract between Taylor and Gregory & Stagg, and consequently to annul the written agreement. All the circumstances surrounding the contracting parties at the time of making the contract evidenced by the writing, as well as the manner in which they transacted business under the agreement, prior to the purchase by appellant, may be shown, to determine whether there was other whiskey in the hands of Taylor belonging to Gregory & Stagg, for which they held no warehouse receipts, and to which, therefore, the authority to sell may have been intended to extend, instead of to such as, under their agreement, was to be covered by the warehouse receipts. Such evidence would be competent for the purpose of identifying the subject-matter of the contract, but not for the purpose of showing that the parties did not mean what the language of their agreement naturally imports: Greenleaf, vol. 1, secs. 281–2; Whart. on Evid., secs. 920–3; *Castleman* v. *Southern Mutual Life Insurance Company*, 14 Bush 197.

For the reasons suggested, we conclude that the court erred in instructing the jury as to the law of the case, and in admitting Stagg to testify as to his understanding of the meaning of the terms used in the written instrument, and also in permitting him to state, in the present condition of the pleadings, that the writing did not contain all the terms of the contract entered into between Taylor and Gregory & Stagg at the time the writing was made.

Judgment reversed, and cause remanded, with direction for further proceeding.

Supreme Court of Tennessee.

VANCE v. PHŒNIX INSURANCE CO.

Directors of a corporation are required to show reasonable capacity for the position, scrupulous good faith, and the exercise of their best judgment.

Directors, who act in good faith and with reasonable care and diligence, but nevertheless fall into a mistake, either of law or fact, are not personally liable for the consequence of such mistake.

The by-laws of a corporation provided that the board of directors should elect a secretary, whose term of office should be twelve months or until his successor was elected, and who was to give bond with security for the faithful discharge of his duties. The board elected a secretary, and took the prescribed bond, and re-elected the same person secretary for several successive years, but took no new bond, supposing, after consideration and discussion of the question, but without taking legal advice, that the bond taken was a continuing security during those years. The secretary became a defaulter in the third year. *Held*, that the directors, who were good and efficient business men, stockholders of the corporation, and acting in good faith, were not liable to make good the loss.

BILL by one stockholder of the Phœnix Insurance Company, upon the refusal of the company to bring the suit, to hold the directors of the company, during the year 1872 and 1873, individually liable for losses occasioned by their neglect to take an official bond from the secretary of the company, in accordance with the by-laws of the corporation.

By the charter the board of directors were authorized to appoint a secretary, &c., and to take from such secretary or other officers, such bonds and securities as may be prescribed by said board of directors. The company organized in February 1871, and adopted by-laws, prescribing, *inter alia:* "At the first regular meeting after the election of directors, the newly-elected board shall elect a president, secretary and assistant secretary, whose term of office shall be for twelve months, or until their successors are elected."

Another by-law was: "The secretary, after his election, shall give bond with satisfactory security to the board of directors, in the sum of $30,000, conditioned for the faithful discharge of his duties, and a failure to give such bond shall cause a forfeiture of his office." Other by-laws gave the secretary: "Special care and control over all books, papers and other documents" of the company; directed him to make regular deposits in bank of the money of the company, and authorized the money to be drawn out only on his check.

In February 1871, the board of directors appointed B. F. White secretary of the company, and took from him a bond, with satisfac-

tory security, in the penalty of $30,000, conditioned to faithfully perform his duty as such secretary, and in all respects properly demean himself in his said office. White was re-elected secretary in February 1872, and again in February 1873, but gave no new bond on either occasion, nor did the board require him to renew his bond. In 1873, White became a defaulter in the sum of $11,328.35, and also issued stock without authority, which the board of directors redeemed at an expense of $3050. The individual defendants were stockholders and members of the board of directors during the years 1872 and 1873. They received no compensation as directors, and gave to the business of the company their personal attention, and such attention, it was agreed, as men of ordinary prudence give their own affairs. They were all, by the agreed statement of facts, "good and efficient business men, several of them heads of large mercantile and manufacturing establishments." "The defendants supposed that the bond taken from White in 1871 was security for White's acts in 1872 and 1873, and so long as he acted as secretary of the company."

