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# Recent Cases

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# RECENT CASES

## Antitrust—Consignment Agreements To Fix Retail Prices

Simpson, a retail gasoline dealer, leased a gasoline station from Union Oil Company of California. Collateral to that lease, Simpson signed a consignment agreement used by Union throughout its distribution system[1] providing[2] that Simpson would sell all gasoline consigned to him at prices set by Union. Thereafter, Simpson over the protest of Union,[3] sold consigned gasoline at prices below those set by Union. Solely because of this conduct[4] Union refused to renew the lease when it expired. Basing his claim on a charge of resale price maintenance in violation of sections 1 and 2 of the Sherman Act, Simpson brought an action in a federal district court for damages under section 4 of the Clayton Act. The district court granted Union's

1. The nature and scope of this system are set out in a footnote to the opinion: "As of December 31, 1957, Union Oil supplied gasoline to 4,133 retail stations in the eight western states of California, Washington, Oregon, Nevada, Arizona, Montana, Utah and Idaho. Of that figure, 2,003 stations were owned or leased by Union Oil and, in turn, leased or subleased to an independent retailer; 14 were company-operated training stations; and the remaining 2,116 stations were owned by the retailer or leased by him from third persons. Union Oil had "consignment" agreements as of that date with 1,978 (99%) of the lessee-retailers and with 1,327 (63%) of the nonlessee-retailers." Simpson v. Union Oil Co., 377 U.S. 13, 15 n.1 (1964).

2. The basic elements of the consignment agreement are as follows: While title to the gasoline remained in Union Oil until the gasoline was sold by the consignee, several of the risks and burdens of that ownership were allocated to the consignee: he was to carry personal liability and property damage insurance by reason of the consigned gasoline; he was responsible for losses incurred in the regular course of business; he was to absorb the cost of his own operation; and he was to absorb a portion of the loss due to declining prices. Union Oil, of course, reserved the right to set the "authorized" or retail price at which the consignee was to sell. Simpson's return until shortly before termination of his employment was figured at 1.5 cents per gallon plus the excess of the "authorized" price over the "tank wagon" (wholesale) price. However, if the "authorized" price fell below the "tank wagon" price the basic commission was reduced by fifty per cent of the difference, with a guaranteed minimum return to Simpson of 5.59 cents per gallon for regular gasoline and 5.75 cents per gallon for ethyl. Shortly before termination of Simpson's employment the minimum guarantee was dropped and the commission was calculated at 1.5 cents per gallon plus eighty per cent of the excess of the "authorized" over the "minimum retail" price; but if the "authorized" price fell below the "minimum retail" price, the commission was reduced by twenty per cent of the difference. For the Court's analysis of these provisions see *Id.* at 20-21, 23 n.10.

3. Despite the demands of Union Oil that he adhere to a price of 29.9 cents per gallon, Simpson reduced his price to 27.9 cents per gallon in order to meet the competition on the retail level.

4. Simpson v. Union Oil Co., 311 F.2d 764, 766. This action was evidently in accord with Union's general policy of leasing only to consignees. *Ibid.*

motion for summary judgment holding, *inter alia*,[5] that Simpson had not established a violation of the Sherman Act.[6] The Ninth Circuit affirmed.[7] On appeal to the Supreme Court of the United States, *held*, reversed. When consignment agreements are used coercively to fix retail prices over a vast distribution network, federal antitrust policy forbids calling them agencies and demands that they be recognized as devices for resale price maintenance prohibited by the Sherman Act.[8] *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964).

In the judicial development of sections 1 and 2 of the Sherman Act, the general rule emerged that contracts or agreements for the purpose of resale price maintenance[9] are illegal.[10] Out of the related corollary that such an agreement could be implied from a course of dealings,[11] *United States v. Parke Davis & Co.*,[12] molded the doctrine that a supplier may not use coercion on its retail outlets to achieve resale price maintenance.[13] These decisions led some commentators to the conclusion that "resale price maintenance programs—most legal ones, at least—are dead."[14]

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5. The district court also held that since the lease and consignment agreement had expired on their own terms Simpson had no standing to enforce the antitrust laws and had suffered no actionable wrong. Simpson v. Union Oil Co., 162 F. Supp. 746, 747 (N.D. Cal. 1958).

6. TRADE REG. REP. (1961 Trade Cas.) ¶ 69,936 (N.D. Cal. 1960).

7. 311 F.2d 764.

8. The Supreme Court also held that Simpson had suffered actionable wrong or damage. However, this issue is beyond the scope of this comment.

9. Resale price maintenance—sometimes referred to as vertical price control—has been defined as "'pricing through agreements or conspiracies between two or more persons operating at different levels of the same production-distribution-consumption process.'" KRONSTEIN, MODERN AMERICAN ANTITRUST LAW 145 n.1 (1958), quoting from KRONSTEIN & MILLER, REGULATION OF TRADE 850 (1953).

10. Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

11. In United States v. A. Schrader's Son, Inc., 252 U.S. 85, 99 (1920), it was held that there was an unlawful combination whenever a manufacturer "enters into agreements—whether express or implied from a course of dealing or other circumstances—with all customers . . . which undertake to bind them to observe fixed resale prices." 252 U.S. at 99.

12. 362 U.S. 29 (1960).

13. In the *Parke, Davis* case the manufacturer had used meetings with the retailers and wholesalers, agreements whereby the wholesalers refused to sell to undercutting retailers, and other high pressure methods to obtain assurances that undercutting would cease.

14. Bork, *Control of Sales*, 7 ANTITRUST BULL. 225, 230 (1962). But see Oppenheim, *The Parke Davis Decision: Colgate's Permissible Suggested Resale Price Policy is Neither Dead Nor Sterile*, 16-17 A.B.A. SEC. OF ANTITRUST LAW 215 (1960).

This statement, however, is valid only when considered apart from the operation of state fair trade laws which permit resale price maintenance by manufacturers of goods which are advertised by trademark or brand name and sold in fair and open competition with goods of comparable kind and quality. The operation of these acts was expressly exempted from the Sherman Act with respect to products resold within a state's borders even though they had been shipped through channels of interstate commerce. Miller Tydings Act, 50 Stat. 693 (1937), 15 U.S.C. § 1 (1958); McGuire

To this general rule prohibiting resale price maintenance *United States v. General Electric Co.*[15] introduced what was thought to be an exception.[16] In that case the Supreme Court upheld General Electric's efforts to maintain the "resale"[17] prices of its patented filament lamps by the use of consignments and an agency system similar to that used by Union Oil in the instant case.[18] Due to the presence of certain dicta in that opinion, it was thought by many that the consignment device for resale price maintenance was not inconsistent with the Sherman Act no matter how large the system using it and regardless of the non-existence of a patented product.[19]

While this supposed exception to the general rule against resale price maintenance had not been directly challenged prior to the instant case, two related developments had cast doubt upon its validity. Both of these developments were evidenced in the *Masonite* case[20] in which the Supreme Court held invalid the use of an agency to effect horizontal price maintenance in the distribution of patented products. While *horizontal* price maintenance may be distinguished from that used in the instant case and in *General Electric* as agreements between persons operating at the same level in competing production-distribution-consumption processes,[21] nevertheless, the reasoning of the Court would seem to apply to both. The decision in

Act, 66 Stat. 632 (1953), 15 U.S.C. § 45 (1958). The instant case and the discussion in this comment concern the distribution of goods which do not come within this exception to the Sherman Act. Although it should be noted that the instant case was remanded for a hearing on issues raised under the McGuire Act. 377 U.S. at 24.

15. 272 U.S. 476 (1926).

16. Note, 27 COLUM. L. REV. 567 (1927); Note, 43 IOWA L. REV. 603 (1958); Note, 46 VA. L. REV. 976 (1960).

17. The term "resale" is not accurate here. The rationale of the Court's decision in this case was that the use of wholesale and retail *agents* dealing on a consignment basis avoided an actual *resale*; rather, these were *direct* sales by General Electric *via* its agents. 272 U.S. at 484. Nevertheless, the net effect of the system was to achieve resale price maintenance as defined above. See note 9 *supra*.

18. See 377 U.S. at 26-27 n.1 (Justice Stewart's dissent). But see 377 U.S. at 23 n.10; *compare* 377 U.S. at 14, *with* 272 U.S. at 481-83.

19. The particular dicta involved are: "We are of the opinion, therefore, that there is nothing as a matter of principle, or in the authorities, which requires us to hold that genuine contracts of agency like those before us, *however comprehensive as a mass or whole in their effect,* are violations of the Anti-Trust Act. The owner of an article, *patented or otherwise* is not violating the common law, or the Anti-Trust law, by seeking to dispose of his article directly to the consumer and fixing the price by which his agents transfer the title from him directly to such consumer." 377 U.S. at 488. (Emphasis added.) The expression, "patented or otherwise" is clearly dictum since the case was involved solely with a patented product. Furthermore, the first sentence of the quoted material is clearly a reiteration of the same conclusion drawn earlier in the opinion where the Court was referring unequivocally to a manufacturer of patented products. 272 U.S. at 484.

20. United States v. Masonite Corp., 316 U.S. 265 (1942).

21. This sort of price fixing arrangement is ealled horizontal price maintenance. Compare note 9 *supra* (definition of resale priee maintenance).

*Masonite* heralded the first development: the existence of a valid agency did not guarantee the validity of the price maintenance scheme.[22] A second development, evidenced in the line of cases following *Colgate*,[23] was succinctly verbalized in the *Masonite* case: the Court, in determining the price maintenance issue, was going to concern itself not with the "skill with which counsel has manipulated the concepts of 'sale' and 'agency' but . . . [with] the significance of the business practice in terms of restraint of trade."[24] In addition to these developments, there was language in *Masonite* indicating that perhaps the *General Electric* case holding was limited to the distribution of patented products.[25]

The majority of the Court[26] brought the instant case within the

22. "We assume in this case that the agreements constituted the appellees as *del credere* agents of Masonite. But that circumstance does not prevent the arrangement from running afoul of the Sherman Act." 316 U.S. at 277. The inference of this statement was drawn by one commentator to mean that courts "may recognize that there *is* an agency and yet deem this particular agency relationship unlawful because it was purposefully organized to fix prices at the retail level . . . ." Note, 43 IOWA L. REV. 603, 612 (1958) (citing the *Masonite* case). But see Note, 41 MICH. L. REV. 744 (1943).

23. An earlier exception to the general rule against resale price maintenance was the *Colgate* doctrine, which, broadly stated, recognized the right of a private businessman to choose the persons with whom he would or would not deal so long as the choice was not made for the purpose of maintaining a monopoly. United States v. Colgate & Co., 250 U.S. 300 (1919). For all practical purposes the use of this doctrine as a means of avoiding the general rule has been eliminated by subsequent decisions. United States v. Schrader's Son, Inc., *supra* note 11; Federal Trade Commission v. Beech-Nut Packing Co., 257 U.S. 441 (1922); United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944); United States v. Parke, Davis & Co., *supra* note 12; Bork, *supra* note 14. See in particular Federal Trade Commission v. Beech-Nut Packing Co., *supra*. In a comment on that case it was said: "The form that resale price maintenance takes may not be controlling if the economic effect of the price maintenance system is in derogation of the policy of the Sherman Act. Setting resale prices is an insignificant restraint on trade so long as the producer is subject to competitive pressures to keep his price low." 64 YALE L.J. 967, 983 (1955).

24. 316 U.S. at 280.

25. "In the *General Electric* case, the Court thought that the purpose and effect of the marketing plan was to secure to the patentee only a reward for his invention." 316 U.S. 280.

26. Mr. Justice Douglas wrote the majority opinion in this five-to-three decision. Mr. Justice Harlan did not take part in the disposition of this case. In a memorandum opinion Justices Brennan and Goldberg did "not necessarily disagree with the Court . . ." but felt that the question should not have been decided on the record presented "and without affording interested parties, including the Antitrust Division of the Department of Justice, an opportunity to express their views." 377 U.S. at 31-32. Mr. Justice Stewart dissented on two grounds: first, the record was too incomplete to be the basis for any decision; second, the majority's overruling of the *General Electric* case was a sudden and severe blow to a large segment of the economy. This latter feeling is based largely on the inequity of allowing damage suits under section 4 of the Clayton Act for damages incurred during a period when there was justifiable reliance upon *General Electric*. However, in view of the indication in the majority opinion, 377 U.S. at 25, that the Court might be persuaded to apply the announced policy prospectively only, such apprehension is at least premature.

*Parke, Davis* holding that a supplier may not use coercion on its retail outlets to achieve resale price maintenance[27] by adding that it did not matter what form the coercion took.[28] It would have been an easy step from this premise to the conclusion that "there . . . [was] nothing left to try, for there was an agreement for resale price maintenance, coercively employed";[29] easy, that is, if it were not for the *General Electric* case and what was generally thought to be its significance.[30] The Court apparently acknowledged the problem and undertook to clear the record. In recognizing that the Sherman Act permitted a manufacturer to consign goods to a dealer who undertakes to sell only at prices set by that manufacturer,[31] the Court was adopting in part the dicta in the *General Electric* case.[32] However, in its analysis of the economic effects of the consignment in the instant case,[33] the Court reached the conclusion that its "inexorable potentiality for . . . destroying competition in retail sales of gasoline" stemmed from its size.[34] As a result it was necessary to distinguish the supposed *General Electric* ruling to the contrary[35] on "its special facts, involving patents . . . ."[36] Having thus freed itself, the Court concluded:

> When . . . a "consignment" device is used to cover a vast gasoline distribution system, fixing prices through many retail outlets, the antitrust laws prevent calling the "consignment" an agency, for then the end result of *United States v. Socony-Vacuum Oil Co.* . . . would be avoided merely by clever manipulation of words not by differences in substance.[37]

With the *General Electric* case thus narrowed and the consignment out of the picture, *Parke, Davis* controlled: "[R]esale price maintenance through the present, coercive type of 'consignment' agreement is illegal under the antitrust laws . . . ."[38]

Aside from the objections raised by Mr. Justice Stewart,[39] there seems to be little basis for disagreement with the result reached in this case.[40] Attention should turn instead to the more important

27. See notes 12 & 13 *supra.*
28. 377 U.S. at 17.
29. *Id.* at 24.
30. See quotation in note 19 *supra.* This quotation would appear to control this case completely. Coercion would fall out of the picture as a legitimate attempt on the part of the owner to enforce his rights.
31. 377 U.S. at 18, 21.
32. Compare the dissenting opinion of Mr. Justice Stewart. *Id.* at 27-29.
33. *Id.* at 18-21.
34. *Id.* at 21.
35. See note 19 *supra.*
36. 377 U.S. at 23.
37. *Id.* at 21-22.
38. *Id.* at 24.
39. See note 26 *supra.*
40. The evidence weighed heavily against the system as a whole. The Court could

aspect of this opinion—its treatment of the consignment method of distribution in general. While the Court's definition of a new "rule governing price fixing by the 'consignment' device"[41] has been strongly criticized as being unreasonably vague,[42] some of this criticism is apparently generated by too literal an interpretation of the term "rule" and an unrealistic desire for a simple solution to a very complex problem. It is submitted that the "rule" announced by the Court is not a fill-in-the-blank test turning upon any particular factor, but rather a balancing of several factors representing the conflicting interests which are involved in the consignment problem. Further, it is submitted that an equitable resolution of these conflicting interests requires such a balancing process. Granted, this process could have been more clearly described than it was in the opinion. Nevertheless, several aspects of this process are relatively certain. It is clear that the Court did not foreclose the consideration of the traditional factors used to evaluate the interests of the businessman: (1) justification of some price control over the consignee due to the consignor's increased assumption of risks and financial burdens[43] and (2) the presence of a legitimate business purpose for adopting the consignment method of distribution.[44] The novel aspect of this opinion is the introduction

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find no reason for Union's adoption of the consignment method of distribution aside from resale price maintenance. See note 44 *infra*. Nor had Union assumed the share of risks and financial burdens normally assumed by the consignor. See note 43 *infra*. Furthermore, Union's tying of the consignment agreement to the short term leases added strength to the Court's conviction that this particular system was merely a device for price fixing under the guise of a legal fiction. These factors, in view of the size of the system, seem to support the conclusion of Justice Douglas that "the present, coercive 'consignment' device, if successful against challenge under the antitrust laws, furnishes a wooden formula for administering prices on a vast scale." 377 U.S. at 22.

41. *Id.* at 25.

42. Handler, *Seventeenth Annual Review of Antitrust Developments—1964*, 19 RECORD OF N.Y.C.B.A. 379 (1964).

43. In the instant case the Court recognized that consignments "perform an important function in trade and commerce" in "allocating risks between the parties." 377 U.S. at 17. Normally, when a consignment system is adopted to replace the conventional wholesale-retail method of distribution, the consignor assumes many of the risks and financial burdens which had theretofore rested on the retailer. For example: (1) increased capital investment representing the inventory investment of the retailer under the conventional system, (2) prolonged period of risk of loss and insurance expense which would have been cut off by sale to the retailer under the conventional system, (3) greater susceptibility to loss due to fluctuations in prices on the retail level, (4) local property tax liability, and (5) additional managerial expenses. Perhaps the reason this factor did not come into more evident play in the instant decision was that there was little or no reallocation of these risks and financial burdens due to (1) the terms of the consignment agreement, see note 2 *supra*, and (2) the mechanics of the conventional system of distribution peculiar to the petroleum industry, see note 44 *infra*. See 377 U.S. at 21-22.

44. *Id.* at 18-20. In the instant case the Court appears to recognize no legitimate purpose for Union Oil's adoption of the consignment system of distribution. Yet there

of a new factor—the size of the consignment system—to represent the interests of federal antitrust policy. Assuming for the moment that the use of a price clause in a consignment system does involve a potential for destroying competition and that this potential may be evaluated reliably in terms of the size of that system, the use of this factor to represent the interest of federal antitrust policy is both reasonable and in line with the current trend of the Court toward concerning itself less with legal fictions and more with economic realities. Further, it is submitted that a balancing of the traditional factors noted above against a properly evaluated factor of size would give adequate weight to the policy of the Sherman Act and at the same time be flexible enough to allow the businessman, who has adopted the consignment system to further some legitimate business purpose, to use a price clause to protect himself against the increased risks and financial burdens assumed by adopting the consignment method of distribution.

From what has been said it is clear that the merits of the new rule governing consignments will depend upon the validity of the assumptions just made: (1) that the use of a price clause in a consignment system does involve a potential for destroying competition and (2) that this potential may be evaluated reliably in terms of the size of that system. To avoid becoming too abstract, the evaluation of these assumptions will be made in the context of the instant case by a consideration of the validity of the Court's conclusion that Union's "vast" consignment system involved an "inexorable potentiality

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is one reason which seems to be persuasive and might have influenced the Court had it been advanced: Under the conventional method of distribution in the petroleum industry, the retail gasoline dealer's extremely low profit margin usually resulted in his folding up under the pressures of the all too frequent price wars unless his supplier agreed to share the loss by granting a temporary price allowance. *Distribution Practices in the Petroleum Industry, Hearings Before Subcommittee Number 5 of the House Select Committee on Small Business,* 85th Cong., 1st Sess. 106-07, 121-22 (1957). In such cases the supplier was faced with the dilemma of sacrificing his own profit margin or loosing an outlet. Long range business judgment and the force of events nearly always resulted in the granting of a temporary price allowance. *Ibid.* By adoption of the consignment system of distribution the supplier could avoid the necessity of facing this dilemma in three ways. First, by removing the burden of financing a gasoline inventory the supplier could improve the retailer's profit margin. Second, by agreeing in advance on how losses would be shared the supplier could avoid the necessity of a hasty decision. Third, by use of price controls the supplier could practice preventive medicine against price wars. Congress has expressly disapproved of price wars and similar unfair methods of competition. Federal Trade Commission Act, 38 Stat. 71 (1914), 15 U.S.C. § 41-44 (1958); Miller Tydings Act, 50 Stat. 693 (1937), 15 U.S.C. § 1 (1958); McGuire Act, 66 Stat. 632 (1953), 15 U.S.C. § 45 (1958). Yet there are some indications that these congressional attempts to solve the problems have not been completely successful, *Hearings Before a Subcommittee of the House Committee on Interestate and Foreign Commerce,* 88th Cong., 1st Sess. (1963). Perhaps, such supplier price control is needed to deal with the price war problem in the petroleum industry.

for . . . destroying competition in retail sales of gasoline . . . ."[45] Assuming that more than one gasoline supplier has retailers in the eight-state area under consideration,[46] for Union's consignment system to have the potential for destroying competition in any of the retail markets within that area, its consignees would have to occupy a substantial position in those markets.[47] If this were not the case, Union's higher, non-competitive price would tend to drive the consumer to another brand.[48] However, in the instant case the record before the Court did not contain any evidence from which it could be conclusively determined that such a condition existed in any of the local markets involved.[49] Evidently, the Court was willing to indulge in the assumption—based upon the number of consignees in the system—that such conditions did exist. At first blush such an assumption seems reasonable; certainly, where there is a relatively large number of consignees in a given area there is a corresponding likelihood that they will occupy a substantial position in at least a few of the local retail markets within that area.[50] But however reasonable it may be in theory, this approach produces serious, and

45. See note 34 *supra* and accompanying text.

46. This would seem to be a valid assumption in light of the Court's action in remanding the case for consideration of issues raised under the McGuire Act, 377 U.S. at 24, the applicability of which presupposes inter-brand competition at the retail level. See note 14 *supra*.

47. Consider how the presence of a consignment system of resale price maintenance might have the potential for destroying competition on the retail level. So as not to wander too far astray from the facts of the instant case, this discussion will be limited to the situations in which there is inter-brand competition at the retail level. In such cases if the competing brand dealers control relatively equal shares of a given local market the consumer who is dissatisfied with the price of one brand can turn to another. The fact that the dealers of one brand are bound to the same price by consignment agreements with their supplier would be unlikely to result in any substantial decrease of competition on the retail level. However, suppose these consignees are concentrated in a given local market. As the share of that local market controlled by these consignees increases, the freedom with which the consumer can turn to another brand decreases. The other retailers, finding that their lower prices do not shift an appreciable number of consumers to their brand, will tend to raise their price to that of the consignees in order to gain from the greater profit margin what they could not gain by increased volume.

48. This assumes, of course, that there is no horizontal price conspiracy between the oil producers which is being imposed upon the retail markets by resale price maintenance programs undertaken by each of the conspiring producers. While this was not involved in the instant case, the Court was evidently concerned about such a possibility. See 377 U.S. at 19 n.5.

49. The only facts before the Court were that Union had 4,133 consignees operating on the retail level in an eight-state area.

50. Underlying this assumption, however, is another: that Union's share of the total gasoline consumed in the eight-state area is substantial. While the Court did not deal with this point explicitly, it seemed to feel that it was dealing with an oligarchy situation. In the gasoline distribution industry this is usually the case. However, to the extent that it was not the case, the reasonableness of Court's assumption that control exists can be questioned.

possibly unreasonable, results. In the first place, it does not give the business community any guidelines—nor does it promise to give any in the future—by which they can determine in advance of litigation the validity of their particular consignment system.[51] All the business community knows from this decision is that if their system is "vast" they are in trouble. But just how vast is "vast" and what factors are to be taken into account in determining this?[52] The Court's failure here is compounded by the practical effect of their assumption. The Court is in effect shifting the burden of proof to the defendant.[53] For all but the relatively small systems this burden of proof would be practically insurmountable. Indeed, such an approach could have the effect of discouraging the use of the consignment method of distribution on any significant scale.[54] But assuming that these objections can be resolved in favor of this method of evaluating the potential to destroy competition, it is submitted that a more reliable and equitable approach is available. Based upon the principle that the potential to destroy competition on the retail level requires that the consignees occupy a substantial position within local markets, the degree of concentration of consignees within each of these local markets would seem to give a more reliable indication of this potential than the number of consignees in the system as a whole.[55] The Court has dealt with the problem of evaluating the degree of concentration for quite some time. Under section 7 of the Clayton Act, the degree of concentration of a proposed merger controls the issue of its legality.[56] There a quantitative evaluation of concentration[57] has provided

51. One can look at this approach in two ways: Perhaps the Court will apply a "presumption of control" in cases involving every large consignment system; on the other hand, the Court may be saying that if a consignment system can be shown to be "vast" the complainant has made out a prima facie case. But in either case the burden of proof has been shifted to the defendant. In those cases in which the consignment will be held invalid, the reason assigned will in all likelihood be a failure to carry the burden of proof. Decisions which rest on this basis do not usually include much in the way of useful criteria for resolving the basic issue before the Court.

52. See footnotes 42 & 46 *supra*. It is submitted that the number of consignees should not he the only factor taken into account.

53. It would seem that an equitable approach to the problem of consignments would place the burden on the complainant—once the defendant has shown that he has a legitimate interest in the consignment method of distribution—to show that regardless of the interest of the defendant the continued existence of the consignment system would involve so much potential for destroying competition that it must be eliminated. The approach taken by the Court in this case places the burden upon the defendant to show that the continued existence of the consignment system would *not* involve a potential for destroying competition. The Court itself seems to recognize the inequity of this result when it announced that it might be persuaded to apply this approach prospectively only. 377 U.S. at 25.

54. See comment cited in note 42 *supra*.

55. See note 47 *supra*.

56. United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963).

57. This quantitative evaluation involves first the determination of a "relevant"

a workable tool for analysis and a rational basis for decision.[58] A similar approach with respect to each local market involved in the consignment system would seem to offer the same advantages here. Once the potential to destroy competition has thus been found to exist within given retail markets, then the number of similarly affected retail markets would provide a reliable indication of the potential of the system as a whole for destroying competition on the retail level. By weighting the factor of size in this manner, proper weight would be given to the Sherman Act's abhorrence of this potential without imposing an unreasonable burden of proof on the complainant, and without meeting the problems involved when the burden of proof is shifted to the defendant.

## Constitutional Law—Fifth Amendment—Denial of Passport

Zemel, a United States citizen, was denied a passport to Cuba by the Director of the United States Passport Office. The denial was based upon the regulations promulgated by the Secretary of State under authority of the Passport Act[1] and the Immigration and Nationality Act[2] and executive orders and proclamations of the President

market area, or more descriptively, the market area in which the merging retailers can be said to play a significant competitive role. Then, if the merger produces a firm controlling an undue percentage share of the relevant market, it is held to be so "inherently likely to lessen competition substantially that it must be enjoined . . . ." *Id.* at 363.

58. In those cases the Court needed—as it does in the instant case—a criterion that: (1) could be used with a fair degree of reliability for determining the probability that a particular merger would substantially affect competition; (2) would not subvert the congressional intent by permitting too broad an economic investigation; and (3) would enable the businessman to assess the legal consequences of a proposed merger in advance of litigation. A quantitative evaluation provided a reasonable compromise of all these objectives.

1. "The Secretary of State may grant and issue passports . . . under such rules as the President shall designate and prescribe for and on behalf of the United States, and no other person shall grant, issue, or verify such passports." 44 Stat. 887 (1926), 22 U.S.C. § 211(a) (1958).

2. "(a) When the United States is at war or during the existence of any national emergency proclaimed by the President . . . and the President shall find that the interests of the United States require that restrictions and prohibitions in addition to those provided otherwise than by this section be imposed upon the departure of persons from and their entry into the United States, and shall make public proclamation thereof . . . . (b) After such proclamation as is provided for in subsection (a) of this section has been made and published and while such proclamation is in force, it

under which, in general, all persons were denied permission to travel to Cuba.[3] On plaintiff's suit in the United States District Court of Connecticut for an injunction and declaratory judgment decreeing relevant sections of the two acts unconstitutional as authorizing the Secretary of State to issue regulations leading to a denial of liberty without due process of law, *held*, defendant's motion for summary judgment granted. Such restriction of freedom to travel by the Secretary of State in administering the relevant portions of the Act involved is necessary to permit American foreign policy effectively to meet the continually changing international situation. *Zemel v. Rusk*, 228 F. Supp. 65 (D. Conn. 1964).

Traditionally passports were issued as a matter of right to American citizens to facilitate travel abroad.[4] However, there have developed a number of restrictions on the issuance of passports. These restrictions have been justified on the basis that passport control is necessary to the executive department, not only for the protection of individuals, but also in controlling their actions abroad, which may affect the international situation and ultimately our national security.[5] Accordingly, the first restrictions on foreign travel were meant to insure public safety during wartime or national emergency by denying permission to travel to potentially dangerous areas.[6] In 1947, the State Department for the first time adopted a policy of preventing those with unsatisfactory political views from traveling abroad.[7] Such

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shall, except as otherwise provided by the President, and subject to such limitations and exceptions as the President may authorize and prescribe, be unlawful for any citizen of the United States to depart from or enter, or attempt to depart from or enter the United States unless he bears a valid passport." 66 Stat. 163, 190 (1952), 8 U.S.C. § 1185 (1958).

3. "No valid passport shall be required of a citizen of the United States or of a person who owes allegiance to the United States . . . . (b) When traveling between the United States and any country, territory or island adjacent thereto in North, Central or South America, excluding Cuba . . . ." 26 Fed. Reg. 482 (1961), amending 22 C.F.R. § 53.3(b) (1958). The purpose of the regulations and the administrative policy of the State Department in their application was set out in Department of State Press Release, No. 24, Jan. 16, 1961, and Public Notice No. 179, 26 Fed. Reg. 492 (1961).

4. Urtetiqui v. D'Arcy, 34 U.S. (9 Pet.) 692 (1835).

5. See note 32 *infra*.

6. In 1918 Congress made it unlawful to travel without a passport subsequent to a proclamation of war. In 1941 this restriction was extended to national emergencies and in 1952 became part of the Immigration and Nationality Act, 66 Stat. 190 (1952), 8 U.S.C. § 1185(b) (1958).

7. See Comment, 61 YALE L.J. 171 (1952); Comment, 3 STAN. L. REV. 312 (1951). The Secretary of State is authorized to grant and issue passports under rules prescribed by the President within his discretion under 44 Stat. 887 (1926), 22 U.S.C. § 211(a) (1958). Since 1947 numerous persons have been denied passports because their travel was deemed contrary to the "best interests" of the United States. Just what is meant by "best interests" is difficult to determine since there are never any public announcements of passport denials. Unless the individual makes a public

executive discretion in restricting the issuance of passports went virtually unchallenged until *Bauer v. Acheson.*[8] There petitioner, while living in France, had her passport revoked without notice or hearing on the grounds that her activities were contrary to the "best interests" of the United States. The court held that revocation of this passport was without "authority in law," thereby limiting the scope of the Secretary's discretion in denying passports to only "reasonable classifications of persons."[9] In recognizing the executive discretion granted by section 211(a) of the Passport Act, but at the same time placing limits on the exercise of this discretion, the court seemed to indicate that there may be a personal right of freedom to travel that is protected under the procedural due process of the fifth amendment.[10] It was stated that the protection of this amendment be arbitrarily or capriciously denied, but can be denied only by a "fair application of the law equally to the exigencies of the situation."[11] A number of decisions that followed *Bauer* made it clear that the Secretary, in the exercise of his discretion, must set up administrative procedures for the denial or revocation of passports, which are consistent with due process of law.[12] Except for one case,[13] the issue of whether

protest, the refusal of the passport will never be known. However, what little is known about these decisions indicates that passports have been denied arbitrarily. For illustration of where there has been a protest made concerning denial of a passport see N.Y. Times, April 4, 1948, p. 30, col. 1, and N.Y. Times, Aug. 4, 1950, p. 1, col. 2.

8. 106 F. Supp. 445 (D.D.C. 1952). This was the first case concerning passport denial to come before the courts. Since it was long believed that the executive's discretion in the area of passports was justified by his responsibility for conduct of foreign affairs, such decisions in the conduct of foreign affairs were not subject to judicial review.

