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Antitrust—A Combination of Physicians and Medical Organizations Not Justified by the Exercise of Professional Judgment When Based Upon Non-Commercial Motivations

Respondents[1] established a non-commercial blood bank[2] and agreed that only the whole human blood from this bank could be used in area hospitals.[3] The Federal Trade Commission filed a complaint charging that this conduct amounted to a conspiracy against the existing commercial blood banks[4] and thus unreasonably restrained interstate commerce in the sale and distribution of whole human blood in violation of section 5 of the Federal Trade Commission Act.[5] Respondents urged that the FTC lacked jurisdiction;[6] and in the

1. The respondents include three distinct groups: The first group is composed of the Kansas City Area Hospital Association, its officers, directors, agents and hospital members. The second group of respondents includes the Community Blood Bank of the Kansas City Area, Inc., a non-profit organization, and its officers, directors, and members. The third group of respondents consists of pathologists affiliated with various hospitals in the Kansas City area.

2. This non-commercial bank was organized by the respondents because of their opposition to existing commercial blood banks. One of the reasons for respondents' objection was their belief that commercial blood banking is morally wrong or at least professionally unethical. In addition, they felt that there was an increased likelihood of the transmission of disease, especially hepatitis, through commercially obtained blood because of reliance upon derelict donors who are less reliable in responding to questions designed to establish the presence of disease. A third reason for respondents' resistance to commercial blood banking was their belief that such operations should be directed by persons experienced in blood banking and that such commercial operations should have the services of a pathologist or hematologist.

3. Specifically, respondents agreed not to use any blood supplied by the commercial blood bank nor to permit such to be used in transfusions in area hospitals.

4. The two commercial blood banks affected by the alleged combination are owned by individuals not connected with the local hospitals, the Hospital Association, or Community Blood Bank. Both of the banks were properly licensed by the National Institute of Health of the Department of Health, Education, and Welfare.

5. "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful." 52 Stat. 111 (1938), 15 U.S.C. § 45(a)(1) (1964).

6. The respondents objected to the Commission's exercise of jurisdiction on the ground that since the process of acquiring and supplying blood constitutes the practice of medicine, the alleged combination to limit these efforts was nothing more than a legitimate attempt by the medical profession to regulate medical matters. The respondents also contended that the act of supplying human whole blood to hospitals, even if not the practice of medicine, nevertheless constituted the furnishing of a service rather than the sale of a commodity as required by the act. Finally, the corporate respondents argued that they were non-profit corporations, and therefore were not included within the definition of "corporation" found in section 4 of the

alternative, that since their conduct was the product of professional judgment devoid of any economic or commercial basis, it was beyond the scope of the act. The hearing examiner concluded that the respondents had unlawfully restrained the operations of the commercial blood banks and issued an order designed to halt further concerted action. On appeal to the Federal Trade Commission, *held,* affirmed. The exercise of professional judgment when based upon non-commercial motivation does not justify a restraint of trade in violation of the FTC Act when the existence of the unlawful combination is established by sufficient evidence. *Community Blood Bank of the Kansas City Area, Inc.,* TRADE REG. REP. ¶ 17728 (Trade Cas.) (F.T.C. 1966).

The FTC Act was enacted to provide a means for preventing activities which could possibly ripen into Sherman Act violations but which were not yet prohibited restraints of trade.[7] Both individuals and corporations are subject to the provisions of the act, with the latter including non-profit as well as profit-making corporations.[8] Regardless of whether the corporation operates for profit or not, however, courts have found violations of the act only when the organization's activities have resulted in undue restraints upon competition and where a commercial motive was apparent. Most non-profit corporations charged with violations of this standard have been trade associations[9] involved

FTC Act, which includes ". . . any company . . . or association, incorporated or unincorporated, without shares of capital . . . which is organized to carry on business for its own profit or that of its members." 52 Stat. 111 (1938), 15 U.S.C. § 44 (1964).

7. Fashion Originators' Guild of America, Inc. v. FTC, 312 U.S. 457, 466 (1941). See also FTC v. R. F. Keppel & Bro., Inc., 291 U.S. 304, 310 (1934); FTC v. Raladam Co., 283 U.S. 643, 649-50 (1931). The FTC Act was interpreted to include Sherman Act violations; therefore, a violation of the Sherman Act automatically violates the FTC Act.

8. In 1920 the Sixth Circuit held that: "The language of the act affords no support for the thought that individuals, partnerships, and corporations can escape restraint, under the act, from combining the use of unfair methods of competition, merely because they employ as a medium therefore an unincorporated voluntary association, without capital and not itself engaged in commercial business." National Harness Mfrs. Ass'n v. FTC, 268 Fed. 705, 709 (6th Cir. 1920). See also FTC v. Cement Institute, 333 U.S. 683 (1948); FTC v. Pacific States Paper Trade Ass'n, 273 U.S. 52 (1927).

9. Trade associations are particularly susceptible to antitrust prosecutions. First, trade associations exist to a great extent for the purpose of exchanging data among the members in order to improve products and marketing procedures. These activities are closely connected with competition, and touch upon sensitive antitrust areas. Second, the associations are necessarily comprised of groups of competitors and, therefore, provide an atmosphere in which the ease of communication may result in an agreement, either expressed or implied, which limits competitive activity. Finally, it is often difficult for the government to determine whether a given market phenomenon—price uniformity, for example—occurs because of the nature of the market itself or because of trade association activities. Therefore, charges of conspiracy may be brought when in fact the challenged price uniformity was the result of natural market forces. See OPPENHEIM, FEDERAL ANTITRUST LAWS 135-37 (1959).

in price-fixing[10] or boycotting.[11] Evidence of an express agreement among the members of an association is seldom—if ever—required; rather, the courts tend to examine the whole series of transactions and events leading up to the charge of an unlawful conspiracy.[12] However, the courts have used a different approach in the cases involving professional organizations charged with FTC Act violations. They have found violations of the act by pharmaceutical[13] and medical organizations[14] and held that the professional status of the defendants was no defense to the charge when the purpose and effect of their combined activities was to restrain trade. In each instance, the professional association's activities were based upon an express agreement[15] and were motivated by the probability of personal commercial gain.[16]

In the instant case, having rejected the respondents' jurisdictional objections,[17] the Commission proceeded to an examination of the

10. See, *e.g.*, FTC v. Cement Institute, *supra* note 8; Eastern States Retail Lumber Dealers' Ass'n v. United States, 234 U.S. 600 (1914).

11. See, *e.g.*, Fashion Originators' Guild of America, Inc. v. FTC, *supra* note 7; Millinery Creator's Guild, Inc. v. FTC, 312 U.S. 469 (1941).

12. In *FTC v. Cement Institute*, the Supreme Court stated: "It is enough to warrant a finding of a 'combination' within the meaning of the Sherman Act, if there is evidence that persons, with knowledge that concerted action was contemplated and invited, gave adherence to and then participated in a scheme." 333 U.S. at 716 n.17.

13. United States v. Utah Pharmaceutical Ass'n, 201 F. Supp. 29 (D. Utah 1962); Northern California Pharmaceutical Ass'n v. United States, 306 F.2d 379 (9th Cir.), *cert. denied*, 371 U.S. 862 (1962).

14. American Medical Ass'n v. United States, 317 U.S. 519 (1943). The Court held that the District of Columbia division of the A.M.A. and its individual members had conspired to prevent Group Health—a non-profit corporation organized by government employees to provide medical care and hospitalization on a risk-sharing prepayment basis—from carrying out its objects. *Id.* at 535-36.

15. In the two pharmaceutical association cases, *supra* note 13, the defendants had circulated lists among their members setting forth the price to be charged for each drug. In *American Medical Ass'n v. United States*, the District Society had adopted the following resolution: "Whereas the Medical Society of the District of Columbia has an apparent means of hindering the successful operation of Group Health Association, Inc., if it can prevent patients of physicians in its employ being received in the local private hospitals . . . ." [1940-43] CCH TRADE GAS. ¶ 56010, at 35 (D.C. Cir. March 4, 1940).

16. The allegations of the indictment in American Medical Ass'n v. United States, *supra* note 14, at 529, specifically state that the defendants opposed Group Health "for economic reasons, and because of fear of business competition . . . ." The presence of such motivation in itself provided an explanation for the organization of the combinations; therefore, the importance of an expressed agreement in relationship to other evidence was diminished considerably.

17. The FTC first concluded that the fact that blood banks are generally supervised by physicians and that medical skills may be utilized at various points in the process before blood is transported to hospitals does not require a finding that it constitutes the practice of medicine. Rather, when performed by licensed commercial blood banks, the acts of acquiring, processing, and supplying blood to hospitals are parts of a "business." The Commission also held that the supplying of human blood is the sale of a product, rather than the furnishing of a service, and therefore within

whole series of events, thereby establishing the existence of several significant factors,[18] and concluded that an unlawful combination existed, the effects of which imposed unlawful restraints upon the operation of properly licensed commercial ventures. The Commission next considered the respondents' contention that their concerted actions were a legitimate exercise of professional judgment. The FTC noted that the boycott imposed upon the commercial banks by the respondents may have resulted from their belief that the commercial ventures did not meet sufficiently high standards. Nevertheless, the Commission concluded that the function of determining such standards was governmental, and therefore, could not be assumed by private organizations or individuals.[19] The dissenters objected to the majority's exercise of jurisdiction over a professional organization's activities in the absence of evidence establishing that the respondents were motivated by the prospect of commercial gain. In addition they urged that since the respondents had a legitimate public interest in preventing the use of commercially procured human blood, their exercise of professional judgment should be considered by the Commission in determining the legality of the alleged conspiracy.

The instant case marks the first time that section 5 of the FTC Act has been held to apply to professional organizations whose alleged restraints of trade were non-commercially motivated. Where this factor of commercial motivation was present in the previous professional cases, the courts justifiably refused to place the alleged conspirators in a separate category from the trade associations. The mere fact that doctors rather than businessmen combined to advance their competitive position and thereby restrained competition did not prevent such activities from coming within the scope of the act. However, where this motivational element is noticeably absent, as in the instant case, the activities of the professional organization should

the meaning of "commerce" for purposes of FTC jurisdiction over alleged restraints imposed upon such sales. Finally, the majority held that even though the corporate respondents were non-profit organizations, they were not prevented from devoting any profits received to their own use, and therefore were included within the definition of "corporation" found in section 4 of the FTC Act, *supra* note 6.

18. "Among these factors are the presence of a motive for a conspiracy, evidence of opportunities for agreement through scheduled meetings of official groups, whether the object of the alleged conspiracy was discussed at such meetings, commission of overt acts consistent with the existence of a conspiracy, and accomplishment of an end which also is consistent with a conspiracy." TRADE REG. REP. ¶ 17728, at 23021.

19. "If the current standards of these inspecting organizations are not sufficient, or if additional regulation is required, there are various administrative and legislative remedies which may be pursued. A group of private citizens, no matter how public spirited or altruistically motivated, may not relegate to themselves the essentially governmental function of determining the standards which will be applied in the interstate operation of blood banks and band together to inhibit the development of licensed commercial banks which meet governmental but not their own self-imposed standards." *Id.* at 23036.

be viewed differently. Although a professional association should not be able to insulate itself from application of the FTC Act, the Commission should not impose liability for conduct which is the result of an exercise of the physician's professional judgment without first balancing the competing policies involved. That is, the public interest in encouraging physicians to exercise their professional judgment in the particular situation, should be considered in light of the act's underlying policy of preventing unlawful restraints of trade which could develop into Sherman Act violations. The FTC's refusal in the instant case to consider the exercise of professional judgment as relevant in determining the legality of the respondents' actions may significantly restrict an essential segment of the community in performing its professional function and may lead to absurd results. For example, a strict application of the FTC's decision might preclude doctors in a medical society meeting from discussing the dangers of prescribing thalidomide for pregnant women, since a subsequent failure to prescribe the drug on an individual basis could result in a reduction in a drug manufacturer's sales. The adoption of this strict test of illegality constitutes an unwise reversal of the Commission's implied policy of viewing the evidence in professional cases in a different fashion from that in trade association cases. At a time when a thorough and penetrating analysis of the competing policies was needed because of the significant absence of either an express agreement or a commercial motive, both of which had been found in prior professional cases, the Commission adopted a per se approach which is inappropriate when applied to professional associations acting without commercial motive.[20]

20. This conclusion apparently has some congressional support as evidenced by a recently proposed Senate bill which provides: "It would not be an act in restraint of trade under the antitrust laws for any nonprofit blood bank, nonprofit reservoir of other human tissue or organs, or any hospital or physician to refuse to accept blood, tissue or organs from other blood banks or reservoirs." S. 628, 90th Cong., 1st Sess. (1967).

Antitrust—Section 2(b) of the Robinson-Patman Act Permits Seller To Use a Pricing System To Meet the Prices of Competing Goods of Equal Saleability

After developing an efficient tufting process,[1] Callaway Mills Co. began to produce carpeting in competition with "old line" manufacturers. The practice of granting purchasers "annual graduated volume discounts"[2] was common in the market, and when the "old line" manufacturers began to produce tufted carpeting,[3] Callaway adopted a modified form of their volume discount pricing systems.[4] The Federal Trade Commission charged that this system resulted in price discrimination in violation of section 2(a) of the Robinson-Patman Act.[5] Callaway admitted the section 2(a) violation,[6] but contended that its discriminatory prices were justified under the "meeting the competition" defense of section 2(b).[7] Although the hearing examiner

1. Tufting is a mechanized process of producing carpeting in which a continuous loop of yarn is pushed through a backing and secured by the application of latex.

2. This system granted purchasers discounts ranging from 1% to 5% according to the dollar-volume of purchases from the manufacturer during the given year. Under this system, chain-store purchasers were permitted to compute their dollar-volumes by totaling the purchases of their individual stores.

3. The carpeting industry is made up of many manufacturers. Each manufacturer markets a "line" of carpeting. This line consists of many styles of various colors, qualities, and designs.

4. The qualifying volumes of this schedule were lower than those required by Callaway's competitors. For instance, to qualify for a 5% discount from one of Callaway's competitors, a purchaser would have to buy from $60,000 to $105,000 worth of carpeting over the year, but to qualify for a 5% discount from Callaway, the customer needed to buy only $50,000 worth of tufted carpeting.

5. "It shall be unlawful for any person engaged in commerce . . . to discriminate in price between different purchasers of commodities of like grade and quality. . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers, of either of them." Clayton Act § 2(a), 38 Stat. 730 (1914), as amended by the Robinson-Patman Act § 2(a), 49 Stat. 1526 (1936), 15 U.S.C. § 13(a) (1964).

6. This was by written stipulation made prior to the FTC hearing. It was also agreed that Callaway's case would be limited to proof of the § 2(b) defense.

7. "Upon proof being made . . . that there has been discrimination in price or services or facilities furnished, the burden of rebutting the prima-facie case thus made by showing justification shall be upon the person charged with a violation of this section . . . *Provided, however,* That nothing herein contained shall prevent a seller rebutting the prima-facie case thus made by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor, or the services or facilities furnished by a competitor." 38 Stat. 730 (1914), as amended, 15 U.S.C. § 13(b) (1964).

upheld this defense,[8] the FTC reversed on the grounds that Callaway had failed to show that its carpeting was chemically and physically similar to that sold by its competitors at the same price levels, and that Callaway had maintained a formal pricing system which had undercut its competitors' prices.[9] On appeal to the Fifth Circuit Court of Appeals, *held,* reversed. Where a market consists of many different product styles, a seller may establish a formal pricing system to meet his competitors' lower prices on goods of equal "saleability." *Callaway Mills Co. v. FTC,* 362 F.2d 435 (5th Cir. 1966).[10]

Section 2(b) of the Robinson-Patman Act accords an absolute defense to a seller charged with a violation of section 2(a) of the act upon proof that his discriminatory prices were granted in good faith to meet the equally low prices of competitors.[11] One prerequisite to a successful defense under this section is proof by the seller that he did not undercut his competitors' prices.[12] Undercutting may come about in two ways. First, the seller cannot set a lower price than his competitors.[13] Although the seller is not held to an exact meeting of his competitor's price, he must show the existence of facts that would lead a reasonable man to believe that he was in fact meeting that price.[14] Undercutting may also be found when the price of a

8. Callaway Mills Co., TRADE REG. REP. (1961-63 Transfer Binder) ¶ 15412 (FTC Sept. 29, 1961).

9. Callaway Mills Co. *sub nom.* Bigelow-Sanford Carpet Co., TRADE REG. REP. (1963-65 Transfer Binder) ¶ 16800 (FTC March 8, 1964). In the dissent, Commissioner Elman stated that the "like grade and quality" requirement of § 2(a) becomes meaningless when transposed into § 2(b). Section 2(a) deals with discrimination between purchasers of the *seller's* goods while § 2(b) is concerned with *competing* produets. The dissent further stated that pricing systems are condemned only when lower prices are granted "as a matter of course" and not in response to lower competing prices.

10. A companion case involving similar facts and identical issues was Cabin Crafts, Inc. v. FTC, 362 F.2d 435 (5th Cir. 1966), in which the court used the same rationale to uphold the § 2(b) defense.

11. FTC v. Standard Oil Co., 355 U.S. 396 (1958) (§ 2(b) held to accord an absolute defense to seller who, in good faith met the equally low price of a competitor); Standard Oil Co. v. FTC, 340 U.S. 231 (1951) (Commission's contention that § 2(b) was not an absolute defense refuted); Reid v. Doubleday & Co., 109 F. Supp. 354 (N.D. Ohio 1952) (motion to strike denied because § 2(b) is an absolute defense).

12. Atlas Bldg. Prods. Co. v. Diamond Block & Gravel Co., 269 F.2d 950 (10th Cir.), *cert. denied,* 363 U.S. 843 (1959) (defendant could not sustain § 2(b) defense if he had undercut competitor's price); FTC v. Standard Brands, Inc., 189 F.2d 510 (2d Cir. 1951) (no defense where seller granted lower prices on lower quantities than competitor).

13. *Ibid.*

14. FTC v. A. E. Staley Mfg. Co., 324 U.S. 746 (1945) (dictum); Covey Oil Co. v. Continental Oil Co., 340 F.2d 993, 998 (10th Cir. 1965) (competitor required to divulge prices in order to determine whether seller acted reasonably); Forester Mfg. Co. v. FTC, 335 F.2d 47 (1st Cir. 1964), *cert. denied,* 380 U.S. 906 (1965) (seller must show reasonableness in establishing 10% lower price than competitor). Accord-

"premium" product is reduced to the level of less acceptable products.[15] A product is deemed to be a "premium" product if it enjoys a greater degree of "public acceptance" than other products of its type.[16] This greater degree of "public acceptance" exists when it is found that "the public is willing to buy the product at a higher price in a normal market."[17] In making this latter determination, the courts and the Commission have looked to advertising, packaging, and other methods of product differentiation which may make the consuming public willing to buy the product at a higher price than competing products.[18] An additional requirement for the "meeting the competition" defense is proof that the seller's discriminatory price reductions were made in response to individual competitive situations.[19]

ingly, it has been held that incidental undercutting does not preclude the seller's good faith. Balian Ice Cream v. Arden Farms Co., 231 F.2d 356, 366 (9th Cir. 1955), *cert. denied*, 350 U.S. 991 (1956); Samuel H. Moss, Inc. v. FTC, 155 F.2d 1016 (2d Cir. 1946).

15. Anheuser-Busch, Inc., 54 F.T.C. 277 (1957), *set aside on other grounds*, 265 F.2d 677 (7th Cir. 1959), *rev'd*, 363 U.S. 536 (1960) (price of a "premium" beer reduced to the level of local beers); Minneapolis-Honeywell Regulator Co., 44 F.T.C. 351 (1948), *rev'd on other grounds*, 191 F.2d 786 (7th Cir. 1951), *cert. denied*, 344 U.S. 206 (1952) (reduction in price of automatic control to the level of less acceptable controls).

16. Gerber Prods. Co. v. Beech-Nut Life Savers, Inc., 160 F. Supp. 916 (S.D.N.Y. 1958) (reduction in price of baby food in glass containers to the level of that in tin containers); Anheuser-Busch, Inc., *supra* note 15; Standard Oil Co., 49 F.T.C. 923, 952 (1953) ("public acceptance rather than the chemical analysis of the product is the important competitive factor"); Minneapolis-Honeywell Regulator Co., *supra* note 15.

17. Anheuser-Busch, Inc., *supra* note 15, at 302; Austin, *Meeting Competition in Good Faith, and the "Premium" Product*, 14 CLEV.-MAR. L. REV. 610 (1965). It has been suggested that this test be applied to determine "like grade and quality" for the purposes of § 2(a) of the act. Borden Co. v. FTC, 339 F.2d 133 (5th Cir. 1964), *rev'd*, 383 U.S. 637 (1966), 19 VAND. L. REV. 1919 (1966); Cassady & Grether, *The Proper Interpretation of "Like Grade and Quality" Within the Meaning of Section 2(a) of the Robinson-Patman Act*, 30 SO. CAL. L. REV. 241 (1957); Rowe, *infra* note 18. The writers advocating the application of the "public acceptance" test under § 2(a) contend that it would eliminate the pressure toward uniform pricing generated by the chemical and physical comparison test and would thus promote rather than frustrate the purposes of our antitrust legislation. However, the FTC and the Supreme Court have not been receptive to these contentions. See FTC v. Borden Co., 383 U.S. 637 (1966), 19 VAND. L. REV. 919.

18. See Rowe, *Price Differentials and Product Differentiation: The Issues Under the Robinson-Patman Act*, 66 YALE L.J. 1 (1956).

19. FTC v. Standard Oil Co., *supra* note 11 (lower rates to four jobbers made in response to competitive situations); Standard Motor Prods., Inc. v. FTC, 265 F.2d 674 (2d Cir.), *cert. denied*, 361 U.S. 826 (1959) (annual volume discount schedule not responsive to individual competitive situations); C. E. Nichoff & Co. v. FTC, 241 F.2d 37 (7th Cir. 1957), *vacated on other grounds sub nom.* Moog Indus., Inc., 355 U.S. 411 (1958) (per curiam), *cert. denied*, 355 U.S. 941 (1958). It has also been stated that a seller must meet a "lawful" price. FTC v. A. E. Staley Mfg. Co., *supra* note 14. However, some lower courts have interpreted *Staley* as condemning the meeting of an unlawful price only when the seller knows or should know that his competitor's price is unlawful. Standard Oil Co. v. Brown, 238 F.2d 54 (5th Cir. 1956); Balian Ice Cream Co. v. Arden Farms Co., *supra* note 14.

Thus price reductions granted pursuant to a formal pricing system are generally unacceptable for the purposes of section 2(b).[20] Although the cases have given no definition by which to determine the existence of a pricing "system,"[21] it is clear that pricing policies which allow automatic reductions to all buyers meeting certain fixed qualifications are unacceptable.[22] Thus, blanket price reductions which attract new customers or give unnecessary reductions to old customers result in more discrimination than is necessary to enable the seller to retain his present competitive position and will preclude the seller from establishing the section 2(b) defense.[23]

In the instant case, the court noted that proof of chemical and physical similarities in grade and quality is not required under section 2(b). To sustain his good faith, the seller need only prove that his products generated public demand substantially equivalent to those of his competitors at the same price levels. Thus, the court held that Callaway did not have to show that its carpeting was of "like grade and quality" with its competitors, but rather could establish the defense by proving that its carpeting was of equal "saleability" with its competitors' at the same price levels. Considering Callaway's method of pricing, the court noted that the many styles of carpeting sold by each manufacturer made it administratively impossible for Callaway to determine the exact prices of its competitors; furthermore, it was impossible to forecast the dollar-volume that each purchaser would accumulate during the given year for the purposes of determining his discount. The court further noted that pricing

20. *E.g.*, Standard Motor Prods., Inc. v. FTC, *supra* note 19, at 677 (annual volume discount schedule constituted a pricing system); C. E. Niehoff & Co. v. FTC, *supra* note 19 (quantity discount schedule constituted a pricing system adopted to meet competition generally).

