[Missouri Law Review](https://scholarship.law.missouri.edu/mlr)

Volume 15
Issue 3 *June 1950*

Article 6

1950

Book Reviews

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Recommended Citation
Book Reviews, 15 Mo. L. Rev. (1950)
Available at: https://scholarship.law.missouri.edu/mlr/vol15/iss3/6

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Book Reviews

BUSINESS LIFE INSURANCE AND OTHER TOPICS. By Albert Hirst. Bloomington, Illinois: State Farm Life Insurance Company, State Farm Insurance Building, 1949. Pp. xvi, 165, with 40 page Tax Handbook as a pocket supplement.

(The company authorizes the statement that it will be glad to furnish a copy without charge to any lawyer who requests it from the company at its home office at Bloomington.)

I.

Trying to get "something for nothing" is a great American pastime. Business life insurance is frequently sold on the premise that, in some way, not made clear, and usually not even spoken, it offers something for nothing. Unfortunately, business insurance frequently does offer the survivor of a business group a substantial benefit, but at the expense of the estate of the associate who has died.

Many a lawyer has probably sensed that the arrangement which he was asked to put into legal form was not exactly what it was represented to be, and yet was unable to say with assurance where the fallacy lay, and therefore went along with a proposition which his better judgment told him had a hidden flaw. The light thrown on the whole terrain by a study of the book under review may enable the attorney to do a much better job of serving his clients the next time that he is asked to draft the documents for a business insurance arrangement.

Indeed, he may in many instances advise the client not to use the business life insurance form at all and instead to cover the risk with an ordinary life insurance policy. While the latter arrangement does not have the glamour and mystery of business life insurance, as commonly sold, it may be found in some situations to be more straightforward, fair and honest than the former.

The book under review contains a detailed and exceedingly well written treatment of the various forms of business life insurance,[1] and especially insurance for the purpose of furnishing funds to buy out the holdings of a deceased business associate, be he stockholder of a corporation, partner or a sole owner.

Twelve illustrative forms are included in a separate section, each consisting of a complete document with comment paragraphs. There are also chapters on: estate planning in a lawyer's office, employee needs and incentives, an employees' salary allotment plan, the Revenue Act of 1948; and one chapter consists of the National Statement of Principles of Cooperation Between Life Underwriters and Lawyers, which was issued in 1948; but these latter are of minor interest.

The book was produced primarily for life insurance agents of the company.

1. At p. 1 the author defines business insurance as meaning:
   (a) Keyman insurance
   (b) Sole ownership insurance
   (c) Stock purchase insurance
   (d) Partnership insurance

Published by University of Missouri School of Law Scholarship Repository, 1950

It is no doubt for this reason that it omits citations to the decided cases to which it refers and adopts a literary style which is somewhat disconcerting at first, since it takes so little for granted of the reader.

Even so, the book is not in any sense elementary. It is in some respects the best treatment of the subject which has come to hand. If the author does not quite put salt on the bird's tail, he comes much nearer to doing so than the authors of most treatises on business life insurance. The typical article simply ignores all the difficulties. Mr. Hirst does not do that. He mentions most of them, and then blithely goes on.

Mr. Hirst is a practicing attorney of wide experience in insurance matters. He is Consulting Legal Editor of Diamond Life Bulletins and a frequent contributor to legal and insurance publications and has appeared in numerous important cases as counsel for the New York State Association of Life Underwriters and other life underwriters' associations.

While there are forms of business life insurance which are not related to a purchase of the proprietary interest of a decedent, they do not in general present difficult problems. They usually do not require implementation by contractual agreements, and, because they do not ordinarily appear to give something for nothing, they are not as useful in promoting the sale of life insurance as the more complicated forms. Even Keyman insurance, which is conceived of primarily as devoted to the purpose of compensating a business enterprise for loss of a valued officer or employee, is frequently used, instead, as an adjunct to buyout insurance,[2] in derogation of its original purpose. The remainder of this review will be devoted to the various forms of buyout insurance.

As described by the author of the treatise, buyout insurance may take one of three forms: (a) it may be utilized to enable a successor to buy out a sole proprietor, or, (b) it may enable one stockholder to buy out another stockholder in the same corporation, or, (c) it may enable one partner to buy out his co-partner.

