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Recent Decisions

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RECENT DECISIONS

ADMIRALTY—WORKMEN'S COMPENSATION—LONGSHOREMEN'S AND HARBOR WORKERS' COMPENSATION ACT COVERS WATERFRONT INJURIES TO CARGO HANDLERS WHO SOMETIMES WORK OFFSHORE OR WHO UNPACK CONTAINERS.

Petitioners,[1] operators of marine container terminals, sought reversal of Longshoremen's and Harbor Workers' Compensation Act[2] (LHWCA) awards to injured respondents.[3] Respondent Caputo, normally a member of a stevedoring gang, was injured while temporarily loading consignees' trucks with goods previously removed from containers. Respondent Blundo, a checker who marked items being taken from containers, sustained injuries after slipping on an icy pier. The Second Circuit Court of Appeals[4] upheld awards[5] finding respondents were both "maritime employees" within the meaning of LHWCA § 902(3).[6] On appeal to the United States Supreme Court, *held,* affirmed. Where a worker actually works over navigable water for part of his activity and is physically moving cargo on the waterfront when injured, or where a worker is an integral part of the loading or unloading process, such as a checker, when injured, the worker is engaged in maritime employment within the meaning of LHWCA § 902(3) and is, therefore,

1. Northeast Marine Terminal Company and International Terminal Operating Company, in consolidated cases on writs of certiorari from the Court of Appeals for the Second Circuit.
2. 33 U.S.C. §§ 901-50 (1970 & Supp. V 1975).
3. Ralph Caputo, employee of Northeast Marine Terminal Company, and Carmelo Blundo, employee of International Terminal Operating Co., both of New York City.
4. Pittston Stevedoring Corp. v. Dellaventura, 544 F.2d 35 (2d Cir. 1976) (consolidation of Blundo & Caputo cases); 2 BRBS 376 (Blundo case); 3 BRBS 13 (Caputo case).
5. Contested LHWCA claims are heard by an administrative law judge. 33 U.S.C. § 919(d) (Supp. V 1975). Appeals are made to a three member Benefits Review Board appointed by the Secretary of Labor under authority of the 1972 amendments. 33 U.S.C. § 921(b)(1) (Supp. V 1975). The Board must affirm if the lower decision is "supported by substantial evidence in the record considered as a whole." 33 U.S.C. § 921(b)(3) (Supp. V 1975). The 1972 amendments provide for direct appeal from the Board to the court of appeals. 33 U.S.C. § 921(c) (Supp. V 1975). If an administrative judgment is awarded, it is paid pending appeal and absent a showing of irreparable harm to the employer. 33 U.S.C. § 921(b)(3) (Supp. V 1975).
6. *See* note 47 *infra.*

entitled to compensation for work-related injuries. *Northeast Marine Terminal Co., Inc. v. Caputo,* 97 S. Ct. 2348 (1977).

Workmen's compensation acts are designed to provide immediate medical care[7] and partial wage substitution[8] to workers disabled by any injury "arising out of and in the course of employment."[9] This subsistence income for every injury[10] replaces the remedies and defenses otherwise available between employer and employee.[11] In testing the first state general compensation act,[12] a unanimous Supreme Court upheld the constitutionality of a death benefits award for a railroad worker.[13] Ten weeks later, in *Southern Pacific Co. v. Jensen,*[14] the Court held an attempt to apply the state act to the maritime death of a longshoreman ten feet from land to be an impermissible intrusion into "the proper harmony

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7. *See* 33 U.S.C. § 939(c)(1) (Supp. V 1975); 33 U.S.C. § 907(b) (Supp. V 1975).

8. Congress expects that 90 percent of LHWCA awards will be equivalent to two-thirds of the worker's former wage. S. REP. No. 1125, 92d Cong., 2d Sess. 5 (1972). The actual amount is based on the "national average weekly wage" of "production or non-supervisory workers on private nonagricultural payrolls." 33 U.S.C. §§ 902(19), 906(b), 908(a)-(c) (Supp. V 1975). Twenty-eight states have recently adopted the state's average weekly wage as the basis rather than the employee's individual wage. 1 A. LARSON, WORKMEN'S COMPENSATION 6 (Supp. 6 1977).

9. The quoted phrase is from the British compensation act. Act of August 6th 1897, 60 & 61 Vict., c. 37, §1(.1). The phrase has been used verbatim in the acts of 42 states and the LHWCA. For a discussion of the construction of the phrase, *see* A. LARSON, *supra* note 8, at §§ 6-29.

10. Compensation acts "do not rest on any tort theory, but upon one of social insurance." W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 80, at 525 (4th ed. 1971). *See also* W. PROSSER § 80, at 531.

11. The "employer liability acts" abrogated the three common law defenses in favor of the employer: the fellow servant rule, assumption of the risk, and contributory negligence. *See* A. LARSON, *supra* note 8, at § 4.50. Workmen's compensation acts lifted the worker's affirmative burden of showing fault on the employer's part. It is sometimes mistakenly assumed that without these compensation acts, the three common law defenses apply. Employer liability acts prevent that in most cases. *See, e.g.,* C.D. Johnson Lumber Corp. v. Hutchens, 194 F.2d 574 (9th Cir. 1952). Whether compensation acts are a form of strict liability is disputed. *See* W. PROSSER, *supra* note 10, § 80 at 531 (strict liability). *Contra* A. LARSON, *supra* note 8, at §§ 2.20-2.30 (the injury, not the risk, needs compensation). *But see* G. GILMORE & C. BLACK, THE LAW OF ADMIRALTY 430 (2d ed. 1975) ("sufficient participation in the risk").

12. New York Workmen's Compensation Act, 1913 N.Y. Laws, ch. 41,316.

13. New York Cent. R.R. Co. v. White, 243 U.S. 188 (1917).

14. 244 U.S. 205 (1917). The *White* and *Jensen* cases were argued together. *Jensen* had a 5-4 majority.

and uniformity of [general maritime law]."[15] As state compensation acts proliferated, Congress twice attempted to permit their application to maritime injuries.[16] Although the Court held such legislation to be an unconstitutional delegation, it fashioned the "maritime but local" doctrine to alleviate the harsh disparity of *Jensen*, permitting state awards in "certain local matters [in which state] regulation would work no material prejudice to the general maritime law."[17] Because the Court excluded longshoremen from this exception,[18] Congress established a federal protection by enacting the Longshoremen's and Harbor Workers' Compensation Act of 1927.[19] To avoid jurisdictional objection, Congress provided LHWCA coverage only where "recovery . . . may not validly be provided by state law."[20] The Court construed this to require mutual exclusivity with state laws.[21] Thereafter, each case forced the Court into a constitutional analysis of its "maritime but local" doctrine to determine which law applied. Moreover, because the Court had defined the effect but not the substance of "maritime but local," a worker could not know prior to litigation which act applied to his injury.[22] The Court ignored the need for certainty in the election of forum as it had ignored the need for

15. 244 U.S. at 216.

16. Act of Oct. 6, 1917, ch. 97, 40 Stat. 395 passed five months after *Jensen* was held unconstitutional in Knickerbocker Ice Co. v. Stewart, 253 U.S. 149 (1920). Act of June 10, 1922, ch. 216, 42 Stat. 634 was held unconstitutional in Washington v. W.C. Dawson & Co., 264 U.S. 219 (1924). *See* G. GILMORE & C. BLACK, *supra* note 11, at 407-08.

17. Grant Smith-Porter Ship Co. v. Rohde, 257 U.S. 469, 477 (1922).

18. "The unloading of a ship is not a matter of purely local concern as we have often pointed out." Employer's Liab. Assur. Corp. Ltd. v. Cook, 281 U.S. 233, 236 (1930) (reversing a state compensation award for longshoreman's death over navigable water).

19. Ch. 509, §§ 1-51, 44 Stat. 1424 (codified at 33 U.S.C. §§ 901-50 (1970)).

20. *Id.* Section 903(a) of the Act read:

> (a) Compensation shall be payable under this chapter in respect of disability or death of an employee but only if the disability or death results from injury upon the navigable waters of the United States (including any dry dock) and if recovery for the disability or death through workmen's compensation proceedings may not validly be provided by state law . . . .

21. In upholding the LHWCA, Justice Hughes insisted that the Court have review of jurisdictional facts de novo rather than the limited review for error as specified in the LHWCA. Crowell v. Benson, 285 U.S. 22, 46-49 (1932).

22. "[T]he contours of the 'local concern' concept were and have been necessarily vague and uncertain. There has never been any method of staking them out except litigation in particular cases." Calbeck v. Travelers Ins. Co., 370 U.S. 114, 124-25 (1962). *See generally*, A. LARSON, *supra* note 8, at § 89.23(b).

parity of benefits in *Jensen*. The problem crippled the administration of waterfront compensation for fifteen years. In *Davis v. Department of Labor & Industries*[23] the Court recognized the need for certainty of forum,[24] and announced that administrative decisions, state and federal, should be presumed correct[25] in "twilight zone"[26] cases absent substantial evidence of error. Justice Frankfurter, in concurring with this procedural bypass of the LHWCA exclusivity clause, indicated "theoretic illogic"[27] was necessary to insure "simple and dependable enforcement" and to avoid "the difficulties which the judicial process itself brought into being."[28] The twilight zone concept largely resolved the jurisdiction and certainty problems.[29] However, the problem of disparity of benefit schedules under the two systems available to each worker remained. Although the Court had designed the twilight zone to assure workers of some remedy, many workers used the zone for a different purpose. The lure of higher benefits[30] caused workers to claim coverage in the higher paying jurisdiction. The Fifth Circuit halted the expansion of the twilight zone after a LHWCA award was made by the district court in *Travelers Ins. Co. v. Calbeck*[31] for injuries suffered during new ship construction on navigable waters. The court of appeals reversed, holding that, in clear cases, effective enforcement required courts to "have the resourcefulness to ascertain and . . . the fortitude to stand by the declaration of

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23. 317 U.S. 249 (1942).

24. Looking for an "undefined and undefinable point . . . . [t]his Court has been unable to give any guiding, definite rule to determine the extent of state power in advance of litigation . . . . Yet, employees are asked to determine with certainty before bringing their actions that factual question over which courts regularly divide among themselves and within their own membership. As penalty for error, the injured individual may not only suffer serious financial loss through the delay and expense of litigation, but discover that his claim has been time barred by the statute of limitations in the proper forum while he was erroneously pursuing it elsewhere." 317 U.S. at 253-54. [Footnote omitted]

25. The Court originally had insisted that it have review of jurisdictional determinations in LHWCA cases. *See* note 21 *supra*.

26. As with the "maritime but local" exception, the Court never defined the substance of the twilight zone.

27. Davis v. Dep't of Labor & Indus., 317 U.S. at 258-59 (Frankfurter, J., concurring).

28. 317 U.S. at 258-59.

29. *See* Hahn v. Ross Island Sand & Gravel, 358 U.S. 272, 274 (1959). (Stewart, J., dissenting).

30. By 1971, eleven maritime states paid higher benefits that did the LHWCA. A. LARSON, *supra* note 8, at § 89.27.

31. 293 F.2d at 52, 56 (5th Cir. 1961).

an identifiable line."[32] The Supreme Court reversed, holding that every injury on navigable waters was covered by LHWCA.[33] LHWCA coverage was no longer exclusive of state coverage.[34] To achieve certainty of forum the Court abandoned the canon that a textual approach was paramount in interpreting the Act. Instead, the Court found passages in the legislative history[35] which recognized the forum problem and thus drew "a reasonable inference" that Congress had never intended to incorporate the judicial "maritime but local" doctrine into LHWCA interpretation.[36] Some courts misinterpreted *Calbeck* as a signal to liberalize federal jurisdiction and to allow LHWCA recovery even on land.[37] These courts did not recognize the destruction of the "maritime but local" line as destruction of the twilight zone around that line. They simply moved the zone landward and centered it on the shoreline. However, in *Nacerima Operating Co., Inc. v. Johnson*[38] the Supreme Court explained why the twilight zone approach was inappropriate after *Calbeck*. "Congress did not extend coverage to longshoremen . . . whose injuries occurred on the landward side of the Jensen line, clearly entitling them to protection under the state compensation Acts [since] otherwise the reach of the federal Act [LHWCA] would be subject to uncertainty."[39] The objective certainty which the shoreline gave to the choice of forum problem overrode the jurisdictional scheme established by the text of the LHWCA and case law.[40] The Court recognized the disparity of compensation for similarly employed workers, but refused to "perpetuate on the landward side of the Jensen line the same

32. 293 F.2d at 56.

33. Calbeck v. Travelers Ins. Co., 370 U.S. 114 (1962). This was a reinterpretation of the substance of the LHWCA, not a procedural distinction as in the creation of the twilight zone concept.

34. The Act will "provide compensation for all injuries sustained by employees on navigable waters whether or not a particular injury might also have been within the constitutional reach of a state workmen's compensation law." 370 U.S. at 117.

35. *See id.* at 120 n.9.

36. *Id.* at 123-24. *See* text accompanying note 21 *supra*.

37. Marine Stevedoring Corp. v. Oosting, 398 F.2d 900 (4th Cir. 1968).

38. 396 U.S. 212 (1969).

39. 316 U.S. at 219-221. "[R]emoving uncertainties . . . is a far cry from construing the act to reach injuries on land . . . . Calbeck's holding rejected the notion that the line should advance or recede . . . . As in Calbeck, we refuse to impute to Congress the intent of burdening the administration of compensation by perpetuating such confusion." 396 U.S. at 221. *See also* 396 U.S. at 215 n.7.

40. *See* note 21 *supra*.

confusion that previously existed on the seaward side."[41] However, refusal to allow LHWCA ashore was not the problem it might have been since most injured workers were eligible for higher awards under state acts than under the LHWCA.[42] When Congress prepared to raise LHWCA rates above those of most states,[43] it recognized that unless coverage were concomitantly extended inland, disparity in benefits would quantitatively increase among longshoremen.[44] Congressional committee reports[45] also recognized a qualitative disparity. With the advent of container techniques, more of the longshoreman's work is performed on shore, causing a greater portion of that group to be denied coverage. The 1972 amendments achieved the overall expansion of LHWCA coverage by expanding the situs[46] and restricting coverage to "maritime employment," a status test.[47] The report describes the status test's application:

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41. 396 U.S. at 224.

42. *See* note 30 *supra.*

43. *See* note 30 *supra.* At present the LHWCA rates (for total disability) are two hundred percent of the average industrial wage and much higher than the benefits paid by any state except Alaska. *See* A. LARSON, *supra* note 8, at § 89.27.

44. The amendments removed a loophole which had allowed workers to recover damages beyond LHWCA benefits. Starting with Seas Shipping Co. v. Sieracki, 328 U.S. 85 (1946), an injured longshoreman could avail himself of the benefits of the LHWCA and also sue the owner of the ship on which he was working for damages. A shipowner was liable, regardless of fault, under the doctrine of seaworthiness. In addition, under Ryan Stevedoring v. Pan Atl. S.S. Corp., 350 U.S. 124 (1956), shipowners could recover the damages from the stevedore's employer on theories of express or implied warranty. Although the Act limits an employer's liability to compensation and medical benefits, a stevedore-employer is indirectly liable for damages to an injured longshoreman. *See* S. REP. No. 1125, *supra* note 8, at 9. Congress wanted to end this triangle but the quid pro quo was higher LHWCA rates and expanded coverage since the Sieracki-Ryan triangle had allowed recovery for shore injuries.

45. S. REP. No. 1125, *supra* note 8, at 12-13.

46. 33 U.S.C. § 903(a) reads in part, "injury occurring upon the navigable waters of the United States (including any adjoining pier, wharf, dry dock, terminal, building way, marine railway, or any other adjoining area customarily used by an employer in loading, unloading, repairing, or building a vessel)."

47. "The term 'employee' means any person engaged in maritime employment, including any longshoreman or other person engaged in longshoring operations, and any harborworker including a ship repairman, shipbuilder, and shipbreaker, but such term does not include a master or member of a crew of any vessel, or any person engaged by the master to load or unload or repair any small vessel under eighteen tons net." 33 U.S.C. § 902(3). Prior to 1972, it was not necessary that the injured employee himself have been in maritime employment. Pennsylvania R.R. Co. v. O'Rourke, 344 U.S. 334, 340-42 (1953).

