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COMMENTS

BANKRUPTCY—SECTION 70e—SUBROGATION OF THE TRUSTEE IN BANKRUPTCY TO THE RIGHTS OF A SECURED CREDITOR*

A. Introduction and General Background

Section 70e of the Bankruptcy Act* permits a trustee in bankruptcy to be subrogated to the rights of any creditor who has a provable claim against the bankrupt’s estate. This subrogation enables the trustee to avoid any security interest which could have been avoided by the creditor outside of bankruptcy. Whether the creditor has the potential right to avoid the security interest depends upon the applicable state or federal law. For example, A obtains a mortgage (i.e., security interest) on X’s property for $1,600, but fails to record the mortgage for a week. Prior to the recordation of the mortgage X purchases on credit a pair of shoes for $4.64 from B. Having extended credit prior to recordation, B can avoid A’s security interest. After A records his mortgage several additional creditors extend credit to X. If X goes bankrupt, the trustee in bankruptcy can use section 70e to be subrogated to the rights of B and increase the bankrupt’s estate by $4.64. A retains a perfected (i.e., properly recorded) security interest worth $1,595.36 and a priority of collection for this amount over the subsequent general creditors. This example also illustrates the purpose of section 70c: to increase the amount of the assets that the trustee is able to bring into the bankrupt’s estate. Since B had the right outside of bankruptcy to avoid A’s security interest, X’s bankruptcy should not aid A by giving him a security interest free of any claims. Nor should A be allowed to pay the general creditor the value of this claim. Allowing the trustee to bring the $4.64 into the estate serves one of the overall purposes of the Bankruptcy Act: the equality of general creditors in sharing in the estate.

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*Abramson v. Boedeker, 379 F.2d 741 (5th Cir. 1967).

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1. 11 U.S.C. § 110(e)(1) (1964). “A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this title which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any reason by any creditor of the debtor, having a claim provable under this title, shall be null and void as against the trustee of such debtor.”

The logical rule, therefore, would be to keep the right of avoidance; and the trustee is the proper person to preserve this right.

In Moore v. Bag, the United States Supreme Court interpreted section 706 to enlarge the effect of a trustee’s subrogation to the rights of a creditor having a provable claim against the bankrupt’s estate. The case involved a mortgagee (i.e., a holder of a security interest) and three classes of creditors: (1) Those who had extended credit prior to the giving of the mortgage; (2) those who had extended credit after the giving of the mortgage, but prior to its recordation; and, (3) those who had extended credit subsequent to the recordation of the mortgage. The mortgagee admitted that the mortgage could be avoided by the first two classes of creditors, but asserted its validity in bankruptcy against the third class. The trustee contended that the mortgage was void against all three classes of creditors since it was void as to either the first or second class of creditors. In an ambiguous opinion the Court held that the trustee could defeat the mortgagee’s perfected security interest. Although equivocal language was used, the case has been interpreted as standing for the proposition that a trustee can totally avoid a perfected security interest by subrogating himself to the rights of an actual creditor who has a provable claim which under federal or state law makes the security interest voidable by the creditor.

Examining the previous hypothetical, Moore has altered a basic principle of subrogation. A obtains a mortgage for $1,600 on X’s property but does not record for a week. During the delay in recordation, B extends credit to X for a pair of shoes worth $4.64. B, under applicable state law, can avoid A’s security interest. After A records his mortgage several subsequent creditors extend credit to X. If X becomes bankrupt, the trustee, by subrogation to B’s rights, can reduce A’s status to that of a general creditor (i.e., A would no longer have a priority over the subsequent general creditors to collect his $1,695.36 security interest). If all general creditors are to receive fifty cents on the dollar, A, with his now worthless perfected security interest of $1,600, would receive only $800.
The decision has persisted notwithstanding sharp criticism. Professor Frank Kennedy, after labeling the decision an "illogical rule," asserted that "[i]t ran a good idea into the ground . . . to invalidate a security interest in toto for the benefit of all unsecured creditors because of a delay that was presumptively prejudicial to no more than one or a very few creditors."

James MacLachlan in a bitter attack on Moore refers to the decision as "one of the most glaring misconstructions to be encountered in the history of Anglo-American law."
The decision's basic injustice was its violation of a fundamental principle of subrogation by giving the trustee greater rights than the creditor to whose position the trustee was subrogated. For example, if in the previous illustration the mortgagee had foreclosed on the mortgage prior to bankruptcy, the $4.64 creditor could have intervened by asserting that the mortgage was void as to him. The mortgagee then would have paid the creditor $4.64 and thereafter foreclosed on the mortgage. In bankruptcy the trustee is now able to use the creditor's position to avoid the perfected security interest in toto by reducing the perfected security interest to the status of a general creditor.

B. Subrogation of a Trustee to the Rights of a Secured Creditor

In Abramson v. Boedeker the bank held an assignment of an account receivable previously owned by the bankrupt. The bank attempted to enforce this security interest against the bankrupt's estate. The Fifth Circuit stated that the trustee under section 70e needed to find only a single creditor to whose interest the assignment was voidable and that "Excel's assignment, as a protected [i.e., perfected] assignment, made the Bank's unrecorde assignment voidable." In Moore the Supreme Court recognized that the trustee could be subrogated to the

7. MacLachlan § 284, at 330. MacLachlan then proceeds to give a sentence by sentence criticism of the eight sentence decision.
8. Kennedy at 1421.
9. A better solution would seem to be to allow the secured creditor the privilege of paying the bankrupt's estate the value of the interim creditor's claim and becoming a general creditor to the extent of these claims; rather than being reduced to the status of a general creditor.
10. 379 F.2d 741 (5th Cir. 1967).
11. Id. at 749.
rights of a general creditor. In Abramson the Fifth Circuit has apparently extended this right to allow the trustee to be subrogated to the rights of a perfected secured creditor. Whether the court knowingly extended the Moore decision, however, remains in doubt, because it never discussed the fact that Excel, to whose rights the trustee was subrogated, was a secured creditor. It mentioned only that Excel was an actual creditor as required by section 70e.\(^\text{12}\)

Another indication that the court was not cognizant of its extension of Moore is its failure to discuss two basic problems arising from subrogation to the rights of a secured creditor. First, if subrogation to the rights of a secured creditor were allowed, the logical result would be to reduce in bankruptcy all junior security interests to the status of general creditors.\(^\text{13}\) Second, the perfected secured creditor (in the Abramson case a perfected assignee of an account receivable) is able to recover on his obligation notwithstanding the debtor's bankruptcy. The general creditor, whether or not he can avoid a security interest outside of bankruptcy, is entitled only to his pro rata share of the bankrupt's estate and can enforce no rights in bankruptcy. A reading of section 70e would seem to indicate that its purpose is to preserve in bankruptcy only those rights which attach outside of bankruptcy (i.e., general creditor avoiding a security interest) but because of bankruptcy are barred. Since a perfected secured creditor can avoid another interest even in bankruptcy, subrogation to a perfected security interest would apparently be invalid under section 70e.\(^\text{14}\)

The court, furthermore, cited Roscoe Moss Company v. Duncan,\(^\text{15}\) In re Plonta,\(^\text{16}\) Levine v. Johnson,\(^\text{17}\) and Corley v. Gorzar\(^\text{18}\) for the proposition that if the assignment could be avoided by one creditor, the trustee could, through subrogation,

\(^{12}\) The court could have reached the same result by the use of section 70c of the Bankruptcy Act [11 U.S.C.A. § 110(c) (Supp. 1967)], which allows the trustee to invoke the status of the ideal hypothetical lien creditor to defeat a security interest that is unrecorded at the time of bankruptcy. In Abramson the bank's assignment was unrecorded at the time of bankruptcy.

\(^{13}\) A further discussion of this point is developed at footnote 25, infra and the accompanying text.

\(^{14}\) See Kennedy at 1435.

\(^{15}\) 336 F.2d 670 (9th Cir. 1964).

\(^{16}\) 311 F.2d 44 (6th Cir. 1962).

\(^{17}\) 287 F.2d 623 (5th Cir. 1961).

\(^{18}\) 115 F.2d 119 (5th Cir. 1940).
avoid the assignment in toto. Only Corley, however, involved a secured gap creditor.19

In Corley the sole stockholder of a corporation sold the corporate assets. The sale was effected to purchase the outstanding stock of the corporation. The benefits from the sale flowed to the stockholder in his individual capacity and not to the corporation. This sale was void under the state law. When the corporation went bankrupt, the trustee was successful in defeating this sale by subrogation to the rights of a secured creditor. Since the sale was void, however, this case could not represent the proposition that a trustee could be subrogated to the rights of a secured creditor in all situations. After an analysis of the cases cited and the wording of the opinion the conclusion is reached that the Fifth Circuit had not been made aware of the issue before it.20

The question of whether a trustee in bankruptcy can be subrogated to the rights of a perfected secured creditor has been discussed by several authorities.21 Collier on Bankruptcy argues that a trustee may be subrogated to the rights of a perfected secured creditor and indicates that such a conclusion is the result of logical deduction:

1. Under section 70e, the trustee can be subrogated to the rights of any creditor having a provable claim.
2. A perfected secured claim may be provable under the Bankruptcy Act.
3. Therefore, a trustee may be subrogated to the rights of a perfected secured creditor.22

The strongest case cited by Collier in support of this argument was Central Chandelier Company v. Irving Trust Company.23

19. Roscoe Moss Co. v. Duncan, 336 F.2d 670 (9th Cir. 1964) (no mention as to whether the intervening creditor was secured or unsecured); In re Planta, 311 F.2d 44 (5th Cir. 1961) ($10 dollar unsecured creditor); Levine v. Johnson, 287 F.2d 623 (5th Cir. 1961) (at the time of the fraudulent transfer, an unsecured creditor).

20. The issue of subrogation to the rights of a secured creditor apparently was not argued before the court. The court therefore did not discuss it. The court cannot be expected su a sponte to discuss issues that are not presented in argument before it.

21. See, e.g., 4A COLLIER ON BANKRUPTCY ¶ 70.90, at 1034 (J. Moore ed. 1967); 1 P. COGAN, W. HOGAN & D. VAGTS, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 9.03 at 990-91, (1967); MACLACHLAN § 286; Kennedy at 1419; Wiseman & King, Perfection, Filing and Forms Under Article 9 of the Uniform Commercial Code, 9 WAYNE L. REV. 580, 596 (1963) (hereinafter cited as Wiseman).