Dealing first with the corporate situation, we find that the author describes two principal forms of buyout insurance under the title, "The Direct and Indirect Methods."[3] The method whereby one associate, whom he calls Jones, insures the life of the other associate, whom he calls Randolf, and in which the corporation plays no part whatever is called the direct method by the author. The indirect method, the author states, would provide in essence for Keyman insurance "carried by the corporation on the lives of its two stockholders-directors-officers coupled with the hope—it is not much more than that—that in case of death there will be available to the corporation a surplus sufficient to acquire some of the stockholdings of the decedent."[4] The author states[5] that since a partnership can never carry Keyman insurance on the life of a partner, one cannot use the indirect method in a partnership. The direct method, however, can be used.

2. See p. 26.
3. See p. 24.
4. P. 25.
5. P. 28.

Coming now to indirect insurance as treated by the author, he says that it has disadvantages which make it a "last resort" rather than a recommended plan. This attitude is in pleasant contrast with the typical treatise in this field which regards any method that requires the purchase of life insurance like the mountaineer regarded whisky.

Taking a typical plan exemplifying the indirect method, let us assume that there are two equal stockholders in a corporation which has a net worth of $50,000, and that the corporation purchases Keyman insurance in the amount of $25,000 on the lives of each of the stockholder-owners on the theory that the interest of each in the business is worth $25,000. However, on the death of one, whom we shall call Jones,[6] the corporation's net assets would be increased by $25,000 of insurance collected on his life, so that the assets would then be worth $75,000 instead of $50,000 in the aggregate, and the one-half interest which was intended to be purchased with the proceeds would be worth $37,500.[7] It will be seen that the insurance will then be insufficient. The author generalizes at this point by stating that "no corporation can ever carry a sufficient amount of life insurance to buy all a deceased stockholder's stock unless the stockholder happened to be a very small minority stockholder."[8]

This must, of course, be understood to be a practical impossibility rather than a mathematical one. If the corporation in question, which has a net worth of $50,000, will carry policies having a face amount equal to the full amount of the net worth on each life, the insurance will be sufficient. When Jones dies the total assets of the corporation will be worth $100,000. One-half thereof will be $50,000, which will be the exact amount of the proceeds of the policy on Jones's life. The proceeds would therefore be adequate, but we can still agree with the author that a corporation having a total net worth of $50,000 is not likely to carry an aggregate of $100,000 of life insurance on its two stockholders.

A question might arise also as to whether such a large amount could be justified as Keyman insurance. The author warns[9] that the amount of insurance is to be determined by the value of the insured life to the corporation and not by the value of the stockholdings.

Since the author assumes that the amount of the insurance will not be adequate, he finds other disadvantages in indirect insurance, such as the necessity to create a corporate setup whereby the estate of the deceased partner will continue, at least for a time, to be financially interested in the company, and others which are set out in the footnote.[10]

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6. For simplicity, we shall call the first to die Jones, in each example, and the survivor, Randolf.
7. At page 26, the author is quite emphatic that it would be unfair to ignore this increment, as is so frequently done.
8. P. 26.
9. P. 27.
10. See p. 25. These disadvantages are:
(a) *Lack of certainty,* in that a corporation cannot presently bind itself to buy

Despite the disadvantages listed by the author, none of which appears to go to the meat of the situation, he thinks well enough of the indirect method to include several "Illustrative Forms"[11] exemplifying it. These are quite complete and are apparently intended to be used with his blessing as models where the direct method, for some reason, cannot be adopted.

The author fails to mention a disadvantage of the indirect method which might be deemed to disqualify it for some stockholders. This is the fact that the purchase by a corporation of its own shares may be deemed by the Commissioner of Internal Revenue to be an indication that it has excess funds which it does not need in its business and therefore is no longer justified in retaining any earnings in the business. As a result there is danger that such retention will subject the corporation to the tax on improper accumulation of surplus imposed by Section 102 of the Internal Revenue Code.[12]

On the other hand, the direct method is quite satisfactory to the author. Under this method, for example, the two associates, called Jones and Randolf under our terminology, would each insure the life of the other for $25,000.00. Upon the death of Jones, Randolf will receive the proceeds of his policy insuring the life of Jones and use the money to buy the stock of Jones from the latter's executor for the sum of $25,000.00. To make sure that this will be done, it is suggested that a trustee can hold the two certificates of stock and the two policies.[13]

