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Arbitration (Axelrod & Co. v. Kordich, Victor & Neufeld; Coenen v. Pressprich)

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upon oral statements made during the hearing. . . . Rather, the court relied upon all the evidence which had been accumulating from the time the . . . [action was] initially commenced."¹¹⁶ SIPC, in fact, had conceded at the district court proceeding that the court should make its own finding about the ability of Hughes, Inc. to meet its obligations to customers within the meaning of the 1970 Act.¹¹⁷ On the facts of the case, the Second Circuit found that the district court had recognized its responsibility under the 1970 Act, and that its responsibility had been fulfilled upon sufficient evidence.¹¹⁸

The importance of the decision rendered by the Second Circuit in this case stems not from the complexity of the issues involved, but rather from the fact that it is a case of first impression.¹¹⁹ In *SEC v. Alan F. Hughes, Inc.* the court made the initial adjudication of constitutional considerations under the 1970 Act.¹²⁰

ARBITRATION

Axelrod & Co. v. Kordich, Victor & Neufeld
Coenen v. Pressprich

An apparent conflict between stock exchange rules and provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 was resolved when the Second Circuit, in separate cases, held 1) that a non-member may use the rules of an exchange to compel a member firm to arbitrate a dispute and 2) that a member firm may likewise compel an allied member to arbitrate.

In the first case, *Axelrod & Co. v. Kordich, Victor & Neufeld*,¹²¹ the non-member defendant, alleging breach of a common stock purchase contract,¹²² had commenced arbitration proceedings before the

question to be resolved. If a case places "adjudicative facts" in dispute, a trial seems best suited. 1 DAVIS, ADMINISTRATIVE LAW TREATISE § 702, at 413 (1958).

The complex fact questions raised in a determination as to the financial stability of a SIPC member are of an adjudicative nature and, therefore, worthy of a due process hearing. No such hearing was guaranteed upon the initial determination and, as the Second Circuit concluded, a cursory review of the initial findings would not remedy the due process issue. See generally 461 F.2d at 979 n.8.

¹¹⁶ 461 F.2d at 981.

¹¹⁷ *Id.*

¹¹⁸ *Id.* at 982.

¹¹⁹ *Id.* at 976.

¹²⁰ Prior to the instant case the only other aspect of the 1970 Act which had been adjudicated was the question of retroactivity. It was held in *Loff v. Casey*, 330 F. Supp. 356 (D. Colo. 1971) (mem.), *aff'd*, CCH FED. SEC. L. REP. ¶ 93,589 (10th Cir.), that the 1970 Act affords protection only to the customers of those firms which were actually in business on or after the effective date of the legislation. In the *Loff* case the firm seeking 1970 Act status had been adjudicated a bankrupt prior to December 30, 1970. *Id.* at 357.

¹²¹ 451 F.2d 838 (2d Cir. 1971).

¹²² *Axelrod* had contracted to purchase five thousand shares of On Site Energy Sys-

New York Stock Exchange (NYSE) against Axelrod & Co., a member firm. Axelrod responded by suing for rescission of the contract in the United States District Court for the Southern District of New York. Axelrod claimed fraudulent misrepresentation in violation of both the Securities Act of 1933¹²³ and the Securities Exchange Act of 1934.¹²⁴ A temporary restraining order staying the arbitration proceedings was issued by the district court on the plaintiff's motion. Subsequently, defendant's cross motion, made pursuant to section 3 of the United States Arbitration Act¹²⁵ for a stay of the action pending completion of arbitration was granted and the injunction dissolved. The court held that the non-member firm had standing to require arbitration of its dispute with the NYSE member firm under the Stock Exchange rules.¹²⁶ The Second Circuit affirmed.¹²⁷

Consistent with the policy of self-regulation effected by the Securities Exchange Act of 1934,¹²⁸ the NYSE requires arbitration of a dispute

tems Corp. for \$54,750. Tender of the shares was refused and the defendant sold the shares to another party for a consideration of substantially less value than that specified in its original contract with Axelrod. *Id.* at 839-40.