9. "This court does not suggest that the Secretary of State is without authority to establish reasonable classifications of persons whose passports shall be revoked or not renewed. The question raised in this case is whether the inherent power of the executive department or § 211a confers upon the Secretary of State absolute discretion in the matter of passports, without regard to the principles of due process and equal protection of the law, and whether or not his discretion be exercised arbitrarily." *Id.* at 452.

10. "Since denial of an American passport has a very direct bearing on the applicant's personal liberty to travel outside the United States, the executive department's discretion, although in a political matter, must be exercised with regard to the constitutional rights of the citizens, who are the ultimate source of all governmental authority." *Id.* at 451. The importance of this idea of a right to travel is highlighted by the fact that such a right is included in the United Nations Declaration of Human Rights. Universal Declaration of Human Rights art. 13, para. 2 (1948); For the most recent discussion of this right to travel see Aptheker v. Secretary of State, 378 U.S. 500 (1964).

11. 106 F. Supp. at 452.

12. In Shachtman v. Dulles, 225 F.2d 938 (D.C. Cir. 1955), a denial of a passport to petitioner without a hearing because he belonged to an organization on the Attorney General's list of subversive organizations was held an unconstitutional violation of due process. The court recognized the executive's "natural right" to exercise discretion, but subjected it to "reasonable regulation under law." It was held in Nathan v. Dulles, 129 F. Supp. 951 (D.D.C. 1955), that an applicant was entitled to a hearing

executive action deprived applicants of a right to travel under the substantive prohibitions of the fifth amendment did not arise until *Kent v. Dulles*,[14] in 1958. The Supreme Court there held that the Secretary's action, under section 211(a) of the Passport Act, in denying a passport to one refusing to file an affidavit concerning alleged connections with the Communist Party violated the individual's fifth amendment right.[15] Thus *Kent*, without completely abolishing the discretion of the Secretary of State in the field of passport control, lends authority to the existence of a broad, but not unlimited, right to travel.[16] The Supreme Court, in refusing to abolish the Secretary's statutory grant of discretion seemed to recognize the necessity for administrative regulation in furtherance of effective foreign policy; even though the high degree of discretionary abridgment of constitutional rights in *Kent* was not justified by the necessity of regulation in that particular situation.[17] Following the decision in *Kent*, the State Department for the first time relied solely upon a policy of area control—a denial of passports to all persons seeking to travel to a specified country or area.[18] This basis for denial of passports was upheld in *Worthy v. Herter*,[19] where petitioner was denied a passport because he refused to refrain from visiting Communist China, an area forbidden to all United States travelers. The court held this a valid exercise of executive discretion on the grounds that the decision was justified under executive responsibility for foreign affairs.[20]

The court in the instant case, in granting respondent's motion for summary judgment, relied upon *Worthy v. Herter*.[21] The Supreme Court decision in *Kent v. Dulles*[22] was distinguished as being appli-

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before being denied a passport. In Boudin v. Dulles, 235 F.2d 532 (D.C. Cir. 1956), the Secretary had openly to produce evidence upon which a denial could be based. See also Forman v. Dulles, Civil No. 4924-54 D.D.C. June 28, 1955; Kamen v. Dulles, Civil No. 5799-53 D.D.C. July 8, 1955.

13. Shachtman v. Dulles, *supra* note 12.

14. 357 U.S. 116 (1958). The substantial right argument is that freedom of travel is an essential "liberty" under the fifth amendment and cannot be denied without due process of law. *Id.* at 129.

15. *Id.* at 130. The case upheld the constitutionality of the statute, but held the Secretary's action was in excess of his authority and therefore could not have been authorized by the statute.

16. *Id.* at 128. See also Aptheker v. Secretary of State, *supra* note 10.

17. 357 U.S. at 128.

18. See Department of State Press Release, No. 428, August 7, 1956, for an example of the type of regulation which was solely relied upon by the State Department after the *Kent* decision.

19. 270 F.2d 905 (D.C. Cir.), *cert. denied*, 361 U.S. 918 (1959). See also Porter v. Herter, 278 F.2d 280 (D.C. Cir. 1960); Frank v. Herter, 269 F.2d 245 (D.C. Cir.), *cert. denied*, 361 U.S. 918 (1959).

20. 270 F.2d at 910.

21. 270 F.2d 905 (D.C. Cir. 1959).

22. 357 U.S. 116 (1958)

cable only to the situation where a citizen is denied a passport solely because of his political beliefs.[23] The court upheld the denial of a passport to Zemel essentially on two grounds. First, the Secretary has authority to take such administrative action, free from judicial review, under the executive power to conduct foreign affairs.[24] Restriction of travel to Cuba is most relevant to the conduct of our foreign affairs as it is intended to prevent the occurrence of any international incident "which would necessitate negotiations . . . with a government whose existence the United States is committed to ignore."[25] Second, the power of the Secretary of State was upheld as a proper exercise of authority delegated to the executive by statute.[26] In view of the ever changing international situation, the executive should have wide discretion enabling him to deal immediately and effectively with each new crisis. Under this necessity of immediate action, Congressional delegation of executive authority with "general specificity" is valid.[27]

The issues presented in this area are not ones of simple solution. It cannot be denied that passport control can be an effective instrument in the conduct of foreign affairs. But is the resulting encroachment on individual freedom justified by the aid to the administration of an effective foreign policy? Congress, in granting the executive wide discretion in this field, has concluded that it is. The courts seem to agree that this discretion is necessary, continually refusing to declare the wide statutory grant of authority unconstitutional, while in certain cases enjoining executive action where the grant was too sweeping and the result was thought to discriminate arbitrarily against particular individuals.[28] They have thereby drawn a line beyond which restriction of individual freedom is not justified by executive action in the field of foreign policy. In *Kent v. Dulles*,[29] the restric-

23. Zemel v. Rusk, 228 F. Supp. 65, 74 (D. Conn. 1964).
24. *Id.* at 81.
25. *Ibid.*
26. *Id.* at 75.
27. *Ibid.*
28. It is appropriate here to refer to the Supreme Court decision in Aptheker v. Secretary of State, 378 U.S. 500 (1964). Although not concerned with executive discretion under statute, it was concerned with the validity of a statute restricting freedom of foreign travel for the protection of national security. The Court held invalid section 6 of the Subversive Activities Control Act which made it unlawful for a member of the Communist Party to apply for or use a passport, as an unwarranted restriction on freedom of travel under the fifth amendment. The case is important here for two reasons: (1) it more firmly establishes the existence of a right to travel protected under the fifth amendment; and (2) the Court says that the restriction used here in protection of national security "sweeps too widely and too indiscriminately across the liberty guaranteed in the Fifth Amendment." 378 U.S. at 514. However it implies that there may be restrictions which will be held valid when "more discriminately tailored to the constitutional liberties of individuals."
29. *Supra* note 22.

tions on the basis of political belief went beyond this line and were held invalid. Thus far, area control seems to be within the bounds of justificd restriction. Whether or not the Supreme Court will agree with lower federal court decisions upholding area control may well depend upon how the Secretary administers this policy.[30] For even under area control, which allegedly prevents *all* citizens from visiting a particular area, the Department has made numerous exceptions where it has found it to be in the national interest.[31] It may be that these exceptions will themselves be held discriminatory and area control held invalid in those situations. If the Court finds that there is *no* way in which the State Department can limit freedom to travel in the administration of foreign policy without discriminating against the rights of individual citizens, it may well deny the executive any discretion in restricting travel. This result is doubtful, however, because of persuasive arguments that passport control over travel is necessary to the administration of an effective foreign policy.[32] The final decision of the Supreme Court on the constitutionality of area control will depend upon how much value the Court puts on the

30. All lower federal court decisions have upheld area control. The Supreme Court has granted certiorari in the principal case and for the first time will pass on this policy.

31. Statement by Robert F. Cartwright, Aeting Director, Bureau of Security and Consular Affairs in *Hearings on the Right to Travel Before the Subcommittee on Constitutional Rights of the Senate Committee on the Judiciary*, 85th Cong., 1st Sess. pt. 2, at 73 (1957): "[T]he restrictions, geographical restrictions which are applied by the Department in certain instances, generally as to Red China, as you know, temporarily as to the Middle East, presently as to Hungary, et cetera, apply to everyone without exception. There is no category of person to whom they do not apply. However the Department has made numerous exceptions, I know—I can't tell you statistics—in, for example, the Middle East for newspaper people, and I mentioned Red Cross workers, and so forth, where the facts of the matter in the Department's judgment put the case in the national interest that they should go. . . .

"The Department considers this exercise of authority within the discretion of the Secretary of State. In these instances that I mentioned it makes the judgment not for the benefit of an individual but in the national interest."

32. See Worthy v. Herter, 270 F.2d 905, 909-10 (D.C. Cir. 1959). "The facts which caused the Secretary to designate these places and to refuse official sanction of travel therein are shown us by the Secretary. Indeed they are established by many current events; they appear almost daily upon the front pages of the newspapers; they have been declared repeatedly by the President, his predecessors, and the Congress. We need not catalog them. The Korean difficulty with Communist China is still in the armistice stage, not finally settled. All trade with this part of China is prohibited. The situation in respect to Formosa and the small off-shore islands, where we have a treaty of mutual defense, fluctuates in intensity. We oppose Communist China's membership in the United Nations. American citizens are held hostage in that country. The reasons underlying the restriction on travel in Hungary are less numerous but amply sufficient. Unless almost the whole of our foreign policy and the titanic domestic burdens being presently borne by our people are devoid of factual foundation, there is presently in the world a deadlock of antagonistic forces, susceptible of erupting into a total cataclysm. The capacity of incidents arising from the conduct of individuals to ignite that conflagration is well proven."

freedom to travel when weighed against the utility of area control in the administration of foreign policy. An example of this weighing process is the *Aptheker* case.[33] There the statute itself authorized a sweeping restriction of travel which the Court said the limited evil being pursued did not justify. In the instant case the statute authorizes restriction, but only that which each particular situation justifies.

The weighing process in *some* of these cases may indicate that the right to travel outweighs the reasons of the State Department for invoking area control. However, the present situation in Cuba, and possible politically embarrassing events which could transpire if American citizens were to travel there, justified, in the eyes of the district court, the restriction of such freedom to travel. Obviously the statute cannot foresee each situation where the restriction may be so necessary as to outweigh freedom to travel. But even though proper situations for travel restrictions cannot be foreseen and must of necessity be determined on an *ad hoc* basis, should this circumstance preclude all restrictions, leading to a holding by the Supreme Court that the statute is an unconstitutional delegation of authority? Clearly not. The wisest approach to the problem is that taken by the courts thus far: allowing executive discretion under the present statutes, keeping in mind that particular exercises of the discretion might be termed arbitrary and therefore invalid as determined by subsequent judicial proceedings.

## Constitutional Law—State Procedure To Determine The Voluntariness of a Confession

A New York court, in the course of a criminal trial, admitted statements of confession wherein the defendant admitted the robbery of a hotel and the fatal wounding of a policeman in an ensuing struggle. The voluntariness of the confessions was questioned by the defendant. Following New York procedure,[1] the trial court submitted

33. *Supra* note 28. This same weighing process was also applied in Kent v. Dulles, *supra* note 14, where the restrictions on travel were not justified by its alleged purpose.

1. Under New York procedure, the trial judge makes a preliminary determination regarding the questioned confession and excludes it if in no circumstances could the confession be found voluntary. But if there is a fair question as to its voluntariness, the judge receives the confession and leaves the ultimate determination of its voluntary character to the jury. See *Jackson v. Denno*, 378 U.S. 368, 377-78 (1964).

the question of voluntariness to the jury. The defendant was found guilty and the conviction was upheld by the New York Court of Appeals.[2] A petition for habeas corpus was denied, and this decision was affirmed by the Court of Appeals for the Second Circuit.[3] On certiorari in the Supreme Court, to consider the constitutionality of the New York procedure for determining voluntariness, *held*, the submission of the question of the voluntariness of a confession to the jury, without the trial judge first having made an independent determination of voluntariness,[4] does not afford a defendant a reliable determination of voluntariness and is violative of the due process clause of the fourteenth amendment, *Jackson v. Denno*, 378 U.S. 368 (1964).

There can be no question that a confession of guilt is as compelling a piece of evidence as can be presented to a jury. The restrictions regarding the exclusion of involuntary or coerced confessions that the Supreme Court has imposed in recent years on federal and state courts testify to their impact. The common law justification for the exclusion of a coerced confession was that it was "testimonially untrustworthy."[5] In 1936 the Supreme Court, in handing down the first coerced confession case based on the desire to protect the right to a fair trial,[6] seemed to shift to a due process theory of exclusion, although the case could easily be squared with the untrustworthiness theory of the common law. In *Lisenba v. California*,[7] an obvious shift occurred as the Court realized that the untrustworthiness theory was not an adequate constitutional basis for the reversal of state convictions, and emphasized the prevention of "fundamental unfairness in the use of evidence, whether true or false."[8] In the noted case of *Ashcraft v. Tennessee*,[9] the Court did not search for a causal relationship between the coercion and the confession,[10] thereby further abandoning the untrustworthiness theory, although it did not specifically

2. People v. Jackson, 10 N.Y.2d 780, 177 N.E.2d 59, *cert. denied*, 368 U.S. 949 (1961).

3. Jackson v. Denno, 309 F.2d 573 (2d Cir.), *affirming* 206 F.Supp. 759 (S.D.N.Y. 1962).

4. Under the Massachussetts procedure there is such an independent determination. See note 22 and accompanying text *infra*.

5. 3 WIGMORE, EVIDENCE § 822 (3d ed. 1940).

6. Brown v. Mississippi, 297 U.S. 278 (1936).

7. 314 U.S. 219 (1941).

8. *Id.* at 236. For a good discussion of the recent history of coerced confessions see, Ritz, *Twenty-Five Years of State Criminal Confession Cases in the U.S. Supreme Court*, 19 WASH. & LEE L. REV. 35 (1962).

9. 322 U.S. 143 (1944).

10. One authority in analyzing *Ashcraft* and the departure from the common law theory observed, "*Ashcraft* thus represents an abandonment of a causal connection as an essential requirement to finding a confession to be involuntary, so that under this decision it is no longer necessary to inquire into the actual effect of the questioner's coercion on the person questioned." Ritz, *supra* note 8, at 46.

rely upon the due process theory. This new and developing concept —that oppressive law enforcement practices "may in the end, defeat, rather than further the ends of justice"[11]—was followed by the Court in *Malinski v. New York*.[12] The Court did not inquire into the effects of the coercive police treatment as it discussed the voluntariness of the confession but moved toward the due process concept. In *Rogers v. Richmond*,[13] the Court concluded that the probable truth of a confession has no place in the determination of voluntariness and clearly set forth the due process rationale as the basis for excluding coerced confessions.[14] The Court has recently held that the fifth amendment's freedom from self-incrimination, including coerced confessions, is made applicable to the states through the fourteenth amendment.[15]

As the Court developed the due process basis for excluding coerced confessions, it was only natural that it should examine state court procedures used in determining voluntariness. In *Stein v. New York*,[16] the Court upheld the New York procedure, with its general verdict, which created uncertainty regarding the jury's disposition, if any, of the voluntariness question. Two alternative justifications were offered by the Court in *Stein*: first, that the jury found the confession to be voluntary, and second, that the jury found the confession to be involuntary and followed the instructions to disregard such a confession. As was pointed out in the *Jackson* decision,

> The failure [in *Stein*] to inquire into the reliability of the jury's resolution . . . as to voluntariness . . . was not a mere oversight but stemmed from the premise underlying the *Stein* opinion that the exclusion of involuntary confessions is constitutionally required solely because of the inherent untrustworthiness of a coerced confession.[17]

Thus the *Stein* decision seemed to break away from the line of opinions that steadily had been advancing the due process theory. In addition to the New York procedure[18] for determining voluntariness, there are

11. Lisenba v. California, *supra* note 7, at 240.

12. 324 U.S. 401 (1945) Justice Frankfurter's concurring opinion is an excellent discussion of the due process clause and a fair trial.

13. 365 U.S. 534 (1961).

14. *Id.* at 543-44.

15. Malloy v. Hogan, 378 U.S. 1 (1964). See Jackson v. Denno, *supra* note 1, at 408, Justice Black's opinion, dissenting in part and concurring in part.

16. 346 U.S. 156 (1953).

17. Jackson v. Denno, *supra* note 1, at 383.

18. This procedure is followed in 15 states: Arizona, Georgia, Idaho, Michigan, Minnesota, Missouri, New York, Ohio, Oregon, Pennsylvania, South Carolina, South Dakota, Texas, Wisconsin, and Wyoming. Jackson v. Denno, *supra* note 1, at 396-400, App. to majority opinion. Justice Black's Apps., *Id.* at 410-23, add Arkansas and Puerto Rico and deletes Arizona. This procedure is followed by the Court of Appeals for the District of Columbia and the Second, Sixth, Seventh, and Eighth Circuits. Majority App., *Ibid.* Justice Black's App., *Ibid.*, includes the Third Circuit.

two other widely followed procedures[19]—the orthodox and the Massachusetts procedures. The orthodox or Wigmore procedure[20] requires the judge finally and solely to determine the voluntariness of the confession. The Massachusetts or "Humane Rule"[21] appears to be a compromise between the New York and orthodox procedures. The primary difference between the New York and Massachusetts procedures is that under the Massachusetts rule the judge must find the confession to be voluntary before he submits it to the jury, allowing them to make a subsequent independent determination of its involuntariness. Thus in Massachusetts there must be two separate findings of voluntariness before the confession can be considered.[22]

In the instant case, the Court overruled *Stein* and characterized the determination of the voluntariness of a confession as "an exceedingly sensitive task, one that requires facing the issue squarely, in illuminating isolation and unbeclouded by other issues and the effect of extraneous but prejudicial evidence."[23] The Court attacked both assumptions advanced by the *Stein* Court. Under the first assumption—that the jury found the confession to be voluntary—the Court was concerned with the fact that the jury was presented corroborating evidence as to the defendant's guilt at the same time it was confronted with making a decision as to the voluntariness of his confession.[24] In such a situation a jury might become convinced of the validity of the confession and find it difficult to become concerned about the question of coercion.[25] Under the second assumption—that

19. In an excellent article, cited several times by the Court and very closely foreshadowing their reasoning, a fourth category is added—the choice to follow either tho orthodox or Massachusetts view. Meltzer, *Involuntary Confessions: The Allocation of Responsibility Between Judge and Jury*, 21 U. CHI. L. REV. 317 (1954).

20. See 3 WIGMORE, *supra* note 5, at § 861. This procedure is followed in 20 states: Alabama, Colorado, Connecticut, Florida, Illinois, Indiana, Kansas, Kentucky, Louisiana, Mississippi, Montana, New Mexico, North Carolina, North Dakota, Tennessee, Utah, Vermont, Virginia, Washington, and West Virginia. It is sanctioned in three Federal Circuits: the First, Fifth, and Tenth. 378 U.S. at 410-23, Justice Black's appendix.

21. This procedure is followed in 14 states: Alaska, Arizona, California, Delaware, Hawaii, Idaho, Maine, Maryland, Massachussetts, Nebraska, New Hampshire, New Jersey, Oklahoma, and Rhode Island. It is stated that the Fourth and Ninth Circuits also observe this practice. *Ibid.*

22. The judge's independent determination seems to be the factor that the Court feels differentiates the Massachusetts procedure from that of New York.

23. 378 U.S. at 390.

24. "The evidence given the jury inevitably injects irrelevant and impermissible considerations of truthfulness of the confession into the assessment of voluntariness." *Id.* at 386.

25. This jury danger is referred to in MCCORMICK, EVIDENCE § 112 (1954). To counter suggestions that this decision is undermining the jury system, the Court advances the proposition that our system of jury trial presupposes that the judge will have applied exclusionary rules prior to allowing the evidence to reach the jury. 378 U.S. at 382 n.10; Meltzer, *supra* note 19, at 327; see also, MORGAN, SOME PROBLEMS OF PROOF UNDER THE ANGLO-AMERICAN SYSTEM OF LITIGATION 104-05 (1956).

the jury found the confession to be involuntary and followed the instructions to disregard such a confession—the Court raised the question whether the jury *can* disregard what it has heard, particularly if it believes the confession to be true.[26] The Court stated that the defendant's right was to have the coerced confession entirely disregarded.[27] It is important to notice that the emphasis was on the moral issue of overcoming the accused's will in securing a confession,[28] as contrasted to the premise of the *Stein* case that the rejection of a coerced confession was required because it was untrustworthy. The *Stein* position was criticized by the Court because it led courts to overlook the definite hearing that the accused deserved on the voluntariness of his confession.[29] Another major point in *Jackson* was that the New York general verdict gives no indication as to how or whether the jury resolved the coercion issue.[30] The Court stated that a defendant "is entitled to a fair hearing in which both the underlying factual issues and the voluntariness of his confession are actually and reliably determined."[31] In disposing of the case the Court remanded it to the district court to allow the State a reasonable time to afford the defendant a hearing on the voluntariness of his confession or a new trial.[32]

There were three dissenting opinions. Justice Black felt that a judge may be no more able than a jury to determine voluntariness and that the majority holding failed to recognize the successful history

26. The majority, 378 U.S. at 388 n.15, referred to a portion of Delli Paoli v. United States, 352 U.S. 232, 248 (1957). "The Government should not have the windfall of having the jury be influenced by evidence . . . . they should not consider but which they cannot put out of their minds." Also cited is the dissent of Justice Frankfurter in Krulewitch v. United States, 336 U.S. 440, 453 (1949). "The naive assumption that prejudicial effects can be overcome by instructions to the jury . . . all practicing lawyers know to be unmitigated fiction." See Meltzer, *supra* note 19, at 326. See also a fine article, Paulsen, *The Fourteenth Amendment and the Third Degree*, 6 STAN. L. REV. 411 (1954).

27. 378 U.S. at 387.

28. "Thus in cases involving involuntary confessions, this Court enforces the strongly felt attitude of our society that important human values are sacrificed where an agency of the government, in the course of securing a conviction, wrings a confession out of an accused against his will." Blackburn v. Alabama, 361 U.S. 199, 206-07 (1960). See also, Spano v. New York, 360 U.S. 315, 320-21 (1959).

29. 378 U.S. at 383-84.

30. *Id.* at 379-80. The Court referred to its earlier discussion of this problem in Stein, *supra* note 16, at 177-78. See also, Cranor v. Gonzales, 226 F.2d 83, 90 (1955), where the Ninth Circuit referred to this weakness of the New York procedure.

31. 378 U.S. at 380.

32. The opportunity given the state to hold initial proceedings may become very significant. "To require a federal judge exercising habeas corpus jurisdiction to attempt to combine within himself the proper functions of judge and jury in a state trial—to ask him to approximate the sympathies of the defendant's peers or to make the rulings which the state trial judge might make . . . is potentially to prejudice state defendants. . . ." Rogers v. Richmond, *supra* note 13, at 548.

of the New York procedure. He also criticized the omission of discussion of the questions of burden of proof and retroactive application. Justice Black's main objection concerned the "downgrading of trial by jury."[33] He did not discuss the question in detail but observed that "the Constitution itself long ago made the decision that juries *are* to be trusted."[34] He argued that the Court was enforcing its own concept of fairness through the due process clause[35]—a power he felt it should not exercise. The issue of piecemeal prosecution was mentioned in his dissent.[36] Justice Harlan in a separate dissent, concurred in by Justices Clark and Stewart, stated that there is a "general preference for submission to a jury of disputed issues of fact."[37] He cited cases where the jury had been allowed to follow very complex instructions[38] and questioned the Court's apparent reversal of policy. Justice Harlan also felt that there had been an invasion of the state's right to allocate the trial of issues between the judge and jury, and pointed out that the Massachusetts procedure, with its similarity to that of New York,[39] had not been invalidated.[40]

It appears that the Court reached the proper conclusion in the instant case. The decision follows two important recent developments in the area of exclusion. First, a definite shift has occurred to the due process theory of exclusion as opposed to the common law concept of untrustworthiness.[41] *Jackson v. Denno* is a logical step for-

33. 378 U.S. at 405.

34. *Ibid.*

35. *Id.* at 407. Justice Black observed that there is a difference between the "law of the land" and a judicial concept of fairness. Justice Black's idea of proper judicial power in the field of due process is outlined in his dissent in Adamson v. California, 332 U.S. 46, 91-92 (1947), citing Federal Power Commission v. Pipeline Co., 315 U.S. 575, 601 n.4 (1942). "In the one instance, courts proceeding within clearly marked constitutional boundaries seek to execute policies written into the Constitution; in the other, they roam at will in the limitless area of their own beliefs . . . . actually select policies, a responsibility which the Constitution entrusts to the legal representatives of the people." See also, Ferguson v. Skrupa, 372 U.S. 726 (1963). *Cf.* Targan, *Justice Black—Inherent Coercion*, 10 AM. U. L. REV. 53 (1961).

36. 378 U.S. at 409-10. The majority allowed a hearing or a new trial in the interest of sound judicial administration and the proper state-federal relation. Justice Black's objection stemmed from the fact that there was "the taking of new testimony." This is the same objection that he raised in an earlier case which he felt infringed either the spirit or substance of double jeopardy. Dissent in United States v. Shotwell Mfg. Co., 355 U.S. 233, 250 (1957).

37. 378 U.S. at 429.

38. Delli Paoli v. United States, *supra* note 26, at 242; Opper v. United States, 348 U.S. 84, 95 (1954); Leland v. Oregon, 343 U.S. 790 (1952).

39. See note 22 and accompanying text, *supra*.

40. Because of the similarity in the Massachussetts and New York procedures, it is important to note that the Court stated that there was no question raised as to the validity of the Massachusetts procedure, since the judge makes a separate finding of voluntariness without regard to questions of reliability and his conclusions may be ascertained from the record. 378 U.S. at 378 n.8.

41. See notes 5-15, *supra* and accompanying text.

ward in the due process rationale. The second development is the greater concern for individual rights and the procedures relating to their protection. *Jackson v. Denno* is an important development in this area of procedure and, indeed, may be the final statement of the Court's position as regards the three procedures for determining voluntariness.[42] The majority of the Court seems to favor the orthodox procedure, but it might be expected that the fifteen states now following the New York procedure[43] will become adherents of the more similar Massachusetts procedure, with its element of jury responsibility. The reasoning of the majority in rejecting the New York procedure is not squarely met by the dissenting justices, although their dissents raise several important questions—one being the inquiry by Justice Black as to the retroactive application of the holding. A recent case, *United States v. LaVallee*,[44] decided prior to *Jackson*, held that *Gideon v. Wainwright*[45] must be applied retroactively because of the fundamental nature of the right to counsel. The other landmark case in the area of due process and retroactive application is *Mapp v. Ohio*,[46] which generally has not been applied retroactively. The difference between the *Gideon* and *Mapp* applications can be explained by their purposes.[47] *Gideon* is concerned with procedural fairness, while *Mapp* was aimed at deterring official misconduct[48]—a goal not served by retroactive application. The *Jackson* Court, in placing its decision on the grounds of procedural fairness, may have attempted to show the similarity between *Jackson* and *Gideon*, thereby tacitly encouraging retroactive application by the New York Court of Appeals. The most popular objection raised by Justice Black's dissent is his charge that there had been a "downgrading of trial by jury." The majority referred to an article by Professor Morgan[49] that effectively meets the objections advanced by Justice Black and states what can be considered the strongest line of argument for the majority:

> A fair consideration of the evidence upon the preliminary question is essential; in this consideration the truth or untruth of the confession is immaterial . . . . It is useless to contend that a juror who has heard the confession can

42. See note 40 *supra*.

43. See note 18 *supra*.

44. 330 F.2d 303 (2d Cir. 1964). There is also a fine dissent that presents the practical objections to a retroactive application.

45. 372 U.S. 335 (1963).

46. 367 U.S. 643 (1961).

47. See, *e.g.*, Bender, *The Retroactive Effect of an Overruling Constitutional Decision: Mapp v. Ohio*, 110 U. PA. L. REV. 650 (1962); Comment, 71 YALE L. J. 907 (1962).

48. United States v. Rundle, 327 F.2d 153 (3d Cir. 1964); United States v. Walker, 323 F.2d 11 (5th Cir. 1963).

49. *Supra* note 25.

> be uninfluenced by his opinion as to the truth or falsity of it . . . . The rule of exclusion ought not to be emasculated by admitting the evidence and giving to the jury an instruction which, as every judge and lawyer knows, cannot be obeyed.[50]

## Criminal Law—Statutory Rape—Good Faith, Reasonable Belief That Female Has Reached Age of Consent as a Defense

The prosecuting witness, when she was seventeen-years-nine-months of age, voluntarily engaged in sexual intercourse with the defendant. The defendant was subsequently prosecuted under a California statute which defines rape as being, *inter alia,* sexual intercourse with a female under the age of eighteen, who is not the wife of the perpetrator.[1] The court, sitting without a jury, convicted the defendant of a misdemeanor after refusing to allow him to introduce evidence to show that he, in good faith, had a reasonable belief that the girl was over eighteen years of age. On appeal to the Supreme Court of California, *held,* reversed. A good faith, reasonable belief that the girl has reached the statutory age of consent is a valid defense to a charge of statutory rape.[2] *People v. Hernandez,* 39 Cal. Rptr. 361, 393 P.2d 673 (1964).

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50. *Id.* at 104-05.

1. CAL. PEN. CODE § 261.

2. It is submitted at this point that the practical effect of this decision in California is difficult, if not impossible, to foresee. Such uncertainty arises from People v. Greer, 30 Cal. 2d 589, 184 P.2d 512 (1947), in which the court held that the crime of statutory rape necessarily includes as a lesser offense the crime of contributing to the delinquency of a minor. At that time the latter offense was defined in CAL. WEL. & INST'NS CODE § 702, which purported to protect all minors under twenty-one years of age. In the principal case the court made no reference to this matter. We are therefore left to conjecture as to how it will handle a conviction for "contributing" rendered (under the doctrine of *Greer*) in the same proceeding where the defendant has successfully defended a charge of statutory rape on the ground that he believed the girl to be over eighteen. If the case involves a course of conduct by which the defendant has led the female into violation of law or disobedience of her parents other than the act of intercourse complained of, it seems likely that the conviction will stand. In such a case, however, the "contributing" would probably be a separate charge and not a lesser included offense in the charge of statutory rape. If, on the other hand, the conviction is based entirely on the act of intercourse complained of, the court may construe the "contributing" statute (now CAL. PEN. CODE § 272) as inapplicable to cases of sexual intercourse where the defendant reasonably believed the female to be above the age of consent. The statute is possibly subject to this construction by a court so inclined, and such a holding would be consistent with the rationale of the principal case. However, since, for the purpose of determining liability

In 1875 the English case of *Regina v. Prince* held that a male charged with abducting a female below the statutory age from the custody of her father could not assert as a defense his good faith belief that she was of age.[3] This rule, which has been applied by American courts to cases of carnal knowledge of females under the prescribed age[4] seems to express the present state of the law of statutory rape.[5] The apparent anomaly that surrounds the imposition of criminal liability on a defendant who actually believed his partner to be above the minimum legal age has been eloquently explained and justified. Indeed, the reasons given in *Prince*[6] are the reasons advanced today in support of the prevailing rule. It is said that "what was done would have been unlawful and highly immoral even under the facts as the offender supposed them to be,"[7] and that, in commiting an act wrong in itself, he accepted the risk that his partner might be under the age limit.[8] The mistake of fact which might, in other areas of the law, eliminate *mens rea* and thereby relieve the defendant of criminal liability, is said to be "in no sense an 'innocent' mistake but merely a mistake as to the extent of the wrong and this is not sufficient to excuse the actual wrong done."[9] No doubt the main consideration of courts confronted by the problem has been the belief that girls under the age presumed by the legislature to be the age of operative consent are, despite their actual consent, unable to understand the implications of the sexual act;[10] therefore, they stand in danger of permanent harm, both physical and emotional.[11] It is further suggested that the chastity of young girls has traditionally been regarded as possessing an independent value—a value which society has an interest in preserving inviolate.[12] The courts, faced

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under the "contributing" statute, minors are persons under twenty-one, the conviction might well be allowed to stand. Moreover, the court might feel compelled by social policy to hold that sexual intercourse with a seventeen-year-old girl contributes to the delinquency of a minor even if it does not constitute statutory rape.