Of course, the estate of Jones will then own a policy on the life of Randolf which will no longer be needed or, in fact, usable, since it is not likely that the heirs of Jones would care to deplete their assets by continuing to pay the premiums until Randolf dies. This might be years hence, and, at all events, the arrangement would be a gamble rather than insurance, since the heirs would no longer have any interest in Randolf's life nor any particular need for funds at his death as distinguished from any other time. Therefore, the plans provide that the survivor is to

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its own stock upon the death of the first to die of its two stockholders, since it is not known whether there will then be a surplus.

(b) *Creditors' rights* which might intervene and prevent utilization of the insurance proceeds to buy and retire stock.

(c) *Settlement options* cannot be used where the beneficiary is a corporation, both because insurance companies refuse ot allow it and because monthly payments, for example, would disclose that the insurance was not for a corporate purpose.

(d) *Stakeholders* cannot be used because it would be an abuse of authority for the corporation to deposit its assets with a stakeholder or trustee as the plan would require.

(e) *Excess payments* over the amount of the life insurance could not be made by a corporation by issuing its note.

11. *E.g.* Illustrative Forms 6 and 7.

12. See O. D. 360, C. B. June 1920, p. 25, 1943 Prentice-Hall Federal Tax Service, para. 4736; Sol. Op. 144 C. B. Dec. 1922, p. 4, W. H. Gunlocke Chair Co. v. Comm., 145 F. (2) 791.

13. P. 21. Various refinements are also suggested, such as adjustment for increased value of the stock, purchase of excess shares out of surplus, safeguards which should be taken when the shareholdings are unequal, and others.

acquire the policy on his own life, either at the surrender value or without charge if it has no surrender value.[14]

The book also has a treatment of life insurance for the purpose of furnishing funds to a successor, such as an employee, to enable him to buy out the interest of the employer who is a sole owner. This is classified as, "Sole Ownership Insurance." In this situation, it is known in advance that the estate of the insured will sell, if the plan is carried out. Generally the successor is a younger man, whom we shall call Randolf, and it is assumed that he will survive the employer, whom we shall call Jones.

Under a typical arrangement,[15] the business is to be sold by the estate of Jones for a price which may be fixed by agreement, or, more usually, by a formula. Randolf, being younger and presumably not a wealthy man, must be put in funds at the death of Jones so that he can buy out the Jones interest. Possibly the insurance will not cover the full agreed price, in which case some provision must be made for securing the payment of the balance. There are numerous complications which will be passed by here.

The plan usually recommended, as set out by Mr. Hirst,[16] contemplates that Jones's life will be insured by Randolf. Since it is recognized that it is unlikely that Randolf will have sufficient income to pay the premiums, it is noted that it will be necessary for Jones to increase his successor's salary so that he can pay the premiums. It is observed that this will be taxable income to Randolf and a deductible expense for Jones.

The rest of the plan conforms closely to the others mentioned above. On the death of Jones, Randolf collects the insurance and uses the money to buy the business at the agreed price. Of course, if the business is incorporated, then it will be the stock which is purchased from the estate of Jones. Possibly the reader will have detected in the foregoing recital that Jones seems to be indirectly furnishing the consideration for which his estate will later "sell" the business.[17]

II.

The author fails to point out a basic flaw in the direct method which is that at the inception of such a plan it in effect operates *to donate the stock of the decedent to the survivor without cost* and that it never operates to pay the decedent's estate the full ostensible price for the decedent's stock.

This comes about as follows:

When Jones enters the arrangement, he is the owner of stock in a corporation which has some value. Randolf is willing to agree to buy it for $25,000.00 if Jones dies. This may be more than it is worth, but it is some indication of value. Jones is able to pay the premiums on $25,000.00 of life insurance. Let us see what would

14. See Illustrative Form No. 5, para. (5) at P. 83.
15. P. 11.
16. P. 12.
17. See detailed treatment below.

happen if Jones follows the traditional procedure and insures his own life, using the available funds to pay the premiums.