¹²³ 15 U.S.C. § 77a *et seq.* (1970).

¹²⁴ 15 U.S.C. § 78a *et seq.* (1970).

¹²⁵ 9 U.S.C. § 3 (1970) provides:

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

¹²⁶ 320 F. Supp. 193 (S.D.N.Y. 1970).

¹²⁷ 451 F.2d at 843.

¹²⁸ Congress's enactment of the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (1970) provided for the self government of Stock Exchanges. 451 F.2d at 840 and cases cited therein.

The courts have been inclined to rule in favor of arbitration in matters involving securities dealers when such holdings would not compromise the protection afforded customers by the anti-waiver provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. *See generally In re Revenue Properties Litigation Cases*, 451 F.2d 310 (1st Cir. 1971) (defendant broker was required to arbitrate at instance of third party defendant); *Daniel v. Board of Trade of City of Chicago*, 164 F.2d 815 (7th Cir. 1947) (commodities board chosen to represent buyer and seller was arbitrator, not mere stakeholder and its actions precluded suit absent a showing of bad faith); *Isaacson v. Hayden, Stone Inc.*, 319 F. Supp. 929 (S.D.N.Y. 1970) (plaintiff, a former allied member, was required to arbitrate his dispute with member firm notwithstanding that plaintiff had relinquished his allied member status after the dispute arose and prior to commencement of his action); *Brown v. Gilligan, Will & Co.*, 287 F. Supp. 766 (S.D.N.Y. 1968) (buyer of unregistered stock, uninformed that it was sold by controlling stockholder, was required to arbitrate dispute with defendant broker); *Robinson v. Bache & Co.*, 227 F. Supp. 456 (S.D.N.Y. 1964) (plaintiff securities buyer who brought diversity action against defendant broker without alleging violations of the Securities Act of 1933 or Securities Exchange Act of 1934 was nevertheless required to arbitrate); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Griesenbeck*, 28 App. Div. 2d 99, 281 N.Y.S.2d 580 (1st Dep't 1967) (action

between a member firm and a non-member at the instance of the non-member.¹²⁹ Therefore, Axelrod was clearly bound by article VIII, section 1 of the New York Stock Exchange Constitution to arbitrate its dispute.¹³⁰

Axelrod insisted, however, that compulsory arbitration of the complaint alleging violation of the Securities Act of 1933 and the Securities Exchange Act of 1934 was barred by sections 14¹³¹ and 29(a)¹³² of the respective Acts which nullify any waiver of legal rights granted by the Acts. The language of section 29(a) of the 1934 Act is almost identical to that of section 14 of the 1933 Act. The latter provision was interpreted by the United States Supreme Court in *Wilko v. Swan*¹³³ which held an agreement to arbitrate any future controversy between a plaintiff customer and a defendant brokerage house void notwithstanding section 3 of the Arbitration Act.¹³⁴

The Second Circuit distinguished *Axelrod* from *Wilko* on two separate grounds, *i.e.*, differences both in the status of the respective parties and in the policy considerations applicable to the two cases.

Section 28(b) of the 1934 Act¹³⁵ removes from the scope of stipula-

arising from short sale on London Exchange to cover drop in price of copper futures on New York Commodity Exchange had sufficient nexus with COMEX to require arbitration under COMEX bylaws); *E.F. Hutton & Co. v. Bokelmann*, 56 Misc. 2d 910, 290 N.Y.S.2d 415 (Sup. Ct. N.Y. County 1968) (plaintiff member firm and former employer of defendant was required to arbitrate dispute over restrictive covenant in defendant's employment contract); *Osborne & Thurlow v. Hirsch & Co.*, 10 Misc. 2d 225, 172 N.Y.S.2d 522 (Sup. Ct. N.Y. County 1958) (libel action brought by plaintiff former member firm against defendant member firm was stayed pending arbitration notwithstanding that plaintiff relinquished member firm status by dissolution prior to suit since cause of action arose while plaintiff was a member firm).