3. 13 Cox Crim. Cas. 138 (1875).

4. People v. Ratz, 115 Cal. 132, 46 Pac. 915 (1896); Commonwealth v. Murphy, 165 Mass. 66, 42 N.E. 504 (1896); State v. Houx, 109 Mo. 654, 19 S.W. 35 (1892).

5. 1 WHARTON, CRIMINAL LAW & PROCEDURE § 321 (12th ed. 1957).

6. Regina v. Prince, *supra* note 3, at 142. The court there reasoned that if a case arose involving carnal knowledge of an underage female and the defense of good faith belief was interposed, it surely must be struck down because, "The act done with a *mens rea* is unlawfully and carnally knowing the girl, and the man doing that act does it at the risk of the child being under the statutory age. It would be mischievous to hold otherwise." The court then stated that the same rationale must be applied in this case.

7. PERKINS, CRIMINAL LAW 127 (1957).

8. Regina v. Prince, *supra* note 3.

9. PERKINS, *op. cit. supra* note 7, at 127.

10. Golden v. Commonwealth, 289 Ky. 379, 158 S.W.2d 967 (1942).

11. See Note, 62 YALE L.J. 55, at 76 (1952)

12. *Ibid.*

with the task of construing statutes so obviously laden with these public policy considerations, have felt themselves bound to impose liability regardless of the belief of the accused concerning the true state of facts.[13] This judicial attitude has resulted in conviction in most jurisdictions on a mere showing that the act occurred, with little inquiry into mitigating circumstances.[14] However, moderating influences have been introduced into the law of statutory rape in comparatively recent years. These influences have come primarily through statutory modifications in the various states, which define more particularly the kinds of factual situations intended to be covered by criminal sanction.[15] For example, there are statutes which allow for consideration of the youth of the male involved,[16] statutes which call for consideration of the past character of the female,[17] and statutes which establish a grading of offenses according to age, with varying punishments provided for violations within the different age groups.[18] It is true, however, that these refinements in the law have to do only with the actual facts of a given case, and make no allowance for a mistake concerning these facts which may have been made by the defendant. Moreover, no cases were found where these statutes were construed to allow the defendant to assert his mistake of fact (as to his partner's reputation, for example) as a defense, although some jurisdictions seem to allow the good faith belief of the defendant that the female was of age to mitigate punishment.[19] The well-established status of the prevailing doctrine has not preserved it from criticism, especially in recent years. Judge Ploscowe points to the vast difference in the statutory age which was in effect when the rule of *Regina v. Prince*[20] was formulated, and during the ensuing years when it was adopted by virtually all the American jurisdictions which had occasion to pass on it.[21] Then the statutory age was generally ten years, or perhaps twelve, but present laws almost invariably provide for ages of fourteen, sixteen, eighteen, or even twenty-one.[22] Ploscowe maintains that, while it no doubt is a

13. Commonwealth v. Murphy, *supra* note 4. See also CLARK & MARSHALL, CRIMES § 5.11 (6th ed. 1958).

14. See State v. Duncan, 82 Mont. 170, 266 Pac. 400 (1928).

15. MODEL PENAL CODE § 207.4, comment (Tent. Draft No. 4, 1955).

16. *E.g.*, ALA. CODE tit. 14, § 399 (1958). N. J. STAT. ANN. § 2A:138-1 (1952); N. Y. PENAL LAW § 2010.

17. *E.g.*, FLA. STAT. ANN. § 794.05 (Supp. 1963); OKLA. STAT. ANN. tit. 21, § 1111 (1958); PA. STAT. ANN. tit. 18, § 4721 (1963); TENN. CODE ANN. 39–3706 (1956).

18. *E.g.*, ALA. CODE tit. 14, § 399 (1958); N. J. STAT. ANN. § 2A:138-1 (1952); TENN. CODE ANN. 39-3706 (1956).

19. People v. Marks, 130 N.Y. Supp. 524 (Sup. Ct. 1911); Reid v. State, 290 P.2d 775 (Okla. Crim. Ct. App. 1955). *Contra*, WHARTON, *op. cit. supra* note 5.

20. Regina v. Prince, *supra* note 3.

21. PLOSCOWE, SEX AND THE LAW 178 (1951).

22. *Id.* at 179.

dangerous, abnormal, and intolerable thing for ten or twelve-year-olds to be inveigled into sexual intercourse by older males, "when age limits are raised to sixteen, eighteen, and twenty-one, when the young girl becomes a young woman, when adolescent boys as well as young men are attracted to her, the sexual act begins to lose its quality of abnormality and physical danger to the victim."[23] It is therefore said to follow that while a mistake concerning the age of a ten-year-old girl should not be a defense, it may be reasonable for the defendant to assert, as a defense, his belief that his partner was over the sixteen or eighteen years prescribed by statute.[24] Another writer[25] suggests an even more far-reaching departure from the prevailing view and would allow any defendant facing a statutory rape charge to show in his own defense that his partner, if she was fourteen or over, comprehended "the nature and implications of the sex act."[26] The legal significance of this showing would be that she would then be considered capable of granting operative consent to sexual intercourse despite her youth.[27] This, it is asserted, would enable the law to recognize the realities of our time, while protecting minor females who actually are innocent of the implications of the sexual act.[28] Looking again to England, where the *Prince* case was decided, we find that it has now by statute provided that the reasonable belief of the male defendant that the female was above the statutory age may be asserted in his defense, under certain prescribed conditions.[29] Furthermore, the Supreme Court of Canada held in 1956 that "the fact that the defendant honestly and reasonably believes that the girl is over the age limit constitutes a good defense."[30] In this country, the Model Penal Code of the American Law Institute suggests a statutory provision which allows the reasonable belief by the defendant that the female is over the "critical" age to be a defense, except where the "critical" age is ten years, in which case no such defense will be heard.[31] It was against this background of a firmly entrenched rule of law, beset in recent years by rising expressions of dissatisfaction, that the California court decided the principal case.

In a unanimous opinion, the Supreme Court of California clearly departed from the majority rule. In so doing, it expressly overruled

23. *Id.* at 184.
24. *Ibid.*
25. *Supra* note 11, at 80.
26. *Ibid.*
27. *Id.* at 82.
28. *Ibid.*
29. The Sexual Offences Act, 1956 4 & 5 Eliz. 2, c. 69.
30. The Queen v. Rees, [1956] Can. Sup. Ct. 640, construing the Juvenile Delinquents Act, 1952, R.S.C. c. 160, § 33.
31. MODEL PENAL CODE § 213.6 (Proposed Official Draft 1962).

*People v. Ratz*,[32] which had hitherto expressed the law of California on this point. The rationale of the *Ratz* case, which was interpreted as upholding strict liability on the ground that the defendant really intended to commit the act regardless of the age of his partner, was conceded to be valid if the defendant actually entertained such an intention. But, the court went on to reason, if he has beforehand satisfied himself that the girl is over the age limit, then he has not consciously taken any risk, and has held no criminal intent. The court then turned to section 20 of the Penal Code,[33] which sets out the general principle that crime requires "unity of act and intent," and to section 26 which provides that one who commits an act under a mistake of fact that disproves any criminal intent is not guilty of a crime.[34] It found in these sections an expression of legislative policy concerning crime, and it further found that this policy was in no way modified by section 261,[35] which defines rape to be, *inter alia*, sexual intercourse with a female under eighteen years of age. The court observed that when *Ratz* was decided in 1896 the statutory age was fourteen, that now it is eighteen, and that the prosecuting witness in the case at bar was seventeen-years-nine-months-old when the act took place. It asserted that it in no way condemned the practice of protecting sexually naive "infants," and it seems clear that this court would follow *Ratz*, in holding if not in rationale, in any case where the defendant could not reasonably believe that the girl was over eighteen. The trend of recent cases in other areas of criminal law involving the question of strict liability versus the requirement of *mens rea* was said to be toward the latter, where the governing statute "by implication or otherwise, expresses no legislative intent or policy to be served by imposing strict liability."[36] The court was careful to point out, however, that its holding in the principal case applied only to cases involving an honest and reasonable mistake of

32. Cases cited note 4 *supra*.
33. CAL. PEN. CODE § 20.
34. CAL. PEN. CODE § 26.
35. *Supra* note 1.
36. The court here cited People v. Vogel, 46 Cal. 2d 798, 299 P.2d 850 (1956), which held that a good faith belief that a former wife had obtained a divorce was a valid defense to a charge of bigamy arising out of a second marriage when the first had not in fact been terminated. The court stated that "it cannot be a greater wrong to entertain a bona fide but erroneous belief that a valid consent to an act of sexual intercourse has been obtained." The court's analogy illustrates the difficulty encountered in attempting to determine the place of the law in the regulation of personal morality. From a moral standpoint a good faith effort to create a valid marriage is not the same thing as an honest mistake of fact made by one who intends to have immoral sexual intercourse. On the other hand, society may suffer more from a bigamous marriage entered into in good faith than from an isolated incident of illicit sexual intercourse between two people who are fully capable of consenting to the act.

fact and would in no way protect a defendant who knew his partner to be underage.

This decision contains an enlightened re-evaluation of important but competing policies—an evaluation drawn in the context of the needs of modern society. Of course, it is still arguable that the policy of preventing young girls from engaging in sexual intercourse requires continued enforcement of the absolute liability doctrine. It is also arguable that, when the California court held that the defendant in *Hernandez* had no criminal intent if he honestly believed the girl to be over eighteen, it was failing to meet the traditional view that the legal wrong inhered in the act itself.[37] On the other hand, a different approach to the problem is justified if it is assumed, as it no doubt should be, that the fundamental purpose of any legal restriction on behavior in this area is to protect the sexually innocent female from an improvident disposition of sexual favor. When a girl who appears to be of age consents to intercourse, perhaps actively induces the male, and strives to allay his fears of becoming entangled with the law by reassurances as to her age, has she not become disassociated from the class which the statute was intended to protect? The pivotal question which seems to emerge at this point is just what role the law should play in the regulation of sexual morality, and the breadth of this question extends far beyond the issue of the principal case. That the law has a role here and that this role includes the protection of children from sexual abuse there can be no doubt.[38] But the *Hernandez* case involves a type of personal and private transgression of morality which may be beyond the effective reach of criminal sanction.[39] Hence it is suggested that the California court has here demonstrated an enlightened grasp of the policy to be served by age of consent legislation and of the limitations inherent in the law's ability to regulate sexual morality generally. Having so analyzed the nature of the policy involved, the court set about to balance that policy with another strong consideration in American criminal law: the concept that one who violates the language of the law in ignorance of the facts which make his act a violation is not to be held criminally liable. It seems clear that it is not wise, profitable, nor justifiable to

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It should be observed that the traditional view as expressed by *Ratz* did not eliminate criminal intent as an element in the crime, but implied intent from the act itself. After the court in the principal case had rejected this reasoning, it was still faced with the idea that public policy may require the imposition of liability irrespective of intent. Both approaches stem from the same basic attitude—the compulsion to promote desired social policy.

37. Regina v. Prince, *supra* note 6, at 142.

38. PLOSCOWE, *op. cit. supra* note 22, at 281-84.

39. *Id.* at 281. "The extraordinary thing about the adultery statutes is that they are dead letters . . . ."

impose the stigma of criminal conviction upon the male partner to a fully consensual, apparently normal, albeit immoral incident of sexual intercourse, when he acts in the reasonable belief that his partner is above the statutory age limit. In this context, another fallacy of the old rule—that the man alone is always to blame—is brought to light, and the injustice of strict liability becomes even more apparent. An examination of the age of consent legislation in effect in other states raises the question why these other states have not preceded California in allowing the defense of reasonable mistake as to age. For example, while the Penal Code of California makes no allowance for consideration of the past reputation of the female,[40] some other states have enacted such provisions.[41] It would therefore appear that these states have at least come to recognize that absolute liability for the simple fact of sexual intercourse with an underage girl does not serve the salutary purpose it was once thought to serve. Perhaps appropriate cases in the courts, and further reflection in the legislatures will bring about changes which will place more jurisdictions in agreement with the progressive attitude adopted by the California court. In this connection it is not suggested that history has come full circle and that, considering the sophistication of our time, we should revert to the common law age of consent of ten years. Despite the much discussed knowledgeability of modern teenage girls, it is probably still socially desirable for the law to play a part in inhibiting overt sexual expression between them and older males. Moreover, there are no doubt many teenage girls who still genuinely need the protection which the law presently affords and benefit from it. But the holding in the principal case, which is actually quite narrow, need not be viewed as the presage of a general relaxing of the law. It should rather be welcomed as the rectifier of a weakness in the law and utilized to illuminate the way to greater harmony between the promotion of desirable public policy and the preservation of fundamental principles of legal analysis.

40. *Supra* note 1.
41. See statutes cited note 17 *supra.*

## Insurance—Validity of Policy Provision Permitting Insured To Choose Forum for Determination of Disputes Under the Policy

Two federal district courts were recently confronted with the issue of the validity of insurance policy provisions which allow the insured to choose the forum in which any dispute that arises under the policy will be litigated. Case 1 was initiated in a Missouri state court by the beneficiary of a life insurance policy against the underwriters, who refused to pay after the death of the insured. The policy contained an express provision to the effect that:

> It is agreed that in the event of the failure of Underwriters hereon to pay any amount claimed to be due hereunder, Underwriters hereon, at the request of the insured (or reinsured), will submit to the jurisdiction of any Court of competent jurisdiction within the United States and will comply with all requirements necessary to give such court jurisdiction and all matters arising hereunder shall be determined in accordance with the law and practice of such Court.[1]

The underwriters removed the case to the Federal District Court for the Western District of Missouri and plaintiff-beneficiary filed a motion to remand the cause to the state court, contending that in agreeing to submit to the court chosen by the insured, the underwriters had waived their right to remove the case to the federal court. *Held,* motion denied. The contractual agreement was void as an unreasonable limitation on the jurisdiction of the federal court, consequently the provision was of no effect and did not constitute a waiver of the underwriter's right of removal. *Hasek v. Certain Lloyd's Underwriters,* 228 F. Supp. 754 (W.D. Mo. 1963).

In Case 2 the plaintiff-insured sustained a theft loss of 39,575 dollars of insured property for which defendant-insurer refused to reimburse him. The insurance policy contained a provision[2] almost identical with that in Case 1 and the issue presented for decision was the same. Insured brought the initial action in the Illinois state court and the insurer removed the case to the federal district court. When the insured sought to remand to the state court, the insurance company argued: (1) that the language does not constitute a waiver

1. Hasek v. Certain Lloyd's Underwriters, 228 F. Supp. 754 (W.D. Mo. 1963).

2. "It is agreed that in the event of the failure of the Company to pay any amount claimed to be due hereunder, the Company, at the request of the Assured, will submit to the jurisdiction of any court of competent jurisdiction within the United States and will comply with all requirements necessary to give such Court jurisdiction and all matters arising hereunder shall be determined in accordance with the law and practice of such court." Euzzino v. London & Edinburgh Ins. Co., 228 F. Supp. 431, 432 (N.D. Ill. 1964).

of the right of removal, and (2) even if it should be construed as a waiver it is invalid as an unreasonable limitation of the court's jurisdiction. *Held,* motion to remand granted. The contractual limitation was valid, and since the insured clearly had the right to choose his forum, the insurance company was not entitled to remove the case. *Euzzino v. London & Edinburgh Insurance Co., Ltd.,* 228 F. Supp. 431 (N.D. Ill. 1964). Thus within the space of one year diametrically opposed holdings on this issue have emanated from two federal district courts.

Authority in this field indicates a dichotomy between those courts which regard provisions for the limitation of the jurisdiction of courts as invalid per se and those which decide the issue of validity on the basis of the reasonabless of each individual provision. The traditional majority view of invalidity per se had its inception in the 1874 United States Supreme Court decision of *Insurance Co. v. Morse,*[3] in which the Court was called upon to rule on the constitutionality of a Wisconsin statute that required insurance companies, as a prerequisite to doing business in the state, to include in their policies a provision in which they agreed not to remove to the federal courts any action brought against them in state courts. In holding these agreements invalid, the Court reasoned syllogistically: (1) A eitizen may not barter away his substantial rights.[4] (2) The right to resort to the courts of the land is a substantial right.[5] (3) Therefore a citizen may not barter away his right to resort to the courts. After discussing cases tending to show that the law was well settled on this point,[6] Mr. Justice Hunt concluded: "The agreement of the insurance company derives no support from an unconstitutional statute and is void, *as it would be had no such statute been passed.*"[7] With few dissents,[8] this rule remained unchallenged until 1949, when Judge Learned Hand formulated the modern minority rule in a dictum in the case of *Krenger v. Pennsylvania R.R.*[9] In the interim from 1874 to 1949 the American Law Institute reflected the doctrine of ille-

3. 87 U.S. (20 Wall.) 445 (1874).

4. *Id.* at 451.

5. This right is based on the Judiciary Act ch. 20, § 12, 1 Stat. 73 (1789). The Wisconsin statute in issue in the Morse case was invalidated as heing repugnant to this federal statute.

6. *E.g.,* Scott v. Avery, 5 H.L. 811, 10 Eng. Rep. 1121 (1856); Thompson v. Charnock, 8 T.R. 139, 101 Eng. Rep. 1310 (1799); Kill v. Hollister, 1 Wils. K.B. 129, 95 Eng. Rep. 532 (1746).

7. 87 U.S. (20 Wall.) at 458. (Emphasis added.)

8. See, *e.g.,* Daley v. People's Bldg., Loan & Sav. Ass'n, 178 Mass. 13, 59 N.E. 452 (1901); Detwiler v. Lowden, 198 Minn. 185, 269 N.W. 367 (1936); Gitler v. Russian Co., 124 App. Div. 273, 108 N.Y. Supp. 793 (1908).

9. 174 F.2d 556 (2d Cir. 1949).

gality of court-limiting bargains in the *Restatement of Contracts*, section 558:

> A bargain to forego a privilege, that would otherwise exist, to litigate in a Federal Court rather than in a State Court, or in a State Court rather than in a Federal Court, or otherwise to limit unreasonably the tribunal to which resort may be had for the enforcement of a possible future right of action or the time within which a possible future claim may be asserted, is illegal.[10]

The *Krenger* case, involving an employee's agreement not to sue except in the state where the injury occurred, provided Judge Hand with the opportunity to inject new reasoning into this aspect of the law by placing a different interpretation on the "limiting unreasonably" portion of the *Restatement*:[11]

> In truth, I do not believe that, today at least, there is an absolute taboo against such contracts at all; in the words of the Restatement, [Section 558] they are invaild only when unreasonable . . . . What remains of the [invalid per se] doctrine is apparently no more than general hostility, which can be overcome, but which nevertheless does persist.[12]

Out of this dictum[13] emerged a new criterion for determining the validity of limiting provisions—the unreasonableness test: agreements between contracting parties to bring suit only in certain courts are not invalid per se but shonld be invalidated only if they are unreasonable. In determining the unreasonableness of a court-limiting provision, the courts consider the relative bargaining power of the contracting parties, the mutuality of benefit, and, if necessary to safeguard public policy, they look beyond the agreement to ascertain the reason for the inclusion of such a provision in the policy. If, after this scrutiny, the agreement does not seem unreasonable, advocates of the modern rule give efficacy to the contract. Conversely, adherents to the traditional rule, citing *Insurance Co. v. Morse*,[14] invalidate such provisions without any consideration on the merits, reasoning that the parties cannot barter away their right to resort to the courts, and that they cannot agree to oust courts of jurisdiction.[15]

10. RESTATEMENT, CONTRACTS § 558 (1932); *cf.* RESTATEMENT, CONFLICT OF LAWS § 617, comment *a* (1934): "Parties to a contract may provide that all actions for breach of the contract shall be brought only in a certain court, and the courts of other states will usually give effect to such a provision; but the requirement can be imposed only by consent of the parties and as a term of a contract. If the parties agree, it is not like the case of one state prescribing by its statute what the courts of another state may do."

11. RESTATEMENT, CONTRACTS § 558 (1932).

12. 174 F.2d at 561 (concurring opinion).

13. This is not the holding of the case since Judge Hand was writing a concurring opinion. The majority opinion of Judge Clark disposed of the case on a statutory basis.

14. *Supra* note 3.

15. See note 5 *supra* and accompanying text.

The minority counters this with the argument that the dictum in *Insurance Co. v. Morse*,[16] is outmoded since it relied on precedent which held that agreements to submit disputes to arbitration were invalid as against public policy in seeking to oust courts of jurisdiction.[17] The modern minority theory is that since arbitration agreements have subsequently been upheld,[18] the public policy arguments against them have been repudiated; and, since the public policy arguments against court-limiting agreements are the same as those repudiated in the arbitration agreements, they should also be repudiated in these cases. The minority reasons that if an agreement completely to forego resort to the courts is valid then agreements to allow one party to choose the court should no longer be invalidated as per se against public policy.

In further support of the modern rule, the minority points to the fact that the law controlling the court-limiting agreements differs depending on whether the cause of action is in existence at the time of the making of the agreement. If the cause of action is already in existence, a majority of courts will uphold the provisions on the ground that this is a matter that is concerned only with venue and may be properly affected by the consent of the parties, while a small minority invalidate these provisions on the ground of public policy violation.[19] As discussed above, the majority of the courts invalidate the agreements if the cause of action has not yet arisen, thus making the time of the agreement determinative of the validity of the provision. Judge Learned Hand attempted to reconcile this apparent inconsistency by reasoning that if a party is given the choice of where to sue on an existing claim, there is no compelling reason that he should not have the same choice before the claim has arisen.[20] He deprecated the view that the existence of the cause of action should be determinative of the validity of the agreement, concluding that each agreement should be upheld or invalidated solely on the basis of its reasonableness.[21]

In analyzing these federal court cases it should be borue in mind that there is no present federal policy against an avoidance of federal

16. This case was disposed of on the basis of the repugnancy of the Wisconsin statute to the federal statute, but Mr. Justice Hunt made it clear that the decision would have been the same even if no statute had existed and the agreement had been voluntary. See note 7 *supra* and accompanying text.

17. See cases cited in note 6 *supra* and accompanying text.

18. See FORKOSCH, LABOR LAW § 298 (1953), for a discussion of the agreement to arbitrate.

19. That these agreements are invalid see Akerly v. New York Cent. Ry., 168 F.2d 812 (6th Cir. 1948). For a good discussion of the existing cause of action cases see Annot., 56 A.L.R.2d 324 (1957).

20. 174 F.2d at 560.

21. *Id.* at 561.

jurisdiction.[22] This is manifested by the fact that federal courts allow jurisdiction to be defeated by several devices, including assignment,[23] lowering the amount requested in the complaint,[24] and appointment of guardians or administrators to establish the same state citizenship as the adversary.[25] In one of the assignment cases, the United States Supreme Court, knowing that the sole purpose of the assignment was to prevent removal by the defendant from the state to the federal court, upheld the assignment, stating: "[I]t may, perhaps, be a good defense to an action in a State court, to show that a colorable assignment has been made to deprive the United States court of Jurisdiction; but . . . not a ground of removing that cause into the Federal court."[26] Federal jurisdiction has had much the same treatment from the Congress in that, although it has taken positive action to prohibit collusive joinder to create federal jurisdiction,[27] it has not taken similar action to preclude collusive joinder to avoid federal jurisdiction. Additionally, by federal statute,[28] remand orders are not subject to review by appellate courts; this statute, when considered with the foregoing analysis, indicates that Congress and the federal courts have not been seriously concerned with protection of the right to remove to the federal courts.

The instant cases well illustrate the two approaches to the problem of court-limiting agreements. Case 1 typifies the traditional view in that Judge Gibson, although alluding to the unreasonableness of the agreement, actually rejected the provision as invalid per se.[29] He held that the agreement was an "unreasonable limitation of jurisdiction"[30] and would thus be void, although he presented no reasons for so holding. The court, rejecting plaintiff's contention that the essence of the provision was the right of the insured to choose the

22. 3 MOORE, FEDERAL PRACTICE ¶ 17.05, at 1320 (2d ed. 1963); WRIGHT, FEDERAL COURTS § 31 (1963).

23. Oakley v. Goodnow, 118 U.S. 43 (1886); Provident Sav. Life Assur. Soc'y, v. Ford, 114 U.S. 635 (1885); see also a general discussion in 3 MOORE, *op. cit. supra* note 22, at 1320.

24. This could be a costly method of avoiding federal jurisdiction if the claim is possibly worth more than the 10,000 dollar requisite for federal jurisdiction.

25. Mecom v. Fitzsimmons Drilling Co., Inc., 284 U.S. 183 (1930).

26. Oakley v. Goodnow, *supra* note 23, at 46.

27. Judiciary Revision Act, 28 U.S.C. § 1359 (1958) states: "A district court shall not have jurisdiction of a civil action in which any party, by assignment or otherwise, has been improperly or collusively made or joined to invoke the jurisdiction of such court."

28. 28 U.S.C. § 1447(d) (1958): "An order remanding a case to the State court from which it was removed is not reviewable on appeal or otherwise." However title 9, § 901 of the Civil Rights Act of 1964, Pub. L. No. 88-352, 88th Cong., 1st Sess. (July 2, 1964), amended this section to make civil rights cases which are remanded appealable.

29. 228 F. Supp. at 755.

30. *Ibid.*

court, emphasized the phrase "competent court" and reasoned that the gist of the clause was that "the defendant would submit to the jurisdiction of a court of competent jurisdiction, but would not submit to the jurisdiction of a tribunal which was not competent to hear the cause."[31] This interpretation rendered the clause ineffective, since it is unnecessary for parties to contract to submit only to courts of competent jurisdiction.

Case 2 provides an excellent example of the application of the modern rule in that Judge Will carefully considered the drafting of the provision by the insurance company and their inclusion of the phrase "at the request of the Assured."[32] In order to give efficacy to this language the court concluded, "Unless all of these provisions are to be deemed mere surplusage, the conclusion is unavoidable that the policy accords to the assured the right to choose the court of competent jurisdiction in which disputes are to be determined."[33] Dispelling defendant's contention that the *Restatement of Contracts* regards such agreements as illegal, Judge Will followed the modern interpretation that the agreements are invalid only if unreasonable.[34] In this case the court looked behind the agreement, considered the language used and the source of that language, and concluded that the agreement should be upheld.

While it is true that Case 1 purports to express the minority view, it is submitted that it actually follows the invalid per se majority view, and that Case 2 which applies the reasonableness test and gives effect to the agreement, is the better reasoned decision. Under the reasoning of Judge Will in Case 2, the clause has a purpose in the contract and its language is carefully weighed and then given effect, while under Judge Gibson's interpretation the clause neither adds to nor detracts from the contract. Aside from the reasoning of the judges, the result in Case 2 is more equitable when consideration is given to the additional factors that: (1) there is a maxim in insurance law that provisions in insurance contracts should be construed strictly against the insurer who is the author of the policy;[35] (2) insurance companies should not be heard to complain when provisions which they drafted into their own policies are given effect

31. *Id.* at 754.
32. 228 F. Supp. at 433.
33. *Ibid.*
34. *Ibid.*
35. This is a maxim of construction that is generally applicable to written instruments, *e.g.*, a deed is construed against the grantor. However this construction should be particularly appropriate when there has been no arms-length bargaining between the parties regarding the contents of the instrument as in a contract of adhesion such as an insurance policy. VANCE, INSURANCE § 41 (3rd ed. 1951).

by the courts;[36] (3) there is no difficulty due to unequal bargaining power since the stronger party, the insurer, is seeking to have its own provision invalidated; (4) there is benefit accruing to each of the parties since the insurer gains a selling point in a highly competitive business and the insured gets the privilege of choosing the forum for disputes that arise; (5) parties should be allowed to have full efficacy given to their contracts as they make them unless contrary to public policy. The reasonableness rule is further enhanced by the foregoing analysis that the traditional public policy arguments urged against these clauses have been repudiated in the upholding of arbitration agreements,[37] that an overwhelming majority of courts would uphold these provisions if the cause of action had existed at the time of the making of the contracts,[38] and that neither the United States Supreme Court nor the Congress has a policy against devices to defeat federal jurisdiction.[39] Thus it is submitted that in order to bring the law in this area up to date, the modern reasonableness rule should be adopted and that contractual provisions providing for litigation to be brought in a court of competent jurisdiction chosen by one of the contracting parties should be declared invalid only if they are unreasonable when considered in the light of the facts of each case.[40]

36. Counsel for the insurance company argued that in submitting to the jurisdiction of the state court they had complied with the provision and having so complied they exercised the right to remove to the federal court. Another possible interpretation of the disputed clauses is that the insurer agrees to voluntarily submit for service of process in the jurisdiction of the court chosen by the insured. Under this interpretation the insurer would not waive the right of removal to the federal court.

37. See note 18 *supra* and accompanying text.

38. See, *e.g.*, note 26 *supra* and accompanying text.

39. See notes 26 & 27 *supra* and accompanying text.

40. See, *e.g.*, General Phoenix Corp. v. Malyon, 88 F. Supp. 502, 503 (S.D.N.Y. 1949), in which the court upheld a provision identical to that in Case 2 stating that the provision "merely restricts the defendant to the Court in which suit is first begun against it, be it Federal or State. Possibly, Lloyd's intended the clause to be merely an agreement to submit to jurisdiction, as defendant suggests, but it is somewhat of a strain to find such intention, whereas the simple verbiage of the clause supports the [insured's] view." Another type of contract that presents the same issue as the insurance provision is the maritime contract where the contracting parties are residents of different countries and the contract provides that the litigation shall be brought in a certain country's courts. The trend in that area has been to follow Judge Hand's test and hold the provisions invalid ouly if unreasonable. See William H. Muller & Co. v. Swedish Am. Line Ltd., 224 F.2d 806 (2d Cir.), *cert. denied*, 350 U.S. 903 (1955).

## Labor Law—Closing of Plant Due to Unionization

On September 6, 1956, the Textile Worker's Union of America, following a heated campaign marked by management threats to close the plant and to blacklist union adherents if unionization occurred, won an election to represent the workers at defendant's plant. On September 12, 1956, defendant's board of directors adopted a resolution recommending liquidation to the stockholders. This recommendation was adopted by the shareholders on October 17, 1956, and liquidation was completed by a sale at auction of the plant machinery and equipment on December 12 and 13, 1956. Since that time defendant has not operated any plant in South Carolina or elsewhere. In an action brought by the Union, the National Labor Relations Board ruled that defendant, by closing its plant, liquidating the corporation, and discharging its employees because of anti-union bias, had committed an unfair labor practice in violation of section 8(a)(3) of the Labor Management Relations Act.[1] The NLRB ordered defendant to pay back-wages to these employees until they were able to find substantially equivalent employment elsewhere or were put on a preferential hiring list by the parent organization, Deering Milliken, Inc., and ruled that Deering Milliken and its affiliates were liable for payment of these wages on the ground that defendant was so allied with Deering Milliken, Inc., that they constituted a single employer.[2] The Court of Appeals for the Fourth Circuit[3] was petitioned by defendant to set aside the order; by the union to enlarge the order to include reopening of the plant with reinstatement of the discharged employees and to render Roger Milliken[4] personally liable for its enforcement; and by the Board to enforce its order. *Held,* enforcement of the order denied. A corporate employer's decision to close its plant due to unionization is not an unfair labor practice when the employer goes completely out of business and the sale of the corporation's plant is entire, bona fide, and irrevocable. *Darlington Manufacturing Co. v. NLRB,* 325

1. "It shall be an unfair labor practice for an employer . . . by discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in a labor organization. . . ." Labor Management Relations Act (Taft-Hartley Act) § 8(a)(3), 61 Stat. 140 (1947), 29 U.S.C. § 158(a)(3) (1958).