If Jones dies soon after the arrangement is entered into, say within one year, his beneficiaries will collect $25,000.00, which they will retain. In addition, Jones's executor will still own the stock, which may be worth considerably less than $25,000.00, but still a neat sum. The executor can sell the stock at the best price obtainable from Randolf or anyone else or retain it. If he sells it to Randolf at a bargain price of, say, $12,500.00, the total assets of Jones's estate arising from the items under consideration will still be $37,500.00.

On the other hand, let us say that the parties enter into a recommended plan such as is exemplified by Illustrative Form No. 5.[18] Under this plan, Jones insures the life of Randolf, and Randolf insures the life of Jones. Assume that Jones dies within a year. Randolf collects $25,000.00 and uses it, as the agreement provides, to buy the stock from Jones's executor for $25,000.00.

Then Jones's executor assigns the policy of insurance on Randolf's life to Randolf. Since the surrender value is zero in the case supposed, the policy is transferred without charge. If the plan had been in effect for several years so that the policy possessed a surrender value, then the estate of Jones would have received from Randolf possibly several thousand dollars. But it will take years in most cases for the surrender value of the policy held by Jones on Randolf's life to equal what could be obtained on sale of one-half of the stock of a corporation, having a theoretical book value of $25,000.00.

At first, since the surrender value is zero, all that Jones's estate or beneficiaries will receive is $25,000.00. Comparing the two cases, if the insurance had been written in the ordinary way, the family of Jones would have $25,000.00 *plus the stock,* while in the second case (the so-called direct method), the family of Jones have $25,000.00 *and nothing else.*

It follows that the so-called direct method, in actual effect, causes Jones's family to part with his stock, not for the very satisfactory price of $25,000.00 as it is supposed to do, but instead for whatever happens to be the surrender value of the policy on Randolf's life when the death of Jones occurs. Since the surrender value is zero at first, the effect of the plan at its inception is to cause the *donation* of Jones's stock to Randolf, if Jones dies then.

The only consolation to Jones's family is that if Jones had been the one to survive instead of Randolf, then Jones would have received a donation of the stock, and it would have been Randolf's family who were shortchanged.

Of course, as time goes on, the surrender value comes into existence and gradually increases. At some time near the end of the life span of the two associates, the amount of the surrender value may overtake the actual value of the stock, which may well be less than the $25,000.00 book value.

It may be asked how such a plan can be sold, for sold it is, in a big way, every year. There may be several reasons. One may be the psychological trait of every

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18. P. 81.

man to contemplate his continued existence rather than his death. In considering the matter, Randolf is likely to tacitly assume that he will be the survivor. He assumes that he will collect the insurance, use it to buy out the Jones stock, get an assignment of the policy on his own life either free or for the surrender value and calls the arrangement good. Jones does likewise. He visualizes *himself* as the survivor, and, since the arrangement favors the survivor in the early years, he finds no fault with the plan.

Another reason may be that the price at which the stock of the first to die is agreed to be sold is more than it is worth. Therefore, even if Jones pictures himself as the decedent, he is satisfied because the plan gives his estate, he believes, a purchaser for the stock at $25,000.00 when he feels that the most that could be obtainable elsewhere would be considerably less. This still does not justify the arrangement because the stock is worth more than zero at all events, and there is no reason to believe that the true value of the stock at any given time will approximate the amount of the surrender value after the policy has been in effect long enough to have a surrender value.

Does the fact that it is not known in advance which will die first make the arrangement a fair one? This reviewer believes not.[19] While the betting odds may be equal, the result will not be. The purpose of life insurance is to compensate for the uncertainties of life, not increase them. If there is to be any bias introduced into an arrangement, it should favor the family of the decedent, who presumably will be more in need of help when the breadwinner has died. Yet the proposed arrangement robs the widow in order to reward the survivor. A more heartless arrangement could hardly be imagined. As was well put by a trust officer in an article years ago:[20] "When the widow asks what has become of her husband's stock what are you going to tell her?"