¹²⁹ Article VIII, section 1 of the New York Stock Exchange Constitution states that:

Any controversy between parties who are members, allied members, member firms or member corporations shall, at the instance of any such party, and any controversy between a non-member and a member or allied member or member firm or member corporation arising out of the business of such member, allied member, member firm or member corporation, . . . shall, at the instance of such non-member, be submitted for arbitration, in accordance with the provisions of the Constitution and the rules of the Board of Directors.

² CCH NEW YORK STOCK EXCHANGE GUIDE, CONSTITUTION, ¶ 1003 (1972). It should be noted that where one of the parties is a non-member, arbitration may be required only at his instance.

¹³⁰ See *Brown v. Gilligan, Will & Co.*, 287 F. Supp. 766, 769-70 (S.D.N.Y. 1968).

¹³¹ 15 U.S.C. § 77n (1970) provides:

Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

¹³² 15 U.S.C. § 78cc(a) (1970) provides:

Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

¹³³ 346 U.S. 427 (1953).

¹³⁴ *Id.* at 438.

¹³⁵ 15 U.S.C. § 78bb(b) (1970) provides:

tions made void by section 29(a) agreements by exchange members to arbitrate disputes in accordance with exchange rules. This exception to the non-waiver provision of the Act applies only to exchange members and could not be invoked by the plaintiff customer in *Wilko* to require arbitration. However, since Axelrod is a member firm, it falls within the purview of the section and may therefore be compelled to arbitrate. The Second Circuit also held that notwithstanding the absence of similar language in the Securities Act of 1933, section 28(b)'s exception to the anti-waiver provisions of the 1934 Act is also applicable to the anti-waiver provisions of the 1933 Act, the two acts being "*in pari materia* and . . . [construable] as one body of law."¹³⁶

The Second Circuit noted that the benefits of permitting litigation in *Wilko* would not result from a similar decision in *Axelrod*. In *Wilko*, the Supreme Court looked behind the anti-waiver provision of the statute and found a legislative intent to protect the small investor from the superior bargaining advantage held by the brokerage firms with whom he dealt.¹³⁷ This purpose, while served by nullification of the plaintiff's agreement to arbitrate in *Wilko*, would not be promoted by relieving Axelrod, a member brokerage firm, of its obligation to arbitrate.

Nine months after *Axelrod*, the Second Circuit, in a similar decision, held that a dispute between an allied member¹³⁸ of the NYSE and

Nothing in this chapter shall be construed to modify existing law (1) with regard to the binding effect on any member of any exchange of any action taken by the authorities of such exchange to settle disputes between its members

¹³⁶ 451 F.2d at 843. See *Brown v. Gilligan, Will & Co.*, 287 F. Supp. 766 (S.D.N.Y. 1968).

See also *In re Revenue Properties Litigation Cases*, 451 F.2d 310 (1st Cir. 1971) (Although the court agreed with the interpretation that section 28(b) of the 1934 Act also applied to the 1933 Act, it was able to require arbitration of a customer-broker dispute by finding that the anti-waiver provisions of the 1933 Act did not apply to a sales transaction which contained no agreement requiring arbitration, the only requirement of arbitration being in the Stock Exchange Constitution.)

¹³⁷ 451 F.2d at 842-43.

¹³⁸ The New York Stock Exchange Constitution provides the following definition:

Article I

(d) Allied Member. The term 'allied member' means:

(i) a general partner in a member firm who is not a member of the Exchange and who has become an allied member as provided in Article IX, or

(ii) an employee of a member corporation who is actively engaged in its business and devotes the major portion of his time thereto, who is not a member of the Exchange, who has become an allied member as provided in Article IX, and who is either:

(a) a director and a holder of record and beneficial owner of voting stock of such corporation, or

(b) a principal executive officer and a holder of record and beneficial owner of voting stock of such corporation, or

(c) a holder of record and beneficial owner of 5% or more of the outstanding voting stock of such corporation.

