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Book Review

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THE RIGHTS OF MARGIN CUSTOMERS AGAINST WRONGDOING STOCKBROKERS AND SOME OTHER PROBLEMS IN THE MODERN LAW OF PLEDGE. By Edward H. Warren. The Plimpton Press, 1941. Pp. xv, 464. $4.00.

The chief title of this work is ascribed to its main topic, and if *some* had been substituted for *the,* as was done in the subtitle, no one should question it as misleading, because of the failure to discuss the rights of customers of bankrupt brokers[1] and other incidents of the relation of customer and broker. In any event, the title shows that the book is not a treatise or a textbook on Pledges, and guards against surprise occasioned by the omission of material on other topics, such as creation of legal and equitable pledges, loss of or injury to the security, and enforcement of pledges. Furthermore, concentration on the effect of entire or partial assignments of claims secured by a pledge, frequently complicated in margin customer cases by prior or subsequent transfer of the security, can easily be justified on the ground that the bench law on these matters is less statical.

A noteworthy feature of the book, entitling Professor Warren to double praise, is the accomplishment of a twofold purpose: to present keen analyses of decisions followed by incisive comments, and, at the same time, to strike hard at the most abused of all judicial prerogatives, the use of unnecessary language creating confusion as to the purport of the accompanying decision. That he pulls no punches is shown by the fact that Cardozo's opinion in *Wood v. Fisk*[2] is described as an "insidious undermining"

[1] One of the earliest and most important articles on the subject is that of Oppenheimer, *Rights and Obligations of Customers in Stockbrokerage Bankruptcies* (1924) 37 Harv. L. Rev. 860, which may have been prompted by In re Archer, 289 Fed. 267 (D. Md., 1923).

[2] 215 N. Y. 233, 109 N. E. 177 (1915). No criticism is made of the decision, namely, that a claim for conversion of stock, by repledging for a greater amount than the customer's debt, is provable in bankruptcy as a contract claim and that a discharge may be pleaded as a bar to an action based on failure to return the stock when the customer's note matured, upon tender to the broker after sale of the stock by the repledgee, this not being a "willful and malicious injury to the property of another". A contrary result was brought about by a New York statute.

Compare Turner & Thomas v. Schwarz, 140 Md. 465, 117 A. 904 (1922), holding that a claim created by an unauthorized repledge could be considered as a "debt fraudulently contracted," within the meaning of the Maryland attachment statute.

of prior decisions, a "citadel of mischief," with "all the appearance of lucidity but all the reality of confusion"—a "dust-cloud," open to criticism for "seventeen reasons." The words provoking these remarks were few in number and clearly foreign to the issue. And yet, by intimating that the unauthorized repledge may not have been a conversion but a breach of contract and that the return of the pledge will prevent recovery of substantial damages, doubts were raised concerning decisions on important questions in margin transactions, particularly those involving the nature of the customer's claim and the necessity of tender and demand.

An examination of pertinent decisions convinced Professor Warren that customers have almost invariably been held to be owners of the stock purchased, as only Massachusetts is said to hold their relation with brokers is that resulting from an executory contract.[3] But he feels that danger exists even here, for he urges that Cardozo's words may be taken as suggesting a rule limiting margin customers to a remedy for breach of contract, without mentioning New York cases to the contrary.

Prior to *Wood v. Fisk*, Professor Warren declares the New York cases held that a wrongful repledge gave rise to an action for conversion without proof of tender and demand. Imposition of such a requirement, it is said, not only violates "one of the most elementary principles in the law of conversion" but also "is out of joint with the doctrine that any act which separates debt and security is, without more, a conversion of the security," and overlooks the fact that a broker should be treated as a fiduciary, instead of being allowed to hide behind a long dead custom-of-the-street. No contention is made that New York courts will now insist on tender and demand, merely that "the law is muddy, there having been a great deal of mud since *Wood v. Fisk*."[4]

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[3] In Hathcock v. Mackubin, 166 Md. 70, 170 A. 573 (1933), the Court suggested that a margin customer does not have legal title, and this might be taken to indicate an improper approach.

[4] P. 359. For comment on New York decisions, compare (1932) 45 Harv. L. Rev. 1264 (tender and demand unnecessary) and (1932) 41 Yale L. J. 1088 (tender and demand necessary), with HANNA, CASES ON SECURITY (1932) 47: "And though an unlawful repledge is *ipso facto* a conversion, the customer is limited to nominal damages unless he shows a tender and demand coupled with a refusal to deliver. Wood v. Fisk."

The great majority of courts do not require tender or demand in actions for conversion, and this is the view adopted in Baltimore Marine Ins. Co. v. Dalrymple, 25 Md. 269 (1866). Conflict in decisions of federal courts will result from Erie R. Co. v. Tompkins, 304 U. S. 64 (1938).