> The intent of the Committee is to permit a uniform compensation system to apply to employees who would otherwise be covered by this Act for part of their activity. To take a typical example, cargo, whether in break bulk or containerized form, is typically unloaded from the ship and immediately transported to a storage or holding area on the pier, wharf, or terminal adjoining navigable waters. The employees who perform this work would be covered under the bill for injuries sustained by them over the navigable waters or on the adjoining land areas. The Committee does not intend to cover employees who are not engaged in loading, unloading, repairing, or building a vessel, just because they are in the area adjoining navigable waters used for such activity. Thus, employees whose responsibility is only to pick up stored cargo for further trans-shipment would not be covered, nor would purely clerical employees whose jobs do not require them to participate in the loading or unloading of cargo. However, checkers, for example, who are directly involved in the loading or unloading functions are covered by the new amendment.[48]

Congress, in an attempt to control the specific scope of coverage, reassumed the role it had delegated to the Court in the original LHWCA.[49]

In the instant case, the Court characterized the original LHWCA as having served as "a gapfiller," a role modified by the 1972 amendments.[50] After declining to detail the previous Act's judicial history, the Court noted without comment the *Nacirema* majority's desire to alleviate confusion and the dissent's desire to lessen the harsh disparity of treatment for workers of the same status.[51] The Court pointed out that Congress had failed to define either in the amendments or in the committee reports the new statutory terms classifying coverage as to either situs of the injury or status of the injured. The Court did not attempt to construe the terms relating to coverage in the text of the amendments. Instead, the Court analyzed the committee reports. While the reports expressed the Act's purpose, the Court found the closest affirmative definition of coverage in the "typical example."[52] Even this example, the Court declared, was silent as to coverage of workers, such as Caputo and Blundo, who handle cargo after its immediate unloading

48. *See* note 45 *supra.*
49. *See* text accompanying note 20 *supra.*
50. 97 S. Ct. at 2354. The statement ignored the earlier judicial modification of the original gapfiller function. *See* text accompanying notes 31-36 *supra.*
51. 97 S. Ct. at 2355.
52. *See* text accompanying note 48 *supra.*

from the ship. However, the Court relied on the broad language of the legislation and found that expansive interpretation is both suggested and appropriate. The Court noted Congress' realization that modern longshoring is more land-based than in the past, and, in considering the purposes of the Act, found a clear intent to cover respondents.[53] The Court reasoned that Congress intended to cover performance of tasks traditionally performed on board ship, noting that filling the hold of a vessel is done on board ship and that a container is the modern equivalent of the hold of a ship. Therefore, until the container is unpacked, the unloading process is incomplete and remains "longshoring" within the amendments. Hence, the Court found it apparent that respondent Blundo was a statutory employee since he was an "integral" part of the modern unloading process. The Court bolstered its conclusion by citing the report's explicit statement that "checkers . . . directly involved, . . . are covered."[54] The Court declared, however, that the redefined unloading process was not relevant to Caputo's case. Here the Court emphasized "another dominant theme"[55] which covers employees who would have been covered by the old Act for "part of their activity." In construing this phrase, the Court announced that the Act focuses primarily on occupations, particularly longshoring, and expresses Congress' desire to provide longshoremen "continuous coverage throughout their employment." Since Caputo spent at least some of his time in indisputably longshoring operations as a member of a stevedoring gang, and since the old Act covered the part of that job that was performed over navigable water, Caputo is, at a minimum, covered when physically handling cargo on the waterfront.

The instant case serves two valuable functions. First, by relying on the legislative history and the purposes of the Act, while ignoring the text per se, the Court has set the goal of seeking practical, not technical, solutions. Second, the Court has neatly defined "unloading" by grouping all tasks which modern technology has added to the cargo's ship-to-consignee movement. The unanimous acceptance of these concepts by the Court makes it unlikely that they will be successfully assailed, whatever their logical flaws.[56] A range of interpretations of the amendments is supportable because

53. 97 S. Ct. at 2356, 2360; S. Rep. No. 1125, *supra* note 8, at 13.
54. *See* text accompanying note 48 *supra.*
55. 97 S. Ct. at 2361.
56. *See, e.g.,* I.T.O. Corp. v. Ben. Rev. Bd., 529 F.2d 1080, 1095 (4th Cir. 1975) (Craven, J., dissenting).

the issue is no longer constitutional, the statute is vague, and the committee reports are ambiguous.[57] For the same reasons, the Court has more freedom to choose a clear and efficient interpretation. Therefore, a constructive evaluation of the instant decision should analyze the extent to which the Court has used the opportunity to avoid confusion landward of the *Jensen* line. Unfortunately, the Court has left much of the issue to be relitigated. Under the Blundo analysis, coverage of a checker as an "integral part" of the unloading process cannot be deduced from the major premise that Congress intended to cover acts equivalent to those traditionally done on ship. The job of "checker" is traditionally not performed on ship. By warping its otherwise clear syllogism to encompass "explicitly" covered checkers, the Court leaves to lower courts the unenviable task of defining the term "integral." Some "theoretic illogic"[58] is compelled by the ambiguous committee reports, but this concession should not be expanded beyond checkers.[59] On the other hand, the holding in Caputo's case is unclear and ineffective. The Court's major premise is that those who spend "at least some of their time in indisputably longshoring operations" are "longshoremen" and have, therefore, "continuous coverage throughout their employment."[60] This is unclear for two reasons. First, it gives no guidance regarding the minimum time sufficient to qualify as "at least some" time.[61] Second, the holding

57. *See, e.g.,* 529 F.2d at 1088 (discussing the ambiguity of the congressional reports).

58. *See* text at note 27 *supra.*

59. Professor Larson suggests that the "stopping point" will be clerical work "essential" to handling cargo in maritime commerce. A. LARSON, *supra* note 8, at § 89.45(g). This, however, is nothing more than a "clerical but maritime" test and would cause the same problems as did the *Rohde* "maritime but local" test. *See* notes 17 and 22 *supra.*

60. 97 S. Ct. at 2363. The desire for continuous coverage is not so obvious as the Court suggests. *See, e.g.,* Maritime Stevedoring Corp. v. Oosting, 398 F.2d 900, 902 (4th Cir. 1968), *rev'd sub nom.* Nacirema Operating Co. v. Johnson, 396 U.S. 212 (1969) (workers "continually pass[ing] back and forth between ship and wharf *during a given operation*"). [Emphasis added]. The 1972 amendments were a reaction to that problem. "Ordinarily the question of whether a person is engaged in 'maritime employment' is to be determined as of 'the time of the accident.'" I.T.O. Corp. v. Ben Rev. Bd., 529 F.2d at 1084, *citing* Pennsylvania R.R. v. O'Rourke, 344 U.S. at 340 and Parker v. Motor Boat Sales, 314 U.S. 244, 247 (1941). *Accord,* Jacksonville Shipyards v. Perdue, 539 F.2d 533, 539 (5th Cir. 1976); Weyerhauser v. Gilmore, 528 F.2d 957, 960 (9th Cir. 1975). *But see,* A. LARSON, *supra* note 8, § 89.43 at 16-231-33 attempting to distinguish *Parker* and *O'Rourke* as "not necessarily" controlling.

61. Professor Larson attempts to minimize the difficulty by rhetorically ask-

inexplicably diverges from the "continuous coverage" rationale, and more narrowly holds that "longshoremen" performing *physical* tasks are covered. Further, the interspersed dicta suggest that perhaps *all* workers performing physical tasks are covered. Neither the holding nor the dicta have a logical basis in the Court's major premise. The *Caputo* holding therefore provides no clarity in advance of relitigation. The holding is also ineffective because employment agreements can be manipulated to assure each worker the judicially determined time to sustain "longshoreman" status.[62] Thereafter, all workers within the situs will be covered throughout their employment. Further, qualitative disparity remains. For example, if Caputo were loading a truck along with another man who always performed that task, and both men were injured in a single accident, only Caputo would be covered. The Court should have considered that the "typical example" used to cover Blundo is intended in the reports as an example of the "part of their activity" phrase used for Caputo.[63] The Court simply proclaimed the latter "*[a]nother* dominant theme" and the former "not relevant" to Caputo. Another possible conclusion is that the two phrases describe only one theme and that the test applied to Blundo is the sole test of status.[64] Were this construction adopted, workers performing longshoring operations would be covered when *that task*[65] takes them onto land. This single test for all workers is consonant with the purposes of the Act, avoids qualitative disparity by covering every man performing the same task, avoids the potential manipulation to which the *Caputo* test will be prone, and substitutes simplicity and clarity for the confused *Caputo* holding.

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ing whether ninety percent is sufficient time. A. LARSON, *supra* note 8, § 89.43 at 16-234. Though Larson does not acknowledge the definitional problem raised by a more narrow case, he does concede that once the Court defines the phrase, the rule "cuts both ways." *Id.* at 16-236. This view conceeds a return to the artificial anomaly deplored by Congress after *Nacirema* and is, to that extent, unacceptable.

62. The Court in the instant case expressed concern over the ability of the employer to manipulate the point of rest theory. 97 S. Ct. at 2364 n.38.

63. The juxtaposition of the phrases supports this view. *See* text accompanying note 48 *supra.*

64. This conclusion is implicit in the holdings of the Fifth and Ninth Circuits. Jacksonville Shipyards v. Perdue, 539 F.2d at 539 (5th Cir. 1976); Weyerhauser v. Gilmore, 528 F.2d at 960 (9th Cir. 1975).

65. *See* note 60 *supra.*

EUROPEAN COMMUNITIES—RESTRICTIVE PRACTICES—ABUSE OF DOMINANT POSITION—DISCRIMINATORY OR UNFAIR PRICING POLICIES AMONG EEC CUSTOMERS BY A CORPORATION IN A DOMINANT MARKET POSITION INFRINGES ARTICLE 86 OF THE EEC TREATY.

In response to complaints filed in 1974 by fruit companies in Denmark[1] and Ireland,[2] the Commission of the European Communities began an investigation[3] into the practices of United Brands Company (UBC)[4] in marketing its "Chiquita" brand bananas in the Common Market (EEC). The Commission sought to determine whether UBC (as a producer, shipper, importer, distributor, and ripener) was in a dominant position in the EEC banana market, and if so, whether UBC infringed article 86 of the EEC Treaty[5] by abusing that position through its marketing practices. In 1975 the Commission, *held*, that within the Belgo-

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1. Application of Th. Olesen A/S, Valby, Denmark, submitted to the Commission on February 20, 1974, and withdrawn on March 13, 1975. *See* note 9 *infra*.

2. Applications of Tropical Fruit Co. and Jack Dolan Ltd., both of Dublin, and Banana Importers of Ireland, Ltd., Dundalk, Ireland, submitted to the Commission on May 27, 1974. *See* note 9 *infra*.

3. Article 14 of EEC Council Regulation No. 17, 5 O.J. EUR. COMM. (No. 13/62) 204 (1962); 1 COMM. MKT. REP. (CCH) ¶ 2401 at 1731 (1973) [hereinafter cited as Regulation 17], provides the Commission with full investigative powers necessary for its enforcement of the EEC Treaty, including the authority to examine and copy business records and books, require oral explanations for clarification, and enter and inspect land, premises, and equipment.

4. UBC, formed by the 1970 merger of United Fruit Co. and AMK Corp. (American Seal-Kap), a major U.S. meat producer, is a large multinational conglomerate with annual sales over $2 billion. Approximately 20% of UBC revenues are generated by its banana operations which control about 35% of world banana exports.

5. Treaty Establishing the European Economic Community, March 25, 1957, 298 U.N.T.S. 3, [hereinafter cited as EEC Treaty]. Article 86 of the Treaty provides:

> Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in:
> (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
> (b) limiting production, markets or technical development to the prejudice of consumers;
> (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
> (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Luxembourg Economic Union (BLEU), Denmark, Germany, Ireland, and the Netherlands, UBC was in a dominant position in the banana industry and that UBC had abused its position in four ways: by requiring its distributor/ripeners (D/Rs) to refrain from the resale of green bananas, by charging dissimilar prices to its D/Rs for equivalent bananas, by setting prices unfairly in excess of the true value of the bananas being sold to the D/Rs, and by arbitrarily refusing to supply "Chiquita" bananas to one of its principal Danish D/Rs. The Commission imposed a fine[6] and ordered UBC to cease the infringements[7] by terminating the resale restrictions upon its customers and by setting prices in accordance with the Commission's recommendation that they be at least fifteen percent below the then-current Danish and German prices. *EEC Commission Decision IV/26.699-Chiquita*, 19 J.O. COMM. EUR. (No. L 95) 1, 2 COMM. MKT. REP. (CCH) ¶ 9800, at 9775 (1976).

Article 86 of the EEC Treaty prohibits "any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it . . . as incompatible with the common market insofar as it may affect trade between Member States."[8] An infringement of article 86 exists when it can be shown that one or more "undertakings" acting as an economic unit within a "substantial part" of the EEC occupies a "dominant position" that it "abuses" in such a manner that it "may affect trade"

6. Regulation 17, *supra* note 3, art. 15, authorizes the Commission to:

(2) impose on enterprises and associations of enterprises fines of from one thousand to one million units of account . . . where these enterprises, wilfully or through negligence:

(a) have infringed the provisions of . . . Article 86 of the Treaty . . . .

In determining the amount of the fine the duration of the infringement shall be considered in addition to its gravity.

7. *Id.*, art. 3 provides:

(1) If, acting on request, or *ex officio,* the Commission finds that an enterprise or association of enterprises is infringing Article 85 or Article 86 of the Treaty, it can by means of a decision oblige the enterprises or associations of enterprises concerned to put an end to such infringement.

(2) A request to this affect may be submitted by: (a) Member States; (b) natural and legal persons and associations of persons, who show a justified interest.

(3) Without prejudice to the other provisions of the present Regulation, the Commission, before taking the decision mentioned in paragraph 1, may address to the enterprises or associations of enterprises concerned recommendations designed to put an end to the infringement.

8. EEC Treaty, *supra* note 5, art. 86.

within the EEC.[9] "Undertaking" is defined in neither the EEC Treaty nor its implementing Regulations, but it seems to be a generic term for any legally recognized economic unit that is doing business or is in trade.[10] The Court of Justice extends the notion to include a parent company not in the EEC on the basis of its "economic and legal ties" with a subsidiary which is incorporated, located, or doing business in the EEC.[11] What constitutes a "substantial part" of the EEC is also undefined in the EEC Treaty and its implementing Regulations, but the Court uses the concept in reference to a case by case determination of a "relevant market" in either a geographic or an economic sense. In the case of *Re the European Sugar Cartel: Cooperative Vereniging Suiher Unic UA and Others v. Comm'n Eur. Comm.*[12] the Court listed as factors to be considered in determining the substantiality of a particular market "the pattern and volume of the production and consumption of the said product as well as the habits and economic opportunities of vendors and purchasers." Belgium and the southern portion of Germany were determined to be "substantial parts" of the EEC with respect to the sugar industry because of the volume of sugar production in relation to consumption and because of the high cost of transportation in relation to production costs, both of which lead to a predominantly local consumption pattern.[13] The

9. *See* Instituto Chemioterapico Italiano SpA & Commercial Solvents Corp. v. Commission Eur. Comm., [1974] C.J. Comm. E. Rec. 223, [1974 Transfer Binder] COMM. MKT. REP. (CCH) ¶ 8209 at 8800 (1974) [hereinafter cited as Commercial Solvents].

10. J. CUNNINGHAM, THE COMPETITION LAW OF THE E.E.C. 47 (1973).

11. Europemballage Corp. & Continental Can Co. v. Commission Eur. Comm., [1973] C.J. Comm. E. Rec. 77, [1971-1973 Transfer Binder] COMM. MKT. REP. (CCH) ¶ 8171 at 8279-83 (1973). The Court of Justice stated:

> The fact that the subsidiary has its own legal personality is not sufficient to rule out the possibility that its conduct can be imputed to the parent company. This applies particularly where the subsidiary does not determine its market conduct autonomously but in the main follows the instructions of the parent company. . . . The fact that Continental does not have its seat in the territory of one of the Member States is not sufficient to remove this enterprise from the application of Community Law.

Id. at 8298.

12. 17 COMM. MKT. L.R. 295 (1975) [hereinafter cited as Sugar Cartel Case].