21. See EDWARDS, THE PRICE DISCRIMINATION LAW 546 (1959); ROWE, PRICE DISCRIMINATION UNDER THE ROBINSON-PATMAN ACT 230 (1962); Austin, *Robinson-Patman and Meeting Competition: A Myriad of Problems with No Solutions*, 40 TUL. L. REV. 313, 325 (1966); Note, *Pricing Systems and the Meeting Competition Defense*, 49 VA. L. REV. 1325 (1963).

22. See, *e.g.*, C.E. Niehoff & Co. v. FTC, *supra* note 19; E. Edelmann & Co., 51 F.T.C. 978, 1006 (1955), *aff'd*, 239 F.2d (7th Cir. 1956), *cert. denied*, 355 U.S. 941 (1958) (nationwide system designed to come close enough to competitors' prices to retain most of seller's customers was unacceptable). The basis of the requirement that prices be reduced in individual competitive situations seems to be a belief that § 2(b) is a defensive privilege extended to a seller threatened with an imminent loss of customers to competitors who have offered them lower prices. Thus, a system which attracts new customers or gives unnecessary reductions to old customers abuses this privilege by causing more discrimination than is necessary to retain the seller's present competitive position. See FTC v. Standard Oil Co., *supra* note 11; FTC v. A. E. Staley Mfg. Co., *supra* note 14; Edelmann & Co., *supra*. *Contra*, Balian Ice Cream Co. v. Arden Farms Co., *supra* note 14 (blanket price cut to all customers will not preclude seller's good faith).

23. See, *e.g.*, C. E. Niehoff & Co. v. FTC, *supra* note 19; E. Edelmann & Co., *supra* note 22.

systems have never been condemned per se and that whether such a system is proper must be determined on an *ad hoc* basis by deciding whether a reasonable and prudent man would have found the adoption of the particular system an unreasonable method by which to meet competitors' prices. In concluding, the court held that Callaway's pricing system did not preclude its good faith, since it was "thoughtfully tailored . . . to meet . . . [its] individual problems in the market."[24]

The words "like grade and quality" do not appear in section 2(b) and to read them into that section could lead only to confusion and harsh results. A seller knows or can easily determine the chemical and physical composition of his product. Thus, while it is not unreasonable to prohibit price discrimination in the sale of a seller's own goods that are chemically and physically alike, it may be wholly unreasonable to require a seller to determine the chemical and physical composition of the many competing products in the market. In addition to being expensive, this requirement may lead to legal impossibility[25] due to patented processes or "secret" chemical ingredients. However, a seller is generally apprised of market conditions and can determine easily which products enjoy "public acceptance" equivalent to his own at the same price levels. Thus by employing the "public acceptance" test, the courts have provided a reasonable method for the seller to retain his position in the market by meeting his competitors' prices. The use of this test also discourages predatory pricing by manufacturers of "premium" products by prohibiting them from reducing their prices to the level of less acceptable products that may be chemically and physically the same.[26] The instant court's approval of a pricing system in certain market situations furnishes an example of another reasonable method of promoting competition under the Robinson-

24. 362 F.2d at 442. The court also stated that Callaway had not undercut its competitors' prices by establishing lower qualifying volumes. Since its competitors sold both woven and tufted carpeting, their buyers accumulated higher volumes and thus qualified for higher discounts than Callaway's customers would have received on equal purchases of tufted carpeting. Thus, the court held that Callaway's lower volumes were a good faith attempt to equal its competitors discounts on sales of tufted carpeting.

25. It has been stated that the Robinson-Patman Act does not intend to place an impossible burden upon sellers. FTC v. A.E. Staley Mfg. Co., *supra* note 14.

26. This is one ground upon which the "like grade and quality" determination of § 2(a) has been attacked. It has been stated that by relying solely upon chemical and physical identities the courts have actually permitted discrimination. This occurs when the buyer of a manufacturer's private-brand product must pay the same price as the buyer of his brand-name product which is physically and chemically identical to the private-brand product. Since the buyer of the private-brand product does not receive the promotional value of the brand name, he is in effect paying a higher price than his brand-name competitor. See note 17 *supra*.

Patman Act.[27] Where a market is composed of many buyers and sellers, it may be impossible for a seller to meet prices in individual competitive situations, and he may thus be forced to adopt a formal pricing system or lose many of his large purchasers to his competitors.[28] While new legislation is needed in the area of price discrimination, the courts should not hesitate to interpret existing statutes in light of such market realities as differentiated products and modern pricing practices. The realistic approach followed by the court in *Callaway Mills* would seem to produce results most consistent with our basic antitrust policy of promoting competition.

Constitutional Law—First Amendment—State Legislature May Not Require Local School Boards To Lend Textbooks to Pupils of Parochial Schools

The New York legislature amended the state's laws to require local boards of education to purchase and lend textbooks to children enrolled in public or private high schools which conform to the state's compulsory education standards.[1] In the Supreme Court of New York, plaintiffs[2] urged that the amendment violated constitutional prohibitions against public aid to religious institutions[3] and

27. It should be noted that under existing precedent Callaway's pricing system would probably be condemned by the majority of courts. The system is not geared to individual competitive offers, but grants discounts as a matter of course to all customers. Thus, the majority would conclude that it is a pricing program "not geared to individual competitive offers . . . but instead represents a nationwide system designed to come close enough to its . . . principal competitors' pricing systems to allow it to retain most of its customers and gain perhaps a few more." E. Edelmann & Co., *supra* note 22, at 1006.

28. This is especially true when competitors are granting discounts which make "net" prices difficult and sometimes impossible to determine.

1. "In the several cities and school districts of the state, boards of education . . . shall have the power and duty to purchase and to loan upon individual request, to all children residing in such district who are enrolled in grades seven to twelve of a public or private school which complies with the compulsory education law, textbooks. [Such textbooks shall be those designated for use in public elementary or secondary schools, unless otherwise approved by such boards of education.] Such textbooks are to be loaned free to such children subject to such rules and regulations as are or may be prescribed by the board of regents and such boards of education . . . ." N.Y. EDUC. LAW § 701(3) (McKinney Supp. 1965).

2. Plaintiffs are local boards of education. For a discussion of their standing to maintain the action, see note 14 *infra*.

3. Plaintiffs contended that the amendment violated the federal constitution which says "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof . . . ." U.S. CONST. amend. I. The plaintiffs also urged that the amendment violated art. II, § 4 of the New York constitution which prohibits the state from using "its property or credit or any public money . . . directly

sought to enjoin the Commissioner of Education from appropriating any money for the purposes of the statute. The Commissioner contended that the amendment did not violate any prohibitions against aid to religion, since the benefits of the amendment accrued directly to the students and not to the denominational schools themselves.[4] *Held,* for plaintiffs. A statute requiring the state to provide textbooks to pupils of parochial schools contravenes the "establishment of religion" clause of the United States Constitution, where such aid directly or indirectly benefits the institution. *Board of Education v. Allen,* 273 N.Y.S.2d 239 (Sup. Ct. 1966).

In its initial interpretation of the "establishment clause" of the first amendment, the Supreme Court upheld congressional appropriations for a hospital operated by a religious order on the theory that title to the property remained in the Government.[5] However, until the religious guarantees of the first amendment had been applied to the states as a "fundamental concept of liberty" guaranteed by the fourteenth amendment,[6] state aid to religious institutions had not been a federal constitutional issue.[7] The principal argument in favor of state appropriations to aid pupils of private schools was developed in state courts and was termed "the child benefit theory." Under this theory the benefits of such aid accrued directly to the student and indirectly to the state, but not to the private institutions.[8] The use of the child benefit theory to support state legislation challenged as being within the establishment prohibition of the Constitution was considered by the Court in *Everson v. Board of Education.*[9] The majority accepted the theory and concluded that even though the first amendment prohibits both state and federal aid to religious institutions,

or indirectly, in aid or maintenance, other than for examination or inspection, of any school or institution of learning wholly or in part under the control or direction of any religious denomination . . . ." For a discnssion of the holding on these New York constitutional provisions, see note 15 *infra.*

4. This contention relies upon the "child benefit theory," discussed in note 8 *infra* and accompanying text.

5. Bradfield v. Roberts, 175 U.S. 291 (1899).

6. Cantwell v. Connecticut, 310 U.S. 296 (1940).

7. State aid to students of *private* schools was considered in Cochran v. Board of Educ., 281 U.S. 370 (1930). The Court rejected contentions that the appropriation of public money for such students violated the due process clause of the fourteenth amendment, holding that there was a sufficient public purpose, "exclusive of private concern," to justify the expenditures.

8. This theory was accepted in Louisiana, not against contentions of violation of state constitutional religious prohibitions, but against due process arguments. Borden v. Board of Educ., 168 La. 1005, 123 So. 655 (1929) (textbooks). *Borden* was affirmed by the United States Supreme Court as a companion case to *Cochran, supra* note 7. The New York courts, however, have rejected the theory. Smith v. Donahue, 202 App. Div. 656, 195 N.Y.S. 715 (1922) (textbooks). See also Judd v. Board of Educ., 278 N.Y. 200, 15 N.E.2d 576 (1938) (bus transportation).

9. 330 U.S. 1 (1947).

that amendment had not been violated since the benefits of the statute in question accrued directly to the parents of the students and not to the institution.[10] The minority construed the statute as authorizing direct aid to the religious schools and warned that if such acts were permissible, then regulation of them was also possible; such regulation was a clear violation of the first amendment. For sixteen years after its decision in *Everson*, the Court did not rely upon any single test or theory, but rather used an *ad hoc* approach in determining the scope of the establishment prohibition as applied to state legislation.[11] In 1963, in *Abington School District v. Schempp*,[12] however, the Court stated that if the purpose and primary effect of the state statute[13] were secular, the enactment would not violate the first amendment.

In its consideration of the federal constitutional question,[14] the court

10. "The 'establishment of religion' clause of the First Amendment means at least this: Neither a state nor the Federal Government can set up a church. Neither can pass laws which aid one religion, aid all religions, or prefer one religion over another. Neither can force nor influence a person to go or to remain away from church against his will or force him to profess a belief or disbelief in any religion. No person can be punished for entertaining or professing religious beliefs or disbeliefs, for church attendance or non-attendance. No tax in any amount, large or small, can be levied to support any religious activities or institutions, whatever they may be called, or whatever form they may adopt to teach or praetiee religion. Neither a state nor the Federal Government can, openly or secretly, participate in the affairs of any religious organizations or groups and *vice versa*. In the words of Jefferson, the clause against establishment of religion by law was intended to erect 'a wall of separation between church and state.'" *Id.* at 15-16. Jefferson's reference to a "wall of separation" was included in a letter to the Danbury Baptist Association, quoted in Rafalko, *The Federal Aid to Private School Controversy: A Look*, 3 DUQUESNE U.L. REV. 211, 213-14 (1965).

11. McCollum v. Board of Educ., 333 U.S. 203 (1948) (invalidated provision for religious instruction on public school property); Zorach v. Glauson, 343 U.S. 306 (1952) (upheld release of public-school students to attend religious services outside school); Engel v. Vitale, 370 U.S. 421 (1962) (invalidated provision for reading of "regents prayer" in public schools). See also McGowan v. Maryland, 366 U.S. 420 (1961) (upheld Sunday closing law as based on social needs).

12. 374 U.S. 203 (1963).

13. "The test may be stated as follows: what are the purpose and the primary effect of the enactment? If either is the advanceement or inhibition of religion then the enactment exceeds the scope of legislative power as circumscribed by the Constitution. That is to say that to withstand the strictures of the Establishment Clause there must be a secular legislative purpose and a primary effect that neither advances nor inhibits religion." *Id.* at 222.

14. The Commissioner urged that the plaintiffs had neither the standing nor the capacity to question the constitutionality of the state statute, since they were local school boards which are agencies of the state. In sustaining the plaintiffs' standing to maintain the action, the court held that a board "is more than a mere agent of the State. It is an entity performing a state purpose pursuant to the mandate of the people as directed by their constitution." 273 N.Y.S.2d at 242. The board is required to manage and control the local schools, pursuant to the education laws, but if such laws would require the board to perform an unlawful act, the board should have the right to seek redress, "as it may deem necessary for the protection and preservation of school funds and property." Furthermore, since the board manages its own property in the administration of local schools, an act such as the one here questioned, if unlawful, would have the effect of depriving the board, and ultimately the citizens of the school district, of their property without due process of law.

in the instant case determined that the statute violated the establishment clause of the first amendment by providing indirect state aid to parochial schools.[15] It reasoned that if the parents and parochial schools came to rely upon a continuous supply of books from public sources, the decision as to whether certain possibly objectionable books should be used might well be affected by this conditioned reliance. In addition, parents, faced with a decision between continuing to send their children to the parochial school and sending them to a public school in order to take advantage of free books, would have their freedom of religion impaired by the state action in violation of the first amendment. Thus, the court held the statute unconstitutional, in spite of possible implications for "many federal and state programs in aid of students attending private educational institutions under religious auspices."[16]

The voluminous commentary on the relationship between first amendment concepts[17] and various tax-supported assistance programs is directed primarily toward two basic issues: 1) whether a particular aid program benefits an individual or an institution; and 2) whether such a program which does aid a religious institution is necessarily unconstitutional. Classifying aid according to whether the student or the institution is benefited requires a prior determination of the proper source for such aid.[18] If textbooks should be supplied by the students themselves regardless of the school they attend, then under the child benefit theory there is no apparent aid to the school, and the grant can be justified on the ground that a good education results in a desirable public asset—an educated citizenry.[19] However, if schools should supply textbooks for their students, then any state assistance in procuring those books clearly benefits the school.[20] Assuming that

15. The court also found a violation of the New York state constitution, note 3 *supra*, holding that the statute here provided the specifically prohibited indirect aid. This decision was directly in line with state precedent, set forth in Smith v. Donahue, *supra* note 8, and Judd v. Board of Educ., *supra* note 8.

16. 273 N.Y.S.2d at 247.

17. The main thrust of the discussion here will be based upon the first amendment, as opposed to state constitutional restrictions. For the most part, state restrictions are more explicit, but it has been suggested that by applying *Everson* to the first amendment we have little difference between state and federal bases for the controversy. La Noue, *The Child Benefit Theory Revisited: Textbooks, Transportation and Medical Care*, 13 J. PUB. L. 76, 88-89 (1964).

18. The idea of "classification" as a phase of the controversy is set forth in Cushman, *Public Support of Religious Education in American Constitutional Law*, 45 ILL. L. REV. 333 (1950).

19. Rafalko, *supra* note 10, at 222.

20. Note also that if the book item is eliminated from the school budget, and if the same amount of money is subsequently expended on the school budget, a greater percentage and greater actual amount may be allocated to religious instruction. This is the indirect aid to religious institutions which often is attacked. There seems to be little question that parochial schools integrate ordinary secular education (*e.g.*,

the first amendment prohibits a direct subsidy to parochial schools, it seems illogical to preclude the state from giving books to those schools, while permitting gifts directly to their students. A more realistic conclusion would be that supplying textbooks to either the parochial school or its students constitutes aid to the parochial institution. If this effective aid to the institution is prohibited, however, and if the arguments against providing books to parochial pupils are extended only slightly, such widely accepted programs as provisions for school lunches,[21] pupil health programs,[22] and governmental loans to college students[23] may be challenged. Thus, incorporation of first amendment religious guarantees into the fourteenth amendment[24] creates possible problems for future public aid programs since states may either be completely precluded from granting such aid, or they may have to subject the grant to certain conditions.[25] Assuming that the states must attach conditions to grants of aid, however, any such conditions might be vulnerable under the first amendment as interference with the free exercise of religion. Furthermore, aside from any positive state control, there is the problem of religious discrimination in the schools themselves. For example, religious schools often permit only members of the church to attend.[26] This is religious discrimination, whether considered reasonable or not, and *Everson* indicated that such discrimination would be a denial of equal protection if the discriminatory practices were attributable to the states. Since the Supreme Court has held that even the slightest state connection is sufficient to

mathematics and spelling) with sectarian instruction. See Drinan, *Should the State Aid Private Schools?*, 37 CONN. B.J. 361 (1963). In fact, this is ostensibly the very purpose of parochial schools. Everson v. Board of Educ., *supra* note 9, at 22-23 (dissenting opinion of Jackson, J.), 59 (dissenting opinion of Rutledge, J.); La Noue, *supra* note 17, at 92.

21. Lunches are usually justified on the ground that this insures wholesome food for all children in school and therefore tends to benefit the public in general. Comment, 33 ROCKY MT. L. REV. 355, 359 (1961).

22. Such programs are justifiable purely on traditional police power-public welfare arguments. Statutes indicating this purpose and justification include MICH. STAT. ANN. § 15.3622 (Supp. 1965); MICH. STAT. ANN. § 14.379(1) (Supp. 1965).

23. These loans may be justified either on equal protection grounds or on the idea that better-educated persons are better citizens. Rafalko, *supra* note 10, at 219. For an extensive list of existing federal aid programs of this nature, see *id.* at 219-21 and nn.27-68.

24. Cantwell v. Connecticut, *supra* note 6.

25. The attaching of conditions indicates control, and control of religious activities by the state has long been seen as one of the evils to be avoided by the first amendment. Note, 77 HARV. L. REV. 1353, 1357 (1964). However, states already exercise considerable control over the curriculum of parochial schools, by setting standards which must be met if the school is to fall within the state compulsory education law. Drinan, *supra* note 20, at 365. Moreover, such conditions are not unknown in federal programs. For example, racial and religious discrimination in federally financed housing was forbidden by executive order. Exec. Order No. 11063, 27 Fed. Reg. 11527 (1962).

26. Comment, 63 MICH. L. REV. 142, 150 (1964).

permit invocation of the fourteenth amendment,[27] there may be sufficient state action to bring religious discrimination in private sectarian institutions under the fourteenth amendment if those schools are the beneficiaries of some type of public aid.[28] But if the primary aim of such programs is to benefit the public by supplying the means for achieving ends which are completely secular, any aid which accrues to religious institutions may be considered purely incidental. Does the first amendment require that these incidental benefits defeat public programs whose paramount goal is societal? To answer "yes" would be to admit that the church may interfere with the state. This raises the second issue mentioned above, *i.e.*, if the benefit which accrues to the institution is seen as incidental to a substantial benefit to the general public, it may not matter that the institution is so benefited. If this view is accepted, the problem becomes that of determining how much benefit to the institution will be permitted before the first amendment demands severance.[29] This suggests that the problem is partially sociological or political in nature, rather than strictly legal.[30] Fortunately, the particular language of the first amendment permits interpretation in light of the prevailing values of the times, and a practical solution would seem to be to ask not only "whether the statute aids religion but whether the statute presents any

27. Nixon v. Condon, 286 U.S. 73 (1932).

28. This becomes even more significant in the more subtle forms of discrimination which might appear. For example, it would violate the beliefs of an Orthodox Jew were he required to receive his education in a room adorned by a crucifix and presided over by a Catholic Sister. Such a requirement would clearly violate his right freely to exercise his religion, but it would appear to be equally objectionable that he should be precluded from attending such an institution by the mere presence of such symbols of a different religious faith. This is so only if we assume that he has a right against such discrimination, but such right may be derived from the argument suggested above.

29. It may be argued that it is impossible to erect a complete "wall of separation" between church and state. For example, if the state supplies books to parochial students/institutions, this is state aid to the inculcation of religious ideas—probably in violation of the first amendment—but if the state supplies books to public school students but denies them to parochial students *because they attend parochial schools*, this is interference by the state with a completely free exercise of choice by parents and students with regard to religious education—in violation of the "free exercise" clause of the first amendment and the equal protection clause of the fourteenth amendment. Note that problems under the "free exercise" clause and the "establishment" clause of the first amendment are closely related. Note, 41 NOTRE DAME LAW. 681, 718 (1966). Concerning the problems under the equal protection clause, see Note, 32 BROOKLYN L. REV. 362, 382 (1966). It may also be contended, under the "value received" theory, that since a parochial school performs valuable functions for the state, the schools should be compensated accordingly. Drinan, *supra* note 20, at 366; Rafalko, *supra* note 10, at 222. However, if the state is forbidden to grant such aid, the school may not be constitutionally entitled to such aid. Cushman, *supra* note 18.

30. Canavan, *Implications of the School Prayer and Bible Reading Decisions: The Welfare State*, 13 J. PUB. L. 439 (1964).

of the particular dangers the first amendment is intended to prevent,"[31] in light of the prevailing social and political values.

Constitutional Law–Imports Shipped Directly to Dealer Under Consignment Contracts With the Importer Are Not Immune to State Taxation Under the Import-Export Clause

Plaintiff, a Washington corporation, purchased fertilizer in Canada and imported it in bags into the United States for sale. A majority of these containers[1] were shipped directly from Canada to individual dealers in Oregon under consignment contracts in which the title to the consigned goods remained in the plaintiff until sold by the dealers. Defendant, Oregon State Tax Commission, levied an ad valorem property tax[2] on the unsold fertilizer in the possession of the dealers. In an action for refund of the taxes paid, the state court accepted the plaintiff's contention that the sacks of fertilizer were immune from state taxation under the import-export clause of the United States Constitution,[3] since they were unsold goods in their original packages and were considered to be "in the hands of the importer" due to his retention of title. On appeal to the Supreme Court of Oregon, *held,* reversed. Unsold goods imported for sale and delivered by the importer to a consignee who is a dealer in such merchandise do not retain their character as imports and are, therefore, outside the protection of the constitutional immunity from state taxation. *Cominco Products, Inc. v. State Tax Commission,* 411 P.2d 85 (Ore.), *cert. denied,* 385 U.S. 830 (1966).

Article I, section 10, of the United States Constitution prohibits taxation of imports by the states and vests that power exclusively in the federal government. The United States Supreme Court first

31. Note, *supra* note 25, at 1357. The test presently employed by the Court, quoted in note 13 *supra,* could be applied so as to achieve this purpose, but it tends to point ouly to the form of the challenged measure. Another possible approach would suggest that "The task of the court is to identify the competing interests, weigh and appraise them carefully, and in the process of judging allow great discretion to the legislature in the choice of the interest to be served." Rafalko, *supra* note 10, at 215-16.

1. The plaintiff stored the remainder of the goods in public warehouses in Oregon. The State Tax Commission conceded that this merchandise was immune from taxation.

2. The Oregon statute provides: "All real property within this state and all tangible personal property situated within this state, except as otherwise provided by law, shall be subject to assessment and taxation in equal and ratable proportion." ORE. REV. STAT. § 307.030 (1965).

3. U.S. CONST. art. I, § 10, states in relevant part: "No State shall, without the consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely nccessary for executing it's inspection Laws . . . ."

interpreted this clause in *Brown v. Maryland*,[4] invalidating a Maryland statute imposing a license tax on importers and sellers of foreign articles or commodities. Although noting that the general purpose of the constitutional provision was to prevent economic discrimination against the non-importing states, the Court declared, "that there must be a point of time when the prohibition ceases and the power of the state to tax commences . . . ."[5] This point was reached when the importer so acted upon the imported article, either by sale or by removal from its original package, that it lost its "distinctive character as an import" and became "incorporated and mixed up with the mass of property in the country . . . ."[6] In subsequent cases, this "original package" doctrine was treated as a constitutional mandate defining the scope of the import-export clause[7] and was applied to protect articles imported other than for sale[8] and to invalidate taxes which were nondiscriminatory in nature.[9] However, in *Youngstown Sheet & Tube Co. v. Bowers*,[10] the Supreme Court rejected the "original package" argument and permitted state taxation of imported raw materials placed in reserve inventory of the manufacturer to supply current operational needs.[11] In holding that the goods were so "irrevocably committed to 'use in manufacturing' "[12] as to lose their distinctive character as imports, the Court stated, "That the package has not been broken is . . . only one of several factors to be considered in factually determining whether the goods are being 'used for the purpose for which they [were] imported.' "[13] Thus the scope of the

4. 25 U.S. (12 Wheat.) 419 (1827).

5. *Id.* at 441.

6. *Id.* at 441.