They considered and discussed the question of White's bond, and their conclusion was that it covered his acts for the whole time he should serve the company. In 1872 and 1873 they gave the business of said insurance company, and the sufficiency of White's bond, that care and attention which prudent men give their own affairs. They did not, however, take advice of counsel as to the sufficiency of the bond or of its binding force, but acted on their own judgment in regard to it until after White's defalcation occurred."

The chancellor dismissed the bill, whereupon complainant appealed.

The opinion of the court was delivered by

COOPER, J.—Directors of a corporation undoubtedly occupy a fiduciary relation towards the stockholders, and are bound to good faith and reasonable diligence in the performance of their duties. They are consequently liable for losses occasioned by their positive misconduct or neglect which warrants the imputation of fraud, or, as it is sometimes vaguely expressed, shows a want of the knowledge necessary for the discharge of their functions so great that they were not justified in assuming the office. Where they are interested in the stock of the company, and act without compensation, they will, at the utmost, be held to answer for ordinary neglect, that is for the omission of that care which every man of ordinary prudence

gives to his own affairs. They do not undertake to be infallible. For error, therefore, though it be in a matter of law, they are not in general, liable. In fine, they are required to show only a reasonable capacity for the position, scrupulous good faith, and the exercise of their best judgment. These principles are recognised in our decisions: *Shea* v. *Knoxville & Ky. Railroad Co.*, 6 Baxt. 277, 283; *Shea* v. *Mabry*, 1 Lea 319, 343. In this last case, it is conceded that directors, who act in good faith, and with reasonable care and diligence, but nevertheless fall into a mistake, either as to law or fact, are not liable for the consequences of such mistake. To the same effect are the authorities elsewhere: *Turquand* v. *Marshall*, Law Rep. 4 Ch. App. 376; *Godbold* v. *Branch Bank*, 11 Ala. 191; *Spering's Appeal*, 71 Penn. St. 11; *Scott* v. *Depeyster*, 1 Edw. Ch. 513; *Hodges* v. *New England Screw Co.*, 1 R. I. 312; s. c. 3 R. I. 9.

The act complained of in this case was the failure to take from the secretary a new bond upon his re-election in 1872, and again in 1873, upon the supposition that the bond given in 1871, did not bind the sureties beyond the re-election at the end of the first twelve months. It has been held that the failure to require the secretary of a corporation to give a bond, would make the president, whose duty it was to take the bond, liable for the defalcation of the secretary: *Pontchartrain Railroad Co.* v. *Paulding*, 11 La. Rep. 41. If this be conceded to be good law, as perhaps it may, it would not necessarily fix liability on the defendants in the present case, for the by-law only requires the secretary to give a bond for the faithful discharge of his duties, and such a bond was taken. The neglect of duty was in not requiring a new bond on each re-election of the same person. If the by-law had plainly required a new bond each year, or if, the language of the by-law admitting of doubt, the directors had come to the conclusion that a new bond should be taken, the authority would have been in point; so too, if the directors had known that, as matter of law, the sureties would not be bound beyond the year, and yet neglected to require a bond. The by-law does not, however, plainly require a new bond each year, and the agreed statement of facts concedes that the defendants considered and discussed "the question of the bond, and reached the conclusion that the bond taken covered his acts for the whole time he should serve the company." It was at most a mistake of law, on errors of judgment, for which, without

more, they would not be liable. There is of course, no pretence for charging the defendants upon the ground of a want of knowledge necessary to discharge their functions, so great that they were not justified in assuming the office, for it is conceded that they were "good and efficient business men, several of them the heads of large mercantile and manufacturing establishments." Now, can they be charged with neglect of duty, it being agreed that they gave to the business of the company, and the matter of the secretary's bond, "that care and attention which prudent men give their own affairs." It is not pretended that there was any bad faith. There is, therefore, clearly no ground for holding the defendants liable, unless it be for failing to take legal advice. But, the very fact that a mistake of law will not, of itself, create liability, necessarily implies that such a mistake may be committed without legal advice. Some of the cases do hold that acting under legal advice may tend to protect against liability, while none of them decide that its absence insures liability. Ordinarily, the advice of counsel will not protect a trustee: Perry on Trusts, § 927. Nor shield any person from the consequences of a wrongful or illegal act: *Kendrick* v. *Cypert*, 10 Humph. 291. The true rule in this class of cases is that if the directors feel any doubts as to the law, they may be guilty of neglect if they fail to seek and be guided by competent legal advice, and this for the obvious reason that they would, under like circumstances, seek such advice in the management of their private affairs.