2. Darlington Mfg. Co., 139 N.L.R.B. 241 (1962).

3. Board orders are directly appealable to the court of appeals. Labor Management Relations Act (Taft-Hartley Act) § 10(e), (f), 61 Stat. 147-48 (1947), 29 U.S.C. § 160(e), (f) (1958).

4. The majority of the stock in both Darlington and Deering Milliken was owned by Roger Milliken or members of the Milliken family. Darlington Mfg. Co. v. NLRB, 325 F.2d 682, 683 (4th Cir. 1963), *cert. granted,* 377 U.S. 903 (1964).

F.2d 682 (4th Cir. 1963), *cert. granted*, 377 U.S. 903 (1964).

Previous Appellate decisions involving violations of section 8(a)(3) have never squarely decided the question whether an employer may close his business because of anti-union feeling.[5] However, a threat to close a business if unionization occurs has always been held to be an unfair labor practice under section 8(a)(1) of the act as a restraint or coercion of employees in the exercise of their rights.[6] It is equally clear that closing or eliminating a section of a business solely because of unionization of that section is an unfair labor practice because it constitutes discrimination with regard to hire or tenure under section 8 (a)(3) of the act.[7] In these situations the motive of the employer has been the determining factor, since it has been assumed that under the Labor Management Relations Act an employer has the right to discharge an employee or change his place or method of operation for any reason so long as he is not motivated by pro- or anti-union feeling.[8] The two other primary motivations for discontinuing business are economic necessity and capricious whim; no cases have arisen involving the latter. In assessing economic necessity, the courts had to weigh the relative strength of economic and anti-union motivation, a violation of the act being found where the union was the primary cause of the change in operations.[9] The question whether an employer can close for anti-

5. Darlington Mfg. Co., *supra* note 2, at 250. However, the National Labor Relations Board has subsequently ruled in the *Star Baby* case that a partnership which dissolved due to unionization violated section 8(a)(3) and was liable to discharged employees for back-pay until such time as the employees could find substantially equivalent employment. Star Baby Co., 140 N.L.R.B. 678 (1963), *modified*, 334 F.2d 601 (2d Cir. 1964). See also Yoseph Bag Co., 128 N.L.R.B. 211 (1960), *remanded for specific findings*, 294 F.2d 364 (3d Cir. 1961), *findings made*, 139 N.L.R.B. 1310 (1962); Barbers Iron Foundry, 126 N.L.R.B. 30 (1960).

6. "It shall be an unfair labor practice for an employer—(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 157 of this title. . . ." Labor Management Relations Act (Taft-Hartley Act) § 8(a)(1), 61 Stat. 140 (1947), 29 U.S.C. § 158(a)(1) (1958). "Employees shall have the right to self-organization, to form, join, or assist labor organization. . . ." Labor Management Relations Act (Taft-Hartley Act) § 7, 61 Stat. 140 (1947), 29 U.S.C. § 157 (1958). NLRB v. West Coast Casket Co., 205 F.2d 902 (9th Cir. 1953); Stokely Foods v. NLRB, 193 F.2d 736 (5th Cir. 1952).

7. NLRB v. Town & Country Mfg. Co., 316 F.2d 846 (5th Cir. 1963); NLRB v. Preston Feed Corp., 309 F.2d 346 (4th Cir. 1962) (economic motive found); Jay's Foods Inc. v. NLRB, 292 F.2d 317 (7th Cir. 1961) (economic motive found); NLRB v. Lassing, 284 F.2d 781 (6th Cir. 1959) (economic motive found); NLRB v. R. C. Mahon Co., 269 F.2d 44 (6th Cir. 1959) (economic motive found).

8. MANOFF, LABOR RELATIONS LAW 83 (1958); NEWMAN, LABOR RELATIONS 49 (1953).

9. This is not to say that the advent of the union cannot be considered as a purely economic factor in determining motivation for changes. Thus a company may consider the probability of higher wages after unionization as a factor when considering a change in operations. NLRB v. Lassing, *supra* note 7.

union reasons has also been presented in the similar, but distinguishable, situations of the "runaway shop,"[10] sale of a business,[11] or the corporate liquidation and reorganization of a business.[12] In *NLRB v. New Madrid Manufacturing Co.*,[13] it was said by way of dictum that an employer always has an absolute right permanently to close and go out of business for any reason, including animosity toward a union, without subjecting himself to liability under the Labor Management Relations Act. It has also been stated that one of the weapons granted employers in labor relations under the act is the right to go out of business entirely.[14] Support for this position is found in the analogous situation involving violation of section 8(a)(5)[15] for failure to bargain concerning termination of employment due to liquidation of the corporation.[16] The obligation of management to bargain relates only to termination and post termination rights and not to the fact of termination itself. Thus by inference the act applies only to the rights arising from the existence of the employer-bargaining unit relation and not to the existence of the employer or the union as a unit. However, the NLRB itself has now stated in *Fibreboard*[17] that a management decision to subcontract a particular work function out of an existing bargaining unit was a mandatory bargaining subject notwithstanding the employer's valid economic reasons and the absence of discriminatory purposes.

The court in the instant case states that: "The fundamental purpose of the National Labor Relations Act is to preserve and protect the rights of both industry and labor so long as they are in the relationship of employer and employee. But the statute's scope does not exceed that province."[18] Thus an employer may end the employ-

10. Rome Products Co., 77 N.L.R.B. 1217 (1948) (no economic motive found); Gerity Whitaker Co., 33 N.L.R.B. 393 (1941), *enforced per curiam*, 137 F.2d 198 (6th Cir. 1942), *cert. denied*, 318 U.S. 801 (1942) (no economic motive found). A "runaway shop" exists when a business is moved to another area in an attempt to escape unionization.

11. NLRB v. Missouri Transit Co., 250 F.2d 261 (8th Cir. 1957) (no economic motive found).

12. NLRB v. Tupelo Garment Co., 122 F.2d 603 (5th Cir. 1941).

13. 215 F.2d 908, 914 (8th Cir. 1954). This position was indirectly approved in the Missouri Transit case, *supra* note 11, which distinguished the *New Madrid* decision on the ground that New Madrid had gone completely out of business.

14. Union Drawn Steel v. NLRB, 109 F.2d 587, 593 (3d Cir. 1940).

15. "It shall be an unfair labor practice for an employer . . . to refuse to bargain collectively with the representatives of his employees. . . ." Labor Management Relations Act (Taft-Hartley Act) § 8(a)(5), 61 Stat. 141 (1947), 29 U.S.C. § 158(a)(5) (1958).

16. Phillips v. Burlington Indus., 199 F. Supp. 589 (N.D. Ga. 1961).

17. NLRB v. Fibreboard Paper Products Co., 130 N.L.R.B. 1558 (1961), *rev'd on rehearing*, 138 N.L.R.B. 550 (1962), *enforced*, 322 F.2d 411 (1963), *cert. granted*, 375 U.S. 963 (1964).

18. 325 F.2d at 685. This statement is questionable in the light of the Act's require-

ment relation for anti-union reasons so long as he pays the price of a total and permanent cessation of his business. While conceding that courts generally mention the presence or absence of economic factors in determining violations of section 8(a)(3), the court pointed out, in contrast to the opinions of the Board and the dissenting judges here, that the presence of these factors is not mentioned as indispensable.[19] It then pointed out that a complete cessation of business has been considered by some courts to be an absolute prerogative of management. Since Darlington's total dissolution was not an unfair labor practice the extension of liability to Deering Milliken by the single employer principle was necessarily precluded as was any enlargement of the Board's order to include Roger Milliken personally.[20]

The primary weakness of the court's opinion is its lack of supporting authority. It is true that decisions on similar points do not specifically declare that a legitimate economic motive is indispensable to the right to close, but the absence of such a declaration probably indicates that this issue was not before the courts rather than support for a right to close for anti-union feeling. In terms of the discriminatory labor practices prohibited by the Labor Management Relations Act, it is difficult to distinguish between closing down an entire operation and closing only a segment of that operation due to anti-union bias, the latter clearly being a violation of the act.[21] The difference becomes even less apparent when considered in the light of the stated purpose of the act, which is to promote interstate commerce.[22] Also, while it has long been held that a threat to close if unionization occurs is a violation of the act,[23] the decision here would allow this threat to be carried out with impunity. The consequences of such an anomalous situation are readily apparent in an industry characterized by a close connection between the managements of many different mills. If management can close one of its mills due to unionization, workers in the remaining mills will be very hesitant to attempt unionization. The primary difficulty in cases such as these lies in discovering an adequate remedy. The courts have generally refrained from ordering reopening of even a segment of a business, and the ordering of reinstatement is a futile

ments concerning organizational picketing which are applicable before an employment relation is credited. Labor Management Relations Act (Taft-Hartley Act) § 8(b)(7), 73 Stat. 542 (1959), 29 U.S.C. § 158(b)(7) (Supp. V, 1959-63).

19. *Id.* at 686.

20. *Id.* at 687.

21. See note 7 *supra.*

22. Labor Management Relations Act (Taft-Hartley Act) § 1, 61 Stat. 137, 29 U.S.C. § 141 (1958).

23. See note 6 *supra.*

gesture where the liquidation is complete. If however the corporation has not yet shut down, a temporary injunction against closing might be granted until a judicial determination of the motivation for closing his been made. The Board's solution of ordering back-pay until substantially equivalent employment is found is satisfactory only where someone remains to be held liable for the payment of these wages. Should a case arise where there was no one left the problem of finding an adequate remedy might well prove insurmountable. There is a possibility that the Supreme Court will avoid determining the question of the right to go out of business for anti-union reasons by a finding that Darlington's closing was for legitimate economic reasons, that is, a fear that the payment of higher union wages would make the operation unprofitable.[24]

## Labor Law—National Labor Relations Act—Strike by Minority of Union as Protected Concerted Activity When in Support of Union Position

Eight employees, all members of the union certified as the authorized bargaining representative, walked off the job during the morning shift without giving any form of notice to the employer in support of union demands for more frequent negotiations with management. At a union meeting the previous evening, where the difficulties in getting the employer to negotiate were enumerated, the union representative advised against striking, but he did not forbid the subsequent walkout. Four and one-half hours after the walkout the union's negotiating committee informed the employer that the striking union members would like to return to work. To this and later applications the employer replied that the men were "under investigation" and would not be reinstated until the investigation was completed. Upon learning of the walkout, the employer cancelled the afternoon work shift and replaced the strikers with the men who had been scheduled to work in the afternoon. The Board found that the employer had built up an excessive inventory in one area of production and, consistent with his policy of providing work, had instituted double production in another area; hence the extra work shift in the afternoon. This arrangement was abandoned because of the walkout.

24. See Star Baby Co., *supra* note 5, where the NLRB found a refusal to bargain for discriminatory reasons but the Court of Appeals found an economic motivation.

The striking workers were not recalled until an increased demand for production caused the employer to offer to reinstate them the following week. The NLRB Regional Director issued a complaint seeking reinstatement and charging the employer with unfair labor practices by interfering with employees in the exercise of their section 7[1] rights,[2] and by discriminating with regard to tenure of employment in discouraging membership in a labor organization.[3] The employer maintained that he was justified in delaying reinstatement because the striking workers did not represent the union, and that there had been no discrimination because the excessive inventory justified the postponing of reinstatement. The NLRB found that the walkout was protected concerted activity, and that the employer had discriminated in delaying reinstatement. The Board ordered the employer to cease and desist from discouraging union membership and to pay the strikers back-pay with interest. On petition to the Fifth Circuit Court of Appeals, *held*, order enforced. A minority walkout is protected concerted activity if it is in support of, rather than contrary to, the position of the union. *NLRB v. R. C. Can Co.*, 328 F.2d 974 (5th Cir. 1964).

The stated purpose of the National Labor Relations Act is to protect the right of employees to organize and bargain collectively through agents of their own choosing in order to safeguard commerce from those injuries and interruptions inherent in "industrial strife and unrest."[4] Pursuant to this purpose, section 7 of the act broadly protects the employees' right to self-organization. Employees may not be punished for, or enjoined from, the exercise of that right,[5] and employer interference with such protected concerted activity is made an unfair labor practice and thus prohibited under section

1. National Labor Relations Act § 7, 49 Stat. 452 (1935), as amended, 29 U.S.C. § 157 (1958), which provides in relevant part that "Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities . . . ."

2. National Labor Relations Act § 8(a)(1), 49 Stat. 452 (1935), as amended, 29 U.S.C. § 158(a)(1) (1958), which provides that "It shall be an unfair labor practice for an employer—(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7."

3. National Labor Relations Act § 8(a)(3), 49 Stat. 452 (1935), as amended, 29 U.S.C. § 158(a)(3) (1958), as amended, 29 U.S.C. § 158(a)(3) (Supp. V, 1963), which provides in relevant part that "It shall be an unfair labor practice for an employer . . . (3) By discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization . . . ."

4. 49 Stat. 449 (1935), as amended, 29 U.S.C. § 151 (1958).

5. CCH 1964 GUIDEBOOK TO LABOR RELATIONS § 301 (5th ed.) [hereinafter cited as GUIDEBOOK].

8[6] of the act.[7] Therefore, employees, as a whole, have the right to organize in order to bargain collectively with the employer through majority action.[8] Implicit in this right of self-organization is the right to strike in order to aid in the attainment of lawful labor objectives,[9] although this right is not unqualified.[10] Employee activities or practices regarded as inimical to the status, process, or product of collective bargaining are not protected concerted activities within the meaning of section 7.[11] Of these practices, it has been said that few are more "harmful and demoralizing" to the collective bargaining process than the "wildcat strike" in which a recalcitrant minority takes a position in conflict with that of its bargaining representative.[12] If such activity were protected, the employer would be placed in the unenviable position of having to deal with conflicting demands as it would be an unfair labor practice for him to discharge or otherwise discipline the strikers under section 8. Further, as such a development tends to erode the position of the bargaining representative, it follows that "national unions and their representatives usually are very vigorous and sincere in their desire to avoid wildcat strikes."[13] As a result of these underlying considerations the employer need not bargain with the minority group or their representative when faced with this situation,[14] and, in fact, he may be guilty of an unfair labor practice if he insists on so doing.[15] In other words, if the minority strikes it is at its peril, insofar as compulsory reinstatement is concerned, should the employer choose to exercise his prerogative of discharge.[16] This is the case whether the minority's action is in violation of a "no-strike" clause in an agreement duly negotiated by the authorized bargaining representative,[17] prohibited or disclaimed by the representative,[18] or in support of a minority union seeking

6. 49 Stat. 452 (1935), as amended, 29 U.S.C. § 158 (1958), as amended, 29 U.S.C. § 158(a)(3) (Supp. V, 1963).
7. GUIDEBOOK § 301.
8. National Labor Relations Act § 9(a), 49 Stat. 453 (1935), as amended, 29 U.S.C. § 159(a) (1958); NLRB v. Draper Corp., 145 F.2d 199 (4th Cir. 1944).
9. National Labor Relations Act § 13, 49 Stat. 457 (1935), as amended, 29 U.S.C. § 163 (1958); GUIDEBOOK § 1101.
10. *Ibid.*
11. See Harnischfeger Corp. v. NLRB, 207 F.2d 575 (7th Cir. 1953).
12. NLRB v. Draper Corp., *supra* note 8.
13. Handsaker, *Arbitration and Discipline for Wildcat Strikes*, 14 LAB. L.J. 395, 398 (1963).
14. NLRB v. Indiana Desk Co., 149 F.2d 987 (7th Cir. 1945).
15. Medo Photo Supply Corp. v. NLRB, 321 U.S. 678 (1944).
16. NLRB v. Indiana Desk Co., *supra* note 14.
17. Western Cartridge Co. v. NLRB, 139 F.2d 855 (7th Cir. 1943); Administrative Rulings of NLRB General Counsel, Case No. F–333, 42 L.R.R.M. 1218 (1958).
18. NLRB v. Sunbeam Lighting Co., 318 F.2d 661 (7th Cir. 1963); Administrative Rulings of NLRB General Counsel, Case No. F–619, 42 L.R.R.M. 1484 (1958).

recognition.[19] However well established these rules may be, it is conversely true that within certain limitations minority group activity in the presentation of a grievance is protected[20] as long as such action is not expressly or inherently violative of an agreement between a union and an employer[21] and is not devoid of all union sanction.[22] This is especially true where the action taken is in support of the representative's policies, the demands of the minority and the union being one and the same.[23] Further, there appears to be no reason for depriving the minority of protection where the representative lends his support to the strikers,[24] rather than repudiating the action in question.

The majority in the instant case laid down a test for determining whether minority action is protected by combining the reasoning expressed in *NLRB v. Draper Corp.*[25] with that of the court in *Western Contracting Co. v. NLRB*:[26] If the action of the minority is in criticism of, or is in opposition to, the policies and actions theretofore taken by the organization, it is unprotected activity. However, if it is more nearly in support of the things the union is trying to accomplish, the minority is protected.[27]

Once having adopted this test, the majority's decision turned on factual considerations. Examining the evidence, including the meeting the night before the walkout and the content of certain union handbills, the court found that the union's aim was "to get the Employer to sit down and talk." Since this was the avowed purpose of the strikers, there was a sufficient similarity of purpose to find the walkout protected concerted activity. The majority further emphasized the fact that, although the walkout was unannounced, it did not place the employer in the "quandary" of having to choose between conflicting demands. Also, there can be little doubt that the short duration of the strike influenced the court's decision. Therefore, on these facts, the court sustained the Board's finding of violations of sections 8(a)(1) and 8(a)(3) of the act.[28] The dissenting judge, in

19. NLRB v. Brashear Freight Lines, Inc., 119 F.2d 379 (8th Cir. 1941).
20. NLRB v. Kearney & Trecker Corp., 237 F.2d 416 (7th Cir. 1956).
21. NLRB v. American Mfg. Co. of Texas, 203 F.2d 212 (5th Cir. 1953).
22. NLRB v. J. I. Case Co., 198 F.2d 919 (8th Cir. 1952), *cert. denied,* 345 U.S. 917 (1953).
23. Western Contracting Co. v. NLRB, 332 F.2d 893 (10th Cir. 1963).
24. *Ibid.*
25. *Supra* note 8.
26. *Supra* note 23.
27. The reasoning of the court is paraphrased.
28. For a more extended discussion of § 8(a)(3) violations see generally, Local 357, Teamsters Union v. NLRB, 365 U.S. 667 (1961); Radio Officers' Union v. NLRB, 347 U.S. 17 (1954); NLRB v. Miranda Fuel Co., 326 F.2d 172 (2d Cir. 1963); NLRB v. Dalton Brick & Tile Corp., 301 F.2d 886 (5th Cir. 1962); NLRB v. W. L. Rives Co., 288 F.2d 511 (5th Cir. 1961). See also GUIDEBOOK § 801.

deciding that the walkout was unprotected, felt that there were "numerous cases from other Circuits directly in point and which should be controlling . . . ."[29] He further contended, after considering the evidence, that the majority's decision could not be justified even in the light of its own test. Finally, he could find no indication of an intent to discourage union membership, and thus no violation of section 8(a)(3).

The decision in the instant case, resting on the flimsy authority of a long series of cases that only allude to the right of a minority to take independent action, goes one step further and actually holds that such action is protected concerted activity. In doing so, it is making an application of dicta accompanying earlier pronouncements rather than a sudden and ill-advised departure from authority contained in earlier cases. A perusal of the two cases primarily depended upon by the dissenting judge will show that they are not directly in point. In *Draper* a date for a meeting between the union and management had already been decided upon, but the meeting was cancelled because of the sickness of the company superintendent. The minority, calling their action a "wildcat strike," walked out because they wrongly felt that the employer was "stalling." In *NLRB v. Sunbeam Lighting Co.*[30] the union was engaged in active negotiation with the employer and the minority strike occurred two days before the entire union body was to vote on the employer's "final offer." Thus, in both cases, the minority action was clearly at variance with the union's position as well as without its sanction. These situations are, of course, markedly different from that of the instant case where the union's aim—negotiation—was in common with that of the minority strikers.

There can be no doubt that difficulties will arise in applying the court's test to future situations of this type, but it would seem that the benefits resulting from the use of this test will outweigh any negative considerations. Perhaps the primary objection to the court's reasoning is that under its test a dissident minority will be free to engage in unauthorized activity whenever it feels that the union is moving too slowly. This objection, while significant, is not fatal since union discipline should be sufficient to keep a dissatisfied minority in check;[31] for if the bargaining representative forbids such action in the first instance, or repudiates it altogether, the activity will no longer be protected. Of course, the employer cannot be faced

29. NLRB v. R. C. Can Co., 328 F.2d 974, 983 (5th Cir. 1964).
30. *Supra* note 18.
31. See Handsaker, *Arbitration and Discipline for Wildcat Strikes*, 14 LAB. L.J. 395 (1963).

with competing demands if the position of the minority strikers and the union are similar. Also, it will not be necessary for the employer to bargain with the minority group as the dispute may be resolved only by negotiating with the authorized representative.[32] The determination of whether minority activity is protected under this test will generally be a close question requiring the careful consideration of the facts peculiar to each case, but this certainly is not beyond the competence of either the Board or the courts. Thus, the chief objections to the application of the test are not insurmountable. At any rate, they are more than offset by the preclusion of the overly drastic and unfair withdrawal of all protection from minority strikers whose only offense is to act for their mutual benefit by strengthening the bargaining position of their representative.[33] One further possibility deserving mention at this time is that this decision may set a precedent whereby a union can select a minority to strike in order to enforce its demands. While the desirability of such a contingency is debatable, there appears to be no controlling reason, from the standpoint of either logic or policy, why a minority of the employees may not strike in a situation where all of them could legitimately strike.[34] However this and other questions may be resolved in the future, it appears that this court has struck a proper balance between the sometimes competing rights of the individual employee on the one hand, and those of the employer and the union on the other.

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

33. See Note, 59 HARV. L. REV. 747, 754 (1946).

34. See Western Contracting Co. v. NLRB, *supra* note 23. Note, however, the possible analogy between this situation and the cases where the employees wrongly attempt to strike and work at the same time. See, *e.g.*, C. G. Conn, Ltd. v. NLRB, 108 F.2d 390 (7th Cir. 1939).

# Labor Law—National Labor Relations Act—Union's Duty of Fair Representation Not Implicit in Section 7—Discrimination Based on Other Than Union Membership Not a Violation of Section 8(a)(3)

At the insistence of defendant union, an employer lowered one of its employees, a member of the union, to the bottom of its seniority list for an alleged violation of the collective bargaining agreement.[1] The National Labor Relations Board found that the employee had not violated the agreement and that the action of the union and employer had been taken for arbitrary reasons[2] and was, therefore, a violation of the union's duty to act fairly. The Board reasoned that this duty of fair representation is implicit under the basic individual rights accorded by section 7 of the National Labor Relations Act[3] and that by punishing the employee, the employer violated section 8(a)(1), which makes an employer's interference with an employee's exercise of section 7 rights an unfair labor practice. The union was found to have violated section 8(b)(1)(A), which prohibits the same interference on the part of a labor organization.[4] The Board produced a second basis for its decision by holding that the employer was guilty of an unfair labor practice under section 8(a)(3) in that he engaged in a discriminatory act which encouraged union membership and that the union was guilty of a violation of section 8(b)(2) for causing the employer to violate section 8(a)(3).[5] The Board petitioned the

1. The agreement designated the period from April 15 to October 15 as the slack season of the business and stated that employees were to take vacations only during that period. The violation of which the employee was accused was based on his departure from work on April 12 with the permission of the company. Because of illness, the employee returned to work after September 15, and the union based its original demand for the reduction of his seniority on this tardiness. Only after learning the cause of the employee's late return did the union base its demand on his early departure.

2. 140 N.L.R.B. 181 (1962).

3. "Employees shall have the right . . . to bargain collectively through representatives of their own choosing." National Labor Relations Act, 61 Stat. 136 (1947), as amended, 29 U.S.C. § 157 (1958).

4. "SEC. 8. (a) It shall be an unfair labor practice for an employer—(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7 . . . . (3) by discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization . . . . (b) It shall be an unfair labor practice for a labor organization or its agent—(1) to restrain or coerce (A) employees in the exercise of the rights guaranteed in section 7 . . . . (2) to cause or attempt to cause an employer to discriminate against an employee in violation of subsection (a)(3) . . . ." National Labor Relations Act, 61 Stat. 136 (1947), as amended, 29 U.S.C. § 158 (1958).

5. In the course of these proceedings, the Board has advanced four separate theories in support of its order. In the original hearing before the Board, 125 N.L.R.B. 454 (1959), it was held that the contract provision establishing a slack season was itself illegal. But a similar provision had been upheld in the Second Circuit in NLRB v.

United States Court of Appeals for the Second Circuit for enforcement of its order directing the union and the employer to cease and desist from their discriminatory activity.[6] *Held,* enforcement denied. A union's duty of fair representation is not implicit in section 7 of the National Labor Relations Act. Also, an act of discrimination which is based on considerations other than union membership or activity is not an unfair labor practice under section 8(a)(3) of the act. *NLRB v. Miranda Fuel Co.*, 326 F.2d 172 (2d Cir. 1964).

The duty of a statutory bargaining agent to represent fairly all the employees for whom it bargains was established in *Steele v. Louisville & N.R.R.*[7] The Court in that case reasoned that a labor union, even though it is a private organization, exercises a statutory authority to bargain for all employees and, acting in this quasi-public capacity, has a corresponding duty to represent them fairly.[8] Although in that case the statutory authority was conferred on the union by the Railway Labor Act,[9] the doctrine of the case was applied to unions certified under the National Labor Relations Act in *Syres v. Local 23,*

Meenan Oil Co., 266 F.2d 552 (2d Cir. 1959). The Board in *Miranda* again ruled that such a provision is illegal and refused to acquiesce in the *Meenan* decision, 125 N.L.R.B. 454, at 455 n.2. The Second Circuit continued to reject this argument in its first hearing of the *Miranda* case, NLRB v. Miranda Fuel Co., 284 F.2d 861 (1960). In that case, however, the court granted enforcement of the Board's order on the other ground advanced by the Board: that the practice of allowing the union to exercise full control over seniority is *per se* an unfair labor practice tending to encourage union membership. See Mountain Pacific Chapter of the Associated General Contractors, Inc., 119 N.L.R.B. 883 (1957). The defendants appealed to the Supreme Court, but, while the appeal was pending, the Supreme Court handed down its decision in Local 357, Teamsters Union v. NLRB, 365 U.S. 667 (1961). There the Court held that the Board's ruling that the very maintenance of a union hiring hall is *per se* an unfair labor practice exceeded the Board's authority under the act. So long as an agreement is not discriminatory on its face, the Board cannot assume that it will be enforced in a discriminatory manner, and although an unusual grant of power to a union may encourage union membership, the act outlaws only those actions which encourage or discourage union membership by means of *discrimination.* Thus actual evidence of discrimination must appear before a contract provision can be held to be an unfair labor practice. This case effectively destroyed the Board's *Mountain Pacific* doctrine and the argument in the instant case that a mere delegation to the union of control over seniority is an unfair labor practice, and at the Board's request the earlier decision was vacated and the case remanded to the Board for reconsideration in the light of *Local 357.* The Board then, in a 3-2 decision, entered the order which it seeks to enforce in the instant case and for the first time raised the argument that the union's section 9 duty of fair representation is implicit in section 7 of the act and the argument that any act of union discrimination tends to encourage union membership and is a violation of section 8(b)(2).

6. 125 N.L.R.B. 454, 457 (1959).

7. 323 U.S. 192 (1944). Federal jurisdiction in non-diversity cases was established in a companion case, Tunstall v. Brotherhood of Locomotive Firemen, 323 U.S. 210 (1944). In both cases, the bargaining agent had negotiated an agreement which would discriminate against Negro employees.

8. "It is a principle of general application that the exercise of a granted power to act in behalf of others involves the assumption toward them of a duty to exercise the power in their interest and behalf . . . ." 323 U.S. at 202.

9. 48 Stat. 1185 (1934), 45 U.S.C. §§ 151-88 (1958).

*Oilworkers Int'l Union.*[10] *Miranda,* however, is the first case in which the Board has argued that not only is the duty of fair representation enforceable in the courts but that any breach of this duty is subject to the jurisdiction of the Board as an unfair labor practice.[11] The argument advanced by the Board has been suggested before[12] and is, in essence, that the right of employees "to bargain collectively through representatives of their own choosing"[13] necessarily implies the right to be free from unfair discrimination practiced by the bargaining agent,[14] and that any such discrimination is therefore subject to the jurisdiction of the Board as an unfair labor practice under section 8(b)(1)(A).[15] The Board says that, since the employer lacks the statutory grant of power enjoyed by the union, his duty under section 8(a)(1) is less extensive.

The Board's other argument—that any discriminatory action urged on an employer by a union tends to encourage union membership and is an unfair labor practice under section 8(b)(2)—raises another point on which there is notably little authority. The typical cases in which unions have been held to have violated this section have involved discriminatory practices against employees who were non-union members,[16] supporters of another union,[17] or "troublemakers" within their own union.[18] In *Miranda,* however, there is no indication that the union's action was motivated by any dissatisfaction with the

10. 350 U.S. 892, *reversing* 223 F.2d 739 (5th Cir. 1955). In a per curiam opinion, the court merely cited *Steele* and other cases decided under the Railway Labor Act and reversed the Fifth Circuit's holding that the federal courts lacked jurisdiction. The case involved a contract which the union had entered and which would bar the promotion of Negro workers.

11. "A majority of the board has recently reached the novel conclusion that, under the general principle laid down in Steele v. Louisville & N.R.R. . . . a union violates the Act if it seeks unfair discrimination, even if that discrimination is not based on union membership or activity." NLRB v. Local 294, Teamsters Union, 317 F.2d 746, 749 n.4 (2d Cir. 1963). See also Winkler, *Apologia for the National Labor Relations Board,* PROCEEDINGS OF THE NEW YORK UNIVERSITY SIXTEENTH ANNUAL CONFERENCE ON LABOR 181 (1963).

12. See Cox, *The Duty of Fair Representation,* 2 VILL. L. REV. 151 (1957).

13. *Supra* note 4.

14. "Viewing these mentioned obligations of a statutory representative in the context of the right guaranteed employees by Section 7 of the Act to bargain collectively through representatives of their own choosing, we are of the opinion that Section 7 thus gives the employees the right to be free from unfair or irrelevant or invidious treatment by their exclusive bargaining agent in matters affecting their employment." 140 N.L.R.B. at 185.

15. *Supra* note 5.