7. See Anglo-Chilean Nitrate Sales Corp. v. Alabama, 288 U.S. 218 (1933) ("[T]he Alabama statute, construed to impose a tax upon appellant for selling in that State in the original packages the nitrate imported by it from Chile, is repugnant to the imports and commerce clauses . . . ." *Id.* at 219); May v. New Orleans, 178 U.S. 496 (1900) ("[A] tax upon the thing imported during the time it retains its charaeter as an import and remains the property of the importer, 'in his warehouse, in the original form or package in which it was imported,' is a duty on imports within the meaning of the Constitution . . . .").

8. Hooven & Allison Co. v. Evatt, 324 U.S. 652 (1945) ("original package" protection was given to goods imported for use in manufacture).

9. Low v. Austin, 80 U.S. (13 Wall.) 29 (1871) (nondiscriminatory personal property tax held invalid as applied to foreign imports held for sale). In this case the Court declared that the authority given to import necessarily carried with it a right to sell the goods in their original package.

10. 358 U.S. 534 (1959).

11. The question of whether the use of imported articles to meet the current operational needs of a manufacturer would result in loss of tax immunity was discussed in Hooven & Allison Co. v. Evatt, *supra* note 8, but decision on this issue was expressly withheld. 324 U.S. at 667.

12. Youngstown Sheet & Tube Co. v. Bowers, *supra* note 10, at 546.

13. *Id.* at 548-49.

"original package" doctrine, at least in cases involving goods imported for manufacture, was significantly restricted. In a subsequent case, however, the Wisconsin Supreme Court strictly applied the doctrine to strike down a tax on goods which had been imported for sale.[14]

In the instant case, the court refused to apply the "original package" doctrine to goods imported and held for sale in their original containers by dealers under consignment contracts. It stated that the import-export clause should be strictly construed to prevent the words of the prohibition from being carried beyond their intended object—that is, the prevention of discrimination against non-importing states. Guided by this principle, the court rejected plaintiff's contention that the goods in the possession of the dealers were goods in the hands of the importer and concluded that the tax on the unsold fertilizer was valid.

The decisions in the instant case and in *Youngstown Sheet & Tube* permit a more rational determination of the "point of time" when the prohibition of the import-export clause ceases. Since it refused to apply the "original package" doctrine, the Oregon court may have felt the decision in *Youngstown* applied to cases involving goods imported for sale as well as goods imported for manufacture. Such a conclusion appears logical. In either situation the condition of the container should be no more than a factor to be considered. The concern of the Constitution was not with the shipping cases but with the character of the goods as imports, and thus, neither unpacking nor sale should necessarily result in loss of immunity.[15] The goods in this case lost their character as imports because possession had passed to the retail dealers under consignment contracts. Thus, in determining whether goods have retained their character as imports, courts in future cases should consider whether the goods have been sold, their packages broken, or their possession transferred.

Regardless of the instant case's effect on the "original package" doctrine, the court's conclusion is sound[16] and consistent with the leading precedent, *Brown v. Maryland*.[17] In that decision, Chief Justice Marshall explicitly refrained from establishing the "original package" doctrine as a constitutional standard by stating that it

14. State *ex rel.* H. A. Morton Co. v. Board of Review, 15 Wis. 2d 330, 112 N.W.2d 914 (1962).

15. Powell, *State Taxation of Imports—When Does an Import Cease To Be an Import?*, 58 HARV. L. REV. 858, 867-68 (1945).

16. There is good basis for the conclusion that the instant case does not affect the "original package" principle and that its holding should be limited to the unique factual situation involved. Indeed, this case is the first involving consignment contracts through which the importer sells the imported goods without having obtained possession of them. Perhaps the court has merely recognized this peculiar set of facts as calling for an exception to the "original package" doctrine.

17. 25 U.S. (12 Wheat.) 419 (1827).

would be "premature to state any rule as being universal in its application."[18] By strictly construing the import-export clause, the Oregon court accepted Marshall's view that there must be a "point of time" when constitutional immunity is removed from imported goods. Indeed, there are compelling reasons for allowing state taxation of imported goods as a part of a property tax which is in no way selective.[19] In the field of state taxation of interstate commerce, these reasons have long been recognized and the Supreme Court has rejected the application of the "original package" doctrine[20] in favor of an approach utilizing economic criteria.[21] The import-export clause was intended to achieve certain economic effects, primarily the prevention of inequality and discrimination between importing and non-importing states.[22] In enforcing the clause, therefore, the courts should consider not only the course and condition of the imported article, but also the economic consequences of the application of the tax, both to the state and to the importer. The application of the "original package" doctrine as a constitutional standard, rather than as a rule of construction, would, thus, seem to be an inappropriate method of producing results consistent with the underlying purpose of the clause.

Constitutional Law—Reapportionment—One Man-One Vote Principle Applies to Popularly Elected Local School Boards

Plaintiffs, residents of the Fifth School Zone of Rutherford County, Tennessee, instituted an action for declaratory judgment and injunctive relief in federal district court challenging the provisions of a Tennessee act[1] pertaining to apportionment of the Rutherford County School Commission. The act in question provided for a school commission of eleven members, one to be elected from each of eleven school zones. The fifth school zone contained approximately one-third of the total population of the county[2] and was three to fifteen times more

18. *Id.* at 441.

19. A tax imposed on domestic goods which cannot be imposed upon imported goods of a comparable nature results in discrimination against domestic products; and the state, by rendering protective services such as fire and police protection, or by providing certain privileges, should be able to assess the recipients of these services and privileges. 47 GEO. L.J. 798, 799 (1959).

20. Woodruff v. Parham, 75 U.S. (8 Wall.) 123 (1868).

21. See, *e.g.*, Nippert v. City of Richmond, 327 U.S. 416 (1946).

22. Note, 47 COLUM. L. REV. 490, 491 (1947).

1. PRIV. ACTS TENN. 1943, ch. 426, at 1488, as amended.

2. The fifth school zone contains most of the City of Murfreesboro and an area outside the city. According to the 1960 census, Rutherford County had a total population of 52,368 and the City of Murfreesboro contained 18,991. TENN. BLUE BOOK 1965-66.

populous than each of the other ten zones.[3] Plaintiffs contended that the wide disparity between the population of the fifth school zone and that of the other zones deprived them of equal representation on the commission, and, therefore, constituted invidious discrimination contrary to the equal protection clause of the fourteenth amendment. Defendants, sued in their representative capacity as members of the Rutherford County School Commission, admitted the disparity in population, but contended that the "one man-one vote" standard of *Reynolds v. Sims*[4] did not extend to a local representative governmental body which was primarily administrative rather than legislative in character.[5] A three-judge federal district court, *held*, judgment for the plaintiffs. The apportionment provisions of the act constitute invidious discrimination contrary to the "one man-one vote" standard and are therefore void as violative of the equal protection clause of the fourteenth amendment. *Strickland v. Burns*, 256 F. Supp. 824 (M.D. Tenn. 1966).

In *Reynolds v. Sims*, the Supreme Court held that state legislatures must be apportioned on the basis of "one man-one vote;"[6] however, the Court has not decided whether the *Reynolds* standard is applicable to local representative governmental units. Nevertheless, the majority of federal and state courts have extended the "one man-one vote" standard to the apportionment of such local governmental units as county boards of supervisors,[7] city councils,[8] and state constitutional conventions.[9] On the other hand, the principle has been held inap-

3. According to the 1950 census, the fifth school zone contained a total population of 15,293, the next largest zone 5,034, and the smallest 1,023. The variance in the numbers of qualified voters is even more profound with the fifth zone (according to 1965 figures) containing 10,110 while the next largest zone contained 2,319 and the smallest zone 455. Thus there are ratios of approximately 5 to 1 and 20 to 1 respectively. See Strickland v. Burns, 256 F. Supp. 824, app. at 829 (M.D. Tenn. (1966).

4. 377 U.S. 533 (1964), 17 VAND. L. REV. 1519 (1964).

5. The commission's powers, derived solely from the legislature, ineluded the hiring of teachers and school employees, regulation of pupil transportation, approval of the annual school budget and the purchase of supplies and equipment. The commission had no tax-levying powers.

6. Actually the phrase "one person-one vote" was first used in Gray v. Sanders, 372 U.S. 368, 381 (1963).

7. Bianehi v. Griffing, 238 F. Supp. 997 (E.D.N.Y.), *appeal dismissed*, 382 U.S. 15 (1965); Miller v. Board of Supervisors, 63 Cal. 2d 343, 46 Cal. Rptr. 617, 405 P.2d 857 (1965) (applying state statute requiring equal population districting); Hanlon v. Towey, 142 N.W.2d 741 (Minn. 1966); Mauk v. Hoffman, 87 N.J. Super. 276, 209 A.2d 150 (Ch. 1965); Augostini v. Lasky, 46 Misc. 2d 1058, 262 N.Y.S.2d 594 (Sup. Ct. 1965); Bailey v. Jones, 139 N.W.2d 385 (S.D. 1966); State *ex rel.* Sonneborn v. Sylvester, 26 Wis. 2d 43, 132 N.W.2d 249 (1965). See also Lynch v. Torquato, 343 F.2d 370 (3d Cir. 1965) (dictum).

8. Ellis v. Mayor and City Council of Baltimore, 352 F.2d 123 (4th Cir. 1965); Seaman v. Fedourich, 16 N.Y.2d, 94 262 N.Y.S.2d 444,209 N.E.2d 778 (1965).

9. State *ex rel.* Smith v. Gore, 143 S.E.2d 791 (W. Va. 1965).

plicable to judicial elections[10] and local political party central committees.[11] The courts in applying the "one man-one vote" principle to cases involving local governmental units have combined the *Reynolds* extension of equal protection to legislative reapportionment with earlier Supreme Court decisions declaring the equal protection clause applicable to political subdivisions of the states.[12] These courts reason that although *Reynolds* holds only that the composition of the legislature must conform to the principle of equal representation, prior decisions have declared that the exercise of powers by political subdivisions are subject to the same equal protection limitations as are imposed on the legislatures. Therefore, it logically follows that the "one man-one vote" principle applies to the political subdivisions of the legislature.[13] Support for this conclusion is also found in the policy argument that important legislative functions performed by these local governmental units, such as taxation and regulation, so affect the local citizenry that their composition should accurately reflect the voice of the electorate. However, three district courts have held that the *Reynolds* standard does not apply to local representative units[14] since they are mere political arms of the state whose powers are created and limited by the legislature.[15] Thus, so long as the citizens are afforded equal protection by true equality of representation in the legislature, they are, in effect, also afforded equal representation at the local governmental level. Although at least one writer[16] was of the opinion that the *Reynolds* standard would not be applied to local governmental units which were created to perform a special function,[17] a federal district court in Pennsylvania has held

10. Stokes v. Fortson, 234 F. Supp. 575, 577 (N.D. Ga. 1964) (judges not "representatives" and do not espouse the cause of particular constituency).

11. Lynch v. Torquato, *supra* note 7.

12. Gomillion v. Lightfoot, 364 U.S. 339, 344-45 (1960) (invalidating change of city boundaries to exclude Negroes); Cooper v. Aaron, 358 U.S. 1, 17 (1958) (school desegregation).

13. However, two courts have stated that a local body exercising solely administrative duties would not be subject to the *Reynolds* standard. State *ex rel.* Sonneborn v. Sylvester, *supra* note 7; Bailey v. Jones, *supra* note 7.

14. Moody v. Flowers, 256 F. Supp. 195 (M.D. Ala.), *prob. juris. noted*, 385 U.S. 966 (1966) (county board); Sailors v. Board of Educ., 254 F. Supp. 17 (W.D. Mich.), *prob. juris. noted*, 385 U.S. 966 (1966) (local school board); Johnson v. Genesee County, 232 F. Supp. 567 (E.D. Mich. 1964), 18 Sw. L.J. 749 (1964) (county board of supervisors). However, this case was decided only three days after *Reynolds*.

15. See also Weinstein, *The Effects of the Federal Reapportionment Decisions on Counties and Other Forms of Municipal Government*, 65 COLUM. L. REV. 21, 27 n.26 (1965).

16. *Id.* at 34-35.

17. *E.g.*, school boards, zoning commissions, fire protection, water supply. A distinction is usually made between general-purpose and special-purpose units of local government, the former including city councils and county boards, the latter school boards. See Weinstein, *supra* note 15, at 22 n.7.

that a local school board must be elected in accordance with that standard.[18]

In the instant case, Judge Gray stated that the rationale of *Reynolds*, prohibiting invidious discrimination based on residence, "is logically as applicable to the backwaters of representative government at the local level as to the fountainhead of representative government at the state level."[19] He found no basis for applying the "one man-one vote" rule to the "congeries" of power possessed by the legislature and at the same time denying its application to a subordinate body simply because its powers were limited. Although the court held that the apportionment provisions of the act constituted invidious discrimination and were void, it witheld injunctive relief until the new legislature could enact a new scheme,[20] since "the formulation of a constitutionally acceptable method . . . is more properly a legislative function than a judicial one."[21] In dissent, Judge Phillips[22] stated that the *Reynolds* doctrine did not extend to local agencies created to perform purely administrative functions. Since these school commissions were subject to unlimited control of the legislature,[23] he felt the court could not assume that a validly apportioned legislature would fail to correct any malapportionment existing in its "arms, agencies and instrumentalities."[24]

18. Delozier v. Tyrone Area School Bd., 247 F. Supp. 30 (W.D. Pa. 1965) (one representative from a township with a population of 410 exercised seven times the voting power of three other townships). *Contra*, Sailors v. Board of Educ., *supra* note 14. One voter from a district with a population of 99 exercised 200 times the voting power of a voter from the district of Graud Rapids with a population of 201,777 and 55.6% of the total population of the county. Each of 39 districts within the county had one vote in the election of each of five members to the county board of education.

19. Citing Ellis v. Mayor and City Council of Baltimore, *supra* note 8; Bianchi v. Griffing, *supra* note 7; and Delozier v. Tyrone Area School Bd., *supra* note 18, Judge Gray stated that a substantial majority of courts considering questions of apportionment of local governmental bodies have arrived at the same conclusion. However, *Delozier* is factually distinguishable since in that case the school board had the power to levy taxes.

20. The next Tennessee legislature will be validly apportioned for the first time. Baker v. Carr, 247 F. Supp. 629 (M.D. Tenn. 1965) (approving the 1965 Tennessee Apportionment Act).

21. 256 F. Supp. at 827. Concurring, Judge Miller felt that the legislative-administrative dichotomy is immaterial so long as a subordinate body is vested with significant and important powers of government, and is chosen by popular vote. 256 F. Supp. at 826.

22. Circuit Judge of the Sixth Circuit Court of Appeals sitting as district judge by designation.

23. Citing Taylor v. Taylor, 189 Tenn. 81, 222 S.W.2d 372 (1949).

24. 256 F. Supp. at 837. The dissenting opinion relies upon Glass v. Hancock County Election Comm'n, 250 Miss. 40, 156 So. 2d 825 (1963), *appeal dismissed*, 378 U.S. 558 (1964) (per curiam); and Tedesco v. Board of Supervisors of Elections, 43 So. 2d 514 (La. App. 1949) (residents of certain districts of New Orleans charged that lack of equal representation on city council violated fifteenth amendment), *appeal dismissed*, 339 U.S. 940 (1950) (per curiam) ("for want of a substantial federal

The reasoning of Judge Gray in the instant case is consistent with the majority of courts which have considered the issue. There is language in *Reynolds* which would indicate that the Supreme Court considers equal representation and participation in the governmental process an "inalienable right" which extends to every level of representative government,[25] and it is thus conceivable that *Reynolds* can be applied mechanically to every representative governmental unit. On the other hand, even if the *Reynolds* holding is narrowly construed to include only the legislature, the vital importance of public education in the community coupled with the influence of local school boards could justify the application of *Reynolds* in order to bring at least these units within the ambit of the "one man-one vote" principle. Judge Phillips' suggestion that the court determine the primary nature of a board's functions, while appealing in its simplicity, is subject to criticism. A clearly defined administrative-legislative dichotomy is illusory when applied to local school boards which often exercise dual functions. By attempting to isolate and define each of the numerous functions of such boards, courts would probably be forced to rely heavily on a process of "labeling" rather than on an analysis of the total effect of these boards in light of the constitutional requirement of equal protection. Regardless of the legal theories involved, both the majority and the dissent recognized that there are practical reasons why courts should abstain from ruling on local apportionment cases until the newly apportioned legislatures have been given an opportunity to correct existing malapportionment.[26] For example, such premature behavior would, in effect, be tantamount to a court's exercise of supervisory authority over legislative functions by specifying necessary legislation and compelling the legislature to act.[27]

One of the most important problems inherent in the application of *Reynolds* to local representative bodies such as school boards is the

question"). However, both of these cases are readily distinguishable. In *Glass*, the court denied injunctive relief on the basis that a statutory procedure for re-districting provided an adequate remedy at law. *Tedesco* was decided in 1950 when the Supreme Court considered such questions non-justiciable. In fact, Baker v. Carr, 369 U.S. 186, 234, 249 (1962) (concurring opinions) would indicate that per curiam decisions decided prior to *Baker v. Carr* have no more effect.

25. "But representative government is in essence self-government through the medium of *elected representatives of the people*, and *each and every citizen has an inalienable right to full and effective participation in the political processes of his State's legislative bodies.*" Reynolds v. Sims, *supra* note 4, at 565. (Emphasis added.) "Diluting the weight of votes because of place of residence impairs basic constitutional rights under the Fourteenth Amendment just as much as invidious discriminations based upon factors such as race . . . or economic status . . . ." *Id.* at 566.

26. See also Note, *Reapportionment*, 79 HARV. L. REV. 1226, 1273 (1966). This note contains an excellent survey of the problems inherent in sub-state apportionment.

27. See BICKEL, THE LEAST DANGEROUS BRANCH 189-98 (1962). See also BICKEL, *op cit. supra* at 247-54 for an analogous discussion of the Court's role in the school desegregation decisions.

difficulty in judicial administration. The school board is the most common form of governmental unit in the United States,[28] numbering over 34,000, most of which are popularly elected.[29] The question immediately arises as to what standards the legislatures are to apply in arriving at an apportionment scheme which will be acceptable to the numerous courts considering these cases.[30] Although *Reynolds* provides that population is the controlling criterion,[31] other important factors will have to be considered in arriving at a statewide plan.[32] Thus it becomes possible that courts in different sections of the state will disagree as to the validity of the plan, and such judicial uncertainty could convince the legislature to make the membership on these bodies appointive or to create fewer districts through widespread consolidation. Although other techniques for equalizing voting power without changing the existing structure have been proposed, such as elections at large, multi-member districts, and weighted voting, all have been criticized,[33] and permanent weighted voting has been declared unconstitutional.[34] The Supreme Court apparently has recognized the problems created by the extension of the "one man-one vote" standard to local representative units and has granted review to three cases which involve this issue.[35]

28. Note, *supra* note 26, at 1275 n.28, citing U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, PERFORMANCE OF URBAN FUNCTIONS: LOCAL AND AREAWIDE 78 (1963).

29. U.S. DEP'T OF COMMERCE, BUREAU OF THE CENSUS, 1966 STATISTICAL ABSTRACT OF THE UNITED STATES 416. The following is a breakdown of local representative governmental units potentially affected by the extension of *Reynolds:* 34,678 school districts, 18,323 special districts, 18,000 municipalities, 17,142 townships and 3,043 counties.

30. See Note, *supra* note 26, at 1275-78.

31. Reynolds v. Sims, *supra* note 4, at 567.

32. In Criffin v. Board of Supervisors, 60 Cal. 2d 318, 33 Cal. Rptr. 101, 384 P.2d 421 (1963), the court construed a statute which stated that districts should be as nearly equal in population as possible; however, the board could consider such factors as topography, geography, cohesiveness, contiguity, integrity, compactness of territory and community of interests of the districts.

33. Elections at large tend to reduce the voter's identity with his government and local representative and may effectively deny him any representation where the area is controlled by a large community. Multi-member districts tend to destroy the effectiveness and efficiency of representative boards, such as a school board, since the increased number of representatives renders these bodies too large and unwieldy. See Weinstein, *supra* note 15, at 40-49.

34. Morris v. Board of Supervisors, 50 Misc. 2d. 929, 273 N.Y.S.2d 453 (Sup. Ct. 1966). See also WMCA, Inc. v. Lomenzo, 238 F. Supp. 916 (S.D.N.Y. 1965) (dictum).

35. Moody v. Flowers, *supra* note 14; Sailors v. Board of Educ., *supra* note 14; Suffolk County Bd. of Supervisors v. Bianchi, 256 F. Supp. 617 (E.D.N.Y. 1966), *prob. juris. noted,* 385 U.S. 966 (1966).

Criminal Law—Admissibility in Evidence of Blood Tests Over Defendant's Objection

Defendant was involved in an auto accident. A police officer at the scene thought he detected signs of drunkenness;[1] and when he observed the same symptoms two hours later at the hospital, the officer placed defendant under arrest, permitted him to consult counsel, and, over his objections, instructed a physician to take a blood sample for analysis of alcohol content. The results of the test were admitted into evidence and defendant was convicted in the trial court of driving under the influence of alcohol. Defendant appealed on the ground that admission of the results of the blood test violated his constitutional rights.[2] The conviction was upheld by the California Superior Court, and on certiorari to the United States Supreme Court, *held,* affirmed. A blood test taken in a reasonable manner over the objections of the defendant violates neither due process of law, the privilege against self-incrimination nor the constitutional prohibition against unreasonable search and seizure. *Schmerber v. California,* 384 U.S. 757 (1966).

The constitutionality of blood tests taken without consent was first presented to the Supreme Court in *Breithaupt v. Abram.*[3] The facts were substantially the same as those in the instant case,[4] but at the time, the Supreme Court had ruled that the federal exclusionary rules of the fourth and fifth amendments were not applicable to state prosecutions.[5] Consequently, *Breithaupt* involved only the question of whether the defendant had been denied due process of law under the fourteenth amendment, as that phrase has been defined in *Rochin v. California.*[6] Since the acts in *Breithaupt* were not so "brutal and

1. The officer testified that he smelled liquor on petitioner's breath and that his eyes were bloodshot, watery and glassy.

2. U. S. CONST. amend. IV: "The right of the people to be secure in their persons . . . against unreasonable searches and seizures, shall not be violated . . . ." U.S. CONST. amend. V: "No person . . . shall be compelled in any criminal case to be a witness against himself . . . ." U.S. CONST. amend. VI: "In all criminal prosecutions, the accused shall enjoy the right . . . to have the Assistance of Counsel for his defence." U.S. CONST. amend. XIV, § 1: ". . . nor shall any State deprive any person of life, liberty, or property, without due process of law . . . ."

3. 352 U.S. 432 (1957), 11 VAND. L. REV. 196 (1957). For a discussion of cases before *Breithaupt* see INBAU, SELF-INCRIMINATION—WHAT CAN AN ACCUSED PERSON BE COMPELLED TO DO? 72-82 (1950). Post-*Breithaupt* cases are discussed in 17 HASTINGS L.J. 139 (1965).

4. The basic factual distinction is that Breithaupt was unconscious when the blood was taken.

5. Twining v. New Jersey, 211 U.S. 78 (1908) (fifth amendment); Wolf v. Colorado, 338 U.S. 25 (1949) (fourth amendment).

6. 342 U.S. 165 (1952). Police officers broke into defendant's room and wrestled with him in an unsuccessful attempt to get narcotics which defendant had swallowed. They took defendant to a hospital where a tube was forced down his throat causing him to

offensive"[7] as to "shock the conscience"[8] of the Court they did not satisfy the test set forth in *Rochin* for establishing a violation of the due process clause of the fourteenth amendment. Subsequent to this decision, the privileges of both the fourth and fifth amendment were extended to state prosecutions through the due process clause of the fourteenth amendment. In 1961, in *Mapp v. Ohio*,[9] the Supreme Court incorporated the privilege against unreasonable search and seizure. Since it is uniformly held that a blood test is a search within the meaning of the fourth amendment, the only problem arising in this area concerns a determination of whether such tests are "unreasonable," particularly in light of the fact that they are frequently administered in the absence of a search warrant. Speaking generally, it appears that where the blood test has been administered incident to arrest,[10] or where a sample has been taken under exceptional circumstances such as to preserve evidence even absent an arrest,[11] it will come within two well-recognized Supreme Court exceptions to the warrant requirements,[12] and will not be considered "unreasonable." Three years after *Mapp*, in *Malloy v. Hogan*,[13] the Supreme Court made a similar incorporation of the fifth amendment privilege against self-incrimination into the due process clause of the fourteenth amendment. The historical foundations of the fifth amendment[14] have led the great majority of courts to confine this privilege to evidence of a

vomit the capsules of heroin. The Court held these actions to be shocking to the conscience and a denial of due process of law as guaranteed by the fourteenth amendment.