The chancellor's decree is affirmed with costs.

Supreme Court of Missouri.

KEITH ET AL. *v.* HOBBS.

State courts have the right to inquire into the validity of a patent for an invention issued by the United States when the question comes up collaterally, as where an action on a promissory note given in consideration of the assignment of an interest in a patent is defended on the ground that the patent is void.

It is a good defence to an action on a promissory note given in consideration of the assignment of the right to make, use and vend a patented article within a limited territory, that while the specifications accompanying the letters-patent call for water as one of the ingredients to be used in the composition of the article, the waters in common use in a portion of the territory sold, by reason of their alkaline properties, or for other reasons, will not produce the desired result. Such specifications are insufficient, the patent is void, and the assignment constitutes no consideration for the note.

ERROR to Jackson Circuit Court.

This was an action on a note. Defendants' answer admitted the execution of the note, and alleged total failure of consideration, and also fraudulent representations by plaintiffs as to the patent right, the sale of which constituted the consideration for the note sued on.

At the trial there was testimony on the part of defendants tending to show that the patent right sold defendants by plaintiffs, was of no value, and testimony on the part of plaintiffs tending to show that it was valuable and useful. There was also testimony tending to prove fraud and to disprove it as alleged. Defendants read in evidence the letters-patent to plaintiffs, No. 78,672, for the invention described in said letters-patent as a new and useful "improved composition for tanning." The sale of the right to make, use and vend this composition, in certain states and territories, one of which was Colorado, was the sole consideration of the note sued on. Defendants also read the schedule annexed to and forming a part of the letters patent. In this schedule, water is mentioned as one of the necessary ingredients to be used in preparing the composition. The quantity to be used is indicated in the schedule, but the schedule does not mention any particular kind of water, except that it must be boiling water. The evidence also tended to show that the waters of Colorado in general use would not accomplish the end for which water was used in the composition, by reason of their alkaline qualities or otherwise, and also that the composition was worthless and could not be used in tanning leather.

A. Comingo, for plaintiffs in error.

Bryant & Holmes, for defendants in error.

The opinion of the court was delivered by

NORTON, J.—The court, at the instance of plaintiffs, gave three instructions, substantially as follows: 1. That notwithstanding the jury should find that the defendants failed to use the tanning composition successfully, they must find for the plaintiffs as to the first defence, unless defendants showed that the composition was wholly useless, and could not be successfully used by practical tanners as a means or in the process of tanning. 2. That if the composition was valuable, the jury would find for plaintiffs as to the first defence, notwithstanding defendants had failed to use it successfully. 3. That the jury must find for plaintiffs as to the alleged fraudulent

representations, unless they were actually made, were known to be false when made, and defendants were thereby induced, &c., &c.

Defendants asked six instructions, as follows: 1. That in order to support the letters-patent in evidence, it is absolutely necessary that the alleged improved composition for tanning be new, and should the jury be satisfied from the evidence, either that the leather produced by said composition was not as good in quality at a cheaper price, or that it was not better in quality at the same price, as leather manufactured by the old and usual process, then said composition is not new within the meaning of the law, and for that reason said letters-patent are void; there was no consideration for the note sued on, and the verdict must be for the defendants.

2. The jury are instructed that the inventor should confine his specifications to substances which he knows will answer the purpose for which they are used; that the specification accompanying the letters-patent, read in evidence, makes use of the general term *water;* and if the jury believe from the evidence that the waters of the territory of Colorado in general use will not accomplish the end for which water is used in the said composition, either by reason of their alkaline properties or otherwise, then the specification is insufficient, and the letters-patent are void; there was no consideration for the note sued on, and the verdict must be for the defendants.

3. The jury are instructed that if they believe from the evidence that the alleged improved composition is worthless, and cannot be beneficially used for the purpose of tanning leather, or if the jury should be satisfied, from the testimony, that any one or more of the ingredients mentioned in the specifications as essential, is either disadvantageous, or utterly useless, then, and in either of said cases, the letters-patent are void, and the verdict should be for the defendants.

4. The jury are instructed that the letters-patent are *prima facie* evidence that the plaintiffs are the joint inventors of the so-called improved composition, yet that fact may be disproved; and if the jury should be satisfied, from the testimony, that said composition was invented by the plaintiff, Keith, alone, and not by Keith & Eylar jointly, the letters-patent are void; there was no consideration for the note sued on, and the verdict must be for the defendants.

