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Institute Examination in Law

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INSTITUTE EXAMINATION IN LAW

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[Note.—The following answers to questions set by the board of examiners of the American Institute of Accountants at the examination of November, 1939, have been prepared at the request of The Journal of Accountancy. The answers have not been reviewed by the board of examiners and are in no way official. They represent merely the personal opinions of the author. —*Editor.*]

EXAMINATION IN COMMERCIAL LAW

November 17, 1939, 9 A.M. to 12:30 P.M.

GROUP I

No. 1 (10 points):

State several conditions or circumstances in which a duly appointed agent may become personally liable to third persons with whom he deals.

Solution:

The following are instances where a duly appointed agent may become personally liable to third persons with whom he deals:

(a) Where the principal is undisclosed and the third person has no reason to know that the agent is acting as such.
(b) Where the principal is partially disclosed, as where the fact of agency is known but the identity of the principal is not revealed.
(c) Where the agent has exceeded his authority.
(d) Where the agent contracts as a principal. Thus the agent may sign a contract as a party in addition to his principal, or he may sign as agent in such a way as not to bind the principal (example: "A agent for P").
(e) Where the agent commits a tort.

No. 2 (10 points):

A depositor in a bank learned that the bank had dishonored several small checks drawn by him on the ground of "insufficient funds," although the depositor's balance had been sufficient to cover them. Upon investigation, he found that the bank had charged his account with $80 paid by it on another check drawn by him which stated the amount in figures as $80, but in writing as "Eight and no/100 Dollars," and which he had regarded and intended as a check for $8. The insufficiency of funds according to the bank's accounts had resulted from this transaction. What principles of law are involved in determining whether the depositor has any legally enforcible claim against the bank for damages?

Solution:

(a) Contracts: The bank had agreed to pay checks when the balance was sufficient, and to pay no more than the amount legally specified in any check.
(b) Negotiable instruments: The amount stated on the check in words controls when different from the amount stated in figures.
(c) Damages: In most jurisdictions a depositor can recover for damages to his reputation by reason of the dishonor of his check.

No. 3 (10 points):

(a) Define a dividend by a corporation.
(b) In what media other than cash may such a dividend be payable?
(c) State each step with respect to dividends ordinarily taken by a corporation with several hundred stockholders and mention the rules or principles of law, if any, applicable to each step.

Solution:

(a) A dividend is a distribution to stock-

holders according to their respective interests made from the surplus of a corporation by resolution of the board of directors.

(b) A dividend may be payable in cash, or in stock of the corporation which declares the dividend, stock of another corporation, notes, bonds, scrip, real estate, or any other property available and readily divisible. A well known corporation once declared a dividend in whiskey.

(c) A dividend is declared by resolution of the board of directors. It must be from surplus and must not impair the capital. Any preferences applicable to outstanding stock must be observed. The dividend is usually declared payable as of a certain date to the owners of stock of record on an earlier date, so that assignments of stock between the dates will not affect the payment of the dividend. The final step is, of course, the payment of the dividend. When the dividend has been declared it becomes a debt from the corporation to the stockholders which cannot be revoked or withdrawn by the corporation.

No. 4 (10 points):

X and Y were partners under a valid partnership agreement which recited the capital contribution of each and provided for the equal division of all profits but made no mention of losses or of the details of settlement upon dissolution. They decided to dissolve and they signed a valid dissolution agreement which provided that the firm's accounts receivable, after collection, were to be divided one-third to X and two-thirds to Y until such distribution had reimbursed each partner in full for the balance of his capital contribution; thereafter, any further collections were to be divided equally. This agreement made no mention of losses. It was soon discovered that collectible accounts would be insufficient by $12,000 to reimburse both partners for their combined capital balances. X claims that only one-third of this loss should be charged to him. Is this claim by X legally valid?