7. Breithaupt v. Abram, 352 U.S. 432, 435 (1957).

8. Rochin v. California, 342 U.S. 165, 172 (1952).

9. 367 U.S. 642 (1961).

10. People v. Duroncelay, 48 Cal. 2d 766, 312 P.2d 690 (1957). The court found a blood test to be reasonable on this basis even though the arrest followed the test. See also State v. Kroening, 274 Wis. 266, 79 N.W.2d 810 (1956), where a blood test was held to be unreasonable because the arrest came nine days after the sample was taken.

11. People v. Huber, 232 Cal. App. 2d 663, 43 Cal. Rptr. 65 (1965).

12. Weeks v. United States, 232 U.S. 383 (1914). A search made incident to a lawful arrest may be made without a warrant. Johnson v. United States, 333 U.S. 10 (1948). The Court held that a search may be made without a warrant under exceptional circumstances. See also Ker v. California, 374 U.S. 23 (1963), where officers were justified by exceptional circumstances in entering defendant's apartment without first announcing themselves because of their belief that narcotics were being destroyed.

13. 378 U.S. 1 (1964).

14. The privilege against self-incrimination is not a natural right of man and is not recognized in many societies. It has evolved in Anglo-American law as a reaction to the inquisitional procedure of the High Commission and Star Chamber in their attempts to punish heresy and sedition. From here it moved slowly until the early 1700's when the principle became accepted that both parties and witnesses would be privileged against compulsion to testify to facts subjecting them to punishment or forfeiture. MCCORMICK, EVIDENCE § 120 (1954); 8 WIGMORE, EVIDENCE § 225 (McNaughton ed. 1961).

communicative or testimonial nature.[15] The Supreme Court recognized this limitation in *Holt v. United States*,[16] where Mr. Justice Holmes stated that, "the prohibition . . . is . . . of the use of physical or moral compulsion to extort communications from . . . [the defendant], not an exclusion of his body as evidence when it may be material."[17]

In the instant case, the Court held that since defendant was unable to distinguish his case from *Breithaupt*,[18] he had not been denied due process of law under the fourteenth amendment. His contention that his privilege against self-incrimination had been violated was also rejected, since the privilege was found to extend only to evidence of a "testimonial" or "communicative" nature. Quoting *Miranda v. Arizona*,[19] the Court recognized that the full scope of the privilege requires "the government 'to shoulder the entire load' . . . to respect the inviolability of the human personality" and to "produce the evidence against . . . [the defendant] by its own independent labors . . . ;[20] but it felt constrained by practicality to follow the great weight of history and precedent which limited the privilege to evidence obtained through "the cruel, simple expedient of compelling it from . . . [the defendant's] own mouth."[21] The Court also rejected defendant's argument that his right to counsel had been violated. Since defendant was not entitled to refuse the test, he had no greater right because counsel advised him not to consent. Finally, the Court ruled that while the blood test was a search and seizure, the fourth amendment had not been violated because the search was not an unreasonable one. In considering reasonableness the Court pointed out that because of the peculiar characteristics of intrusions upon the human body it was "writing on a clean slate" with regard to the previously established rules for determining reasonableness.[22] The Court then established the reasonableness of the test upon the three grounds that it was incident to an arrest by an officer who had reason to believe that evidence

15. 8 WIGMORE, EVIDENCE § 2263 (McNaughten ed. 1961).

16. 218 U.S. 245 (1910). The prisoner was forced to put on a blouse to see if it fit him.

17. *Id.* at 252-53.

18. The Court failed, however, to explain the footnote in *Breithaupt* indicating that it might be reasonable to assume defendant would have consented had he been conscious. Breithaupt v. Abram, *supra* note 7, at 435 n.2.

19. 384 U.S. 436 (1966).

20. *Id.* at 460.

21. *Ibid.*

22. The Court cites the source of many of these rules at 384 U.S. at 768 nn.10 & 11. One particular rule which was thought to have given the Court some problem if they chose to recognize it requires that articles seized be either "fruits" or "instruments" of the crime. Harris v. United States, 331 U.S. 145, 154 (1947). Of course, if the Court had chosen to recognize this as a rule they could have stretched it by saying that the alcohol found in the blood was an instrument of the crime.

was being destroyed, that it was a common medical practice involving little risk or pain, and that it was conducted by a physician in a hospital environment.[23] Four Justices dissented from the majority opinion on various grounds.[24]

The apparent significance of *Schmerber* is that it resolves the question, left open by *Breithaupt*, of the effect of the fourth and fifth amendment upon involuntary blood tests. The result may shock many who are familiar with the recent Supreme Court decisions greatly modifying the structure of police practices. Perhaps in this respect the decision implies that the Supreme Court has reached a temporary equilibrium in its attempt to balance the rights of the accused individual against the needs of law enforcement agencies. This may be the immediate underlying reason for the Court's willingness to limit the scope of self-incrimination to communicative acts, even though the historical development of the privilege was given as the primary justification. But this history is one which dates back to a time when most evidence was by oath and blood tests were nonexistent. Some might argue that the privilege was so limited because through coercion a man can be made to say what he does not mean, but this does not explain holdings like *Boyd v. United States*,[25] which applied the privilege to communications in their permanent state, *i.e.*, personal papers. Viewing the amendment liberally, the test would be not whether the evidence was communicative, but whether compulsion was employed in procuring it.[26] To follow this view, however, might upset the balance against the needs of law enforcement. In particular it would curtail the use of the widely employed police practice of taking blood to determine intoxication[27] and might also lead to applica-

23. The Court placed great emphasis on these facts and made no indication of what the result might be if these conditions were varied. 384 U.S. at 772.

24. Mr. Justice Black believed the majority erred in its interpretation of the fifth amendment. Citing Boyd v. United States, 116 U.S. 616 (1886), where the privilege was held to extend to personal papers, he said, "It is a strange hierarchy of values that allows the State to extract a human being's blood to convict him of a crime because of the blood's content but proscribes compelled production of his lifeless papers." 384 U.S. at 775. Mr. Justice Douglas added that the taking of defendant's blood without his consent violated the right to privacy as recognized in Griswold v. Connecticut, 381 U.S. 479 (1965). Mr. Justice Fortas felt the taking of blood over the protest of defendant was an act of violence, and was as much a violation of due process as the physical violence employed in *Rochin*.

25. *Supra* note 24.

26. This theory has received limited support. See, *e.g.*, Breithaupt v. Abram, *supra* note 7, at 443-44 (dissenting opinion); Rochin v. California, *supra* note 8, at 175 (concurring opinion); State v. Height, 117 Iowa 650, 91 N.W. 935 (1902) (rape: compulsory examination by doctor for venereal disease); State v. Newcomb, 220 Mo. 54, 119 S.W. 405 (1909).

27. Forty-seven states have accepted the police use of blood tests either judicially or by statute. The statutes are listed in 18 WASH. & LEE L. REV. 370, 377-78 (1961). Ten

tion of the privilege to such activities as fingerprinting and photographing of suspects.[28] *Schmerber* is the first treatment by the Supreme Court of the relationship of the fourth amendment to compulsory blood tests and intrusions upon the body in general and several important factors deserve consideration. First, a search is no longer sufficiently justified merely because it is made incident to an arrest, although an arrest was present in the instant case. However, a search without a warrant may still be constitutional if the officer has probable cause to believe that evidence will be found, and if he is faced with the immediate destruction of the evidence.[29] In such a situation the individual would be freed of the technicality of an arrest. Second, even though the search without a warrant is permitted the method and manner of the search must be examined to determine its reasonableness, and only a case-by-case approach will reveal what will satisfy this standard. The blood test in the instant case was found to be a reasonable method because it was commonplace, involved little pain or risk, and its results were reliable, but the question remains as to how these elements are to be balanced. For example, the results of a stomach pump may be reliable, but on the basis of individual sensitivities it may be found to involve more pain than a blood test, and would not be considered a commonplace occurrance. Is such a search reasonable?[30] In determining the reasonableness of the manner in which the test is performed the Court recognized the problems that might arise from varying fact situations. In addition, there is no indication that in assessing the manner in which the test is performed the Court will take cognizance of the force employed or that it will examine the acts taking place before the test. This raises the question of the continued vitality of *Rochin*, which spoke in terms of due process. If the courts take into consideration acts occurring prior to the search as bearing upon the reasonableness of the search, there would seem to be no need to speak in terms of due process and what is shocking to the conscience. However,

states have attempted to avoid the problem of compulsion by enacting implied consent statutes calling for revocation of drivers' licenses for refusal to submit to a chemical test. 18 WYO. L.J. 252, 257 n.35 (1964).

28. Both practices have met with general approval; see 8 WIGMORE, EVIDENCE § 2265 n.2 (McNaughton ed. 1961).

29. This was the approach of the California court in People v. Huber, *supra* note 11, where there was no arrest.

30. The same week the decision in the instant case was announced, the Ninth Circuit held that the use of a stomach pump was reasonable as a medically approved method of search. The court distinguished the case from *Rochin* on the basis that there was no violence employed and that it involved a border search. Bletare v. United States, 362 F.2d 870 (9th Cir. 1966). This case may indicate a withdrawal from *Rochin*. Although the fact that it was a border search is signifieant in establishing probable cause for the search, this alone should not affect the standard of reasonableness to be applied to the search.

whether the rule is spoken of in terms of "shocking to the conscience" or unreasonableness of the search, the question remains as to why Rochin was permitted to go free because he chose to resist violently while the convictions of Breithaupt and Schmerber were affirmed because Breithaupt was unable to resist and Schmerber, through fear, chose not to do so.[31]

Criminal Law—Resentencing—Court Has Duty To Make Known Reasons for Increased Sentence

Defendant was convicted of armed robbery in 1960 and sentenced to twenty years imprisonment. In 1964, defendant applied for post-conviction relief under the appropriate North Carolina statute[1] and was awarded a new trial.[2] On retrial defendant was sentenced to a new twenty-year term, thereby delaying his eligibility for parole from 1965 to 1970, and his unconditional release from 1980 to 1985. Defendant contended that the denial of credit for time previously served was violative of the due process and equal protection clauses of the Constitution, and that the sentence on a second trial of the same charge cannot exceed the penalty imposed after the first trial. On petition to a federal district court for a writ of habeas corpus[3] to reduce the sentence, *held,* granted. Arbitrary denial of credit at the second trial for time served is so fundamentally unfair as to constitute a violation of the due process and equal protection clauses of the fourteenth amendment, and the imposition of a harsher penalty without proper justification is an unconstitutional infringement on the right to appeal. *Patton v. North Carolina,* 256 F. Supp. 225 (W.D.N.C. 1966).

Not infrequently a prisoner who is successful in obtaining a retrial of his case is resentenced in a manner that deprives him of all benefits

31. The point was raised in Mr. Chief Justice Warren's dissent in Breithaupt v. Abram, *supra* note 7, at 441.

1. N.C. GEN. STAT. §§ 15-217 to 15-222 (1965), provides for review of constitutional questions and is distinguished from state habeas corpus proceedings. North Carolina also provides for a direct appeal.

2. Patton obtained a new trial because he had been denied the assistance of counsel at his first trial.

3. Jurisdiction was exercised in this case despite the fact that defendant had not exhausted state remedies. Exhaustion of state remedies is not a prerequisite to federal habeas corpus jurisdiction if the result in state courts is a foregone conclusion. Fay v. Noia, 372 U.S. 391 (1963). There the court excused petitioner's failure to exhaust state remedies because of his well-founded fear of receiving an increase from life imprisonment to the death penalty in the event of a retrial.

acquired by having served a portion of the first sentence.[4] Thus, he may lose his "good and honor" time, thereby effectively increasing his sentence, and he may delay his eligibility for parole. Since it is unconstitutional to penalize a prisoner for seeking post-conviction relief,[5] two rationales are used to justify the imposition of a harsher sentence on retrial.[6] The first is that since a fundamental error in any trial renders its conviction void, the second sentencing court is not obligated to consider any time served under the previous sentence in deciding the penalty. Following this view, North Carolina upheld the imposition of a harsher sentence on retrial, finding the second trial to be a retrial of the whole case, including verdict, judgment, and sentence.[7] The increased penalty was held to be one of defendant's risks in seeking a new trial.[8] A second theory which permits the same result is the doctrine of waiver.[9] By seeking post-conviction relief a defendant is said to waive any benefit he may have received under the prior sentence, including a lighter sentence and credit due for time served.[10] Although commentators have severely criticized the waiver

4. See Van Alstyne, *In Gideon's Wake: Harsher Penalties and the "Successful" Criminal Appellant,* 74 YALE L.J. 606 (1965). See also Note, 1965 DUKE L.J. 395, containing an informal survey showing the high incidence of increased sentences after a second trial in North Carolina.

5. United States v. Boyce, 352 F.2d 786 (4th Cir. 1965); United States v. Wiley, 278 F.2d 500 (7th Cir. 1960); State v. White, 262 N.C. 52, 136 S.E.2d 205 (1964), *cert. denied,* 379 U.S. 1005 (1965); State v. Patton, 221 N.C. 117, 19 S.E.2d 142 (1942).

6. See Agata, *Time Served Under a Reversed Sentence or Conviction—A Proposal and a Basis for Decision,* 25 MONT. L. REV. 3, 36 (1963).

7. State v. White, *supra* note 5. North Carolina permits any increase in sentence, without justification, subject only to the restriction that the increased sentence, when added to the time previously served, does not exceed the maximum allowed for the crime. Although this seems to allow credit for the time served, credit can *effectively* be denied where the second sentence is greater than the first but less than the maximum. Only where the maximum was imposed at the first trial is credit insured at the second. Using the nullity of the previous trial as a justification for sentencing discretion misapplies the void doctrine. The doctrine originated as the only means by which courts could exercise jurisdiction in habeas corpus proceedings. *Ex parte* Watkins, 28 U.S. (3 Pet.) 191, 202-03 (1830) contains perhaps the first statement that all previous proceedings are an absolute nullity.

8. *But see* Lewis v. Commonwealth, 329 Mass. 445, 447-48, 108 N.E.2d 922, 923 (1952), a minority view that allows credit, even without statutory authorization, on the ground that "glaring and intolerable injustice would result if the time served on a first sentence should not be taken into account in imposing a second sentence." Compare *Ex parte* Wilkerson, 76 Okla. Crim. 204, 135 P.2d 507 (1945). There is no constitutional requirement that credit be allowed. State v. Williams, 261 N.C. 172, 134 S.E.2d 163 (1964) (per curiam). Defendant received two-year sentence at first trial, ten-year sentence at second trial. The court said defendant "took the risk."

9. For a discussion of the "waiver" and "void" theories of previous sentences, see Van Alstyne, *supra* note 4, at 610, and Note, *supra* note 4.

10. The general justification given is that the defendant must accept the hazards of a new trial as well as its benefits. Hobbs v. State, 231 Md. 533, 191 A.2d 238, *cert. denied,* 375 U.S. 914 (1963). There is a split of authority on this position. See 5

and nullity theories as illogical and unfair,[11] the majority of American courts still accept these rationales to permit increased sentences on appealed cases. The United States Supreme Court held, however, in *Green v. United States*,[12] that an increased sentence would constitute double jeopardy where it resulted from an increase in the degree of the crime charged at the second trial. Faced with facts similar to those in *Green*, the California Supreme Court[13] reversed on narrow double jeopardy grounds, but indicated that emphasis is more properly placed on the need for protection of post-conviction remedies.[14]

The court in the instant case was primarily concerned with the fundamental unfairness of arbitrarily increasing punishment after a new trial. While acknowledging the difficulty of trying to discover and evaluate the motives of the trial judge, the court nevertheless felt constrained to require that some rational reason for the punishment be apparent on the record. Barring such an explanation the only apparent reason for the decision was to punish the defendant for appealing. The court shifted the burden to the state to establish on the record a rational justification for a harsher sentence, whether affected by a denial of credit for time served or an absolute increase in the sentence. The court refused to apply the "waiver" or "nullity" doctrines and also repudiated the rationale previously accepted by North Carolina courts, that is, where the sum of the time served and the new sentence is less than the maximum statutory penalty, a presumption exists that credit for the time served was in fact given.[15]

WHARTON, CRIMINAL LAW AND PROCEDURE § 2216 (1957). *Compare* King v. United States, 98 F.2d 291 (D.C. Cir. 1938), *with* Short v. United States, 344 F.2d 550 (D.C. Cir. 1965).

11. "Where one 'waives' the effect of the first trial and 'consents' to a new trial he does so only because the law imposes this as a consideration of setting aside the conviction. To say that the defendant has waived all consequences of the first conviction is to say that he served no sentence, but merely spent time in jail. Such a characterization penalizes a defendant even though it was the *state's* deficiency which necessitated the new trial." Note, *supra* note 4, at 402-03. See also, Whalen, *Resentence Without Credit for Time Served: Unequal Protection of the Laws*, 35 MINN. L. REV. 239 (1951). In England, under the Criminal Appeal Act, 1964, 12 & 13 Eliz. 2, c. 143, the law provides that upon reconviction no sentence greater than the original may be given, and that the new sentence shall be dated back to the commencement of the old.

12. 355 U.S. 184 (1957).

13. People v. Henderson, 60 Cal. 2d 482, 35 Cal. Rptr. 77, 386 P.2d 677 (1963). The defendant received the death penalty at the second trial and a life sentence at the first. The court held that the first sentence *automatically* barred a more severe sentence on retrial.

14. "Since the state has no interest in preserving erroneous judgments, it has no interest in foreclosing appeals therefrom by imposing unreasonable conditions on the right to appeal." *Id.* at 497, 35 Cal. Rptr. at 86, 386 P.2d at 686.

15. State v. Weaver, 264 N.C. 681, 142 S.E.2d 633 (1965). The court had difficulty reconciling language in *Weaver* stating that "intolerable injustice" results from a denial

If the state failed to maintain its burden, the new sentence was voidable to the extent of the increased punishment.

Since "due process of law" includes the fair and equitable treatment of defendants, it can be argued that an arbitrary increase in sentence after appeal and reconviction is highly questionable. Unless factors are present at the second trial which were not present at the first (*e.g.*, knowledge of the defendant's past record or evidence that the defendant cannot be rehabilitated) it is possible to interpret a harsher sentence on retrial as a punishment for having appealed. Courts which hold that a defendant risks a greater sentence when he appeals[16] in effect challenge prisoners to gamble benefits received under a prior sentence against the possibility of complete release.[17] While increased sentences may prevent the filing of frivolous appeals, this hardly justifies discouraging appeals by convicts seeking relief from errors of the lower court. There is no reason to demand that there be a "waiver" of benefits as a condition to obtaining a corrective trial, and it is unrealistic to say that under a "void" sentence time served in prison was not actually served at all. There are times when an increased sentence may be justifiable, and the restrictive effect such a sentence might have on the right to appeal must necessarily be subordinated to the public interest served by such increases. But the fundamental unfairness of effectively conditioning appeals by arbitrarily increasing sentences should be recognized. Hopefully, the requirement that there be a rational reason for an increased sentence will provide a standard that will be consistent with the exercise of the constitutional right to appeal. However, there is a distinct possibility that those courts which now permit the imposition of a harsher sentence on retrial will have little difficulty continuing this policy under the vague "rational reasons" test. *Patton* does not say there is an absolute constitutional right to credit for time previously served, but to the extent that harsher sentences may now be subject to the limitations imposed by due process, criminal appellants have been afforded a new measure of protection.

While there can be little disagreement that requiring a defendant to choose between the freedom possible by appeal and the prospect of increased punishment in the event of reconviction is offensive to

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of credit, with the result in the instant case. *Weaver* was interpreted to establish a presumption that where a sentence less than maximum is passed on retrial, credit has been given. See discussion, note 7 *supra*.

16. State v. White, *supra* note 5.

17. "[T]he pressure to relinquish post-conviction remedies will be strongest . . . for those who have already served a substantial time . . . and for whom even a small risk of being convicted again—with its concomitant risk of a substantial increase in the sentence, and the loss of credit for time previously served and of good conduct points—would appear unreasonable." Van Alstyne, *supra* note 4, at 623.

general concepts of fairness, it is not so certain that all courts would classify increased sentences given without "rational reasons" as so fundamentally unfair as to invoke the protection of the due process clause.[18] By placing the right to justification on a constitutional plane, the court in *Patton* has raised several difficult questions. If a defendant is now constitutionally entitled to rational reasons for his increased sentence on retrial, it logically follows that he may also require that valid reasons be given for his sentence at the initial trial.[19] Moreover, if the reasons given for increased sentences are to be subject to review under the fundamental fairness test, it may well follow that the state should be given equally rational reasons for decreases in penalty.[20] Finally, if the absence of judicial justification for increasing sentences places so great a burden on the defendant that his dilemma sufficiently "shocks the judicial conscience" so as to require constitutional protection, the basic practice of placing sentencing discretion in the trial judge may itself be subject to attack. Thus, while the result in the instant case may be desirable, its constitutional underpinnings pose difficult problems with respect to the traditional discretion allowed trial judges in the sentencing process.

18. In Shear v. Boles, 35 U.S.L. WEEK 2461 (N.D.W.Va. Feb. 3, 1967) a harsher sentence on retrial was upheld in the absence of any showing that the increased sentence was retributive. It should be noted that the burden of establishing improper judicial motivation was on the defendant. While acknowledging that to place an appellant in a dilemma was unconscionable, the court emphasized that it was also necessary to respect the function of the sentencing judge. The court felt it "tenuous" to suggest that the mere imposition of a more severe sentence, without more, was violative of the constitution.

19. Just as it was argued in the instant case that a defendant who wished to appeal was placed in an uncomfortable dilemma, it could be argued that a defendant at his initial trial is placed in a similar dilemma when he considers whether to plead guilty or stand trial. What assurance, one might ask, does a defendant have that the trial judge is not, upon conviction, punishing him for not pleading guilty? Why not require rational justification at this level as well?

20. For instance, although somewhat an extreme example, where the defendant is sentenced to twenty years at his first trial, serves five years before his second trial, and is resentenced to a one year term.

Implied Warranty—Liability of Immediate and Remote Vendors for Product Defects Under Section 2-318 of the Uniform Commercial Code

Decedent was killed by the explosion of a steam vaporizer which had been purchased from a druggist by decedent's aunt, who lived next door. Decedent's administrator brought an action in assumpsit for damages resulting from breach of implied warranty of merchantability.[1] Named as defendants were the druggist, the distributor and the manufacturer, all of whom demurred on the ground that decedant was not in privity of contract with them as required in an action of assumpsit. The trial court sustained the demurrers, holding that decedent was not within the scope of section 2-318 of the Uniform Commercial Code, which extends the seller's warranties to "any natural person who is in the family or household of his buyer."[2] On appeal to the Supreme Court of Pennsylvania, *held*, reversed as to the druggist, affirmed as to the distributor and the manufacturer. Decedent was a member of the buyer's "family" within section 2-318, but the action in assumpsit will not lie against remote vendors without proof of privity between the parties. *Miller v. Preitz*, 422 Pa. 383, 221 A.2d 320 (1966).