22. 4A COLLIER ON BANKRUPTCY ¶ 70.90, at 1033 (J. Moore ed. 1967).

In *Chandlier*, Company A obtained a mortgage on X's property including any permanent fixtures to be added thereafter. Chandlier furnished X with light fixtures under a conditional sales agreement. Prior to the recordation of the conditional sales agreement, but after some fixtures had been installed, Company A made a final advance to X. When X went into bankruptcy, the trustee was subrogated to the rights of the mortgagee, a perfected secured creditor, to defeat Chandlier's now perfected security interests to the extent that fixtures had been permanently installed in the mortgaged property. Collier contends that the *Chandlier* case proceeds upon the theory that the trustee can avoid Chandlier's security interest, with the amount of the mortgagee's interest being deducted from the recovery and the excess going to the bankrupt's estate. For example, if the mortgagee's advancement was for $1,500 and the value of the attached fixtures was $2,000, the trustee by subrogation to the mortgagee's interest would recover only $500 for the estate. The mortgagee, of course, would recover his $1,500. Kennedy contends that the idea that the case proceeds upon this theory is conjectural, for the court did not state whether it was concerned with any excess recovery nor did the court state upon what theory the case was decided.24

While *Collier* and a few cases suggest that subrogation to the rights of secured creditor is allowed, strong policy arguments and other judicial decisions support the opposite conclusion. Kennedy suggests that, if the trustee can be subrogated to the rights of a secured creditor, the result in bankruptcy would be the general avoidance of all junior liens and interests.25 In bankruptcy the trustee would be subrogated to the rights of the senior mortgagee who has the right to avoid outside of bankruptcy the junior mortgagee's interests. Under this interpretation, therefore, the trustee could be subrogated in bankruptcy to the rights of a perfected senior mortgagee with a mortgage worth $1,000 to avoid totally the claim of the perfected junior mortgagee with a mortgage worth $10,000 and

24. Kennedy at 1428. The court in holding for the trustee stated:

"[T]he trustee represents . . . all creditors, and is interested in preserving the assets of the estate. Incidentally, the trustee is interested in preserving the validity of the mortgage security for the title company and thus reducing a possible deficiency judgment against the bankrupt."


25. Kennedy at 1424 n.20.
reduce the junior mortgagee to the status of a general creditor. This would be the result regardless of the value of the mortgaged property. The purpose of the Bankruptcy Act, however, is to equalize the shares received by the general creditors from the bankrupt's estate. The Act, therefore, should not be construed to permit one perfected security interest to be defeated by another security interest when neither was prejudicial to or voidable by a general creditor. Kennedy observes that, although total avoidance of the junior security interest has not been followed in any decision, this would be the unfortunate logical result if the trustee is allowed to be subrogated to the rights of a secured creditor.

MacLachlan maintains that "[i]t is illogical and indefensible to allow the trustee to inflate a valid lien for the purpose of using the augmentation to displace a junior lien." He asserts that this fallacy is basically the fallacy of Moore v. Bay but that it is buttressed by the assumption that section 70e applies to secured interests. MacLachlan fails to explain, however, his reasons for rejecting this application of section 70e.

The proposition that a trustee cannot be subrogated to the rights of a secured creditor has some general judicial support. In Silverman v. Wedge, a Massachusetts Supreme Court case, a trustee sought to invalidate a sale by the bankrupt to the defendant. The trustee alleged that a state statute made the transfer void and fraudulent against the state since notice of the sale was not filed at least five days prior thereto. The applicable state statute created a tax lien in favor of the state giving the state the status of a secured creditor. In denying to the trustee the use of section 70e-Moore v. Bay powers, the court stated that the trustee did "not by his mere appointment as trustee represent the Commonwealth. No special benefit [was] conferred upon him by the statute." In re Whitney Carriage Company involved a similar situation. In deciding against the trustee, the Federal District Court in Massachusetts declared that "the Court should take a realistic view of the purposes intended to be accomplished by both the Massachusetts Laws

29. Id., 158 N.E.2d at 669.
and the Bankruptcy Act and should apply common sense in reaching its decision.31 While both cases denied the trustee subrogation to the rights of a secured creditor, each case was interpreting a particular state statute. Whether a trustee can be subrogated to the rights of a secured creditor under the Bankruptcy Act, therefore, has not been squarely decided by any court.

O. Effect of the Uniform Commercial Code

Under the Uniform Commercial Code a perfected or unperfected security interest is not voidable by a general creditor.32 Most Moore v. Bay situations, therefore, will be eliminated. There may arise two possible situations, however, in which the trustee may be vested with section 70e-Moore v. Bay powers. The first would occur when a general creditor reduces his claim to a judgment and becomes a lien creditor (i.e., a secured creditor). This would happen only if the owner possesses a purchase money security interest and delays more than ten days in perfecting his security interest, or if the owner of a chattel mortgage delayed in recording and a general creditor became a lien creditor.33 Under the Code the interim gap creditor must also be a secured creditor in order to avoid an unperfected security interest.34 The first situation would be true only if a trustee may be subrogated to the rights of a perfected secured creditor. The second situation, suggested in Collier,35 involves section 9-306 (5)(d) of the Code. For example, Company A sells a car to B and sells the commercial paper given for the car to C Bank, which perfects its security interest showing B as the owner of the car. Because of a breach of warranty B cancels the sales contract and returns the car. Under section 9-306(5)(d), C Bank must rerecord its security interest, showing Company A as the owner. If C Bank fails to rerecord the security interest until after a general creditor extends credit and A goes bankrupt, a trustee may be subrogated to the rights of the general creditor to avoid in toto C Bank's perfected security interest. The general creditor's potential ability to avoid a perfected security interest

31. Id. at 711-12.
32. UNIFORM COMMERCIAL CODE § 9-301(1)(b). This section requires a general creditor to become a lien creditor before he can avoid another security interest.
33. UNIFORM COMMERCIAL CODE § 9-301(2).
34. UNIFORM COMMERCIAL CODE § 9-301(1) (b).
35. 4A COLLIERS ON BANKRUPTCY ¶ 70.81, at 940-42 (J. Moore ed. 1967).
in this particular situation conflicts with other sections of the Code. The reason for this exception is that section 9-306(5)(d) uses the word creditor without the modifying adjective lien found in other sections concerning the rights of secured creditors. The Code’s definition of creditor includes both a lien creditor and a general creditor.

There have appeared suggestions that the Code will totally eliminate the effects of Moore v. Bay. The authors of an article in the Wayne Law Review recognize that under the Code a general creditor cannot displace an unperfected or perfected security interest. They further contend that the effect of subrogation of the trustee to the rights of a secured creditor should not have the same result as subrogation to the rights of a general creditor. They reason that this should invalidate only the amount of the secured interest to whose position the trustee is subrogated. For example, if A had an unperfected (i.e., unrecorded) security interest of $1,000 when B became a lien creditor for $250, in bankruptcy the trustee would recover $250 by being subrogated to the rights of B. A would receive the remaining $750 (assuming, of course, A recorded prior to bankruptcy). The $250 recovered by the trustee would go to B. The result is identical to recovery outside of bankruptcy. Their reasoning is based on the statement in Moore v. Bay that “what thus is recovered for the benefit of the estate is to be distributed in ‘dividends of an equal per centum . . . on allowed claims, except such as have priority or are secured.” They assert that this expressly excludes secured creditors because secured creditors recover for themselves and not for the benefit of the estate.

37. Uniform Commercial Code § 1-201(12).
38. 1 P. Coogan, W. Hogan, & D. Vagts, Secured Transactions Under the Uniform Commercial Code § 9.03, at 950 (1967); Wiseman at 596. The recent extension of Moore in Abramson v. Boedecker would also be eliminated.
39. Wiseman at 596.
40. 284 U.S. 4, 5 (1931).
41. The authors list one exception to this proposition. When the security interest is unperfected at the time of bankruptcy, the authors suggest that the trustee could avoid the security interest in toto because the trustee would represent all the creditors and not just the few interim creditors. This result, they state, would not be true if all the creditors had knowledge of the unperfected security interest. If the authors are proceeding under the theory that section 70e of the Bankruptcy Act is applicable this would be the result. If, however, the authors are proceeding under section 70c, knowledge by all creditors of the unperfected security interest would not defeat the trustee. It is recognized that 70c is the strongest section to employ when a security interest is unperfected at the time of bankruptcy. This section gives the trustee the status of an ideal hypothetical lien creditor. In comparison with 70e, in which
This conclusion, however, depends on the definition of the phrase "for the benefit of the estate." Wiseman and King appear to interpret the phrase to mean that a person to whose position the trustee is subrogated must have an interest in recovering for the benefit of the estate. A secured creditor, as they point out, recovers for himself and not for the benefit of the estate. *Moore v. Bay*, however, allows the in toto avoidance of a security interest. Therefore, if subrogation to a secured interest were allowed, the trustee would recover the excess for the benefit of the estate. The secured party to whose position the trustee would be subrogated would, of course recover his full obligation. *Moore v. Bay* also states that "[t]he rights of the trustee by subrogation are to be enforced for the benefit of the estate." This would imply that the result of any subrogation would be a recovery, whether partial or not, for the benefit of the estate. This would not imply, as Wiseman and King appear to contend, that a recovery for the benefit of the estate is a condition precedent to subrogation. Therefore, since subrogation to the rights of a secured creditor is not specifically excluded from *Moore v. Bay*, this subrogation will result in the in toto invalidation of the voidable security interest. The conclusion is reached that, while the Uniform Commercial Code will limit the number of situations in which *Moore* could apply, the trustee is bound to the rights of the creditor to whose position he is subrogated, the 70c trustee will be able to avoid the unperfected security interest under any circumstance. The authors, however, appear to find a limitation on the trustee's power in the Uniform Commercial Code. In section 9-301(3) the Code states that a lien creditor is to include a trustee in bankruptcy. The Code section states that "unless all the creditors represented had knowledge of the security interest such a representative of the creditors is a lien creditor . . ." Wiseman and King contend, therefore, that if all the creditors had knowledge, the trustee as representative for the creditors, could not be a lien creditor and could not defeat the unperfected security interest. This argument has two fallacies. First, under section 70c the trustee does not act as a representative, but is given the status of an ideal hypothetical lien creditor. Second, the argument appears to apply section 9-301(3) to 70c. Since section 70c does not depend upon state law, a state law would be ineffective in trying to change the effect of section 70c. Finally, although 70c would be the strongest section to use in this one instance, their basic argument revolves around the Code's effect upon *Moore v. Bay*. *Moore*, of course, interpreted 70c, not 70c; see 4A Collier on Bankruptcy § 70.62A, at 727-29 (J. Moore ed. 1967) and Kennedy, *The Trustee in Bankruptcy Under the Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9*, 14 Rutgers L. Rev. 518, 521-25 (1960).