Solution:

Since the dissolution agreement provided that ⅓ of the collections should go to X and ⅔ to Y "until such distribution had reimbursed each partner in full," X would automatically be left with ⅓ and Y with ⅔ of any deficiency which might result from the collections being less than the total capital contributions. The clear intent of the agreement thus would seem to be that ⅓ of the loss should be charged to X. Such an agreement would seem to be consistent with the better rule on the subject, for while there are decisions which state that a provision for an equal division of profits implies an equal division of losses even on dissolution, the better rule seems to be that each member of the firm is entitled to receive upon dissolution a share of the firm assets proportionate to his contribution to capital. (I assume that X contributed ⅓ of the capital and Y ⅔. Otherwise it could not have been expected that the performance of the agreement would ever reach a point where "such distribution had reimbursed each partner in full for the balance of his capital contribution.") The claim of X is therefore legally valid.

No. 5 (10 points):

(a) State the various conditions or circumstances which would make a contract fraudulent.

(b) What remedies has the innocent party to a contract which has been procured or induced by fraud?

Solution:

The essential element of fraud in a contract is a mistake of one party as to a material fact, wrongly induced by the other party in order that it might be acted on, or, in cases where there is a duty of disclosure, at least taken advantage of, with knowledge of its falsity, to secure action. A contract is fraudulent if there is a misrepresentation known to be such or made with reckless disregard of its truth or falsity, or concealment, or nondisclosure where there was a duty to disclose, by any person intending or expecting thereby to cause a mistake by another to exist or to continue, in order to induce the latter to enter into or refrain from entering into the contract.

The following remedies are open to the defrauded party:

(a) A right to damages for being led into the transaction.

(b) Rescission of the fraudulent transaction and restoration of the situation which

the parties occupied before the fraudulent transaction was entered into.

(c) Enforcement against the fraudulent person of the kind of bargain which he represented that he was making.

Relief in all these ways is generally enforced at law, but when appropriate, equity offers other remedies based on the inadequacy of relief at law, as, for example, by injunction, by equitable lien, or by constructive trust.

GROUP II

No. 6 (10 points):

A corporation duly executed and issued a legally binding negotiable promissory note, on which the president of the corporation was an accommodation indorser. Prior to maturity of the note, the president initiated and conducted bankruptcy proceedings for the corporation with the result that when the note matured the corporation was without funds, its business suspended, its place of business closed, and its property in the hands of a receiver. Upon due presentation of this note, the corporation failed to pay it but no notice of dishonor was given to said indorser who still was president. Can the president be held liable on his indorsement? What rule or principle of law is involved?

Solution:

The negotiable-instruments act provides that notice of dishonor may be waived either before the time for giving notice has arrived or after omission to give notice, and the waiver may be express or implied. Ordinarily, knowledge of dishonor is not equivalent to notice and does not constitute a waiver, but in this case it should be held that the president has waived notice by his action in initiating and conducting bankruptcy proceedings for the corporation, from which it was clear that he not only knew that the corporation could not pay the note when due but that he had been instrumental in bringing this situation about.

No. 7 (10 points):

Where one person properly has legal title to all of the capital stock of a duly organized corporation, in what circumstances will courts disregard the separate entity of the corporation and hold the sole stockholder personally liable for obligations incurred in the name of the corporation?

Solution:

An individual may incorporate his business for the purpose of escaping individual liability for the debts of the corporation, and even though all the shares are owned by one person, yet so long as the corporate existence is maintained the liability or nonliability of this one person as a stockholder is the same as where there are many stockholders. The courts may, however, disregard the corporate entity, and hold the sole stockholder personally liable for obligations incurred in the name of the corporation where the corporation has been used by the stockholder for the purpose of perpetrating a fraud or committing an illegal act.

No. 8 (10 points):

X and Y were having a genuine controversy as to the amount of indebtedness due by X to Y when X mailed to Y X's check for an amount less than that claimed by Y. On the face of this check X had written "This check is in full settlement of my indebtedness to Y," and with the check X enclosed a letter written by him to Y in which he stated that the enclosed check was in full settlement. Y did not acknowledge receipt, or otherwise communicate with X, or do anything whatever with this check except to retain it in his office for two months.

