THE EFFECTIVENESS OF COMMISSION REGULATION OF PUBLIC UTILITY ENTERPRISE

Francis X. Welch*

Evaluating recent criticism of public utilities regulation, the author examines commission history, organization and operation, emphasizing the problems of ex parte pressures and commissioner selection. Mr. Welch concludes that while some criticisms have been legitimate and that remedial legislation is necessary, Congress should proceed cautiously lest unwise and drastic revision disrupt what is essentially a workable system.

INTRODUCTION

With the advent of the Kennedy administration in Washington, D.C., on January 20, 1961, it seemed for a short time as though scarcely a day went by without some report or study being filed with the new Congress or elsewhere on the subject of reorganizing the federal regulatory agencies or reforming their practices and procedures. Starting off with the controversial Landis report, filed even before the new Congress arrived on the Washington scene, there was the staff report of the Harris Subcommittee on Legislative Oversight. Then there was the report of the Harris group itself.

There was also the 732-page staff report of the Senate Commerce Committee calling for sweeping changes in the nation's transportation...
policies. There were recommendations about creating a Cabinet-level transportation department in former President Eisenhower's Budget Message. There was the report of the Kennedy-Johnson natural resources advisory committee. There were other task force reports bearing indirectly on the same subject, and, of course, the inevitable trickle of bills introduced in Congress to carry out such recommendations.

A superficial reaction to this avalanche of criticism might lead a casual observer to jump to the conclusion that regulatory commissions did not, at that time, enjoy much popularity and faced an uncertain future. But actually, when we dig beneath the surface of criticism and shortcomings, we can see quite an opposite conclusion emerging, in one form or another, in all these reports and studies. That is, that there should be more regulation rather than less. Certainly that is true of Mr. Landis' report.

Statutory powers, duties and jurisdiction of the regulatory commissions may be changed in form, but no influential source has yet suggested doing away with the commissions along the lines, for example, proposed by Louis J. Hector, former Civil Aeronautics Board member who resigned in July 1960 and sent a long memorandum to President Eisenhower. Hector told the President in that document that even the Founding Fathers could not have made the commissions, as presently constituted, effective instruments. He was all for taking policy-making functions away from the commissions entirely and handing them over to the executive branch.

The Landis report, which goes about as far as any of the reports filed in Washington, rejects any such division of functions and says that the integrity and independence of the regulatory agencies must be preserved. It can, and probably will, be contended that the report is somewhat contradictory in this respect, inasmuch as it calls for agency independence on the one hand while at the same time proposing presidential leadership through a new White House office for the oversight of regulatory agencies. But, in any event, it should be clear by this time that the federal regulatory commissions are here to stay. They may be con-

---

8 1960 Landis Report 82-87.
solidated (as proposed for the Interstate Commerce Commission and Civil Aeronautics Board\(^9\)) or bisected (as proposed for the Federal Power Commission\(^{10}\)). But when the smoke of controversy clears away it is fairly certain that they will at least be in business—and probably at the same old stands around Washington. If anything, the recent spate of studies and recommendations has given rise to some fears that a few proposals might result in regulation for regulation's sake, or more regulation than is actually needed. Of that, Congress must be the judge.

The use of a commission or special board to regulate public utilities goes back very far in the history of the States. Very early attempts to regulate these special business enterprises charged "with a public interest," as Mr. Chief Justice Waite expressed it in *Munn v. Illinois*,\(^{11}\) took the form of special legislation even among the colonies.\(^{12}\) The creation of special boards assigned to control particular public service enterprises, such as we call public utilities today, came much later. As early as 1836, the Massachusetts legislature\(^{13}\) reserved to itself the power to modify the rates of railroads.

The fairly large number of these special boards, many established in the nineteenth century, can be seen from the following table; but it must be kept in mind that these early boards—prior to 1907—were mainly advisory commissions, designed to promote service or prevent discrimination rather than actually fix rates or otherwise exercise full-powered jurisdiction as we know it today. It is noteworthy, in this respect, to compare the original dates of establishment of the various state commissions, with the subsequent dates of the organization (or virtual re-establishment) of these same commissions with full regulatory powers.

---

\(^{9}\) Report on National Transportation Policy, supra note 4, at 107.

\(^{10}\) Report on Independent Regulatory Commissions, supra note 2, at 96 (Comm. Print 1960). The staff recommended separation of the gas and electric jurisdictional functions of the Federal Power Commission. Actually the very name "Federal Power Commission" has become anomalous in view of the relatively predominant proportion of the Commission's activities in the natural gas field.

\(^{11}\) 94 U.S. 113, 133 (1877).

\(^{12}\) In Hamilton, Affectations With Public Interest, 39 Yale L.J. 1089, 1094 (1930), it is said: "In Lord Hale's time . . . all activities comprehended under what we call business, was public, and all of it subject to price control." Eight of the thirteen States passed statutes during the Revolution fixing the prices of numerous marketable commodities. 33 Harv. L. Rev. 839 (1920).