42. 284 U.S. 4, 5 (1931).

43. Uniform Commercial Code § 9-301. This section lists the situations in which an unperfected or perfected security interest is subordinate to other security interests; § 9-201 This section states that unless expressly provided elsewhere, a security interest, perfected or unperfected, prevails over a general creditor.
it does not solve the problem of subrogation to the rights of a secured creditor.

Coogan is another authority who contends that the Code will eliminate the effects of Moore v. Bay. Coogan demonstrates that under the Code a person with a perfected security interest is, under certain circumstances, subordinate to a lien creditor. He asserts that since section 70e requires a security interest to be either fraudulent against or voidable by another creditor, a security interest that is subordinate to another security interest does not come within section 70e provisions.44 The Coogan argument apparently proceeds on the theory that since the secured interest would be subordinate to a lien creditor, the lien creditor has a priority for recovering his claim over the claim of the secured interest.

In re Consorto Construction Company45 lends some judicial support to the Coogan interpretation. In In re Consorto a trustee sought to invalidate a mortgage by attempting to subrogate to either the interests of two attaching tax liens or to the interests of several creditors who had extended credit prior to the recordation of the mortgage. The court stated that a lien perfected before the recordation of the mortgage “prevails not under any concept that the lien of the chattel mortgage is voidable, but by reason of priority in time.”46 This interpretation of section 70c and the Uniform Commercial Code would nullify the effect of Moore v. Bay. Kennedy, however, contends that this analysis is incorrect because it forces the operation of section 70c to depend upon the particular lexicon of the different state legislatures. He asserts that the purpose of section 70c is to allow the trustee to take advantage of any law protecting creditors against fraudulent conveyances or secret liens.47

44. 1 P. Coogan, W. Hogan, & D. Vagts, Secured Transactions Under the Uniform Commercial Code ¶ 9.03, at 990-91 (1967). The argument presented in Coogan would be the only argument that could counter Kennedy's statement that subrogation to the rights of a secured creditor would lead to the avoidance in bankruptcy of all junior liens and interests (see footnote 25, supra). The argument is that the junior mortgage is subordinate to the senior mortgage; not voidable by the senior mortgage. Wiseman and King contend that subordinated means the same as invalid. Wiseman at 596 n.54.
46. Id. at 680.
47. Kennedy at 1428-29.
D. Conclusion

The results of Moore v. Bay seem of minor consequence when compared with its apparent extension in Abramson v. Boedecker. While Abramson did not discuss the concept of allowing a trustee to be subrogated to the rights of a secured creditor, on its facts it is apparent authority for that proposition. Although this result is presently limited to the Fifth Circuit, the decision has advanced a misconceived concept of subrogation. It will not reach a practical judicial limitation until the total avoidance in bankruptcy of all junior liens is allowed. This limitation, however, is not within the scope or purpose of the Bankruptcy Act. Since the Act is a federal statute the obvious solution would be for Congress to amend section 70e to allow subrogation of the trustee only to the rights of general creditors. Because Moore v. Bay has withstood thirty-seven years of criticism, however, it would appear that Congress is reluctant to make any changes in this area of the Bankruptcy Act.

The enactment of the Uniform Commercial Code by the states will limit the impact of Moore v. Bay. It will not, however, resolve the question of whether the trustee can be subrogated to the rights of a secured creditor. Under the Code, a person holding a perfected security interest can, except for one situation, be defeated only by a lien creditor. The Code will, therefore, have the effect of squarely presenting before a court the question of whether a trustee can be subrogated to the rights of a secured creditor. Only then, when a court knows exactly the issue before it, will this mumbled area of the law receive any clarity.

C. RAUCH WISE
COMMERCIAL TRANSACTIONS—WARRANTIES—IMPLIED WARRANTIES OF QUALITY UNDER THE UNIFORM COMMERCIAL CODE*

In 1793, in South Carolina, Shoolbred purchased a slave from Timrod. Unknown to either the buyer or the seller the poor devil was infected with smallpox at the time of purchase and shortly thereafter died. The buyer refused to pay the purchase price and the seller sued. The seller’s attorney argued that this was a loss which could not be foreseen or guarded against. Sales warranties in such cases, he asserted, should never be extended to the question of whether the subject matter should live “an hour or a day after the sale.”1

In 1967, in Pennsylvania, the buyer purchased from the seller two thousand one-day old chickens. Unknown to either the buyer or seller, the birds were infected with leukosis (bird cancer) and soon began to die. In the buyer’s suit for damages, the seller argued that this was a loss that could not be foreseen or cured after detection and that no action for breach of warranty should lie.2

Both the South Carolina and Pennsylvania courts found that the seller had breached an implied warranty of quality to the buyer. The South Carolina decision was made, at that early date, under common law. The Pennsylvania decision was made under the Uniform Commercial Code provisions relating to implied sales warranties, as adopted by that state.3 Since the Code became law in this state on January 1, 1968,4 and because our court has not been faced with this question under the new statute, it should be helpful to review some representative pre-Code South Carolina cases and a few decisions of other jurisdictions made under the Code. The purpose of this review will be an attempt to determine whether adoption of the Code can be expected to change South Carolina law in the area of implied warranties of quality arising from sales.


I. The Transaction

Before considering the types of sales warranties under the Code, there must first be a determination that the transaction itself is within the scope of Article 2.

The Code states that Article 2 "applies to transactions in goods. . . ." "Goods" is defined to mean "all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action." These expressions indicate the broad coverage intended by Article 2.

While broad coverage is intended and accomplished by the Code, the Code has generally qualified and narrowed the scope of coverage in many of the specific sections. The sales warranty sections under discussion fit this pattern.

The term "transaction" implies virtually unlimited application. Its scope of coverage is qualified, however, because section 2-314 and 2-315 warranties arise only when there has been a sale or contract for sale. Although there are non-sales warranties within and without the Code, the plaintiff's attorney will usually want to bring his action under the warranty sections since proof of negligence is not required. For the same reason, the defendant's attorney will want to avoid a decision based solely on a contractual basis. These conflicting interests will probably continue to cause litigation with respect to whether a "sale" has taken place.

The fact that West's volume on Words and Phrases devotes one hundred and forty-four pages to cases defining the term "sale" indicates that there is no definitive legal definition. Under the Code a "sale consists in the passing of title from the seller to the buyer for a price." This definition seems to assume a qualifying transaction has taken place. It proceeds to the basic conclusion that a sale is completed by the passing of title between two persons for a price. Since the Code fails to define the term "transaction" it seems evident that the courts, not the Code, must determine the scope of the term "sale." For example, as will be discussed later, courts inter-

5. *Id.* § 10.2-102.
6. *Id.* § 10.2-105(1).
interpreting the Code have determined that the fact that title has passed between a buyer and a seller for a price will not automatically give rise to a "Code sale" if the transaction as a whole is a "service." The Code's definition of "sale," therefore, must be considered in light of the overall transaction.

While the Pennsylvania decision did not have to consider the definition of sales, and no South Carolina cases defining the term have been found, other courts have found sales within the meaning of Article 2 when an in-state "delivering" florist filled a telegraphic order from an out-of-state florist; when a gas company supplied gas to a customer's home on a month-to-month basis; when goods were sold "on consignment" and in the "gift" of a gallon of antifreeze with the purchase of an automobile tire.

When the complete transaction is determined to be a service, the "sale" of an item deemed secondary to the overall transaction will not get warranty protection under the Code. The surgical insertion of a device to regulate a heartbeat, therefore, is not a transaction constituting a sale within Article 2 with relation to the surgeons or the hospital, because the primary relationship of buyer and seller does not arise.

A beauty parlor patron who suffered acute dermatitis and disfigurement from loss of hair, allegedly because of the use of certain products during a beauty treatment, could not recover under the Code because there was no "sale of goods" within Article 2. This type of plaintiff must seek damages in a negligence action.

While this "sales versus service" distinction continues, Section 2-314 settles one of the most frequently litigated questions in this area by providing that "the serving for value of food or

drink to be consumed either on the premises or elsewhere is a sale.\textsuperscript{116}

In summary, most situations of potential litigation will clearly fall within or without the coverage of Article 2. There exists, however, a penumbral area in which the courts will have to determine whether the purchase of an item, as a transaction, satisfies the "sale" concept of Article 2.\textsuperscript{17} This possibility merits careful consideration and should be the initial point of inquiry in many of the day to day cases that will present themselves to the general practitioner.

II. Types of Implied Warranties of Quality Under the Code

A. Merchantability\textsuperscript{18}

In a leading British case the plaintiff had bought copper sheathing for installation on his ship. Evidence demonstrated that the sheathing normally lasted four or five years. This sheathing, however, was corroded and unfit for service after only four or five months. The court, not content with a narrow holding, stated: "[W]e wish to put the case on a broad principle: If a man sells an article, he thereby warrants that it is merchantable,—that it is fit for some purpose."\textsuperscript{119} The term merchantable was subsequently incorporated into the British Sale

18. Implied warranty: merchantability; usage of trade.
   (1) Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.
   (2) Goods to be merchantable must be at least such as
       (a) pass without objection in the trade under the contract description; and
       (b) in the case of fungible goods, are of fair average quality within the description; and
       (c) are fit for the ordinary purposes for which such goods are used; and
       (d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and
       (e) are adequately contained, packaged, and labeled as the agreement may require.
   (3) Unless excluded or modified (Section 2-316) other implied warranties may arise from course of dealing or usage of trade.
of Goods Act of 1895, and the Uniform Sales Act.\textsuperscript{20} South Carolina did not adopt the Sales Act, however, and does not seem to have employed the term in its case law. The carrying-forward of its use into the Code, therefore, projects a new word into our law.

South Carolina, from its earliest reported case,\textsuperscript{21} has used "soundness" as a measure in implied warranty cases. The soundness warranty—a sound price warrants a sound commodity\textsuperscript{22}—arose from horse sales\textsuperscript{23} and was at one time distinctly aimed at protection for the consumer who himself planned to use the goods. South Carolina case law, however, has applied the "soundness" test to applicable transactions without regard to whether the buyer intended to re-sell\textsuperscript{24} or use\textsuperscript{25} the goods.