(a) Can X successfully claim that his indebtedness had been settled in full?

(b) What is the legal name of the agreement, or method, of settlement attempted by X?

Solution:

(a) X cannot successfully claim that his indebtedness has been settled in full. If Y had cashed the check it would have been a settlement, but the mere retention of the check by Y, even for an unreasonable length of time, does not constitute an acceptance by Y because the payment is still within the control of X who could stop payment on the check.

(b) Accord and satisfaction.

No. 9 (10 points):

(a) What is the name of the principle of law by which a state, or a subdivision of a state, is permitted to institute proceedings to obtain privately owned real property for a public purpose?
(b) Where such real property includes a building in which a tenant of the owner had installed and used factory machinery, in what circumstances must the damages awarded in the condemnation proceeding include the value of such machinery?

Solution:

(a) The principle of law is usually called "eminent domain"; the proceeding is usually called "condemnation."
(b) If the machinery is attached to the building in such a way that it cannot be removed without material injury to machinery or building, if the building was specially designed to house the machinery, or if other evidence establishes that its installation is of a permanent nature, the machinery is considered part of the realty and its value should be included as part of the damages.

No. 10 (10 points):

If a mortgagor and a mortgagee of real property validly agree to a reduction of the interest rate but fail to notify a guarantor of the mortgage, who does not learn of this reduction until the maturity of the debt, is the guarantor thereby released from his guaranty of the principal of the mortgage?

Solution:

The guarantor is not released. It may be said generally that any material alteration of a debtor's agreement is sufficient to discharge a guarantor, but in this case the reduction in the rate of interest is merely a remission of part of the obligation, which leaves the debtor liable for payment of the balance. If the debtor fails to pay this balance, the guarantor may be held, on the theory that this is not a new or altered obligation, but merely a balance of the original obligation.

No. 11 (10 points):

A solicitor was hired by a corporation to develop its business by procuring new customers, his compensation to consist of commissions. The contract specified that the employment could be terminated by either party on one week's notice and that in the event of termination by either party the solicitor was not to solicit for himself or for any other business organization within the county or within any adjoining county during a period of ten years thereafter.

(a) Is the ten-year provision legaly valid?
(b) Would a similar provision be valid if the promise not to solicit was made by the owner of a business as part of a contract whereby the owner sold his entire business (including goodwill) to another person?

Solution:

(a) The restriction is not valid. The inequality in bargaining power between employer and employee has led the courts to require a strong degree of necessity before enforcing a covenant not to engage in one's occupation. Even if the prohibition had been the solicitation of business in competition with that of the employer corporation, such a restriction for ten years and covering two counties would seem to be unreasonable in an employer-employee case.
(b) The courts are more liberal in enforcing provisions of contracts not to engage in business which are part of an agreement to sell a business, including goodwill, because such contracts are necessary to obtain a sale of the goodwill of the business. If this contract had provided that there be no solicitation for a competing business it would have been enforcible in such a case. But even in the case of the sale of a business, a contract "not to solicit for himself or any other business organization" within the county or the adjoining county for ten years would seem to be unreasonable. There is no reason, for example, why the former proprietor of a laundry may not become the proprietor of a milk company without injuring a laundry business which he has sold.

No. 12 (10 points):

Define briefly:

(a) Slander.
(b) Libel, as distinguished from slander.
(c) Equity, as distinguished from common law.
(d) Bailment.

Solution:

(a) Slander consists of the publication of defamatory matter by spoken words or transitory gestures.

(b) Libel consists of the publication of defamatory matter by written or printed words.

(c) Equity is a branch of remedial justice by which relief is afforded to suitors when the remedy at common law or statutory law would be inadequate. For example, the common law had no machinery for an injunction, which is provided in equity.

(d) Bailment is a delivery of personal property by one party to another, to be held according to the object of the delivery, and to be returned to the bailor or delivered according to his order when that object is accomplished.