13. *Id.* at 451-52, 463-65. Belgium, with a population of less than ten million, produces about 10% of the total EEC sugar output and consumes up to 70% of its own production with the remainder staying predominantly inside Benelux (BLEU and the Netherlands). The southern sales control region in Germany produces about 10% of the Common Market sugar output, is nearly as populous as Benelux, and imports less than 3% of its annual consumption needs.

nature of the product or service offered is as important in the determination of substantiality as the geographic expanse of the undertaking's operations. Whereas in *Sugar Cartel*[14] the Court held that Belgium is a substantial part of the EEC with respect to the sugar industry, in *General Motors Continental N.V. v. Commission Eur. Comm.*,[15] it held that Belgium is not such a substantial part of the EEC as to warrant Commission regulation of the Belgian vehicular safety inspection services. The determination of substantiality is always interrelated with the Court's determination of the presence of a "dominant position" in the market. Again, there are no definitions of the term in either the EEC Treaty or its implementing Regulations. A position of dominance may be determined by the degree of control or the extent of the operations of one or several enterprises in a relevant market. Thus the Court has held that undertakings with control of 90 percent of the sales and 70 percent of the production in a regional market are in dominant positions as is an undertaking that controls 65 percent of a national market.[16] Yet numbers alone do not establish a basis for the application of EEC law.[17] The Court has identified three additional factors in the determination of dominance in a market: capacity to act independently of competitors' responses or activities, ability to have a significant influence on the operation of the market, and knowledge that one has sufficient strength and independence to exert influence over the market.[18] In establishing that there has been an infringement of article 86 by an undertaking in a dominant position, the "abuse" of that position is the most significant element. Article 86 lists four market practices that are abusive: direct or indirect imposition of unfair prices or trading restrictions; limitation of production, markets, or technical development prejudicial to consumers; application of dissimilar conditions or terms to equivalent transactions with other traders that place them at a competitive disadvantage; and insertion in contracts of obligations

14. *Id.* at 451-52, 464-65. The Court adopted the Commission's findings that the Belgian group controlled 85%, rather than the admitted 65%, of the Belgian sugar market. *Id.* at 452.

15. [1975 Transfer Binder] COMM. MKT. REP. (CCH) ¶ 8320 at 7727-29, 7734-35 (1975).

16. J. CUNNINGHAM, *supra* note 10, at 102.

17. Commercial Solvents Case, *supra* note 10.

18. *See* Sugar Cartel Case, 17 COMM. MKT. L.R. 295 (1975); Europemballage Corp. & Continental Can Co. v. Commission Eur. Comm., [1973] C.J. Comm. E. Rec. 77, [1971-1973 Transfer Binder] COMM. MKT. REP. (CCH) ¶ 8171 at 8279-83 (1973).

that are immaterial to the contract subject matter.[19] In a Commission Memorandum the Commission added three other practices: a merger or consolidation that results in the elimination of other competition, price slashing to a level that eventually would eliminate competition, and any other "cut-throat" practices designed to force a competitor into an unfavorable or undesirable merger.[20] In *Commercial Solvents,* a decision that appears to apply both the Treaty prohibition against prejudicial market limitation and the Commission criterion of cut-throat practices, the Court held that "refusal to supply" is also an abuse prohibited by EEC restrictive practices law.[21] This holding implies that once a dominant supplier begins servicing a competitor, it cannot thereafter refuse to supply him if the refusal results in the elimination of that competitor from the market.[22] In the *Sugar Cartel Case* the Court expanded the concept of prejudicial market limitations in article 86 by holding that "market segregation" through the imposition of import or export restrictions is an abuse if a dominant position is thereby consolidated or if it results in a discriminatory limitation of EEC competition.[23] Restrictive practices alone do not necessitate a finding of an infringement of article 86; rather the use of a dominant position to the detriment of EEC competition is what is prohibited.[24] The language of article 86 clearly suggests that the domi-

19. *See* note 5 *supra.*

20. Commission Memorandum P-1/66, *Concentration of Firms in the Common Market,* 2 COMM. MKT. REP. (CCH) ¶ 9081 at 8173 (1966).

21. [1974] C.J. Comm. E. Rec. 223, [1974 Transfer Binder] COMM. MKT. REP. (CCH) ¶ 8209 at 8800, 8820 (1974).

22. The competitor had cancelled his contract with the parent supplier and its subsidiary before the parent decided to stop supplying the EEC. The competitor brought this complaint to the Commission only after all the other sources for the needed chemicals had dried up and after he realized that he had to recontract for supplies with the Commercial Solvents group. Only then did he discover the change in the supplier's policy concerning the EEC. *Id.* at 8802-03. This decision forcing a supplier to service an ex-customer poses some interesting questions. Three of these questions are: whether the termination of supply can ever be justified absent a lack of materials, whether the customer is guaranteed his supplies forever, and whether the decision applies only to prior (or currrent) customers. J. CUNNINGHAM, THE COMPETITION LAW OF THE E.E.C. 62-63, 275-76 (Supp. 1975).

23. 17 COMM. MKT. L.R. at 457, 467-69.

24. Thus, the quotas and limitations effectively imposed upon exporters by the principal refinery doing buisness in Belgium was held to be an abuse, while the marketing restrictions maintained between particular German producer groups and various vendor/distributors establishing sales regions and exclusive dealerships were found not to be an infringement of this principle. *Id.* at 469-70.

nant position is merely the instrument by which an enterprise takes advantage of the market or competition. In *Continental Can,* however, the Court held that the strengthening of a dominant position alone is a prohibited abuse.[25] In other words, under article 86 the Commission may change the structure of competition as well as the use of the structure.[26] Thus, when mergers involve an undertaking in a dominant position, they can be prohibited by the Commission even though article 86 does not so state.[27] In *Commercial Solvents,*[28] the Court found both direct and indirect potential effects on the "competitive structure within the Common Market" to be sufficient for a finding of an article 86 violation. Presumably this "effects" doctrine is limited to substantial or appreciable effects and is not so broad as to include all detrimental consequences[29] or the inadvertant elimination of an insignificant competitor. Once the Commission determines that article 86 has been infringed,[30] it has the authority under Regulation 17/62 to order the termination of the abuse in whatever manner it

25. [1972] C.J. COMM. E. REC. 77, [1971-1973 Transfer Binder] COMM. MKT. REP. (CCH) at 8300-01.

26. For a detailed analysis of the Court's holding on this point, see J. CUNNINGHAM, *supra* note 10, at 261-63.

27. Immediately after the *Continental Can* decision, the Commission submitted to the EEC Council a draft proposal authorizing Commission regulation over planned mergers and market concentrations, ostensibly to clarify its control over the structural modifications involved therein, but arguably to extend the power of the Commission into an area that article 86 does not expressly cover. Proposal for a Council Regulation on the Control of Concentrations Between Undertakings. O.J. EUR. COMM. (No. C 92) 1 (1973), salient portions reprinted in J. CUNNINGHAM, *supra* note 10, at 371-74.

28. [1974] C.J. Comm. E. Rec. 223, [1974 Transfer Binder] COMM. MKT. REP. (CCH) at 8820-22. The Court held that it was "immaterial" that the competitor's EEC trade was minimal (about six percent of gross sales) and declining so long as the market structure within the EEC would be altered by its elimination as a consequence of the monopolistic suppliers' refusal to deal.

29. *Cf.* General Motors Continental N.V. v. Commission Eur. Comm., [1975 Transfer Binder] COMM. MKT. REP. (CCH) ¶ 8320 at 7735 (1975). Only five specific instances of excessive pricing were charged by the Commission.

30. The five decisions in which the Commission found an infringement of article 86 are: General Motors Continental N.V. v. Commission Eur. Comm., [1975 Transfer Binder] COMM. MKT. REP. (CCH) ¶ 8320 (1975); Sugar Cartel Case, 17 COMM. MKT. L.R. 295 (1975); Instituto Chemioterapico Italiano SpA and Commercial Solvents Corp. v. Comm'n Eur. Comm., [1974]. C.J. Comm. E. Rec. 223, [1974 Transfer Binder] COMM. MKT. REP. (CCH) ¶ 8209 at 8800 (1974); Europemballage Corp. & Continental Can Co. v. Commission Eur. Comm., [1973] C.J. Comm. E. Rec. 77, [1971-1973 Transfer Binder] COMM. MKT. REP. (CCH) ¶ 8171 at 8279-83 (1973); Re GEMA, 10 COMM. MKT. L.R. D35 (1971).

"recommends" as most appropriate,[31] to impose a fine of up to one million units of account,[32] and to charge a periodic penalty of up to 1000 units of account per day for delay in complying with the termination order.[33] Regulation 17/62 grants the Commission unlimited discretion in formulating its "recommendations" for the termination of an infringement of article 86. In *Commercial Solvents*, the only case in which this exercise of discretion resulted in any theoretical problems, the Court affirmed a Commission recommendation for a non-EEC enterprise to supply an EEC competitor with a sufficient amount of material to make competition with the supplier's EEC subsidiary in the market "economically feasible" even though the EEC market was relatively unimportant for both EEC companies.[34] Consequently, the competitor received a substantial portion of the material necessary for world-wide competition with the supplier in order to make competition locally with the EEC subsidiary feasible. This demonstrates the broad impact a Commission decision can have beyond the Common Market.

In the instant case, the Commission determined that United Brands Co. (UBC) was an undertaking with a dominant position in the EEC banana market, that UBC had abused its position in four ways affecting competition in the EEC market, and that UBC had therefore infringed article 86 of the EEC Treaty.[35] According to the Commission, UBC is an undertaking for the purposes of article 86 because it is the parent of United Brands Continental, B.V., which is located in Rotterdam and which coordinates most of UBC's Common Market banana operations, although it merely implements UBC instructions and policy.[36] The Commission established that the relevant economic market was limited to bananas because no other fruit is a satisfactory substitute to consumers who generally prefer bananas, even when less expensive fruit is available.[37] The Commission limited the relevant geographic

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31. *See* note 7 *supra.*

32. The unit of account is determined by budgetary regulation pursuant to articles 207 and 209 of the EEC Treaty and generally approximates the value of the U.S. dollar.

33. Regulation 17, *supra* note 3, art. 16.

34. [1974] C.J. Comm. E. Rec. 223, [1974 Transfer Binder] COMM. MKT. REP. (CCH) at 8822-23.

35. 19 J.O. EUR. COMM. (No. L 95) 1, (1976), [1975 Transfer Binder] COMM. MKT. REP. (CCH) ¶ 9800 at 9774 (1975).

36. *Id.* at 9776, 9785.

37. *Id.* at 9785.

market to BLEU and the Netherlands (Benelux), Denmark, Ireland, and Germany where it is not under the Scipio group, because the market conditions in these areas are virtually identical and clearly distinguishable from those in the remainder of the EEC.[38] Although UBC controls only 45 percent of the EEC sales volume, the Commission determined that it had a dominant position in the banana market because the strong vertical integration[39] of its operations and the substantial margin between its share of sales and that of its closest competitors[40] gave UBC the requisite capacity for both independent action and the exertion of significant influence on the market.[41] This evaluation by the Commission is supported

38. UBC is as active in France, Italy, and the United Kingdom, but distinguishable factors in those markets are import arrangements, trading conditions, and the marketing of different kinds of bananas produced in different parts of the world. The Commission also weighed heavily the role of the Rotterdam subsidiary in the operations of the markets in the five countries ultimately selected and the use of the two ports for the greater bulk of banana deliveries to those same countries. *Id.* at 9785-86. The Scipio group in Germany represents better than three-quarters of UBC sales in Germany but is excluded from the Commission's deliberations and from this comment because the group purchases its bananas from UBC under significantly different terms and conditions from other D/Rs as a result of an historical relationship between Scipio and UBC. Among the factors most significant in the eyes of the Commission were that Scipio uses its own ships for the transport of bananas from Latin America and that its prices were f.o.b. Latin American port of origin rather than the usual UBC practice of setting prices f.o.r. European port of destination. *Id.* at 9779, 9782.

39. *See* note 4 *supra.*

40. UBC's principal competitors and their shares of the EEC banana market are Castle & Cook (9%), Del Monte (5%), the "Alba" group (5%), the "Belhoba" group (5%), and Geest Industries Ltd. (6%). These five competitors combined still only have two-thirds of the share held by UBC. [1975 Transfer Binder] COMM. MKT. REP. (CCH) at 9780-81.

41. *Id.* at 9785-87. The Commission stated:

> Undertakings are in a dominant position when they have the power to behave independently without taking into account, to any substantial extent, their competitors, purchasers and suppliers. Such is the case where an undertaking's market share, either in itself or when combined with its know-how, access to raw materials, capital or other major advantage such as trademark ownership, enables it to determine the prices or to control the production or distribution of a significant part of the relevant goods. It is not necessary for the undertaking to have total dominance such as would deprive all other market participants of their commercial freedom, as long as it is strong enough in general terms to devise its own strategy as it wishes, even if there are differences in the extent to which it dominates individual submarkets.

Id. at 9785.

by the effective conversion of the industry's processing technology and sales methods after UBC introduced the "Chiquita" brand. Having found UBC to be in a dominant position in the EEC banana market, the Commission determined that four UBC practices abused that position. The Commission held that UBC pricing practices amounted to abuses of the express provisions of article 86 (a) and (b).[42] Based on both the minimal differences between UBC's branded and unbranded bananas and the significantly lower prices charged by UBC for "Chiquita" bananas in Ireland than elsewhere in the EEC, the Commission held that the pricing of "Chiquita" bananas 30 to 40 percent above its unbranded bananas was an "unfairly excessive" margin.[43] The Commission concluded that at least half of the price difference was unjustifiable, and therefore abusive under article 86(a).[44] Also, the Commission determined that UBC applied unjustifiably dissimilar prices in substantially equivalent transactions, thereby abusing its position under article 86(c). UBC set its prices on a country-by-country basis although the terms of the sales always quoted the price as f.o.r. (free on rail) port of destination (either Rotterdam or Bremerhaven). The discrepancy in the prices paid by the D/Rs in Germany, Benelux, and Denmark ranged as high as 50 percent in spite of UBC delivering bananas produced, packaged, and transported under identical conditions.[45] The Commission went further and

42. *See* note 5 *supra*.

43. 19 J.O. EUR. COMM. (No. L 95) 1, [1975 Transfer Binder] COMM. MKT. REP. (CCH) at 9778, 9782-83, 9788-89. Because UBC packages its bananas at the time they are picked or harvested, it is possible that by the time they reach the retail outlets there will be a larger difference between ripe and unripe, or between clean and damaged bananas of the same brand, than there will be between separate brands which are generally distinguished by length or curvature at the time of harvest. Prices in Ireland for "Chiquita" bananas are c.i.f. Dublin and thus include the substantial amount required to insure and transport the goods across the land and through channels from the port of destination to Dublin, yet these prices run as much as 60% *below* the average BLEU price. UBC still admits the possibility of profit even at the low rates suggested herein.

44. *Id.* at 9789. UBC argued unsuccessfully that the price differences are attributable to the additional advertising and promotional costs generated by the marketing of bananas by brand name. The Commission observed, however, that other competitors consistently priced their own brand name bananas below the UBC levels even when the competitor lacked the cost-efficient market integration enjoyed by UBC (although the depressed prices may be partially due to the inferior quality or lack of uniformity that may result without the market integration).

45. *Id.* at 9782-83, 9788. The discrepancy is most pronounced when the Irish price is compared with the Danish price; at one time the c.i.f. Dublin price

held that this systematic setting of prices at the highest tolerable level in each segment of a market intentionally segregated by an undertaking in a dominant position was an abuse of UBC's position because it could not justify the price discrepancy by reference to variations in the market structure or production costs.[46] The Commission said it was not satisfied that UBC's desire to maximize profits by setting its prices as high as the market would bear was an "objective justification" for the UBC price schedule.[47] Furthermore, the Commission found another abuse by UBC in the "market segregation" itself. UBC maintained country-by-country segregation by prohibiting the resale of green bananas through restrictive clauses in the supply contracts with the D/Rs and through sales agreements permitting sale to consumers only within a narrow period of specified ripeness. The Commision again was not satisfied with the UBC explanation for these restrictions—that they were necessary to insure the consumer of both quality and uniformity in the "Chiquita" brand—and looked to the broader effects of the restrictions.[48] The Commission held these restrictions and the resulting market segregation to be an infringement of article 86 because their practical consequence was a complete ban on competition among EEC members in the banana market. The Commission found two of the UBC restrictions on its D/Rs unacceptable. First, D/Rs could not compete with other D/Rs and UBC for the retail trade in other countries because the fully-ripened bananas UBC would allow to be exported from country to country were too highly perishable to make the trade economically feasible. Second, D/Rs could not enter the "Chiquita" market in the first place unless they had access to the sophisticated ripening facilities necessary for the UBC-approved preparation of the bananas for resale to consumers.[49] The Commission found the resultant market segregation facilitated UBC's discriminatory price structure as well as other market-controlling behavior.[50] Finally, the Commission investigated UBC's relationship with one of its principal Danish D/Rs and held that UBC's refusal to supply the D/R with

(including insurance and ground transportation) was 72% *below* the Danish f.o.r. Bremerhaven price (not including the additional insurance and transportation costs).