a member brokerage firm must be arbitrated. In *Coenen v. Pressprich*,¹³⁹ the plaintiff contended that a dispute¹⁴⁰ between himself and the defendant NYSE member firm which arose prior to the plaintiff's attainment of allied member status¹⁴¹ was not within the scope of the arbitration clause of the New York Stock Exchange Constitution. The Second Circuit rejected this argument and affirmed the district court's decision granting the defendant's motion to stay the action pending arbitration.¹⁴²

In addition to the policy considerations of protecting the small

Article IX

Sec. 9 Any person, not a member of the Exchange, shall become an allied member of the Exchange by pledging himself to abide by the Constitution as the same has been or shall be from time to time amended, and by all rules adopted pursuant to the Constitution and by either

- (a) becoming a general partner in a member firm, or
- (b) becoming a holder of record and beneficial owner of 5% or more of the outstanding voting stock of a member corporation, or
- (c) becoming a director and a holder of record and beneficial owner of voting stock of a member corporation, or
- (d) becoming a principal executive officer and a holder of record and beneficial owner of voting stock of a member corporation.

Such pledge to abide by the Constitution and Rules shall be made by written instrument filed with the Exchange in which the signer pledges himself as aforesaid.

Id. at ¶ 1409.

¹³⁹ 453 F.2d 1209 (2d Cir. 1972).

¹⁴⁰ Plaintiff's complaint states three causes of action based on an alleged conspiracy between R. W. Pressprich & Co., a brokerage firm, and Stirling Homex Corporation to force his sale of shares in the latter company at an unconscionably low price. The first is a claim under the common law and UNIFORM COMMERCIAL CODE § 8-401 which requires an issuer to register transfer of a security when criteria enumerated in the statute have been met. The second count asserts a scheme to defraud plaintiff under rule 10b-5, 17 C.F.R. § 240.10b-5 (1971), promulgated in furtherance of the Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1970). Finally, count three of plaintiff's complaint asserts violations of Sherman Act §§ 1, 2, 15 U.S.C. §§ 1, 2 (1970) and Clayton Act §§ 4, 12, 15 U.S.C. §§ 15, 22 (1970).

Plaintiff, while a director of Stirling Homex Corporation, is alleged to have purchased 90,000 shares of unregistered Stirling stock for "investment purposes." The shares were imprinted with a restrictive legend prohibiting transfer unless registered in accordance with the Securities Act of 1933 or Stirling received satisfactory opinion of counsel that registration wasn't required. (For the type of restrictive legend used see 1 P-H SECURITIES REGULATION, HOW TO COMPLY WITH SEC RULES ¶ 115.4 (1972)). Following this transaction, Pressprich sold 1,175,000 shares of Stirling stock to the public pursuant to a registration statement. Plaintiff alleged that his subsequent attempt to sell his 90,000 shares to raise needed cash was thwarted by Pressprich and Stirling ostensibly for lack of registration or satisfactory opinion of counsel that registration was not required, but actually to limit the number of shares available to the market and thus artificially support the price of Stirling stock. It was further alleged that as a result of misrepresentations and coercion by Pressprich, plaintiff was eventually forced to sell his stock through Pressprich to an institutional buyer at the inequitable price of ten dollars per share.

¹⁴¹ When Coenen & Co. became a member of the NYSE, the plaintiff, an officer of that brokerage firm, became an allied member of the Exchange and a party to a contract with both the Exchange and its members of which the constitution and stock exchange rules were a part.

¹⁴² 453 F.2d at 1212.

investor promulgated in *Axelrod*, the court distinguished *Coenen* from *Wilko* on the basis of differences in the statutes under which each action was brought.¹⁴³ It also noted that the sequence of the arbitration agreement and the occurrence of the dispute differed in the two cases.¹⁴⁴

Coenen's contention that the exchange constitution's arbitration clause is restricted to future disputes, *i.e.*, those arising subsequent to attainment of member status by both parties, was rejected upon examination of the constitution's text which refers to "any controversy" and not merely to future controversies.¹⁴⁵