The term merchantability, in its historical development, contemplated as a party the factor-merchant who planned to re-sell the goods to another merchant. In other words, this warranty originally developed in application to transactions among merchants, not the merchant-to-consumer sale. The goods sold had to pass, among other tests, without objection in the trade and, if fungible, be of fair average quality within the description;\textsuperscript{26} phrases implying quality or bulk sales. Reference to section 2-314(2) (a) and (b) shows that these ideas have undergone very little modification.

The scope of 2-314, however, is not limited to this idea of resale by one merchant to another merchant. In completely rewriting section 15(2) of the Uniform Sales Act the Code recognized developing case law and the impact of judicial decisions on the scope of this warranty. The prefatory note and comment one of 2-314, taken together, state that the purpose of the change in language from that of the Uniform Sales Act "is intended to make it clear that... the warranty of merchantability applies to sales for use as well as to sales for resale."

\begin{itemize}
\item[20.] Uniform Sales Act § 15(2).
\item[21.] Timrod v. Shoolbred, 1 Bay 324 (S.C. 1793).
\item[24.] E.g., Simmons v. Roanoke City Mills, 116 S.C. 432, 107 S.E. 903 (1921) (sacks of meal purchased for sale in the city of Columbia and vicinity).
\item[25.] E.g., Timrod v. Shoolbred, 1 Bay 324 (S.C. 1793).
\item[26.] Mathieu v. George A. Moore & Co., 4 F.2d 251 (N.D. Cal. 1925).
\end{itemize}
While the term "merchantable" and the term "sound," as applied to warranties, therefore, might not have the same historical meaning, "merchantability" as defined in the Code has been extended "down" to include the consumer;27 and "soundness," as interpreted by the South Carolina court, has been extended "up" to apply to the merchant.28 It is submitted that these terms, as used, seem comparable and differ more in form than in substance and actual application. Assuming this overall similarity, however, an examination of the specific language of section 2-314 is still necessary.

Section 2-314 still requires that the seller be a "merchant" with respect to goods of the kind being sold. Merchant is defined by the Code to mean:

[A] person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.29

Comment two to 2-104 further clarifies this definition and provides that, "[t]he professional status under the definition may be based upon specialized knowledge as to the goods, specialized knowledge as to business practices, or specialized knowledge as to both. . . ." "Obviously," the Comments go on to say, "this qualification restricts the implied warranty to a much smaller group than every one who is engaged in business and requires a professional status as to particular kinds of goods."

Notwithstanding this restriction, the vast majority of cases involving implied warranties will no doubt have a "merchant" seller involved. The practitioner should merely recognize the possibility that his particular case might not qualify for 2-314 coverage because of failure to meet this requirement.

Reference in section 2-314 to "goods of that kind" indicates the Code's recognition that an experienced seller of one type of goods could be a novice in the sale of another type. The sales manager of an automobile dealership, for example, probably

would not give this warranty on the sale of his second-hand fishing boat to a neighbor.

The remainder of section 2-314 leaves to the judiciary the power to expand coverage. Sub-section (2) does not intend to be an exhaustive listing of the qualities of merchantability\(^\text{\textsuperscript{30}}\) and subsection (3) allows any warranty based on a usual course of dealing.\(^\text{\textsuperscript{31}}\)

The overall scope of 2-314 addresses itself to whether the buyer received goods fit for use for ordinary purposes for which such goods are used. The numerous cases dealing with this problem are less helpful than an understanding of the underlying theory. The statement that "[t]he entire purpose behind the implied warranty sections of the Code is to hold the seller responsible when inferior goods are passed along to the unsuspecting buyer"\(^\text{\textsuperscript{32}}\) seems to represent the Code's position.

By rejecting the doctrine of caveat emptor, South Carolina, at an early date, adopted the general sales theory presently incorporated into the Code. Whether the buyer receives his money's worth will continue to be a jury question. The basic problem for the attorney, therefore, is whether his case is within the coverage of this section. That answer will depend as much upon the court's interpretation of "merchant," "goods of that kind" and other specific phrases, as it will on the facts themselves.

**B. Fitness for Particular Purpose\(^\text{\textsuperscript{33}}\)**

While merchantability and fitness for particular purpose are often involved in a single sale, the difference between them becomes obvious by distinguishing the word "ordinary" from the word "particular." Comment 2 to Section 2-315 states that a "particular purpose differs from the ordinary purpose for which the goods are used in that it envisages a specific use by

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30. *Id.* § 10.2-314, Comment 6.

31. *Id.* § 10.2-314(3); *see, e.g.*, Annawan Mills Inc. v. Northeastern Fibers Co., 26 Mass. App. 115 (1963). This case distinguished the term "cotton waste" and "cotton linters" on the basis of usage in the trade. (emphasis added).


33. Implied warranty: Fitness for particular purpose.

Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is, unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

the buyer which is peculiar to the nature of his business. . . .”
The Code gives the example of the difference between shoes, and shoes to be used for climbing mountains.84

A leading English case, Randall v. Newsom,85 held a coach-builder liable for damages to the plaintiff’s horses and carriage when the carriage tongue, recently constructed from a pole purchased from the defendant for that purpose, broke. The court asserted that “[t]he subject matter of the contract was not merely a pole, but a pole for the purchaser’s carriage. If the subject matter be an article . . . to be used for a particular purpose, the thing . . . delivered must answer that description . . . and [be] reasonably fit for the particular purpose.” This language is declaratory of the theory behind this warranty.

Knowledge and reliance have traditionally been the elements necessary to give rise to this warranty. Under the Uniform Sales Act the buyer had to make known to the seller, expressly or by implication, the particular purposes for which the goods were required.86 In addition, the seller had to know of the buyer’s reliance. Since the Code requires only that the seller have “reason to know” of the particular purpose and the buyer no longer has a duty to make the seller aware of his reliance,87 the burden of proof is now on the seller to establish that the warranty does not arise. One example of this section’s buyer oriented approach may be recognized in purchases by patent or trade name. The Uniform Sales Act expressly excluded such purchases from the “particular purpose” warranty because the purchaser did not “rely” on the seller’s skill or judgment. Under the Code, purchase by trade name may be a factor in determining whether there is reliance on the seller’s skill or judgment, but it is not conclusive.

Finally, while a merchant would normally be involved in this kind of transaction, the Code makes no distinction among the classifications of sellers under this section. This warranty can arise whenever it is justified by the particular circumstances.88

This section of the Code seems similar to the development of the “fitness” doctrine under South Carolina’s common law. In

85. 2 Q.B.D. 102 (1877).
86. Uniform Sales Act § 15(1).
a leading South Carolina case39 the defendant purchased a soda fountain from the plaintiff. Plaintiff's agent knew that the defendant bought the unit to "keep his ice cream hard... and to keep water cold."40 While the plaintiff sought at trial to show that the machine was ninety-six percent operable and therefore almost perfect, our court upheld the jury's award on defendant's counterclaim. The court explained that in the absence of an express warranty or a non-warranty clause, the law would imply a warranty that the article is fit and suitable for the purpose for which it is bought.41 In another case42 the court considered specially mixed varnish which, according to defendant, did not meet the specific requirements for which it was sold. The court held that when the seller has knowledge of the use to which goods are to be put, he impliedly warrants (unless it is otherwise affected by agreement) "that the materials sold [are] reasonably adapted to the purpose for which they [are]... purchased."43

The cases arising under the Code in other jurisdictions seem to be substantially in accord with the few South Carolina cases in this field.

The recommendation of a particular paint for use on stucco walls raised the fitness warranty when the buyer relied on the seller's judgment;44 and a helicopter bought to be used in utility work (i.e., laying heavy weights in construction) must perform in that particular manner.45

In another case the ordinary purposes for which seller's holiday boxes were to be used was to contain individual bottles of buyer-distiller's liquor. The fact that the boxes could not be placed in compartments of the buyer's reshipping cases without damaging the removable acetate band bearing information required by law did not breach the fitness for a particular purpose warranty.46

To summarize, although fitness for a particular purpose, as a specific term, seems not to have been used by our court, de-

40. Id. at 45, 159 S.E. at 463.
41. Id.
43. Id. at 97, 48 S.E.2d at 659.
45. Boeing Airplane Co. v. O'Malley, 329 F.2d 585 (8th Cir. 1964).
decisions under this section of the Code seem to be in accord with the pre-Code South Carolina fitness standard. While the reliance requirement has been lessened by placing a heavier burden upon the seller, the pre-Code South Carolina decisions seem also to have placed a higher duty on the seller of goods for a particular purpose.

III. Conclusion

The underlying theory behind these sections of the Code seems comparable to that of the South Carolina case law. The South Carolina buyer already possesses the protection which, through judicial decisions, is comparable to that given by the Code. The seller in this state has long had the duty to deliver sound goods. The major problem in the administration of decisions under the Code will concern the scope of coverage, and the age old problem of defining terms such as "sale," "goods" and "merchant"; terms which at once are commonly used but not definitive when a transaction departs significantly from the "ordinary" case.

The two warranties, while both often arise in a single transaction, are substantially different and could require more specificity in pleading. Article 2, however, will be applied by the court in its entirety. The attorney pleading warranties will be sadly surprised if the other sections, particularly those dealing with disclaimers, are not studied and understood.

The result in implied warranty cases should continue to be the same under the new Code as it was under South Carolina case law. The practitioner must recognize, however, that whether he has an implied warranty action and whether he will achieve a successful result are now dictated by statute, a sometimes less flexible friend than the old common law.

Donald H. Stubb
CONSTITUTIONAL LAW — LOYALTY OATHS*

I. INTRODUCTION

Following World War II the United States was confronted with the threat of International Communism. As the threat became increasingly evident, a growing fear spread among the American people. The public reacted predictably to this international stress with the herd instinct asserting itself in urging conformity. Loyalty programs were developed as a distinct manifestation of extreme public anxiety. Among these were the blacklists (e.g., Red Channels), restrictions on union membership, restrictions on the right to participate in primary elections, and loyalty oaths primarily for public employees.¹

Loyalty oaths, although taking various forms, generally involved:

[The] abjuration of belief in or advocacy of the forcible overthrow of the government or of membership in organizations so advocating, sometimes of membership in a particular organization such as the Communist Party, or connections with others found “subversive” by executive or administrative determination.²

Following the war these oaths received general judicial affirmation. By October of 1952 the Supreme Court had upheld the validity of all loyalty oath enactments considered by it.³ In the following years the Court restricted both the scope and coverage of the oaths. To understand the changing judicial attitudes over the past two decades the Supreme Court decisions must be discussed and briefly analyzed.