46. *Id.* at 9788.

47. *Id.*

48. *Id.* at 9778, 9781-82, 9787.

49. *Id.* [1975 Transfer Binder] at 9787.

50. *See* text accompanying notes 45-47 *supra*.

"Chiquita" bananas for sixteen months was an abuse. UBC had responded to the D/R's trade in a competitor's brand by gradually cutting off the D/R's access to supplies of "Chiquita" bananas. The Commission said this interfered with market competition by discouraging "Chiquita" dealers from selling non-UBC brands.[51] Having determined that UBC market practices infringed article 86 in at least four ways, the Commission imposed the maximum fine of one million units of account ($1.168 million). The decision was based on three grounds: UBC was at least negligent in not realizing the anti-competitive effects of its marketing policies, the abuses had lasted since 1967, and UBC had persisted in consolidating its already significant dominant position in the banana market. The Commission noted that UBC had notified the Commission since 1968 of the sales restrictions on green bananas, that UBC had voluntarily terminated the refusal-to-supply infringement, and that this was the Commission's first full consideration of pricing policies and article 86. The Commission concluded that a moderate fine would be appropriate and that maximum million-unit fine was "moderate" in view of the high profitability of UBC's banana market practices and the $50 million value of UBC's annual EEC trade.[52] The Commission also ordered UBC to cease its violation of article 86 by terminating its restrictions on the resale of green bananas and by establishing a uniform Common Market pricing schedule that would be neither discriminatory nor excessive. The specific price level recommended by the Commission was "at least fifteen per cent below that of the prices currently charged to its customers in Denmark and Germany."[53] The Commission denied that it was assuming the function of a pricing board and stressed that it was UBC's responsibility to fix particular prices in accordance with production costs and general fairness. The Commission did, however, require UBC to submit periodic reports detailing the prices actually charged to its customers for "Chiquita" bananas. Finally, to compel compliance with its orders, the Commission

51. *Id.* [1975 Transfer Binder] at 9783-85, 9789-90. The D/R (who was the complainant at note 1 *supra*) had first participated in a UBC competitor's sales promotion campaign similar to the ones frequently employed by UBC. Eventually the D/R became the exclusive Danish outlet for the competitor's brand and UBC thereafter terminated deliveries of its "Chiquita" brand. The D/R had invested heavily in the UBC "Chiquita" technology and needed the "Chiquita" business. UBC again supplied the D/R after the commencement of the Commission's investigation.

52. *Id.* [1975 Transfer Binder] at 9790-91.

53. *Id.* at 9792.

imposed the maximum periodic penalty of 1000 units per day in the event that UBC delayed in complying with the Commission Decisions.[54] The Court of Justice has issued an interim order suspending the Commission's sanctions pending the outcome of the substantive appeal filed by UBC.

Four of the five prior cases in which the Commission found an infringement of article 86 were appealed to the Court of Justice.[55] The Court agreed with the Commission as to the legal theories espoused in at least three of the four cases, yet it affirmed in full only one of the Commission Decisions while overturning two others outright. The Court seems to consent to expanding regulation of anti-competitive practices under article 86 but limits the extent to which sanctions are applied in those cases where the Commission first expands the application of article 86. With so few previous Commission Decisions dealing with article 86, the instant case is significant. It reaffirms the trend towards expanded regulation of anti-competitive practices through article 86 and Regulation 17 in two ways. The case further develops the "refusal to supply" and the "market segregation" doctrines not specifically enumerated in article 86 or its attendant proclamations and regulations. It also provides the first Commission analysis of how pricing policies will be determined to be abusive within the enumerated guidelines of article 86. The principles of competitive policy upon which the Commission bases its increasingly active regulation of the marketplace are consistent and should receive the support of the Court on appeal. Further, the instant decision is significant in exposing the Commission's method of determining that UBC has a dominant position in the banana market. The Commission's use of the "capacity for independent action" and "capacity to exert substantial influence" doctrines was not unique, but it is notable that these factors were sufficient to find that an undertaking with less than a majority share of the market is nonetheless in a dominant position. In none of the BLEU nations did UBC's share of the banana market exceed 45 percent and in the German market the Commission excluded three-quarters of UBC's share because it

54. *Id.*

55. The four cases appealed are those which have been discussed herein. They are (with the court's action and position): *Commercial Solvents* (affirmed outright), *Continental Can* (annulled only on the facts, the legal theory was supported), *Sugar Cartel* (sanctions were substantially modified, the legal theory was supported), and *General Motors Corp.* (annulled but arguably the legal theory was supported).

was under the control of the Scipio group. Since anti-competitive practices under article 86 are only prohibited if the undertaking is in a dominant position, the Court might annul the Commission Decision on the grounds that UBC could not have known its practices were illegal until it had some notice that it might be in a dominant position despite its less-than-majority share of the market. The Court's ruling on appeal will be critically important to other undertakings doing business in the EEC. In applying the specific performance sanction of Regulation 17 for only the second time, the Commission was affirming the use of both prescriptions and proscriptions in regulating anti-competitive market practices, and it added a new tool for active regulation in the market place—a mandatory reporting scheme, here used to check on UBC's pricing policies. There is no reason for the Court not to permit this development, and as a result the instant case provides for a more flexible system of regulating market practices. Finally, the Commission's attempt to establish guidelines for UBC pricing is most significant.[56] Although the Commission stressed that it was not setting itself up as a price control board, the recommendation of a maximum price level operates in exactly that fashion. The determination that a price is unfair, excessive, prejudicial, or abusive requires less thorough knowledge of a particular market than does the establishment of a specific price requirement or limitation. Although the former is a logical function of the Commission, the latter seems beyond its expertise. Thus, the Commission could determine that UBC's pricing policy needed modification but may find itself seriously jeopardizing the market when it determines what specific price is justifiable and proceeds to enforce it.

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56. There are two conflicting purposes in the policy underlying the EEC, both of which are reflected in the name "Common Market." "Market" suggests free competition among its participants and it is this notion with which the *UBC* decision deals, namely termination of anti-competitive activity. On the other hand, "community" suggests consolidation of efforts among participants for a strengthened and unified activity, and insofar as this consolidation is anti-competitive there will be a constant antagonism between the two Common Market principles of consolidation and competition. Every Court decision and Commission ruling, therefore, is significant insofar as it shifts the prevailing policy closer toward one or the other of these principles.

FEDERAL JURISDICTION—STATE REGULATION OF INTERSTATE COMMERCE—FEDERAL COURTS HAVE JURISDICTION TO ENJOIN STATE OFFICIALS FROM ENFORCING STATE LAWS REGULATING INTERSTATE TANKER TRADE WHERE CONGRESS INTENDED THAT FEDERAL REGULATIONS PRE-EMPT THE AREA

Plaintiffs, Atlantic Richfield Company and Seatrain Lines, Inc.,[1] sued named officials[2] of the State of Washington to enjoin enforcement of the state's Tanker Law.[3] The State of Washington in 1975 enacted laws regulating oil tankers with the intent of decreasing the likelihood of oil spills on the Puget Sound.[4] The laws prohibited supertankers[5] not complying with the requirements of the statute from entering the Puget Sound or its adjacent waters.[6] Furthermore, the laws required oil tankers above a certain size[7] to employ pilots licensed by the State of Washington,[8] and required vessels lacking certain safety and maneuvering capabilities[9] to be

1. Plaintiffs are United States corporations engaged in the transportation of oil to and from domestic and international ports.

2. The state officials named in plaintiff's brief are: Daniel J. Evans, Governor of the State of Washington; Slade Gordon, Attorney General of the State of Washington; William C. Jacobs, Chairman, and Harry A. Greenwood, Benjamin W. Joyce, Philip H. Luther, and J.Q. Paull, Members, Board of Pilotage Commissioners; and David S. McEachran, Whatcom County Prosecuting Attorney.

3. WASH. REV. CODE §§ 88.16.170 to 88.16.190 (Supp. 1976) (The Tanker Law). Jurisdiction was conferred by 28 U.S.C. 1337, which provides: "The district courts shall have original jurisdiction of any civil action or proceeding arising under any Act of Congress regulating commerce or protecting trade and commerce against restraints and monopolies."

4. The new laws require tankers to have collision avoidance radar, double bottoms, twin screens and other safety equipment, and in the alternative to be escorted by tugs.

5. Supertankers are a class of large oil tankers, statutorily defined as any oil tanker that is larger than 125,000 deadweight tons. WASH. REV. CODE § 88.16.190(1) (Supp. 1976).

6. *Id.*

7. The laws apply to all oil tankers, whether enrolled or registered, of 50,000 deadweight tons or greater. *Id.* § 88.16.180.

8. Washington provides for the procurement of state pilot licenses via state exams in addition to those provided by the United States where the statutes so authorize.

9. "An oil tanker . . . of 40 to 125 thousand deadweight tons may proceed beyond the points enumerated in subsection (1) if such tanker possesses all of the following standard safety features:

(a) Shaft horsepower in the ratio of one horsepower to each two and one-half deadweight tons; and

(b) Twin screws; and

escorted by tugs[10] while navigating in the defined waters. Plaintiffs asserted that the state laws were pre-empted by federal regulation,[11] violated the Commerce Clause,[12] and invaded the foreign affairs powers[13] of the United States. Defendents contended that the federal courts lacked jurisdiction under the judicial doctrine of abstention[14] and that the congressional policy of "cooperative federalism"[15] precluded plaintiffs' asserting any federal pre-emption.[16]

(c) Double Bottoms, underneath all oil and liquid cargo compartments; and

(d) Two radars in working order and operating, one of which must be collision avoidance radar; and

(e) Such other navigational position location system as may be prescribed from time to time by the board of pilotage commissioners . . . ."

Id. § 88.16.190(2) (Supp. 1976).

10. The statute requires that such tankers shall be under escort of a tug or tugs with an aggregate shaft horsepower equivalent of five percent of the deadweight tons of that tanker. *See id.* § 88.16.170 (Supp. 1976).

11. *See* note 3 *supra*.

12. "The Congress shall have power . . . to regulate commerce with foreign Nations, and among the several States, and with the Indian tribes." U.S. CONST. art. I, § 8, cl. 3.

13. The regulation of foreign commerce is exclusively within the powers of the federal government. The plaintiffs claimed that by the very nature of such power it would be inconsistent with the national interest to allow each state to regulate commerce with foreign nations. *See* Board of Trustees of the University of Illinois v. United States, 289 U.S. 48 (1933).

14. The abstention doctrine is a response to the problems caused by the existence of two sets of courts, state and federal, with authority to adjudicate questions of state and federal law. Federal district court abstention has been especially important and controversial in suits challenging state action on federal grounds—suits made more readily possible by the nationalizing impacts of post-Civil War amendments, the enactment of civil rights laws, and the 1908 Supreme Court decision in *Ex parte Young*, 209 U.S. 123 (1908). Congress was asked to curtail that jurisdiction, but the legislative restrictions imposed were of limited scope. Beginning in 1940, Court-developed doctrines have created significant additional restraints on the exercise of federal jurisdiction.

15. "Cooperative federalism" has been the congressional policy for designing a United States environmental policy. The Congress funded and encouraged the coastal states to design comprehensive and forward-looking coastal management plans. *See* Coastal Zone Management Act of 1972, 16 U.S.C. §§ 1451-64 (Supp. V 1975). Congress has invoked "cooperative federalism"—or at least some state involvement—in virtually all of its water-related regulatory programs: *e.g.*, Federal Water Pollution Control Act, 33 U.S.C. §§ 1251-1376 (Supp. V 1975); Clean Air Act, 42 U.S.C. § 1857 (1970 & Supp. V 1976); The Estuarine Act of 1968, 16 U.S.C. §§ 1221-26 (1970); The Deep Water Ports Act of 1974, 33 U.S.C. §§ 1501-24 (Supp. V 1975).

16. The Secretary of Commerce can approve a state's coastal management

The United States District Court for the Western District of Washington, *held*, for the plaintiff. The federal courts have jurisdiction to enjoin state officers from enforcing state laws regulating the oil tanker industry because Congress intended that the Ports and Waterways Safety Act of 1972[17] pre-empt state regulation in the area. *Atlantic Richfield Company v. Evans*, No. 75-648 (W.D. Wash., decided April ___, 1977).

When a state law or action is challenged as violative of some federal right, federal courts may enjoin the state officer, though not the state, from enforcing the state law in question. In *Ex parte Young*[18] the Supreme Court held that the eleventh amendment[19] barred federal courts from rendering any judgment in private suits against a state.[20] The Court established, however, that neither the eleventh amendment nor the doctrine of sovereign immunity prevented an action to enjoin a state officer from applying a state law that violated a right arising either under the Constitution or United States statutes and treaties.[21] Congress responded by enacting statutes that restricted the application of *Young*, thereby giving rise to the concept of abstention. The abstention doctrine was first enunciated in *Railroad Commission v. Pullman Co.*[22] In *Pullman* the Court upheld a federal district court's refusal to issue an injunction against the Texas Railroad Commission until the state courts had had an opportunity to void the Commission's action on state law grounds. The Court reasoned that such a solution would avoid possible federal-state friction prompted by a tentative and premature adjudication[23] in the federal court. The Court further added that federal injunctive relief would be granted only in "special circumstances to prevent irreparable injury which is

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plan (thereby making it eligible for federal funding) only if "the views of Federal agencies principally affected by such program[s] have been adequately considered." 16 U.S.C. § 1456(b) (1970).

17. 33 U.S.C. §§ 1221-27 (Supp. V 1975).

18. 209 U.S. 123 (1908).

19. "The judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or Citizens or Subjects of any Foreign State." U.S. CONST. amend. 11.

20. The broad power conferred by Article III of the Constitution has been modified in part by the eleventh amendment.

21. 209 U.S. at 123.

22. 312 U.S. 496 (1941). In *Pullman*, black porters alleged that a state railroad commission denied them their jobs on racial grounds by requiring conductors to be put in charge of all sleeping cars.

23. *Id.* at 500.

clear and imminent."[24] This abstention by federal courts was most notable in four decisions handed down on June 8, 1959.[25] The Court established another "prerequisite" of a grant of federal injunctive relief: that the state court remedies be inadequate, or alternatively that the litigant have exhausted his state court remedies.[26] In *Louisiana Power & Light Co. v. Thibodaux*,[27] abstention was ordered on the ground that there was a special danger of state-federal friction that could be avoided by first obtaining state court clarification on an unclear point of state law. *Thibodeaux*, however, was the high water mark of the federal court's flexibility in the abstention doctrine, because in *Zwickler v. Koota*[28] the Court shifted noticeably by removing the federal court's equitable discretion to abstain in all cases involving freedom of expression and first amendment rights. Abstention, therefore, has historically served three functions: the avoidance of unnecessary friction between federal courts and the states; the avoidance of unnecessary rulings on constitutional questions; and the avoidance of error in construing

24. Douglas v. City of Jeannette, 319 U.S. 157, 163 (1943). In this case, the Court upheld a federal district court's refusal to enjoin the application of a city ordinance to certain religious solicitation, even though the ordinance was held unconstitutional the same day by the Court in reviewing a criminal conviction under it. Murdock v. Pennsylvania, 319 U.S. 105 (1943). The Court later explained its actions by stating: "Since injunctive relief looks to the future, and it was not alleged that Pennsylvania courts and prosecutors would fail to respect the *Murdock* ruling, the Court found nothing to justify an injunction." Dombrowski v. Pfister, 380 U.S. 479, 485 (1965).

25. Louisiana Power & Light Co. v. City of Thibodaux, 360 U.S. 25 (1959); Harrison v. NAACP, 360 U.S. 167 (1959); County of Allegheny v. Frank Mushuda Co., 360 U.S. 185 (1959); Martin v. Creasy, 360 U.S. 219 (1959).

26. The requirement of exhausting state remedies provided a rationale for the federal district court's abstention in Zwickler v. Koota, 261 F. Supp. 985, 993 (E.D.N.Y. 1966), *rev'd on other grounds*, 389 U.S. 241 (1967). *But see* Turner v. City of Memphis, 369 U.S. 350 (1952) (abstention which had been ordered only because state declaratory judgment remedy had not been exhausted). The first exception to the *Ex parte Young* federal injunction doctrine was that a litigant must have first exhausted his state remedies. Prentis v. Atlantic Coast Line Co., 211 U.S. 210 (1908). The rationale for this exception was that this would avoid federal-state friction. *Id.* at 230. This same rationale was applied in Railroad Comm'n v. Pullman Co., 312 U.S. 496, 500-01 (1941). Similarly, in certain cases, litigants attempting to remove an action from a state court to a federal court were not allowed to show that the state court remedies were inadequate.