5. The court instructs the jury that the specification accompa-

nying the letters-patent, read in evidence, must in and of itself contain a full, clear and exact description of the invention, and if the object of the alleged patent improved composition for tanning cannot be obtained when the specification is fairly followed out, by competent workmen, of ordinary skill and proficiency in the art of tanning, without invention or addition of their own, or if in order to obtain the object of the patent, information must be derived from other sources than the specification as by experiments or from using other methods to make the thing described; or if it requires the solution of a problem; then, and in either of said cases, the letters-patent are void, and the note sued on is without any consideration, and the jury must find for the defendants.

The sixth instruction for defendants is substantially the same as plaintiffs' third. The court gave all defendants' instructions except the first. Plaintiffs took a nonsuit with leave to move to set aside, and filed a motion accordingly, which was overruled, and plaintiffs excepted.

The plaintiffs insist that the action of the court in giving the declarations of law asked by defendants was erroneous, because they are inconsistent with those given for plaintiffs, because they are not predicated on the pleadings, and because the court had no jurisdiction to inquire into the validity of the patent for which the note in suit was given. Counsel have not attempted to point out the alleged inconsistency between the instructions given on the part of plaintiffs and defendants, and we are unable to perceive that it exists. Nor are we able to discover that the instructions are not predicated on the pleadings and facts in evidence. The defence to the note is founded on the theory of want of consideration and fraudulent representation on the part of the vendors of the patent. The instructions given on both sides are applicable to the defence thus set up, and only touch the questions raised by it.

It is, however, claimed that under the laws of the United States the United States courts have exclusive jurisdiction in all cases involving the validity of patents, and that, therefore, the action of the court was erroneous in directing the jury that if they believed certain facts recited in the instructions were true, the patent sold by plaintiffs to defendants was void, and constitutes no consideration for the note given for it. If this was a proceeding for an infringement of a patent or a direct proceeding to invalidate a patent there could be no doubt but the Federal courts would have exclusive

jurisdiction, and that it could not be exercised by the state courts. But it is equally clear that where the validity of a patent is called in question or arises collaterally in a proceeding of which a state court has jurisdiction, such court may then pass upon the question. In the case of *Billings* v. *Ames*, 32 Mo. 265, where the validity of a patent was collaterally questioned, it was held that, "it is insisted by appellants that this is virtually a suit for an infringement of a patent, and is, therefore, only cognisable in the Federal courts. We think differently. It is a suit on a contract in which the patent is brought in collaterally; and while it is settled that the validity of a patent-right is a subject peculiarly within the jurisdiction of the courts of the United States, it is equally well settled that when it comes in question collaterally, its validity may become a subject of inquiry in the state courts." So in *Slemmer's Appeal*, 58 Penn. St. 155, 163, SHARSWOOD, J., observes: "The Act of Congress of July 4th 1836, section 17th, provides, 'that all actions, suits, controversies and cases arising under any law of the United States granting or confirming to inventors the exclusive right to their inventions or discoveries, shall be originally cognisable, as well in equity as at law, by the Circuit Courts of the United States.' It has been held in the construction of this and former acts on the same subject, that the jurisdiction thus conferred upon the Federal courts is exclusive, so that the state courts have no cognisance of either actions at law or bills in equity in which the validity of a patent is directly involved. * * * But though patent-rights are peculiarly within the jurisdiction of the courts of the United States, yet it is undoubtedly true that when they come in question collaterally their validity may become a subject of inquiry in the state courts. Thus in a suit upon a promissory note, if it is set up as a defence that the consideration was the sale of a patent-right, and that the patent is void, so that in fact there was no consideration, the state courts constantly exercise jurisdiction. * * * Accordingly the courts of the United States refuse to take cognisance of cases between citizens of the same state, when they involve not the infringement of a patent, but controversies growing out of contracts of which it is merely the subject-matter: *Goodyear* v. *Day*, 1 Blatch. 565; *Burr* v. *Gregory*, 2 Paine 426; *Brooks* v. *Stolley*, 3 McLean 523." To the same effect are the following cases: *Rich* v. *Hotchkins*, 16 Conn. 409; *Lindsay* v. *Roraback*, 4 Jones Eq. (N. C.) 124; *Sherman* v. *Champlain Transportation Co.*, 31