Privity of contract has traditionally been required in an action for breach of implied warranty.[3] This rule, based upon contract law, treats the warranty as an element of the contract of sale which

1. The action was brought in two counts, one under the wrongful death statute and the other under the survival statute. The count based on wrongful death was dismissed on the authority of DiBelardino v. Lemmon Pharmacal, 416 Pa. 580, 208 A.2d 283 (1965), which held that an action under the wrongful death statute could be brought only in trespass. The court distinguished an action based on the survival statute, finding no statutory limitation on the form of that action. It noted that the survival statute created no "new" cause of action but merely continued the decedent's right of action by allowing his representative to sue. Miller v. Preitz, 422 Pa. 383, ——, 221 A.2d 320, 322 (1966). This view that an action under the wrongful death statute cannot be based on an implied warranty is in line with the majority. PROSSER, TORTS 652 n.95 (3d ed. 1964). See, *e.g.*, Sterling Aluminum Prods. v. Shell Oil Co., 140 F.2d 801 (8th Cir.), *cert. denied*, 322 U.S. 761 (1944). For a case applying the minority rule, see Greco v. S. S. Kresge Co., 277 N.Y. 26, 12 N.E.2d 557 (1938). A detailed treatment of the problem is found in Note, 51 IOWA L. REV. 1010 (1966).

2. PA. STAT. ANN. tit. 12A, § 2-318 (1954). The section reads: "A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty . . . ." Pennsylvania, on April 6, 1953, became the first state to adopt the Uniform Commercial Code. The UCC Reporting Service lists 44 states and the District of Columbia as having enacted the Code. See 2 UCC REPORTING SERV. 88 (1965) for the trial court opinion in the instant case.

3. See Annot., 75 A.L.R.2d 43 (1961), for a listing of the cases requiring privity and the growing contrary authority.

passes from the seller to the buyer as a part of the consideration.[4] The requirement of privity has gradually been eroded in cases involving food and other products for intimate bodily contact,[5] and the rapid growth of strict liability for all injuries resulting from defective products may have reduced the majority rule to minority status.[6] Strict liability has been imposed on two theories, indistinguishable in result and barely so in form. Some courts have totally eliminated the privity requirement in implied warranty actions, basing their decision on public policy and the essential tort nature of the action.[7] Others have allowed recovery on the basis of strict liability in tort, creating an independent action free of the technicalities of the law of sales.[8] Although the UCC followed the contract theory of implied warranty, section 2-318 extended the seller's warranties to the buyer's family, household, and guests who might reasonably be expected to use the product.[9] The purpose of this extension was to free these classes from the requirement of privity with the buyer's vendor,[10] but the section was "not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to the buyer who resells, extend to other persons in the distributive chain."[11]

4. For a brief survey of the origin of the action for breach of implied warranty in tort, its assimilation into the subsequent assumpsit action and its treatment as a part of the law of sales and contracts, and the confusion of the courts today in designating the nature of the action, see PROSSER, TORTS 651-54, 678-81; Prosser, *The Assault Upon the Citadel*, 69 YALE L.J. 1099, 1124-34 (1960).

5. Prosser, *The Assault Upon the Citadel, id.* at 1103-12; Wade, *Strict Tort Liability of Manufacturers*, 19 SW. L.J. 5, 7 (1965).

6. See Prosser, *The Fall of the Citadel*, 50 MINN. L. REV. 791, 794-97 (1966), for his latest listing of the jurisdictions which have imposed strict liability for defective products. Prosser's summary shows 24 jurisdictions adhering to strict liability for all products, 6 by statute, with another 6 jurisdictions approaching acceptance of the doctrine.

7. See, *e.g.*, Mitchell v. Miller, 26 Conn. Supp. 142, 214 A.2d 694 (1965); Picker X-Ray Corp. v. General Motors Corp., 185 A.2d 919 (Munic. Ct. App. D.C. 1962); Hill v. Harbor Steel & Supply Corp., 374 Mich. 194, 132 N.W.2d 54 (1965); Goldberg v. Kollsman Instrument Corp., 12 N.Y.2d 432, 191 N.E.2d 81, 240 N.Y.S.2d 592 (1963); Brewer v. Oriard Powder Co., ___ Wash.2d ___, 401 P.2d 844 (1965).

8. See, *e.g.*, Greenman v. Yuba Power Prod., Inc., 27 Cal. Rptr. 697, 377 P.2d 897 (1962); Suvada v. White Motor Co., 32 Ill. 2d 612, 210 N.E.2d 182 (1965); Santor v. A & M Karagheusian, Inc., 44 N.J. 52, 207 A.2d 305 (1965).

9. See note 2 *supra* for the text of the section. The warranties the buyer receives, aside from the express warranties given by the seller, are the implied warranties of title and merchantability and perhaps fitness for the particular purpose of the buyer. See PROSSER, TORTS 653. These warranties form §§ 2-312 to-315 of the UCC.

10. ALI, UCC § 2-318, comment 2.

11. ALI, UCC § 2-318, comment 3. Logically the exclusions limit the requirement of horizontal privity (privity between seller and a third party related to buyer), and the section is neutral as to vertical privity (privity between manufacturer or remote seller and subpurchaser). Thus the section controls the question of whether a third party can recover from the immediate seller. Case law will determine whether a third party may sue a remote seller. See Rapson, *Products Liability Under Parallel Doctrines*, 19 RUTGERS L. REV. 692, 697-98 (1965), for a more detailed explanation

There are few cases defining section 2-318's application to suits by third parties against the buyer's immediate vendor since other convenient forms of action are available for damages caused by defective products.[12] Pennsylvania courts have required privity where the plaintiff was a corporation which was the successor to the purchaser,[13] a guest of the buyer's donee,[14] and an employee,[15] but have allowed suit by an employee who purchased the product for his employer.[16] In determining the requirement of privity in an action against a remote vendor (the question left to developing case law by section 2-318) Pennsylvania in *Hochgertel v. Canada Dry Corp.*[17] adhered to the waning majority view, and summarized the status of products liability law in the state as requiring privity in all assumpsit actions for breach of implied warranty, except those involving food and beverages.[18]

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of the section on the basis of these two "types" of privity. This declaration of neutrality in comment 3 to § 2-318 has been expressly relied on by some courts in extending the third party's action to a remote seller. See, *e.g.*, Picker X-Ray Corp. v. General Motors Corp., *supra* note 7, at 922-23. In some jurisdictions § 2-318 was altered to prevent the defense of privity where the seller might reasonably have expected the plaintiff to use the product. See, *e.g.*, VA. CODE ANN. § 8.2-318 (1965). In California the section was omitted when the Code was enacted. Other jurisdictions have not allowed the Code to prevent extension of strict liability. See notes 7 & 8 *supra.*

12. The action may be for negligence, or it may be based upon the doctrine of strict liability. And in cases involving foods and other products designed for intimate bodily contact, the privity requirement is widely relaxed, even where the theory of the action is implied warranty. See note 5 *supra* and accompanying text.

13. Facciolo Paving & Constr. Co. v. Road Mach., Inc., 8 Chest. 375 (C.P. Pa. 1959).

14. Wolovitz v. Falco Products Co. (C.P. Allegheny County, Pa. 1963), printed at 1 UCC REPORTING SERV. 135 (1965).

15. Hochgertel v. Canada Dry Corp., 409 Pa. 610, 187 A.2d 575 (1963). The plaintiff was injured when a bottle of carbonated soda water purchased by his employer exploded near him while he was tending bar.

16. Yentzer v. Taylor Wine Co., 414 Pa. 272, 199 A.2d 463 (1964). Comment, 17 VAND. L. REV. 1537 (1964). The employee was injured when a bottle of wine which he had purchased for his employer exploded while he was handling it.

17. *Supra* note 15.

18. In adhering to the majority rule, the Pennsylvania Supreme Court relied on Loch v. Confair, 361 Pa. 158, 63 A.2d 24 (1949). The case is questionable as authority for the rule, since the issue was whether or not plaintiff had become a "purchaser" of the product who could maintain an action under the Uniform Sales Act. The question of privity between plaintiff and the remote vendor was not specifically decided. *Id.* at 161-66, 63 A.2d at 26-27. The Pennsylvania Court in *Hochgertel* also ignored the theory developed in the federal courts that privity had been obliterated in all implied warranty actions. The first statement of this theory came in Mannsz v. MacWhyte Co., 155 F.2d 445 (3d Cir. 1946) (dictum). The case cited the food cases and negligence actions as authority for its conclusion. *Id.* at 450. Main reliance seemed to be on language in the food and drug cases indicating the action on an implied warranty was essentially a tort action. *Id.* at 452 n.13. A federal district court following this authority cited *Loch v. Confair* as further support for the elimination of privity. Thompson v. Reedman, 199 F. Supp. 120, 123-24 (E.D. Pa. 1961). See also Jarnot v. Ford Motor Co., 191 Pa. Super. 422, 156

In deciding that decedent was a beneficiary within section 2-318 to whom the seller's warranties extended, the Pennsylvania court interpreted literally the words of the statute before it. Defendant's contention that the words "family" and "household" are synonymous was rejected. Rather the court construed the section to benefit three classes—family, household, and guests—subject to the added condition that it be reasonable to expect the individual plaintiff to use the product.[19] Decedent was held to be within the buyer's "family;" and because of his geographical proximity to the purchaser, he might reasonably be expected to use the vaporizer. Although it found decedent exempted from the requirement of privity in an action against the immediate seller, the court refused to remove the privity requirement in an action against the distributor and manufacturer. In so holding, the court felt bound by the limitations imposed on strict liability in assumpsit by section 2-318[20] and by the statement of Pennsylvania law in *Hochgertel.* The court recognized the policy considerations of the developing law of strict liability as expressed in the *Restatement of Torts Second,*[21] but adhered to the contract concept of implied warranty and refused to allow any further exceptions to the rule of privity in assumpsit actions based on warranty. However, the court explicitly did not preclude later consideration of the doctrine of strict liability if an appropriate case should arise.

The inclusion of the decedent in the instant case within section 2-318 seems consistent with the intent of the draftsmen. Although the infant was not a member of the buyer's immediate family, he was a relative, and one who might reasonably be expected to use the product. The Pennsylvania court had previously considered the much closer question of whether an employee who purchased the product for his employer was within the section,[22] and the court's liberal construction there made the result in the instant case predictable. If the decedent is allowed to recover from the immediate vendor without privity, however, familiar policy reasons suggest the removal of

A.2d 568 (1959), a decision by an intermediate state court which seems to be based on the doctrine of strict liability, although containing language of a warranty created by advertising.

19. See note 2 *supra* for the text of § 2-318. See also comment 2 to this section, *supra* note 10 and accompanying text.

20. The court viewed the declaration of nentrality in comment 3 to § 2-318, *supra* note 11 and accompanying text, as unauthoritative since the comment was not specifically enacted by the legislature. 422 Pa. 383, ——, 221 A.2d 320, 325. Prosser states that Peunsylvania has been the only jurisdiction to view § 2-318 as a limitation on the further elimination of privity. Prosser, *supra* note 6, at 799.

21. 422 Pa. 383, ——, 221 A.2d 320, 325 (dictum). RESTATEMENT (Second) TORTS § 402A (1965), is the American Law Institute's enactment of the doctrine of strict liability.

22. Yentzer v. Taylor Wine Co., *supra* note 16.

that barrier in an action against the remote vendors.[23] The instant court's unwillingness to extend the application of section 2-318 to the remote vendor, and its decision to await a more "appropriate" case to consider the doctrine of strict liability, are the result of tenacious adherence to the strict contract nature of an implied warranty action, a concept abandoned by Pennsylvania courts for food products, and by an increasing number of other courts for all products.[24] Yet the court's refusal to remove the implied warranty action from contract law may be justifiable if, in a future negligence case, it adopts strict liability as an independent action, a distinct possibility in light of its apparent sympathy with the doctrine.[25] Adoption of an independent strict liability action in tort for injuries resulting from defective products would eliminate the confusion of tort and contract in actions brought for breach of implied warranty. It would also have the effect

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23. These include: (1) The fact that the manufacturing level is the occasion where most defects are born, and the manufacturer should bear the cost of damages resulting from such defects since the cost of liability insurance to him is considerably less than the cost to the individual plaintiff. (2) The very nature of commerce which insulates the manufacturer from the ultimate consumer by numerous middlemen and the unsuitability of the privity doctrine in such a situation; the duplication which successive suits up the line of privity entails, and the possibility that a judgment proof middleman may foil recovery.

24. The court's conclusion that precedent and § 2-318 bound it to the contract theory of implied warranty as embodied in the majority rule was not inevitable. The prior cases were susceptible of more than one interpretation, as evidenced by the line of federal cases contrary to the instant rule. *Supra* note 18. In addition, Pennsylvania is the only jurisdiction which has construed § 2-318 to limit expansion of strict liability in warranty actions. *Supra* note 20. Many of the jurisdictions adopting strict liability have incorporated the doctrine into the action for breach of implied warranty. See note 7 *supra* for exemplary cases. The bases for the elimination of privity in these cases were policy and the recognition of the tort nature of the implied warranty action. Other jurisdictions, which have adopted an independent doctrine of strict liability in tort, promulgated the rule in an action based on an implied warranty. (Of the exemplary cases cited in note 8 *supra*, all were introduced to the courts grounded in whole or in part on an action for breach of implied warranty.) All the jurisdictions listed in notes 7 & 8 *supra* have now adopted the code, although it was not in force in all of them at the date of decision. See the UCC REPORTING SERVICE, state correlation section for the state adoptions of the code.

25. Two strong dissents, joined by a third justice, lend support to this possibility. 422 Pa. 383, ____, 221 A.2d 328, 335.

The Pennsylvania Supreme Court, in an opinion handed down on the same date as the instant case, did in fact adopt the *Restatement* doctrine of strict liability. Webb v. Zern, 422 Pa. 424, 220 A.2d 853 (1966). In this case plaintiff, who was injured by the explosion of a keg of beer, brought suit in trespass against the brewer, beer distributor, and keg manufacturer based on the theory of exclusive control. The trial court dismissed the complaint on the ground that plaintiff had failed to join as defendants his father (who purchased the keg) and his brother (who tapped it), thus making his theory of recovery defective. On appeal the Pennsylvania Supreme Court adopted § 402A of the *Restatement of Torts Second*, overturned the dismissals, and remanded the case to allow plaintiff to amend his complaint to state a cause of action *in trespass* for defective products liability.

of limiting even further the scope and utility of section 2-318, a result consistent with this trend toward recognizing products liability as a tort concept free of the technicalities of the law of contracts.

Insurance—Deferred Annuity Policy Which Guarantees Return of 100 Per Cent of Net Premiums Not Subject to SEC Regulation

Defendant insurance company offered deferred annuity contracts[1] which guaranteed the annuitant the return of at least 100 per cent[2] of his net premiums.[3] Any benefit payment above this assured minimum was to vary directly with the value of the annuitant's pro rata share of the profits resulting from the investment of a special fund composed of premiums paid on such policies. The SEC sought to enjoin the sale of defendant's contracts until the policies were registered as "securities" under the Securities Act of 1933[4] and until there was a compliance with the Investment Company Act of 1940.[5] The defendant contended that since the company had assumed a substantial portion of the investment risk, the contracts qualified as "insur-

1. The policy was termed the Flexible Fund Annuity (hereinafter FFA). Under the FFA contract the annuitant agreed to pay the insurance company specified monthly premiums which were segregated into a special, separate account (Flexible Fund). The policyholder then would be credited with his proportionate share of the profits resulting from the investment of the money in the Flexible Fund. In order to protect the annuitant from the vicissitudes of a "bear market," the company guaranteed that at least 100% of the net premiums would remain in the account of the annuitant during the deferred period. At the maturity of the policy, the policyholder could withdraw the accumulated value of his policy in cash or apply this accumulated value to a fixed annuity. At this point, the value of the policy became fixed, and the policyholder no longer shared in the investment profits made by the Flexible Fund.

2. The guarantee of 100% applied only if the deferred period were ten years or longer. If the period were less than ten years, the guarantee ranged from 50% (first year) to 90% (ninth year).

3. The court defines net premium as gross premium minus deductions for expenses. SEC v. United Benefit Life Ins. Co., 359 F.2d 619, 621 (D.C. Cir. 1966).

4. 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77 (1964). Section 77f requires a company involved in the sale of securities in interstate commerce to file a registration statement with the SEC describing the nature of the enterprise. Section 77j sets forth the elements and the information required in a prospectus. The congressional purpose behind the act is to apprise prospective buyers of the information relevant to risks that may be involved.

5. 54 Stat. 789 (1940), as amended, 15 U.S.C. §§ 80a-1 to -24 (1964). Section 80a-8 requires the investment company to comply with provisions for registration and recital of its investment policies and operating practices. Also, a limited measure of regulation of the investment policies and practices is provided.

ance,"[6] which is exempt by the McCarran-Ferguson Act[7] from federal regulation. The trial court entered judgment for the defendant, and on appeal, *held,* affirmed. The guarantee of 100 per cent of net premiums is a sufficient assumption of the investment risk to exempt the contract as "insurance" from federal securities regulation. *SEC v. United Benefit Life Ins. Co.*, 359 F.2d 619 (D.C. Cir. 1966).

Although the regulation of insurance is within the ambit of the federal plenary power over interstate commerce,[8] Congress has expressly reserved the control of the insurance industry to the states. This policy determination was enunciated in the McCarran-Ferguson Act, which directed that no act of Congress shall be construed "to invalidate, impair, or supersede" any state law relating to the regulation of insurance.[9] Thus, while the Federal Securities Act and the Federal Investment Company Act create a regulatory structure for the sale of securities,[10] both acts specifically exclude insurance contracts from their coverage.[11] Viewed as a whole, these three acts create a dichotomy of regulation between the federal control of securities on the one hand, and state control of insurance on the other. During the 1950's, however, a new concept in insurance emerged which did not fit neatly into this established dichotomy—the variable annuity contract.[12] This type of policy differed from the

6. "[T]he concept of 'insurance' involves some investment risk-taking on the part of the company. . . . '[I]nsurance' involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts." SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65, 71 (1959) (hereinafter cited as VALIC).

7. 59 Stat. 33 (1945), as amended, 15 U.S.C. § 1012 (1964), which provides in relevant part that: "(a) The business of insurance . . . shall be subject to the laws of the several States which relate to the regulation or taxation of such business. (b) No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . ."

8. It was not until 1944 that this power was recognized. In United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944), the Court held that control of the interstate insurance industry was within the scope of federal regulation under the commerce clause.

9. 59 Stat. 33 (1945), as amended, 15 U.S.C. § 1012 (1964). See note 7 *supra.* The McCarran-Ferguson Act was passed in quick response to *South-Eastern Underwriters,* the ostensible intent of Congress being to reject the exercise of their newly-acknowledged power and to allow the states to retain their individual controls over the business of insurance.

10. See notes 4 & 5 *supra.*

11. "Any insurance or endowment policy or annuity contract . . . issued by a corporation subject to the supervision of the insurance commissioner [of a State] . . . ." is specifically excluded in the Securities Act of 1933, § 3(a)(8), 48 Stat. 76, 15 U.S.C. § 77c(a)(8) (1964). "Any bank or insurance company" is excluded in the Investment Company Act of 1940, § 3(c)(3), 54 Stat. 798, 15 U.S.C. § 80a-3(c)(3) (1964).

12. The first variable annuity, the College Retirement Equities Fund, was established in 1952. See VALIC, *supra* note 6, at 69. "A variable annuity contract functions in the following manner: The purchaser acquires accumulation units in a fund which is invested in common stocks. To determine how much an accumulation unit will cost, the total market value of the fund is divided by the number of outstanding units,

traditional fixed annuity in that the annuitant's benefits were not a fixed dollar amount, but rather a sum which varied with the success of the invested premiums. Yet, the variable annuity retained many of the insurance features of the classic fixed annuity, including in particular the distribution of mortality risk.[13] Conceptually, therefore, the variable annuity was a hybrid form, an amalgam of insurance and security characteristics. Debate[14] over whether this type of policy was subject to federal regulation as a "security" or exempt from such regulation as "insurance" was resolved by the Supreme Court in *SEC v. Variable Annuity Life Ins. Co.*[15] (hereinafter referred to as *VALIC*). Employing a conceptual approach,[16] the Court concluded that since the policy guaranteed no fixed income and thus placed the burden of risk upon the policyholder, the variable annuity was a "security."[17] In ascertaining the nature of the contract, the *VALIC*

just as the value of each share of an investment fund is computed by dividing the total asset value of the fund by the number of outstanding shares. Usually the contract holder will be investing a fixed sum per year and the number of units he will buy each year fluctuates with the price of the accumulation unit as it reflects changes in the common stock fund. The units will accumulate over the years, and when the policy holder retires and elects to take the variable annuity option as opposed to one of the other options offered, his total accumulation units will be converted into an annuity fund. To do this, the number of units he has accumulated will be multiplied by the value of a unit at that time, giving a cash sum. Using this sum, the first annuity payment is computed using the progressive annuity table and an interest rate . . . ." Comment, 12 VAND. L. REV. 1398 n.2 (1959). For a detailed comparison of the variable annuity with the classic fixed annuity, see Mearns, *The Commission, The Variable Annuity, and The Inconsiderate Sovereign*, 45 VA. L. REV. 831, 833-37 (1959).

13. Other features include term life and disability insurance. For the argument that a variable annuity is "insurance," see Day, *A Variable Annuity is Not a "Security,"* 32 NOTRE DAME LAW. 642 (1957); Comment, 11 VAND. L. REV. 1453 (1958).

14. *Compare* Day, *supra* note 13, *with* Haussermann, *The Security in Variable Annuities*, 1956 INS. L.J. 382. See Note, *Variable Annuity: Security or Annuity?*, 43 VA. L. REV. 699 (1957).

15. *Supra* note 6. The Variable Annuity Life Insurance Company was primarily engaged in the sale of variable annuity contracts. The SEC sought injunctive relief against the company until these contracts were registered under the Securities Act of 1933 and until there was a compliance with the Investment Company Act of 1940. The SEC asserted that the contracts were securities and, therefore, subject to federal regulation. The defendant argued that the policies were insurance contracts and exempt from federal regulation by the McCarran-Ferguson Act. The district court dismissed the complaint, and the court of appeals affirmed. On certiorari to the Supreme Court, *held*, reversed. Since the variable annuity contracts place all the investment risks upon the annuitant, such contracts must be considered as securities and within the scope of federal regulation. In a concurring opinion, Mr. Justice Brennan urged that the contracts presented the type of regulatory problems that Congress intended to solve by federal securities regulation. The dissent noted the historic policy of entrusting the regulation of insurance to the states and concluded that this new experiment in insurance should be regulated by the various local insurance boards.

16. This approach may be described as an attempt to determine the concept (*i.e.*, "security" or "insurance") to which the policy most closely conformed.

17. "The difficulty is that, absent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant, none on the company." VALIC, *supra* note 6, at 71.

Court placed primary emphasis upon the determination of whether there had been a substantial assumption of the investment risk by the insurer.[18]

In determining the amenability of the policy to federal regulation, the court in the instant case was faced with essentially the same type of problem as that presented in *VALIC, i.e.,* characterization of an annuity contract which combined features of both insurance contracts and investment securities. Initially, the court noted the similarities between this new type of contract and the traditional deferred annuity, *i.e.,* both had such common characteristics of insurance as the assumption of mortality and expense risks by the company and provisions for cash surrender value and death benefits. The only significant difference between the two types of policies was that the contract in the instant case promised only a return of principal, rather than assuring principal plus interest.[19] Denying the SEC's contention that a policy is not "insurance" unless it guarantees *both* principal *and* interest, the court concluded that "by guaranteeing principal . . . United has assumed a substantial part . . . [of the investment] risk during the deferred period of the contract."[20] This assured return provided "a substantial and meaningful 'floor' to the . . . policy"[21] and distinguished it from the variable annuity contract which had been declared a "security" in the *VALIC* decision.

The instant decision closely adheres to the logic of the approach employed by the *VALIC* Court. This approach may be summarized as an attempt to determine whether the policy is "insurance," and therefore exempted from SEC regulation, by gauging the substantiality of the issuer's assumption of the investment risk.[22] If there is a sufficient guarantee of return, then the policy is an insurance contract to be regulated solely by the states; if the issuer fails to assume a substantial portion of the risk, the policy is a regulable security, subject to SEC controls. On its face this technique appears to conform to the congressional intent as evidenced by the statutes previously considered. In fact, however, it disregards the consideration that such

18. *Id.* at 71-73. This emphasis on the risk-taking aspect as determinative has been followed by the SEC. See Prudential Ins. Co. of America, SEC Investment Co. Act Release No. 3620, Jan. 22, 1963.