27. 360 U.S. 25 (1959).

28. 389 U.S. 241 (1967). In *Zwickler* the Court extended and clarified the first amendment exception to the abstention doctrine by holding that a federal court has the *duty* to decide the appropriateness and the merits of a declaratory request if the state statute is constitutionally attacked as void for overbreadth.

a state law. Accordingly, the present rule requires that when a federal constitutional claim is premised on an unsettled question of state law, the federal court *should* abstain from acting in order to provide the state courts an opportunity to settle the underlying state-law question. The federal court would thus avoid any unnecessary decision on a constitutional question.[29] Nevertheless, this rule is qualified by the Court's warning that because of delays inherent in the abstention process and the danger that valuable federal rights might be lost in the absence of expeditious adjudication in the federal court, jurisdiction may be invoked in "special circumstances," upon careful consideration of the facts in each case.[30] Parallel to the abstention doctrine in the area of federal-state law interaction is the problem raised by pre-emption, as it applies to the Commerce Clause. In granting Congress the power to "regulate Commerce . . . among the several States,"[31] the Constitution neither expressly excludes nor reserves a concurrent power in the states. Although initially it was thought that the power to regulate interstate commerce resided exclusively in the Congress and all state regulation was impliedly prohibited,[32] this doctrine of exclusivity was quickly superceded by a doctrine of concurrent state and federal power. The concurrent power doctrine recognizes that a state, in the face of congressional silence, may regulate an aspect of interstate commerce that does not require

29. Harris County Commissioners Court v. Moore, 420 U.S. 77, 84 (1975). In *Harris County* appellee justices of the peace and constables, threatened with removal before their elected terms expired, brought this action in federal court. The suit challenged, on due process and equal protection grounds, the constitutionality of a Texas statute providing, *inter alia*, that when the boundaries of certain precincts are changed and more than the allotted number of justices of the peace and constables reside within the changed district, the offices shall become vacant and shall be filled as are other vacancies. A three-judge federal district court held that the statute violated equal protection by removing some county officers but not others and ordered appellee officials' reinstatement. The Court held that in view of the unsettled state of Texas law as to whether the state constitutional provisions ensure justices of the peace and constables tenure until their elected terms expire even when the challenged statute would require their ouster, the district court should have abstained from deciding the federal constitutional issue, since it was far from certain under Texas precedent that appellee officeholders would lose their jobs or that the reinstatement relief ordered by the district court would be available.

30. Baggett v. Bullitt, 377 U.S. 360 (1964).

31. U.S. CONST. art. 1, § 8, cl. 3. *See generally* F. RIGGLE, STATE AND NATIONAL POWER OVER COMMERCE (1937); Dowling, *Interstate Commerce and State Power*, 27 VA. L. REV. 1 (1940).

32. Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824).

uniformity of regulation,[33] unless doing so would discriminate against[34] or burden the free flow of commerce to an extent not justified by local benefit to the state.[35] Congress may also provide that an area within its jurisdiction be regulated exclusively by the states.[36] Furthermore, Congress may also exclude the states from regulating any aspect of interstate commerce.[37] Thus, whenever Congress exercises its commerce power, a state statute will be invalid if it either conflicts with the federal legislation[38] or intrudes into a field Congress intended to occupy exclusively.[39] In the absence of a clear expression of congressional intent to pre-empt state regulation, courts face the difficult problem of defining "the field"[40] of regulation and determining whether Congress intended pre-emption,[41] or whether state legislation can function without impairing the policy underlying related federal enactments.[42] Since Congress usually legislates against a background of state law,[43] courts are reluctant to conclude pre-emption was intended.[44] Furthermore, even absent express intention by Congress to pre-empt, state legislation that duplicates a pervasive federal scheme having national uniformity as its objective has been held invalid.[45] State

33. *See, e.g.*, Union Brokerage Co. v. Jensen, 322 U.S. 202 (1944); South Carolina State Highway Dep't v. Barnwell Bros., 303 U.S. 177 (1938). *See generally*, Dunham, *Congress, The States and Commerce*, 8 J. PUB. L. 47 (1959).

34. *See, e.g.*, Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951); H.P. Hood & Sons v. Du Mond, 336 U.S. 525 (1949).

35. *See* Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440 (1960); Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520 (1959).

36. Prudential Ins. Co. v. Benjamin, 328 U.S. 408 (1946).

37. *See, e.g.*, Guss v. Utah Labor Relations Bd., 353 U.S. 1 (1957); Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947).

38. U.S. CONST. art. 6, cl. 2. *See* Hill v. Florida *ex. rel.* Watson, 325 U.S. 538 (1945); Cloverleaf Butter Co. v. Patterson, 315 U.S. 148 (1942); Sinnot v. Davenport, 63 U.S. (22 How.) 227, 243 (1859).

39. Guss v. Utah Labor Relations Bd., 353 U.S. 1 (1957). *Cf.* Pennsylvania v. Nelson, 350 U.S. 497 (1956).

40. *See generally*, Note, 12 STAN. L. REV. 208 (1959).

41. *See* Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 229-30 (1947); H.P. Welch v. New Hampshire, 306 U.S. 79 (1939); Savage v. Jones, 225 U.S. 501 (1912).

42. California v. Zook, 336 U.S. 725, 729 (1949); Hill v. Florida *ex rel.* Watson, 325 U.S. 538 (1945). *See* Dunham, *supra* note 38, at 52.

43. H. HART & H. WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 435 (1953).

44. *See* Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440, 446 (1960); Local 1111, United Electrical Workers v. Wisconsin Employment Relations Bd., 315 U.S. 740, 749 (1942).

45. *See, e.g.*, Garner v. Teamsters Union, 346 U.S. 485 (1953); Rice v. Santa

statutes which are not duplicative but concern subjects not covered by federal law have been upheld as complementary legislation as long as no direct conflict with the federal regulatory scheme appears likely.[46] When directed toward local problems, such state statutes have been sustained because the state and federal legislation differ in their purposes[47] or operate in different regulatory spheres.[48] Thus, if there is no federal pre-emption, the states maintain power to control local matters that may in some degree affect interstate commerce,[49] provided the exercise of this power neither discriminates in favor of local commerce[50] nor unreasonably burdens the free flow of interstate commerce.[51] In determining the constitutionality of state regulations alleged to be a burden on the free flow of commerce, a court must carefully weigh[52] the effectiveness of such regulations in promoting legitimate local interests against the extent to which the regulations restrict the movement of commerce or interfere with uniform regulation.[53] State laws designed to improve working conditions of employees[54] and to protect the health, safety, and welfare of the community[55] have been sustained as reasonable exercises of state police power. More recently, the Supreme Court upheld a state law imposing strict liability in tort on coastal oil spillers, finding that the Federal Water Quality Improvement Act was concerned only with recovery of actual

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Fe Elevator Corp., 331 U.S. 218 (1947).

46. California v. Zook, 336 U.S. 725 (1949). *See* International Association of Machinists v. Gonzales, 356 U.S. 617 (1958).

47. De Veau v. Braisted, 363 U.S. 144 (1960); Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440 (1960). *Cf.* Parker v. Brown, 317 U.S. 341 (1943).

48. Union Brokerage Co. v. Jensen, 322 U.S. 202, 208 (1944).

49. Mauer v. Hamilton, 309 U.S. 598 (1940).

50. *Compare* Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951) (restriction on sale of non-local milk invalid), *and* H.P. Hood & Sons v. Du Mond, 336 U.S. 525 (1949) (refusal of license to out-of-state buyer invalid), *with* Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179 (1950) (natural gas production law valid), *and* Parker v. Brown, 317 U.S. 341 (1943) (agricultural production and marketing act valid).

51. Southern Pacific Co. v. Arizona, 325 U.S. 761 (1945).

52. *See*, Dowling, *Interstate Commerce and State Power—Revised Version*, 47 COLUM. L. REV. 547, 549 (1947) (emphasizes discretion).

53. Southern Pac. Co. v. Arizona, 325 U.S. 761, 770 (1945).

54. Terminal R.R. Ass'n v. Brotherhood of Railroad Trainmen, 318 U.S. 1 (1943).

55. *E.g.*, Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440, 445-48 (1960) (smoke control ordinance); Chicago, R.I. & P. Ry. v. Arkansas, 219 U.S. 453 (1911) (full crews required on trains); Smith v. Alabama, 124 U.S. 465 (1888) (medical examination of engineers).

clean-up costs incurred by the federal government and presupposed a coordinated federal-state effort to deal with coastal oil pollution.[56] In a related area of regulation, Congress has legislated on aspects of marine navigation. The Port and Waterways Safety Act of 1972 (PWSA)[57] was primarily designed to regulate the operations, traffic routes, pilotage, and safety design specifications of tankers. Under the statute, the Coast Guard is authorized to create traffic control systems and to "control vessel traffic in areas which it determines to be especially hazardous."[58] Title II of the PWSA also empowers the Coast Guard to "establish *comprehensive* minimum standards of design, construction, alteration, repair, maintenance and operation"[59] of tankers. In *David v. M/V Ester*,[60] the United States Court of Appeals for the Fifth Circuit held that a Florida state law requiring state licensed pilots on certain vessels was pre-empted by federal statute.[61] This is the only case interpreting congressional intent regarding pre-emption and the pervasiveness of federal regulation as applied to the PWSA.[62] It is left to the courts in cases of this type[63] to construe the relevant statute to determine whether Congress intended that its regulation pre-empt the field, or whether it intended to provide a complete national regulation of the subject matter to the exclusion of any local regulation.[64] Where there is no pre-emption in fact,[65] the court must consider the completeness of the federal regulatory scheme,[66] the dominance of fed-

56. Askew v. American Waterways Operators, Inc., 411 U.S. 325 (1973).

57. 33 U.S.C. §§ 1221-27 (1970).

58. *Id.* § 1221(3).

59. 46 U.S.C. § 391a(1) (Supp. V 1975). *See also*, 41 Fed. Reg. 15859 (April 15, 1976) (proposed regulations).

60. 509 F.2d 1377 (1975).

61. The federal statutes restricted state regulations as to the licensing of steam vessel pilots, setting of pilot charges, and the proscription of any fee levy against any steamer.

62. Title I of the PWSA, however, states that "nothing contained in this title . . . [shall] prevent a State or political subdivision thereof from prescribing *for structures only* higher safety equipment requirements or *safety standards* than those which may be prescribed pursuant to this title." 33 U.S.C. § 1222(b) (Supp. V 1975) (emphasis added).

63. This refers to cases where the state laws touch on areas in which Congress has legislated.

64. Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947).

65. Northern Natural Gas Co. v. State Corp. Comm. of Kansas, 372 U.S. 84 (1963); Farmers Educational Cooperative Union v. WDAY, 360 U.S. 525 (1959); McDermott v. Wisconsin, 228 U.S. 115 (1913).

66. Cloverleaf Butter Co. v. Patterson, 315 U.S. 148 (1942).

eral interest in the field,[67] and the interest in national uniform regulation.[68]

In the instant case, the three judge district court unanimously decided that it had jurisdiction over the parties under the doctrine of *Ex parte Young*. Although the district court did not discuss this issue in its opinion, it noted that the Supreme Court would have ample opportunity to reconsider[69] *Young*. On the merits of the case, the court found that federal law pre-empted Section 3(2) of the Washington Tanker Law, explaining that differing state regulations in the area were foreclosed by the national policy of uniform standards and regulations embodied in the PWSA. The instant court rejected the defendant's argument that pre-emption should be avoided because a non-complying tanker would have the option of choosing a tug escort,[70] stating that Congress gave the Coast Guard authority to require a tug escort. The court also rejected defendant's argument that since the state's Tanker Law is part of a comprehensive coastal management plan, and since Congress encouraged the states to design these plans in forming environmental regulations, the law should be upheld. Instead, the court found that such "cooperative federalism" has only been invoked in its water-related regulatory programs,[71] where Congress explicitly invited state participation,[72] and that since the PWSA did not invite such state participation, it did not share regulatory authority with the states over oil tankers.[73] The court considered in detail defendant's proffered case authority, finding that in *Askew v. American Waterways Operations, Inc.*,[74] the state regulatory scheme did not conflict with federal tanker regulations since

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67. Missouri Pac. R.R. v. Porter, 273 U.S. 341 (1927).

68. Campbell v. Hussey, 368 U.S. 297 (1961).

69. *See* 28 U.S.C. § 1253 (1970).

70. *See* WASH. REV. CODE § 88.16.170 (Supp. 1976).

71. The Federal Water Pollution Control Act, 33 U.S.C. §§ 151 *et seq.* and The Clean Air Act, 42 U.S.C. § 1857.

72. *Id.*

73. Consequently, the court invalidated WASH. REV. CODE § 88.16.180 (Supp. 1976), which required the presence of a state licensed pilot on all tankers larger than 50,000 deadweight tons, because it found that statute conflicted with 46 U.S.C. § 215 (1952), which declares that "[n]o State or municipal government shall impose upon pilots of steam vessels any obligation to procure a State or other license in addition to that issued by the United States, or any other regulation which will impede such pilots in the performance of the duties required by Title 56 . . . ."

74. 411 U.S. 325 (1973) (upheld Florida statute imposing strict liability on oil spillers).

Askew involved the Federal Water Quality Improvement Act of 1970,[75] not the PWSA, and since the Supreme Court's holding in that case reflected in part the congressional policy of "cooperative federalism" in the Federal Water Quality Improvement Act. The instant court also distinguished the case of *Huron Portland Cement v. City of Detroit*[76] by explaining that the environmental purpose of Detroit's ordinance was not pre-empted by federal safety regulations since there was "no overlap between the scope of the federal ship inspection laws and that of the municipal ordinance."[77] Since the PWSA introduced environmental considerations into the federal tanker regulations,[78] the instant court found that the State of Washington could not maintain that there was "no overlap" between the state and the federal laws. Finally, the court decided that the Secretary of Commerce's approval of Washington's coastal management plan did not preclude federal preemption of the area. The court noted that although the Secretary of Commerce can approve a state's coastal management plan *only* if the "views of the Federal agencies principally affected by such program have been adequately considered,"[79] the Secretary may or may not have "considered" the views of the Coast Guard or noticed the pre-emption effect of the PWSA on Washington's Tanker Law. Thus, the court decided that the Secretary's approval of the coastal management plan to which the Tanker Law was only collaterally related would not foreclose an inquiry into whether there had been federal pre-emption of oil tanker regulations. Therefore, the court held that since the Washington Tanker Law conflicted with federal law which intended to pre-empt state regulation in the area, state officers could be enjoined from enforcing that state law.

Although the instant court did not discuss its decision on abstention,[80] it appears to have correctly decided that jurisdictional issue.

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75. 33 U.S.C. §§ 1151-75 (1970).

76. 362 U.S. 440 (1960).

77. 362 U.S. at 446.

78. 33 U.S.C. § 1221 (Supp. V 1975) (stating that its purpose is "to protect the navigable waters and resources therein from environmental harm resulting from vessel or structure damage.")

79. 16 U.S.C. § 1456(b) (1970). *See* Atlantic Richfield Co. v. Evans, No. C 75-648 at 6. ___ U.S. ___, ___ S.Ct. ___ (19___).

80. The opinion of the instant court only touched upon the abstention question stating that ". . . the state invites us to 'overrule' *Ex parte Young*, 209 U.S. 123 (1908), or at least to restrict the scope of the cases falling within the *Young* 'exception' to the Eleventh Amendment. The invitation is attractively and persuasively argued, but we decline it. The Supreme Court, if it chooses to do so,

The *Pullman* doctrine requires that for a federal court to abstain, the relevant state law must be unclear and must be subject to an interpretation that would avoid ruling on a constitutional question. In the instant case the court appropriately decided not to abstain since the state Tanker Law was clear on its face, the state issue was not overly sensitive, and the issue demanded swift adjudication. On the other hand, the court discussed extensively the issue of pre-emption. Although in dealing with the issue of preemption a court should base its holding on an assessment of the functional and practical issues raised by the facts of the particular case,[81] the instant court disposed of the issue by referring to formal and conceptual statements of law. In doing so, the court gave no indication that it had considered such practical factors as the effect of the state ordinance on the flow of commerce, the effectiveness of the ordinance in eliminating the evil to be controlled, or the character of the business being regulated. Moreover the factors most frequently cited by the Supreme Court in recent pre-emption cases were conspicuously absent from the instant court's opinion. These four important factors are: (1) the existence or non-existence of conflicting state regulations on the same subject,[82] (2) the effect of the regulation on the free flow of commerce,[83] (3) the effectiveness of the regulation in achieving the goal that the state is attempting to attain through the use of its police power,[84] and (4) the nature and extent of the interest that the state is trying to protect. In the instant case, it is questionable whether the first factor should be applied in deciding the constitutionality of this regulation. If the mere existence of a conflict among the laws of different states is a sufficient ground for invalidating the statute, healthy

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will have ample opportunity to reconsider *Young*." No. 75-648, slip op. at 2 (W.D. Wash. 1976).