16. See, *e.g.,* Philadelphia Woodwork Co., 121 N.L.R.B. 1642 (1958).

17. See, *e.g.,* C. Rasmussen & Sons, 122 N.L.R.B. 674 (1958).

18. See, *e.g.,* Imperato Stevedoring Corp., 113 N.L.R.B. 883 (1955). It has long been established that "union membership" refers not only to nominal membership in a union but also to loyalty of union members. See Radio Officers v. NLRB, 347 U.S. 17 (1953).

employee's conduct as a union member.[19] The Board argues that a union's success in prompting *any* act of discrimination tends to strengthen the influence of the union, thereby abandoning its earlier decisions on this point.[20] Two issues are raised by this contention of the Board: the issue whether such discrimination does in fact tend to encourage union membership and the issue whether, if actual encouragement is found, the union must also be found to have intended that the discrimination encourage union membership. A number of cases have held that some degree of intent to encourage or discourage union membership must appear if a violation of this subsection is to be found. In *Radio Officers v. NLRB*,[21] it was held that, although intent must be found, independent evidence of specific intent need not be presented. The Board is permitted to infer that the defendant intended the forseeable consequences of his acts. Although the theory advanced by the Board in *Miranda* has never been properly before the Supreme Court, the Court took cognizance of the Board's position in *Humphrey v. Moore*[22] without disapproving it. In two recent deci-

19. "Lopuch was a member of the Union, and there is nothing in the record that has been called to our attention to indicate that Lopuch had been disloyal to the Union, or had been guilty of any acts detrimental to the Union, or in any way transgressed the rules or policies of the Union. Nor is there anything to indicate he was regarded by Union officials as a troublemaker." 326 F.2d at 174.

20. Int'l Hod Carriers Union, 135 N.L.R.B. 865 (1962); Bricklayers Union, 134 N.L.R.B. 751 (1961). In each case, the Board found that the union had urged the employer to lay off outsiders rather than local residents but ruled that this was not an unfair labor practice, since it did not appear that there was any discrimination based on union membership. The Board's doctrine in *Miranda* has been developed in several recent decisions. In *Local 1070, United Bhd. of Carpenters,* it was said that "a discharge made to mollify a labor organization encourages membership in that organization and stands as a warning to employees that the favor and good will of responsible union officials is to be nurtured and sustained." 137 N.L.R.B. 439, 442 (1962). This theory was also set forth in NLRB v. Local 294, Teamsters Union, 317 F.2d 746 (2d Cir. 1963), and in NLRB v. Shear's Pharmacy, Inc., 327 F.2d 479 (2d Cir. 1964). In these two cases, the Board's contention was rejected by the Second Circuit. Although the decision of the court was handed down shortly after the *Miranda* case, the Board decided *Shear's Pharmacy* before it decided *Miranda*. There, the Board's order was enforced because the employee had been shown to be in disfavor with the union for reasons relating to union activity. The Board, however, had based its order on the theory that, since the union had caused discrimination against this employee and since the discrimination was not based on a failure of the employee to render periodic dues, the discrimination was necessarily an unfair labor practice.

21. *Supra* note 18. The court held that intent to cause encouragement or discouragement of union membership is a prerequisite to a finding of an unfair labor practice under section 8(a)(3) but that specific intent need not be shown as long as the encouragement or discouragement is a reasonable and forseeable consequence of the discrimination. See also Associated Press v. NLRB, 301 U.S. 103 (1937); NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1937); MANOFF, LABOR RELATIONS LAW 82 (1958).

22. 375 U.S. 335 (1964). Citing the Board's decision in *Miranda*, the Court said, "Although there are differing views on whether a violation of the duty of fair representation is an unfair labor practice under the Labor Management Relations Act, it is not necessary to resolve that difference here." 375 U.S. at 344. In the concurring opinion, however, Justice Goldberg's synthesis of the cases following *Steele* gives no

sions the Board has reaffirmed its position in *Miranda.*[23] In these cases the Board has advanced a third ground for holding a union which commits acts of arbitrary discrimination guilty of an unfair labor practice by ruling that a bargaining agent's failure to represent an employee or to press his grievance is a refusal to bargain collectively and therefore an unfair labor practice under section 8(b)(3). These cases, both involving discrimination against Negro employees, suggest the potential impact of the Board's decision in *Miranda* on the field of race relations. Although there was no racial discrimination in *Miranda,* a rule that any act of arbitrary discrimination by a labor union constitutes an unfair labor practice would give employees who had been subjected to racial discrimination by a labor union a remedy before the Board in addition to the present remedy in the courts.

In the instant case, the opinion of the court, written by Judge Medina, first holds that there is no evidence to support the Board's finding that the union engaged in a hostile or invidious act against the employee, since the proper interpretation of the collective bargaining agreement was debatable and the Board produced no evidence to show that the defendants did not arrive at their interpretation of the contract in good faith.[24] The court, however, went on to reach the issue whether Congress intended that the duty of fair representation be read into section 7 of the act,[25] and held that the authorities cited by the Board failed to establish the existence of such a duty under section 7. *Steele*[26] and the cases following[27] it established the existence of a duty of fair representation by reason of the powers con-

suggestion that they have served to create an unfair labor practice under the NLRA

23. Locals 1367 & 1368, International Longshoremen's Ass'n, 148 N.L.R.B. No. 44 (1964); Locals 1 & 2, Independent Metal Workers Union, 147 N.L.R.B. No. 166 (1964).

24. The only circumstance tending to show hostility toward the employee was the fact that the union, after failing to secure the reduction of seniority on the ground of his late return made a second attempt to punish him basing its claim on his early departure. *Supra* note 6. "Thus, even if we were disposed to agree with the Board on the principal law question in the case, we would disagree with its conclusion that the Union, on the meager facts in the record, had taken against Lopuch 'hostile action, for irrelevant, unfair or invidious reasons,' and we would feel constrained to remand the case to the Board for the taking of further evidence and the making of additional findings of fact." 326 F.2d at 175.

25. It should be noted, however, that the case's status as authority for this point is uncertain, because, of the three judge court, Judge Friendly dissented, and Chief Judge Lumbard, in a concurring opinion, said that he decided the case solely on the issue of the Board's failure to produce evidence that the defendants had not interpreted the agreement in good faith and saw "no cause for the court even to consider the important and far-reaching question raised by the Board whether action which violates a union's duty of fair representation may constitute an unfair labor practice in violation of section 8(b)(1)." 326 F.2d at 180 (concurring opinion).

26. *Supra* note 8.

27. *Supra* notes 8 & 11.

ferred on the bargaining agent in section 9[28] but only held that it was enforceable by the courts and not that it could be the basis of an action before the Board.

In passing on the Board's second holding, the court points out that earlier applications of sections 8(a)(3) and 8(b)(2), such as *Wallace Corp. v. NLRB*,[29] involved activity which clearly tended to encourage union membership. In his dissenting opinion,[30] Judge Friendly does not deal with the issue whether the union's duty of fair representation is implicit in sections 7 and 8. Instead he accepts the Board's second argument—that a union, by any act of unfair discrimination, displays its power and tends to encourage union membership and loyalty, even if the particular act of discrimination is wholly arbitrary and its victim is selected at random. The dissent rejects the idea that failure to show the union's intent to encourage union membership must bar the action and argues that the act does not require a showing of intent.[31] Thus, even if the union had in good faith misinterpreted the collective bargaining agreement, it would still be guilty of an unfair labor practice if the resulting discrimination did in fact tend to encourage union membership.

Although there is no authority bearing directly on the issue whether section 7 of the National Labor Relations Act implies a duty of fair representation, the court's conclusion that Congress did not intend to impose such a duty is supported by the fact that the Board has long failed to rule that the duty exists under this section. Also, the fact that Congress in amending the act has not sought to change this result suggests that it relied on the body of case law following the *Steele* opinion to enforce the union's duty and did not intend to broaden the jurisdiction of the Board. The broad guarantee of employee rights in the Landrum-Griffin Act[32] and that act's establishment of procedures for enforcing them is another indication that

28. National Labor Relations Act, 61 Stat. 136 (1947), as amended, 29 U.S.C. § 159 (1958).

29. 323 U.S. 248 (1944).

30. 326 F.2d at 180 (dissenting opinion).

31. "What the National Labor Relations Act makes an unfair labor practice is for an employer 'by discrimination in regard to hire or tenure of employment * * * to encourage or discourage membership in any labor organization,' § 8(a)(3), and for a union 'to cause or attempt to cause an employer' to do so, § 8(b)(2). Congress did *not* say 'to discriminate in regard to hire or tenure of employment *because* of membership in any labor organization,'—language which, indeed would not support the result here reached by the Board. Neither did it define the unfair labor practice as being discrimination *'in order to* encourage or discourage membership in any labor organization . . .'" 326 F.2d at 181 (dissenting opinion).

32. The Labor-Management Reporting and Disclosure Act of 1959, 73 Stat. 519 (1959), 29 U.S.C. §§ 401-531 (Supp. V, 1964). See sections 411-15 setting forth a bill of rights for union members and section 464 authorizing the Secretary of Labor to bring suits to enforce the provisions of the act.

Congress did not regard all acts of unfair union discrimination as subject to the control of the Board. Moreover, if Congress had placed this broad duty of fair representation on the unions in section 8(b)(1), then section 8(b)(2) would be superfluous, since it is restricted to acts of discrimination which affect terms or conditions of employment, and any union discrimination in this area would clearly be a breach of the duty of fair representation and thus would be prohibited under the Board's interpretation of section 8(b)(1). While there is an attractive logic in the Board's argument that the right to bargain through representatives necessarily implies the right to be represented fairly, it seems that a grant to the Board of sweeping power over all unfair discriminatory practices by bargaining agents should be couched in more specific terms.

The court's holding that an unfair labor practice must involve some element of intent to affect union membership is supported by a considerable body of authority.[33] Although the dissent is correct in pointing out that the requirement is not explicit in the act, the rule set forth in *Radio Officers*[34] that defendants may be presumed to have intended the forseeable consequences of their acts makes this rule not a requirement of specific intent but a requirement somewhat similar to proximate cause. In any case in which the defendants could not, under this test of foreseeability, be found to have intended to encourage or discourage union membership, it is probable that the actual effect on union membership would be so remote as to justify a finding that the discrimination did not in fact affect union membership. Some such limitation is made necessary by the rule, also set forth in *Radio Officers*, that actual results of the encouragement need not be found but only a tendency to encourage or discourage membership. It seems clear that a holding that *any* discrimination on the part of a labor union is an unfair labor practice under section 8(b)(2) would broaden the jurisdiction of the Board to the same extent as a holding that a union's duty of fair representation is enforceable by the Board under section 8(b)(1), since the Board would be given power to control any union discrimination and to interpret collective bargaining agreements in all matters affecting terms or conditions of employment. Under such a rule, the requirement that the discrimination must tend to encourage or discourage union membership would automatically be met as soon as any unfair discrimination was found to exist. Thus, this requirement which clearly reflects Congress' intent to impose some limitation on the jurisdiction of the Board, would become meaningless. The possible

33. *Supra* note 22.
34. *Supra* note 19.

desirability of drastically enlarging the jurisdiction of the Board is pointed out by Judge Friendly, who says,

> I cannot share my brother Medina's qualms that sustaining the Board's rulings . . . will steer grievances of union members as to arbitrary union action away from the courts and toward the expert agency which Congress created to deal with labor matters. That would seem a rather good place for them to be.[35]

There is a danger, however, that too great an enlargement of the Board's jurisdiction would destroy the Board's ability to deal effectively with the fairly specialized area which it was created to handle. In any event, such an expansion of the Board's jurisdiction does not seem warranted under the present wording of the act and appears to be a matter for legislative rather than judicial action.

## Securities Exchange Act of 1934—Power of Federal Courts To Grant Relief in Derivative and Direct Actions Under 14(a)

Plaintiff-stockholder brought an action in federal district court to rescind a merger between the J. I. Case Company and another corporation. It was alleged that the merger had been consummated by a stockholder vote based on proxy statements that violated section 14(a) of the Securities Exchange Act of 1934.[1] The Plaintiff also sought damages for himself and other similarly situated stockholders and such further relief "as equity shall require." The complaint con-

35. 326 F.2d at 186 n.7 (dissenting opinion).

1. "It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of any national securities exchange or otherwise to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered on any national securities exchange in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." Securities Exchange Act § 14(a), 48 Stat. 895 (1934), 15 U.S.C. § 78n(a) (1958). This section was amended by Pub. L. No. 88-467, 88th Cong., 2d Sess. § 5(a) (August 20, 1964), to read as follows:
"It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protectiou of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 12 of this title."

tained two counts, one based on diversity jurisdiction alleging a breach of fiduciary duty on the part of the corporate officers, and another, a federal question alleging violation of section 14(a) of the Securities Exchange Act. The district court held that as to the federal question it had no power in actions brought by a private party to offer other than declaratory relief under section 27[2] of the act since the form and extent of this relief would be prescribed by state law.[3] As to the first count, which would be determined entirely by state law, the court held that a Wisconsin statute[4] requiring an expense-bond to be posted in derivative actions must be applied. On plaintiff's refusal to post bond, the action, except count two seeking declaratory relief, was dismissed. On appeal the United States Court of Appeals for the Seventh Circuit reversed both holdings. On certiorari in the Supreme Court of the United States, *held*, affirmed. Federal courts have power to grant all necessary relief in derivative or direct actions based on violation of section 14(a) of the Securities Exchange Act of 1934.[5] *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964).

The question of private rights and remedies other than damages or declaratory relief[6] has been an active area of judicial inquiry since the inception of the Securities Exchange Act of 1934. Most recently the proxy-regulation provision of the act, section 14(a), has been the focal point of the inquiry. The courts have had two theories available under which they might allow private actions.[7] The first theory is

2. "The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder . . . ." Securities Exchange Act § 27, 48 Stat. 902-903 (1934), 15 U.S.C. § 78aa (1958).

3. The court considered what remedy to apply a separate question from that of whether the statute had been violated, and held that since section 27 gave the court no authority to grant equitable relief and since no jurisdictional basis other than violation of a federal statute had been alleged, it had no power to give full equitable relief. Thus the plaintiff would be forced to seek declaratory relief as to the illegality of defendant's actions in federal court and an adequate remedy for the wrong in a state court.

4. WIS. STAT. ANN. § 180.405(4) (1957).

5. The Court said, "We consider only the question of whether § 27 of the Act authorizes a federal cause of action for rescission or damages to a corporate stockholder with respect to a consummated merger which was authorized pursuant to the use of a proxy statement alleged to contain false and misleading statements violative of § 14(a) of this Act." J. I. Case Co. v. Borak, 377 U.S. 426, 428 (1964).

6. The Court referred to these as "remedial remedies."

7. Enforcement rights under the act are specifically granted to the Securities and Exchange Commission under sections 21(e) and 21(f), but over the past three decades the courts have inferred private rights of action under section 10(b) through either the contract or tort theory explained in the text. For cases construing § 10(b) see Ellis v. Carter, 291 F.2d 270 (9th Cir. 1961); Matheson v. Armbrust, 284 F.2d 670 (9th Cir. 1960); Hooper v. Mountain States Sec. Corp., 282 F.2d 195 (5th Cir. 1960); Reed v. Riddle Airlines, 266 F.2d 314 (5th Cir. 1959); Errion v. Connell, 236 F.2d 447 (9th Cir. 1956); Fratt v. Robinson, 203 F.2d 627 (9th Cir. 1953); Fischman v. Raytheon

predicated upon that provision of the statute which invalidates contracts entered into in violation of the act or rules promulgated under it.[8] The second, more common approach relies on the tort theory that breach of a statutory duty normally gives rise to a right of action on behalf of the injured person for whose protection the statute was enacted.[9] Prior to the instant case the most significant treatment of both private rights and remedies available under the act was *Dann v. Studebaker-Packard Corp.*[10] There, shareholders sued under section 27 for violation of section 14(a) of the Securities Exchange Act and denominated their suit both derivative and individual in seeking judicial determination that certain proxies were void and asking for rescission of an "arrangement"[11] perfected thereby. The court held that plaintiffs had a personal right of action irrespective of diversity of citizenship or the fact that they were not deceived by the misleading proxy information. Emphasizing the legislative history of section 14(a), the court based its decision on the tort theory that breach of a statutory duty normally gives rise to a right of action on behalf of the injured person for whose protection the statute was enacted. Thus the decision was consistent with previous interpretations of other sections of the same act.[12] Cognizant also of an earlier case, *Howard v. Furst*,[13] which squarely held that violation of proxy rules does not create a corporate cause of action, the *Dann* court stressed the individual right violated rather than the resulting damage. In doing so the case substantiated the availability of an individual right of action where *Howard* was explicitly silent, without upsetting the *Howard* court's treatment of derivative actions. *Dann's* final contribution to the state of private rights inferred from section 14(a) was a reinforcement of the availability of those rights unhampered by any significant administrative bottlenecks. *Phillips v. United Corp.*[14] limited private rights of action by giving precedence to Commission-initiated actions and by requiring the private litigant to exhaust his administrative remedies by an unsuccessful appeal to the Commission before

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Mfg. Co., 188 F.2d 783 (2d Cir. 1951); Kohler v. Kohler Co., 208 F. Supp. 808 (E.D. Wis. 1962); Speed v. Transamerica Corp., 99 F. Supp. 808 (D. Del. 1951); Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946).

8. Thus, treating the proxy as a contract, plaintiff asserts standing as a contract-party to have the court determine whether his proxy conforms to the SEC rules and hence whether his proxy is valid.

9. RESTATEMENT, TORTS § 286 (1934). Thus plaintiff-stockholder, by pleading violation of a statute intended to protect him, acquires standing.

10. 288 F.2d 201 (6th Cir. 1961).

11. The opinion does not specify what the "arrangements" were. Despite this, there is little question that shareholder approval was necessary for their consummation.

12. See note 7 *supra* for a discussion of private rights implied under section 10(b).

13. 288 F.2d 790 (2d Cir. 1956), *cert. denied*, 353 U.S. 937 (1957).

14. 5 S.E.C. Jud. Dec. 449 (S.D.N.Y. 1947).

coming into federal court. Later cases, including *Dann*, imposed no such qualifications.

The *Dann* court was more hesitant, however, in considering the issue of relief. Prior to *Dann*, no case had sought retrospective relief[15] under section 14(a), yet there was language in several cases to support such a remedy. In *Mack v. Mishkin*,[16] for example, the court said, in denying an injunction against the use of proxies because of plaintiff's failure to show irreparable harm, that if it was later found that the proxies were unlawfully obtained and utilized, the election of the directors by the use of such proxies could be set aside.[17] Yet in the face of this, *Dann*, after recognizing that the decision was difficult, followed *Gully v. First National Bank*,[18] a case in which the federal courts were denied jurisdiction because at most there was "a question of federal law lurking in the background"[19] and allowed only declaratory relief as to the validity of the proxies rather than extending the full, requested relief of rescission. Thus stood the law when the instant case was decided. Individual private rights under section 14(a) were available, but no derivative rights existed. These individual rights were probably unqualified in that exhaustion of administrative remedies was not required, but no Supreme Court decision had as yet upheld them, and lastly, relief was available, but only prospective relief, because of the federal court's refusal to decide questions of remedy based on state law.

In the instant case, Mr. Justice Clark reasoned for a unanimous Court that private parties have an unqualified right of action that is inferred from the Act, whether the suit be derivative or direct. He based this conclusion on the recorded congressional intent that section 14(a) insure "fair corporate sufferage,"[20] and on the words of the

15. By "retrospective relief" the court meant resoission.

16. 172 F. Supp. 885 (S.D.N.Y. 1953).

17. Other somewhat tangential, though relevant, authority was also available: Bell v. Hood, 327 U.S. 678 (1946), leading authority for the principle that where a right created by federal law has been invaded, federal courts may use any available remedy to right the wrong done, and Osborn v. Bank of the United States, 22 U.S. (9 Wheat.) 738 (1824), where Chief Justice Marshall allowed federal questions to be decided despite the presence of state law questions, are examples of other cases that were available to round out a cogent argument in favor of a remedy other than money compensation. See also Texas & N.O.R.R. v. Brotherhood of Ry. Clerks, 281 U.S. 548 (1930); United States v. Kaufman, 96 U.S. 546 (1877); Horwitz v. Balaban, 112 F. Supp. 99 (S.D.N.Y. 1953).

18. 299 U.S. 109 (1936). Plaintiff, state tax collector, sought to recover from defendant, a national bank, tax obligations the latter had assumed from a defunct national bank. The Court held that since the claim was based on state contract law and that federal law entered in only as a defense (permission from federal government for state to tax federal interests) the defendant could not have the case removed to federal court on the basis of a federal question.

19. *Id.* at 117.

20. 377 U.S. at 431, quoting H.R. REP. No. 1383, 73d Cong., 2d Sess. 13 (1934).

section which were intended to insure that it operate "for the protection of the investors."[21] Finding also that damage resulting from proxy falsification was primarily imposed on the corporation, the Court concluded that viability of the *Howard* doctrine, that private rights do not inure to the corporation, would "be tantamount to a denial of private relief"[22] and held that "for the protection of the investors" and efficient operation of the Commission's policing responsibilities, private rights of action should be available both to the individual and to the corporation. The second aspect of the holding, that dealing with the availability of retrospective remedies, was determined by the Court's considering the degree to which state law should participate in the enforcement of proxy regulation and holding that the problem as a whole is federal in nature. Thus, while reiterating the doctrine "that where federally secured rights are invaded . . . 'federal courts may use any available remedy to make good the wrong done' "[23] the court upheld the *Dann* holding insofar as it required the federal court to look to the state issues it would have to decide in determining the scope of the remedy available. In so doing the Court found the issues presented under the statute to be overwhelmingly federal[24] and, as a result, held that the federal court might use any remedy in its legal or equitable repertoire "to make good the wrong done."

This case acknowledges the danger in securities regulation which exists in all other fields of law—that a denial of an effective remedy denies the right itself—and in doing so the Court smoothed many of the rough edges of effective enforcement. In the first place, litigants no longer need to shuffle back and forth between federal and state courts seeking declaratory judgment as to the validity of a proxy in the former and appropriate relief in the latter. This in itself will save time and money and thereby will encourage private enforcement. Secondly, the interests of the corporation, through its minority stockholders, no longer need be dependent on their success in persuading the Commission to bring an action. At the most this will relieve the Commission of a significant portion of its enforcement burden by allowing private parties to bring actions, and at the least, judicial review will be available to the shareholder unhampered by administrative delay. Thirdly, the shareholder no longer need be burdened by

21. *Id.* at 432, quoting Securities Exchange Act of 1934 § 14(a), 48 Stat. 895 (1934), 15 U.S.C. § 78n(a) (1958), as amended by Pub. L. No. 88-467, 88th Cong., 2d Sess., § 5(a) (Aug. 20, 1964).

22. *Id.* at 432.

23. *Id.* at 433, quoting Bell v. Hood, *supra* note 17.

24. Note that the Court looked at the problem as a whole and found that so taken, it was substantially federal. This is to be distinguished from the lower court's view of the problem as consisting of a question of statutory violation and a question of proper remedy.

posting such expense bonds as are required by state law. This should make the likelihood of such actions greater and correspondingly, the threat of litigation and effect of regulation more real. Lastly, the courts no longer need impale themselves on the dilemma of whether the question is predominantly one of state or federal law in order to determine jurisdictional issues. If the duty allegedly violated is created by section 14(a), the courts have jurisdiction to grant whatever relief the facts might require. This too will streamline the use and effectiveness of the statute. Note, however, that while this last point might well be the most encouraging aspect of the decision insofar as effective regulation is concerned, it also suggests a wide spectrum of problems[25] likely to arise. The Court, by allowing federal courts jurisdiction to grant full relief when the basis of the wrong is a violation of section 14(a), is using a federal wedge to open a wealth of state law questions to federal decision-making. Still, if our dual system is to work, both state and federal courts must have legitimate spheres of activity. This sphere, proxy regulation, has been left almost entirely to the federal government,[26] and, although state questions must be ruled upon in remedying proxy violations, such questions are, under *Erie R.R. v. Tompkins*,[27] decided by state law despite its being applied by federal courts. In this process of application alone many problems will undoubtably emerge.[28] What *state* law remedy might facts constituting a *federal* violation require? What quantum of wrong is necessary to justify rescission under the various state law norms? Of what effect is the equitable-remedial-rights doctrine? To what extent must a federal court adhere to those norms and to what extent might it develop and use an "*Erie*-resistant" federal common law as to remedies where state norms do not coincide with a federal court's conception of adequate relief? Thus, while the Court has eliminated the hurdle barring the entrance to federal court, many more difficult problems remain in the field of proxy regulation before our system of corporate control functions smoothly.

25. The 1964 amendments, Pub. L. No. 88-467, 88th Cong., 2d Sess. (August 20, 1964), to the Securities Exchange Act of 1934 merely aggravate the potential number of problems by expanding the applicability of the act to corporations whose securities are traded over-the-counter or on a national exchange.

26. See Loss, *The SEC Proxy Rules in the Courts*, 73 HARV. L. REV. 1041 (1960).

27. 304 U.S. 64 (1938).

28. See generally, Hart, *The Relationship Between State and Federal Law*, 54 COLUM. L. REV. 489 (1954); Loss, *The SEC Proxy Rules and State Law*, 73 HARV. L. REV. 1249 (1960); Note, 71 HARV. L. REV. 513 (1958); Note, 70 HARV. L. REV. 509 (1957).

## Taxation—Federal Estate Tax—Proceeds of Flight Insurance as Insurance Under Section 2042(2)

The decedent purchased two flight insurance policies before departing on the plane which crashed and thereby caused his death. Each policy reserved to the insured the right to assign it or to change the beneficiary without the consent of the original beneficiary. Petitioners, as executors of the decedent's estate, filed the required estate tax return but did not include in the gross estate the flight insurance proceeds received by the widow as beneficiary. The Tax Court sustained[1] the Commissioner's deficiency determination that the proceeds of the policies were includable in the gross estate of the decedent pursuant to section 2042(2) of the Internal Revenue Code of 1954.[2] On appeal to the Third Circuit Court of Appeals, *held,* reversed. The phrase "insurance under policies on the life of the decedent"[3] as found in section 2042(2) does not include insurance covering the risk of accidental death, and, therefore, the proceeds of flight insurance policies are not includable in the determination of a decedent's gross estate. *In re Noel's Estate,* 332 F.2d 950 (3d Cir. 1964).

With the exception of earlier periods of national emergency, the estate tax was first employed as a means of revenue in the Revenue Act of 1916.[4] Although this act did not specifically refer to the proceeds of life insurance, such proceeds were includable in the gross estate to the extent receivable by the executor of the estate.[5] As a result, estate taxes could be reduced by purchasing life insurance with proceeds payable to specific beneficiaries other than the executor. This situation was corrected with the passage of the Revenue Act of 1918, which taxed as a part of the gross estate all proceeds from life insurance taken out by the decedent upon his own life[6] payable to the executor and proceeds in excess of 40,000 dollars receivable by all other beneficiaries.[7] The Revenue Act of 1924[8] retained the same

1. Estate of Noel, 39 T.C. 466 (1962).
2. "The value of the gross estate shall include the value of all property . . . . (2) Receivable by other beneficiaries.—To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person." INT. REV. CODE OF 1954, § 2042(2).
3. *Ibid.*
4. Revenue Act of 1916, ch. 463, § 201, 39 Stat. 777.
5. Revenue Act of 1916, ch. 463, § 202, 39 Stat. 777.
6. Revenue Act of 1918, ch. 18, § 402(f), 40 Stat. 1098.
7. *Ibid.*
8. Revenue Act of 1924, ch. 234, § 302(g), 43 Stat. 305.

insurance provisions as found in the 1918 Act. The Revenue Act of 1942 changed the requirements to the extent that life insurance proceeds were includable if the payment of premiums was made directly or indirectly by the decedent, or if the deceased possessed any of the incidents of ownership at his death.[9] The 1954 Code eliminated the requirement that payments of premiums must have been made directly or indirectly by the decedent.[10] Thus, there are two requirements that must be met in order for the proceeds of an insurance policy to be includable in the determination of the decedent's gross estate under section 2042(2) of the present code: the insurance must be "insurance under policies on the life of the decedent," and it must be insurance "with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person."[11]

There has been little litigation concerning whether accident insurance policies covering the risk of accidental death are within the meaning of the phrase "insurance on the life of the decedent." Until the decision in the instant case, the controlling view was represented by *Leopold Ackerman*,[12] decided in 1929. In that case the decedent had taken out accident insurance and life insurance which provided for double indemnity in the event of accidental death. The Board of Tax Appeals held that the phrase "policies taken out by the decedent upon his own life"[13] included accident policies which covered the risk of accidental death as well as life insurance policies which provided double indemnity for accidental death.[14] The court, while recognizing a distinction between life insurance and accident insurance, reasoned that both are taken out upon the life of the policyholder and that "in each case the risk assumed by the insurer is the loss of the insured's life, and the payment of the insurance money is contingent upon the loss of life."[15]

The court of appeals in the instant case agreed with the Tax Court[16] that the change of beneficiary provisions were exercisable incidents of ownership within the meaning of the statute.[17] However, in regard to the other requirement, the court denied that accident policies which cover the risk of accidental death as well as bodily injury are within the ambit of the phrase "insurance under policies on the life of the

9. Revenue Act of 1942, ch. 619, § 404(g), 56 Stat. 944.
10. INT. REV. CODE OF 1954, § 2042(2).
11. *Ibid.*
12. 15 B.T.A. 635 (1929).
13. Revenue Act of 1942, ch. 619, § 404(g), 56 Stat. 944.
14. 15 B.T.A. at 637.
15. *Ibid.*
16. 39 T.C. at 471.
17. 322 F.2d at 951.

decedent."[18] Obviously, the controlling determination to be made is the construction of the phrase, and to make this determination, the court employed two methods of statutory construction—the plain meaning rule and determination of legislative intent. The Treasury Regulations define "insurance" as "life insurance of every description, including death benefits paid by fraternal beneficial societies operating under the lodge system."[19] However, the phrase "insurance under policies on the life of the decedent" is not defined by the regulations. The court reasoned that the plain, generally accepted meaning of the phrase was life insurance. Therefore, the question became whether accident insurance and life insurance are the same for purposes of this statute. The court listed several differences to justify its negative answer. A life insurance policy insures against the occurrence of an "inevitable" event, death being the contingency insured against, regardless of cause. On the other hand, an accident insurance policy insures against the occurrence of an "evitable" event not likely to occur, the contingency insured against being the accident—death by accident being merely one of the possibilities which would create liability. Also issuance of an accident insurance policy assumes a conditional risk of loss which does not create an immediate estate transferrable on the death of the insured. The court concluded that payment in the event of the insured's accidental death does not convert an accident insurance policy into life insurance, because such a feature does not alter the "essential nature" of the insurance.[20] In order to determine the legislative intent, the court looked to the history of the statutory provision. As was pointed out above, the Revenue Act of 1916 made no provision for inclusion of the proceeds of life insurance in determining the gross estate. As a means of estate tax avoidance, resort could be made to the purchasing of life insurance with the proceeds designated to specific beneficiaries instead of giving them certain assets which would be includable in the gross

18. The Tax Court held that the amounts received by a beneficiary from flight insurance were includable in the decedent's gross estate. As to whether the flight insurance policies constituted "insurance under policies on the life of the decedent," the court relied on the *Ackerman* case. Since the *Ackerman* case was decided in 1929, the Revenue Act of 1924 was controlling in that case as to the includability of insurance policies in the gross estate, and it was held that the phrase "policies taken out by the decedent upon his own life," Revenue Act of 1924, ch. 234, § 302(g), 43 Stat. 305, included accident insurance policies which covered the risk of accidental death. 15 B.T.A. at 638. The Tax Court stated that since the 1954 Code provides "insurance under policies on the life of the decedent," INT. REV. CODE OF 1954, § 2042(2), the statutory provisions involved are substantially identical as they relate to this question, 39 T.C. at 470. Since the provisions are substantially identical, the court said that it was too late to raise this issue, for the matter had been settled for too long a period to warrant reexamination. 39 T.C. at 470.

