UNIVERSITY OF PENNSYLVANIA
LAW REVIEW
AND AMERICAN LAW REGISTER

FOUNDED 1852

VOLUME 56	JANUARY	NUMBER 1

Editors:

PAUL FREEMAN, President Editor.

RUSSELL S. WOLFE, Book Review Editor. OTTO KRAUS, Business Manager.

Associate Editors:

C. H. ALBRECHT, E. M. BIDDLE,
R. M. BOWMAN, G. A. BROWNBACK,
E. C. CARMAN, R. W. CHILDS,
J. A. HARTPENCE, A. E. HUTCHINSON,
R. T. McCRACKEN, W. K. MILLER,
D. H. PARKE, L. W. ROBEY,

EDWARD W. EVANS, (*Fellow in the Department of Law,*)
Superintendent Note Department.

SUBSCRIPTION PRICE, $3.00 PER ANNUM, SINGLE COPIES, 35 CENTS.

The Faculty of the Law Department and the Board of Editors of the American Law Register have determined to discontinue the department heretofore known as the "Progress of the Law" and to publish in its stead a series of Notes and short Comments on the most important recent cases. Although fewer cases will thus be treated, yet inasmuch as there will be fuller discussions of those noted and more frequent references to similar cases, it is hoped that the change will be a benefit to and will be approved by our readers. The change takes place in this issue.

NOTES.

WHEN A STATE IS A PARTY WITHIN THE ELEVENTH AMENDMENT.

On the twenty-second of June, last, the Circuit Court of the United States for the District of Arkansas, decided the case of *Western Union Telegraph Company* v. *Andrews*.[1] The decision raises again the much-mooted question of the circumstances under which a State is a party to a suit against its offi-

[1] 154 Fed. 95.

cials in the performance of their duty as State officers within the prohibition of the Eleventh Amendment. The case under consideration was as follows: A statute of the State of Arkansas provided that if any foreign corporation doing business in Arkansas removed any suit from the State to the Federal Courts they should forfeit their right to do business within the State. A penalty of $1000 was provided for every day such company continued to do business. The second section of the statute made it the duty of the prosecuting attorneys in the various counties to sue for these penalties in the name of the State, for the benefit and use of the county in which the suit was brought. The suit in the Circuit Court was brought by the complainant to enjoin the prosecuting attorneys of the several judicial districts of Arkansas from instituting against it any proceedings for penalties forfeited under the above statute. The injunction was refused on the ground that the suit was within the prohibition of the Eleventh Amendment.

The Eleventh Amendment, passed to stay the wave of indignation which spread through the country as a result of the decision of *Chisholm* v. *Georgia*,[2] has become since the Civil War a serious bone of contention in the Federal Courts as a result of two lines of cases: (1) the attempts of the various Southern States to resuscitate their finances by means of the creation of certain bond-issues which were subsequently repudiated, and (2) the various statutes passed by the States throughout the last twenty-five years to regulate the rates charged by public service corporations. The earliest test as to when a State was a party was that laid down by Chief Justice MARSHALL in *Osborn* v. *Bank*:[3] that the appearance or absence of the State as a party defendant on the record was a criterion that would determine whether or not the suit was against the State.[4] The test was later repudiated, the courts declaring they would look beyond the record to see if the State was the real party in interest, and a new test was evolved:—whether or not the complainants asked for specific performance against the State. If they did, the Court said there could be no relief; the suit was against the State.[5] If they did not the Court would take jurisdiction.[6]

[2] 2 Dallas, 419 (1793).

[3] 7 Wheaton, 738 (1824).

[4] *Davis* v. *Grey*, 16 Wall. 203 (1872).

[5] *Louisiana* v. *Jumel*, 107 U. S. 711 (1882); *Hagood* v. *Southern*, 117 U. S. 52 (1885).

[6] *Board of Liquidation* v. *McComb*, 92 U. S. 531 (1875); *Virginia Coupon Cases*, 114 U. S. 270 (1884); *Pennoyer* v. *McConnaughy*, 140 U. S. 1; *Scott* v. *Donald*, 165 U. S. 58.