81. It has been the practice of the Supreme Court, in pre-emption cases analogous to the instant case, to rest its decision on the basis of such factors. The Court has pursued an increasingly interventionist role, assuming an almost quasi-legislative stance, by inquiring into the effectiveness and wisdom of the legislature. *See, e.g.*, Southern Pacific Co. v. Arizona, 325 U.S. 761 (1945). In many instances, however, although the Court has inquired into the functional aspect of such state laws, it has not pursued this line of thinking in its written opinions.

82. For a discussion of this problem, see *The Supreme Court, 1959 Term*, 74 HARV. L. REV. 132 (1960).

83. *See* South Carolina Highway Dep't v. Barnwell Bros., 303 U.S. 177 (1938); Sproles v. Binford, 286 U.S. 374 (1932).

84. Bibb v. Navajo Freight Lines, 359 U.S. 520 (1959); Southern Pacific Co. v. Arizona, 325 U.S. 761 (1945).

innovation would be stifled and the latter of two conflicting state statutes would necessarily be invalidated. Furthermore, a court might interpret "conflicting state regulations" to mean "conflicting state policies." The regulations of a given state might then be found to conflict when that state promulgated regulations in an area another state chose to leave unregulated. Acceptance of this view could require invalidating the state regulation in the instant case since the record would show conflicting state regulations, although no other state was shown to have a regulation dealing with the entry of supertankers into their harbors. With respect to the second practical factor, the Supreme Court would be less likely to invalidate the instant regulation if it merely increases the cost of engaging in interstate commerce,[85] rather than if it actually restricts the physical flow of goods from one state to another.[86] Compliance with the tanker regulation in the instant case would not restrict the free flow of goods across state lines but would surely increase the cost of shipping oil.[87] Third, if it appears that the regulation does not achieve its goal, the Supreme Court would be more likely to invalidate the law.[88] The Court, however, would have a difficult time disproving the utility of the oil tanker regulation.[89] In approaching the fourth practical factor, the Supreme Court would be more inclined to uphold a state statute if it appears that the state is regulating some legitimate *local* interest.[90] In the in-

85. *See* South Carolina Highway Dep't v. Barnwell Bros., 303 U.S. 177 (1938); Sproles v. Binford, 286 U.S. 374 (1932).

86. *See* Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520, 526 (1959); Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951).

87. Compliance with the standards would require additional investments in costly equipment, the re-routing of supertankers to more distant ports, or the delay and cost of utilizing the tug escort.

88. The Court noted in *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520, 526 (1959) that cost, taken into consideration with other factors, might be relevant in some cases to the issue of the burden on commerce. For instance, in striking down a maximum train length regulation in *Southern Pacific Co. v. Arizona, supra* note 81, the Court itself determined that the regulation would not increase safety by reducing train accidents and employee injuries.

89. *See* Askew v. American Waterways Operations, Inc., 411 U.S. 325 (1973). Justice Douglas' majority opinion noted that there have been over 3000 oil spills within U.S. waters annually and that the number increases yearly because of the increased importation of foreign oil. In addition, the rash of oil spills in 1977, highlighted by the grounding of the *Argo Merchant* off the Massachusetts coast, has prompted President Carter to call for more legislation, much of which is similar to the Washington Tanker Law.

90. A state's proprietary interest in the maintenance of its highways weighs heavily in favor of laws regulating the use of those highways. South Carolina

stant case, it should be clear to the Supreme Court that Washington has a legitimate local interest in protecting its environment, wildlife, fishing industry, and its inhabitants and their property from oil spill contamination. The instant court also failed to consider other functional factors such as the extra-territorial effect of the state regulation, the economic effect on the industry involved, and the likelihood of future congressional action in the disputed area.[91] Nevertheless, the most important factor to be considered in a state regulation requiring the use of certain equipment is the regulation's effect on the use of equipment in interstate commerce. Where the prescribed type of equipment is specified in a contract or agreement, a carrier engaged in interstate commerce may be forced to stop and change equipment if two states have differing requirements.[92] The Washington requirements can be avoided, however, if the carrier arranges a tug boat escort for its tanker. It appears, therefore, that the instant court decided the pre-emption issue incorrectly since it not only failed to consider the practical and functional factors involved, but also failed to provide persuasive arguments in finding any specific legislative pre-emption of the state regulation.[93] The ultimate effect of the instant holding is that although the states may participate with the federal

Highway Dep't v. Barnwell Bros., 303 U.S. 177 (1938).

91. For a discussion of this problem see, Wall St.J., March 21, 1977, at 8, col. 1. The article notes that the new administration under President Carter is calling for a number of legislative and regulatory steps to crack down on accidental and intentional discharges of oil by ocean-going vessels. These steps involve plans for tougher Coast Guard rules for tankers entering U.S. ports, a request that the Senate ratify a previously shelved international agreement under which tanker requirements are admittedly less stringent than the envisioned United States rules, and backing for an already proposed $200 million fund to compensate persons or towns suffering damage from oil spills.

92. In *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520 (1959), the challenged regulation would have necessitated changing mudguards at the state line, since Illinois and Arkansas both required a different type of mudguard. Thus the Illinois regulation was invalidated.

93. The minimum design specifications required by § 3(2) of the Tanker Law were not pre-empted because they can be avoided if a tanker has a tugboat escort. The instant court's argument that the tugboat escort provision was also pre-empted because Congress gave the Coast Guard authority to require such escorts is incorrect. The congressional grant of authority to the Coast Guard to require such escorts does not mean that the authority is exclusive. States have been allowed to legislate in many areas covered by federal law as long as those regulations do not conflict with federal law. The state's power to require tug escorts does not directly conflict with any federal laws on the subject but merely modifies the conditions under which such escorts would be used.

government in the establishment of certain environmental controls, such an emission (air) and discharge (water) standards,[94] they will not be able to regulate in the area of marine safety equipment in an attempt to prevent environmental harm resulting from large oil spills. The instant court rationalizes this result on the basis of federal pre-emption. The underlying reason for the court's decision, however, appears to be that such a law would increase the cost and burden on the interstate and international transportation of oil at a time when the public is more willing to sacrifice the environment in order to deal with the energy crisis.[95] Regardless of the future disposition of this case, analysis of the pre-emption issue would benefit measurably from the more systematic approach adopted by the Supreme Court in the most recent pre-emption cases. The instant decision's subjective approach points up the hazards of allowing different federal courts to inject their own policy considerations into their interpretations of existing federal laws and the relevant state regulations.

Christopher Ryan

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94. As the court noted in the instant case, "cooperative federalism" has been the congressional policy for designing the United States environmental policy. Congress funded and encouraged the coastal states to design comprehensive and forward looking coastal management plans. 16 U.S.C. § 1451 (1976). Congress has invoked "cooperative federalism" or at least some state involvement in virtually all of its water-related regulatory programs. *See, e.g.*, The Federal Water Pollution Control Act, 33 U.S.C. §§ 1251-1376 (Supp. V 1975); Clean Air Act, 42 U.S.C. § 1857 (1970 & Supp. V 1975); Estuarine Act of 1968, 16 U.S.C. §§ 1221-26 (1970).

95. *See The Price of Environmentalism—The Backlash Begins*, FORBES, June 1977, at 36.

SECURITIES REGULATION—JURISDICTION—ALLEGATIONS THAT AN INTERNATIONAL SECURITIES TRANSACTION INVOLVING STOCK REGISTERED ON AN AMERICAN EXCHANGE ADVERSELY AFFECTED THE AMERICAN MARKET ARE SUFFICIENT TO INVOKE SUBJECT MATTER JURISDICTION IN SECTION 10(b) ACTIONS

Plaintiffs, a Canadian national[1] and former Canadian Plywood Corporation, Ltd. shareholder, and the Western Pacific Trust Company of Canada, a Canadian corporation and trustee for former Canadian Plywood shareholders, sought to secure equitable relief and recover damages arising out of an allegedly fraudulent stock transaction in violation of section 10(b)[2] between the Goldfield Corporation and Canadian Plywood. Goldfield, a Delaware corporation, entered into a contract in 1969 to purchase the stock and assets of Canadian Plywood, a Canadian corporation.[3] The three-step acquisition plan provided that Canadian Plywood would form the Canadian Plywood Holding Corporation (CPHC), a Canadian corporation,[4] to acquire outstanding Canadian Ply-

1. Richard S. Des Brisay brought this derivative action both individually and on behalf of all former Canadian Plywood shareholders. One member of the purported class, Sigvard Dahl, is allegedly an American citizen; the remaining 307 are Canadians.

2. Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b)(1970), provides in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Plaintiffs allege that Dahl, a Washington resident, received a fraudulent "Take-Over Bid Circular" through the United States mails. The Circular stated that "The contents of this Take-Over Bid Circular have been approved and delivery thereof has been authorized by the executive committee of the Board of Directors of Goldfield and Goldfield Lumber."

3. Canadian Plywood was incorporated in 1968 in British Columbia, Canada, as a public company. Of the 400 shares of Canadian Plywood stock issued, 308 were held by Canadian Plywood employees or former employees. The remaining 92 shares were issued to three British Columbia "shell corporations" which had been formed for the purpose of assuming Canadian Plywood's debts, which included wage claims, taxes, and trade obligations. Brief for Appellee at 4, 6, Des Brisay v. Goldfield Corp., 549 F.2d 133 (9th Cir. 1977).

4. CPHC was incorporated on September 26, 1969, in British Columbia, Canada. Most of its directors were also directors of Canadian Plywood. *Id.* at 5.

wood shares in exchange for its own shares.[5] Goldfield in turn would place sufficient shares of Goldfield or Goldfield Lumber Enterprises Limited (GLEL) stock[6] to make up the purchase price in CPHC, accompanied by an opinion by Goldfield's New York counsel that Goldfield stock could be validly traded on the American Stock Exchange. CPHC would then transfer the Canadian Plywood shares and assets to Goldfield. Finally, CPHC would exchange the Goldfield stock for its own stock as part of its liquidation, and then dissolve.[7] Goldfield further agreed to deliver additional Goldfield shares to the extent necessary to make up the difference between the price at closing and the price obtained where such shares were sold on the American Stock Exchange within sixty days of the closing date, where the closing price was higher than the traded price.[8] The Securities and Exchange Commission, upon learning of the proposed transaction, instituted proceedings in the United States District Court for the Southern District of New York and secured an order[9] enjoining further sale of Goldfield securities.[10] All trading in Goldfield stock on the American Stock Exchange was subsequently suspended.[11] The district

5. On September 21, 1969, Canadian Plywood shareholders held an extraordinary general meeting and passed a resolution establishing the terms under which their shares would be exchanged for those of CPHC. *Id.* at 5.

6. GLEL, a British Columbia corporation, is named as a defendant in the case and is allegedly a wholly-owned subsidiary of Goldfield. The court's opinion makes no mention of GLEL, and appellee's brief contends that GLEL was not served with process, did not participate in the district court proceedings, and is not a party in the instant appeal.

7. The agreement provided that CPHC would deliver the Goldfield shares to Western Pacific Trust Company of Canada, which would act as trustee for the individual shareholders.

8. This provision was intended to protect the former Canadian Plywood shareholders from temporary fluctuations in the price of Goldfield stock following the transaction.

9. [1969-70 Transfer Binder] FED. SEC. L. REP. (C.C.H.) ¶ 92,636 (S.D.N.Y. April 10, 1970).

10. Appellee's brief alleges that the Goldfield shares involved in this transaction had not been registered with the S.E.C.; accordingly, the order entered on April 10, 1970, only sought to enjoin the further sale of *unregistered* Goldfield stock pursuant to §§ 5 and 20 of the Securities Act of 1933, 15 U.S.C. §§ 77e & 77t (1970).

11. Of the 489,193 Goldfield shares originally held in trust by Western Pacific, some had been distributed to those former Canadian Plywood shareholders who had so elected, and approximately $1,376,750 worth of the other shares had been sold prior to the suspension of trading in Goldfield stock. As a result, Western Pacific still retained approximately 144,000 Goldfield shares which could not be traded or transferred.

court sustained Goldfield's Rule 12(b) motion for summary judgment as plaintiffs failed to establish the court's subject matter jurisdiction.[12] On appeal to the United States Court of Appeals for the Ninth Circuit, *held,* reversed. Allegations that a transaction involved an improper use of securities of a United States corporation, that such securities were registered and listed on a national stock exchange, and that the transaction adversely affected both the plaintiff and the United States market in that corporation's securities are sufficient to invoke the federal district court's subject matter jurisdiction over enforcement actions brought under section 10(b) of the 1934 Securities Exchange Act. *Des Brisay v. Goldfield Corp.,* 549 F.2d 133 (9th Cir. 1977).

The Securities Act of 1933[13] and the Securities Exchange Act of 1934[14] were enacted to protect private individuals investing in the domestic securities market and "to insure the maintenance of fair and honest markets in such transactions."[15] Recently, the federal courts have struggled to determine the extent to which United States securities laws should apply extraterritorially to international securities transactions.[16] While section 30(b) of the 1934

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12. Section 22 of the Securities Act of 1933, 15 U.S.C. § 77v (1970) provides:

> (a) The district courts of the United States, and the United States courts of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter . . . .

Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa (1970), provides a similar grant of jurisdiction to the federal district courts over alleged violations of United States securities laws. In its unpublished memorandum opinion and order entered April 23, 1975, however, the district court held that it did not have subject matter jurisdiction as United States securities laws do not apply to an essentially foreign transaction where there is no significant impact on United States markets or investors, or where Goldfield did not engage in substantial conduct in the United States in perpetrating the alleged fraud.

13. Ch. 38, 48 Stat. 74 (codified at 15 U.S.C. §§ 77a-77bbbb (1970 & Supp. V 1975)).

14. Ch. 404, 48 Stat. 881 (codified at 15 U.S.C. §§ 78a-78jj (1970 & Supp. V 1975)).

15. 15 U.S.C. § 78b. *See also* H.R. REP. NO. 85, 73d Cong., 1st Sess. 1 (1933).

16. One commentator defines an international securities transaction as one "involving a buyer and seller of different nationalities in which more than de minimis contacts between them take place outside the territory of the state whose jurisdiction is invoked over the transaction." Comment, *From* Schoenbaum *to* Scherk: *The Continuing Question of Subject Matter Jurisdiction in an International Securities Transaction,* 12 HOUS. L. REV. 924 (1975).

Act[17] does exclude any person who "transacts a business in securities without the jurisdiction of the United States" from the Act's provisions,[18] there is unfortunately no language in the 1934 Act governing the extraterritorial applicability of section 10(b) to international transactions. In the absence of specific congressional intent, then, the courts have applied principles of international law in defining the scope of United States jurisdiction over international securities transactions disputes.[19] The principle of objective territoriality has been applied where conduct occurring outside a state's territory has a significant effect within that territory.[20] The principle of subjective territoriality has been applied where significant conduct occurs within a state's territory.[21] In *Schoenbaum v. Firstbrook,*[22] the Second Circuit Court of Appeals applied the principle of objective territoriality to find subject matter jurisdiction under United States securities laws over a stock transaction conducted by a Canadian corporation, where the securities involved were listed on a domestic exchange and the activities alleged had

17. 15 U.S.C. § 78dd(b) (1970).