19. Treas. Reg. § 20.2042-1(a) (1963).

20. 322 F.2d at 953.

estate.[21] This could not have been done with accident insurance because there was no assurance that the insured would meet an accidental death, and therefore the specific beneficiaries would not be assured of receiving proceeds upon the death of the insured. This deficiency was corrected by the Revenue Act of 1918, which included the proceeds of life insurance in determining the gross estate of the decedent. Also, the 1954 Code eliminated the provision of the earlier statutes which required that, to be includable, the payments of the premiums must have been made directly or indirectly by the decedent. The court reasoned that since tax avoidance by purchasing life insurance, as opposed to accident insurance, brought about the statutory provisions for including insurance in the gross estate, and since the purpose of the change in the statutory provisions was to preclude the purchase of life insurance as a means of avoiding estate taxes, Congress must have contemplated life insurance only, and not accident insurance.

If the instant case is followed by other circuits, the question arises as to how far the decision will be extended. There appear to be three possibilities. First, if limited to a strict interpretation confined to the facts, the result is that all trip flight insurance proceeds paid in the event of death are not includable in the gross estate under section 2042(2). Second, if the case is not limited to its facts, but the court's reasoning is also followed, the decision would cover the estate tax consequences of accident insurance in general wherein the insured loses his life and a benefit is paid. Such an extension is certainly reasonable because of the court's conclusion that accident insurance of which flight insurance is a species is not the same as life insurance for purposes of section 2042(2). It seems doubtful that such an extension would change the course of estate tax planning since accident insurance provides no guarantee that the estate will receive proceeds because death by accidental means cannot be contemplated. For the same reason, it is doubtful that this extension would greatly aid the accident insurance business or prove detrimental to the life insurance business. Third, a still broader interpretation might cover the estate

21. This is verified by a report of the Ways and Means Committee which stated: "The provision with respect to special beneficiaries has been included for the reason that insurance payable to such beneficiaries usually passes under a contract to which the insurance company and the individual beneficiary are the parties in interest. . . . Amounts passing in this way are not liable for expenses of administration or debts of the decedent and therefore do not fall within the existing provisions defining the gross estate. It has been brought to the attention of the Committee that wealthy persons have and now anticipate resorting to this method of defeating the estate tax. Agents of insurance companies have openly urged persons of wealth to take out additional insurance payable to specific beneficiaries for the reason that such insurance would not be included in the gross estate." H.R. REP. No. 767, 65th Cong., 2d Sess. 22 (1918).

tax consequences of the double indemnity features of life insurance since the double indemnity provision insures against accidental death. Such an extension might be questioned because of the "essential nature" of the insurance, an element which the court emphasized. However, if such an extension does occur, it might be feasible for the insurance companies to separate the double indemnity provisions from life insurance and sell the two as separate policies in order to facilitate the ease of administration of the estate after an accidental death. Therefore, this case could result in the non-includability in the gross estate under section 2042(2) of (1) all accident insurance proceeds paid upon death, and (2) double indemnity proceeds paid upon accidental death. If so, this case overrules thirty-five years of precedent represented by the *Ackerman* case.

## Taxation–Federal Estate Tax–Inclusion in Gross Estate of Accumulated Income of Trust Fund To Be Governed by Sections 2036(a)(2) and 2038(a)(2)

In 1934 and 1935 decedent created three spendthrift trusts for the principal benefit of his five minor children, reserving the power as co-trustee to invade and distribute the corpus and to accumulate or distribute income. In 1957 decedent petitioned a state court for the appointment of a conservator for his property,[1] a doctor certifying that he was mentally competent to petition the court. A decree of the appointment was granted and was in full force and effect until decedent's death in 1958.[2] The Commissioner of Internal Revenue, over the objection of the executors that the accumulated income from the trusts should not be included in the gross estate, included

1. MASS. GEN. LAWS. ch. 201, § 16 (1955).

2. The court of appeals reasoned that the appointment of a conservator was not the definitive act required to extinguish decedent's power to act as co-trustee within meaning of Hurd v. Commissioner, 160 F.2d 610 (1st Cir. 1947), *affirming* Estate of Edward L. Hurd, 6 T.C. 819 (1946). It pointed out that the conservatorship raised no conclusive presumption of continued incapacity since the conservator could have been discharged and, therefore, included the corpus in decedent's gross estate. 332 F.2d at 594.

The treatment of this problem is outside the scope of this comment but for discussion of the definitive act and the ascertainable external standard of Jennings v. Smith, 161 F.2d 74 (2d Cir. 1947). See LOWNDES & KRAMER, FEDERAL ESTATE & GIFT TAXES §§ 12.6, 28.12-13 (2d ed. 1962).

both the corpus and the accumulated income in the decedent's gross estate for estate tax purposes. The Tax Court sustained the action of the Commissioner[3] on the ground that there had been an incomplete transfer within the meaning of sections 2036 (a)(2) and 2038 (a)(2) of the Internal Revenue Code of 1954.[4] On petition for review by executors, *held*, affirmed. Since the "transfer" of trust property was incomplete until decedent, by his death, relinquished the control he held over such property, the property must be valued at the time of his death, when the transfer is complete, and the undistributed accumulated income, along with trust principal, is included in the valuation. *Round v. Commissioner*, 332 F.2d 590 (1st Cir. 1964).

The federal estate tax is imposed upon transfers of property at death[5] and upon incomplete transfers made prior to death which become complete at death, the death causing the relinquishment of the powers which caused the property to be included in his estate.[6] The valuation of the transferred property for estate tax purposes is usually made as of date of death.[7] Section 2036 (a)(2) provides that there shall be included in a decedent's estate all property transferred by the decedent over which he has retained "the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom."[8] Section 2038 (a)(2) provides that there shall be included in the decedent's estate all property transferred by the decedent "where the enjoyment thereof was subject at date of his death to any change through the exercise of a power either by the decedent alone or by the decedent in conjunction with any person, to alter, amend, or revoke . . ."[9] The sections are not mutually exclusive and the same

3. Estate of John J. Round, 40 T.C. 970 (1963), 17 OKLA. L. REV. 345 (1964).

4. See Int. Rev. Code of 1939, ch. 3, §§ 811(c)(1)(B), 811(d)(2), 53 Stat. 121-22. The sections of the 1939 Code are basically the same as sections 2036(a)(2) and 2038(a)(2) of the 1954 Code.

5. INT. REV. CODE OF 1954, § 2001.

6. Commissioner v. Church, 335 U.S. 632 (1949); Sanford v. Commissioner, 308 U.S. 39 (1939); Lowndes, *Some Doubts About the Use of Trusts to Avoid the Estate Tax*, 47 MINN. L. REV. 31, 42 (1962).

7. See INT. REV. CODE OF 1954, § 2031(a) for the alternative valuation date; LOWNDES & KRAMER, *op. cit. supra* note 2, § 18.4.

8. An example of operation of section 2036 (a)(2) is where *A* creates a trust to pay the income to *B* for life, remainder to *B*'s children, and *A* retains power to invade corpus for the benefit of *C*. See WARREN & SURREY, FEDERAL ESTATE AND GIFT TAXATION 260 (1961), for this and other examples. See also State Street Trust Co. v. United States, 160 F. Supp. 877 (D. Mass. 1958), *aff'd*, 263 F.2d 635 (1st Cir. 1959) where three trusts created by decedent were includible in his gross estate under the predecessor of section 2036(a)(2) of 1954 Code because of the retention by decedent as a co-trustee of management powers which the court felt permitted the decedent to shift beneficial interests under the trusts.

9. See Lober v. United States, 346 U.S. 335 (1953), where decedent had transferred

transfer may be taxable under both sections.[10] If *A* transfers property in trust to *B* for life, remainder to *C*, and retains for himself the power to revoke the trust, both section 2036 (a)(2) and section 2038 are applicable.[11] Section 2038, however, differs from 2036 (a)(2) in that the transferor does not have to retain the power to affect the trust but can later acquire it.[12] Under 2038 taxability is limited to those interests the enjoyment of which may be modified by the decedent at the time of his death through the exercise of a power.[13]

It is well settled that the corpus of a trust transferred within the meaning of sections 2036 and 2038 can be included in the gross estate,[14] but there is a conflict whether the undistributed accumulated income from such trusts is property "to the extent of which the decedent has at anytime made a transfer."[15] Some courts have reasoned that since the accumulations were subject to the settlor's power to control beneficial enjoyment at the time of their accumulation, the accumulated income was an incomplete transfer until the decedent's death and should be included in his gross estate.[16] A similar result has been reached by courts reasoning that the decedent had the same right to alter the disposition of the income as he did the corpus.[17] Other courts have concluded that the transfer of the trust corpus was complete when the trust was created, as is a transfer under section 2035, and, therefore, the income which accumulated to principal was never transferred by the settlor.[18] Section 2035 is applicable to transfers in contemplation of death,[19] and a

property to himself as trustee for his minor children, reserving discretionary power to invest and reinvest the principal and income, which were to be paid to the children when they attained certain ages. Although the trusts were declared irrevocable they were held includible under predecessor of section 2038 (a)(2) (§ 811(d)(2)) since decedent reserved the right to pay over to the children at any time any or all of the trust assets.

10. Treas. Reg. § 20.2031 (a)(2) (1958).

11. See Gray & Covey, *A Case Study of Sections 2036(a)(2) and 2038*, 15 TAX L. REV. 75, 76-78 (1959).

12. Section 2036 specifically requires that the power be "retained," whereas, section 2038 does not use the word "retain."

13. Treas. Reg. § 20.2038-1(a)(3) (1958).

14. Lober v. United States, *supra* note 10; Commissioner v. Holmes, 326 U.S. 480 (1946).

15. This phrase is included in both section 2036 and section 2038 of the Code.

16. Estate of Myrtle H. Newberry, 17 T.C. 597 (1951), *rev'd on other grounds*, 201 F.2d 874 (3rd Cir. 1953); Estate of Showers, 14 T.C. 902 (1950).

17. Estate of Cyrus C. Yawkey, 12 T.C. 1164 (1949).

18. Michigan Trust Co. v. Kavanagh, 284 F.2d 502 (6th Cir. 1960), *reversing* 171 F. Supp. 227 (W.D. Mich. 1959); Commissioner v. McDermott, 222 F.2d 665 (7th Cir. 1955). The court in *McDermott* relied upon Gidwitz and Burns, *infra* note 20, which involved transfers in contemplation of death under section 2035. The rule established by *McDermott* was followed in *Kavanagh*. For criticism of *McDermott* see O'Malley v. United States, 220 F. Supp. 30 (N.D. Ill. 1963).

19. See Commissioner v. Gidwitz, 196 F.2d 813 (7th Cir. 1952); Burns v. Com-

transfer in contemplation of death is complete when the trust is created; therefore, there is no estate tax imposed on the income which accumulates subsequent to the creation of the trust since that income has not been transferred.[20] They have also relied on the maxim that a tax statute is to be strictly construed in favor of the taxpayer,[21] and on the decedent's inability to invade and obtain the corpus and accumulations for himself,[22] as supporting arguments for the exclusion of the accumulated income. The Treasury Regulations are silent as to whether this undistributed accumulated income is to be included in the gross estate.[23]

The court in the instant case, after concluding that decedent still retained sufficient power as co-trustee to make the corpora of the trusts includible in his gross estate,[24] held that the income accumulated to principal should also be included in his gross estate for estate tax purposes. The decedent's control of the trust property had extended to accumulations as well as to the corpora.[25] The court, therefore, reasoned that the accumulated income had also been "transferred" under sections 2036 and 2038 since the transfer had been completed only when the decedent died, thereby relinquishing his control over the trust property. As the income had been transferred, its value must also be included in the valuation of decedent's gross estate.

The decision of this court is sound. It recognizes the distinction between a transfer in contemplation of death and a transfer with a retained power in the transferor.[26] The transfer in contemplation of death is complete when made, whereas, if a power is retained in the transferor to affect the trust, the transfer is completed only when that power is relinquished. Further, the court does not seek support for its conclusion in maxims that are of little substantive value, as other courts in the same situation have done.[27] The policy objective

missioner, 177 F.2d 739 (5th Cir. 1949), *affirming* Estate of James C. Frizzell, 9 T.C. 979 (1947), involving transfers in contemplation of death; Note, 58 YALE L.J. 313 (1949); See Int. Rev. Code of 1939, ch. 3, § 811 (d)(4), 53 Stat. 121, for the predecessor of section 2035 of the 1954 Code.

20. "Neither income received subsequent to the transfer nor property purchased with such income is considered in the valuation of the estate." Treas. Reg. § 20.2035-1(e) (1958).

21. Commissioner v. McDermott, *supra* note 19.

22. *Ibid.*

23. LOWNDES & KRAMER, *op. cit. supra* note 2, § 18.7, at 432.

24. See note 2 *supra.*

25. Although one of the trusts contained no express power to accumulate income the tax court treated it the same as the other trusts since more than $20,000 had already accumulated to principal. 40 T.C. at 981.

26. See MONTGOMERY, FEDERAL TAXES—ESTATES, TRUSTS & GIFTS 628-30 (1952); for discussion of the distinction.

27. See, *e.g.*, note 17 *supra.*

of sections 2036 (a)(2) and 2038 of the Code is to impose an estate tax upon property transferred during life when the transferor reserves significant powers over the possession or enjoyment of the property.[28] This court gave effect to that policy when it recognized that the power to control the disposition of the accumulated income was a significant power reserved by the decedent. Since decedent relinquished this power only upon his death, there had been no completed transfer before that time. The undistributed accumulated income was therefore "transferred" and at the same time as the corpora—the date of decedent's death. Both section 2036 (a)(2) and section 2038 would then require the inclusion of the entire property transferred since the decedent had retained the power to alter and amend the income as well as the corpora.[29]

## Taxation—Federal Gift Tax—Spouse's Signification of Consent for Split Gifts Under Section 2513

Petitioner, in 1954 and for three years thereafter, made gifts from a bank account held jointly with his wife. His gift tax returns indicated his desire to take the election under section 2513 of the Internal Revenue Code of 1954,[1] which allows a person who makes a

28. WARREN & SURREY, *op. cit. supra* note 9, at 257. A significant power is there said to be reserved when the transferee is unable to freely enjoy or dispose of his interest on account of this reserved power.

29. See note 13 *supra.*

1. INT. REV. CODE OF 1954, § 2513:

"(a) Considered as Made One-Half by Each.—

(1) In General.—A gift made by one spouse to any person other than his spouse shall, for the purposes of this chapter, be considered as made one-half by him and one-half by his spouse, but only if at the time of the gift each spouse is a citizen or resident of the United States. This paragraph shall not apply with respect to a gift by a spouse of an interest in property if he creates in his spouse a general power of appointment, as defined in section 2514 (c), over such interest. For purposes of this section, an individual shall be considered as the spouse of another individual only if he is married to such individual at the time of the gift and does not remarry during the remainder of the calendar year.

(2) Consent of Both Spouses.—Paragraph (1) shall apply only if both spouses have signified (under the regulations provided for in subsection (b)) their consent to the application of paragraph (1) in the case of all such gifts made during the calendar year by either while married to the other.

(b) Manner and Time of Signifying Consent.—

(1) Manner.—A consent under this section shall be signified in such manner as is provided under regulations prescribed by the Secretary or his delegate.

(2) Time.—Such consent may be so signified at any time after the close of the calendar year in which the gift was made, subject to the following limitations-

gift to a third party to consider it as having been made one-half by his spouse. However, petitioner's wife neither signed the 1956 and 1957 gift tax returns nor filed a separate return.[2] The Commissioner of Internal Revenue determined that since she had not signed the returns, she had not given her consent; thus he disallowed the split gifts and assessed a tax deficiency of ten thousand dollars. Admittedly no tax would have been due if the gifts had been split. The Tax Court upheld the deficiency.[3] On appeal in the United States Court of Appeals for the Fourth Circuit, *held*, reversed. The spouse of the donor had signified her consent to the split gifts although she had not signed the donor's gift tax returns. *Jones v. Commissioner*, 327 F.2d 98 (4th Cir. 1964).[4]

Section 2513 allows a gift made by a husband or wife to a third party to be considered for gift tax purposes as made one-half by each.[5] Such gift splitting is allowed only if both spouses consent.[6] The code states that consent shall be signified as provided under regulations prescribed by the Secretary of the Treasury or his delegate.[7] In turn the regulations provide that if only one spouse files a gift tax return the consent of *both* spouses shall be *signified* on that return.[8] Neither

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(A) the consent may not be signified after the 15th day of April following the close of such year, unless before such 15th day no return has been filed for such year by either spouse, in which case the consent may not be signified after a return for such year is filed by either spouse;

(B) The consent may not be signified after a notice of deficiency with respect to the tax for such year has been sent to either spouse in accordance with section 6212 (a).

(c) . . .

(d) Joint and Several Liability for Tax.—If the consent required by subsection (a) (2) is signified with respect to a gift made in any calendar year, the liability with respect to the entire tax imposed by this chapter of each spouse for such year shall be joint and several."

2. She was not required to file a separate return as no gift to any donee exceeded $6,000 and there was no gift of a future interest. Treas. Reg. § 25.6019-2 (1958).

3. Edwin L. Jones, 39 T.C. 734 (1963).

4. For general information on split gifts see LOWNDES & KRAMER, FEDERAL ESTATE & GIFT TAXES 817-20 (1956); 5 MERTENS, FEDERAL GIFT & ESTATE TAXATION § 37.02 (1959); 20 J. TAXATION 230 (1964).

5. See INT. REV. CODE OF 1954, § 2513(a)(1), quoted *supra* note 1.

6. See INT. REV. CODE OF 1954, § 2513(a)(2), quoted *supra* note 1.

7. See INT. REV. CODE OF 1954, § 2513(b)(1), quoted *supra* note 1.

8. Treas. Reg. § 25.2513 (1958): "Manner and time of signifying consent. (a) Consent to the application of the provisions of Section 2513 with respect to a calendar year shall, in order to be effective, be signified by both spouses. If both spouses file gift tax returns within the time for signifying consent, it is sufficent if—(1) The consent of the husband is signified on the wife's return, and the consent of the wife is signified on the husband's return; (2) The consent of each spouse is signified on his own return; or (3) The consent of both spouses is signified on one of the returns. If only one spouse files a gift tax return within the time provided for signifying consent, the consent of both spouses shall be signified on that return. However, wherever possible, the notice of the consent is to be shown on both returns and it is preferred that the notice be executed in the manner described in subparagraph (1) of this paragraph. . . ."

section 2513[9] nor the regulations[10] state that the signature of the consenting spouse is necessary to indicate such consent. Section 6061, however, requires that any return must be signed in accordance with *forms* provided by the Secretary,[11] and where consent to a split gift is to be indicated on the donor's gift tax return, the form requires that the consenting party sign the return.[12] There have been no court decisions under the 1954 Code determining whether or not a signature is necessary in order to signify consent. However, in a case decided under the 1939 Code,[13] *Camiel Thorrez*,[14] petitioner filed a gift tax return for the year 1951, but his wife did not sign the return. The Tax Court assumed that a signature was necessary in order that consent be shown and held that the donor was not entitled to have his gifts treated as having been made one-half by his wife.[15] Since the 1954 Code and regulations concerning consent to split gifts are quite similar to the 1939 Code and regulations,[16] it appears that the instant case is directly contrary to the only prior consideration.[17] By the so-called theory of tacit consent, silence is sometimes taken for consent in the case of joint income tax returns. This theory has been applied by the courts where the Commissioner was seeking to impose a tax liability upon a spouse who had not signed a return.[18] The tacit

9. Quoted in part note 1 *supra.*

10. *Supra* note 8.

11. INT. REV. CODE OF 1954, § 6061.

12. Form 709, United States Treasury Dept., Internal Revenue Service.

13. INT. REV. CODE OF 1939, ch. 168, § 374, 62 Stat. 127 (1948) (now INT. REV. CODE OF 1954, § 2513). The regulation promulgated to carry into effect this Code section was Treas. Reg. 108, § 86.3a (1949), as amended: "(b) Manner and time of signifying consent.—Consent to the application of the provisions of section 1000(f) with respect to a calendar year shall, in order to be effective, be signified by both spouses. If both spouses file gift tax returns, Form 709, within the time for signifying consent it is sufficient if (1) the consent of both spouses is signified on one of such returns or (2) the consent of one spouse is signified on one such return and the consent of the other spouse is signified on the other return. If only one spouse files a gift tax return within the time provided for signifying consent, the consent of both spouses shall be signified on such return. However, wherever possible notice of the consent is to be shown on both returns. The consent may be revoked only as provided in paragraph (c) of this section. (As to whether one or both spouses are required to file returns, see section 86.20). Where one spouse files more than one Form 709 for a calendar year on or before the 15th day of March following the close of such year, the last Form 709 so filed will, for the purpose of determining whether a consent has been signified, be considered as the return."

14. 31 T.C. 655 (1958), *aff'd per curiam*, 272 F.2d 945 (6th Cir. 1959).

15. Neither the taxpayer nor the Commissioner doubted that a signature was necessary.

16. See notes 1, 8, & 13 *supra.*

17. The *Thorrez* case had not been decided when Congress passed the 1954 Code; thus passage of the code can not be interpreted as approval of the assumption in the *Thorrez* case.

18. Sullivan v. Comm'r, 256 F.2d 4 (5th Cir. 1958); Jack Douglas, 27 T.C. 306 (1956); W. L. Kann, 18 T.C. 1032 (1952), *aff'd*, 210 F.2d 247 (3d Cir. 1953), *cert. denied*, 347 U.S. 967 (1954).

consent doctrine raises a presumption that a joint return is intended;[19] however, this doctrine has never been applied to a gift tax return situation.[20]

The court in the instant case stated that (1) nowhere, save on the return itself, is it required that the other spouse sign the return; (2) nowhere is it stipulated that her consent can be signified only by her, and (3) nowhere is it stated that the consent can be evidenced only by her signature.[21] The court further stated that if Congress or the Internal Revenue Service intended to confine signification of consent to signature they would have so directed, as was done in income tax returns.[22] To further support its holding, the court emphasized that the gifts were made from a joint bank account,[23] that the wife had filed no separate returns herself,[24] and that there was no actual or potential tax liability to the wife by her consenting to the return.[25] The court referred to the so-called theory of tacit consent used in income tax cases but did not apply it in the instant case.[26] The court indicated that the holding might be limited in the future by requiring a more rigid exaction of signification if there were undesirable results from the decision; for example, cases where a spouse attempts to avoid tax liability by claiming no consent had been given.[27]

It appears best to examine the court's decision from two points of view: is the decision a correct interpretation of the requirements of the regulations[28] and the Code;[29] and, assuming that neither the code nor the regulations are determinative, what *should* the law be? Turning to the first point, it is to be noted that the regulation requires the consent of *both* spouses to be signified on the return.[30] Since the petitioner's wife neither filled out nor signed the return it is difficult to see how she signified her consent *on* the return. Furthermore, the code clearly states that returns must be signed in accordance with forms provided.[31] Although the court did not say so, it apparently based its decision on the grounds that petitioner consented for his wife, however there is a revenue ruling that provides a specific

19. Vincent S. Hennen, 35 T.C. 747 (1961).
20. 327 F.2d at 101. A perusal of cases in the area discloses no cases that have applied the tacit consent doctrine to a gift tax return.
21. *Id.* at 99.
22. *Id.* at 100.
23. *Ibid.*
24. *Id.* at 101.
25. *Ibid.*
26. *Ibid.*
27. INT. REV. CODE OF 1954, § 2513(d). See note 1 *supra.*
28. Treas. Reg. § 25.2513 (1958). See note 8 *supra.*
29. INT. REV. CODE OF 1954, §§ 2513, 6061.
30. See note 8 *supra.*
31. See note 12 *supra.*

means by which a taxpayer can consent as agent for his absent spouse.[32] Thus, from a plain reading of the code it appears that the holding in the instant case is incorrect. As to the question of what the law *should* be, it is necessary to examine the practical reasons for requiring that a spouse consent to a split gift and see if these reasons justify requiring a signature. One reason is that when a husband and wife consent to a split gift, the tax liability in the event any tax is due is both joint and several.[33] It would be unfair to make a wife liable for the tax on a gift made by her spouse unless she consented to the gift; thus in such cases it would be especially important to determine accurately the wife's intent. Her signature would be the best way to indicate her consent. The other reason for requiring consent to a split gift is to prevent taxpayers from changing their minds. Once an election is made a taxpayer is not permitted to change his mind to the detriment of the revenue.[34] The signature of both spouses would be the best way to indicate such election. However, there is a valid reason for allowing consent to be shown by other than a signature. Each year out of the many gift tax returns filed, a certain number will not be properly signed either from misunderstanding or by inadvertence. In an area as complex as tax law, there is no justification for imposing an extra tax because of a mistake of this type. As long as there is a clear manifestation of intent shown by competent evidence, there is no valid reason for not allowing consent by means other than a signature.

32. Rev. Rul. 54-6, 1954-1 CUM. BULL. 205: "A husband and wife are entitled to the gift splitting benefits . . . where one spouse files a Federal gift tax return for himself and, in addition to signifying his own consent, executes thereon as agent for his absent spouse a consent to treat the gift as having been made one-half by each spouse, and files a gift tax return for the absent sponse as her agent, provided the return filed and the consent executed by the one spouse as agent for the other are ratified within a reasonable time after the absent spouse is able to so do."

33. INT. REV. CODE OF 1954, § 2513(d). See note 1 *supra*.

34. Camiel Thorrez, *supra* note 14, at 668.

# Taxation–Federal Income Tax–Characterization of Distribution to Employees of Retirement Trust on Account of Termination of the Trust Incident to a Change of Stock Ownership of Corporate Employer

Taxpayer's employer, Waterman Steamship Corporation, had maintained a non-contributory retirement plan for its employees in the form of a qualified employees' trust.[1] G. Lee Company purchased ninety-nine per cent of the stock of Waterman, promptly terminated the retirement plan and made lump sum distributions of the trust fund to employees. Taxpayer continued in Waterman's employ after the stock transfer, and after Lee formally merged into Waterman. Taxpayer claimed that the lump sum payment he had received upon dissolution of the trust was entitled to capital gains treatment.[2] The Internal Revenue Service ruled that payments received by taxpayer were based on a termination of the plan and not "on account of the employee's death or other separation from the service"[3] as required by the Code. The district court held for the taxpayer. On appeal, *held*, reversed. Lump sum distributions from an employees' retirement trust on account of a termination of the trust incident to a change of stock ownership of the corporate employer are to be treated as ordinary income. *United States v. Johnson*, 331 F.2d 943 (5th Cir. 1964).

The purpose and scope of the legislation granting capital gains treatment to lump sum distributions from employees' trusts has been a subject of confusion since its inception in 1942. By amendment to the Internal Revenue Code of 1939, Congress limited special tax benefits to only those distributions made "on account of the employee's death or other separation from the service."[4] The proper interpretation of this clause has been constantly in question since the passage of the statute.[5] In a 1951 decision, *Edward Joseph Glinske, Jr.*,[6] the Tax

1. INT. REV. CODE OF 1954, § 401(a).

2. "In the case of an employees' trust described in section 401 (a), which is exempt from tax under section 501 (a), if the total distributions payable with respect to any employee are paid to the distributee within 1 taxable year of the distributee on account of the employee's death or other separation from the service, or on account of the death of the employee after his separation from the service, the amount of such distribution, to the extent exceeding the amounts contributed by the employee . . . shall be considered a gain from the sale or exchange of a capital asset held for more than 6 months." INT. REV. CODE OF 1954, § 402(a)(2).

3. INT. REV. CODE OF 1954, § 402(a)(2).

4. Int. Rev. Code of 1939, ch. 1, § 165(b), 53 Stat. 67, as amended, 56 Stat. 863.

5. In both the 1942 amendment and the 1954 Code, Congress failed to rationalize its granting of special capital gains treatment to lump sum distributions from employees'

Court held that the clause meant separation from the service *of the employer*. Two subsequent cases[7] held that the employee, in order to be eligible for the tax benefits, must have severed his connection with his employer and not continued to work. However, in a 1954 decision, *Mary Miller*,[8] it was first held that distributions on account of *a termination of the trust incident to a change of employers* were entitled to capital gains treatment even though the employee remained in his previous capacity under the new employer. The Tax Court reasoned that the employee became separated from the service of his employer when the assets of the employer corporation were exchanged for stock in the purchasing corporation.[9] Another case with a ruling favorable to the taxpayer was *Lester B. Martin*,[10] where a corporation acquired the stock of the employer corporation and ran it as a subsidiary. The Tax Court held that the employee became separated from the service of his employer when the employer corporation was liquidated, after the change in stock ownership, but before its assets were transferred to the parent corporation. In both *Miller* and *Martin*, the distributions were *caused* by a termination of the plan, but, since the termination was incident to a change of employers, either by a sale of assets or by a complete liquidation, the distributions were declared to be on account of separation from the service.

Congress, concerned about the *Miller* case and apparently anticipating the *Martin* decision, became apprehensive of the possible abuse by corporations liquidating and reincorporating to gain tax advantages on lump sum distributions of retirement funds.[11] Consequently, under the 1954 Code, payments made on account of a termination of the plan incident to a liquidation of the employer were to be considered on account of separation from the service only if distributed *before January 1, 1955*.[12] However, in 1958 the Internal Revenue Service stated its position to be that distributions owing to a termination of the plan are on account of separation from the service if they are incident

trusts. Miller, *Capital Gains Taxation of the Fruits of Personal Effort: Before and Under the 1954 Code*, 64 YALE L.J. 1, 5 (1954).

6. 17 T.C. 562 (1951).

7. Estate of Edward I. Rieben, 32 T.C. 1205 (1959); Estate of Frank B. Fry, 19 T.C. 461 (1952), *aff'd*, 205 F.2d 517 (3d Cir. 1953).

8. 22 T.C. 293 (1954), *aff'd*, 226 F.2d 618 (6th Cir. 1955).

9. This transfer of ownership constitutes a § 368(a)(1)(c) reorganization which is distinguishable from a mere stock purchase. However the case is generally treated as if there had only been a stock purchase.

10. 26 T.C. 100 (1956).

11. The Senate Finance Committee explained its reason for adopting the restriction in the 1954 Code as follows: "Your committee's bill revises this provision of the House bill to climinate the possibility that reorganizations which do not involve a substantial change in the make-up of employees might be arranged merely to take advantage of the capital gains provision." S. REP. No. 1622, 83rd Cong., 2d Sess. 54 (1954).

12. INT. REV. CODE OF 1954, § 402(e).

to either: (1) a transfer of assets and liabilities from the employer sufficient to constitute a reorganization[13] under section 368(a)(1)(C),[14] or (2) an acquisition of the stock of the employer *prior to* liquidation of the employer, so that both acts may be regarded as a single integrated transaction.[15] The Service indicated that it is willing to allow capital gains treatment where there is a "substantial change" in the make-up of the employment relationship, but not where there is only a change in a technical or formal sense.[16] This is consistent with the intent of Congress; however, the effect of these rulings was somewhat negated by statements[17] by the Service that Congress did not intend to discriminate against the corporate employer. The inference seems to be that since a change of ownership in the non-corporate organization constitutes a change of employers, the same should be true of the corporate employer. The reasoning of the Revenue Rulings discussed above was applied in 1963 in *Nelson v. United States*,[18] where the court held that a mere transfer of ownership within the employer corporation did not substantially change the employment relationship, and, since the employee remained under the same corporate employer, there was no separation from the service. However, an opposite result was reached in the decision of *Martin v. United States*,[19] a case based on facts identical to those in the present case. There it was held that a change of corporate ownership, being similar to a change of non-corporate ownership, is sufficient to bring about a separation. A third 1963 case, *Thomas E. Judkins*,[20] involved similar facts except that the employee severed his employment prior to the termination of the plan. Separation was found either on this basis or on the transfer of ownership of the corporate employer.