II. EARLY DECISIONS

In Gerende v. Board of Supervisors⁴ the appellant had been denied a place on the ballot for a municipal election on the ground that she had refused to file an affidavit required by Maryland law. The Maryland Court of Appeals had previously

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2. Id. at 155.
3. Annot., 97 L.Ed. 226, 228 (1951).
narrowed the scope of the applicable state law in *Shub v. Simpson*. The Supreme Court assumed that the narrow construction of the statute would be used by the proper Maryland authorities and upheld the oath requirement stating:

We read this decision to hold that to obtain a place on a Maryland ballot a candidate need only make oath that he is not a person who is engaged ‘in one way or another in the attempt to overthrow the government by force or violence,’ and that he is not knowingly a member of an organization engaged in such an attempt.6

*Garner v. Board of Public Works*7 came before the Supreme Court in the same year. The oath involved was similar to the oath in *Gerende* but covered a broader time period and a wider range of prohibited activities. The petitioners were required to swear that within the previous five years they had not advised, advocated, taught nor been:

[A] member of or affiliated with any group, society, association, organization or party which advises, advocates or teaches, or has, within said period of five (5) years advised, advocated or taught the overthrow by force or violence of the government of the United States of America or of the State of California.8

The petitioners also had to swear to the same with regard to their present and future conduct. Again the Court upheld the validity of the oath. In disposing of the contention of denial of due process of law, the Court stated that there was no reason to suppose that the oath would be construed by the “California courts as affecting adversely those persons who during their affiliation with a proscribed organization were innocent of its purposes...”9

The Court upheld the validity of a New York statute in *Adler v. Board of Education*.10 The Court considered only a portion of the statute on the merits and did not discuss the validity of the oath provision because it had not been considered by the state court. The statute barred from employment in the

5. 196 Md. 177, 76 A.2d 332 (1950).
8. Id. at 718.
9. Id. at 723.
public schools persons who advocated, or belonged to organizations which advocated, the overthrow of the government by unlawful means. The New York Board of Regents was to make a listing of organizations of the type described. The Board provided by regulation that membership in a listed organization should be prima facie evidence of disqualification for employment in the New York public schools. The Court noted the importance of determining whether a rule of exclusion from employment based on association applied to innocent as well as knowing activity. In upholding the regulation, the Court affirmed the construction of the statute by the New York courts which required knowledge of organizational purpose before the regulation could be applied.

In 1952, Wiemann v. Updegraff11 became the first Supreme Court decision which held a loyalty oath invalid. The case involved an Oklahoma statute barring persons from state employment solely on the basis of organizational membership, without regard to their knowledge of the purposes of the organizations. The Court acknowledged its consideration of scien-
ter in Garner and Adler. Because the Oklahoma statute did not require knowledge of the purposes of the organization to which the individual belonged, the Court held the statute to be an assertion of arbitrary power and a denial of due process of law.

III. RECENT DECISIONS

The validity of a loyalty oath statute was not considered by the Supreme Court again until 1961 in Cramp v. Board of Public Instruction.12 The crucial portion of that oath required each state employee to swear that he had never lent his aid, support, advice, counsel, or influence to the Communist Party. The Court indicated by a series of rhetorical questions13 "the extraordinary ambiguity of the statutory language."14 It therefore held that "a statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to

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13. There is a gradual crescendo to the final question which asks, "[I]ndeed, could anyone honestly subscribe to this oath who had ever supported any cause with contemporaneous knowledge that the Communist Party also sup-
ported it?" Id. at 285.
14. Id.
its application violates the first essential of due process of law.\textsuperscript{15}

This decision involved a recognizable shift in the standards by which the Court evaluated loyalty oaths. Previous to\emph{Cramp}, the Court had required that the statute merely contain a knowledge requirement. Following\emph{Cramp} the knowledge requirement had to be explicit. The inclusion of a knowledge requirement, without more, risked a judicial declaration of unconstitutionality on the grounds of vagueness.

The Supreme Court next considered the validity of a loyalty oath in\emph{Baggett v. Bullitt}.\textsuperscript{16} The Act which the Court interpreted required all state employees to swear that they were not subversive persons. A subversive person was defined as follows:

‘Subversive person’ means any person who commits, attempts to commit, or aids in the commission, or advocates, abets, advises or teaches by any means any person to commit, attempt to commit, or aid in the commission of any act intended to overthrow, destroy or alter, or to assist in the overthrow, destruction or alteration of, the constitutional form of the government of the United States . . . by revolution, force, or violence; or who with knowledge [of its purposes] becomes or remains a member of a subversive organization or a foreign subversive organization.\textsuperscript{17}

The Act also defined “subversive” and “foreign subversive” organizations, declaring the Communist Party to be a subversive organization and membership therein a subversive activity.

Applying the standards utilized in the\emph{Cramp} case the Court held the oath invalid because its language was unduly vague, uncertain, and broad. Persons required to swear to the above oath, the Court explained, might reasonably conclude that a person aiding the Communist Party or teaching or advising known members of it might be considered subversive persons. Under the statute, the Court reasoned, this person was not only subversive if he committed the act but also if he advised another in aiding a third person to commit an act which would assist a fourth person in the overthrow of the government.

\textsuperscript{15} Id. at 287.
\textsuperscript{16} 377 U.S. 360 (1964).
\textsuperscript{17} Id. at 362.
Again, by a series of rhetorical questions, the Court indicated that this provision rendered the oath unconstitutionally vague.

Justices Clark and Harlan dissented and were very critical of the majority opinion. The dissent considered the vagueness contention pointing out that the *Cramp* case was not a similar decision. The oath in *Cramp* was unconstitutionally broad and vague because a wide range of innocent activity could easily be included within the scope of the statute. The oath in *Baggett* only involved the commission of an act intended to overthrow the government. Overthrow of the government is the heart of subversive activity. An act containing language limited to this narrow purpose does not encompass prohibition of a wide range of undefined innocent activity. The dissent asserted that:

>[It was] absurd to say that, under the words of the Washington Act, a professor risks violation when he teaches German, English, history, or any other subject included in the curriculum for a college degree, to a class in which a Communist Party member might sit. To so interpret the language of the Act is to extract more sunbeams from cucumbers than did Gulliver’s mad scientist.

The other contention by the majority also extracted a few “sunbeams.” It stated that a person would be considered a subversive if he advised another in aiding a third person to commit an act which would assist a fourth person in the overthrow of the government. The words of the statute, however, clearly state that he must advise another person to aid a third person in the overthrow of the government. This should not have been interpreted to include a wide range of undefined innocent activity as the majority seemed to believe.

The dissenting opinion also accused the majority of failing to follow precedent. “It is strange that the Court should find the language of the statute so profoundly vague when in 1951 it had no such trouble with the identical language presented by another oath in *Gerende v. Board of Supervisors of Elec-

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18. The last question asks:

[II]s selecting outstanding scholars from Communist countries as visiting professors and advising, teaching, or consulting with them at the University of Washington a subversive activity if such scholars are known to be Communists, or regardless of their affiliations, regularly teach students who are members of the Communist Party, which by statutory definition is subversive and dedicated to the overthrow of the Government? *Id.* at 369.

19. *Id.* at 382-83 (dissenting opinion).
The oath in *Garner v. Board of Public Works* also presented a case of an identical loyalty oath which the court had upheld. The majority, however, dismissed *Gerende* in a footnote stating that it was not applicable, and made no mention of *Garner*.

The Supreme Court followed its *Baggett* decision by holding a loyalty oath invalid in *Elfbrandt v. Russell*. The Arizona legislature had enacted a statutory oath which subjected any state employee taking it to criminal liability if he became or remained a member of an organization that had for one of its purposes the overthrow of the government of Arizona, when he had knowledge of its unlawful purpose. This oath seemed to be drawn consistently with the Supreme Court restrictions announced in *Gerende*, *Garner*, *Adler*, and *Wiemann*. The Court considered the form of the oath and, relying upon its recent decisions, held the statute to be vague and unconstitutionally broad. In *Elfbrandt*, however, the Court did not consider vagueness in relation to due process and the fourteenth amendment. It asserted that the oath threatened first amendment freedoms. It stated that a statute touching freedom of association and other first amendment freedoms "must be 'narrowly drawn to define and punish specific conduct as constituting a clear and present danger to a substantial interest of the State.'" The statute, therefore, was held invalid because it might have punished those who were members of an organization which had an illegal purpose and which purpose was known to the member; although he might not have had the specific intent to further those unlawful aims. The Court in *Gerende*, *Garner*, and the statute in *Adler*, as interpreted in *Wiemann* affirmed the loyalty oath if the employee was a knowing member of an organization with unlawful purposes. *Elfbrandt* limited the rule by demanding both a knowledge and a specific intent requirement.

In *Keyishian v. Board of Regents*, the Supreme Court reconsidered its decision in *Adler*. Applying the *Elfbrandt* criteria it held that the provision requiring state employees to swear that they were not members of the Community Party was unconstitutionally broad. In order to obtain a conviction, the Court

20. *Id.* at 382 (dissenting opinion).
21. *Id.* at 368 n.7.
23. *Id.* at 18.
asserted, the employees must have the specific intent to further unlawful aims. The Court also held invalid the statutory provision requiring state employees to certify that they had not by word of mouth or writing wilfully and deliberately advocated, advised or taught the doctrine of forceful overthrow of the government. The Court stated that "[t]his provision is plainly susceptible of sweeping and improper application." \(^{25}\) The Court explained that advocating, advising and teaching could be construed as including a wide range of innocent activity. \(^{26}\) Although the Court did not mention \textit{Garner}, the similarity in the oath provisions lead to the conclusion that \textit{Garner} was overruled sub silentio.