The test was not always applied with substantial accuracy[7] and seems to have been abandoned, since the later cases say almost nothing about it. Then came the famous decisions of *Reagan* v. *Farmers' Loan and Trust Co.*,[8] and *Smyth* v. *Ames*,[9] which have been affirmed in a number of cases.[10] All these were suits to enjoin State officials from prosecuting indictments or suits for penalties against the defendants for charging rates in excess of those declared reasonable by a rate-fixing commission created by State statute—the complaint being that the rates fixed were so low as to be a deprivation of property without due process of law and hence a violation of the Fourteenth Amendment. In each of these cases the injunction was granted, the Court basing its decision on the proposition that as the State had no pecuniary or proprietary interest in the suit, but merely a governmental one, the suit could not be against the State.[11] In the case of *Fitts* v. *McGhee*[12] the injunction was refused upon similar facts on the ground that in the latter case the defendants who were not mentioned by name in the statute were not "specifically charged" with the duty of carrying out the law in question, as they had been in *Reagan* v. *Co.*[8] and *Smyth* v. *Ames*.[9] The distinction of the Court seems questionable in theory, but has never been overruled.[13]

As in the present case the defendants were specifically charged with the duty of carrying out the statute, the decision seems erroneous whether considered in the light of the specific performance test, that of *Reagan* v. *Co.*, or that of *Fitts* v. *McGhee*. The Court, however, bases its decision on *Fitts* v. *McGhee*, bringing the case within the rule of that decision by saying that the statute in question putting the duty of prosecuting

---

[7] *In re Ayers*, 123 U. S. 443 (1887); *Hagood* v. *Southern*, 117 U. S. 52 (where of plaintiff's three prayers it would seem that only two amount to specific performance and yet the bill was dismissed).

[8] 154 U. S. 362 (1894).

[9] 169 U. S. 466 (1898).

[10] *Chicago, M. & St. P. R. R.* v. *Tompkins*, 176 U. S. 167 (1900); *Prout* v. *Starr*, 188 U. S. 544 (1902); *Mississippi R. R. Commission* v. *Illinois Central R. R.*, 203 U. S. 235 (1906); *Central Consolidated Gas Co.* v. *Mayer*, 146 Fed. 150 (1906).

[11] *Reagan* v. *Farmers' Loan & Trust Co.* at p. 390.

[12] 172 U. S. 516 (1899). It is interesting to note that this decision was pronounced only a year later than *Smyth* v. *Ames* by the same court which pronounced the latter decision—the opinion in both cases being by Justice Harlan.

[13] As a matter of fact, the statute in *Smyth* v. *Ames* nowhere seems to charge the Attorney-General or the board with the special duty of bringing suits for penalties or instituting criminal prosecution. (House Roll No. 33, Nebraska Statutes for 1893.)

the suits for penalties upon the prosecuting attorneys of the various counties was merely declarative of their duty under the general laws of the State, and interpret the "special charging" of *Fitts* v. *McGhee* to mean "an administrative duty such as is exercised by boards or ministerial officers, but not attorneys." The Federal Courts have, however, frequently enjoined attorneys-general from bringing suit.[14] It is also true of all these cases that the duties laid upon the attorney-general by the statutes in question were merely declaratory of his duty to prosecute all suits for penalties incurred under State statutes and hence this distinction of the Court, too, seems to fall. The Court considered the penalties collectible for the benefit of the counties sufficient to give the State a pecuniary interest in the result. In a long line of decisions, however, the collection of penalties forfeited to the State have been enjoined.[15] In both these respects the case seems to carry the principle of the Eleventh Amendment beyond any of its immediate predecessors, and the result of an appeal to the Supreme Court, if taken, should be awaited with interest. The question is one of ever-increasing importance, and appeals from the Circuit Courts of North Carolina and Minnesota[16] involving similar questions under the Eleventh Amendment are now pending before the Supreme Court.

LIABILITY OF WHOLESALE MANUFACTURER TO CONSUMER.