### Dates of Establishment of State Utility Regulatory Commission Laws

<table>
<thead>
<tr>
<th>State</th>
<th>Original</th>
<th>Present</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>1881</td>
<td>1915</td>
</tr>
<tr>
<td>Arizona</td>
<td>1911</td>
<td>1912</td>
</tr>
<tr>
<td>Arkansas</td>
<td>1899</td>
<td>1945</td>
</tr>
<tr>
<td>California</td>
<td>1879</td>
<td>1912</td>
</tr>
<tr>
<td>Colorado</td>
<td>1907</td>
<td>1914</td>
</tr>
<tr>
<td>Connecticut</td>
<td>1853</td>
<td>1911</td>
</tr>
<tr>
<td>Delaware</td>
<td>1949</td>
<td>1949</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>1913</td>
<td>1913</td>
</tr>
<tr>
<td>Florida</td>
<td>1887</td>
<td>1951</td>
</tr>
<tr>
<td>Georgia</td>
<td>1879</td>
<td>1922</td>
</tr>
<tr>
<td>Idaho</td>
<td>1913</td>
<td>1913</td>
</tr>
<tr>
<td>Illinois</td>
<td>1871</td>
<td>1921</td>
</tr>
<tr>
<td>Indiana</td>
<td>1913</td>
<td>1933</td>
</tr>
<tr>
<td>Iowa</td>
<td>1878</td>
<td>1888</td>
</tr>
<tr>
<td>Kansas</td>
<td>1911</td>
<td>1933</td>
</tr>
<tr>
<td>Kentucky</td>
<td>1880</td>
<td>1934</td>
</tr>
<tr>
<td>Louisiana</td>
<td>1898</td>
<td>1921</td>
</tr>
<tr>
<td>Maine</td>
<td>1858</td>
<td>1914</td>
</tr>
<tr>
<td>Maryland</td>
<td>1910</td>
<td>1910</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>1869</td>
<td>1919</td>
</tr>
<tr>
<td>Michigan</td>
<td>1909</td>
<td>1909</td>
</tr>
<tr>
<td>Minnesota</td>
<td>1871</td>
<td>1899</td>
</tr>
<tr>
<td>Mississippi</td>
<td>1884</td>
<td>1938</td>
</tr>
<tr>
<td>Missouri</td>
<td>1875</td>
<td>1913</td>
</tr>
<tr>
<td>Montana</td>
<td>1907</td>
<td>1907</td>
</tr>
<tr>
<td>Nebraska</td>
<td>1907</td>
<td>1907</td>
</tr>
<tr>
<td>Nevada</td>
<td>1907</td>
<td>1911</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>1844</td>
<td>1911</td>
</tr>
<tr>
<td>New Jersey</td>
<td>1911</td>
<td>1911</td>
</tr>
<tr>
<td>New Mexico</td>
<td>1941</td>
<td>1941</td>
</tr>
<tr>
<td>New York</td>
<td>1907</td>
<td>1921</td>
</tr>
<tr>
<td>North Carolina</td>
<td>1891</td>
<td>1949</td>
</tr>
<tr>
<td>North Dakota</td>
<td>1889</td>
<td>1919</td>
</tr>
<tr>
<td>Ohio</td>
<td>1911</td>
<td>1915</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>1907</td>
<td>1907</td>
</tr>
<tr>
<td>Oregon</td>
<td>1907</td>
<td>1931</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>1907</td>
<td>1937</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>1912</td>
<td>1939</td>
</tr>
<tr>
<td>South Carolina</td>
<td>1896</td>
<td>1922</td>
</tr>
<tr>
<td>South Dakota</td>
<td>1889</td>
<td>1897</td>
</tr>
<tr>
<td>Tennessee</td>
<td>1883</td>
<td>1919</td>
</tr>
<tr>
<td>Texas</td>
<td>1891</td>
<td>1891</td>
</tr>
<tr>
<td>Utah</td>
<td>1917</td>
<td>1941</td>
</tr>
<tr>
<td>Vermont</td>
<td>1886</td>
<td>1908</td>
</tr>
<tr>
<td>Virginia</td>
<td>1816</td>
<td>1902</td>
</tr>
<tr>
<td>Washington</td>
<td>1905</td>
<td>1949</td>
</tr>
<tr>
<td>West Virginia</td>
<td>1913</td>
<td>1915</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>1874</td>
<td>1905</td>
</tr>
<tr>
<td>Wyoming</td>
<td>1915</td>
<td>1915</td>
</tr>
</tbody>
</table>
During the boom following the Civil War, an Illinois statute fixing the maximum charges on the storage of grain was adopted.\textsuperscript{14} But the demand for rate regulation by commissions probably had its beginning in the Granger agitation of the 1870’s directed principally against the railroads. Numerous States adopted the Granger laws fixing maximum railroad charges.\textsuperscript{15} By the time court proceedings, testing the constitutionality of these laws, had reached their final stages, the depression of 1873 had set in. Many railroads were in receivership and these laws, in many States, had been repealed.

Although the classic decision of the United States Supreme Court, which paved the way for regulation of public utilities in the United States, goes back to 1877,\textsuperscript{16} and although the oldest of the federal regulatory commissions—the Interstate Commerce Commission—was created only ten years later, full-powered commission regulation as we know it today is still less than sixty years old. And it was not until 1907, almost a decade after the Supreme Court’s decision in Smyth v. Ames,\textsuperscript{17} that the first full-powered regulatory commissions were set up in New York and Wisconsin.

Before that time both the Interstate Commerce Commission and the sporadic attempts of some of the States, such as Massachusetts, to establish special commissions or boards to look after various types of utility operations (mainly railroad and gas companies) were more advisory than regulatory. In any event, their powers were greatly limited and fell short of the full authority over service and rates which is commonplace today. The table on the following pages shows the increased scope as well as authority of these state regulatory authorities.

I

Earlier Criticisms of the Regulatory Commissions

Generally, commission regulation in this country came into being (1) because of the public evils of competition in the utility field; (2) because direct regulation by legislatures was unscientific and inadequate; (3) because local authorities were not equipped to deal with utilities on an even footing in regulatory matters; and (4) because general laws and contracts were too inflexible for reasonable regulation under varying conditions of operation.

\textsuperscript{14} Ill. Rev. Stat. § 15, at 824 (1874).
\textsuperscript{15} E.g., Minn. Laws 1870, ch. 19, § 1, at 28; Wis. Laws 1872, ch. 119, § 46, at 161.
\textsuperscript{16} Munn v. Illinois, 94 U.S. 113 (1877).
\textsuperscript{17} 169 U.S. 466 (1898).
<table>
<thead>
<tr>
<th>Commission</th>
<th>Personnel</th>
<th>Utility Types Regulated(^1)</th>
<th>Rates</th>
<th>Service</th>
<th>Securities</th>
<th>Accounts</th>
<th>Transfers</th>
<th>Certificates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama Public Service Commission</td>
<td>3</td>
<td>Elec</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Arizona Corporation Commission</td>
<td>3</td>
<td>Elec</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Arkansas Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>California Public Utilities Commission</td>
<td>5</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Colorado Public Utilities Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Connecticut Public Utilities Comm.</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Delaware Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Dist. of Columbia Pub. Util. Comm.</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Florida Railroad and Pub. Util. Comm.</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Georgia Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Idaho Public Utilities Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Illinois Commerce Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Indiana Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Iowa State Commerce Commission</td>
<td>3</td>
<td>Elec</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Kansas State Corporation Comm.</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Kentucky Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Louisiana Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Maine Public Utilities Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Maryland Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Massachusetts Dept. of Pub. Utilities</td>
<td>7</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Michigan Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Minn. Railroad and Warehouse Comm.</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Mississippi Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Missouri Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Mont. Bd. of R.R. Comrs. &amp; P.S. Comm.</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Nebraska State Railway Commission</td>
<td>3</td>
<td>Elec</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Nevada Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>New Hampshire Public Utilities Comm.</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>New Jersey Bd. of Pub. Util. Comm.</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>New Mexico Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>New Mexico State Corporation Comm.</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>New York Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>North Carolina Utilities Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>North Dakota Public Service Comm.</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Ohio Public Utilities Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Oklahoma Corporation Comm.</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Oregon Public Utilities Commissioner</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Pennsylvania Public Utility Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Rhode Island Dept. of Bus. Regulation</td>
<td>1</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>South Carolina Public Service Comm.</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>South Dakota Public Utilities Comm.</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Tennessee Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Texas Railroad Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Utah Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Vermont Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Virginia State Corporation Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Washington Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>West Virginia Public Service Comm.</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
<tr>
<td>Wisconsin Public Service Commission</td>
<td>3</td>
<td>App</td>
<td>No</td>
<td>No</td>
<td>B &amp; G only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
<td>B &amp; only</td>
</tr>
</tbody>
</table>

The commission form of regulation seemed best adapted to meet the public need. Commissions could give their full attention to the job and their staffs would be technically equipped for the work. As their services would be available at all times it was believed they would be in a position to act promptly, which looked good, both from the public and utility viewpoints.