18. In order for the section 30(b) exclusion to apply, the courts have apparently held that three conditions must be met. First, no substantial conduct must have occurred in the United States. Roth v. Fund of Funds, Ltd., 405 F.2d 421 (2d Cir. 1968), *cert. denied,* 394 U.S. 975 (1969); Kook v. Crang, 182 F. Supp. 388 (S.D.N.Y. 1960). Second, an actual "business in securities" must be involved rather than merely an isolated sale of securities. Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), *rev'd on the merits,* 405 F.2d 215 (2d Cir. 1968) *(en banc), cert. denied sub nom.,* Manley v. Schoenbaum, 395 U.S. 906 (1969). Third, no legitimate American interests must be at stake, whether the conduct occurs within or without United States territorial limits. SEC v. United Financial Group, Inc., 474 F.2d 354 (9th Cir. 1973). *See* 28 VAND. L. REV. 1382, 1384 (1976).

19. Generally, a state has jurisdiction to prescribe rules of law governing conduct and persons within its territory. RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 17(a) (1965) [hereinafter cited as RESTATEMENT]. In addition to territorial jurisdiction, there are five other bases of jurisdiction available to states: 1) objective territorial jurisdiction (a state may regulate conduct occurring outside its territory and producing an effect within its territory); 2) nationality jurisdiction (a state has jurisdiction over its citizens' conduct, even where such conduct occurs outside the state's boundaries); 3) passive personality jurisdiction (a state has jurisdiction over conduct which injures one of its citizens); 4) protective jurisdiction (a state has jurisdiction to prescribe legal rules governing conduct that threatens its national security or governmental operations); and 5) universal jurisdiction (a state having custody of a person committing an act has jurisdiction over that act—*e.g.*, piracy). *Draft Convention on Jurisdiction with Respect to Crime,* 29 AM. J. INT'L L. 437, 445 (Supp. 1935).

20. *Id.*

21. *Id.*

22. 405 F.2d 200 (2d Cir. 1968).

an adverse effect upon the United States securities market.[23] The court in *Finch v. Marathon Securities Corporation*[24] took the *Schoenbaum* holding one step further and held that where neither objective nor subjective territorial jurisdiction exists, no subject matter jurisdiction under United States securities laws exists. Two years later, in *Leasco Data Processing Equipment Corp. v. Maxwell*,[25] the Second Circuit Court of Appeals apparently limited its ruling in *Schoenbaum* and held that adverse market effects alone are insufficient to invoke subject matter jurisdiction.[26] The court applied the theory of subjective territoriality in requiring a combination of adverse effects and significant conduct within the United States[27] before applying United States securities laws to an international securities transaction. The court further suggested that subject matter jurisdiction might not exist where United States interests are not substantially involved.[28] The Eighth Circuit Court of Appeals consequently adopted the *Leasco* standard and held that extensive use of the United States mails and other facilities of interstate commerce, such as the telephone, constituted the minimum amount of activity within the United States needed to invoke subject matter jurisdiction.[29] In *SEC v. United Financial Group*,[30] the Ninth Circuit Court of Appeals declined to hold that significant conduct within the United States was in itself

23. 405 F.2d at 206. In this shareholder derivative suit brought by an American shareholder of a Canadian corporation, the court stated that:

> We believe that Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities.

24. 316 F. Supp. 1345 (S.D.N.Y. 1970).
25. 468 F.2d 1326 (2d Cir. 1972).
26. 468 F.2d at 1333.
27. Acts constituting conduct within the United States consisted of transatlantic telephone calls and letters referring to the transaction between the American and British corporations, face-to-face conversations in the United States between representatives of the two corporations, and the signing of the agreement in New York for the future purchase of stock. *Id.* at 1332.
28. *Id.* at 1338. The court's hypothetical involved a German and a Japanese businessman meeting in New York merely for convenience, where the Japanese visitor fraudulently induced the German investor to purchase Japanese securities listed on the Tokyo Stock Exchange.
29. Travis v. Anthes Imperial Ltd., 473 F.2d 515 (8th Cir. 1973). Note that both *Leasco* and *Travis* involved resident American investors holding stock in Canadian corporations.
30. 474 F.2d 354.

sufficient grounds to justify application of United States securities laws, although the court did note that the SEC's contention that jurisdiction existed solely on the basis of fraudulent misrepresentations made through the mails by a United States corporation to a foreign corporation was "not without merit."[31] On the other hand, the court stated that the relative number of United States shareholders involved is not determinative of jurisdiction.[32] While that factor is to be considered, courts should focus upon a defendant's activities within the United States and the impact of such activities upon United States investors.[33] Applying these twin requirements of substantial conduct within the United States and a resultant significant effect upon United States securities markets, the court in *Selas of America (Nederland) v. Selas Corporation of America*[34] exercised jurisdiction in an action brought by a foreign plaintiff, a Dutch corporation and former subsidiary of the defendant United States corporation. The court reasoned that the defendant's stock was traded in the United States, that the agreement to sell was reached in the United States, and that the transaction had a significant effect on a United States stock exchange.[35] At this point, the courts' slow development of a test for the extraterritorial application of United States securities laws took a strange twist in the Supreme Court's determination of *Scherk v. Alberto-Culver Co.*[36] Despite the presence of sufficient facts[37] under the *Leasco*

31. 474 F.2d at 354. In this case, the SEC sought an injunction against a Delaware holding company which controlled a large complex of mutual funds incorporated in various foreign countries. The court found that jurisdiction existed since the complex of foreign companies was directed and controlled from the United States, Americans held shares in some of the funds, and defendant used the United States mails and other interstate commerce facilities.

32. *Id.* at 356. *See* Finch v. Marathon Sec. Corp., 316 F. Supp. 1345, 1347-48 (S.D.N.Y. 1970) (American citizenship of parties who controlled an off-shore mutual fund considered to be significant but not sufficient for subject matter jurisdiction).

33. 474 F.2d at 356-57.

34. 365 F. Supp. 1382 (E.D. Pa. 1973).

35. 365 F. Supp. at 1386.

36. 417 U.S. 506 (1974). For a discussion of the case, *see* 8 VAND. J. TRANSNAT'L L. 901 (1975).

37. The facts indicated that there was an omission of a material fact by defendant during crucial negotiations in the United States, that plaintiff corporation's stock was listed on the New York exchange, that negotiations took place in the United States as well as in England and Germany, and that the trademarks, the disputed elements of the transaction, were licensed both in the United States and in Europe. 417 U.S. at 515-29.

standard to invoke subject matter jurisdiction, the Court held that the arbitration clause[38] in the parties' contract was enforceable and effectively circumvented the extraterritorial scope of the securities laws.[39] One year later, the Second Circuit Court of Appeals returned to the main line of cases and issued two opinions further restricting the scope of the *Schoenbaum* "adverse effects" test.[40] In *Bersch v. Drexel Firestone, Inc.*,[41] the court held that, in actions brought by domestic United States investors, the significant domestic effect requirement would be met only where the effect of extraterritorial conduct was "a direct and foreseeable result of the conduct."[42] In *IIT v. Vencap, Ltd.*,[43] decided on the same day, plaintiff's argument that the mere existence of United States investors indicated that defendant's activities had a significant effect in the United States was rejected by the court.[44] Instead, jurisdiction was predicated upon the defendant's fraudulent acts within the United States, where such acts constituted per se violations of the securities laws.[45] The most recent case determining the issue of subject matter jurisdiction, *Straub v. Vaisman & Co., Inc.*,[46] involved a West German plaintiff in an action for securities fraud brought against a registered securities broker-dealer in New

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38. The arbitration clause provided, in pertinent part, that "any controversy or claim [that] shall arise out of this agreement or the breach thereof . . . shall be settled exclusively by arbitration in accordance with the rules . . . of the International Chamber of Commerce, Paris, France . . . ." 417 U.S. at 508-09 n.1.

39. *Id.* at 517-18.

40. *See* Note, *American Adjudication of Transnational Securities Fraud,* 89 HARV. L. REV. 553 (1976).

41. 519 F.2d 974 (2d Cir. 1974), *cert. denied sub nom.* Bersch v. Arthur Andersen & Co., 423 U.S. 1018 (1975).

42. 519 F.2d at 1000. *See also* RESTATEMENT, *supra* note 19, § 18(b). The court noted that three classes of purchasers were involved in this transaction: (1) resident United States investors; (2) United States residents abroad; and (3) foreigners purchasing outside the United States. Subject matter jurisdiction existed over the first class because of adverse effects on the investors; jurisdiction existed over the second class where preparatory acts in the United States necessarily involved United States interests; and jurisdiction existed over the third class if and only if direct acts in the United States caused the fraud (mere preparatory acts are insufficient). 519 F.2d at 984-93.

43. 519 F.2d 1001 (2d Cir. 1975).

44. Only 0.2% of IIT's fundholders were Americans, and they controlled no more than 0.5% of the fund's total shares. Also, IIT had not intended to offer its shares to United States citizens. 519 F.2d at 1016-17.

45. *Id.* at 1017-18.

46. 540 F.2d 591 (3d Cir. 1976).

Jersey. The Eighth Circuit Court of Appeals cited *IIT* and expressly held that foreign nationals may invoke the protection of the federal securities laws where defendant's fraudulent scheme was conceived in the United States by an American citizen, where the scheme involved stock in a United States corporation traded on an American exchange, and where a United States securities broker was responsible for the wrongful omissions.[47] Stating that defendant's conduct within the United States was sufficient to invoke its territorial jurisdiction,[48] the court ignored the principle of objective territoriality applied originally in *Schoenbaum.*

In the instant case, the court first noted that it was required to take the plaintiff's allegations as true for purposes of reviewing the district court's dismissal of plaintiff's case for lack of subject matter jurisdiction.[49] Accordingly, the court found itself unable to consider the affidavits and exhibits offered by defendants showing that this transaction had already resulted in considerable litigation in Canadian courts,[50] especially since the district court's opinion had not considered such evidence in granting defendant's motion 'for summary judgment.[51] The court further emphasized the provisional nature of its holding that subject matter jurisdiction existed, stating that the district court should properly dismiss the action on remand if the plaintiffs failed to establish the facts necessary for jurisdiction. The court found that the precise issue on appeal was whether the district court had erred in finding that the plaintiffs had failed to establish prima facie the existence of sufficient jurisdictional facts to maintain an action under 15 U.S.C. §§ 77v and 78aa.[52] Noting that congressional intent in enacting the

47. 540 F.2d at 595. The court also noted that the United States had a strong policy interest in regulating the conduct of its broker-dealers and in increasing world confidence in its securities markets. *Id.*

48. *Id.*

49. 549 F.2d at 135 n.3 *citing* Steele v. Bulova Watch Co., 344 U.S. 280, 284 (1972).

50. Apparently, Canadian courts had supervised the settlement of disputes arising between Goldfield and CPHC in 1970-71. The formal settlement was approved by CPHC shareholders at a shareholders meeting and by the Supreme Court of British Columbia. Various CPHC shareholders had unsuccessfully challenged the settlement in British Columbia courts. Additionally, the Canadian courts had heard other disputes arising out of Western Pacific's handling and distribution of the Goldfield shares. *See* Brief for Appellee at 8-9, 549 F.2d 133. The instant case was the first action instituted in a United States court arising out of the Goldfield-Canadian Plywood transaction.

51. 549 F.2d at 135 n.3.

52. These are the jurisdictional statutes of the Securities Acts. *See* note 12 *supra.*

Securities Acts was "to insure the maintenance of fair and honest markets,"[53] the court cited *Schoenbaum* in finding that this objective would be best served by extending the jurisdictional scope of the Acts to include fraudulent extraterritorial transactions involving securities registered on American exchanges, where such transactions had an effect on domestic securities markets. Using the precedent established in *Roth v. Fund of Funds, Inc.*,[54] the court then found that relief could be granted under the Securities Acts where foreign corporations improperly dealt in United States securities, since the effect of such conduct on the domestic securities market does not depend upon the nationality of the trader.[55] Applying the "significant effects" test to the instant case, the court concluded that both the plaintiffs and the United States market in Goldfield securities were adversely affected by the takeover transaction where a court order issued enjoining further trading in Goldfield stock. The court factually distinguished the instant case from *Bersch v. Drexel Firestone, Inc.*, finding that *Bersch* involved trading in the securities of a foreign corporation, where such securities were not listed on an American exchange and where the transaction did not result in direct financial injury to holders of the securities.[56] The court accordingly held that plaintiffs' allegations, contending that the instant transaction involved the securities of a United States corporation which were listed on a national stock exchange and adversely affected domestic markets, were prima facie sufficient to invoke the district court's subject matter jurisdiction under the Securities Acts.

The instant court's application of the *Schoenbaum* "significant effects" test has completed the circular development of the extraterritorial scope and application of United States securities laws. The courts have applied a three-step test in determining the question of federal subject matter jurisdiction over international securities transactions. The court would first decide whether jurisdiction existed under the *Straub* doctrine of territorial jurisdiction, that is, if the defendant engaged in sufficient conduct within the United States so as to make the United States the locus of the transaction. If jurisdiction could not be based on territoriality, the court would then determine whether defendant's conduct constituted a per se violation of United States securities laws sufficient to invoke juris-

53. 15 U.S.C. § 78b.
54. 405 F.2d 421.
55. 549 F.2d at 135.
56. 549 F.2d at 136 n.4.

diction under the Securities Acts under the *IIT* doctrine. Third, in cases such as *Bersch* where no domestic conduct was involved, the court would consider whether objective territorial jurisdiction could be found where extraterritorial conduct resulted in an adverse effect on domestic commerce which was a direct and foreseeable result of that conduct.[57] In any case, allegations that a defendant's extraterritorial conduct resulted in adverse effects in the United States would not be as persuasive as allegations that a defendant's conduct within the United States resulted in fraud. In the instant case, the Ninth Circuit Court of Appeals adopted the *Schoenbaum* "significant effects" test, which repudiates the three-step test previously applied by the courts. This decision has reversed a ten year development in judicial construction of the Securities Acts' extraterritorial applicability. Thus, the instant opinion raises the question of whether courts should apply a "significant effects" test, a "substantial conduct" test, or a combination of both in determining the extraterritorial application of United States securities laws. Arguably, the "significant effects" test would be most consistent with the Acts' original purpose—namely, the protection of domestic securities markets and investors. While the "substantial conduct" test was originally a substantive test used to determine jurisdiction over disputed securities transactions, the courts have distorted its purpose to such an extent that it has become merely a procedural method of establishing personal jurisdiction and ensuring service of process upon defendant corporations. The courts have thus extended their jurisdiction under the securities laws to the point where transactions intended to have no effect in the United States can be subjected to United States regulation. Such a result cannot be inferred from the statutory language. On the other hand, adoption of the "substantial conduct" test enables the United States to broaden the scope of its jurisdiction to include foreigners whose conduct adversely affects United States markets.[58] In their decision to exercise jurisdiction over extraterritorial securities transactions, however, the courts have overlooked or ignored the nationality of foreign plaintiffs, assuming that such injured parties have standing to sue where the defendants violated United States securities laws.[59] Where the defendant is a United States corporation subject

57. *See* text accompanying notes 40-47 *supra.*

58. For a discussion of the problems of enforcing judgments rendered in international securities litigation, *see* 12 Hous. L. Rev., *supra* note 16, at 938.

59. *See* text accompanying note 32 *supra.*

to the jurisdiction of United States laws, a suit by a foreign plaintiff would seem to be fair and equitable from a policy standpoint. It should be noted, however, that other nation states can also exercise jurisdiction over transnational securities disputes by invoking principles of international law.[60] Thus, where a transaction is structured to satisfy Canadian laws, and adequate Canadian judicial remedies are available to a Canadian plaintiff, United States courts should be reluctant to accept jurisdiction over and apply United States laws to such a transaction. Injured American investors, however, should have the opportunity to bring suit in American courts under the securities laws. In view of the rapid proliferation of multinational corporations and the resulting international flow of capital, nations will need to coordinate their securities legislation in order to determine areas of questionable jurisdiction. Due to the equally important need for a clear judicial standard to apply in determining jurisdiction questions, Congress should offer the courts some needed guidance by remedying the legislative ambiguity concerning extraterritorial application of the Securities Acts.[61]

Phyllis K. Fong

60. *See note* 19 *supra.*

61. Until Congress deals with this issue, practitioners would do well to advise clients engaged in international securities transactions to include an arbitration clause in the contract which stipulates the applicable law. *See* Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974). *Cf.* text at notes 36-39 *supra.*

TAXATION — Investment Tax Credit — Provisions of Closing Agreements Between Subsidized Ship Operators and the Internal Revenue Service Which Deal with Reserve Funds Constitute Special Depreciation Arrangements

Taxpayer, Pacific Far East Lines, Inc.,[1] brought an action for a tax refund based on the difference between the investment tax credit taxpayer had claimed and the investment tax credit the Internal Revenue Service (IRS) had allowed.[2] The Revenue Act of 1962[3] provided for an investment tax credit[4] for qualified investments,[5] which included "any vessel documented under the laws of the United States which is operated in the foreign or domestic commerce of the United States."[6] Taxpayer purchased two new vessels in 1962 and, basing its computations on the total amount it had invested in the purchase,[7] claimed an investment tax credit. The IRS disallowed from taxpayer's computations the inclusion of monies expended from tax-deferred funds held by taxpayer[8] and reduced taxpayer's tax credit accordingly, issuing a deficiency notice for taxes due.[9] The IRS contended that a tax credit based on investments made with tax-deferred funds would permit taxpayer a double deduction.[10] The Court of Claims, however, granted taxpayer's motion for summary judgment and, *held*: For the purposes of the investment tax credit, tax-deferred funds invested in new vessels were properly included in taxpayer's basis in the vessels. *Pacific Far East Lines, Inc. v. United States*, 544 F.2d 478 (Ct.Cl. 1976).