The court in the instant case was essentially confronted with a choice between the rationale of the *Nelson*[21] and *Martin*[22] cases. In following *Nelson*, the court concluded that a mere change of stock ownership of the Waterman Corporation did not cause a separation from the service. The majority reasoned that Congress only intended

13. Rev. Rul. 58-94, 1958–1 CUM. BULL. 1954. This is one of many rulings which the Service issued in 1958 covering various factual situations under this section of the Code.

14. INT. REV. CODE OF 1954, § 368(a)(1)(c).

15. Rev. Rul. 58-95, 1958-1 CUM. BULL. 197.

16. Rev. Rul. 58-94, 1958-1 CUM. BULL. 194, 196.

17. Rev. Rul. 58-94, 1958-1 CUM. BULL. 194, 196.

18. 222 F. Supp. 712 (N.D. Idaho 1963).

19. 63-2 U.S. Tax. Cas. ¶ 89,858 (D.C. Minn. 1963). The taxpayer in this case was also an employee of Waterman Steamship Corp. and received a lump sum payment from dissolution of the same employees' trust.

20. 31 T.C. 1022 (1963).

21. Nelson v. United States, *supra* note 18.

22. Martin v. United States, *supra* note 19.

the tax benefits to accrue when there was "a substantial change in the make-up of employees"[23] and held that a mere acquisition of stock ownership in a corporation does not effectuate such a change because the employment relationship is not interrupted. Therefore, to allow capital gains treatment in this type of situation would defeat the intent of Congress and abuse the purpose of the benefit. In reaching its decision, the majority of the court rejected the authority of the *Martin*[24] case by stating that the insistence of the Service that employees of corporate and non-corporate employers be treated the same "cannot be taken literally."[25] The majority reasoned that the very essence of the corporation is that it achieves immortality, and that its existence transcends any change in ownership of its stock. Hence, the corporate entity as an employer continues even with a bona fide change in ownership, while the non-corporate employer disappears. Therefore the court thought that the two employer forms were distinguishable and should be treated differently. The main objection of the dissent was the failure of the majority to "give proper emphasis"[26] to the rulings and cases which support the taxpayer, and upon which the public should be able to rely.

On the basis of policy considerations as well as authority and reasoning, the majority opinion, concurring with the *Nelson* court, is the sounder view. Since the termination of a trust plan, incident to a change of stock ownership that does not constitute a separation from the service, is beyond the control of the employee, it seems rather unjust to deprive him of the tax benefits. However, Congress did intend, as manifested through the language that it employed,[27] to restrict the scope of the benefit. Therefore the court must effectuate this intent by interpreting the scope of the benefit and limiting capital gains treatment strictly to those areas within the scope, irrespective of the harsh results. The decision follows the general reasoning and most of the stated positions of the Service, conflicting only with the Service's interpretation of the similarity of the corporate and non-corporate employers.[28] The majority's rationale concerning separation only where there is "a substantial change in the make-up of employees,"[29] finds support in the reasoning of almost all of the

23. Rev. Rul. 58-94, 1958-1 CUM. BULL. 194, 196.

24. Martin v. United States, *supra* note 19. The court's main authority was Rev. Rul. 58-94, 1958-1 CUM. BULL. 194.

25. United States v. Johnson, 331 F.2d 943, 951 (1964).

26. *Id.* at 955. However, the dissent failed to note why the emphasis was improper, or what the proper emphasis should have been.

27. If Congress had intended the tax benefit to be applied whenever there was a termination of the plan, then it should have used that language instead of separation from the service.

28. Rev. Rul. 58-94, 1958-1 CUM. BULL. 194, 196.

29. *Ibid.*

cases. Indeed, the *Miller*[30] case, upon which the opposing view heavily relies, represents more than a mere change of stock ownership. Involved in that case was a section 368(a)(1)(c) reorganization,[31] a change which the Service has admitted[32] constitutes a separation from the service of the employer. The *Martin*[33] case, however, did raise a question which was not satisfactorily answered in the present case. There it was argued that since a merger by the Waterman Corporation into Lee subsequent to the purchase of Waterman stock, thereby leaving Lee the continuing corporation, would undoubtedly have constituted a separation from the service,[34] why should the tax benefits be lost merely because the merger occurred in the opposite manner, leaving Waterman as the continuing corporation. The answer is that until the Waterman Corporation ceases to exist, the relationship with its employees remains uninterrupted. Only when it disappears will there be a bona fide separation. The decision should give rise to future acquisitions by methods other than a mere stock transfer within the corporation, if the purchaser wishes to terminate the trust while retaining the tax benefits for his employees. In all probability this court will approve the holdings of the Service that a substantial change in the employment relationship occurs in an acquisition involving a section 368(a)(1)(c) reorganization or by a purchase of stock and a subsequent liquidation or merger of the corporation, thereby leaving the purchaser with two alternative methods of acquisition.

## Taxation—Federal Income Tax—Deductibility of Expenses Incurred by Teachers on Sabbatical Leave

Advice was requested from the Internal Revenue Service concerning the deductibility of expenses (including traveling expenses) incurred by teachers on sabbatical leave. The Service posed the following hypothetical: A teacher of French, while on sabbatical leave, granted for the purpose of travel, journeys through France to improve

30. Mary Miller, *supra* note 8.
31. INT. REV. CODE OF 1954, § 368(a)(1)(c).
32. Rev. Rul. 58-94, 1958-1 CUM. BULL. 194.
33. Martin v. United States, *supra* note 19, ¶ 89864.
34. See Rev. Rul. 58-95, 1958-1 CUM. BULL. 197. This ruling concerned a change of stock ownership plus a subsequent liquidation.

his knowledge of French. His activities consist largely of visiting French schools and families, attending motion pictures, plays, lectures, etc., in the French language. *Ruled,* deduction allowed. The travel expenses (including transportation and expenses necessarily incurred for meals and lodging) are deductible as ordinary and necessary business expenses if and to the extent that the travel is directly related to the duties of the teacher in his teaching position and is expected to result in actual or potential benefit to him as a teacher holding such position, due consideration being given to the normal duties of that position. Revenue Ruling 64-176, *1964 Int. Rev. Bull. No. 23,* at 7.

The traveling expenses of a teacher who has a temporary job away from his regular place of employment are deductible.[1] Likewise, a taxpayer who travels away from home primarily to pursue education, the expenses of which are deductible, may deduct the traveling expenses incurred.[2] These expenses are allowed under section 162(a)(2) of the Internal Revenue Code of 1954, which permits deduction of "traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in pursuit of a trade or business . . . ." Treasury Regulation 1.162-5(d) determines the extent to which the taxpayer's expenditures will be deductible where the trip is partially personal and partially in pursuit of deductible education.[3] Quite another problem is presented by travel as a form

1. G.C.M. 10915, XI-2 CUM. BULL. 245, *implemented,* I.T. 2640, XI-2 CUM. BULL. 246 (1932), *revoking* I.T. 1238, I-1 CUM. BULL. 122 (1922); see Laurence P. Dowd, 37 T.C. 399 (1961), where a deduction was allowed for the traveling expenses of a Fulbright lecturer; Rev. Rul 62-1, 1962-1 CUM. BULL. 9; Special Rul., 5 CCH 1950 STAND. FED. TAX REP. ¶ 6052, where an exchange teacher accepting temporary employment abroad was allowed to deduct the travel to and from the job and the cost of meals.

2. Brooks v. Comm'r, 274 F.2d 96 (9th Cir. 1959); Coughlin v. Comm'r, 203 F.2d 307 (2d Cir. 1953); Hill v. Comm'r, 181 F.2d 906 (4th Cir. 1950); Alexander Silverman, 6 B.T.A. 1328 (1927), acq., VI-2 CUM. BULL. 6 (1927); Rev. Rul. 63-275, 1963-2 CUM. BULL. 85.

3. The Regulation provides that where the trip is primarily to obtain deductible education, the expenses for travel, meals, and lodging while away from home are deductible, although that portion of the expenses attributable to personal activity, such as sightseeing or entertaining, is not. If the primary purpose of the trip is personal, with some time devoted to deductible education, the expenditures for meals and lodging during the time spent on the educational activity are deductible, but none of the traveling expense is allowed. An important factor in determining whether a trip is primarily personal or primarily for deductible education is the relative amount of time devoted to personal activities as compared with the amount of time devoted to the educational pursuits. Compare Treas. Reg. §§ 1.162-2(a)-(b) (1958), which explains similar rules for deductibility of traveling expenses in pursuit of business; see also INT. REV. CODE OF 1954, § 274(c), and Treas. Reg. § 1.274-4 (1963) (allocation of travel expenses when the taxpayer engages in substantial personal activity in his travel outside of the United States for more than one week, if he cannot show a lack of a major consideration to obtain a vacation); INT. REV. CODE OF 1954, § 274(d), and Treas. Reg. § 1.274-5 (1962) (substantiation of traveling expenses).

of education. If not eonsidered as personal in nature by Treasury Regulation 1.162-5(c),[4] the expense may be allowed under section 162(a) of the Internal Revenue Code of 1954 as an ordinary and necessary business expense. It would seem that the regulations appropriate to this type of travel are Treasury Regulations 1.162-5(a) and (b),[5] which are applicable to the deductibility of expenditures for education as an ordinary and necessary business expense.[6]

Historically, expenses related to a person's education have been disfavored by the Internal Revenue Service. As early as 1921, the Service issued two Office Decisions which characterized education as personal in nature.[7] Subsequently, the Supreme Court noted that "reputation and learning are akin to capital assets . . . . The money spent in acquiring them . . . is not an ordinary expense of the operation of a business."[8] The few cases involving education expenses which were litigated before 1950 generally resulted in disallowance.[9] In that year, the case of *Hill v. Commissioner*,[10] opened the door to deduction of education expenses by allowing a teacher to deduct the expenses of a summer school course on the ground that she was fulfilling a requirement to maintain her present position. Although the Tax Court maintained a restrictive policy toward educational deductions,[11] the Court of Appeals for the Second Circuit in *Coughlin v. Commissioner*,[12] recognized that the knowledge obtained need not be required by an employer if it were appropriate to the taxpayer's business. *Hill* and *Coughlin* were the first cases to recognize that education is not necessarily a capital expenditure and that it could

4. See text accompanying note 24 *infra*.

5. See text accompanying notes 21-23 *infra*.

6. *But. cf.* notes 72-75 *infra* and accompanying text.

7. O.D. 892, 1921-4 CUM. BULL. 209; O.D. 984, 1921-5 CUM. BULL. 171. *But cf.* G.C.M. 11654, XII-1 CUM. BULL. 250, *implemented*, I.T. 2688, XII-1 CUM. BULL. 251 (1933), *revoking* I.T. 1520, I-2 CUM. BULL. 145 (1922).

8. Welch v. Helvering, 290 U.S. 111, 115-16 (1933) (dictum); *cf.* Knut F. Larson, 15 T.C. 956 (1950), where the Tax Court, citing Welsh v. Helvering, *supra*, declined to state whether the expense was disallowed as "personal" or as "capital" since the result would have been the same.

9. Welch v. Helvering, *supra* note 8; James M. Osborne, 3 T.C. 603 (1944); T. F. Driscoll, 4 B.T.A. 1008 (1926); Jay N. Darling, 4 B.T.A. 499 (1926). *Contra*, Alexander Silverman, *supra* note 2 (deduction allowed for a chemistry professor attending a scholarly meeting).

10. 181 F.2d 906 (4th Cir. 1950), *reversing* 13 T.C. 291 (1949); *accord*, I.T. 4044, 1951-1 CUM. BULL. 16.

11. See Matilda Brooks, 30 T.C. 1087 (1958), *rev'd*, 274 F.2d 96 (9th Cir. 1959); Clark S. Marlor, 27 T.C. 624 (1956), *rev'd*, 251 F.2d 615 (2d Cir. 1958); Robert M. Kamins, 25 T.C. 1238 (1956); George G. Coughlin, 18 T.C. 528 (1952), *rev'd*, 203 F.2d 307 (2d Cir. 1953); Richard Lampkin, 11 CCH Tax Ct. Mem. 576 (1952); Knut F. Larson, *supra* note 8; Nora Payne Hill, 13 T.C. 291 (1949), *rev'd*, 181 F.2d 615 (4th Cir. 1950); Manoel Cardoza, 17 T.C. 3 (1951). *But see* Robert S. Green, 28 T.C. 1154 (1957).

12. 203 F.2d 307 (2d Cir. 1953).

qualify as an "ordinary and necessary business expense," subject to the rules of construction applicable to that phrase.

As with other business expenses, the presence of a personal motive does not preclude deductibility where the expense is primarily a business one.[13] The theory of allowing a deduction when the taxpayer's primary purpose is to maintain and improve skills, even though he has a secondary personal motive, has become known as the "dual purpose doctrine."[14] Although it has been thought that the education must be required to receive the deduction,[15] the prevailing rule seems to be to the contrary.[16] However, if the education is required, it will ordinarily be deductible,[17] and an in-grade increase in salary will not preclude deduetibility.[18] If the taxpayer may satisfy the requirements of his employer in one of two ways, he is free to choose the one he wishes and is not denied the deduction merely

13. Marlor v. Comm'r, 251 F.2d 615 (2d Cir. 1958), *reversing* 27 T.C. 624 (1956). A tutor at a college was required to make substantial progress toward his Ph.D. to retain his position as tutor; the Ph.D. was also a prerequisite to obtaining a permanent position as an instructor. Judge Raum's dissenting opinion in the Tax Court, which was adopted by the majority in the circuit court, indicated that the immediate objective, rather than the ultimate result, is determinative. *Accord,* Devereaux v. Comm'r, 292 F.2d 637 (3d Cir. 1961), *reversing* 19 CCH Tax Ct. Mem. 453 (1960); Treas. Reg. § 1.162-5(b) (1958). *But see* the "minimum requirements" test of Treasury Regulation 1.162-5(b), which denies the deduction if the education is required in order to meet the minimum requirements of the taxpayer's intended trade, profession, or specialty. In Robert S. Green, 28 T.C. 1154 (1957), a teacher was allowed to deduct the expenses of obtaining summer school college credits, which were required to qualify her for annual salary increments, despite the fact that the credits were later nsed in partial fulfillment of the requirements for a Master's degree. *Accord,* Elmer R. Johnson, 20 CCH Tax Ct. Mem. 582 (1961), *aff'd,* 313 F.2d 668 (9th Cir. 1963). *Contra,* T.I.R. No. 76, 6 CCH 1958 STAND. FED. TAX REP. ¶ 6445.

14. Shaw, *Education as an Ordinary and Necessary Expense in Carrying on a Trade or Business,* 19 TAX L. REV. 1, 11 n.48 (1963).

15. See Rev. Rul. 55-412, 1955-1 CUM. BULL. 318, *revoked,* Rev. Rul. 64-176, 1964 INT. REV. BULL. No. 23, at 7; *cf.* Dennehy v. Comm'r, 309 F.2d 149 (6th Cir. 1962); Harold H. Davis, 38 T.C. 175 (1962), *vacated by agreement of the parties,* 7 CCH STAND. FED. TAX REP. ¶ 1360.721 (Jan. 30, 1964); Manoel Cardoza, *supra* note 11; Proposed Treas. Reg. § 1.162-5(d), 21 Fed. Reg. 5091 (1956) (not adopted).

16. See, *e.g.,* Brooks v. Comm'r, *supra* note 2; Harold H. Davis, *supra* note 15 (dissent); Rev. Rul. 63-275, 1963-2 CUM. BULL. 85. For an extensive analysis of the *Davis* case and the resultant Revenue Ruling, see Wolfman, *Professors and the "Ordinary and Necessary" Business Expense,* 112 U. PA. L. REV. 1089 (1964).

17. See, *e.g.,* United States v. Michaelson, 313 F.2d 668 (9th Cir. 1963), *affirming* 203 F. Supp. 830 (E.D. Wash. 1961) (deduction allowed for the expense of a year of law school, where a fifth year of college was required to maintain teacher's job, even though there was no evidence that law was related to his teaching position); Devereaux v. Comm'r, *supra* note 13 (moral obligation sufficient to make the educatiou "required"); Ruth D. Truxall, 21 CCH Tax Ct. Mem. 726 (1962) (expense of education required to secure annual advancements in salary held deductible); Treas. Reg. § 1.162-5(a)(2) (1958). *But see* Harold H. Davis, *supra* note 15 (iudirect pressure by univcrsity officials to do research and writing, without an express requirement, held not sufficient to allow deduction).

18. Treas. Reg. § 1.162-5(e), example (6) (1958).

because it is the more expensive or the less usual means.[19]

In 1958 the Treasury Department issued detailed regulations that were substantially more liberal than those it had proposed in 1956.[20] The final regulations make education expenses deductible if they are

> for education (including research activities) undertaken primarily for the purpose of: (1) Maintaining or improving skills required by the taxpayer in his employment or other trade or business, or (2) Meeting the express requirements of a taxpayer's employer . . . imposed as a condition to the retention by the taxpayer of his salary, status, or employment.[21]

The taxpayer will ordinarily be considered to have undertaken the education for the purpose of maintaining or improving skills "if it is customary for other established members of the taxpayer's trade or business to undertake such education."[22] However, when the expenses are incurred (1) primarily for the purpose of obtaining a new position or substantial advancement in position, (2) primarily for the purpose of fulfilling the general educational aspirations or other personal purposes of the taxpayer, or (3) in order to meet minimum requirements for qualification or establishment in the taxpayer's intended trade or business or specialty, they are considered primarily personal in nature and are not deductible.[23] Furthermore, the regulations state that "in general, a taxpayer's expenditures for travel (including travel while on sabbatical leave) as a form of education shall be considered as primarily personal in nature and therefore not deductible."[24]

Prior to the issuance of the Regulations, the Commissioner had said that expenses incurred by a teacher on sabbatical leave would not be deductible if the travel and study were not required by the school in order to maintain his position.[25] The Commissioner reasoned that these expenses were voluntarily assumed to increase prestige, to improve the teacher's reputation for scholarship and learning, and to better fit him for the duties he was employed to perform; thus the

19. Hill v. Comm'r, *supra* note 2; Evelyn L. Sanders, 19 CCH Tax Ct. Mem. 323 (1960); *accord*, Rev. Rul. 60-97, 1960-1 CUM. BULL. 69, 75. *But see* Richard Siebold, 31 T.C. 1017 (1959), where deduction was denied because the teacher's trip to Europe, which satisfied the school's requirement for renewal of his certificate, was not the "ordinary" way to earn credits.

20. Proposed Treas. Reg. § 1.162-5, 21 Fed. Reg. 5091 (1956). The Proposed Regulations disallowed expenses for courses which were taken voluntarily if they carried academic credit, resulted in an increase in salary or promotion, improved present skills, or maintained skills not directly and immediately required. Moreover, meals and lodging spent on deductible education while away from home on a trip that was primarily personal were disallowed.

21. Treas. Reg. § 1.162-5(a) (1958).

22. *Ibid.*

23. Treas. Reg. § 1.162-5(b) (1958).

24. Treas. Reg. § 1.162-5(c) (1958).

25. Rev. Rul. 55-412, 1955-1 CUM. BULL. 318, *revoked*, Rev. Rul. 64-176, 1964 INT. REV. BULL. No. 23, at 7.

expenses were personal in nature.[26] However, where the traveling was required, compensation was received, and it was required that a report on the travel be submitted, the Commissioner had held that the expenses would be deductible.[27]

The courts have struggled with this problem of travel as education, aware that it concerns the deductibility of an education expense but at times confusing it with an expenditure for travel in pursuit of education, the cost of which is deductible. It is easy to see how a court may become confused when presented with the problem of a taxpayer taking a tour which is educational in and of itself, and as a part of the tour attending classes to earn credits required by his employer.[28] Furthermore, the courts have been prone to follow the rationale of the older cases and the Commissioner's rulings, instead of applying the more liberal rules of the regulations and the recent cases.[29]

26. *Ibid.; accord,* Manoel Cardoza, *supra* note 11.

27. I.T. 3380, 1940-1 CUM. BULL. 29, *modified,* Rev. Rul. 64-176, 1964 INT. REV. BULL. No. 23, at 7.

28. See Hier v. United States, 64-1 U.S. Tax Cas. ¶ 9313 (S.D. Cal. Feb. 26, 1964) (cost of university-sponsored cruise, on which college courses for credit were taken by high school teacher, not deductible because not directly connected to taxpayer's teaching); Sid Neschis, 22 Tax Ct. Mem. 927 (1963) (applying the *Cohan* rule, fifty per cent of a teacher's expenses for combination European tour and education seminar, for which college credits were granted, deductible as an expense of maintaining or improving skills); Reuben B. Hoover, 35 T.C. 566 (1961) (part of doctor's expenses for combination cruise and postgraduate medical seminar, on which he earned twenty-five credits, deductible under *Cohan* rule); *cf.* Alan Thomas James, 1964 CCH TAX CT. REP. (23 CCH Tax Ct. Mem.) Dec. 26,676 (Feb. 28, 1964) (asserted deduction allowed for European music tour taken by music instructor, who only claimed eighty per cent of his expenses).

29. *Compare* Dennehy v. Comm'r, *supra* note 15, *with* Rev. Rul. 55-412, 1955-1 CUM. BULL. 318, *revoked,* Rev. Rul. 64-176, 1964 INT. REV. BULL. No. 23, at 7 (notes 25-26 *supra* and accompanying text), *and* Harold H. Davis, 38 T.C. 175 (1962) (dissent), *vacated by agreement of the parties,* 2 CCH 1964 STAND. FED. TAX REP. ¶ 1360.721 (Jan. 30, 1964) (note 15 *supra* and accompanying text). In Dennehy v. Comm'r *supra,* the school gave a summer sabbatical to its professors every third year; the time could be spent only for travel, reading, resting, and self-improvement. The court held that taxpayer's expenses for European travel were not deductible because the travel was voluntary, no report was required by the school, there was no showing that this was the customary way to spend the sabbatical leave, and "in no known instance has one ever been discharged for that reason [not traveling] . . . ." *Id.* at 150. *Compare* Richard Siebold, *supra* note 19, *with* Clark S. Marlor, *supra* note 11, *and* Treas. Reg. § 1.162-5(b) (1958) (note 13 *supra* and accompanying text). In Richard Siebold, *supra,* a teacher was required to earn a number of credits to renew his teaching certificate; this could be accomplished by study, travel, research, authorship, etc. The Tax Court held that the expenses of his European tour were not deductible because they were not "ordinary" expenses. "Merely because necessary credits were obtained in some permissible way does not mean the expense incurred by the teacher in securing them is deductible. Going to summer school can well be considered an ordinary way to obtain the required credits but a sightseeing trip to Europe as a form of education is something less than ordinary." *Id.* at 1021. Furthermore, there was no finding that the tour was undertaken *essentially* to enable him to secure credits to maintain his teaching position.

In *Cross v. United States*,[30] however, a foreign language professor was allowed to deduct the cost of his European trip as an ordinary and necessary business expense. In a well reasoned opinion, the court found that his trip was primarily for the purpose of maintaining and improving his skills as a Romance language instructor.[31] The

30. 222 F. Supp. 157 (S.D.N.Y. 1963), *rev'd on other grounds*, CCH 1964 STAND. FED. TAX REP. (64-2 U.S. Tax Cas.) ¶ 9697 (2d Cir. August 7, 1964).

31. *Id.* at 160. The specific activities engaged in seem to be most important, if not determinative. Professor Cross visited theatres, movies, restaurants, cafes, law courts, churches, schools, etc.; he read newspapers, talked to students, teachers, and others, attended political meetings, and listened to radio broadcasts, including political speeches; he had many discussions with book publishers about books in the various Romance languages and bought many of them for his teaching library.

In Smith v. United States, 61-1 U.S. Tax Cas. ¶ 9403 (N.D. Fla. 1961) (charge to the jury), the jury, considering the specific facts presented (not mentioned in the judge's charge), found that taxpayer, a teacher, took her trip to Europe "as a necessary matter of maintaining and improving her skill so that she could continue to teach adequately and fully and ably the courses which she was teaching," and allowed the asserted deduction of ninety per cent of her expenses.

In Alan Thomas James, 1964 CCH TAX CT. REP. (23 CCH Tax Ct. Mem.) Dec. 26,676 (Feb. 28, 1964), two elementary and high school music and band instructors took part in an organized twenty-two day music and cultural tour of Europe and the Soviet Union. They interviewed people in music education, visited colleges and schools in which music was taught, attended operas and listened to orchestras, visited places of interest related to the history of music, and in their spare time went sightseeing. The expense of a six-day personal trip to Germany after the tour was not sought as a deduction. On their return they found that the observations and techniques they had obtained were beneficial and useful in their music and band work. Taxpayers asserted eighty per cent of the cost of the tour as a deduction. The court, in upholding them, found that the expenditures were ordinary and necessary, undertaken primarily for the purpose of maintaining or improving skills.

In Sid Neschis, *supra* note 28, an elementary school teacher took a European tour, for which college credits were given, although the travel was in no way necessary for the retention of his job. During the tour, instruction was given in the administrative aspects of education and in education from primary grades to adult level. Lectures on the local school systems were held at a number of foreign universities, and the schools of the various countries were visited. While on the tour taxpayer bought and collected books for use in his teaching assignment. In addition, the museums, art centers, and other historical places of interest were visited in each country. After his return, taxpayer utilized and put into application much of the knowledge and techniques obtained on the tour and was active in trying to uplift education in his community. On the basis of these facts, the court, noting the difference between "mere sightseeing" and deductible expenses, found that fifty per cent of the amount paid for travel, meals, and lodging was expended to maintain or improve skills.

In Evelyn L. Sanders, 19 CCH Tax Ct. Mem. 323 (1960), an elementary school teacher, who taught art and geography, as well as reading, spelling, arithmetic, English, writing, science, and health, had the choice of taking summer courses or undertaking a certain amount of travel once every five years to meet a school requirement. She decided to travel to Europe, where her itinerary included visits to numerous art museums, churches and other outstanding architectural works, places of historical interest, etc. As evidenced by the report she was required to submit on her return, she had noted the geographical relationship of places to which she had traveled, the customs and habits of the people, features of the terrain, the industrial and agricultural activities, and climatic conditions prevalent in the various countries. The court commented that a visit to an art museum by a teacher of art could hardly be considered

court also noted that it is "customary" for foreign language teachers to visit the countries in which their languages are used.[32]

The court in *Adelson v. United States*,[33] adopted a different approach to the European tour of a teacher of English language and literature who was on sabbatical leave. The taxpayer argued that the sabbatical leave was an alternative way of following his trade or business and that he had to continue his traveling for the year or his salary would have been terminated.[34] The court, however, found that his expenses were not directly related to his business, and despite conditions imposed on him by the school board,[35] his trip

the reaction to a "common tourist attraction," the characterization given to such places by the Commissioner. Richard Siebold, *supra* note 19, was distinguished by saying that in that case no facts were presented which could establish a reasonable relationship between the travel and the subjects taught by the taxpayer. The court allowed the deduction, stating that the travel was required by her employer and that the expenditures were both "ordinary" and "necessary."

In Hier v. United States, *supra* note 28, husband and wife, both teachers, went on a study-cruise of the South Pacific sponsored by the California Teachers' Association and the University of Southern California. A number of courses, which carried college credit, were offered to participants, but enrollment in a course was not a prerequisite to obtaining passage on the cruise. The husband, who was a guidance counselor and taught high school government, foreign relations, psychology, and sociology, took two courses, one in Human Geography and the other in Peoples of the South Pacific. The wife, who taught high school homemaking, English, geography, and history (including geography and history of China), took the course in Peoples of the South Pacific and another course in Family and Social Life in China. The court said that there was no proof that the study-cruise was directly connected to their teaching, nor was there any proof that the expenses were ordinary and necessary. Accordingly, it was held that the expenditures were non-deductible personal expenses.

In Adelson v. United States, 221 F. Supp. 31 (S.D. Cal. 1963), a teacher of English language and literature and journalism planned his European trip so that each place visited was mentioned in English literature or was a place where an author lived, died, or was buried. He was impressed with the large number of newspapers in Europe as well as by the large number of bookstores, the number of American works in foreign translation, the Europeans' knowledge of American authors, and the fact that so many Europeans were multilingual. He discussed American literature with the natives of the various countries and collected a large number of slides and guide books, some of which would be suitable for class. The court, noting that Treasury Regulation 1.162-5(c) does not foreclose deductibility, nevertheless did not uphold taxpayer's contention that his travel was education undertaken primarily to maintain or improve skills required in his teaching position. Finding that his trip was not distinguishable from the usual tourist visit and was not directly related to his business, the court refused to allow deduction of his expenses.

32. 222 F. Supp. at 159-60.

33. 221 F. Supp. 31 (S.D. Cal. 1963).

34. *Cf.* Brooks v. Comm'r, *supra* note 2. He also urged that he had undertaken travel as a form of deductible education. See note 31 *supra*.

35. He had to meet certain requirements to be qualified to take the leave, and to present travel plans to the school authorities. It was necessary to execute the plan so that the general purpose of providing such leaves would be accomplished and, while he was away, he was under an obligation to perform services for the school had they been requested. On his return, he was obliged to make a report on the travel experience and to continue teaching for at least two more years.

was "in essence a leave from his work, and the way he spent the time substantiates this fact."[36]

The instant ruling comments on the deductibility of the educational and related traveling expenses of teachers on study or research sabbaticals, noting that such deductibility is generally governed by sections 1.162-5(a),[37](b),[38] and (d)[39] of the Regulations and not by section 1.162-5(c),[40] which is the primary concern of the ruling. Turning to the problem of sabbatical leave travel, the ruling notes that such travel is usually attendant with numerous safeguards which would indicate that the travel has a business motivation. As a general rule, the teacher must convince the school authorities that his proposed plan has professional worth,[41] and in some states the statute authorizing sabbatical leave for employees of the state school system requires that the travel be of such a nature as to benefit the teacher's school and pupils.[42] Upon completion of the travel, the teacher usually submits a report describing his trip, evaluating his experiences, and stating the professional benefits derived therefrom.[43] The teacher's salary is generally continued, at least in part,[44] and in such cases the teacher is ordinarily obligated to teach for at least a year after his return.[45]

Recognizing that all travel that is not merely repetitive has some educational value, the ruling states that such a generalized value is inherently personal to the traveler and normally has insufficient relationship to any business to meet the test of deductibility under

36. Adelson v. United States, *supra* note 3, at 38.
37. See text accompanying notes 21-22 *supra.*
38. See text accompanying note 23 *supra.*
39. See note 3 *supra* and accompanying text.
40. See text accompanying note 24 *supra.*
41. See, *e.g.*, Los Angeles, Cal., City School District, Personnel Division Memorandum A12, para. 1, cited in Adelson v. United States, *supra* note 33, at 33. "'A sabbatical travel leave is one during which an employee engages in planned educational travel for at least 60% of the leave period. Travel is considered educational if it results in a significant contribution to professional growth by exposing the participant to new peoples, cultures, environments, experiences, and events.'"
42. See, *e.g.*, CAL. EDUC. CODE § 13457.
43. See, *e.g.*, Los Angeles, Cal., City School District, Personnel Division Memorandum A12 para. 7, cited in Adelson v. United States, *supra* note 33, at 33, which requires the teacher to submit a report of at least 1,500 words, which will "include a brief description of places visited, and place primary emphasis on the significance of the experience to the employee as an educator and to the application of the educational growth to his regular assignment."
44. See, *e.g.*, CAL. EDUC. CODE § 13459, which grants a minimum salary of the difference between the teacher's regular salary and the salary of a substitute, and a maximum of the teacher's full salary.
45. See, *e.g.*, CAL. EDUC. CODE § 13460, which provides that the teacher must return to his school district and complete two more years of teaching before his right to compensation during the leave is finally established.

section 162(a) of the Code.[46] However, it concedes that the travel of a teacher on sabbatical leave may have such a direct relationship to the conduct of his trade or business as to make the expenses of the travel deductible, "even though it [the travel] may also be of the broadening, cultural type, which is generally considered to yield only personal advantage . . . ."[47]

The Service realizes that there is great similarity between the type of travel undertaken by teachers and that undertaken by other taxpayers, and thus warns that a teacher's expenses will be deductible "only if and to the extent that the travel is directly related to the duties of the teacher in his teaching position . . . ."[48] The ruling comments further that, in view of the unique character of this kind of travel, there must be a showing in every case that this direct relationship existed and that the travel was expected to result in actual or potential benefit to the teacher. Thus it would not be conclusive, as it might be with the conventional, formal type of education, to show that the travel was required[49] or that it was customary for established teachers to undertake such travel.[50] Referring to the amount of educational activity necessary to support the deduction, the ruling notes that the expenses will be allowed "if the taxpayer can show that his itinerary was chosen and the major portion of his trip was undertaken for the primary purpose of maintaining or improving his skills. . . ."[51]

The Commissioner's former position that sabbatical leave travel must be required to be deductible[52] was untenable, consistent with sound administration of the tax laws.[53] The instant ruling is a recognition of the fact that education, including travel as a form of education, may be an "ordinary and necessary business expense," subject to the usual rules of construction applicable to that phrase. It implicitly acknowledges the vitality of the "dual purpose doctrine,"[54] which permits the deduction of education expenses where there

46. "There shall be allowed as deductible all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." INT. REV. CODE OF 1954, § 162(a).