The merit of the plan is supposed to be that the insurance is a source of funds. This merit exists in the early stages—while, it will be remembered, the plan is but a mask for a free gift from the decedent's estate to his survivor. By the time the plan outgrows this fault, it has acquired another one. It is no longer a source of

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19. It is recognized, of course, that another answer is possible, namely that Randolf is *entitled* to $25,000.00 because it was he that owned the policy on the life of Jones. This is supposed to folow from the fact that the premiums on the policy on Jones's life were paid by Randolf. In like manner, it may be urged that the estate of Jones should not complain of a loss suffered by discontinuance of the policy on the life of Randolf. This is supposed to follow from the fact that a loss normally follows discontinuance of a policy. This argument does not meet the issue. Neither Jones nor Randolf would take out insurance on the life of the other unless it were in connection with a contract giving the opportunity to acquire the stock to the survivor and an opportunity to sell the stock to the estate of the decedent. These are the motivating factors. The plan, among other things, calls for *two* life insurance policies. The fact that of record Jones pays the premiums on the policy on the life of Randolf and vice versa does not make any real difference. Each could just as well pay the premiums on his own policy, assuming that their ages were the same.

20. The quotation is from an article by the late F. W. Vierling of Mississippi Valley Trust Co. published in "Trust Companies," now "Trusts and Estates."

funds. The survivor has cashed in a policy on his associate and used it to buy the associate's stock at a high figure. He could have been paying on life insurance on his own life and have it well along to maturity. Instead of that he will be totally without insurance on his own life, so far as this plan is concerned, unless he *buys* the policy at the surrender value from the estate of the decedent.

Two consequences are seen here. The decedent's estate has a loss by selling out for the surrender value, which will be considerably less than the premiums plus compound interest on them. The survivor, on the other hand, if it is near the end of the game is about as hard to put to find funds to pay, to the executor of the decedent's estate, the amount of the surrender value, as he would have been to buy the stock. He is exactly as badly off as he would be if he had agreed to pay the amount of the surrender value as the price of the stock and had retained the policy on his own life for his own family's protection.

The stock which we have thought so ill of that a great effort must be made to sell it is still owned by the survivor, only he owns twice as much, namely, his original one-half plus the one-half which he has bought by mortgaging the homestead and shaking the piggie bank to pay the surrender value. He may end up with what the stock can be sold for plus a $25,000.00 insurance policy on his own life, which he has in effect paid for. by premiums on his associate's policy and upon which he must now continue to pay premiums. His own death may occur the following year, but there is no provision whatever to bail out his widow.

What it amounts to is this. When an insured dies you can collect the face amount of the policy and that is ready cash. A dead asset like stock in a closely held corporation remains a dead asset, even though held by Randolf and ultimately by Randolf's widow instead of Jones's widow.

It will be recalled that the plan for sole ownership buyout insurance contemplated that the employee, Randolf, would insure the life of the employer, Jones, and utilize the proceeds of the policy upon the death of Jones to acquire the business. By hypothesis, Randolf is a younger and less wealthy man. One plan outlined requires Randolf to pay the premiums on a policy large enough to buy out the business. Modifications of plan might reduce the amount of the insurance, but in such event Randolf would be required to pledge all of the stock, if the business is incorporated or otherwise secure the estate of Jones, if the business is not incorporated, for the unpaid portion of the purchase price.

Two disadvantages of this modification are apparent. First, it requires Randolf to buy the business "on a margin," and he runs some risk of being wiped out if he cannot meet the payments as they fall due. If he signs the notes personally, which would doubtless be required, his entire personal fortune, such as it is, might be wiped out also. Since the price in these deals is generally an inflated one, it behooves the attorney to think twice before he advises Randolf to enter into this arrangement.

Another disadvantage of the modification is that if the business does prosper and Randolf is able to pay the balance out of earnings of the business, the funds

are being furnished, in effect, by the estate of Jones, provided that it could have continued as owner of the business.

Reverting to the plan without modification, that is, that the insurance will be sufficient to pay the entire purchase price, it would seem that Jones is really donating the business to Randolf rather than selling it to him. He increases Randolf's salary by an amount sufficient to pay the premiums, after personal income taxes on the increase are first deducted. In a time of high income taxes or if the amounts are large, so that Randolf is in, say, the 50 per cent bracket, this would mean that the increase in salary might have to approximate double the amount of the annual premiums. This would be actually a burden on Jones or on Jones's company rather than on Randolf.