Section 607 of the Merchant Marine Act of 1936[11] required each

1. Taxpayer is a contractor, subsidized under the provisions of the Merchant Marine Act of 1936, 46 U.S.C. §§ 1101-1294 (1970 & Supp. V 1975).

2. Taxpayer claimed an investment tax credit pursuant to the Revenue Act of 1962, Pub. L. No. 87-834, § 2, 76 Stat. 962 (current version at I.R.C. §§ 38, 46-48 (1977).

3. Pub. L. No. 87-834, 76 Stat. 960 (codified in scattered sections of I.R.C.).

4. *Id.* § 2. The amount of the credit was seven percent of qualified investment.

5. I.R.C. § 46(c).

6. I.R.C. § 48(a)(2)(B)(iii).

7. "Plaintiff paid $14,558,925 for the ships." Pacific Far E. Lines, Inc. v. United States, 544 F.2d 478, 482 (Ct.Cl. 1976).

8. These were taxpayer's "capital reserve fund" and "special reserve fund," discussed in text accompanying notes 16-20 *infra*.

9. 544 F.2d at 482.

10. *See* note 23 *infra*.

11. Ch. 858, § 607, 49 Stat. 2005 (current version at 46 U.S.C. § 1177 (1970 & Supp. V 1975)).

vessel operator with a subsidy contract under the Act[12] to establish a "capital reserve fund"[13] and a "special reserve fund"[14] in order "[t]o insure the prompt payment of the contractor's obligations to the United States and the replacement of the contractor's subsidized vessels."[15] The Act defined the "capital reserve fund"[16] as a deposit composed of amounts equal to (1) the annual depreciation expenses of subsidized vessels, (2) all proceeds from the sale or disposition of subsidized ships, (3) any insurance benefits and indemnities on such ships, (4) one half of all profits in excess of ten percent per annum, (5) such further amounts as the Maritime Administration might deem necessary, and (6) such additional amounts as the contractor, with the approval of the Maritime Administration, might desire.[17] The statute permitted subsidized operators to use the fund to reconstruct old or to purchase new ships and to "pay the principal, when due, on all notes secured by mortgage on the subsidized vessels."[18] The "special reserve fund," comprised of certain excess profits,[19] served as a source of reimbursement for operating losses and for any portion of subsidies "recaptured" by the Maritime Administration under other provisions of the subsidy agreement.[20] Both funds[21] received deferential

12. The operating-differential subsidy was instituted in order to equalize the cost of operating United States flag vessels with the cost of operating foreign flag vessels, since the latter benefit from lower labor and construction costs. The subsidy's *raison d'etre* is, in part, based on the theory that a strong merchant marine is necessary for national defense. *See* Moore-McCormack Lines, Inc. v. United States, 413 F.2d 568, 570-71 (Ct.Cl. 1969) (describing the history and purpose of the operating-differential subsidy).

13. Merchant Marine Act of 1936, ch. 858, § 607(b), 49 Stat. 2005 (current version at 46 U.S.C. § 1177 (1970 & Supp. V 1975)).

14. *Id.* § 607(c).

15. *Id.* § 607(b).

16. Descriptions of the composition and use of capital and special reserve funds and other provisions of the Merchant Marine Act are derived from the provisions of the Act, as amended, which were in force in 1962.

17. Merchant Marine Act of 1936, ch. 858, § 607(b), 49 Stat. 2005 (current version at 46 U.S.C. § 1177 (1970 & Supp. V 1975)).

18. *Id.*

19. "If the profits, without regard to capital gains and capital losses, earned by the business of the subsidized vessels and services incident thereto exceed 10 per centum per annum and exceed the percentage of profits deposited in the capital reserve fund . . . the contractor shall deposit annually such excess profits in this reserve fund." Act of June 23, 1938, ch. 600, § 25, 52 Stat. 960.

20. Merchant Marine Act of 1936, ch. 858, § 606(5), 49 Stat. 2005 (current version at 46 U.S.C. § 1177 (1970 & Supp. V 1975)), *as amended by* Act of May 10, 1956, Pub. L. No. 84-515, 70 Stat. 148, provided:

tax treatment, since the Act provided that "earnings . . . deposited in the contractor's reserve funds . . . shall be exempt from all Federal taxes."[22] However, since treatment of the funds as tax-exempt would allow vessel owners a double deduction,[23] the IRS determined that these funds would be treated as "tax-deferred" rather than as tax-exempt, and in 1947 all then-subsidized operators entered "closing agreements" with the IRS[24] to that effect.[25] "Tax-deferred" meant that ordinary income and capital gains deposited into reserve funds would not be recognized as taxable income when received, but that contractors could not include any fund monies invested in ships in their tax bases in such vessels.[26] Despite the financial advantages the tax-deferred treatment afforded subsidized contractors,[27] however, Congress enacted no spe-

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> . . . that when at the end of any ten-year period during which an operating-differential subsidy has been paid under a contract . . . if the net profit of the contractor . . . during such period . . . has averaged more than 10 per centum per annum upon the contractor's capital investment necessarily employed in the operation . . ., the contractor shall pay to the United States an amount equal to one-half of such profits in excess of 10 per centum per annum as partial or complete reimbursement for operating-differential subsidy payments received by the contractor for such recapture period. . . .

See also Sarisky, *Sea and Air Subsidies: A Comparative Study*, 36 FORDHAM L. REV. 59, 81-85 (1967) (subsidy reduction programs).

21. Both funds will be collectively referred to as "reserve funds."

22. Act of June 23, 1938, ch. 600, § 28, 52 Stat. 961.

23. Ordinary income and capital gains deposited into reserve funds were not included in taxable income. If the funds were to be treated as tax-exempt, vessels purchased with monies from the funds could be depreciated, thereby providing a second reduction in taxable income due to the same ordinary income and capital gains. *See* 544 F.2d at 491 (Cowan, C.J., dissenting). The question became moot as to funds deposited after December 31, 1969, by operation of an amendment to the Merchant Marine Act of 1936, providing for essentially the same tax treatment of reserve funds as provided by the 1947 closing agreements. Act of Oct. 21, 1970, Pub. L. No. 91-469, § 21(a), 84 Stat. 1026 (codified at 46 U.S.C. § 1177 (1970 & Supp. V 1975)).

24. 544 F.2d at 480. The agreements also stated that if a court were to hold the statutes to mean tax-exempt, the funds would be so treated beginning in the year of the court's decision. *Id.*

25. Taxpayer in the instant case was not a party to the 1947 closing agreements, but entered an essentially identical agreement in 1954 as a prerequisite to receiving a subsidy under the Merchant Marine Act of 1936. *Id.* at 481.

26. *Id.*

27. The subsidy itself provides a financial advantage since it enables ship operators to construct and operate vessels at a lower cost. *See generally* Morse, *A Review of the Assistance Provided to the American Merchant Marine Under*

cial provisions to limit the application of the 1962 investment tax credit with regard to vessel operators. Attempts by the IRS to minimize the benefits derived by subsidized contractors from the tax credit were unsuccessful. In *Lykes Brothers Steamship Co., Inc. v. United States*,[28] the Court of Claims held that the credit could not be reduced because ships were constructed using operators' plans and specifications. The court also proscribed a diminution of the credit where ships were substantially completed prior to the passage of the Revenue Act of 1962[29] and held that the credit could not be used to reduce the amount of subsidy received.[30] In each of these cases the Court of Claims based its decision, in part, on the purpose for which the tax credit was enacted: to increase "the profitability of productive investment by reducing the net cost of acquiring new equipment."[31] In *States Steamship Co. v. United States*,[32] the court indicated that subsidy agreements were not to be construed in a manner which would thwart the economic effectiveness of the investment tax credit, and held that parties to subsidy agreements were not to be bound to "*future* changes in the tax laws, no matter how far reaching or important."[33] [Emphasis by the court.] Thus, prior to the instant case the courts had established that subsidized ship operators were to be accorded the full benefit of the investment tax credit.

In the instant case, the court affirmed the *States Steamship Co.* finding that subsidized shippers were not to be denied the benefits of the investment tax credit, noting that any restriction on the credit not specifically contained in the language of the Revenue Act of 1962 would defeat the intent of Congress. Relying on previous holdings that the tax credit provisions are to be liberally construed,[34] the court determined that qualified investment, for

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Statutes of the United States and Their Administration by the Federal Maritime Board and the Maritime Administration, U.S. Department of Commerce, 18 FED. B.J. 355 (1958).

28. 513 F.2d 1342 (Ct.Cl. 1975).

29. Pacific Far E. Lines, Inc. v. United States, 513 F.2d 1355 (Ct.Cl. 1975).

30. States S.S. Co. v. United States, 428 F.2d 832 (Ct.Cl. 1970). For a discussion of the investment tax credit's relation to airline subsidies, *see* North Central Airlines, Inc. v. Civil Aeronautics Bd., 363 F.2d 983 (D.C. Cir. 1966) (credit may not be used to reduce airline's subsidy); 33 J. AIR L. & COMM. 165 (1967).

31. H.R. REP. No. 1447, 87th Cong., 2d Sess. 7 (1962). *See also* H.R. REP. No. 2508, 87th Cong., 2d Sess. 14 (1962).

32. 428 F.2d 832 (Ct.Cl. 1970).

33. 428 F.2d at 837.

34. *See, e.g.*, Minot Fed. Sav. & Loan Ass'n v. United States, 435 F.2d 1368,

the purposes of the credit, is the taxpayer's basis in the property. That basis, the court explained, is the taxpayer's cost[35] regardless of the source of funds used,[36] except as specifically altered by provisions of the Revenue Act.[37] Since the tax treatment of reserve funds under the closing agreements merely deferred the recognition of income until a future period,[38] the court concluded that the agreements were merely special depreciation arrangements, similar to other accelerated depreciation schemes. Finding the closing agreements not to be related to the purposes of the tax credit, the court affirmed the *States Steamship Co.* principle that the parties to such agreements are not to be bound to future changes in the tax

1372 (8th Cir. 1970); Lykes Bros. S.S. Co. v. United States, 513 F.2d at 1353; Alabama Displays, Inc. v. United States, 507 F.2d 844, 848 (Ct.Cl. 1974).

35. I.R.C. § 46(c)(1)(A) defines "qualified investment" as "the applicable percentage of basis of each new section 38 property . . . ." "Section 38 property" includes vessels by operation of I.R.C. § 48(a)(2)(B)(iii). Under Treas. Reg. § 1.46-3(c)(1):

> The basis of any new section 38 shall be determined in accordance with the general rules for determining basis of property. Thus, the basis of property would generally be its cost . . . and would include all items properly included by the taxpayer in the depreciable basis of the property, such as installation and freight costs.

36. The court noted that investments are often made with borrowed funds, which are not taxed when received by the taxpayer. The court also noted that "money received as a gift exempt from tax [I.R.C. § 102], . . . interest earned by the taxpayer on tax-exempt municipal bonds [I.R.C. § 103]," and other similar untaxed income could, likewise, be used to make investments on which the investment tax credit would be applicable. 544 F.2d at 485.

37. The court cited two examples of provisions making specific exclusions from the tax credit: I.R.C. § 46(c)(4) (insurance proceeds invested in replacement property) and I.R.C. § 362(c)(2) (property purchased with funds contributed to a corporation by a non-stockholder). The court concluded that since some specific exclusions were made, Congress must have intended that in all other cases "the basis be the full amount of the moneys invested . . . ." *Id.* at 486.

38. "Since basis controls the computation of depreciation, future annual deductions for depreciation expense would thus be reduced by operation of the agreement. New ships would earn a larger taxable income than in the absence of the agreement, and over the life of the ships the government would recover the taxes that had been deferred when the deposited income was earned. To illustrate, $100 of earnings deposited in the reserve funds would be untaxed when earned. But when invested in a new ship costing $1000 the untaxed $100 would reduce the basis for depreciation ('cost basis') of the new ship to $900. Over the 20-year life of the new ship the annual deduction for depreciation would be $45 rather than $50, the $5 difference would be taxable income, and in 20 years the government would have recovered the deferred taxes on $100." *Id.* at 488 n.11 (citing brief for plaintiff) (footnotes omitted).

laws.[39] The court also determined that it was not to be bound by a revenue ruling[40] excluding investments made with reserve funds from a ship owner's basis for purposes of the investment tax credit,[41] particularly since the ruling did not issue until 1967, while the credits were claimed for the years 1962-64.[42] The court concluded that reserve fund capital invested in new vessels was properly to be included in taxpayer's basis in the vessels for the purposes of the investment tax credit.

The instant case is one of first impression, insofar as the court has undertaken a determination of the tax status of contractors' reserve funds. In concluding that the tax-deferred treatment of reserve funds constitutes merely a special depreciation arrangement,[43] however, the instant court has created an anomalous form of depreciation deduction. Ordinarily the first depreciation deduction taken on new property, whether accelerated or straight-line, is made at the end of the taxable year in which the property was purchased. The depreciation scheme here established allows a deduction (in the amount of reserve funds eventually invested in the ship) to be taken before the property is *purchased*. The effect is that new vessels are depreciated in the amount of reserve funds invested at the moment of their acquisition. The logical applica-

39. The IRS contended that the investment tax credit was in the contemplation of the parties insofar as the 1964 credit was concerned, since taxpayer had entered a new closing agreement in that year. The court rejected the contention on the ground that "the new agreement, as compared with the 1947 agreement, contained identical terms and conditions concerning the nonrecognition of tax deferred funds in the determination of cost basis . . . ." *Id.* at 490.

40. *See, e.g.*, Stubbs, Overbeck & Assoc., Inc. v. United States, 445 F.2d 1142, 1147 (5th Cir. 1971).

41. Rev. Rul. 67-395, 1967-2 C.B. 11.

42. Cowan, C.J., and Skelton, J., dissented. Cowan, C.J., determined that the closing agreements reduced taxpayer's basis for all tax purposes, rejecting the majority's conclusion that the agreements constituted special depreciation arrangements. Referring to a subsequent Senate report (S. REP. No. 938, 94th Cong., 2d Sess. 196-97 (1976)), he found that Congress had not contemplated the instant situation when it defined basis as cost and decided that I.R.C. provisions and Treasury Regulations relied upon by the majority were, therefore, inapplicable. He concluded that both the applicable law and the legislative history militated against taxpayer's position. 544 F.2d at 491-93 (Cowan, C.J., dissenting).

Skelton, J., found that the 1964 closing agreement bound taxpayer to the I.R.S. position. Accepting the I.R.S. contention that use of reserve funds in calculating investment tax credit would allow taxpayer a double deduction, he concluded that Treas. Reg. § 1.48-1(b)(2) (1964) precluded use of reserve funds in computing the credit. *Id.* at 493 (Skelton, J., dissenting).

43. *See* note 37 *supra*.

tion of this scheme would compel a judgment for the IRS in the instant case. In order to preserve its holding, therefore, the instant court has left this area of the tax law at least as confused as it was prior to this decision. To determine whether reserve fund investments are to be properly included in the calculation of total investment, it is now necessary to ascertain the *purpose* of the taxing statute. The court implies that if a tax provision is concerned with the amount *expended*, monies spent from reserve funds may be properly included in computations. Where provisions are concerned primarily with the taxpayer's depreciated basis, however, investments made with reserve funds would be excluded from calculations, much as depreciation taken under more conventional schemes would be subtracted from a taxpayer's cost in determining basis. Most of the statutes of the former description would be economic incentives, rather than revenue-raising measures. For most tax purposes, therefore, reserve fund investments still may not properly be included, even though the instant court has accorded the fund agreements the status of depreciation arrangements.

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