The Supreme Court has recently considered the validity of a loyalty oath statute in \textit{Whitehill v. Elkins}. \(^{27}\) Maryland teachers were required to certify that they were "not engaged in one way or another in the attempt to overthrow the Government of the United States, or the State of Maryland, or any political subdivision of either of them, by force or violence." \(^{28}\) The opinion recognized the earlier Maryland case of \textit{Gerende v. Board of Supervisors}. By a process of reasoning that defies analysis, \(^{29}\) the majority of the Court failed to overrule \textit{Gerende}, while it ruled the \textit{Whitehill} oath to be unconstitutionally vague. The majority opinion incorporated the entire authorizing statute into the oath. A portion of that statute defined a subversive person as one who was a member of an organization that would alter the form of government by revolution, force, or violence. Utilizing the rhetorical question, \(^{30}\) the Court indicated that the oath, by incorporating the authorizing statute, might in-

\(^{25}\) \textit{Id.} at 599.

\(^{26}\) The court stated that the provision:
May well prohibit the employment of one who merely advocates the doctrine in the abstract without any attempt to indoctrinate others, or incite others to action in furtherance of unlawful aims . . . . And in prohibiting ‘advising’ the ‘doctrine’ of unlawful overthrow does the statute prohibit mere ‘advising’ of the existence of the doctrine, or advising another to support the doctrine? Since ‘advocacy’ of the doctrine of forceful overthrow is separately prohibited, need the person ‘teaching’ or ‘advising’ this doctrine himself ‘advocate’ it? Does the teacher who informs his class about the precepts of Marxism or the Declaration of Independence violate this prohibition? \textit{Id.} at 599, 600.

\(^{27}\) 88 S. Ct. 184 (1967).

\(^{28}\) \textit{Id.} at 185.

\(^{29}\) \textit{Id.} at 188.

\(^{30}\) “Would a member of a group that was out to overthrow the Government by force or violence be engaged in that attempt ‘in one way or another’ within the meaning of the oath, even though he was ignorant of the real aims of the group and wholly innocent of any illicit purpose?” \textit{Id.} at 186.
clude undefined innocent activity (membership in a subversive organization without the specific intent of furthering its unlawful purposes).

The dissenting opinion indicated that “[t]he oath [did] not refer to the statute or otherwise incorporate it by reference. It [contained] no terms that are further defined in the statute.”

The dissent felt that the oath should have been judged without inclusion of this statute. If it had been, the majority would have had to overrule expressly its decision in Gerende or uphold the oath as valid, because this oath was identical to the first half of the Gerende oath as interpreted by the Supreme Court.

IV. CONCLUSION

The Supreme Court upheld the validity of all loyalty oath statutes brought before it when they were widely employed in the years following World War II. In recent years, however, the Court has held invalid all loyalty oath statutes which it has considered. Without expressly admitting it, moreover, the Supreme Court has overruled all of its earlier decisions with the exception of Gerende; and its validity is doubtful. On the basis of Gerende, it could be argued that a statutory oath, requiring public employees to swear only that they are not “engaged” in one way or another in the attempt to overthrow the government by force or violence, would be upheld by the Supreme Court. As the dissent pointed out in Whitehill, however, the majority of the Court disapproves of loyalty oaths. The word “engaged” could easily be given the same interpretation given “advised,” “advocated,” and “taught” in Keyishian, and consequently be held vague, unconstitutionally broad and invalid.

From an interpretation of Elfbrandt, it could be argued that the Supreme Court would uphold the validity of an oath requiring public employees to swear that they do not have the specific intent of furthering the aims of any organization, to which they might be a member, which has as its purpose the overthrow of the Government of the United States by force or violence. The oath might also require them to swear that they alone do not have the specific intent of overthrowing the government of the United States by force or violence. Assuming the Supreme Court might hold this oath valid, however, its effect

31. Id. at 188, 189 (dissenting opinion).
would be nugatory. It would be very difficult to prove specific intent. The purposes of the states in enacting loyalty oath statutes would be indirectly thwarted.

Hosack v. Smiley, a federal district court decision, suggests a possible constitutional construction of a loyalty oath. The University of Colorado requires all its employees to swear that they will support the Constitution and laws of the United States and of the state of Colorado. This oath was upheld by the District Court of Colorado. It is difficult to conceive of any way in which the Supreme Court could find this loyalty oath vague and unconstitutionally broad.

In every loyalty oath decision since Cramp the Court has mentioned its great concern for first amendment rights. It is possible that the Supreme Court will not uphold the validity of any loyalty oaths because the oaths may impede the "broad" freedom of association. The Court does not seem willing to overrule precedent or conclude that loyalty oaths are unjust per se. In Baggett and Whitehill, however, the Court had to stretch constitutional principles to find constitutional violations. This possibly indicates, therefore, that the Court has indulged in some personal subjective considerations; and has determined that loyalty oaths are unjust per se.

EDWIN B. BRADING

INSURANCE—INSURER'S LIABILITY FOR UNREASONABLE REFUSAL TO SETTLE WITHIN POLICY LIMITS*

I. INTRODUCTION

Most insurance policy holders are unaware of their right to recover damages from their insurance company arising out of its wrongful refusal to settle an insurance claim. Under the terms of the typical insurance policy, the insurer has the exclusive right to negotiate the settlement of a case; and generally, it has the right to decide whether or not it will effect a settlement. Nevertheless, the insurer cannot arbitrarily refuse a settlement; rather, it must act in good faith in handling the interests of its insured. Nor can the insurance company merely tender the full amount of the policy coverage without considering the nature of the claim and the extent of the insured's involvement. The defense of such suits by the insurer is a valuable right for which the insured pays and to which he is entitled under the policy.

The recent case of Crisci v. Security Insurance Company illustrates this much litigated issue. Security insured Mrs. Crisci for $10,000 and was obligated under the general liability policy to defend any claim against her and to make any settlement it deemed expedient. Mrs. Crisci was sued by her tenant who was injured when a stairway collapsed in her apartment house. The tenant suffered physical injuries and developed a severe psychosis. After confronting psychiatric evidence that the accident caused the tenant's psychosis, Security refused an offer for settlement within the policy limits. A jury awarded the plaintiff-tenant $100,000. After an unsuccessful appeal the insurance company paid $10,000 of this amount. The plaintiff collected the balance of $90,000 from Mrs. Crisci. Mrs. Crisci sued Security alleging a breach of implied covenant of good


2. 45 C.J.S. Insurance § 935 (1946).
faith for its failure to settle within the policy limits and was awarded $91,000, plus interest. In addition, Mrs. Crisci, who had attempted suicide after becoming ill and impoverished, recovered $25,000 for mental suffering.

II. Duty of Insurer to Settle

There is a definite disparity of interests created between the insurer and the insured when an offer to settle is made by a claimant. The insurer is anxious for any settlement within the limits of its insurance policy. The insurer with a fixed liability will attempt to effect a low settlement below the policy limits. There is a coinciding division of opinion within the nation's judiciary regarding the emphasis the insurer must accord to these conflicting interests. The older cases permit the insurance company to consider its interests above those of the insured.5 Others have held that the insured's and the insurer's interests should be given equal consideration.6 The South Carolina Supreme Court has held that, if there is a conflict of interest, the insurer is bound by its contract of indemnity and good faith to subordinate its interests to those of the insured.7

The great majority of jurisdictions define the insurer's liability in terms of "negligence" and "bad faith."8 "Bad faith," generally, embraces more than bad judgment or negligence. It imports a dishonest purpose or conscious wrongdoing, and embraces an actual intent to mislead or deceive another.9 The burden of proving "bad faith" rests with the insured.10 Other jurisdictions, including South Carolina, have rejected the "bad faith" rule, holding the insurer liable for negligence in refusing a reasonable compromise offer.11 The degree of care

required under the "negligence test" is usually that which an ordinary prudent person would exercise in the conduct of his own affairs. The question of the insurer's negligence is left to the jury. If there is no real evidence of negligence, however, the court may make such determination as a matter of law. The negligence test looks to the manner and skill of the insurer in conducting all aspects of the investigation together with all facts and circumstances leading to the decision to reject the proposed settlement.

Some commentators have observed that, for all practical purposes, there is no difference between the "bad faith" and "negligence" tests. There is, however, at least one noticeable difference. While bad faith may be established with some certainty, formulating a standard of due care for negligence, to be employed in evaluating the insurer's exercise of judgment, involves considerable practical difficulty. In some jurisdictions the negligence and bad faith standards seem to coalesce with the result that a showing of negligence is considered an element in determining the bad faith issue. In other jurisdictions both rules apply—the negligence rule to the investigation and processing of the claim and the bad faith rule to the litigation of the claim.

The South Carolina court seems to have merged the two tests. The Tyger River cases established that a liability insurer has the duty to compromise a claim against its insured if the circumstances make it reasonable to do so. An insurer who acts unreasonably and is guilty of negligence, fraud or bad faith in its failure or refusal to settle a claim within its policy limits

is responsible for damages resulting from such negligence, fraud or bad faith. The court has also determined that negligence unaccompanied by fraud or bad faith in failing to settle gives rise to a cause of action.

III. When Does the Cause of Action Arise?

Judicial opinions have generally divided with respect to whether the insured must pay the judgment in excess of the policy limits before he can recover from the insurer. The older decisions require payment of the excess judgment as a condition precedent to recovery. They reason that until actual payment is made the injury is both contingent and speculative.\(^\text{20}\) The more recent cases have held that entry of the judgment completes the actionable wrong and is sufficiently injurious to permit the insured to recover.\(^\text{21}\) In Gray v. Nationwide Mutual Insurance Company\(^\text{22}\) the Pennsylvania court ruled that the insured’s payment to his judgment creditor was not a prerequisite to a cause of action against the insurer. The court gave these reasons for adopting the “non-payment” view:

1. Such view prevents an insurer from benefiting from the impecuniousness of an insured who has a meritorious claim but cannot first pay the judgment imposed upon him.

2. Were payment the rule, an insurer with an insolvent insured could unreasonably refuse to settle, for, at worst, it would only be liable for the amount specified by the policy.

3. Such view recognizes that the fact of entry of the judgment itself against the insured constitutes a real damage to him because of the potential harm to his credit rating.\(^\text{23}\)

In Chitty v. State Farm Mutual Automobile Insurance Company\(^\text{24}\) the South Carolina District Court recognized the division of opinion among many jurisdictions, and observed that the


\(^{23}\) Id. at 506, 223 A.2d at 10. See also 27 U. PRRT. L. REV. 726, 728 (1966).

South Carolina Supreme Court had not decided the question. It determined that the more logical and better reasoned view was not to require payment by the insured before suit could be brought against the insurer. Recently, in Andrews v. Commercial Union Insurance Company, the district court essentially restated its Chiity opinion concluding that it was not necessary for the insured to pay the excess judgment; and that it was no defense to the insured's claim that he had insufficient assets for its payment. If this apparent majority rule is followed, and the insured is permitted to sue the insurer before paying the claimant, it also follows that he must thereafter pay the claimant from the proceeds of the suit.