19. "The only meaningful difference between the FFA and the conventional deferred annuity is that the FFA does not guarantee interest on the accumulation of net premiums during the deferred period, but instead promises 100% of net premiums plus a share in any profits made by the investment and reinvestment of the money in the Flexible Fund," 359 F.2d at 622.

20. *Id.* at 623.

21. *Ibid.*

22. See Mearns, *supra* note 12, at 844-49. Professor Mearns criticizes this approach and suggests that the Court should have looked to what the law ought to be, *i.e.,* which governmental agency should regulate.

contracts are really a mixture of investment securities and insurance contracts, since despite the minimum return guaranteed the annuitant, a substantial portion of the contract represents an investment in the common-stock portfolio of the special fund. Although it seems reasonable that the policyholder-investor should be entitled to the investment regulation prescribed by Congress, the instant decision appears to deny the annuitant the benefit of that special protection. Furthermore, since the controls imposed by state insurance boards are generally irrelevant to the regulation of investment policy and operating practice,[23] exclusive state regulation of such hybrid contracts would preclude any meaningful control over the investment aspects of the policy. Perhaps a better approach would have been to regard the policyholder's, rather than the issuer's, assumption of the investment risk as determinative of whether the contract was "insurance" for the purposes of exemption from SEC regulation. Thus, even though the policy appears on its face to be an insurance contract, it should be subject to SEC regulation if the policyholder has assumed a significant measure of the investment risk. The consequences of such an approach would be to assure a more comprehensive protection of the public by effecting control of both the insurance and investment features of the policy. Applying this test to the facts of the instant case, it is submitted that since the policyholder had assumed a significant measure of the investment risk, SEC regulation should have been required.

Jurisdiction—"Minimum Contacts"—"Corporate Veil" Pierced by Use of Tenuous Agency Relationship

The United States sued in a New York federal district court[1] to recover delinquent income taxes from the estate of a Canadian domiciliary. It alleged that the deceased taxpayer had used his position as manager of a Canadian distillery to direct American distributors to

23. The controls imposed by the state insurance boards are directed toward the regulation of rates and other policy terms, reserves, solvency, and permissable investments. See VALIC, *supra* note 6, at 79. The controls imposed by the Securities Act of 1933 and the Investment Company Act of 1940 are directed primarily toward disclosure.

1. Jurisdiction was assumed over the taxpayer's executor pursuant to rule 4(e) of the Federal Rules of Civil Procedure, incorporating § 302 of the New York Civil Practice Laws and Rules. FED. R. CIV. P. 4(e) provides in part: "Whenever a statute or rule of court of the state in which the district court is held provides (1) for the service of a summons . . . upon a party not an inhabitant of or found within the state . . . service may . . . be made under the circumstances prescribed in the statute or rule." See note 24 *infra*.

share their profits with the taxpayer's friends and relatives.[2] The government claimed such "commissions" were taxable income to the taxpayer.[3] Pursuant to New York's "long-arm"[4] statute (hereinafter referred to as Civ. Prac. § 302),[5] personal service of process was made upon the defendant Canadian trust company, executor of taxpayer's estate. The government contended that, since the distributors, as personal agents of the taxpayer, drafted and executed the contract directing payment of funds to the taxpayer's designees in the state of New York,[6] there were sufficient local acts to render taxpayer's estate amenable to New York jurisdiction. The trust company claimed that service upon it was unauthorized since the taxpayer's corporate activities did not constitute the transaction of personal "business" by him within New York as required by the statute. The district court accepted this contention and dismissed the suit for lack of jurisdiction.[7] On appeal, *held*, reversed. Where a foreign corporation's non-domiciliary manager, acting through corporate contractual agents, transacts any personal business in New York from which a cause of action arises, New York has sufficient contacts to justify the assertion of jurisdiction over his estate. *United States v. Montreal Trust Co.*, 358 F.2d 239 (2d Cir.), *cert. denied*, 384 U.S. 919 (1966).

Traditionally, the due process clause of the fourteenth amendment required the physical presence of defendant within the forum state

2. More specifically the facts show that the exclusive world-wide agent for the Canadian distillery of which deceased taxpayer was manager entered into a contract with a New York corporation by which the New York corporation became the exclusive sub-agent for the distribution of whiskey in the United States. Deceased taxpayer insisted as a precondition to the making of the contract that the New York corporation agree to put on its payroll as salesmen various relatives and friends of the deceased taxpayer. There was evidence to show that the deceased taxpayer wrote to the New York corporation's New York manager instructing him as to the method by which his designees were to be paid. These instructions were followed and the designees were paid in New York with funds drawn on a New York bank for doing little or no work. The facts also show that a San Francisco distributor purchased whiskey from the distillery for shipment to military bases. As a precondition to this contract, deceased taxpayer insisted that the distributor pay two-thirds of his profit to deceased taxpayer's brother-in-law in New York. While negotiations took place in Canada, the contract to pay funds to deceased taxpayer's brother-in-law was drafted and executed in New York.

3. Under the rule of attribution of income the payments received by designees may be considered taxable income of the designor. Helvering v. Horst, 311 U.S. 112 (1940).

4. The term "long-arm" is generally applied to statutes which grant jurisdiction over parties not present in the geographical area of the state.

5. N.Y. Civ. Prac. § 302, *Personal Jurisdiction by Acts of Non-domiciliaries*, provides: "A court may exercise personal jurisdiction over any non-domiciliary, or his executor or administrator, as to a cause of action arising from any of the acts enumerated in this section . . . if, in person or through an agent, he: 1. transacts any business within the state. . . ."

6. As to these transactions, the taxpayer was never personally in New York and allegedly acted at all times in his fiduciary capacity as manager of the corporation.

7. United States v. Montreal Trust Co., 235 F. Supp. 345 (S.D.N.Y. 1964).

before a judgment binding him personally could be rendered.[8] However, the Supreme Court has gradually loosened this rather strict jurisdictional requirement.[9] After finding that service of process need only be "reasonably calculated to give the defendant actual notice and opportunity to be heard" in order to satisfy due process requirements, the Supreme Court in *International Shoe Co. v. Washington*[10] held that judicial jurisdiction could exist if the defendant had sufficient minimum contacts with the forum state such that the maintenance of the suit would not offend "traditional notions of fair play and substantial justice."[11] Twelve years later, in *McGee v. International Life Ins. Co.*,[12] the Supreme Court upheld in personam jurisdiction under a "single act" statute where the lone contact with the forum state was an isolated insurance contract. As a result of this expansion in the permissible scope of jurisdiction over nonresidents, many states enacted "single act" statutes enabling them to acquire personal jurisdiction over nondomiciliaries sued on a cause of action arising from single or occasional acts within the state.[13] New York joined this trend in 1963 by enacting Civ. Prac. § 302 which requires that the defendant "transact business" within the state and that the cause of action arise out of that transaction before jurisdiction can be asserted over him.[14] In the broadest interpretation of this phrase to

8. Pennoyer v. Neff, 95 U.S. 714 (1877).

9. Milliken v. Meyer, 311 U.S. 457 (1940). The trend toward expanded in personam jurisdiction over nonresidents rests on the view that as the flow of interstate travel has increased, the need for easily obtainable and inexpensive forums in which to litigate actions arising out of the increased contact has similarly increased. Additionally, it would seem that each state has a right to protect its own citizens from the actions of nonresidents. See generally *Student Symposium of Jurisdiction and Venue: A Reconsideration of Long Arm Jurisdiction*, 37 IND. L.J. 333 (1962).

10. 326 U.S. 310 (1945).

11. *Id.* at 316.

12. 355 U.S. 220 (1957).

13. See ALA. CODE tit. 7, § 199(1) (Supp. 1965); ARK. STAT. ANN. § 27-2502 (Supp. 1963); CONN. GEN. STAT. ANN. § 33-411(c) (1961); FLA. STAT. ANN. § 47.16 (Supp. 1965); IDAHO CODE ANN. § 5-514 (Supp. 1965); ILL. ANN. STAT. ch. 110, § 17 (Smith-Hurd 1956); IOWA CODE ANN. § 617.3 (Supp. 1965); KAN. GEN. STAT. ANN. § 60-308(6) (1964); LA. REV. STAT. ANN. § 13.3201 (Supp. 1965); ME. REV. STAT. ANN. tit. 14, § 704 (1965); MD. ANN. CODE art. 75, § 96 (1965); MICH. STAT. ANN. §§ 27A.701-735 (1962); MINN. STAT. ANN. §§ 303.13(1),(3) (Supp. 1965); MO. ANN. STAT. §§ 351.630(2), 355.375(2) (Supp. 1965); MONT. REV. CODE ANN. ch. 2701, rule 4B (Supp. 1965); N.M. STAT. ANN. § 21-3-16 (Supp. 1965); N.Y. CIV. PRAC. § 302; N.C. GEN. STAT. § 55-145 (1965); OHIO REV. CODE §§ 2307.381-385 (Anderson 1965); OKLA. STAT. ANN. tit. 12, § 187 (Supp. 1966); ORE. REV. STAT. § 14.035 (1963); R.I. GEN. LAWS ANN. § 9-5-33 (Supp. 1965); S.C. CODE ANN. § 10-424 (Supp. 1965); TEX. REV. CIV. STAT. ANN. art. 2031B (1964); VT. STAT. ANN. tit. 12, § 855 (1959); VA. CODE ANN. §§ 8-81.1-5 (Supp. 1966); WASH. REV. CODE ANN. § 4.28.185 (1962); W. VA. CODE ANN. § 3083 (1961); WIS. STAT. ANN. § 262.05 (Supp. 1966).

14. See, *e.g.*, Schneider v. J & C Carpet Co., 23 App. Div. 2d 103, 258 N.Y.S.2d 717 (1st Dep't 1965) (transacting business through performance in furtherance of

date by New York courts, a foreign corporation was held to be "transacting business" in New York on the basis of extensive negotiations in New York, the execution of a supplemental agreement there, and the performance of a contract there under the supervision of the defendant's representatives.[15] Generally, the New York courts seem to require that three conditions be satisfied before upholding jurisdiction asserted over a nondomiciliary on the basis of Civ. Prac. § 302. He must have "transacted business" in New York in an individual capacity rather than in a corporate capacity;[16] either he or his agent must be physically present in New York with relation to that transaction;[17] and the transaction of business in New York must be purposefully undertaken by him so that he may be said to have invoked the benefits and protection of the laws of New York.[18]

The majority in the instant case limited itself to the jurisdictional issue and focused on whether the taxpayer had transacted "sufficient business" in New York to subject the executor of his estate to New York jurisdiction. It dealt with two interrelated problems: (1) whether the taxpayer was acting in an individual capacity when he directed that funds be diverted to his friends and relatives; and (2) whether, since the taxpayer had never been in the state, his dealings with New York distributors constituted a transaction of business there within the meaning of the statute. The majority reasoned, without further explanation, that on the findings of fact the taxpayer could not have been acting in his corporate capacity when he allegedly directed payments to his designees who had no connection with the corporation. Thus, the court held that the taxpayer had engaged in activity within New York in his individual capacity and was not protected by his "role as corporate officer."[19] Turning next to the question of the defendant's presence in the state, the court first held that the dis-

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contract). New York courts have not yet extended jurisdiction over nondomiciliaries to its outer limits; rather they have adopted a case-by-case approach, always watching the experiences of other states in relation to their "loug-arm" statutes. See Comment, 14 BUFFALO L. REV. 525, 539 (1965).

15. Longines-Wittnauer Watch Co. v. Barnes & Reinecke, 21 App. Div. 2d 474, 251 N.Y.S.2d 740 (1st Dep't 1964).

16. Boas & Associates v. Vernier, 22 App. Div. 2d 561, 257 N.Y.S.2d 487 (1st Dep't 1965) (action to recover commissions earned by business broker).

17. Longines-Wittnauer Watch Co. v. Barnes & Reinecke, *supra* note 15 (action for breach of warranty in performance of contract); Iroquois Gas Corp. v. Collins, 42 Misc. 2d 632, 248 N.Y.S.2d 494 (Sup. Ct. 1964) (action for breach of construction contract).

18. Schroeder v. Loomis, 46 Misc. 2d 184, 259 N.Y.S.2d 42 (Sup. Ct. 1965) (products liability); Lewin v. Boch Laundry Mach. Co., 42 Misc. 2d 599, 249 N.Y.S.2d 49 (Sup. Ct. 1964) (products liability).

19. 358 F.2d at 243.

tributors served merely as personal agents of the taxpayer.[20] Since these agents established the necessary "contacts"[21] with New York when they negotiated and executed contracts there, the court concluded that the taxpayer had purposefully conducted activities in New York, and his estate was, therefore, amenable to service of process. The minority dissented on the ground that under well recognized principles of agency the distributors were clearly not the taxpayer's personal agents.[22]

The "long-arm" concept was initially intended to protect local citizens from the intrastate activities of nondomiciliaries by extending judicial jurisdiction to parties not present within the geographical area of the state. In the instant case, the local activities of a nondomiciliary were not relied upon to establish judicial jurisdiction for the purpose of protecting a local interest, rather they were used to uphold judicial[23] jurisdiction in a matter of national concern, *i.e.*, federal taxation. It is in this area that the instant case may have its most significant implications. Since no federal legislation granted jurisdiction, the circuit court had to rely upon a tenuous agency relationship to establish the taxpayer's necessary connections with New York. In the absence of a federal statute extending judicial jurisdiction to federal courts in areas of federal concern,[24] the approach of the instant case seems

20. The majority found that the district court erred in requiring the government to go beyond the presentation of prima facie evidence to establish threshold jurisdiction. The apparent willingness of the American distributors to comply with the taxpayer's wishes in directing portions of their profits to the taxpayer's designees was considered by the majority to indicate sufficient control to justify a finding that they were the taxpayer's personal agents.

21. The minority urged that the majority confused the "doing business" test of Civ. Prac. § 301 with the "transacting any business" test of Civ. Prac. § 302 by referring to "contacts" to determine if the taxpayer transacted business. The test under Civ. Prac. § 302 is not whether there are sufficient contacts, but whether the defendant transacted any business in the state from which a cause of action arose.

22. The minority states: "[I] would agree with the conclusion reached by the majority if I could accept its premise that Klein [taxpayer] was engaged in the state *through agents* in the transacting of any business out of which the alleged cause of action arises . . . . Upon that issue, accordingly, I respectfully but emphatically dissent." 358 F.2d at 244. The assertion of jurisdiction based on such tenuous evidence, the minority urged, violated the due process requirements of the United States Constitution, and will plague the bar with uncertainty until corrected.

23. The majority felt that since the jurisdictional issue of whether there was a transaction of business in New York was so involved with the substantive issue of tax liability, a proof of tax liability would necessarily prove the requisite jurisdictional transactions. Therefore the establishment of "prima facie tax related transactions" will be sufficient to invoke the New York "long-arm" statute and force the defendant into a trial on the merits. For a more detailed discussion of this point see Comment, 42 NOTRE DAME LAW. 273 (1966).

24. Professors von Mehren and Trautman suggest that this case is, on the federal level, an analogue to International Shoe Co. v. Washington, *supra* note 10. As in *International Shoe*, the assertion of federal jurisdiction in the instant case was justified on the ground that it was necessary to vindicate a state policy. However, the relevant cir-

essential, especially in light of possible misuse of the corporate form to shield taxpayers from personal liability. In using this approach, however, the court has significantly extended the minimum contacts theory with respect to a state "long-arm" statute. As a possible result of this decision, state courts may attempt to use such statutes to obtain jurisdiction over both individuals and corporations domiciled in other states whose connections with the forum state are almost non-existent. Whether there are sufficient minimum contacts to obtain jurisdiction over a nondomiciliary, however, depends in large measure upon the interests of a state in reaching the particular transaction; and thus the expanded use of a state "long-arm" statute in a case of national concern would not necessarily mean that a similar expansion in a state case lacking such national interest would be held constitutional. In any event, the court's reliance on this doubtful relationship lends much uncertainty to an area of the law which should be characterized by certainty. Alternatively, the court might have followed the approach adopted in *Young v. Masci*,[25] where the Supreme Court in interpreting a nonresident motorist statute refused to apply the doctrine of agency in holding a nondomiciliary amenable to local jurisdiction. Instead, the Court determined that it would be reasonable under the facts and in the interest of justice to subject the nondomiciliary to in personam jurisdiction. Since application of such a test to the facts of *Montreal Trust* would probably not have produced a different result, the majority should not have relied upon "a principal-agent relationship so tenuous as to be non-existent. . . ."[26]

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cumstances through which jurisdiction was obtained were clearly those which the taxpayer had with the United States as a whole. Since there were no applicable federal standards, the court was forced to utilize the incorporative provisions of the "long-arm" statute. Von Mehren & Trautman, *Jurisdiction to Adjudicate: A Suggested Analysis*, 79 HARV. L. REV. 1121, 1123 n.6 (1966).

25. 289 U.S. 253 (1933).

26. 358 F.2d at 258. For the facts upon which this agency relationship was found see note 2, *supra*.

Labor Law—Injunctions—State Court Injunctive Proceeding for Breach of No-Strike Clause Removable to Federal Court

Plaintiff, Avco Corporation, brought an action in state court for injunctive and general relief against the defendant union, alleging breach of the no-strike and mandatory arbitration clauses of their collective bargaining agreement. After the injunction was issued, defendant successfully removed[1] the case to the federal district court. On plaintiff's motion to remand to state court, *held*, motion denied. State court actions requesting injunctions for breach of collective bargaining agreements may be removed to federal district courts since these courts have original jurisdiction of such disputes which is not obviated by the Norris-LaGuardia Act. *Avco Corp. v. Lodge 735, Machinists Union*, 2 LAB. REL. REP. (63 L.R.R.M.) 2014 (M.D. Tenn. March 2, 1966).[2]

Section 301 of the Taft-Hartley Act empowered federal district courts to entertain suits for violations of labor contracts between unions and those industries affecting commerce.[3] Where a state court injunctive action has been removed to a federal court, two principal problems arise in determining whether the court has the power under section 301 to entertain the suit. First, since diversity of citizenship is not usually present, a federal question must be established to satisfy the original jurisdiction requirements of the Removal Act. Second, the court must find that this jurisdiction is not negated by section 4 of the Norris-LaGuardia Act, which provides that no federal court "shall have jurisdiction" to issue an injunction where employees cease

1. The pertinent provisions of the Removal Act, 28 U.S.C. § 1441 (1964), under which the removal was effected, are as follows:

"(a) Except as otherwise expressly provided by Act of Congress, any civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed by the defendant or the defendants, to the district court of the United States for the district and division embracing the place where such action is pending.

"(b) Any civil action of which the district courts have original jurisdiction founded on a claim or right arising under the Constitution, treaties or laws of the United States shall be removable without regard to the citizenship or residence of the parties. Any other such action shall be removable only if none of the parties in interest properly joined and served as defendants is a citizen of the State in which such action is brought."

2. This case is presently on appeal to the Court of Appeals for the Sixth Circuit. Interview with attorney for plaintiff-appellant.

3. Labor Management Relations Act § 301(a), 61 Stat. 156 (1947), 29 U.S.C. § 185(a) (1964): "Suits for violation of contracts between an employer and a labor organization representing employees in an industry affecting commerce as defined in this chapter, or between any such labor organizations, may be brought in any district court of the United States having jurisdiction of the parties, without respect to the amount in controversy or without regard to the citizenship of the parties."

to work or remain in an employment relation.[4] Any discussion of the federal question requirement must begin with *Textile Workers v. Lincoln Mills*,[5] where the Supreme Court held that section 301 authorizes the fashioning of a body of federal substantive law for the enforcement of collective bargaining agreements. The contention that this federal substantive law doctrine deprives state courts of jurisdiction to enforce rights arising under collective bargaining agreements was refuted in *Charles Dowd Box Co. v. Courtney*.[6] However, in exercising this jurisdiction, the Supreme Court ruled in *Local 174, Teamsters Union v. Lucas Flour Co.*,[7] that inconsistent doctrines of local law must yield to the principles of federal law developed under *Lincoln Mills*. The second problem in removing a state court injunctive proceeding is presented by *Sinclair Refining Co. v. Atkinson*,[8] where the Court held that section 301 actions were within the injunction restrictions of the Norris-LaGuardia Act, and thus the federal courts could not issue no-strike injunctions in section 301 breach of contract actions. The circuits have split on whether *Sinclair* and its predecessors permit removal of a state court injunctive proceeding to federal court.[9] The Third Circuit has held that since a state court action for an injunction for breach of a labor contract was a "state-created" right not arising under any federal law, it was not removable.[10] The court also ruled that under the Norris-LaGuardia Act the federal court lacked the "original jurisdiction"[11] of the subject

4. The Norris-LaGuardia Act § 1, 47 Stat. 70 (1932), 29 U.S.C. § 104 (1964): "No court of the United States shall have jurisdiction to issue any restraining order or temporary or permanent injunction in any case involving or growing out of any labor dispute to prohibit any person or persons participating or interested in such dispute (as those terms are herein defined) from doing whether singly or in concert, any of the following acts: (a) ceasing or refusing to perform any work or remain in any relation of employment."

5. Textile Workers v. Lincoln Mills, 353 U.S. 448, 451 (1957).

6. Charles Dowd Box Co. v. Courtney, 368 U.S. 502 (1962). There the Court expressly refused to rule on the following two questions which are involved in the instant case: "Whether the Norris-LaGuardia Act might be applicable to a suit brought in a state court for violation of a contract made by labor organization, and whether there might be impediments to the free removal to a federal court of such a suit." *Id.* at 514 n.8.

7. Local 174, Teamsters Union v. Lucas Flour Co., 369 U.S. 95, 102 (1962).

8. Sinclair Ref. Co. v. Atkinson, 370 U.S. 195 (1962).

9. In cases involving a paramount state interest, such as prevention of violence, federal courts have been more inclined to show deference to state court actions. See UAW-CIO v. Russell, 356 U.S. 634 (1958) (union violence subject to tort action in state court); Acme Markets, Inc. v. Local 692, Retail Store Employees, 231 F. Supp. 566 (D.C. Md. 1964) (state court injunctive action to halt violence not removable).

10. American Dredging Co. v. Local 25, Operating Eng'rs, 338 F.2d 837 (3d Cir. 1964), *cert. denied*, 380 U.S. 935 (1965).

11. In citing and discussing several meanings of "jurisdiction," the court concluded that the term as used in the Norris-LaGuardia Act means the authority to take *cognizance* of injunctive actions. *Id.* at 840-42. Other courts have viewed Norris-LaGuardia's withdrawal of jurisdiction as no more than a denial of the court's

matter required by the Removal Act, and thus could not take cognizance of the cause of action even if a federal question were shown. The Ninth Circuit has ruled to the contrary,[12] reasoning that under the *Lucas Flour* and *Dowd Box* decisions, any action for breach of a labor contract was necessarily a federal question within section 301 of the NLRA.[13] Evidently the Ninth Circuit did not feel that section 4 of the Norris-LaGuardia Act presented a problem, as it did not deal with it.[14]

Faced with plaintiff's contention that the lack of a federal question rendered the Removal Act inapplicable, the court in the instant case first reasoned that since *Lucas Flour* required inconsistent doctrines of local law to yield to federal substantive law, state law no longer existed "as an independent source of private rights in regard to collective bargaining contracts."[15] Since under this analysis only federal substantive law was applicable, a federal question was presented and the original jurisdiction requirement of the removal act was thus satisfied. Turning next to plaintiff's argument that the Norris-LaGuardia Act prevented federal courts from taking cognizance of the subject matter when injunctive relief was sought, the court cited *Atkinson v. Sinclair Refining Co.*,[16] as authority for the proposition that a district court has jurisdiction where both general and injunctive relief is sought.[17] It was pointed out that in spite of a

power to give the requested relief; that is, the act does not prohibit the court from taking the case under consideration. See note 20 *infra*. According to Professor Wright, the federal courts have jurisdiction to determine jurisdiction. Each "has the power to determine if it has the capacity to hear and decide the merits of the case before it." WRIGHT, FEDERAL COURTS 46 (1963). "[Jurisdiction] is the authority by which courts and judicial officers take cognizance of and decide cases." BLACK, LAW DICTIONARY 991 (4th ed. 1951).