The third count in plaintiff's complaint alleged anti-trust law infractions, *viz.*, conspiracy to restrain trade in and monopolize the market for the subject common stock in violation of sections 1 and 2 of the Sherman Act¹⁴⁶ respectively.¹⁴⁷ Violations of sections 4 and 12 of the Clayton Act¹⁴⁸ were also alleged without supporting argument.¹⁴⁹ Although the Second Circuit conceded that antitrust claims are not normally arbitrable,¹⁵⁰ it noted that a claimant's recourse in such a dispute

¹⁴³ *Coenen* dealt with an alleged violation of section 10(b) of the Securities Exchange Act of 1934. *Wilko* involved only the Securities Act of 1933. Despite the Second Circuit's earlier holding in *Axelrod*, that the exception (section 28(b)) to the non-waiver provision (section 29(a)) of the 1934 Act was equally applicable to that of the 1933 Act, the court relied on the absence of a similar exception from the 1933 Act to distinguish *Coenen* from *Wilko*.

In *Axelrod*, the finding that section 28(b) of the Securities Exchange Act of 1934 applied to section 14 of the Securities Act of 1933 was expressly limited to the facts of the case. 451 F.2d at 843. In *Coenen*, the court made no reference to the broadened interpretation given section 28(b) in *Axelrod*. Judge Mulligan sat in both cases. An explanation of the factual distinctions which warranted different applications of section 28(b) in the two instances is desirable. *Axelrod* relied on the fact that the plaintiff in *Wilko* was a small investor and not affected by section 28(b). *Coenen* depended on the absence of language similar to that of section 28(b) from the 1933 Act to reach the same result.

¹⁴⁴ In *Wilko*, the plaintiff had executed an agreement to arbitrate differences between himself and the defendant brokerage firm prior to occurrence of the subject discord and therefore without knowledge of it. Coenen, on the other hand, was fully aware of the existence of his claim against Pressprich at the time he contracted to arbitrate "any" discrepancies between himself and all NYSE member firms. 453 F.2d at 1213. The non-waiver provisions of the Securities Exchange Act of 1934 do not bar arbitration of a controversy already in existence at the time of the agreement to arbitrate. See *Garden v. Shearson, Hammill & Co.*, 433 F.2d 367 (5th Cir. 1970), *cert. denied*, 401 U.S. 978 (1971); *Pearlstein v. Scudder & German*, 429 F.2d 1136, 1143 (2d Cir. 1970), *cert. denied*, 401 U.S. 1013 (1971); *Moran v. Paine, Webber, Jackson & Curtis*, 389 F.2d 242 (3d Cir. 1968).

¹⁴⁵ 453 F.2d at 1212.

¹⁴⁶ 15 U.S.C. §§ 1, 2 (1970).

¹⁴⁷ 453 F.2d at 1214.

¹⁴⁸ 15 U.S.C. §§ 15, 22 (1970).

¹⁴⁹ 453 F.2d at 1215.

¹⁵⁰ There has been general agreement among the courts that antitrust claims are not arbitrable. Among the reasons courts have given are: rights adjudicated in an antitrust dispute affect not only the parties involved but also the public at large. *A. & E. Plastik Pak Co. v. Monsanto Co.*, 396 F.2d 710, 715-16 (9th Cir. 1968); *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821, 826-28 (2d Cir. 1968). Arbitrators are not qualified to properly apply the antitrust laws. *Associated Milk Dealers, Inc. v. Local 753, Milk Drivers*

is not limited to litigation and out-of-court settlement is a permissible alternative. Since the plaintiff had executed the arbitration agreement with full knowledge of his claim, he was deemed to have consented to settle his triple damage claim without the aid of the courts.¹⁵¹

In both *Axelrod* and *Coenen*, the Second Circuit supported the policy of self government of stock exchanges and compelled arbitration of disputes originally submitted to litigation by a member firm and an allied member respectively. At the same time, the court expressed its willingness to exclude the small investor from the scope of parties subject to the jurisdiction of the stock exchange and achieved that objective by affording him a less biased forum.¹⁵² In applying them to

Union, 422 F.2d 546, 552 (7th Cir. 1970). The severe penalty of treble damages associated with antitrust law violations evidences a Congressional intent to keep such disputes from the largely unreviewable power of an arbitrator. *Silvercup Bakers Inc. v. Fink Baking Corp.*, 273 F. Supp. 159, 163 (S.D.N.Y. 1967).