The numerical weight of American authorities supports the doctrine that there is generally no liability of a manufacturer for injury to one purchasing from a dealer caused by defects due to negligence in the manufacture of those articles.[1] Three reasons are stated for this rule: First, that injury is not probable; second, that the agency of the dealer is an intervening. independent cause, and third, that public policy requires such a limit of liability of the manufacturer. It is submitted that in the case of latent defects, the first two reasons are unsound as being inconsistent with the law of negligence; for as to the first, there is an evident probability of danger—and as to the

---

[14] *Reagan* v. *Farmers' Loan and Trust Co.*, 154 U. S. 362; *Smyth* v. *Ames*, 169 U. S. 466; *Chicago, M. & St. P. R. R.* v. *Tompkins*, 176 U. S. 167; *Prout* v. *Starr*, 188 U. S. 544; *Haverhill Gas Co.* v. *Barker*, 109 Fed. 694 (1901); *Consolidated Gas Co.* v. *Mayer*, 146 Fed. 150 (1906).

[15] *Smyth* v. *Ames*, 169 U. S. 466; *Missouri, K. & T. R. R. Co.* v. *Missouri Railroad Commissioners*, 183 U. S. 53 (1901); *Chicago, St. P. & M. R. R.* v. *Tompkins*, 176 U. S. 167; *Prout* v. *Starr*, 188 U. S. 544; *Consolidated Gas Co.* v. *Mayer*, 146 Fed. 150 (1906).

[16] *Ex parte Long*.

[1] *Huset* v. *J. I. Case Machine Co.*, 120 Fed. 865.

second, the mere passage of the article through the hands of an intermediate person who could not discover the defect does not constitute an intervening independent cause. If public policy is to decide the question, it should be noted further that the rule is in conflict with the common law principle which requires that a man should exercise care in the conduct of his business,[2] this duty being imposed because of the remunerative character of his employment, although the consideration need not necessarily move from the plaintiff. Thus, a physician has been held liable for negligence in treating plaintiff's wound, although he was hired by a third person.[3] The rule of exemption from liability does not, despite *dicta* to the contrary, seem to be supported by the English[4] cases, nor by those of New York[5] or Minnesota.[6]

Moreover, there are admitted exceptions, and these exceptions "are as well defined and settled as the rule itself."[1] One of these exceptions exists in the case of negligence in the manufacture of articles which are "intended to preserve, destroy or affect human life."[1] Parenthetically,—it would seem that these "exceptions" are merely the most obvious instances of the application of the common law principle above referred to, but as the principle has been submerged these instances are left isolated. Within the scope of this exception, are explosives,[7] drugs[8] and foods.[9]

The recent case of *Tomlinson* v. *Armour & Co.*, 65 Atl. Rep. 883 (N. J.), held that a declaration was demurrable which alleged that the plaintiff had been made sick by eating diseased ham bought from a retailer, but negligently packed by the defendant wholesaler. The Court rested its decision upon a principle of contract law; *i. e.*, that there is no implied warranty of wholesomeness by a manufacturer in the sale of food to a retail dealer, a conclusion that seems supported by the weight of authority.[10]

It would seem, however, that the denial of the existence of such a warranty should not bar the plaintiff's claim, which was framed *in tort*. In fact, even if such a warranty had existed it

---

[2] See Mr. Bohlen's essay on "The Basis of Affirmative Obligations in the Law of Torts," pp. 6, 10, 51-101.

[3] *Pippin* v. *Shepard*, 11 Price, 411.

[4] *George* v. *Skivington*, L. R. 5 Ex. 1; *Dalyrell* v. *Tyson*, 96 E. C. L. R.; *cf. Winterbottom* v. *Wright*, 10 M. & W. 109 (*dicta*).

[5] *Devlin* v. *Smith*, 89 N. Y. 470; *cf. Fox* v. *Buffalo Co.*, 21 App. Div. N. Y. 321.

[6] *Shubert* v. *Clark Co.*, 49 Minn. 331.

[7] *Peters* v. *Johnson*, 41 S. E. 190 (W. Va.).

[8] *Thomas* v. *Winchester*, 6 N. Y. 497.