The first quarter of the twentieth century witnessed the period of the establishment of the state commissions. It was the period in which the young commissions struggled to work out their legal principles to come within the pattern of the fair value doctrine laid down in the *Smyth v. Ames* case.18 Also, it was a period of great physical growth of many of our utility companies.

Then came the period of growing pains on the eve of the great depression. The 1929 crash of the securities market was soon to reduce many holding companies to difficult financial positions and even to receiverships. The state commissions were still somewhat weak and understaffed, with more responsibilities thrust upon them than they were equipped to handle with top efficiency.

During this period, from the late 1920's into the early 1930's, some of the most active and controversial events of the past thirty years took place. They began to boil up in charges against monopoly and "power trust," which had culminated in the Walsh resolution,19 so bitterly debated in the United States Senate.20 It was a period of sharp criticism against commission regulation. Charges were made in the press that utility regulation had broken down; that regulation had not worked as it was intended to work; that many of the old evils had continued; that new evils had developed; that the intricate questions of law and administration, which govern the cost to the citizen of his utility services, were in a desperate tangle, and so forth.

The entrance of the federal government into the electric power field and the abandonment by federal courts of the fair value doctrine brought forth vigorous discussions, pro and con, throughout the country. Commissioners, legislators, educators, executives and professional specialists joined with the politicians in threshing over the economic consequences

---

18 Ibid.
19 S. Res. 83, 70th Cong., 1st Sess. (1928). The original resolution by the late Senator Walsh (D-Mont.) proposed a Senate investigation, but it was subsequently diverted to the Federal Trade Commission which for eight years probed gas and electric companies and holding company affiliates. S. Doc. No. 92, 70th Cong., 1st Sess., pts. 74, 84-A (1928) (pub. 1936).
20 69 Cong. Rec. 2890-3054 (1928).
of the fair value rule and the advantages, or lack of advantages, of the original cost basis.

These are all arguments that have not been fully settled yet, and are not likely to be settled in the immediate future, in these inflationary days. It can be recorded, however, that this period of storm and controversy tested the strength and stability of commission regulation as an institution. It survived because after each storm there was an evaluation of arguments and the adoption of reforms as needed. Invariably such reforms had the ultimate effect of strengthening the commissions, both state and federal.

Among the federal acts to come out of this period were the Holding Company Act (1935),21 the Federal Power Act (as amended 1935),22 and the Federal Communications Act (1934).23 The state commissions were generally strengthened by their respective legislatures with larger staffs, better appropriations, and more effective regulatory laws.

It was January 21, 1929, that the old (New York) World published an editorial entitled "The Breakdown of the Public Service Commissions." This editorial stated:

The high hopes with which the existing system of public utility regulation was inaugurated in this state have not been fulfilled. It is a fact beyond dispute that in certain important respects this system has broken down...

The new system was intended to end the existing evils. Its purpose was to put the utilities under such positive commission control as to assure them a fair return and at the same time assure the public of reasonable rates, adequate service, efficient operation, and proper financial management. In large measure these hopes have failed...

The public has come to realize that its expectations of twenty years ago have not been fulfilled; that regulation has not worked as it was intended to work; that many of the old evils have continued; that new ones have developed; and that the intricate questions of law and administration which govern the cost to the citizen of light, fuel, power, local transportation, and telephone communication are in a desperate tangle.

There is widespread recognition of the fact the present system no longer protects the public's interest adequately...

What is needed is no mere tinkering with the existing law but a comprehensive investigation to discover exactly how regulation has worked in the state of New York, what difficulties have been encountered, and by what means the present system can be reconstructed to serve effectively the purposes for which it was originally established. With this aim in view we believe that the legislature

should provide for a special Public Service Investigating Commission to make a thorough survey. . . .

We face a fact and not a theory. The law of 1907 has broken down.\textsuperscript{24}

With regret for the passing of a fine old newspaper, it might be noted that since that editorial the \textit{World} has disappeared into the syndicated bosom of the Scripps-Howard system, while the state commissions are still going strong—as already observed. Of course, some of the charges complained of in the old \textit{World} editorial came on to be heard at length by investigating tribunals in Albany as well as in Washington or elsewhere. Reforms were bitterly debated and a good many were placed on the statute books. But, note well, they invariably had the effect of strengthening the state commission and the federal commissions.

Compared with this earlier criticism of the regulatory commissions, more recent complaints which gave rise to the more recent activity of the House Subcommittee on Legislative Oversight are indeed mild by comparison.

The Legislative Reorganization Act of 1946, in section 136, entitled "Legislative Oversight by Standing Committees," provides: "[E]ach standing committee of the Senate and House of Representatives shall exercise continuous watchfulness of the execution by the administrative agencies concerned of any laws, the subject matter of which is within the jurisdiction of such committee . . . ."\textsuperscript{25} Subsequently, this provision was incorporated in the House rules.\textsuperscript{26} On March 6, 1957, the authorizing resolution was passed.\textsuperscript{27}

The subcommittee in a policy statement listed among the subjects to be considered:

(1) Review and analysis of the laws and amendments, and intent of the Congress when enacted;
(2) Area of the field regulated by each law, changing circumstances and growth of the field since enactment;
(3) Consideration of the legislative standards in the law to determine whether they can be drafted in more precise terms with the view of reducing administrative discretion . . . .\textsuperscript{28}

The subcommittee recommended in its report of January 3, 1959, cer-

\textsuperscript{24} The World (N.Y.), Jan. 21, 1929, p. 12, cols. 2, 4, 5.
tain across-the-board changes applicable to several of the agencies.\(^{29}\)

These involved primarily administrative functions, internal agency organization and the isolation of the agencies from pressures from within and outside the Government. Many of these recommendations have been embodied in H.R. 4800, which the subcommittee chairman, Representative Harris (D-Ark.), introduced in the House of Representatives on February 19, 1959.\(^{30}\) In addition these recommendations met a number of problems that are peculiar to the separate statutes governing the several agencies.