No one seems to question sufficiently the propriety of the increase of salary or the deductibility of the entire salary for purposes of Federal income tax, either by Jones if unincorporated, or by Jones's company, if incorporated. But this would be a real problem. The increase in salary might well be disallowed by the Treasury Department, since it would seem to be for the benefit of the seller rather than as compensation for services. If Randolf was worth the money, why was he not receiving it previously, might well be asked.

But even if the arrangement is approved from a tax standpoint, does it not seem to be merely an indirect way of making a gift to Randolf of the amount of the increase in his salary?

The price at which the business is to be sold may be considerably in excess of the true value of the interest sold. This may incline Jones to favor the arrangement, but against this must be weighed the fact that an amount equal to the entire fund for the purchase of the interest seems to be furnished by Jones by reason of an increase in salary which would not have otherwise been paid. Even the tax saving is only apparent and not real except to the extent that the income tax on the increase of salary in the hands of Randolf is less than the tax reduction to Jones or Jones's company by reason of the additional payment.

Conclusion

Business life insurance, intended to facilitate the purchase of the interest of a deceased business associate by the surviving associate, has frequently been bought without adequate realization of its true characteristics. Only too often the estate of the first to die is penalized in order to benefit the surviving associate. On the other hand, the contract may require the purchase by the survivor of assets at admittedly more than their market value and, frequently, more than their true value.

The interaction of these two tendencies may have any number of results and the net balance of advantage may shift from time to time.

In some situations, it would be very much better if the participants would realize that stock in a close corporation after the death of one of the men responsible for its success is not of as great value as it was before the death. Therefore, this loss should be guarded against by the participant carrying life insurance

on his own life for the benefit of his own family. That is the very purpose of life insurance.

This will eliminate the supposed necessity of selling the decedent's interest in the business at a fancy, and frequently unrealistic, price and incidentally the unwitting payment by the decedent himself of all or part of this inflated price. It should not result in the sale of less life insurance and it should result in elevating the whole arrangement to a higher plane.

Where buyout insurance is used, the agreement should recognize the realities of the situation and be so set up as to treat both parties fairly, both at the beginning and at the end of the period. Mr. Hirst's book could be an invaluable aid to this end if understandingly and intelligently used. It is to be hoped that those interested will take advantage of the company's generous and public-spirited offer to supply it to them.

RALPH R. NEUHOFF*

COMPANY ANNUAL REPORTS TO STOCKHOLDERS, EMPLOYEES, AND THE PUBLIC. By Thomas H. Sanders. Boston: Division of Research, Graduate School of Business Administration, Harvard University, 1949. Pp. xiii, 338. $3.75.

Many of us are prone to brag about the superiority of our private enterprise system. Lawyers are especially inclined to consider themselves the principal defenders of "our way of doing things." How well do we really understand the workings of our economic system? An increasing number of businessmen are deeply concerned about the fact that so few of us really understand the nature and operation of business and industry. We expect great accomplishments, but we suspect the achievers of those accomplishments. David Sarnoff, Chairman of Radio Corporation of America, recently stated: "It is . . . worthy of note that in the many investigations which take place in our country, it is almost always true that a successful company and a successful enterprise is the subject of suspicion and investigation. I wish they would start investigating the failures instead of the successes. There might be some very interesting economic information developed as a result."[1] The plain truth of the matter is that there is an alarming amount of ignorance about business and industry. This ignorance must be reduced. No economy can continue to succeed in a permanent climate of misunderstanding and indifference to fact. How can the situation be improved? A significant number of corporations have become convinced that business itself must assume the responsibility for giving the public the facts relating to the operation of business. Traditionally, corporations have made annual reports to stockholders; such reports have presented basic financial data, but the method of presentation has often been drab and uninteresting. Recently, some corporations have made drastic changes in their annual reports. The reports have been glamorized with pictures and charts,

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1. New York Times, May 28, 1950.

and with well-written texts describing various aspects of the company's operations. The circulation of some of the reports has been broadened by some companies to include employees and the public generally. This trend in popularization has been motivated primarily by a desire to give data relative to the company in such a manner as to encourage the reading of the report and to give the reader the sort of information he wants to know or ought to know about the company.

Professor Sanders directs his attention to the nature of this trend. He endeavors to discover the objectives, forms, contents and results of reports made by corporations to stockholders and others. Most of his basic data was obtained from answers to a series of seven letters of inquiry he sent out to selected corporation executives and investment analysts. The potentialities of such a study are intriguing. It should have produced a wealth of informative and useful data. The finished study is, however, disappointing.