[9] *Bishop* v. *Weber*, 139 Mass. 411.

[10] Benjamin on Sales, Sec. 671.

could not have bound the defendant to whom the plaintiff was a stranger. The Court ignored the real ground upon which the plaintiff's claim rested; *i. e.*, the breach of a duty imposed by law. It is submitted that the case falls within the exception to the general rule as to liability of manufacturers, which exists in the case of an article "intended to preserve, destroy or affect human life." In the case cited above,[9] which so held. it is said: "The furnishing of provisions which endanger human life or health stands clearly upon the same ground as the administering of improper medicines, from which a liability springs, irrespective of any question of privity between the parties."

Liability of Stockholders upon Unpaid Stock Subscription.

The liability of a stockholder upon his unpaid stock subscription to the corporate creditor, has always been worked out through the fictional person of the corporate entity, on the ground that the entity is the debtor of the corporate creditor. The problem has always been to devise some theory by which to prevent the stockholder from asserting rights, which are perfectly valid against the entity, in order to give the corporate creditor a greater right against the stockholder than that possessed by the entity itself. Two theories have been advanced. The "trust fund" doctrine regards the capital stock as a trust fund for the benefit of the creditors. When the stockholder attempts to escape liability, by settling up claims which are good as against the entity, as for example, a set-off or a release, but which would prevent any remedy to the creditor, he finds that the claims are no longer mutual, and cannot be set up against each other. This theory has been severely criticised. It is admitted that in the strict sense of the word there is no trust; that it is a misnomer; and that what is meant, is merely admisistration of assets in equity.[1] If that is so, the "trust fund" theory does not explain why the creditor should be given a greater right against the stockholder than that possessed by the entity. The other theory gives relief on the ground of fraud, in an action of deceit. It is said that the creditor is presumed to rely upon the stated capital of the entity, as security, and that when stock is issued, purporting to be fully paid up, when, in fact, it is not, he is deceived. The stockholder who accepts such stock is guilty of a misrepresentation, because he holds out the entity as possessing its capital stock fully paid up,

[1] *Hollins* v. *Brierfield Coal and Iron Co.*, 150 U. S. 371 (1893); *McDonald* v. *Williams*, 174 U. S. 397 (1899); *O'Brear Jewelry Co.* v. *Volfer & Co.*, 106 Ala. 205 (1894); Cook on Corporations (5th Ed.).

when it is not, and is compelled to make good his representation,[2] when any person advances credit to the entity in reliance thereon. But if credit is advanced prior to the issue of the stock, or with notice that it was not in fact paid up, there could be no reliance,[2] and, therefore, no recovery on the ground of fraud. The entity cannot recover, because of the release. But this theory does not explain why a stockholder is not allowed a set-off of a valid claim against the entity, when the stock is not issued as fully paid up with a release from further payment. Because a creditor has notice that a balance of the stock subscription is still unpaid, subject to call, he is not prevented from compelling the stockholder to pay it, and the authorities agree that no set-off is allowed.[3] Therefore, the fraud theory is also unsatisfactory, and we have no theory which does account for the liability of the stockholder upon his unpaid stock subscription, when we regard the entity as the debtor of the corporate creditor. Justice to the creditor demands the enforcement of this liability. There is a consistent solution for it.

To-day, when a certain solution of a corporate problem is demanded by justice, and it cannot be reached by working out the problem through the fictional entity, some courts absolutely disregard[4] the entity; and instead, consider the stockholders as a group of associates with joint assets and liabilities.[4] Such decisions are notices to the entity to quit. The solution that has been reached in the problem before us, demands that the entity be disregarded. It is a fiction, and as such implies that the truth is otherwise. It is merely a substitute for a real explanation, and can have no permanent place in a sound legal system.[5] The stockholders, not the entity, owe the creditor.[6] At common law they were liable to him without limit.[7] The limitation[8] is a modern doctrine.[9] If we regard the entity as the

---

[2] *Hospes* v. *Northwestern Mfg. Co.*, 48 Minn. 174 (1892).

[3] *Bickley* v. *Schlag*, 46 N. J. Eq. 533 (1890).