In its initial outline of policy the subcommittee indicated that it would approach this aspect of the problem by inquiring into the faithful execution of the law in the public interest and the extent to which statutory standards are being interpreted, by rule or internal procedures, so as to distort their original purposes. The subcommittee regarded the following as requiring further legislative inquiry: (1) consistency of agency findings, absent amending legislation or court decisions, as to what constitutes the public interest; and (2) the reasons for frequent variation in the application of criteria from case to case. The subcommittee also studied and made a number of recommendations with respect to the internal organization and operational efficiency of the several agencies.

II

Ex Parte Pressures

A difficult and delicate problem exists in maintaining the freedom and independence of administrative agencies and their necessary access to information from the public, the regulated industry and others, while at the same time inhibiting improper ex parte approaches. There is a legitimate need for proper means of communication between agencies and interested persons in the categories mentioned. Information of great value to the agencies is constantly provided them from such sources. Persons in these groups can submit to agencies requests and inquiries which are entirely appropriate and which help to expedite the administrative process. Often, by proper ex parte conferences, lengthy hearings can be avoided and public interest objectives can be reached more quickly and economically. However, unless caution is constantly observed, such activities can quickly expand to the point where they go beyond the limits of propriety. A great difficulty lies in drawing

---


clearly and equitably the line of demarcation between proper and improper ex parte contacts.

This situation required the subcommittee to give earnest consideration to the degree of identification of a regulatory agency with those whom it regulates and to activities of government officials which constitute excessive pressure upon an agency. As a step toward keeping the contacts within proper bounds, the subcommittee recommended across-the-board legislation requiring that

any communication, written or non-written, to or from a commissioner or commission employee, pertaining to any proceeding which by law or by commission rule or practice must be determined upon the record shall be included in the public record. A memorandum containing the substance of any such nonwritten communication shall be included in such record.31

Another fundamental problem involves the question as to what effective measures can be put into practice which will have a reasonable prospect of winning the desired confidence of the public in the impartiality, fairness and integrity of the administration of the law. The task of formulating an ethical code calls for the thoughtful consideration and creative ingenuity of members of the bar, especially those practicing before administrative agencies, and of commissioners and staff personnel of the agencies themselves.

When commissions have the power to grant licenses or franchises worth millions of dollars, it may be expected that certain selfish interests will put on the pressure. If, to paraphrase The Federalist, the seekers after franchises were angels, there would be no need for ethical codes or even a criminal law in the administrative field. These pressures, generally exerted by ex parte communications between commission members and personnel of an agency on the one hand, and other interested persons or institutions on the other, constitute perhaps the greatest obstacle to achievement of the highest level of excellence in the administrative process. Unfortunately, the hearing record of the subcommittee is replete with instances of improper ex parte pressures upon commissioners.

While this type of activity has been said to exist in every branch of the Government, its most widespread and damaging influence is felt in connection with the exercise by the agencies of their adjudicatory and rule-making powers.

The issue of ex parte communications in connection with rule-making proceedings of an administrative agency is not so clear-cut. The myriad

varieties of administrative activity falling under the rubric "rule making" spread over a wide spectrum. Some of the "rules" laid down are of such broad and general application that they apply with equal force to all members of a particular industry.

In other instances of rule making, while the proceedings may appear to be developing a policy of broad application, a realistic view of the situation will reveal that the practical result vitally affects one or a very few industry members. Certainly in the latter situation justice to the few so directly affected requires that they be apprized of all relevant matters considered by the commission in arriving at its decision. Should the prohibition against ex parte communications be applied to all rule-making proceedings just as everyone seems to agree it should be applied to adjudicatory proceedings?

There is little dispute that the commissions, when exercising their responsibilities in adjudicatory proceedings, as for example when licenses or franchises are sought by contending applicants, should hold to the standards of propriety applicable to courts of law. As Professor Clark M. Byse of the Harvard Law School said in a statement made before the House subcommittee:

[1] If the adjudicative form is utilized—that is, if Congress says that the decision shall be based on evidence adduced at a hearing—then I can see no reason why the ethical standards applicable to judges and lawyers in court proceedings should not be applied to the administrative judge and the counsel who appears before him.32

It is easier to say, however, that commissioners and their staffs should conduct themselves, in adjudicatory proceedings, according to judicial and courtroom proprieties than it is to apply such a general principle in practice. Ex parte approaches come from various sources—the White House and members of Congress as well as the regulated industries. Many of these are made in good faith and some are so inconsequential as to cause little difficulty. If a member of Congress, to soothe a restless constituent, wants to know what the "status" of a certain pending matter is and how soon it might come on to be heard, there would seem to be little objection to a commissioner relaying such information, if the inquiry goes no further.

Then, again, there are certain situations involving definite or sudden developments relating to a pending matter which might increase the urgency of its disposition in the public interest. If the circumstances are

such that these can be brought to the attention of the commission in no other way except by ex parte contact, the commissioners might feel that such an approach were warranted, provided complete and proper records were kept of who said what. The House Subcommittee on Legislative Oversight recognized this in its final report, where the majority states:

In the *Northeastern Pipeline* case, Commission delay in issuing a certificate also led to an additional 3 cents per thousand cubic feet. Mr. Randall J. LeBoeuf, Jr., an eminent attorney practitioner before the Federal Power Commission, testified before the subcommittee in June 1959, that because of the delay in granting a certificate in the *Northeastern* case, that he went to the then Chairman of the Federal Power Commission and pointed out that the gas was under option with time limits and that delay would increase the price. His urgings were ineffective, and the price of gas did increase 3 cents a thousand because of delay. Mr. LeBoeuf stated that he believed it was proper and in the public interest for him to make the ex parte representation of these facts to the Chairman. He stated that he had "no objection to publicity being given in the record to such ex parte approach."33

Another case mentioned in this same report also involved an application by the Midwestern Gas Transmission Company for a certificate to build a pipeline.34 The company had represented to the Federal Power Commission that unless it could be assured of a 7 percent return, the line could not be financed. A previous decision granting the certificate with a 6½-return limitation had been rejected because of unsuccessful attempts to finance. A tentative draft, following argument, was prepared for the Commission, leaving open the question of the return allowance. Before final decision an attorney for Midwestern called on three of the Commissioners to point out that if the Commissioners failed to act before a November 1 deadline (it was then October 26), a Canadian supply contract would be defaulted, that it would not be possible to renegotiate in time to build a pipeline in 1960, and that such renegotiation would almost certainly result in a rise in the price of gas to a level which would make it "almost unmarketable." On October 31, the Commission decided to grant the certificate without any return limitation, reserving that question for subsequent determination. All three of the Commissioners approached testified that their decision had not been effected by the ex parte contact, but it was undoubtedly expedited. The House report commented on this case:

It is clear from the subcommittee's hearings that, because of intolerable delays in thousands of pending FPC proceedings, there have been numerous ex parte approaches.