The fundamental weakness of the study arises out of the nature of the inquiries made by Professor Sanders. The inquiries were not specific enough to elicit detailed information. For the most part the inquiries offered recipients an opportunity to indulge in generalizations too broad to be of real value. Thus, one of the letters sent to investment analysts inquired about the "newer forms of financial statements" such as those included in the annual reports of U. S. Steel Corporation. The letters asked two specific questions: "Are these newer forms more useful or less useful for your purposes than the older forms?" and "Do you agree with the view that the new forms give a clearer general picture of the business?" This letter was sent to fifty analysts, fourteen of whom replied.

Letter No. 2 to company executives merely asked: "Would you kindly list by descriptive titles the various communications which are sent to your stockholders throughout the year? If you would care to comment on your experience with any of these, I should appreciate it." This letter was sent to one hundred and eleven executives and eighty-three of them replied.

Some of the other letters were more specific. Letter No. 1 to corporation executives asked:

"Do you regard any particular phases of the annual report a problem? Do you have in mind any special steps with respect to them? Have you in recent years made any specific effort to get an impression from stockholders of their own wishes or opinions about the annual report? If so, I would much appreciate your informing me of the steps you have taken. I would be especially grateful if you would send me the summary report of the results of the questionnaire or other communication to stockholders, and a statement of any results which may have followed in the way of changes in your annual report, or otherwise."

Letter No. 3 to company executives asked:

"Will you please list by descriptive titles the various communications which your company distributes to your employees throughout the year? Will you indicate which of these communications discuss the financial operations and position of the company, either at the end of the accounting year or at other times during the year?

"Could you send me sample copies of such materials? If you would care to comment on your experience with any of these, I should appreciate it."

Letter No. 4 to company executives asked what steps had been taken to explain company financial data to foremen and to enlist their assistance in developing understanding of this data among employees in general. (Out of the 63 replies received, 34 had taken no direct steps to so inform foremen.)

Letters Nos. 1 and 2 to investment analysts were somewhat more specific and inquired primarily as to the evaluation of company annual reports as compared with other sources of information concerning such companies and as to what the analysts would like to see in annual reports.

In discussing each of the seven letters of inquiry, Professor Sanders sets out excerpts from the various replies. A few of these excerpts do present some interesting considerations. It is believed that a more probing inquiry would have elicited much more valuable data. Moreover, the viewpoints that were obtained could have been more succinctly summarized. As a whole, the book suffers from too much padding. There is a chapter entitled: "Labor Unions and the Annual Report" which is nothing more than a sketchy treatment of pamphlets issued by the United Steel Workers of America, C. I. O., the U. A. W.-CIO and the Textile Workers Union, C. I. O. A good deal of information is available on union attitudes and interpretation of company financial reports. The author would have done well to omit the chapter rather than consider the subject in such an inadequate manner.

Scattered throughout the book are many sound conclusions and provocative viewpoints. They could be better organized. Indeed, Professor Sanders' article, "The Annual Report: Portrait of a Business"[2] does a much better job of presenting most of the basic conclusions resulting from this study than does this book. Were it not for one chapter, this reviewer would recommend that most people interested in this field read the article and not spend time on the book. That chapter is the one on company questionnaires, and it is a distinct, original contribution. It sets out the questionnaires sent to stockholders, together with a statistical breakdown of replies, by Allegheny Ludlum Steel Corporation, Consolidated Edison Company of New York, Inc., General Foods Corporation, General Motors Corporation, Union Bag & Paper Corporation, Westinghouse Electric Corporation and West Virginia Pulp and Paper Company. This technique of establishing a two-way communication between management and the stockholders is one that might well be considered by other companies. The questionnaires themselves are enlightening. In three of the cases, the questionnaires were sent to all stockholders and in the other cases from 4½% to 14% of the stockholders were sent questionnaires. Professor Sanders does a very able job in analyzing the potential benefits and dangers of using such a technique. Incidentally, three of the questionnaires were initiated in connection with Professor Sanders' study and he is to be congratulated for stimulating such experimentation.