[4] *United States* v. *Milwaukee Refrig. Transit Co.*, 142 Fed. 247 (1905); *Att'y. Gen.* v. *Standard Oil Co.*, 49 Ohio St. 137 (1892); *Northern Securities Co.* v. *U. S.*, 193 U. S. 199 (1903); *Mobile* v. *Watson*, 116 U. S. 289 (1886).

[5] See article by Mr. George Wharton Pepper entitled, "A Brief Introduction to the Study of the Law of Associations," 49 Am. Law Reg. (N. S.) 255, pp. 258-259.

[6] See same article, pp. 266-267.

[7] See article by Mr. Samuel Williston entitled, "History of the Law of Business Corporations before 1800," 2 Har. Law Rev. 105, 148, pp. 160-162. Also *Dr. Salmon* v. *The Hansborough Company*, Ch. Cas. 294; 6 Vin. Abr. 310 (1641); *Hume* v. *Windyard and Wando Canal Co.*, 1 Car. L. J. 217 (1826).

[8] *Carr* v. *Inglebart*, 3 Ohio St. 457 (1854).

[9] See article by Mr. George Wharton Pepper entitled, "Irregular Associations," 52 Am. Law Reg. (N. S.) 409, 504, 576, pp. 432-435.

debtor, it is correct conclusion. A creditor can only look to the assets of his debtor for payment.[10] But this limitation of the liability has not changed its nature. It is that of co-debtor, and until the limit is reached the problem is the same as though no limit were imposed.[6] No one would contend that co-debtors could defeat the claims of their common creditor by an agreement *inter se,* releasing each other from liability, nor would it be possible to conceive of co-debtors setting off claims, which they had against each other, when sued by the common creditor. Such claims can only be asserted when the rights *inter se* are determined, and can have nothing to do with the right of the common creditor against the individual associate. The interposition of the entity as debtor, has merely served to confuse these two distinct sets of rights. This view readily explains why a stockholder upon a subsequent issue of stock, is not liable to a prior creditor, because in no sense of the word did he contract the debt. But notice on the part of the creditor, that stock was not, in fact, paid up, though issued as such, should not necessarily bar him, if we regard the associates as co-debtors, and it would not be necessary to pass a statute to accomplish such a desired result, nor to resort to grounds of public policy in order to construe a statute to intend such."[11] Neither single debtors nor co-debtors can restrict their liability to certain specific assets, by merely hanging up a notice of their intention. There must be an express stipulation to that effect in the contract with the creditor.[12]

Since stockholders are co-debtors, after judgment is obtained against the group, each is liable severally for the whole debt—within the limit of his restricted liability—and therefore a creditor need not join all the associates.[15] But the principle of marshalling requires that he first exhaust the joint assets, by a return of *nulla bona,* before proceeding against the individual associate. In order to prevent multiplicity of suits, and settle the right *inter se* in the same action, those associates who are sued, have the right to file a bill to have all the other stockholders joined.[15] If the creditor is also an associate, he need only contribute his own pro rata share towards the payment of his own claim;[13] and should not be compelled to pay his own stock balance in full, as a condition precedent to suit.[14]

---

[10] *In re Sheffield and South Yorkshire Permanent Bld. Soc.,* 22 Q. B. D. 476 (1889).

[11] *Easton Nat. Bank* v. *Am. Brick and Tile Co.,* 64 Atl. (N. J.) 917 (1906).

[12] *Greenwood's Case,* 3 De G. M. & G. 459 (1854); *Hess* v. *Wertz,* 4 S. & R. 356 (1818).

[13] *Bissel* v. *Kty.,* 15 Fed. 353 (1882); *Wilson* v. *Kiesel,* 9 Utah, 397 (1894).

[14] Cook on Corporations (5th Ed.), Sec. 205, p. 405; *cf. Weber* v. *Fickey,* 47 Md. 196 (1877).

[15] *Hatch* v. *Dana,* 101 U. S. 205 (1879).

And since as a creditor he need not join all his associates, the whole claim of the associate will be apportioned among those before the court, the creditor-associate contributing his own proportion. *Blood* v. *La Serena Land and Water Co.*, 89 Pac. (Cal.), 1090 (1907).