---

contacts or extrarecord communications with members of the Commission by persons seeking expedition and other assistance. The Midwestern case is an informative example of the costliness of these delays. It focuses attention on the statutory provisions relating to fair hearings. It also sheds light on why delay is productive of extrarecord communications, especially in cases where the Commission staff is the only opponent. It demonstrates, however, that the Commission in meeting emergencies and deadlines is acting in the public interest by having cooperative ex parte contacts with industry representatives. It "invited" and "encouraged" Midwestern not only to file its application but also to engage in ex parte contacts in order that gas could be supplied to Michigan and Wisconsin consumers for the winter of 1960...35

The whole question of ex parte contacts, of course, involves the purpose, timing and attitudes of those who attempt them. And since it takes "two to tango," as the song goes, it inescapably involves the common sense, discretion and ethical sensitivity of the commissioners or others who listen, or refuse to listen to such approaches.

It would seem to be a matter of prudence, if not self-preservation, for a commissioner so approached to make his own record of the incident and suitably file it with the commission if there be any doubt in his mind as to the propriety of such contacts. The worst abuse in this area, of course, is the "influence peddler"—an uncomplimentary term in legal professional circles in Washington, D.C.—applicable to attorneys or others who trade on their supposed "inside track" not so much to practice law as to sell their influence, real or fancied.

President Kennedy's advisor on this problem, James M. Landis, said of this in his report concerning ex parte contacts:

Many of them emanate from the lawyers striving to press their clients' cause, indeed, one of the worst phases of this situation is the existence of groups of lawyers, concentrated in Washington itself, who implicitly hold out to clients that they have means of access to various regulatory agencies off the record that are more important than those that can be made on the record. These lawyers have generally previously held positions of more or less importance in the Government.36

Such outright bids for improper benefits, of course, pass into the realm of regulatory ethics. There have been regrettable instances of downright venality among commissioners, just as there have been in the history of the judiciary. Bearing in mind the impossibility of legislating morality, whether prescribed codes or canons are actually of much use in preventing such fortunately rare lapses is debatable. No law,

canon or code can make an honest man out of a knave, whereas no honest man has any need of such formal commandments to avoid a clear betrayal of his trust. It certainly does no harm to spell out prescribed standards of conduct; yet this is a matter which any regulatory commission can also handle through its own rules (as most have already done) without the need for statutory direction or reinforcement. Mr. Landis, himself a former member of three federal regulatory commissions and a former chairman of two, gave the following view of this at a House subcommittee panel discussion:

I have never felt or resented any approach that is made with reference to the merits of a problem, but I have felt a little disturbed when the approach had no relationship to the kind of considerations in order to govern its disposition.

I, for one, am not too hopeful that some of [sic] prescribed code of ethics will do the trick. I have a feeling that the real answer to this lies in the manner of men who are appointed to these administrative agencies. I don’t believe that we are paying enough attention to the qualifications of the individuals who are frequently elevated to those positions.

It does appear to me that very frequently selections are fairly casual. Naturally, they have to have a certain political aspect to them, but the political aspect sometimes overshadows everything else.

Now, to my mind, there is the essential problem. Fortunately, their salaries have been increased so that the job becomes an attractive one, but the manner of selection of the individuals to these agencies should be studied to see whether it could not be improved.37

III

QUALIFICATION AND ORGANIZATION OF THE REGULATORY COMMISSIONS

This brings us to the thorny problem of selecting suitable commissioners from the standpoint of expert qualifications as well as character and integrity. Mr. Landis lays much stress on this as does the final report of the House subcommittee.

Looking back once more to the earlier history of the commissions at the state as well as federal levels we see so few qualification standards as to be virtually nonexistent. Indeed, this selection of our regulatory commissioners seems to be among our most democratic practices of government. There is no discernible barrier based on age, color, creed, sex, politics, nor—what may be more important—previous training. Most of the regulatory statutes, state as well as federal, do require bipartisan membership, except in those States where commissioners are elected by popular vote. A few have domestic residential requirements,

37 Hearings on Administrative Process and Ethical Questions, supra note 32, at 111.
and in Massachusetts, for reasons which may be political as well as gallant, one of the seven members "shall be a woman."\(^{38}\)

In most States, and under all federal statutes, there is nothing to prevent the appointive authority from naming minor children, lunatics, aliens, ex-convicts or worse to these regulatory posts. This is a facetious reference, of course, and aside from executive discretion, the frequent requirement that such appointments withstand the scrutiny of Senate confirmation is a check against any flagrant abuse of the appointive authority.

When we consider, however, the emphasis the United States Supreme Court has placed on so-called "expertise"\(^{39}\) in connection with the work of these commissioners, the failure of the legislators to provide some standards of qualification may require a little explanation for the casual observer.

A glance at the table at the beginning of this article\(^{40}\) shows that the typical state commission is composed of three members—thirty-nine out of fifty commissions listed have that number. The reason for so few is mostly a matter of economy since a larger board occurs mainly in the larger States. Yet it is significant that only two States (Oregon and Rhode Island) have decided to concentrate the regulatory authority in a single commissioner.

Obviously the rationale of multi-commissioner boards is to insure balanced judgment and to guard against arbitrary action, if not administrative despotism, which might result from a single commissioner. The same might be said of the usual bipartisan requirement.

Why therefore has there been no statutory effort to insure background qualification? The answer seems to be in a preference for latitude in making appointments. There has been speculation from time to time, for example, as to whether the "ideal" commission (of three members) might well consist of a lawyer, an engineer and an accountant. But no such requirement or anything like it has been enacted. A survey by this writer in 1929, showed that out of a total of 164 state commissioners, 79 were lawyers, 13 were engineers, only 9 had other government service background, and the balance was scattered among other pro-


\(^{39}\) "Expertise" is a word which was taken from the French and given a special connotation in connection with the work of regulatory commissions by Mr. Justice Frankfurter in his celebrated dissent in FPC v. Hope Natural Gas Co., 320 U.S. 591, 627 (1944), wherein he said: "Expertise is a rational process and a rational process implies expressed reasons for judgment."

\(^{40}\) See p. 644 supra.
fessions and callings, including 24 classified as having a "general business" background. There was only one accountant.41

Dr. Lincoln Smith, Associate Professor of Political Science of the New York University faculty, has done an exhaustive amount of research into the background and qualifications of both state and federal commissions.42 His studies range through various professions, lawyers, engineers, staff or career appointments, and general business. He gives arguments for and against each background classification, but his conclusions are remarkably neutral. He finds that while there has been a modest trend away from the heavy preponderance of lawyers (as was the case in 1929), there has been no pronounced trend to any other particular pattern.