IV. SHOULD THE INSURED BE ALLOWED TO ASSIGN HIS CAUSE OF ACTION TO THE CLAIMANT?

In discussing the possibility of assignment of a claim by the insured to the judgment creditor, consideration must be given to whether the cause of action is ex delicto or ex contractu. Modern common law prohibits two types of assignment:

(1) Tort action for personal injuries [ex delicto].
(2) A cause of action based on an executory contract which is purely personal in nature or contains a provision forbidding assignment [ex contractu].

The California Supreme Court recognized that a provision forbidding assignment does not preclude transfer of a cause of action for breach of the policy. This decision reaffirms a generally well settled area of the law. If an executory contract is unassignable because of a nonassignment provision or otherwise, it is generally recognized that once the contract is breached, giving rise to liability, the reason for the prohibition is removed and the cause of action may be assigned. If the court, therefore, regards the action as one ex contractu, the wrongful refusal to settle constitutes a breach making an action to recover as-

signable. Only a few states, however, recognize that the action based upon an executory contract may be in contract.\textsuperscript{30}

A cause of action based on a tort causing "strictly" personal injuries that does not survive, is not capable of being assigned.\textsuperscript{31} In the early case of \textit{Miller v. Newell}\textsuperscript{32} the South Carolina Supreme Court stated:

Torts, in their effects, may be divided into two classes, to wit: those which affect injuriously the estate, real or personal, of a party, and those which cause injuries strictly personal; those which survive . . . and those which die with the party injured. It appears that those which affect the estate may be assigned, but those of a personal character cannot.\textsuperscript{33}

In the recent case of \textit{Doremus v. Atlantic Coast Line Railroad Company}\textsuperscript{34} the supreme court focused upon the precise question of whether a cause of action for tortious personal injuries is assign able in South Carolina. The court recognized that \textit{Miller} held generally that torts of a personal character did not survive. The supreme court, however, interpreted \textit{Miller} to mean that \textit{if} a cause of action for a tort survived, it would be assignable. The court next acknowledge the split of opinion among the federal district court judges with respect to South Carolina law\textsuperscript{35} and affirmed the principle laid down in \textit{Bultman v. Atlantic Coast Line Railroad Company}.\textsuperscript{36} Bultman held that Section 3963 of the South Carolina Code of Laws, 1912 (Section 10-209


\textsuperscript{32} 20 S.C. 124 (1882).

\textsuperscript{33} 33. \textit{Id.} at 139. For the view that the damage is one of property and not personal, \textit{see} Brown v. \textit{Guarantee Ins. Co.}, 155 Cal. App. 2d 679, 319 P.2d 69 (1958).


\textsuperscript{36} 103 S.C. 512, 88 S.E. 279 (1915).
of the 1962 Code) providing for the survival of certain causes of action, had the incidental effect of making such causes of action assignable. The South Carolina court has acknowledged two instances in which a cause of action survives: (1) injuries and trespasses to and upon real estate, and (2) any and all [physical] injuries to the person or to personal property. In contrast, a cause of action for fraud and deceit is generally held not to survive. As a general rule, therefore, survival is the test of assignability of a right of action in tort [ex delicto].

V. ELEMENTS OF DAMAGES INCLUDED IN INSURED'S RECOVERY

Punitive damages have generally been denied in cases involving mere negligence. Here again the negligence and bad faith test may become significant. In Zumwalt v. Utilities Insurance Company the Missouri court was confronted with a factual situation similar to that presented in Grisci. The court held that when the insurer was obligated to subordinate its interests in favor of the insured's, the refusal to settle did not constitute such malicious, willful, intentional or reckless conduct to warrant an award of punitive damages. Punitive damages were held improper in the Texas case of Linkenhoez v. American Fidelity and Casualty Company. The court ruled that negligence in rejecting a compromise offer did not amount to gross negligence necessary to warrant an award of punitive damages. In South Carolina punitive damages are allowed in tort actions when there

Causes of action for and in respect to any and all injuries and trespasses to and upon real estate and any and all injuries to the person or to personal property shall survive both to and against the personal or real representation as the case may be of a deceased person and the legal representative of an insolvent person or a defunct or insolvent corporation, any law or rule to contrary notwithstanding.


41. 360 Mo. 362, 228 S.W.2d 750 (1950).

42. Id. at 374, 228 S.W.2d at 756; see State v. Hughes, 348 Mo. 177, 153 S.W.2d 46 (1941).

43. 152 Tex. 534, 260 S.W.2d 884 (1953).
is proof of willful, reckless or malicious violation of a person's rights.\footnote{44}

In order for a breach of contract to entitle the insured to punitive damages in South Carolina the breach must be with fraudulent intent and accompanied by a fraudulent act. The mere failure or refusal to pay money, for whatever motive, is not a basis for an award of punitive damages unless accompanied by a fraudulent act.\footnote{46} The conduct of the insurer in attempting to settle a claim for a sum substantially less than the amount owing under the policy, however, is evidence from which fraud can be inferred. It is sufficient to require the trial judge to submit the issue of fraud to the jury.\footnote{48}

South Carolina generally agrees with the majority of states that in the absence of physical contact or fear of physical harm there can be no recovery for mental suffering.\footnote{47} There is growing authority, however, to the contrary.\footnote{48} The \textit{Crisci} court recognized that many jurisdictions have allowed damages for mental distress when the tortious conduct constituted an interference with property rights. It found no substantial reason to compel it to distinguish these decisions from the instant case.\footnote{49} In \textit{Dawkins v. National Liberty Life Insurance Company},\footnote{50} another case involving mental suffering, the plaintiff brought an action \textit{ex contractu} to recover for the alleged fraudulent breach of an insurance contract. The court held that mental suffering was not a proper element of damages for the fraudulent breach of a contract unless the breach permitted the injured party to sue in either contract or tort.\footnote{51}

There can generally be no recovery of the expenses of litigation

\footnote{44} Pennsylvania Threshermen & Farmers' Mut. Cas. Ins. Co. v. Thornton, 244 F.2d 823 (4th Cir. 1957). The court stated that negligent conduct may be so gross as to merit characterization as willful and wanton in the sense of the rule for punitive damages; \textit{accord}, Davenport v. Woodside Cotton Mills Co., 225 S.C. 52, 80 S.E.2d 740 (1954).


\footnote{46} Corley v. Coastal States Life Ins. Co., 244 S.C. 1, 135 S.E.2d 316 (1964).


\footnote{51} \textit{Id.} at 802.
VI. Conclusion

The balancing of interests between the insured and his insurance company with relation to the liability of the insurer for wrongful refusal to settle an insurance claim has gradually shifted to favor the insured. An increasing number of courts have required the insurer to exercise a higher duty of care in its consideration of settlements. These courts, moreover, have not required the insured to pay a judgment in excess of the insurance policy limits before he can bring an action against his insurer for the excess. Many courts have also applied survival of a cause of action as the test of assignability of a right of action in tort.

The South Carolina judiciary has been in accord with the general trends in each of these areas. In Orisco, however, a court has introduced a new element to damage recovery—mental suffering. Because the general tort law in South Carolina has never considered mental suffering as the sole basis of recovery, South Carolina will hesitate to follow California in this damage extension. Recognizing this qualification, the South Carolina judiciary indicates that it will continue to weigh considerations in these cases in favor of the insured.

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53. 69 F.2d 616 (8th Cir. 1934).

54. Id. at 620.


TAXATION—THE “OVERNIGHT” RULE—BUSINESS TRIPS MUST INVOLVE SLEEP BEFORE TRAVELING EXPENSES MAY BE DEDUCTED*

In order to appreciate fully United States v. Correll, take these words: “There shall be allowed as a deduction . . . in carrying on any trade or business . . . traveling expenses (including amounts expended for meals and lodging . . .) while away from home . . .” From these, extract “while away from home.” Turn the words over in your mind, play with them, draw upon all reason for an application of these words as a limiting device for allowing a business expense deduction. Now take these words: “[An] . . . employee can deduct expenses for meals and lodging only when . . . his duties require him to obtain necessary sleep away from home.” To say that the latter statement is a reasonable promulgation of a ruling to implement the former statutory language, requires, at best, reading more into the statute than Congress provided; or, at worst, an unashamed emasculation by the Commissioner of a legitimate business deduction. When the United States Supreme Court agreed to hear Correll—the first time the “overnight” rule had been considered by the Court—it was felt that the Court might put the plain meaning back into the statute. On December 11, 1967, however, Justice Stewart, speaking for a majority of five, reversed the lower court’s determination and held that the “overnight” rule was a “reasonable” interpretation of the applicable Code language.

Before examining the case itself, it may be helpful to discuss briefly the history of the “overnight” rule. The original version of the present section 162(a) (2), which allows the deduction of traveling expenses, was enacted in 1921. A prior regulation had imposed the burdensome task of trying to determine the excess expended for meals and lodging over the “expenditures ordinarily required for such purposes when at home.” In supporting


5. Rev. Act of 1921, ch. 136, § 214(a) (1), 42 Stat. 227
6. Regulations 45, Art. 292 (1920 ed.).

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the 1921 enactment the Treasury seemed to imply that allowing the entire amount of the expenditure permitted a more accurate determination of the deduction.

Nineteen years passed before the Commissioner first interpreted “away from home” to mean away from home overnight.\(^7\) The Commissioner allowed a deduction in a ruling involving locomotive engineers and other railroad trainmen assigned to long runs, who, on arrival at away-from-home terminals, were released from their jobs for necessary rest.\(^8\) In 1954 the Commissioner interpreted this ruling in unambiguous language:\(^9\) “The line of demarcation . . . is generally referred to, for Federal income tax purposes, as an ‘overnight’ trip, that is a trip in which the taxpayer’s duties require him to obtain necessary sleep away from his home . . .”\(^10\)

After the federal circuit court case of Williams v. Patterson,\(^11\) the Commissioner slightly expanded this rule. There the taxpayer was a railroad conductor whose train left his home at 6:45 A.M. and arrived in Atlanta at 12:15 P.M. He did not have to report back for the return run until 6:15 P.M., and arrived home near midnight. During the six hour break in the afternoon he ate dinner at a hotel, rented a room and slept for several hours. He then ate supper and reported back to work. Revenue Ruling 54-497\(^12\) stated that the employee could obtain “necessary sleep.” The Commissioner contended that this meant it had to be required by the employer.\(^13\) The Court of Appeals for the Fifth Circuit rejected the Commissioner’s contention and held that due to the unusual hours of the taxpayer’s employment it was reasonable for him to rest during his release from duty, and as a result the deduction was allowed. The commissioner acquiesced in Williams but asserted that he would not consider an employee’s release for the purpose of eating rather than sleeping as constituting an adequate rest period to satisfy the “overnight” rule.\(^14\)

Throughout this period the Commissioner had the task of

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8. Id.
10. Id. at 79.
11. 286 F.2d 333 (5th Cir. 1961).
implementing the Internal Revenue Code.\textsuperscript{15} At the same time the judiciary had the task of applying the Commissioner's rulings in its own interpretations of the pertinent Code sections.