Measuring damages for conversion of securities by the value at the time of conversion, or within a reasonable time after notice, is now common practice.[5] But Professor Warren, although inclined to allow a choice between "fair market value at the date of the conversion" and "the average market price in the replacement period," concludes that customers have and should be given the benefit of a rebound in price after conversion and before notice. He links denial thereof, in *In re Salmon Weed & Co.*,[6] to Cardozo's suggestion limiting recovery to loss sustained as a result of a repledge, saying this "thought has certainly not been the law of New York for well over half a century." The realization that the check placed on the prior rule, allowing the highest value between conversion and date of trial, was wedged by the doctrine of avoidable consequences makes clear that only the highest replacement value is recoverable. And, actually, this was the result reached by a New York court many years before the *Weed* case, as well as the decision in a fairly recent case, if it be judged by the statement of facts rather than the headnote.[7]

Turning from actions for conversion to actions in which a customer seeks to recover possession of the security, Professor Warren says it is necessary to consider the pith of the modern law of pledge. This is declared to be the fact that some conversions by a pledgee will not result in

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See Adair v. Reorganization Inv. Co., 125 F. (2d) 901 (C. C. A. 8th, 1942). And a hint that a demand is necessary to make a bona fide repledgee a converter (RESTATEMENT, SECURITY (1941) §23, Comment b), seemingly contrary to the black letter text, may bring about new conflicts in the state court decisions.

[5] Until recently Maryland followed the rule applied to conversion of an ordinary chattel and limited recovery to the value at the date of conversion. The prevailing rule, known as the New York rule, was adopted by decision. Fisher v. Dinneen, 161 Md. 605, 158 A. 9 (1931). The Court remarked that the broker acted in good faith, but it did not purport to limit the rule to such cases. Still, it is of interest to note that Pennsylvania found a statute necessary to extend the rule to wilful conversions. Gervis v. Kay, 294 Pa. 518, 144 A. 529 (1928), and Act of April 10, 1929, P. L. 476, 68 P. S. §481.

[6] 53 F. (2d) 335, 340 (C. C. A. 2d, 1931) (opinion on petition for rehearing).

Fisher v. Dinneen, *supra*, n. 5, 161 Md. 605, 614, misstates the rule as "the highest intermediate value of the stock between the time of its conversion and a reasonable time after the owner has notice of it." This tendency needs to be corrected or Professor Warren's yearning may yet be satisfied.

[7] See the book reviewed at pp. 309 and 357 for references to Burnham v. Lawson, 103 N. Y. S. 482 (1907), and German v. Snedeker, 13 N. Y. S. (2d) 237 (1939), aff'd., 281 N. Y. 832, 24 N. E. (2d) 492 (1939). See also Gerdes v. Reynolds, 30 N. Y. S. (2d) 755 (1941).

loss of his security interest. In this category he places conversions by tortious transfers, but conversions by withholding are regarded as working a forfeiture of the security. So to differentiate permits a customer whose securities have been wrongfully withheld to recover them without keeping his tender good, while a fellow customer complaining of tortious repledge would be sent home empty-handed, if he failed to make tender and demand. Any attempt to justify this half-and-half view, on the major-minor tort theory sometimes advanced by the author, appears hopeless, and it would seem better to adopt the Restatement rule, that every conversion works a forfeiture of the security, or to require tender in all actions to recover possession. The latter rule has the merit of avoiding the necessity of a second action by the broker to recover the amount due whenever a counterclaim is deemed improper, as well as the risk of not satisfying a judgment against the customer, and some claim it is supported by a Supreme Court decision.[8]

Criticism will undoubtedly be leveled at Professor Warren for his failure to mention the Restatement of Security at any time, and especially so where the rule adopted is contrary to the view he advocates. Yet on this point many will feel that the score is about even, for nothing in the Restatement, as adopted and promulgated by the Institute, indicates that Professor Glenn, an outstanding law teacher and legal writer, while serving as an Adviser on the Restatement, opposed the application of the forfeiture rule to repledge cases in which the defendant holds the security intact, on the ground that it is not sanctioned by the best authority and ignores the fact that a pledge is a security device. Nor is there any disclosure of the contest in the Council of the American Law Institute, although it was evenly divided and the Chair gave the deciding vote.[9]

Further, those imbued with the idea that the restaters always put the law "as it is," and "not as what it ought to be or as it was,"[10] and others believing that all pledge cases involving conversion are outmoded, should consider the question whether receipt of an unauthorized pledge constitutes conversion. It is so treated in the Restatement of

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[8] Talty v. Freeman's Trust Co., 93 U. S. 321 (1876).
[9] See (1937-1938) 15 Proc. A. L. I. 320.
[10] Id. at 243. Taken from a statement by Director Lewis at an annual meeting.