Dr. Smith does say a good word for career appointments—meaning, here, the elevation of staff members or persons having some other regulatory background to the top positions on the commissions. He thinks this is good for staff morale and gives the commission the benefit of specialized experience. But the fact remains that neither Presidents nor State governors have often followed such a pattern in making regulatory appointments. President Eisenhower probably made more career appointments than his predecessors. Yet, at this writing, only two out of the five Federal Power Commissioners had any previous regulatory experience,43 and only two out of the seven members on the Federal Communications Commission44 are careerists. So far, President Kennedy's designations to these two Commissions (two to the FPC and one to the FCC) have not been federal regulatory careerists.

43 FPC Chairman K. Kuykendall formerly served on the Washington State Public Service Commission; Commissioner Frederick Stueck served on the Missouri Public Service Commission.
44 FCC Commissioners T. A. M. Craven and Rosel H. Hyde were formerly commission engineer and counsel, respectively.
As a matter of fact there has even been some reverse sentiment about appointments to regulatory commissions of persons who already know a great deal about the business to be regulated. And where else would they get such experience except by working for the regulated industries? There seems to be a suspicion, however, that such a background might make a commissioner too sympathetic with the problems of the business he knows so well. It was not surprising, therefore, that a party, designated by President Eisenhower to a vacancy on the Federal Power Commission, jokingly said to the press that the closest connection he ever had with the gas and electric business was his monthly utility bills!45

Fortunately (or unfortunately, as one may care to view the matter) the emoluments offered by regulatory commissions are not such as to lure successful utility officials away from the ranks of private enterprise. The record looks in the other direction. Regulatory officials who have gained their experience in public service often find it expedient, in their own interest, to enter the service of utility companies or private practice specializing in utility regulatory matters. This is one of the grounds for complaint by Mr. Landis, in his report, that regulatory commission salaries should be higher, their tenure of office longer (at least ten years), and their staff assistance, prestige and working conditions generally improved and made more secure. Only in this way, the former Harvard Law School dean believes, can well-qualified men be attracted and encouraged to make commission posts the capstone and not merely a steppingstone in their careers. The Landis report comments on this:

The prime key to the improvement of the administrative process is the selection of qualified personnel. Good men can make poor laws workable; poor men will wreak havoc with good laws.

As long as the selection of men for key administrative posts is based upon political reward rather than competency, little else that is done will really matter. Thus, the real issues are two: (1) are these posts sufficiently attractive to draw good men, and (2) how can these men be found?

Good men are primarily attracted by the challenge inherent in a job. Salary is a secondary consideration, provided only that it is high enough to enable them to meet reasonable standards of living comparable to their positions in the society. Our universities have known and, indeed, traded on these facts. Tenure is another consideration of more importance than salary, for with tenure goes independence and the opportunity for long-range planning.46

45 The designation was for Thomas J. Donegan of New York, a former FBI agent, named by President Eisenhower on May 1, 1960. The Senate failed to act on his nomination.

The Landis report goes on to concede that the present pay for federal regulatory commissioners, $20,000 a year, is pretty fair compensation. It compares, relatively, with the compensation of federal judges, members of Congress and Cabinet officers. But it substantially outstrips the pay of state commissioners except in four of the larger States as will be seen in the table on the following page.

Landis thinks, however, that there are two other fringe benefits, so to speak, which would make the federal commission posts more attractive. One would be a moderate entertainment allowance for the chairman. "Like an ambassador he needs to maintain a certain prestige with the industry . . .,"47 says the report. There should also be an adequate retirement allowance.

The reason why there are far more lawyers on the commissions than from any other profession or background is not hard to understand. It is the same reason why there are more lawyers in Congress and in other government jobs. Lawyers by training and disposition naturally gravitate towards public service and always have. Hence the interesting comparison made by Donald C. Power, Chairman of the General Telephone and Electronics System, to the effect that while eighteen out of thirty-four Presidents of the United States have been lawyers, only five out of fifty major industrial corporations listed on the New York Stock Exchange have lawyer executives.48

The absence of career appointments, despite the arguments in favor of them, has a more political overtone. The blunt fact, which any realistic observer in this field must acknowledge, is that these appointments have very often gone to political favorites, at both the federal and state levels. Having said that, this writer hastens to add that many of our most competent and dedicated regulators have come from a background of public life flavored by party politics. And since career appointments have been the exception rather than the rule, the overall success of the regulatory commission, if it is to be conceded, must depend upon appointment or election of commissioners from outside rather than inside the commissions.

The high quality of these public servants, despite the handicaps of poor pay, insecure tenure, and the like belies the charge occasionally made that the commissions are "dumping grounds" for political hacks or lame ducks. Merely a casual check of the roster of state and federal

47 Id. at 67.
COMPENSATION OF STATE REGULATORY COMMISSIONERS
Corrected to July 1, 1960, and based on reports from the respective commission secretaries.