47. 1964 INT. REV. BULL. No. 23, at 9.

48. *Id.* at 10; see Hier v. United States, *supra* note 28.

49. See Richard Siehold, *supra* note 19; Shaw, *supra* note 14, at 24. *But cf.* United States v. Michaelson, *supra* note 17. I.T. 3380, 1940-1 CUM. BULL. 29, discussed in the text accompanying note 27 *supra*, is modified to conform to the instant ruling, and Rev. Rul. 55-412, 1955-1 CUM. BULL. 318, discussed in the text accompanying notes 25-26 *supra*, is specifically revoked.

50. *But cf.* Cross v. Comm'r, *supra* note 30, at 159-60.

51. 1964 INT. REV. BULL. No. 23, at 9.

52. Rev. Rul. 55-412, 1955 CUM. BULL. 318, *revoked*, Rev. Rul. 64-176, 1964 INT. REV. BULL. No. 23, at 7.

53. See Rev. Proc. 64-22, 1964 INT. REV. BULL. No. 22, at 74.

54. See text accompanying note 14 *supra*.

is both a business and a personal motivation, by allowing a deduction for travel, even though motivated in part by personal desires, where the travel is a form of business-related education. Moreover, it recognizes that the skills which are appropriate and helpful in the teaching profession are subjective in nature, and consequently, that the education which is appropriate and helpful may be more subjective than in the case of the usual trade or business. It is thus another step in the liberal trend that allows teachers a deduction for their education expenses; this trend having been begun by the courts[55] and continued by the Commissioner in the recent ruling allowing college professors, with or without tenure, to deduct the cost of their research, including any traveling expenses related to the research.[56]

The Commissioner has determined that the implied presumption of Treasury Regulation 1.162-5(c) ("In general . . . travel . . . as a form of education shall be considered as primarily personal. . . .") is not appropriate when there is, in fact, a business relationship between the travel and the teaching position of the taxpayer. In addition, he has announced a new standard for this type of education—expenses will be deductible when there is (1) a *direct relationship* between the travel and the duties of the teacher and (2) actual or potential *benefit* to the taxpayer as a teacher. A new standard was needed because the rules of Treasury Regulation 1.162-5(a)[57] had, in several ways, proved unsatisfactory as applied to travel as a form of education.

One difficulty encountered is that Treasury Regulation 1.162-5(a)(2)[58] is based on the assumption that education required by an employer will necessarily be related to the taxpayer's trade or business. This assumption, however, is not necessarily valid when applied to the teaching profession and to travel as education. For example, a school may require its teachers to undertake a certain amount of travel[59] as a prerequisite to renewing their teaching certificates, and often the travel need not be related to the specific duties of the instructor.[60] Sabbatical leave travel also may be regarded as "required" although initially undertaken voluntarily, since the retention of the teacher's salary is usually dependent on the completion of his proposed travel plans. In addition, the sabbatical traveling may be considered as an alternative means of following one's profession.[61]

55. See, *e.g.*, Hill v. Comm'r, *supra* note 10; Marlor v. Comm'r, *supra* note 13.
56. Rev. Rul. 63-275, 1963-2 CUM. BULL. 85.
57. See text accompanying notes 21-22 *supra*.
58. See text accompanying note 21 *supra*.
59. Usually the teacher has several alternative courses in addition to travel, *e.g.*, study, research, reading books, which he may follow to renew his certificate.
60. See, *e.g.*, Richard Siebold, *supra* note 19.
61. See note 34 *supra* and accompanying text.

The leave may be granted by the school for the broadening, cultural value of the travel, and this may sufficiently satisfy the school's requirement to permit the granting of salary.[62] However, in both situations the teacher's expenses for such travel should probably be considered personal and should be disallowed despite the fact that the travel is "required."[63] The expenses would be disallowed not because they are not "ordinary and necessary," but because they are not business expenses.[64]

Secondly, the Regulation assumes that education customarily undertaken by other established members in the same field will in and of itself usually indicate a business motivation.[65] This is based on the supposition that people established in their trade or business do not as a rule undertake education for recreation or other personal reasons. However, neither the supposition nor the assumption which is based on it, is valid when the education in question involves travel as a form of education. Because of the rise in the level of teachers' salaries in recent years, it is, in fact, becoming quite usual for educators, who often have the summer months off, to engage in the type of travel which is purely recreational.

A third problem arises from the reference in Treasury Regulation 1.162-5(a)(1) to "skills required by the taxpayer" as those which must be maintained or improved by the education.[66] It is true that the Commissioner has adopted a somewhat liberal attitude in this regard by providing that the skills "required" by the taxpayer in his employment are not those which are absolutely essential but "those which are appropriate, helpful or needed."[67] Although certain skills, *e.g.*, writing ability for an English professor, fluency in a foreign tongue for a language professor, may be helpful, appropriate, or needed in a teacher's specific subject, most of the knowledge and abilities which he must have cannot properly be called "skills." To perform his function effectively, an educator must possess such qual-

62. If the school is a taxpayer, it will be able to deduct the payments to the teacher as an ordinary and necessary business expense.

63. This is the result reached in Adelson v. United States, *supra* note 31. However, the decision is questionable on the basis of the facts presented, for in this case the travel did seem to be directly related to the taxpayer's teaching position. It does not seem reasonable to completely disallow all expenses (see notes 69-71 *infra* and accompanying text) in a case such as this, where there was evidence that taxpayer was maintaining or improving skills (see notes 66-68 *infra* and accompanying text), there was evidence that this type of travel was customary among members of the profession (see note 65 *infra* and accompanying text), and there was substantial evidence that the travel was required by the employer. *Cf.* note 68 *infra.*

64. *Cf.* Kornhauser v. United States, 276 U.S. 145 (1928).

65. See text accompanying note 22 *supra.*

66. See text accompanying note 21 *supra.*

67. Rev. Rul. 60-97, 1960-1 CUM. BULL. 69, 75.

ities as an understanding of the educational process, an understanding of and the ability to cope with human nature, the ability to reason, and the ability to communicate effectively. The Regulation, designed to cover the usual trade or business which requires certain objective, well-defined skills, in fact, is inadequate for a profession in which such skills play a relatively insignificant role. The best, and perhaps only way to maintain and improve the abilities a teacher must possess is by going through the educational process, obtaining a broad, general education and an appreciation for similarities and differences in value systems. The need for this type of education is indicated by the very fact that schools permit their teachers to take sabbatical leaves with pay to travel, to do research, or to pursue a course of study. A further indication is that schools often require their teachers to read a specified number of books, undertake a certain amount of travel, or obtain a certain number of college credits as a prerequisite to the renewal of their teaching certificate.[68]

Finally, Treasury Regulation 1.162-5(a) conditions deductibility on a finding that the education is *primarily* business motivated.[69] Thus an educational trip which was primarily personal, but which involved some education which maintained or improved the taxpayer's skills, would be completely disallowed.[70] This is, however, inconsistent with the policy of Treasury Regulation 1.162-5(d), which permits deduction of meals and lodging allocable to such education even though the trip is primarily personal. Likewise, it is inconsistent with the policy of Code section 162(a), which permits deduction of any expense to the extent that it is an ordinary and necessary business expense. The difficulty stems from the nature of travel as a form of education, which may be considered a traveling expense in pursuit of education, or the education itself, and may be viewed as one educational experience, or as comprising separable educational events.[71]

The ruling seems to indicate that the Commissioner has decided to allow the deduction by an application of both section 162(a) and section 162(a)(2) of the Internal Revenue Code of 1954. Apparently the travel is to be characterized under Code section 162(a)

68. This analysis would indicate that a teacher should be permitted to deduct all of his educational expenses, including travel as education, even though it is not "directly related" to his duties as a teacher. Certainly where the education is required, this would not seem unreasonable.

69. See text accompanying note 21 *supra.*

70. *Cf.* Adelson v. United States, *supra* note 31.

71. The ruling is ambiguous on this point. Statements are made which could support complete disallowance, partial disallowanee, or allocation of meals and lodging on a *per diem* basis. See note 73 *infra.*

and Treasury Regulations 1.162.5(a)-(c),[72] as education which is an ordinary and necessary business expense, and the standards to be applied to determine the extent of deductibility will be those governing traveling expenses in pursuit of a trade or business, as expressed by Code section 162(a)(2) and as explained in Treasury Regulation 1.162-5(d).[73] The synthesis of the two Code sections and the two Regulation sections has several advantages. The rigid formulae embodied in the Code and Regulation section taken separately are unrealistic when applied to this type of expense. If the travel were considered solely as education which is an ordinary and necessary business expense, any segment of the trip which was not educational would have to be disallowed. On the other hand, if it were considered solely as travel in pursuit of deductible education, any day on which there was no educational activities would have to be disallowed. The subjective nature of the education received through travel does not permit a ready distinction between education which is personal and that which is business-related. Thus neither of these determinations seems practical, and considering the nature of this expense, which is in fact a cross between an ordinary and necessary expense in carrying on a trade or business and a traveling expense in pursuit of business, neither of the results seems proper. The Commissioner's position, however, is flexible enough to disallow the expenses allocable to an extended portion of the trip devoted solely to personal activities. In such a case, the determination would be feasible, and the result would be proper. Furthermore, this synthesis permits the retention of aspects of both provisions, resulting in more favorable treatment than would be possible under either alone. The teacher need show that only one-half of his time abroad was spent on educational activities to permit the deduction of the cost of transportation without allocation as provided by Code section 274(c) of the Internal Revenue Code of 1954.[74] In addition, even though

72. See text accompanying notes 21-24 *supra*.

73. See note 3 *supra* and accompanying text. Consider the following passages from the Ruling. "[T]he expenses of [the French teacher's] . . . travel (including transportation and expenses necessarily incurred for meals and lodging) [Code § 162(a)(2)] are deductible as education expenses [Treas. Reg. § 1.162-5(a)] if the taxpayer can show that his itinerary was chosen and the major portion of his activities during the trip [Treas. Reg. § 1.162-5(d)] was undertaken for the primary purpose of maintaining or improving his skills [Treas. Reg. § 1.162-5(a)] . . . ." 1964 INT. REV. BULL. No. 23, at 9. "[T]he expenses of a teacher for such travel will be deductible as ordinary and necessary business expenses [Code § 162(a)] . . . to the extent that [Treas. Reg. § 1.162-5(d)] the travel is directly related to the duties of the teacher in his teaching position." 1964 INT. REV. BULL. No. 23, at 10.

74. See note 3 *supra*. Although § 274(c) is specifically mentioned in connection with teachers on research or study sabbaticals, and § 274(d), concerning substantiation, is specifically noted as applicable to travel as a form of education, the ruling nowhere mentions § 274(c) as applicable to this type of travel.

there is no showing that each day is educational, a deduction could be allowed for meals and lodging.[75]

There are, however, disadvantages to the synthesis. It may be said that the Commissioner's very liberality defeats the intent of Congress on the one hand to disallow an expenditure which is not an ordinary and necessary business expense[76] and on the other hand, to require allocation of traveling expenses as expressed in section 274(d). Furthermore, the synthesis raises questions that are left unanswered by the ruling. (1) Although the expenses allocable to an extended portion of a teacher's trip may be disallowed, *quaere* whether they will be? (2) Although the meals and lodging may be allowed without a showing that each day involved educational activity, *quaere* whether they will be, or will the taxpayer be able to deduct only a certain percentage of his expenses?[77] (3) On a primarily personal educational trip, where some of the travel is directly related to the teacher's job and is expected to result in benefit to him in his position, (a) will all of the expenses be disallowed, (b) will a deduction be granted for a certain percentage of the entire tour, or (c) will a full deduction be granted for the cost of meals and lodging attributable to those days on which the taxpayer's travel was directly related to his work? (4) Will the deduction be allowed in computing taxable income as a business expense of an employee or in computing adjusted gross income as a traveling expense of an employee? In the latter case, the teacher may take the minimum standard deduction as well as the traveling expense.

Analytically, the ruling makes a permissible exception to Treasury Regulation 1.162-5(c) and formulates an administrative standard applicable to this maverick expense. The effect of the Revenue Service's promulgation, however, is to reverse the implication of the Regulation so that it may now be said that travel (including travel while on sabbatical leave) as a form of education is not necessarily personal in nature and may be deductible. Since each case must be decided on the facts presented to determine if the necessary "direct relationship" exists, the ruling, as a matter of law, says little. However, it is a strong indication of the more liberal attitude which the Commissioner will take when presented with a concrete factual situation.

75. See text accompanying note 51 *supra*.

76. If the hypothetical French teacher, during the course of his trip were to spend a day or two socializing exclusively with an American friend, it could hardly be contended that this visit was directly related to his duties as a teacher and that the expenses incurred during this time were ordinary and necessary business expenses. It is doubtful, however, that these expenses would be disallowed.

77. *Cf.* Smith v. United States, *supra* note 31; Alan Thomas James, *supra* note 31; Sid Neschis, *supra* note 28.

## Taxation—State Taxation of Interstate Business—Constitutionality of Public Law 86-272

Louisiana imposed an apportioned net income tax on the plaintiff, which tax the plaintiff paid under protest, and brought suit to recover on the grounds that the tax violated Public Law 86-272.[1] That statute expressly forbids a state or local net income tax from being placed on a company that does no more than send representatives into the state for the purpose of soliciting orders for the sale of tangible personal property. Plaintiff, a Delaware corporation, conducted no business in Louisiana other than sending traveling salesmen into the state to solicit orders for shoes, which orders were forwarded to the home office in St. Louis, Missouri, where they were accepted, filled, and shipped. Plaintiff had no office, warehouse, or other place of business within Louisiana. The taxing state took the position that Public Law 86-272 is an unconstitutional attempt by Congress to regulate intrastate commerce. The trial court held for the plaintiff, sustaining the validity of the statute.[2] On appeal to the Supreme Court of Louisiana, *held,* affirmed. Congress is vested with plenary power under the commerce clause and this power includes prohibiting the states from levying apportioned net income taxes on multi-state businesses whenever Congress finds that such taxes burden the free flow of commerce. *International Shoe Co. v. Cocreham,* 246 La. 244, 164 So. 2d 314,[3] *cert. denied sub nom. Mouton v. International Shoe Co.,* 902 U.S. 379 (1964).

Congress is given the plenary power under the commerce clause to displace otherwise valid state action or to consent to otherwise invalid state action in the regulation of commerce among the states,

1. 73 Stat. 555 (1959), 15 U.S.C. § 381 (Supp. 1959-63).
"§ 101. Imposition of net income tax—Minimum standards. (a) No State, or subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such state by or on behalf of such person during such taxable year are either, or both, of the following: (1) the solicitation of orders by such, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and if approved, are filled for shipment or delivery from a point outside the State; and (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1)."
2. Dist. Ct., docket No. 88,023 Div. B., 19th Dist., Baton Rouge, La. (1963).
3. Under similar facts the Supreme Court of Oregon held that Congress did not have the power under the commerce clause to prohibit Oregon from placing a properly apportioned net income tax on a multi-state business that had sufficient nexus with Oregon. Smith, Kline & French Laboratories v. State Tax Commission, CCH STATE TAX CAS. REP. ¶ 250-116 (Ore. April 1964).

and the United States Supreme Court has frequently upheld this power.[4] One example of Congressional displacement of state action is the *Shreveport Rate Cases*.[5] There the Court held that Congress had the power to compel the equalizing of local freight rates with interstate rates, where Congress, as a part of an overall policy in fixing interstate rates, determined it was necessary to control local rates. The Court went even further in supporting Congressional power under the commerce clause when it held in the *Wickard* case[6] that Congress could regulate the local matter of how much grain a farmer could raise for his own use, where such production would have an adverse affect on Congressional legislation regulating prices and production of grain moving in interstate commerce. Public Law 86-272, however, is not completely similar to the Congressional legislation involved in *Shreveport* and *Wickard*, since the local activity regulated by Public Law 86-272 is not incident to an overall Congressional regulation of state taxation of interstate commerce. Perhaps the most notable instances of Congressional control over state power are in the areas where Congress has given permission to the states to regulate or tax interstate commerce in a manner which would otherwise not be permissible. *International Shoe Co. v. Wash-*

4. U.S. CONST. art. I, § 8. "Congress, in the exercise of its plenary power to regulate interstate commerce, may determine whether the burdens imposed on it by the state regulation, otherwise permissible, are too great, and may, by legislation designed to secure uniformity or in other respects to protect the national interest in the commerce, curtail to some extent the state's regulatory power . . . ." South Carolina State Highway Dep't v. Barnwell Bros., 303 U.S. 177, 190 (1937). "It is no longer debatable that Congress, in the exercise of the commerce power, may authorize the states, in specific ways, to regulate interstate commerce or unpose burdens upon it." International Shoe Co. v. Washington, 326 U.S. 310, 315 (1945). "Congress has undoubted power to redefine the distribution of power over interstate commerce. It may either permit the States to regulate the commerce in a manner which would otherwise be not permissible . . . or exclude State regulation of matters of peculiarly local concern which nevertheless affect interstate commerce." Southern Pacific Co. v. Arizona, 325 U.S. 761, 769 (1945). See HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE 247-56 (1953).

5. Houston, E. & W.T. Ry. v. United States, 234 U.S. 342 (1914). See California v. Pacific R.R., 127 U.S. 1 (1887) (under the commerce clause Congress had authorized California private corporations to exercise certain franchises resulting in an implied immunity from state privilege tax). Following the *Shreveport Rate* case Congress passed the Transportaton Act of 1920 which gave the Interstate Commerce Commission explicit authority to control intrastate activities which affected interstate commerce, 41 Stat. 484 (1920), 49 U.S.C. § 13 (4) (1958). The Supreme Court upheld the power of the Interstate Commerce Commission, acting under that act, to allow an intrastate railroad to abandon its operation over the objection from the state in which it operated because continued operation would adversely affect interstate commerce. Colorado v. United States, 271 U.S. 153 (1926). In Southern Ry. v. North Carolina, 376 U.S. 93 (1964), the Court sustained an order requiring discontinuance of a local line. Colorado v. United States, *supra*, was cited with approval, but the constitutionality of the power was assumed without discussion of the point.

6. Wickard v. Filburn, 317 U.S. 111 (1942).

*ington,*[7] was apparently the first holding that Congress could validly consent to a state unemployment tax, where Congress had provided that the employer should not be "relieved from compliance therewith on the ground that he is engaged in interstate commerce."[8] *Prudential Insurance Co. v. Benjamin*[9] sustained an act of Congress, the McCarran-Ferguson Act,[10] giving permission to the states to tax and regulate interstate insurance business, which state action the Court assumed, without deciding, would otherwise have been in conflict with the commerce clause. Congress' power to consent to state action was shown in the early case of *Pennsylvania v. Wheeling & Belmont Bridge Co.*[11] and the succeeding history of that case. There the Supreme Court held that a bridge over the Ohio River was an obstruction to commerce and enjoined its maintenance. Later the Court upheld an act of Congress[12] declaring that the same bridge was a lawful structure.[13] Prior to Public Law 86-272 Congress had failed to pass any comprehensive legislation relating to state and local taxation of multi-state business, consequently the Supreme Court has had to settle on an individual basis many controversies involving a state's power to tax a multi-state business.[14] In *Northwestern States Portland Cement Co. v. Minnesota,*[15] the Court decided that neither the commerce clause nor the due process clause prohibits the imposition of an apportioned, non-discriminatory excise tax on the net income of a foreign corporation, even though the income is derived exclusively from interstate commerce.[16] This decision provoked an adverse reaction from business leaders and in response to this reaction, Congress hurriedly passed Public Law 86-272 as a stop-gap measure to abrogate the *Northwestern-Stockham* decisions.[17]

7. *Supra* note 4.

8. International Shoe Co. v. Washington, *supra* note 4, at 315.

9. 328 U.S. 408 (1946).

10. 59 Stat. 33 (1945), 15 U.S.C. § 1011 (1958).

11. 54 U.S. (13 How.) 518 (1852). Other cases upholding congressional consent to otherwise invalid state action are: Kentucky Whip & Collar Co. v. Illinois Cent. R.R., 299 U.S. 334 (1937); Whitfield v. Ohio, 297 U.S. 431 (1936); Clark Distilling Co. v. Western Maryland Ry., 242 U.S. 311 (1917); *In re* Rahrer, 140 U.S. 545 (1891).

12. 10 Stat. 112 (1852).

13. Pennsylvania v. Wheeling & Belmont Bridge Co., 59 U.S. (18 How.) 421, 430 (1856).

14. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959) (*Williams v. Stockham Valves & Fittings, Inc.* was consolidated in this case); Spector Motor Serv., Inc. v. O'Connor, 340 U.S. 602 (1951); General Trading Co. v. Tax Comm'n, 322 U.S. 335 (1944); McLeod v. Dilworth Co., 322 U.S. 327 (1944); Pennsylvania v. Wheeling & Belmont Bridge Co., *supra* note 13; Brown v. Maryland, 25 U.S. (12 Wheat.) 419 (1827). See also HARTMAN, *op. cit. supra* note 4.

15. *Supra* note 14.

16. See Hartman, *State Taxation of Income from a Multistate Business,* in SELECTED PROBLEMS IN THE LAW OF CORPORATE PRACTICE 20, 42-26 (1960).

17. Hartman, *State Taxation of Interstate Commerce: A Survey and an Appraisal,* 46 VA. L. REV. 1051, 1097, 1098 (1960).

The Supreme Court of Louisiana rejected the defendant's argument that the act of Congress was unconstitutional because the state tax in question was neither placed on interstate commerce nor an undue burden on interstate commerce, and thus was not within the regulatory power of Congress granted by the commerce clause.[18] The court reasoned that Congress could properly find that the state net income tax was a burden on interstate commerce, and that Congress had power to prohibit such a tax.[19] The court further reasoned that the Supreme Court of the United States in *Northwestern-Stockham* had only held that such a tax was not a burden on commerce such as would violate the commerce clause of the Constitution. No congressional action was there involved. Thus, the court concluded, Congress has the power to determine whether a tax is a burden on interstate commerce or not; and once it has so determined, the Supreme Court cannot redetermine it.[20] The majority cited with approval *Gibbons v. Ogden*[21] to the effeet that the power to regulate commerce was granted to Congress by the Constitution and was complete within itself, thus the power has no limitations except those prescribed in the Constitution.

In the light of the Supreme Court's denial of certiorari in this case[22] and its historical treatment of the commerce power, it seems highly probable that Public Law 86-272 will be upheld. Nevertheless, Public Law 86-272, which this decision declares to be constitutional, has been criticised as removing the taxing power of the states and infringing upon their sovereignty, since the Supreme Court has held that the net income tax is not a forbidden burden on interstate commerce.[23] The answer to this charge seems clear.

18. International Shoe Co. v. Cocreham, 246 La. 244, 164 So. 2d 314 (1964).
19. 164 So. 2d at 320-22 (La. 1964).
20. *Id.* at 316-17.
21. 22 U.S. (9 Wheat.) 1 (1824).
22. 379 U.E. 902 (1964).
23. In the Smith, Kline case, *supra* note 3, the court reasoned that P.L. 86-272 was unconstitutional because it prohibited the exercise of state sovereignty rather than regulating its exercise, therefore it was not a valid regulation of intrastate commerce affecting interstate commerce. In answer to this reasoning it can be argued that prohibition of state taxation of one type of business is in reality a "regulation" of the state's power to tax multi-state businesses. Furthermore, the Supreme Court in deciding the Northwestern States case, *supra* note 14, did not prohibit Congress from enacting a law such as P.L. 86-272. If the Court, in deciding that case, were proceeding under the Marshall view of the exclusive nature of congressional power over commerce, it could have only held that the situation was such that there was room for action by the state because it was local activity; but this activity could affect interstate commerce in a way that Congress can regulate it. See HARTMAN, *op. cit. supra* note 4, at 22-23. However, if the Court decided that case under the doctrine of Cooley v. Board of Wardens, 53 U.S. (12 How.) 298 (1851), Congress would have the power to preempt the tax at any time since the states have concurrent power only as long as Congress takes no action to displace it. Actually P.L. 86-272 is limited in scope since many, if

Public Law 86-272 is valid under the general principles applicable to congressional exercise of the commerce power. The power of Congress to regulate interstate commerce extends to all aspects of the national economy except those that are completely local.[24] This power is full and complete. The power to prescribe the rule for the conduct of interstate commerce may be exercised by Congress to its utmost extent except as restrained by other express provisions of the Constitution or by the political restraints involved in running for election.[25] The power of Congress to regulate interstate commerce includes the power to foster, develop, and protect the channels and instrumentalities of interstate commerce, as well as the power to remove impediments to, and burdens upon interstate commerce.[26] The power to regulate interstate commerce also includes the power to prohibit or otherwise regulate local or intrastate practices where such control is appropriate to the protection of interstate commerce or is required to make the interstate regulation effective.[27] The fact that the states may constitutionally regulate certain subject matter in the absence of congressional action does not control or necessarily limit in any degree the validity of a congressional regulation of the same subject matter.[28] When Congress has acted within the scope of a granted power (in this case, the commerce power) such action does not invade the reserved powers of the states contrary to the tenth amendment.[29] Furthermore, under the supremacy clause to the Constitution, when Congress has acted pursuant to any power granted to it, conflicting or inconsistent state law and practices are rendered unconstitutional and void.[30] There does arise a question whether the

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not the vast majority, of multi-state businesses have more contact with the taxing states than the particular contacts covered by the act. Thus P.L. 86-272 will not deprive the states of all sources of revenue, but only limits one of many sources.

24. Gibbons v. Ogden, *supra* note 21; Houston, E. & W.T. Ry. v. United States, *supra* note 4. See Electric Bond & Share Co. v. SEC, 303 U.S. 419 (1938); United States v. Wrightwood Dairy, 315 U.S. 110 (1941); Wickard v. Filburn, *supra* note 6.

25. Wickard v. Filburn, *supra* note 6; Gibbons v. Ogden, *supra* note 21.

26. NLRB v. Jones & Laughlin Steel Co., 301 U.S. 1 (1937); Stafford v. Wallace, 258 U.S. 495 (1922); Postal Teleg. Cable Co. v. Warren-Godwin Lumber Co., 251 U.S. 27 (1919); Luxton v. North River Bridge Co., 153 U.S. 525 (1894); California v. Pacific R.R., 127 U.S. 1 (1888); The Daniel Ball, 77 U.S. (10 Wall.) 557 (1870); 2 STORY, COMMENTARIES 32 (3d ed. 1858).

27. Wickard v. Filburn, *supra* note 6; Houston, E. & W.T. Ry. v. United States, *supra* note 4.

28. Cloverleaf Butter Co. v. Patterson, 315 U.S. 148 (1942); Colorado v. United States, 271 U.S. 153 (1926); Cooley v. Board of Wardens, *supra* note 23; Willson v. Black Bird Creek Marsh Co., 27 U.S. (2 Pet.) 105 (1829).

29. United States v. Darby, 312 U.S. 100 (1941); McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819).

30. Addyston Pipe & Steel Co. v. United States, 175 U.S. 211 (1899); Schollenberger v. Pennsylvania, 171 U.S. 1 (1898); Gibbons v. Ogden, *supra* note 21. See also Pennsylvania v. Nelson, 350 U.S. 497 (1956); Hines v. Davidowitz, 312 U.S. 52

Supreme Court may review Congress' decision of what affects interstate commerce.[31] The Court should be able to review this congressional decision using some liberal standard such as "valid unless clearly erroneous."[32] Congressional regulation of state and local taxes on multi-state business is designed to improve the free trade among the states, stimulate business, and benefit each state as well as the nation as a whole. If some states tax the net income of multi-state business, it will deter some of these businesses with a small margin of profit from doing business in that state due to the added tax and administrative costs.[33] Moreover, Congress is best equipped to hear, through its committees and sub-committees, experts representing all the interests and then determine whether there is a burden on interstate commerce and what congressional action would promote interstate commerce.[34]

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(1941); Pittman v. Home Owners Loan Corp., 308 U.S. 21 (1939); Napier v. Atlantic Coast Line R.R. Co., 272 U.S. 605 (1926); Postal Tel. & Cable Co. v. Richmond, 249 U.S. 252 (1919); 12 STAN. L. REV. 208 (1959).

31. In Wickard v. Filburn, *supra* note 6, the Court said that any restraints on Congress' power under the commerce clause "must proceed from the political rather than the judicial process." However, in that case the Court went on to decide whether Congress had acted beyond its power under the commerce clause.

32. "They [the courts] cannot act as Congress does when, after weighing all the conflicting interests, state and national, it determines when and how much the state regulatory power shall lead to larger interests of national commerce." South Carolina State Highway Dep't. v. Barnwell Bros., *supra* note 4, at 190. "The problem calls for a full and thorough canvassing of the multitudinous and intricate factors which compose the problem of the taxing freedom of the States and the needed limits on such state taxing power. Congressional committees can make studies and give the claims of the individual States adequate hearing before the ultimate legislative formulation of policy is made by the representatives of all the States. The solution of these problems ought not rest on the self-serving determination of the States of what they are entitled to out of the Nation's resources. Congress alone can formulate policies founded upon economic realities, perhaps to be applied to the myriad situations involved by a properly constituted and duly informed administrative agency." Northwestern States Portland Cement Co., *supra* note 14, at 476-77 (dissent).

33. Dane, *Small Business Looks at Public Law 86-272 in Perspective of Its Alternatives*, 46 VA. L. REV. 1190, 1198-1202 (1960).

34. *Supra* note 33.