In \textit{Correll} the Court used a rule of statutory construction stating that "[t]reasury regulations and interpretations long continued without substantial change, applying to ... substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law."\textsuperscript{16} The Court cited \textit{Helvering v. Winmill}\textsuperscript{17} and \textit{Fribourg Navigation Company v. Commissioner}\textsuperscript{18} for the reenactment principle. These cases, however, may both be distinguished from \textit{Correll}. The \textit{Winmill} case was concerned with whether brokerage commissions were included in the sale price of securities. Supporting that case were a settled rule of the Treasury, uniform rulings of the Board of Tax Appeals, and no adverse judicial decisions.\textsuperscript{19} \textit{Fribourg} dealt with established law concerning the question of the taking of depreciation in the year of sale of a depreciable asset. The taxpayer cited numerous cases and several rulings supporting his position. The Court noted that "in several instances, the Commissioner did not merely consent to depreciation in the year of sale, but insisted over the taxpayer's objection that it be taken."\textsuperscript{20}

In comparison to these situations, the "overnight" rule was not only unsettled, but the approval by some courts and repudiation by others had created an almost chaotic situation. The Commissioner had adhered to this rule since he first enunciated it.\textsuperscript{21} The courts, however, had been sharply divided. The Sixth\textsuperscript{22} and the Eighth\textsuperscript{23} Circuits had disavowed the rule totally, and

\textsuperscript{15} \textit{Int. Rev. Code} of 1954, § 7805(a).
\textsuperscript{17} 305 U.S. 79, 83 (1938).
\textsuperscript{18} 383 U.S. 272, 283 (1966).
\textsuperscript{19} See Hutton v. Commissioner, 39 F.2d 459, 460 (5th Cir. 1930).
\textsuperscript{21} In recommending additional statutory guides to clarify the law, the Secretary of the Treasury kept the time requirement. "Food and lodging expenses would be deductible by taxpayers who were temporarily away from their duty areas for periods of at least 16 hours, or a shorter time if they could prove that substantial rest was required on such trip." \textit{Hearings Before the Committee on Ways and Means on The Tax Recommendations of the President}, 88th Cong., 1st Sess., pt. 1, at 98 (1961).
\textsuperscript{22} Correll v. United States, 369 F.2d 87 (6th Cir. 1966).
\textsuperscript{23} United States v. Morelan, 356 F.2d 199 (8th Cir. 1966); Hanson v. Commissioner, 298 F.2d 391 (8th Cir. 1962).
the Fifth Circuit had modified it. The First Circuit had been opposed to the rule and only recently accepted it.

The Tax Court's treatment of the rule bordered upon judicial schizophrenia as it ran the gamut from disapproval, to making a decision of each case on its particular facts, to a position of general acceptance. In a 1949 case involving transportation costs only, the Tax Court rejected the Commissioner's reading of the statute and evaluated the phrase "away from home" stating: "There is no connotation that the trip must be an overnight one, nor do we think Congress intends such a connotation." The following year the court refused to allow the deduction of meal expenses for a railway clerk who at supper at the "away town" on a round trip that lasted six hours and fifteen minutes. The deduction was denied because the taxpayer's work day was "shorter than the work day for the ordinary worker."

The Tax Court in 1952 decided the case of David G. Anderson. The court allowed the deduction of the meal expense of Anderson, a railroad employee, who started on a round trip at 2:00 A.M. and returned the same day. As the trip required sixteen hours to complete, the court concluded that the need to obtain rest on completion of the outbound run prior to commencing the return run was sufficient to come within the rule. This was the same interpretation of the rule that the Fifth Circuit subsequently employed in Williams v. Patterson. The Commissioner, however, never recognized the result in the Anderson case; yet he issued a ruling nine years later in which he acquiesced in the Williams case.

In the 1954 case of Frank N. Smith the Tax Court again repudiated the "overnight" rule in dictum. This was followed

24. Williams v. Patterson, 286 F.2d 333 (5th Cir. 1961) (allowing deduction for expenses on trips of such a duration that the employee required rest).
28. Id. at 417.
29. Fred Marion Osteen, 14 T.C. 1261 (1950).
30. Id. at 1262.
31. 18 T.C. 649 (1952).
32. 286 F.2d 333 (5th Cir. 1961).
34. 21 T.C. 991 (1954).
by a general acceptance of the rule. The reasoning used in Allan J. Hanson is an example of the court’s attitude with respect to general acceptance.

This interpretation seems justified for the statute is only dealing with expenses “while away from home.” A lodger is one who, for the time being, is lodged away from home. One who completes a business trip in one day is not “away from home” within the meaning of the statute. He incurs meal expenses on such a day the same as he does on a day he takes no trip. But on both days the meal expenses were personal expenses for they were incurred while he was lodged in his own home.

In the recent case of William A. Bagley, however, the court modified its position with regard to the “overnight” rule. The court asserted that Congress had not voiced approval of an inflexible rule disallowing the deduction of meal expenses on trips which were not overnight. The court stated that the facts of each case should be considered subjectively.

It is submitted that during the period in which the “overnight” rule was developed both the Tax Court and the Commissioner misinterpreted the Code phrase “while away from home.” The logical application of the phrase “away from home” is in a geographical test, not a time consideration. For tax purposes, the word “home” in the phrase was originally given the meaning of “post of duty or place of employment on duties connected with his employment.” This definition, subsequently accepted by the Commissioner, had a plain meaning of geographical location. In deciding Amoroso v. Commissioner, the Court of Appeals for the First Circuit was faced with a case involving a salesman who lived in Milton, Massachusetts, a suburb ten miles from Boston. In disallowing the deduction of the tax-

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36. 35 T.C. 413 (1960), rev’d, 298 F.2d 391 (8th Cir. 1962).
37. Id. at 417.
38. 46 T.C. 176 (1966), rev’d, 374 F.2d 204 (1st Cir. 1967).
40. G.C.M. 23672, 1943 CUM BULL. 66.
41. 193 F.2d 583 (1st Cir. 1952).
payer's meals in Boston while on daily business trips, the court interpreted "away from home" and made no mention of a time consideration. The court looked at the distance of travel and the fact that Milton was considered to be part of the greater Boston metropolitan area in concluding that the taxpayer never left his "home." The court could have dismissed the case easily if it had used the overnight test. It apparently, however, determined that time was not a valid test, and, instead, employed the geographical test.

The meaning can be focused more clearly by substituting the Commissioner's definition of "home" into section 162(a)(2): "There shall be allowed as a deduction ... in carrying on any trade or business ... traveling expenses (including amounts expended for meals and lodging ...) while away from [the business location, post, or station of the taxpayer] ... ."42

It is also inaccurate to assert that Congress limited the travel expense deduction that it granted by reenactment of the statute; because Congress cannot add to or diminish a tax statute by impliedly approving a Treasury interpretation.43 Even if this were accurate, when an erroneous construction has been placed on a statute by the body (Treasury Department) charged with its enforcement, the rule that the reenactment of the statute adopts the body's construction does not apply.44

In deciding the result in Correll the Court, interpreting section 162(a)(2), stated that the Code language, "meals and lodging,"45 could arguably mean that to be allowed a deduction for meals the taxpayer must also incur lodging expenses.46 A grammatical construction of section 62(2)(B) which states that a deduction for travel expenses while away from home for employees "consist[s] of expenses of travel, meals, and lodging . . . ." would lead to the opposite result. Unlike section 162(a)(2), three principal deductions are listed and commas have distinctively separated the terms; and the word "consists" indicates that any of the three expenses may be used separately. It is contended, therefore, that the phrase "away from home," not the presence of the word "and" in the phrase "meals and

43. Commissioner v. Acker, 361 U.S. 83, 93 (1959); Arkansas-Oklahoma Gas Co. v. Commissioner, 201 F.2d 98, 102 (8th Cir. 1953).
lodging," should have been the determining language for the deduction. In the treasury regulations for section 214(a)(1) of the Revenue Act of 1921, moreover, the Commissioner used this language to define traveling expenses: "Traveling expenses, as ordinarily understood, include railroad fares and meals and lodging." 47 Was the Commissioner saying that a taxpayer on making a business trip away from home had to ride a train before he could deduct expenses for meals and lodging? Again, applying the reasoning employed in Correll, the answer to the question would be, incorrectly, yes.

In most of the cases in which a court has decided not to follow the "overnight" rule, examples have been given to demonstrate the potential inequitable effects of the rule. With the broad holding in Correll, however, it will be difficult to determine the scope of its future interpretation. A businessman could fly to Washington from St. Louis at 6:00 A.M., work the entire day, and purchase his dinner and supper. If he left that night after eating he would get no deduction for his meals. Another person could drive over from Baltimore, Maryland on business, purchase dinner and supper, check into a motel for an hour's rest, drive back to Baltimore and be allowed to deduct the entire expense. This does not seem to be a proper application of the statute.

The Supreme Court and the Commissioner should not be allowed to rewrite legislation. If Congress felt that the overnight feature should be included in the traveling expense deduction, it could be included by amending the statute. Although the rule is one of administrative convenience, and provides a simple and certain interpretation, a comment made by the Tax Court in William A. Bagley 48 best summarizes the problem. "[J]ust as most rules of law yield to exceptions, so too must administrative workability yield to logic, reason, and justice." 49

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47. Regulations 45, Art. 292 (1920 ed.). This language also appeared in subsequent regulations. E.g., Regulations 77, Art. 122 (1933).
48. 46 T.C. 176 (1966), rev'd, 374 F.2d 204 (1st Cir. 1967).
49. Id. at 183.