<table>
<thead>
<tr>
<th>State</th>
<th>Number of Comm'rs</th>
<th>Annual Salary of Chairman</th>
<th>Annual Salary of Comm'rs</th>
<th>Tenure of Office (years)</th>
<th>Method of Selection</th>
</tr>
</thead>
<tbody>
<tr>
<td>New York</td>
<td>6</td>
<td>$23,486</td>
<td>$22,486</td>
<td>10</td>
<td>Gov.-Senate</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>5</td>
<td>20,000</td>
<td>19,000</td>
<td>10</td>
<td>Gov.-Senate</td>
</tr>
<tr>
<td>New Jersey</td>
<td>3</td>
<td>20,000</td>
<td>17,000</td>
<td>6</td>
<td>Gov.-Senate</td>
</tr>
<tr>
<td>California</td>
<td>5</td>
<td>19,950</td>
<td>19,950</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Texas</td>
<td>3</td>
<td>17,500</td>
<td>17,500</td>
<td>6</td>
<td>Elective</td>
</tr>
<tr>
<td>Virginia</td>
<td>3</td>
<td>16,500</td>
<td>16,000</td>
<td>6</td>
<td>Elected by Gen. Assembly</td>
</tr>
<tr>
<td>Ohio</td>
<td>3</td>
<td>16,000</td>
<td>16,000</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>3</td>
<td>15,150</td>
<td>15,150</td>
<td>3</td>
<td>2 by Pres.-1 by Corp. of Engineers</td>
</tr>
<tr>
<td>Illinois</td>
<td>5</td>
<td>15,000</td>
<td>15,000</td>
<td>5</td>
<td>Appointive</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>3</td>
<td>15,000</td>
<td>14,000</td>
<td>6</td>
<td>Gov.-Senate</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>7</td>
<td>14,000</td>
<td>10,500</td>
<td>5</td>
<td>Appointive</td>
</tr>
<tr>
<td>Michigan</td>
<td>3</td>
<td>12,500</td>
<td>12,000</td>
<td>6</td>
<td>Gov.-Senate</td>
</tr>
<tr>
<td>North Carolina</td>
<td>5</td>
<td>12,500</td>
<td>12,000</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Florida</td>
<td>3</td>
<td>12,500</td>
<td>12,500</td>
<td>4</td>
<td>Governor</td>
</tr>
<tr>
<td>Colorado</td>
<td>3</td>
<td>12,000</td>
<td>12,000</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>3</td>
<td>12,000</td>
<td>12,000</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Nevada</td>
<td>3</td>
<td>12,000</td>
<td>10,000</td>
<td>4</td>
<td>Governor</td>
</tr>
<tr>
<td>Georgia</td>
<td>5</td>
<td>11,980</td>
<td>11,500</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Minnesota</td>
<td>3</td>
<td>11,500</td>
<td>11,500</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Alabama</td>
<td>3</td>
<td>11,500</td>
<td>11,000</td>
<td>4</td>
<td>Elective</td>
</tr>
<tr>
<td>Washington</td>
<td>3</td>
<td>11,500</td>
<td>11,000</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Missouri</td>
<td>5</td>
<td>11,000</td>
<td>11,000</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Indiana</td>
<td>3</td>
<td>11,000</td>
<td>10,500</td>
<td>4</td>
<td>Appointive</td>
</tr>
<tr>
<td>Maine</td>
<td>3</td>
<td>11,000</td>
<td>10,000</td>
<td>7</td>
<td>Gov.-Council</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>3</td>
<td>10,868</td>
<td>10,868</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Arkansas</td>
<td>3</td>
<td>10,800</td>
<td>10,800</td>
<td>2, 4, 6</td>
<td>Governor</td>
</tr>
<tr>
<td>Connecticut</td>
<td>3</td>
<td>(10,560-14,880)</td>
<td>(10,560-14,880)</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Louisiana</td>
<td>3</td>
<td>10,500</td>
<td>10,500</td>
<td>6</td>
<td>Elective</td>
</tr>
<tr>
<td>New Mexico PSC</td>
<td>3</td>
<td>10,200</td>
<td>10,200</td>
<td>6</td>
<td>Gov.-Senate</td>
</tr>
<tr>
<td>New Mexico CC</td>
<td>3</td>
<td>10,000</td>
<td>10,000</td>
<td>6</td>
<td>Elective</td>
</tr>
<tr>
<td>Tennessee</td>
<td>3</td>
<td>10,000</td>
<td>10,000</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>West Virginia</td>
<td>3</td>
<td>10,000</td>
<td>10,000</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Mississippi</td>
<td>3</td>
<td>10,000</td>
<td>10,000</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Kentucky PSC</td>
<td>3</td>
<td>10,000</td>
<td>7,500</td>
<td>4</td>
<td>Gov.-Legis.</td>
</tr>
<tr>
<td>Kentucky DMT</td>
<td>1</td>
<td>10,000</td>
<td>-</td>
<td>4</td>
<td>Appointive</td>
</tr>
<tr>
<td>Oregon</td>
<td>1</td>
<td>(10,000-12,500)</td>
<td>-</td>
<td>4</td>
<td>Appointive</td>
</tr>
<tr>
<td>Arizona</td>
<td>3</td>
<td>9,600</td>
<td>9,600</td>
<td>6</td>
<td>Elective</td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>3</td>
<td>9,600</td>
<td>9,600</td>
<td>4</td>
<td>Appointive</td>
</tr>
<tr>
<td>Kansas</td>
<td>3</td>
<td>9,000</td>
<td>8,500</td>
<td>6</td>
<td>Gov.-Senate</td>
</tr>
<tr>
<td>Maryland</td>
<td>3</td>
<td>9,000</td>
<td>8,000</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Wyoming</td>
<td>3</td>
<td>9,000</td>
<td>9,000</td>
<td>6</td>
<td>Gov.-Senate</td>
</tr>
<tr>
<td>Iowa</td>
<td>3</td>
<td>8,500</td>
<td>8,500</td>
<td>6</td>
<td>Appointive</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>1</td>
<td>8,500</td>
<td>8,000</td>
<td>indef.</td>
<td>Appointive</td>
</tr>
<tr>
<td>Nebraska</td>
<td>3</td>
<td>8,000</td>
<td>8,000</td>
<td>6</td>
<td>Elective</td>
</tr>
<tr>
<td>South Carolina</td>
<td>7</td>
<td>7,920</td>
<td>7,700</td>
<td>4</td>
<td>Jt. Assembly</td>
</tr>
<tr>
<td>Vermont</td>
<td>3</td>
<td>7,750</td>
<td>2,500</td>
<td>part time</td>
<td>Gov.-Senate</td>
</tr>
<tr>
<td>Montana</td>
<td>3</td>
<td>7,500</td>
<td>7,500</td>
<td>6</td>
<td>Elective</td>
</tr>
<tr>
<td>Utah</td>
<td>3</td>
<td>7,300</td>
<td>7,000</td>
<td>6</td>
<td>Gov.-Senate</td>
</tr>
<tr>
<td>Idaho</td>
<td>3</td>
<td>7,000</td>
<td>7,000</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>South Dakota</td>
<td>3</td>
<td>6,615</td>
<td>6,615</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>North Dakota</td>
<td>3</td>
<td>6,000</td>
<td>6,000</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Delaware</td>
<td>3</td>
<td>4,500</td>
<td>4,500</td>
<td>6</td>
<td>Governor</td>
</tr>
<tr>
<td>Kentucky RR (Part time)</td>
<td>3</td>
<td>3,600</td>
<td>3,000</td>
<td>4</td>
<td>Elective</td>
</tr>
<tr>
<td>Hawaii (Part time)</td>
<td>5</td>
<td>1,000</td>
<td>1,000</td>
<td>3</td>
<td>Gov.-Senate</td>
</tr>
</tbody>
</table>
officials carried in the opening pages of each volume of *Public Utilities Reports* shows conclusively that this just isn’t so.