It is submitted that such a decision cannot be satisfactorily explained, if the entity is regarded as the debtor, unless some other theory than the two above mentioned, is discovered. If we regard the associates as the debtors, the case needs no explanation. The same result has been reached in cases where the associates are admitted to be co-debtors—viz. partners.[16]

Municipal Corporations.

Right of City to Dispose of Surplus Electric Power for Private Purposes.

The general form of government in the United States, with its three-fold division of powers, exercised by the legislative, the executive, and the judicial departments, early influenced the courts in favor of the view that the functions of each department, were, except, perhaps, in extreme situations, to be exercised independent of the others and free from interference by them, and that there existed, therefore, a point beyond which the judicial department could not go in regulating the acts of either the legislative or the executive branches.[1]

This rule has been held applicable to the acts of municipal corporations, which are but sub-divisions of the sovereign government, with powers delegated by the Legislature, and hence the Supreme Court of New York refused to reverse, on *certiorari*, the proceedings of a municipal corporation relating to certain street improvements, where it appeared that it had acted within the scope of the authority conferred by a statute of the Legislature, and had complied with the forms which the statute required.[2]

And this same Court held that "Courts of Equity have no general supervisory power over the government of municipal corporations or over acts and proceedings of their governing bodies . . . . except where it is shown that the rights of an individual have been injured or menaced in a matter falling under some recognized head of equity, and which it is the peculiar province of a court of equity to prevent or redress."[3]

---

[16] *In re Professional Life Assurance Co.*, L. R. 3 Eq. Cas. 668 (1867).

[1] *Marbury* v. *Madison*, 1 Cranch, U. S. 137 (1803); *Rees* v. *City of Watertown*, 19 Wall. U. S. 107 (1873).

[2] *Ex parte Mayor, &c. of Albany*, 19 Wend. N. Y. 277 (1840).

[3] *Phelps* v. *City of Watertown*, 61 Barb. N. Y. 121 (1871).

Where, however, the exercise of a legislative function by a body having but a delegated power contravenes the authority derived from the supreme governing body, the courts have not hesitated to intervene for the purpose of safeguarding the welfare of parties whose rights were injuriously affected;[4] or to prevent funds raised for specific purposes or from specific activities, from being diverted into general channels.[4]

The Court of Civil Appeals of Texas has recently applied the general rule to a situation which marks a modern and growing tendency in municipal activity. *Crouch* v. *City of McKinney*, 104 S. W. Rep. (Tex.) 518 (1907.)

The City of McKinney, acting under legislative authority, had issued bonds for the purpose of establishing a public electric lighting system in the city. The funds thus procured were insufficient, however, to extend the system throughout the city's territorial limits, but to the extent that the system was in operation, the lighting plant was adequate to supply sufficient power and to have a surplus. This surplus it purposed disposing of to private parties for compensation, and to use current funds of the city to effectuate this purpose. The lighting plant had been installed in conjunction with a municipal water plant. The McKinney Electric Light & Motor Power Company, which had previously received from the city a franchise to install a lighting plant and supply private parties with light and power, sought to restrain the city from thus disposing of its surplus electricity.

The Court, in refusing to enjoin the city, held that, "So long as the affairs of a city are conducted by its council in a reasonably judicial manner, its acts will not be interfered with by the courts, unless it is transcending its powers, or a clear right has been withheld, or a wrong perpetrated or threatened," and that the city "may, after discharging its duty to the public, sell its surplus electricity to private citizens for lighting."

It was further held that, "The surplus of the proceeds of a municipal water works system remaining after the payment of the expenses of maintaining the system as installed, are current funds, and the city may divert the same to other needs of the city."

The decision would seem to be a much desired step in favor of the successful administration of municipal affairs where relief from stringent situations is possible by such use of the city's funds, otherwise unavailable, except through the usually tedious medium of legislation.

---

[4] Cent. Dig. (Am. Ed.), vol. 36, tit. Munic. Corp., Secs. 1868, 1869.