Torts (§§223, 227), although no effort was made to examine the cases on the point in the Explanatory Notes (Proposed Final Draft No. 1, p. 344, mentions two conflicting decisions without discussing either), and the Restatement of Security adopted this view by comment (§22, Comment b) and black letter text (§23, Subsection 1). Its use in a recent decision,[11] from which two judges dissented, prevented recovery for a conversion, by the receiver of a state bank which made an illegal pledge of bonds to secure deposits, despite the fact that the sale of the bonds by the pledgee occurred within the statutory period. Professor Warren's argument in favor of the contrary view is convincing and the authorities supporting it should not have been overlooked.

That the book will be of value to anyone interested in security law is apparent from the titles of the last six chapters and appendices F and G: Tortious Withholdings, Tortious Transfers of Second-Class Securities, Tortious Transfers of First-Class Securities [in general], The New York Law in Detail, Legislation and Decisions in Jurisdictions Other Than New York, Separation of Debt from Security, Customer's Agreement [embodied in 18 paragraphs] and Securities and Exchange Commission Rules [effective Feb. 17, 1941]. And those concerned with remedies for enforcement of claims to chattels and debts will enjoy the first part of the book, made up of five chapters and an equal number of appendices, totaling 193 pages. In them the author gives a brief survey of Mortgages, Pledges and Liens, discourses on the classification of Debts and Securities, and provides an elaborate treatment of Assignability at Law of Debts before Default and Trover and Conversion. All but one of the first five appendices deal with conversion, and the inclusion of this material is explained by stating that "the law of pledge and the law of conversion are inextricably intertwined" and that "no

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[11] O'Connell v. Chicago Park Dist., 376 Ill. 550, 34 N. E. (2d) 836 (1941). *Contra:* City of Fort Worth v. McCamey, 93 F. (2d) 964 (C. C. A. 5th, 1937), cert. denied, 304 U. S. 571 (1938); Chicago v. Joseph, 95 F. (2d) 444 (C. C. A. 7th, 1938), cert. denied, 304 U. S. 578 (1938).

This question is very important because of the number of pledges securing deposits by states or subdivisions thereof, or by federal agents or agencies. Under 12 U. S. C. §90 (1934) national banks are permitted to make pledges securing deposits only when authorized by state law or by Congress. But federal courts do not follow state law where a pledge is held invalid and its recovery is in issue. Yonkers v. Downey, 309 U. S. 590 (1940) (New York rule, denying recovery by receiver until depositor secured by an unauthorized pledge is paid in full, properly rejected by federal court).

problems . . . [are] more difficult to probe to rock bottom foundations than some of the problems in conversion."

It is believed that the whole of the book will prove interesting and stimulating to students and lawyers, and this recommendation even includes the last appendix, containing old examination questions with answers by the author. Throughout, readers will be inclined to accord the author special commendation on at least three grounds. First, for evaluating one of Cardozo's opinions and issuing a warning against the use of unnecessary and speculative language; second, for enlivening the book with much picturesque language, as witness the reference to a tortious transfer being made by blunderer with a white soul and a gray brain; third, for providing so few examples of hasty work,[12] although devoting only 450 hours to the preparation of the manuscript.

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[12] The most flagrant are as follows:

P. 12. The statement that a chattel mortgagee is not entitled to possession until default is inaccurate unless the mortgage so provides. Clemmitt v. Miehle Printing Press & Mfg. Co., 136 Md. 385, 110 A. 713 (1920).

P. 17. The conjecture that the legal capacity of a pledgee to assign may not be restricted by agreement is unsound, if not limited to cases in which an assignee reasonably relied on written statements in the pledge agreement or on other manifestations by pledgor. RESTATEMENT, SECURITY (1941) §14, Ill. 4, and §29.

Pp. 30, 34 and 128-136. The tirade against the "legal power theory" will win few, if any, converts, and little more can be said for the criticism of cases denying recovery against an innocent agent selling a negotiable instrument for a thief. See Comment by Walter Wheeler Cook (1918) 28 Yale L. J. 175, and a recent case in accord, First National Bank of Blairstown v. Goldberg, 340 Pa. 337, 17 A. (2d) 377 (1941).

Pp. 402-404. In the endeavor to show that possession by defendant is always a requisite of conversion, no account is taken of cases like Kirby v. Porter, 144 Md. 261, 125 A. 41 (1923).

P. 405. The rule that a sheriff is a convertor, although he reasonably believes the goods seized belong to the debtor, is not followed in a number of jurisdictions. Potash Stores, Inc., v. Bay Dev. Corp., 118 N. J. L. 243, 192 A. 379 (1937) (decision); Barry v. McGrade, 14 Minn. 163 (1869) (statute). For a discussion of statutory limitation of responsibility, see Note (1939) 23 Minn. L. Rev. 799.

P. 409. The remark that a father is responsible for the torts of his child can hardly be the law at Harvard.

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