12. Johnson v. England, 356 F.2d 44 (9th Cir. 1966). This was an original action by the union in state court seeking both specific performance of an arbitration agreement and an injunction to restrain the trustee in bankruptcy of the former employer. The decision is authority for the proposition that the cause of action arises under the "laws of the United States," and is thus within the Removal Act.

13. *Id.* at 48. *Accord*, Minkoff v. Scranton Frocks, Inc., 172 F. Supp. 870 (S.D.N.Y. 1959).

14. See Merchants Refrigerating Co. v. Local 6, Warehouse Union, 213 F. Supp. 177 (N.D. Cal. 1963) (Norris-LaGuardia Act and *Sinclair* held to have deprived the district court of jurisdiction even though federal question involved).

15. 2 LAB. REL. REP. at 2015.

16. Atkinson v. Sinclair Ref. Co., 370 U.S. 238 (1962) (not to be confused with its companion case Sinclair Ref. Co. v. Atkinson, 370 U.S. 195 (1962)).

17. See Oman Constr. Co. v. Local 327, Teamsters Union, 2 LAB. REL. REP. (63 L.R.R.M.) 2033 (M.D. Tenn. Aug. 24, 1966) (action for injunction in state court held removable). When plaintiff asks for general relief or damages in addition to an injunction, there is less dispute over removal because the injunctive prohibitions of the Norris-LaGuardia Act and the *Sinclair* case are not in issue as to the general relief portion of the complaint. Removal may then be effected under the separate controversy clause of the removal statute, 28 U.S.C. § 1441(a), which permits defendant

prayer for an injunction and damages in *Atkinson,* the Supreme Court had remanded the case to the district court, and had thus indicated its implicit approval of a federal district court's assumption of jurisdiction over a cause of action involving a prayer for injunctive relief. The court added that even if the plaintiff had not asked for general relief, the decision would remain the same since "a prayer for an injunction constructively acts as a prayer for all appropriate relief."[18]

As a result of decisions such as the instant one, state courts must comply with federal standards in labor injunctive proceedings or face removal of these actions to federal courts. Although this indirect application of Norris-LaGuardia is certainly not implicit in the words of that act,[19] this result appears inevitable when the provisions of the Removal Act are considered. The original jurisdiction of a federal court which is required by the Removal Act would not seem to be obviated when a realistic interpretation of section 4 of the Norris-LaGuardia Act is adopted.[20] It is highly unlikely that Congress intended section 4 to deprive courts of the authority to entertain or take cognizance of an action for injunctive relief, when in section 7 of the same act the courts are authorized to issue injunctions under specified conditions.[21] In addition the application of the federal substantive law doctrine of *Lincoln Mills–Lucas Flour* would seem to support the instant decision. In his opinion for the majority in *Lincoln Mills,* Mr. Justice Douglas said: "There is no constitutional difficulty. Article III, § 2, extends the judicial power to cases 'arising under . . . the laws of the United States. . . .' A case or controversy

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to remove to a federal court and there to have decided either all issues or just the federal question, within the court's discretion. Professor Moore feels that "the presence of a prayer for damages should not alter the result." IA MOORE, FEDERAL PRACTICE ¶ 0.167[7], at 1003 (2d ed. 1961).

18. 2 LAB. REL. REP. at 2016. FED. R. CIV. P. 54(c).

19. The statute refers only to the jurisdiction of federal courts. Lesnick, *State-Court Injunctions and the Federal Common Law of Labor Contracts: Beyond Norris-LaGuardia,* 79 HARV. L. REV. 757 (1966).

20. Publishers' Ass'n v. Printing Pressmen's Union, 246 F. Supp. 293, 295 (S.D.N.Y. 1965), found that the jurisdiction in Norris-LaGuardia "refers only to the authority to grant an injunction after entertaining the suit." See Food Fair Stores, Inc. v. District Council 11, Retail Clerks, 229 F. Supp. 123 (E.D. Pa. 1964), where the court held that although *Sinclair* reaffirmed the restrictions of Norris-LaGuardia, "we do not accept it as authority for the plaintiff's argument that this Court is without jurisdiction to even *consider* a complaint which prays for such [injunctive] relief . . . . The jurisdiction of this Court does not depend upon the ingenuity of the form of a complaint in equity." *Id.* at 127. See Pocahontas Terminal Corp. v. Portland Bldg. & Constr. Trade Council, 93 F. Supp. 217 (S.D. Me. 1950): "It [Norris-LaGuardia] does not deprive the court of jurisdiction to consider cases in which such relief is asked, or to grant other than injunctive relief therein." *Id.* at 224-25. See generally, CHAFFEE, SOME PROBLEMS OF EQUITY 367-74 (1950); Aaron, *Strikes in Breach of Collective Agreements: Some Unanswered Questions,* 63 COLUM. L. REV. 1027, 1040-52 (1963).

21. 47 Stat. 70 (1932), 29 U.S.C. § 107 (1964).

arising under § 301(a) is, therefore, one within the purview of judicial power as defined in Article III."[22] Thus the federal substantive law developed by the federal courts may properly be equated with "the laws of the United States" for purposes of satisfying the Removal Act. It should also be noted that removal does not necessarily produce "an exercise in futility,"[23] since the district courts have the power to grant specific performance of an obligation to arbitrate,[24] decree damages,[25] and order injunctive relief if the required conditions are met.[26] Realistically, however, the unfortunate result of such decisions is that, aside from the often inadequate remedy of damages,[27] there now appears to be no effective sanction for a union's breach of a no-strike clause.[28] The *Sinclair* decision eliminated the federal courts as a recourse for injunctive relief, and decisions such as the instant case have the same practical effect on state courts. Yet a no-strike clause, when coupled with a binding arbitration provision, has been viewed favorably by the Supreme Court as being in harmony with national labor policy.[29] Perhaps the solution to this conflict between current decisions and relevant policy considerations should be a legislative one,[30] or the Supreme Court could provide the desired result by reversing the instant decision or by overruling *Sinclair*.[31] However, until some relief is provided, a no-strike clause seems of quite limited utility.

22. Textile Workers v. Lincoln Mills, *supra* note 5, at 457.

23. The basis for the contention that removal is futile is that plaintiff has an effective remedy in the state court, yet when the federal court denies remand and accepts the case, it is with the knowledge that no injunctive relief can be granted due to Norris-LaGuardia.

24. Textile Workers v. Lincoln Mills, *supra* note 5, at 451.

25. Local 174, Teamsters Union v. Lucas Flour Co., *supra* note 7.

26. 47 Stat. 70 (1932), 29 U.S.C. § 107 (1964) (injunctions by federal courts).

27. Damages as a remedy is inadequate primarily because it may come only after the business has been forced to terminate due to the effects of the strike.

28. Both the Supreme Court and Congress have recognized that the effort for industrial peace is purposeless unless both parties to a labor contract can have reasonable assurance that the contract will be honored. Charles Dowd Box Co. v. Courtney, *supra* note 6, at 509. In Textile Workers v. Lincoln Mills, *supra* note 5, at 454, the Court quoted from the legislative history of § 301 to the effect that one of its prime concerns was to provide the employer with an effective remedy when the union failed to abide by its contract.

29. Textile Workers v. Lincoln Mills, *supra* note 5, at 455.

30. This could come in three forms: (1) a legislative declaration accommodating Norris-LaGuardia and § 301 so as to overrule *Sinclair*; (2) the repeal of § 4 of Norris-LaGuardia; or (3) a specific prohibition against removal of this type of action to federal court.

31. *Sinclair* was a 5-3 decision. A suggested method of avoiding the frustrating consequences of removal is for the employer to seek specific performance of an arbitrator's award that the union cease to strike in violation of its contract. Although *Lincoln Mills* indicates that arbitrator's awards are specifically enforcible, an award of this nature might still run afoul of § 4 of Norris-LaGuardia.

Municipal Corporations—Michigan Approves Use of Municipal Industrial Development Bonds

Plaintiff, a municipal corporation, sought to issue tax exempt municipal revenue bonds to finance the acquisition of an industrial plant.[1] The city council approved the bond issue and a plywood corporation agreed to purchase land and construct the plant. Pursuant to the agreement, the plywood corporation was to sell the completed facilities to the city with a lease-back provision lasting twenty-five years.[2] After the plant had been constructed, defendant, the city clerk, refused to complete the transaction and plaintiff brought a mandamus proceeding to compel performance. Upon certification to the Michigan Supreme Court,[3] *held*, a writ of mandamus would issue. The state industrial development revenue bond act[4] does not contravene Michigan's constitutional prohibitions against lending public credit for private purposes.[5] Since the city's primary objective was to promote the general public welfare, its issuance of revenue bonds pursuant to this statute exhibited a public purpose in accordance with the provisions of the state constitution. *City of Gaylord v. Beckett*, 144 N.W.2d 460 (Mich. 1966).

The modern concept of municipal industrial development bonds[6]

1. Revenue bonds are payable, both as to principal and interest, solely from revenues derived from the operation of the project so financed. Britt v. City of Wilmington, 236 N.C. 446, 73 S.E.2d 289 (1952). Some statutes provide that the bonds can be secured by a mortgage on the facilities while others authorize only a pledge of income obtained from the facility. Abbey, *Municipal Industrial Development Bonds*, 19 VAND. L. REV. 25, 28 (1965). General obligation bonds, on the other hand, are payable from general ad valorem taxes on all taxable property and represent debts for which the municipality is directly liable. DeLoach v. Scheper, 188 S.C. 21, 198 S.E. 409 (1938). See also Rivers v. City of Owensboro, 287 S.W.2d 151 (Ky. 1956). Bonds must be authorized by enabling legislation since municipalities are creatures of state legislation. Virtue, *The Public Use of Private Capital: A Discussion of Problems Related to Municipal Bond Financing*, 35 VA. L. REV. 285, 304 n.66 (1949).

2. The rentals payable by the plywood company were to be sufficient to make the bonds self-liquidating. After the twenty-five-year lease period, the company was to have an option to buy the premises for one dollar. City of Gaylord v. Beckett, 144 N.W.2d 460, 464 (Mich. 1966).

3. A total of eight questions were certified to the Michigan Supreme Court dealing with the interpretation of and the validity of the enabling act in light of various provisions of the state constitution, as amended. The crucial questions in this case involved those constitutional provisions relating to the lending of the public credit and the application of the public purpose doctrine.

4. MICH. STAT. ANN. § 5.3533(21) (Supp. 1, 1965). For a compilation of similar provisions enacted in other jurisdictions, see Abbey, *supra* note 1, at 67-71.

5. The state constitution broadly declared that the public health and general welfare were matters of public concern. MICH. CONST. art. IV, § 51.

6. The Mississippi plan was not the first plan involving the encouragement of new industrial development through the use of public funds. The colony of Virginia had a tobacco bounty plan to encourage the textile industry and several states issued railroad bonds in the era of nineteenth-century railroad expansion. Pinsky, *State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach*, 111 U. PA. L. REV. 265-66 n.4 (1963).

originated with the Mississippi Balance Agriculture With Industry Law (BAWI),[7] enacted in 1936 to relieve severe economic conditions caused, in part, by the depression[8] and to accelerate the advent of the industrial "take-off" period.[9] The BAWI plan authorized issuance of general obligation bonds by any municipality to finance industrial plant construction, subject to approval by the municipal electorate and the Mississippi Agricultural and Industrial Board. The facilities so constructed were to be leased to the incoming industry.[10] This plan was attacked on the grounds that (1) the state constitution required the taxing and borrowing power to be used only for a public purpose, and (2) the credit of the state, or its political subdivisions, could not be used for the aid of private parties. These challenges were successfully met in *Albritton v. City of Winona*,[11] where the state supreme court held that the public purpose requirement was satisfied.[12] Subsequently, other southern states adopted industrial development bond laws for economic reasons similar to those of Mississippi. Revenue bonds rather than general obligation bonds were utilized in most plans[13] and constitutional attacks in state courts, based primarily upon the public purpose doctrine, were usually unsuccessful.[14] Criteria used by the courts to determine the existence of a public purpose were often vague and undefined, but the general approach to the problem seemed to be whether there was a net gain to the community as a whole.[15] Other courts, viewing the problem in terms of the credit clause, found that the issuance of self-liquidating revenue

7. MISS. CODE ANN. §§ 8936-24 (1956) (re-enacted). For an extensive discussion of the BAWI program, see Bell, *Legal Problems That May Be Encountered in the Administration of Mississippi's BAWI Program*, 29 MISS. L.J. 22 (1957).

8. Pinsky, *supra* note 6, at 267.

9. See W. W. ROSTOW, THE STAGES OF ECONOMIC GROWTH 6-9 (1960), where "take-off" is described as the period where growth becomes a normal condition, compound interest becomes a part of society's habits, and industrial expansion is rapid.

10. Abbey, *supra* note 1, at 27.

11. 181 Miss. 75, 178 So. 799, *appeal dismissed per curiam*, 303 U.S. 627 (1938).

12. In so holding, the majority of the Mississippi Supreme Court viewed the public purpose as the promotion of the welfare, peace, happiness, and prosperity of the state's citizens. The court declined to substitute its judgment for that of the legislature as to the means of accomplishing that purpose. *Id.* at 95, 178 So. at 803.

13. Revenue bonds were favored because with them the municipality incurred only limited liability. See note 1 *supra*; Pinsky, *supra* note 6, at 268.

14. See, *e.g.*, Wayland v. Snapp, 334 S.W.2d 633 (Ark. 1960). *Contra*, State v. Town of North Miami, 59 So. 2d 779 (Fla. 1952). Suits attacking the constitutionality of the bond enabling acts were often brought by industrialists and other interested parties to secure judicial approval of such projects. Note, 70 YALE L.J. 789, 791 (1961).

15. Dyche v. City of London, 288 S.W.2d 648 (Ky. 1956) (underlying economic conditions determine public nature); Village of Deming v. Hosdreg Co., 62 N.M. 18, 303 P.2d 920 (1956) (overall picture must indicate a comfortable balance of advantages over disadvantages). See 66 HARV. L. REV. 898 (1953). *Cf.* Polanski v. Town of Eagle Point, 30 Wis. 2d 507, 141 N.W.2d 281 (1966) (Public purpose is a matter of law, not fact).

bonds did not constitute a lending of credit since no charges were made on tax revenues and no ad valorem taxes or property assessments were imposed on the citizens of the community.[16] As the industrial revenue bond and similar[17] plans became widespread during the 1950's,[18] certain interest groups expressed varying degrees of opposition to them.[19] The most vocal was the Investment Bankers Association which, in 1951, adopted a resolution expressly condemning the use of municipal revenue bonds to finance industrial development.[20] The IBA, reflecting the views of revenue bond opponents generally, asserted that "principle and good government" are violated by industrial bond financing since: (1) increasing amounts of industrial facilities become owned by the government, causing erosion of local tax bases; (2) the tax-exempt status of municipal bonds is abused; (3) economic dislocations are likely in areas unable to sustain such industry; and (4) industrial piracy becomes widespread.[21] The use of these tax-exempt[22] bonds to reduce the federal income taxes paid by participating corporations has been of special concern to the Treasury.[23] In an effort to curb this practice, bills have been introduced in Congress which would remove the tax exemption from mu-

16. Sublett v. City of Tulsa, 405 P.2d 185 (Okla. 1965). See generally City of Dearborn v. Michigan Turnpike Auth., 344 Mich. 37, 73 N.W.2d 544 (1955). There are ways, however, in which the municipality may be liable to revenue bond holders. Some theories include: (1) gross negligence in issuance, (2) misrepresentation, (3) breach of implied covenant, warranty, or good faith, and (4) breach of trust. Note, 70 YALE L.J. 789, 793 (1961).

17. Several other plans have been implemented in areas outside the South. These include the Pennsylvania plan (second mortgage loans financed by current taxation), the New England plan (state insurance of first mortgages), and the Oklahoma plan (general obligation bonds to finance mortgage loans to local nonprofit development corporations). Pinsky, *supra* note 6, at 269-72.

18. For an indication of the increased use of industrial revenue bonds in recent years, see Business Week, Dec. 14, 1963, p. 45.

19. These groups include the Investment Bankers Association, the AFL-CIO, the American Bar Association, and the Association of Municipal Finance Officers. *Ibid.*

20. Reilly, *Industrial Aid Financing: Pro and Con Arguments*, The Commercial and Financial Chronicle, April 29, 1965, p. 16.

21. Public Management, Jan. 1965, pp. 16-17. See also Westmeyer, *Industrial Bond Controversy Boils*, National Civic Review, June 1964, pp. 329-30.

22. INT. REV. CODE OF 1954, § 103.

23. A typical scheme would include a purchase of the entire bond issue by the incoming corporation. Rents paid to the municipality under the lease would be returned, in part, to the corporation in the form of tax-free interest on the bonds. A double benefit is possible since such rental payments may be deductible as business expenses under § 162 of the Internal Revenue Code. See INT. REV. CODE OF 1954, § 162(a)(3) (rental deduction not allowed if taxpayer takes title to or acquires equity in the premises). *Cf.* Gem, Inc. v. United States, 192 F. Supp. 841 (N.D. Miss. 1961) (deduction allowed although there was a provision for successive lease renewals at nominal rentals). This practice prompted Treasury Secretary Fowler to label industrial revenue bonds as a "new financial arrangement" to which the Treasury "can't condone extension of the tax exemption." The Wall Street Journal, June 17, 1966, p. 22, col. 3.

nicipal revenue bonds used for industrial development.[24] Another criticism of these bonds is that small communities may undertake large development projects with little chance of success. Since the municipality could become directly liable to the revenue bond holders under the theories of misrepresentation or breach of implied covenant of good faith,[25] the tax revenues of the municipality could be reached to satisfy such creditors. Thus, two states, Mississippi[26] and Tennessee,[27] require prior approval of state agencies before industrial projects are publicly financed.

In the instant case the court faced the initial task of determining the constitutionality of the Michigan revenue bond enabling act in light of the state constitution's public credit and public purpose clauses.[28] Although the court recognized that liability might possibly be imposed upon the municipality under one of several theories,[29] it found that the revenue bond enabling act was not an attempt to authorize loans of public credit. In so holding, the court noted that potential governmental liability was a danger common to all municipal and state revenue bonds whatever their nature, and looked to a previous decision[30] holding that an issuance of revenue bonds for highway development was not a pledge of the state's credit. Turning to the challenged existence of a public purpose in the instant plan, the majority applied what seemed to be a "net worth" test,[31] and found that since the plan promoted the general economic welfare of the community, it satisfied the constitutional requirement. The court found additional support for its conclusion in the weight of authority upholding municipal industrial development financing which had been similarly challenged.[32]

Before enacting revenue bond enabling acts or advocating the approval of proposed revenue bond financing plans, legislators and administrators should examine the state's constitutional and statutory

24. *E.g.*, H.R. 517, 88th Cong., 1st Sess. (1963).

25. See note 16 *supra*.

26. MISS. CODE ANN. § 8936-52 (Supp. 1964).

27. TENN. CODE ANN. § 2902-03 (Supp. 1966) (requirement for general obligation bonds only).

28. Other questions certified to the court concerned technical and procedural aspects of the enactment of the enabling act and compliance with the requirements of the city charter. The certified questions were all resolved in favor of the city.

29. City of Gaylord v. Beckett, *supra* note 2, at 466-67.

30. Schureman v. State Highway Comm'n, 377 Mich. 609, 141 N.W.2d 62 (1966).

31. See note 15 *supra* and accompanying text.

32. City of Gaylord v. Beckett, *supra* note 2, at 467. Since the enabling act in question in the principal case was enacted eight months prior to the effective date of the newly-amended constitution, the dissent, after a lengthy discussion and comparison of the two constitutions, found that the act should be interpreted according to the old constitution. This conclusion was based largely on constitutional procedural grounds. The majority construed the act in light of the newly-amended constitution.

framework with a view toward affording the best protection for both public and private interests. In this light, at least three important policy questions can be raised in addition to the typical public credit and public purpose issues. First, how broad is the state's power of eminent domain when used in the furtherance of such plans; that is, what factors should be considered in determining the extent of community power to condemn private property and convert it to the use of private manufacturing concerns? Generally, statutes dealing with eminent domain have required a public "use" rather than the broader requirement of a public "purpose,"[33] but since the municipality acquires title to the land which is developed for industrial use, it can be argued that the public is, in effect, using the land.[34] Thus, even the public use statutes may not afford the desired degree of protection in this important area. Second, how can the community best be protected from revenue bond liability incurred through negligent misrepresentation of its capacity to support manufacturing industries? Administrative agencies similar to Mississippi's Agricultural and Industrial Board could be established to evaluate local conditions before approving proposed revenue bond plans, thus substantially reducing the risk of direct municipal liability. Third, how can the plans be tailored to prevent abuse of the tax-exempt treatment of municipal bonds under section 103 of the Internal Revenue Code? One method would be to prohibit the incoming corporation from purchasing all or substantially all of the bond issue.[35]

Revenue bond financing of industrial development has become an established practice in an increasing number of localities, despite continued controversy among regional,[36] corporate, financial, and labor interests over the legality and propriety of revenue bond plans.[37] Once industrial revenue bond plans are adequately safeguarded through prudent legislation and administration, they would seem to fulfill a public purpose by accelerating the industrial "take-off" periods, stimulating sluggish economies, and providing additional jobs in

33. Abbey, *supra* note 1, at 63.

34. Although this problem has not yet arisen concerning industrial development bonds, it could be contended that the municipality, as lessor, is indirectly using the land by deriving rentals therefrom. It should be noted that statutes in four states authorize the acquisition of specific industrial sites by condemnation. *Id.* at 63 & n.138. Additionally, legislatures have the right to declare what constitutes a public use. *E.g.*, State *ex rel.* Smith v. Kemp, 124 Kan. 716, 261 Pac. 556 (1927), *writ of error dismissed*, 278 U.S. 191 (1928).

35. See note 23 *supra* and accompanying text.

36. Prior to the growing trend toward revenue bond financing of industrial development, use of these plans was largely confined to the Southern states that pioneered them. Consequently these plans met with some disfavor among Northern and Eastern interests which feared the "pirating" of their industry. See generally Westmeyer, *Industrial Bond Controversy Boils*, National Civic Review, June 1964, pp. 329-30.

37. See geuerally Business Week, Dec. 14, 1963, p. 45.

regions of unemployment. While such plans make some inroads on traditional free enterprise concepts, it should be recognized that governmental activity in this area is not a new development, and it would be unrealistic to expect local governments to ignore possible advantages available through properly administered bond plans.

State Taxation—Commerce Clause—Privilege Tax Measured by Gross Receipts on Commissions Received From Interstate Solicitation Held Valid

Defendant, a West Virginia corporation, was a manufacturers' representative and merchandise broker which solicited orders for certain manufacturers under a fanchise or contract agreement. Orders were solicited from wholesalers and chain-store operators located in West Virginia and sent by the defendant to the manufacturers, the great majority of which were located outside West Virginia.[1] Upon acceptance of the order by the manufacturer, the merchandise was shipped directly to the West Virginia purchaser. All of the defendant's income came from commissions received from these manufacturers. Pursuant to statute, West Virginia levied and collected a tax measured by defendant's gross receipts for the privilege of conducting business activity within the state.[2] Plaintiff, State Tax Commissioner of West Virginia, then instituted an action for declaratory judgment to determine whether the taxes were unlawfully collected. The defendant contended that the tax constituted an unconstitutional burden on interstate commerce, while the plaintiff maintained that the tax was lawful since it was levied on the privilege of conducting a business activity performed wholly within the state of West Virginia. The trial court entered judgment for the defendant. On appeal to the Supreme Court of Appeals of West Virginia, *held*, reversed. Where a manufacturers' representative obtains orders from resident wholesalers and chain store operators for merchandise shipped by nonresident sellers, imposition of a gross earnings tax on commissions paid to the representative does not violate the commerce clause. *State ex rel. Battle v. B. D. Bailey & Sons, Inc.*, 146 S.E.2d 686 (W. Va. 1965).