The view that antitrust claims are not arbitrable has also developed on the state level. See *Aimcee Wholesale Corp. v. Tomar Prods., Inc.*, 21 N.Y.2d 621, 628-30, 237 N.E.2d 223, 226-27, 289 N.Y.S.2d 968, 973-74 (1968). In addition to the reasons given above, the New York Court of Appeals in *Aimcee* noted that the equitable doctrines of waiver, estoppel, and *in pari delicto* would be more readily applied by an arbitrator than by a court of law thereby weakening the deterrent effect of the antitrust laws. *Id.* at 629, 237 N.E.2d at 277, 289 N.Y.S.2d at 973.

Perhaps the most often quoted statement on the subject and the one which most concisely makes the case for barring arbitration of antitrust disputes is found in Circuit Judge Clark's dissent in *Wilko v. Swan*, 201 F.2d 439, 445 (2d Cir.) *rev'd*, 346 U.S. 427 (1953).

Commercial arbitration has been highly successful in bringing a businessman's adjudication to business questions. But it would be vastly unfortunate if it became useable as a device to blunt or break social legislation.

Id.

The Second Circuit in *Coenen*, however, noted a recognized exception to the general rule barring arbitration of antitrust claims, *viz.*, where the agreement to arbitrate takes place after the dispute arises. 453 F.2d at 1215 and cases cited therein. *Coenen* was found to fall within this exception. *Id.*

¹⁵¹ *Id.* Judge Medina, writing for a unanimous panel, intimated that the antitrust count was not supported by the facts alleged in the complaint and was included merely to provide the plaintiff with an additional avenue by which to pursue redress of his grievance and collect treble damages. This practice was criticized as an unfortunate attempt to circumvent the arbitration provisions of the New York Stock Exchange Constitution. The court, therefore, denied the plaintiff's right of action and ordered arbitration to proceed. *Id.* at 1215-16.

¹⁵² Although the neutrality of an arbitrator is theoretically equal to that of a judge, the former's repeated contact with a narrow class of parties necessitated by his specialized role sometimes raises the issue of the arbitrator's objectivity. See *Garfield & Co. v. Wiest*, 432 F.2d 849 (2d Cir. 1970), *cert. denied*, 401 U.S. 940 (1971) wherein plaintiff sought to vacate an adverse arbitration award on the basis of the arbitrators' failure to fully disclose their former dealings with the defendant brokerage firm. The Second Circuit upheld the award on the basis of the plaintiff's constructive knowledge, as a member of the NYSE, that "any arbitrators, by their very connection with the Exchange, would, in the ordinary course of business, have dealings with specialists . . ." *Id.* at 853. However, the court went on to note that "[w]e find rather unrealistic the Exchange's contention in its *amicus* brief that there is no possibility of favoritism . . ." *Id.* at 853-54.

Cases dealing with the issue of an arbitrator's possible bias are not particularly rare. See, e.g., *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145 (1968), *rehearing denied*, 393 U.S. 1112 (1969); *Saxis S.S. Co. v. Multifacs Int'l Traders, Inc.* 375 F.2d

implement these policies, the Second Circuit also demonstrated the extreme flexibility of the non-waiver sections of the Securities Act of 1933 and the Securities Exchange Act of 1934 as well as the statutory exception to the non-waiver provision included in the 1934 Act.

577 (2d Cir. 1967); *San Martine Compania De Navegacion, S. A. v. Saguenay Terminals Ltd.*, 293 F.2d 796 (9th Cir. 1961); *Kentucky River Mills v. Jackson*, 206 F.2d 111 (6th Cir. 1953), *cert. denied*, 346 U.S. 887 (1953); *Hyman v. Pottberg's Ex'rs*, 101 F.2d 262 (2d Cir. 1939); *American Guar. Co. v. Caldwell*, 72 F.2d 209 (9th Cir. 1934).