2. Sanders, *The Annual Report: Portrait of a Business*, 27 HARV. BUS. REV. 1 (1949).

The author is certainly right when he concludes that questions relating to annual reports cannot be solved by routinized treatments and that: "The first question is one of attitudes. Do the company officers really want to inform the reader, to make things clear to him, to interest him, to carry part of the educational load of creating more understanding and a general financial and business literacy? If they do, then the second question concerns their ability to accomplish these things. . . . What is required is the continued interest and attention of the management, persistent novelty and experimentation, and the timely introduction of topics of current moment in this history of the company. There is call for as much imagination and leadership in telling the story of the company's year as in the planning and performance of its activities. The narrative report and the financial statements should alike be regarded as opportunities of the management to disclose the dynamics of the business—what is making it live, function and succeed." Professor Sanders properly takes the position that it is the duty of business, in fact, one of its first social obligations, to explain the contributions which its successes have made to the general welfare. Concurrently, he points out this explanation must be expressed in terms of sincerity and truth. This will at times be "difficult and painful" because there will be some incidents of "unsuccess or failure, which must be told with equal clarity and candor."

It is regrettable that the book is not more effectively and compactly organized and that Professor Sanders did not fully utilize the potentialities of the inquiries to corporate executives and investment analysts. Professor Sanders' own personal philosophy about annual reports is certainly sound.

JOHN R. STOCKHAM*

THE GROWTH OF AMERICAN LAW: THE LAW MAKERS. By James Willard Hurst. Boston: Little, Brown and Company, 1950. Pp. xiv, 502. $5.50.

The author, a graduate of Harvard Law School who served as law clerk to Mr. Justice Brandeis and has been a member of the University of Wisconsin Law Faculty since 1937, has made a pioneering attempt to evaluate in broad terms the contributions to the development of American law made by its five chief formative agencies, the legislatures, the courts, the constitution-making process, the bar and the executive. He describes how colonial distrust of royal governors and judges and confidence in locally elected legislatures led to a post-revolutionary period of legislatures with broad powers and primary responsibility for the formulation of policy. By the 1870's, lack of continuity due to short terms and sessions and heavy membership turnover, failure to perfect efficient organizational techniques for investigation of facts and dispatch of business, local-mindedness abetted by the single-member district electoral system and undue susceptibility to such pressure groups as the railroad interests had caused a loss of public confidence in the legislatures and forfeiture of much of their preeminence in the field of policy development to the courts and the bar. These, in turn, because of too great concentration on law as de-

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termined by the appellate process to the neglect of factual investigation, a tendency to restrict attention to particular cases to the exclusion of broad considerations of policy, lack of coordination of the work of individual judges, failure to develop efficient methods for handling specialized types of controversies in heavy volume, and a conservatism which lags behind public need and popular sentiment, are losing ground rapidly to the executive, both in policy formation and in adjudication of particular cases.

To lawyers—judges, practitioners and law teachers alike—Professor Hurst's critical evaluation of the American bar will be especially thought-stimulating. He suggests that, notwithstanding notable contributions by individual lawyers holding public office, the twentieth-century American bar collectively has failed to assume the position of leadership in the formulation of public policy of which it is capable and which the English bar holds. This he attributes in considerable measure to the bar's pre-occupation with the the problems of its paying clients, largely corporations and members of the thirteen per cent of the country's families in higher income brackets. These problems, chiefly concerned with production and distribution of goods, rarely with their consumption, embrace only a small part of the social needs of the community. American lawyers tend either to identify the interest of their clients with that of society, to divorce their social thinking from their practice, or to do no thinking at all on social questions. Some readers will think that the author is not wholly just in his characterization of the typical American lawyer as unreasonably ultra-conservative but his warning, which is not new, that too-close identification of one's self with the economic interests of clients makes independent objective thought difficult, must be accepted.

This is a pioneer study. It does not pretend to be complete or authoritative as to many of the problems which it touches. No study of such broad scope can be until numerous detailed studies of particular phases of the field are made. What Professor Hurst has done is to sketch in the broad outlines of our legal history and suggest areas in which there is a need for detailed factual investigation and careful evaluation. In doing so he has made an important contribution toward the development of an all-too-neglected field. The lucid style will make the book attractive to the average lawyer and the extensive bibliography will make it useful to the scholar.

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