1. Approximately 90% of the defendant's gross business was transacted with manufacturers or food processors located outside of West Virginia. State *ex rel.* Battle v. B. D. Bailey & Sons, Inc., 146 S.E.2d 686, 689 (W. Va. 1965).

2. "[2h] Service Business or Calling Not Otherwise Specifically Taxed.—Upon every person engaging or continuing within this state in any service business or calling . . . there is . . . levied and shall be collected a tax equal to one and five one-hundredths per cent of the gross income of any such business." W. VA. CODE ANN. § 960(8) (1961).

The Supreme Court has traditionally protected interstate commerce from state and local taxes levied directly on the gross income from interstate transactions.[3] State legislatures have been permitted, however, to levy a tax on certain local privileges and measure the tax by gross receipts even though the tax constituted an "indirect" burden on interstate commerce.[4] This "direct-indirect burdens" test drew considerable criticism from Mr. Justice Stone, and beginning in 1938 with the case of *Western Live Stock v. Bureau of Revenue*,[5] the Court's approach to the constitutionality of state gross income taxes was substantially altered by his influence. In that case Mr. Justice Stone laid the groundwork for the "multiple burdens" theory under which the Court was primarily concerned with whether the tax would place interstate commerce at a competitive disadvantage with local business.[6] This theory seemed to be founded upon the two main propositions that interstate commerce should pay its just share of state tax burdens, and that state taxes on interstate commerce should be sustained when not involving the risk of cumulative burdens not imposed on local commerce.[7] Although the "multiple burdens" test was heavily relied upon by the Supreme Court for a number of years,[8] this test was rejected and the "direct-indirect" test was resurrected by the Court in the case of *Freeman v. Hewit*.[9] Speaking for the majority, Mr. Justice Frankfurter dismissed the "multiple burdens" doctrine as "fashions" in judicial writing and struck down an Indiana tax on gross income as a "direct" tax "on" interstate commerce.[10] Although

3. HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE 180, 184 (1953).

4. *Compare* American Mfg. Co. v. St. Louis, 250 U.S. 459 (1919) (tax levied upon the privilege of manufacturing and measured by gross receipts upheld), *with* J. D. Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938) (tax levied directly "on" gross receipts from the sale of manufactured goods held invalid). Hartman, *State Taxation of Income from a Multistate Business*, in SELECTED PROBLEMS IN THE LAW OF CORPORATE PRACTICE 20, 92 (Roady & Andersen ed. 1960).

5. 303 U.S. 250 (1938) (privilege tax levied upon gross amount received from interstate advertising upheld). See Di Santo v. Pennsylvania, 273 U.S. 34, 44 (1927) (Stone, J., dissenting).

6. See, *e.g.*, Gwin, White & Prince, Inc. v. Heuneford, 305 U.S. 434 (1939), where the Court struck down a Washington occupation tax even though Washington had used the correct statutory formula by placing the tax upon the privilege of growing fruit within the state and measuring the value of the privilege by the grower's gross receipts. The Court felt that a similar tax could be levied on the same sales proceeds by those states in which the fruit was shipped and subsequently sold. Thus, the tax would place interstate commerce at a competitive disadvantage with local commerce.

7. Hartman, *supra* note 4, at 95.

8. See, *e.g.*, International Harvester Co. v. Department of Treasury, 322 U.S. 340 (1944), where Indiana was allowed to apply her gross income tax to receipts from interstate transactions consummated within its borders on the ground that not to allow the tax would be to make local industry suffer a competitive disadvantage.

9. 329 U.S. 249 (1946) (tax on proceeds from the sale of certain securities of an Indiana trust estate on the New York Stock Exchange held invalid).

10. *Id.* at 253-54.

the subsequent cases did not produce a uniform test,[11] the Supreme Court once again stressed the importance of finding a "local activity" or a "local incident" that would support the gross receipts tax,[12] but the extent of immunity to be afforded a particular transaction remained in doubt until *Norton Co. v. Department of Revenue*[13] was decided in 1951. In that case, Illinois sought to impose an occupation tax, measured by gross receipts, upon a foreign corporation which maintained a sales office and warehouse in Chicago. Some orders were forwarded by the Illinois branch office to the manufacturer, while other orders were mailed by Illinois customers to Massachusetts. The Court held that Illinois could include receipts from all sales that utilized the branch office either in receiving the orders or in distributing the goods. Illinois was not permitted, however, to include proceeds

11. See, *e.g.*, Central Greyhound Lines, Inc. v. Mealey, 334 U.S. 653 (1948), in which a gross receipts tax levied upon proceeds from interstate transportation of passengers was held invalid because the tax was unapportioned, but the Court stated that the tax would be upheld if properly apportioned even though the tax was levied "on" gross receipts from interstate transportation; Joseph v. Carter & Weekes Stevedoring Co., 330 U.S. 422 (1947), in which a gross receipts tax on stevedoring was held invalid because the Court could not find a sufficient local event to sustain the tax and because a multiple tax burden could possibly be placed on the proceeds.

12. Originally the Supreme Court required that substantial localism be found before allowing the imposition of a gross receipts tax. See Pugent Sound Stevedoring Co. v. Tax Comm'n, 302 U.S. 90 (1937) (loading and unloading interstate business held non-taxable activity); Fisher's Blend Station, Inc. v. State Tax Comm'n, 297 U.S. 650 (1936) (occupation tax on broadcasting measured by gross receipts from advertising struck down as a tax on interstate commerce); Cheney Bros. Co. v. Massachusetts, 246 U.S. 147 (1918) (in-state office which received orders but did not accept them could not form the basis for a tax). Under the influence of Mr. Justice Stone the Court had developed, primarily in a series of income tax cases, a more liberal interpretation of the local incident necessary to support a state tax. See McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940), where the Court upheld a New York City sales tax levied upon a Pennsylvania seller who maintained a sales office in New York City at which it received and accepted orders for the sale of coal. The Court found that the delivery of the goods within the taxing state was a sufficient local incident to sustain the tax. Using *Berwind-White* as the basis of its decision, the Court in McGoldrick v. Felt & Tarrant Mfg. Co., 309 U.S. 70 (1940), upheld a sales tax measured by gross income where the only local activity of the vendor was the solicitation of orders through an agent, even though the Court had consistently held that the solicitation of orders for the interstate sale of goods was not a taxable "local incident" of interstate commerce. With the passing of Mr. Justice Stone and the rejection of the "multiple burdens" doctrine, however, the concept of a taxable "local activity" was considerably restricted. Thus, although McGoldrick v. Felt & Tarrant Mfg. Co., *supra*, seemed to indicate that solicitation might lose its commerce clause immunity, the Supreme Court in Nippert v. City of Richmond, 327 U.S. 416 (1946), made it clear that such was not the case. Striking down a municipal ordinance requiring solicitors to pay a license tax, the Court stated that if the only thing necessary to sustain a state tax bearing upon interstate commerce were to discover some local incident and then to lay the tax on that incident, all interstate commerce could be subjected to state taxation. In so holding, the Court extended the doctrine established in 1887 by Robbins v. Shelby County Taxing Dist., 120 U.S. 489 (1887), that the solicitation of sales is an essential and integral non-taxable part of interstate commerce.

13. 340 U.S. 534 (1951).

from the orders sent directly by the customer to the manufacturer's out-of-state home office where the order was filled and the goods shipped directly to the customer. One authority has pointed out that the Court clearly indicated in *Norton* what transactions Illinois could regard as taxable local activities but it failed to state the reasons why some of the transactions were taxable.[14] In *Field Enterprises, Inc. v. Washington*,[15] the Supreme Court relied upon its decision in *Norton* to affirm per curiam a decision of the Washington Supreme Court upholding a business and occupation tax upon a foreign corporation even though its local activity was confined to maintaining an office which was used to instruct salesmen and transmit orders out of state for acceptance and direct shipment to the purchasers. Nearly eight years later, in *General Motors Corp. v. Washington*,[16] the State of Washington was permitted to tax gross receipts from sales of automobiles and spare parts which were shipped to dealer-purchasers in the state pursuant to orders sent by the dealers to General Motors' offices outside the state. In finding the sales taxable, the Court apparently relied upon "the bundle of corporate activity" by the taxpayer within the taxing state.[17] The Court, speaking through Mr. Justice Clark, stated the test to be, "whether the State has exerted its power in proper proportion to appellant's activities within the State" and "whether the state has given anything for which it can ask return."[18]

The majority in the instant case recognized that the shipments of merchandise from nonresident sellers to resident buyers constituted shipments in interstate commerce, but found that the defendant taxpayer was engaged in the performance of services within the state, as distinguished from the solicitation of the sale of goods for interstate transportation or shipment of property. The court concluded, therefore, that the defendant taxpayer could not be exempt from payment of the taxes merely because its business incidentally involved

14. Hartman, *State Taxation of Corporate Income from a Multistate Business*, 13 VAND. L. REV. 21, 107-08 (1959). In view of the instant case, Professor Hartman points out the very interesting observation: "[I]t is not clear whether the Court is saying that local activity of the branch office may bring within the taxing power of the state some other transactions which otherwise would escape taxation on commerce clause grounds. Specifically, would those controversial transactions [in the *Norton* case] have been held to be taxable if the Illinois branch office bad done nothing but solicit the orders from customers?" *Id.* at 108.

15. 47 Wash. 2d 852, 289 P.2d 1010 (1955), *aff'd per curiam*, 352 U.S. 806 (1956). For an interesting discussion of this case in relation to the Supreme Court's treatment of local incidents see Strecker, *"Local Incidents" of Interstate Business*, 18 OHIO ST. L.J. 69, 71-78 (1957).

16. 377 U.S. 436 (1964).

17. *Id.* at 447.

18. *Id.* at 441 (quoting from Wisconsin v. J. C. Penney Co., 311 U.S. 435, 444 (1940)). "A careful analysis of the cases in this field teaches that the validity of the tax rests upon whether the State is exacting a constitutionally fair demand for that aspect of interstate commerce to which it bears a special relation." *Id.* at 440.

interstate commerce. Finally, the tax was held to satisfy the "discrimination" or "multiple burdens" tests set forth by the Supreme Court since the taxpayer could not be taxed by any other state and since even if the tax affected interstate commerce in some way, its application was too remote to constitute an unconstitutional burden on interstate commerce.[19] Judge Haymond, in his dissenting opinion, maintained that the taxpayer engaged directly in the sale of goods in interstate commerce.[20] He felt, therefore, that the defendant's commissions constituted earnings derived from interstate commerce, and the tax imposed upon such income contravened the commerce clause.

In holding that the taxpayer was not engaged in interstate commerce but merely rendered services as an intermediary between nonresident sellers and resident buyers, the court in the instant case drew a superficial distinction that is difficult to justify on the facts. The dissenting argument of Judge Haymond that "there would have been no nonresident sellers, no resident buyers, and no interstate shipment of goods . . . without the business activities of the defendant . . . ."[21] correctly pointed out that the defendant's business activities had more than an incidental relationship to interstate commerce. However, the result reached by the majority was probably correct since there was no burden on interstate commerce not borne by intrastate commerce, and since the interstate commerce involved was not subject to the risk of repeated exactions of the same nature from other states. Yet, the problem remains of reconciling this case with Supreme Court decisions which have consistently held that mere solicitation for interstate sales is a non-taxable local activity which does not meet the "local incident" rule. Since all of defendant's business activities took place within West Virginia, the instant case can be distinguished from the usual "drummer" situation where solicitors travel across state lines. Furthermore, it is obvious that the defendant's activities constitute more local activity than has been the case when the Supreme

19. Judge Berry concurred in the majority opinion but upon the ground that any previous cases decided by the West Virginia Court which might indicate that income from personal services performed within the state could not be taxed because such services were a burden on or discriminated against interstate commerce, should be specifically overruled. Judge Berry stated that a state should not be prohibited from taxing its citizens or resident corporations for the privilege of doing business within the state because the income therefrom is derived from orders taken by them from others doing business within the state. 146 S.E.2d at 695.

20. "It is clear beyond question that there would have been no nonresident sellers, no resident buyers, and no interstate shipment of goods, with respect to the subject matter of this case, without the business activities of the defendant and that the sales and consequent interstate shipments of goods were produced by and resulted from the business activities and transactions conducted and engaged in by the defendant." *Id.* at 700.

21. 146 S.E.2d at 695.

Court has spoken of interstate solicitation as an insufficient "local incident" to support a gross receipts tax. Finally, the Supreme Court's recent holding that the validity of a gross receipts tax should depend upon the "bundle of corporate activity" and "whether the state has given anything for which it can ask return," lends considerable support to the result reached by the West Virginia court. In fact, not to subject the defendant corporation to the tax would definitely be a discrimination against intrastate commerce, and Mr. Justice Stone's contention that interstate commerce should pay its own way seems particularly relevant. Although the instant case would probably have been more significant if it had not relied upon superficial distinctions, it is nevertheless of considerable importance in demonstrating the need for a more flexible rule to govern state taxation of interstate solicitation. The pronouncements of the Supreme Court do not provide a satisfactory basis for deciding cases in which there is a significant local activity which is technically interstate solicitation. The instant case correctly indicates that extensive local activity in the furtherance of interstate solicitation should be sufficient to bring within the taxing power of a state the interstate solicitation which would otherwise escape taxation on commerce clause grounds.

Taxation—Federal Income Taxation—Capital Gains Treatment of Sale of Professional Goodwill

Taxpayer, a certified public accountant, made an oral partnership agreement in 1957 for the sale[1] of a one-half interest in his accounting practice.[2] On his federal income tax returns for the years 1959 through 1961, he reported the installments received on the purchase price as long term capital gains[3] from the sale of professional goodwill. The

1. There is no professional prohibition against the sale of an accounting practice by a Certified Public Accountant. CAREY, PROFESSIONAL ETHICS OF CERTIFIED PUBLIC ACCOUNTANTS 206 (1956).

2. Prior to 1956, Butler operated his accounting business as a sole proprietorship, employing four persons, including the purchaser of the partnership interest. The value of the business was approximately $40,000, or one year's gross fees. The one-half interest was computed to be $20,000 (or one-half of the total worth) for which interest the purchaser would pay $10,000 in scheduled installments. Butler was to receive 60% of the profits in 1957, and in decreasing stages of percentages until 1961 when each partner's share would be equal. The agreement called for the seller to render continued service to the business.

3. INT. REV. CODE OF 1954, §§ 1221-22. From the $10,000 sale price Butler received $2500 in 1959 and 1960, and $1500 in 1961. On his income tax returns for these years he reported as capital gains the amounts of $2,410.50, $2,410.50, and $1,446.30, respectively. These amounts were determined by reducing the total payments he received in each of these years by amounts obtained by multiplying such payment by a fraction whose numerator was one-half of the book value of the tangible assets and whose denominator was $10,000. One-half of the amount of capital gain was reported as taxable income for that year.

Commissioner assessed a deficiency,[4] treating the gains as ordinary income on the ground that payment for the partnership interest in excess of the tangible assets was received either for relinquishment of the right to receive ordinary income in the future, or as present payment for future services, or for a combination of the two.[5] On petition to the Tax Court of the United States, *held*, the Commissioner's action was incorrect. Proceeds from a sale of goodwill, resulting from the transfer of an interest in a professional practice, are entitled to capital gains treatment even though the transferor continues in the practice. *Butler v. Commissioner*, 46 T.C. 280 (1966).

Although its intangible nature precludes a concise definition,[6] professional goodwill may be considered as "the probability that the customers of the old establishment will continue their patronage."[7] For thirty years there has been a controversy between the courts and the Internal Revenue Service over whether gains from the sale of goodwill should be reported as capital gains or as ordinary income. In 1935, the Board of Tax Appeals decided *O'Rear v. Commissioner*,[8] holding that amounts paid to a lawyer for admission of partners represented his right to part of the future earnings of the practice and were, therefore, taxable as ordinary income. On this basis, the Commissioner first refused to acknowledge the existence of professional goodwill as a transferable asset, maintaining that goodwill could not be disposed of if it depended exclusively upon the professional skill or personal characteristics of the seller.[9] When subsequent decisions rendered this position untenable,[10] the Commissioner ruled that professional goodwill could not be transferred unless exclusive use to the name of the business was purchased as well.[11] The courts, however, specifically rejected this interpretation in three cases involving

4. For calendar years 1959, 1960, 1961, in the amounts of $361.58, $361.57, and $216.95, respectively.

5. If the payment is considered to be for present or future services, it cannot result in capital gain. If it is considered as assignment of future ordinary income, it results in present ordinary income. See Freling, *Sales of Intangible Business Assets*, 14 TUL. TAX INST. 209, 240 (1965); 19 J. TAXATION 335 (1963).

6. McDonald, *Goodwill and the Federal Income Tax*, 45 VA. L. REV. 645 (1959); Note, *An Inquiry Into the Nature of Goodwill*, 53 COLUM. L. REV. 660 (1953).

7. Richard S. Wyler, 14 T.C. 1251, 1259 (1950).

8. 80 F.2d 473 (6th Cir. 1935), *affirming* 28 B.T.A. 698 (1933).

9. Rev. Rul. 60-301, 1960-2 CUM. BULL. 15.

10. Since 1935 the courts have failed to follow *O'Rear* and have distinguished it on several bases: age, that the statements made there concerning goodwill were dicta, and that a more recent group of cases was controlling. See, *e.g.*, Estate of Leo Melnik, 21 CCH Tax Ct. Mem. 671 (1962), *aff'd sub nom.* Karan v. Commissioner, 319 F.2d 303 (7th Cir. 1963) (sale of accounting practice); Rees v. United States, 187 F. Supp. 924 (D. Ore. 1960), *aff'd per curiam*, 295 F.2d 817 (9th Cir. 1961); Malcolm J. Watson, 35 T.C. 203 (1960). See also 3B MERTENS, FEDERAL INCOME TAXATION § 22.50 (Malone rev. ed. 1966).

11. Rev. Rul. 57-480, 1957-2 CUM. BULL. 47.

the sale of an accounting practice.[12] The Commissioner, therefore, reluctantly acquiesced and modified his position to recognize goodwill as a salable capital asset[13] regardless of dependence upon professional skill or the use of the business name.[14] He has steadfastly refused, however, to permit capital gains treatment of proceeds from the sale of professional goodwill if the practitioner continues in the business,[15] even though the only two cases directly in point have rejected this contention also. In *Rees v. United States*,[16] a federal district court held that the goodwill involved in the sale of a partnership interest in a dental practice might be treated as a capital asset even though the taxpayer remained active in the same practice. Similarly, in *Malcolm J. Watson*,[17] where an accountant was to remain in the business for ten years after selling partnership interests, the Tax Court held that gains realized on the sale of professional goodwill are capital gains, regardless of whether the transferor continues in active practice with the purchasers. The Commissioner,[18] however, contends that to have an actual or effective transfer of goodwill, the seller must separate himself from the clients.[19] If he does not remove himself entirely from the business, the Commissioner argues, he continues to share in the goodwill to the same extent as he did before the alleged transfer.

In the instant case, the court found that before the sale of the partnership interest, the taxpayer had the full benefit derived from both the goodwill and the tangible capital assets. It reasoned that subsequent to the transfer, the taxpayer obtained the benefits from

12. Estate of Masquelette v. Commissioner, 239 F.2d 322 (5th Cir. 1956), *reversing* 14 CCH Tax Ct. Mem. 879 (1955); Richard S. Wyler, 14 T.C. 1251 (1950); Rodney B. Horton, 13 T.C. 143 (1949).

13. Rev. Rul. 55-79, 1955-1 CUM. BULL. 370.

14. See Rev. Rul. 60-301, 1960-2 CUM. BULL. 15, for the Commissioner's acquiesence in Estate of Masquelette v. Commissioner, *supra* note 12, and 1959-2 CUM. BULL. 7, for the Commissioner's acquiesence in Richard S. Wyler, *supra* note 12 and Rodney B. Horton, *supra* note 12.

15. Rev. Rul. 64-235, 1964-2 CUM. BULL. 18, modifying Rev. Rul. 57-480, 1957-2 CUM. BULL. 47, Rev. Rul. 60-301, 1960-2 CUM. BULL. 15, and superseding Rev. Rul. 62-114, 1962-2 CUM. BULL. 15.

16. *Supra* note 10.

17. *Supra* note 10.

18. See Rev. Rul. 64-235, 1964-2 CUM. BULL. 18; Rev. Rul. 62-114, 1962-2 CUM. BULL. 15, based on T.I.R. 388 (June 29, 1962), reflecting Rev. Rul. 57-480, 1957-2 CUM. BULL. 47.

19. Rev. Rul. 64-235, 1964-2 CUM. BULL. 18, stated, in essence, that (1) professional goodwill is a salable capital asset, (2) a one-man professional practice or any other one-man business can have salable good will, (3) the extent to which the proceeds of a sale can be allocated to good will shall be determined on the facts rather than by whether the business is, or is not, dependent solely upon the professional skill or other personal characteristics, (4) *where a man takes in partners rather than transfering his entire practice, he cannot be regarded as having made a sale of goodwill within the meaning of the code provision relating to capital gain or loss.*

the tangible assets and the goodwill only to the extent of his proportionate interest in the business. Finding that a partial transfer had been made, the Commissioner's contention that a sale of goodwill could only be accomplished by total disposition was rejected. The results reached in *Rees* and *Watson* were approved and that portion of the *O'Rear* decision urged by the Commissioner to be controlling was dismissed as dicta. Thus the court concluded that there may be a partial transfer of professional goodwill by a transferor who remains in the practice.

The *Butler* decision has eliminated the last line of resistance to capital gains treatment of proceeds from the sale of professional good will by rejecting the arguments that professional goodwill is not a vendable capital asset, and that a partial disposition of professional goodwill is not possible. If professional goodwill reflects the desire of business clients to continue to patronize the practitioner's services, then its sale is an attempt to shift future client patronage. One writer,[20] reasoning that such a transfer can be accomplished only by the seller's removal from the business and abstention from competing for the former client's patronage, has suggested that an effective disposition of goodwill is the practical equivalent of a covenant not to compete. If amounts derived from a sale of a covenant not to compete result in ordinary income as compensation in return for an abstention from personal effort, then, the argument is that payments from the sale of goodwill should be similarly treated as ordinary income. However, this syllogistic argument fails to distinguish between commercial and professional goodwill. A complete transfer of commercial or industrial goodwill (such as that associated with a particular product) with its usual incumbent use of the name of the business or product, might possibly have the same effect on client patronage as a covenant not to compete. On the other hand, professional goodwill is not so susceptible to transfer because of its innately personal quality. Thus, an actual transfer of professional goodwill should not be likened to a commercial covenant not to compete since the latter in no way depends upon personal efforts of the seller to influence either his or his buyer's continued client patronage. This same reasoning also refutes, in large part, the assumption of the IRS that a transfer of goodwill can be made solely by the seller's removal from the business. Professional goodwill is bound to the person, and can be transferred only by his affirmative efforts. If the transferor leaves the practice, the probability of client succession to the transferee, even with the use of the name of the business, is at

20. Weiss, *The Tax Treatment of a Disposition of Professional Good Will*, 73 YALE L.J. 1158, 1176-79 (1964).

best uncertain, since goodwill is personal and would in most instances remain with the transferor. An affirmative effort to persuade clients to continue to conduct business with the transferee is seriously jeopardized by the transferor's removal. Indeed, the most effective transfer occurs when the transferor continues in the practice in some capacity, with the purpose of persuading clients to continue their patronage. The sale of the partnership interest in *Butler* included payment for a share of the goodwill enjoyed by the seller. Since a removal of a share must necessarily diminish the whole, the transferor continues to enjoy the professional goodwill only to the extent of that remaining after the sale. In any event, the long trend of court decisions involving transfers of professional goodwill has made it clear that the decision in *Butler* was inevitable, and it is highly improbable that future decisions will reach a different result.