Since, however, there is no such place as a national training school for public service commissioners, if such a thing were practicable or desirable, the best training ground would seem to be the commissions themselves. Here have developed such outstanding examples of regulatory experts as the late Joseph Eastman and Clyde Atchison of the Interstate Commerce Commission, and “Judge” H. Lester Hooper, Chairman of the Virginia Corporation Commission and dean of the state regulators—to name but three of a host of gifted commissioners, present and past. The regulatory commissions have been the training ground for other fields of public service as in the case of David Lilienthal who went from the chairmanship of the Wisconsin Public Service Commission to become head of the Tennessee Valley Authority and later chairman of the Atomic Energy Commission. Longer tenure and the other improved benefits would, of course, encourage such training “on the job” and tend to cut down the turn-over which has, admittedly, drained the commissions of their ablest members and slowed down the development of “expertise” which the courts have expected of these boards.

IV

The Role of the Courts

The Landis report stressed the importance of finding qualified commissioners to exercise the responsibilities of modern expertise. This will certainly pose a challenge for the new administration. Where to find these paragons of virtue and wisdom will be hard enough. But after they are found (and confirmed by the Senate), the job of making their brilliance emerge in such a way as to gain the approval of at least two tiers of federal courts may prove even more of a chore.

After all, expertise is as expertise does, and no matter how well qualified a commission’s members, their combined and individual efforts can all be modified, if not nullified, by appellate tribunals relatively innocent of any background in detailed knowledge of public utility industry operation or regulation.

What price the expertise of a Ph.D. in engineering or a career on a regulatory commission if a federal judge, whose background has been confined to legal practice in other fields or in judicial chambers, is set over them in the role of supervisor?

---

49 The national reporting system for federal and state regulatory commissions published by Public Utilities Reports, Inc., Rochester, New York.
In this writer's opinion much of the difficulties of the Federal Power Commission must be laid at the door of the appellate courts. Without presuming to contradict their decisions, the plain fact is that efforts of the Federal Power Commission to find some practical shortcut out of its present crushing log jam of cases have been blocked by judicial opinions which paid slight tribute to the "expertise," such as it is, of that regulatory tribunal.

The troubles of the FPC, which have resulted in the piling up of a backlog of approximately 4,000 producer rate cases—with more coming in far faster than they can be disposed of—started with the Supreme Court's decision in the celebrated Phillips Petroleum case.\(^{50}\) In that decision, a divided Court (5 to 3) ruled that the FPC had the jurisdiction and the duty to fix rates of producers of natural gas for interstate sale for resale. The FPC had previously ruled that producers were exempt under a provision of the Natural Gas Act which says that the "provisions of this act . . . shall not apply . . . to the facilities used for . . . the production or gathering of natural gas."\(^{51}\) Without going into the merits of this question, it must be conceded that there was at least a serious problem as to whether the FPC had jurisdiction. Congress itself twice enacted bills to repeal the FPC authority, as ruled by the Court, only to be vetoed by two different Presidents.\(^{62}\)

As a result of this, an avalanche of producer rate cases began to swamp the Commission. It appeared that if the conventional case-by-case approach were used, with its exact findings as to rate-base value, allowable expenses, return et cetera, the Commission could never hope to catch up. In an effort to step up the pace, it was decided to use the easily ascertainable price of gas in the production fields as a substitute for the usual utility rate-base approach. This attempt was struck down by the Court of Appeals for the District of Columbia Circuit,\(^{53}\) on the ground that while the Natural Gas Act did not impose any rate-fixing formula on the FPC, yet having once used the rate-base approach in other cases, it must now do the same in producer cases or explain why not. In other words, to vindicate its use of field prices, the court said, the


52 President Eisenhower's veto message pointed out that he was sympathetic to the legislation and would have signed it, had it not been tainted by irregularities during Senate consideration. He virtually invited Congress to pass a similar measure again for his signature. H.R. Rep. No. 6645, 84th Cong., 2d Sess. (1956).

Commission must first find what the rates would be if determined by the case-by-case rate-base approach, "as a point of departure," in order to justify the field-price approach.\(^{54}\) Obviously this cancelled out any short-cut advantage. What price expertise?

Needless to say, the FPC rate-case docket did not improve. It grew much worse and on September 28, 1960, the Commission once again attempted to break away from the traditional utility cost-base approach in fixing independent producers' natural gas prices,\(^{55}\) and announced it would regulate these prices by a geographic yardstick. The Commission said that, as a practical matter, it would be impossible for it to determine reasonable costs and rate of return for each individual producer. Instead it published "area price levels for natural gas sales by independent producers."\(^{56}\) These prices, the Commission said, "will serve as a guide" in determining fair rates.\(^{57}\) A commission spokesman said it was impossible to tell immediately whether the new schedules of prices would oblige some producers to reduce their present rates. The FPC noted that 3,278 rate increases were pending. Under this case load, the Commission said, "if our present staff were immediately tripled, and if all new employees would be as competent as those we now have, we would not reach a current status in our independent producer rate work until 2043 A.D."\(^{58}\) The Commission in making this projection also took into account expected future filings. Whether the courts will take any kindlier view of this latest attempt of the FPC to exercise its "expertise" remains to be seen. A former general counsel of the FPC, Willard W. Gatchell, said this of the role of appellate courts in such matters, in testifying before the House subcommittee:

When judges review the substantive exercise of legislative functions, their individual philosophies may subconsciously or even intentionally tend to find expression. If, for example, the judges reviewing an agency order on natural-gas rates have an impression that the agency is not sufficiently vigorous in opposing rate increases (without knowing intimately whether that impression is well founded or not), it would be fairly easy to find some ground for reversing the Commission in a case where an increase had been allowed. Also, occasionally, courts might read into statutes substantive requirements limiting apparent agency discretion which has not been limited by Congress. Thus, the Federal Power Commission was required in fixing natural-gas producer rates to at least consider


\(^{55}\) Re Rate Standards for Independent Natural Gas Producers, 35 P.U.R.3d 195 (FPC 1960).

\(^{56}\) Id. at 198.

\(^{57}\) Id. at 197.

cost as a point of departure although the rate criteria sections of the Natural Gas Act, sections 4 and 5, do not so require.59

In administrative actions, as in judicial, there is a tendency to follow precedents in order to avoid any charge of arbitrary or inconsistent action. Nevertheless, one of the reasons for using the administrative rather than the ad hoc judicial process is that agencies are directed by Congress to look at regulated industries broadly and to exercise discretion in individual cases to bring about broader benefits to the public. Judge Learned Hand of the Second Circuit observed that commissions (and courts, too) sometimes tend to give way to reliance on precedents instead of investing their decisions with flexibility. He continued:

On the other hand, they do get an expertness and acquaintance with the subject matter that we judges cannot possibly have. The thing that teases me most, and I confess seems to be insoluble as far as I have been able to judge, is whereas the courts have a more widespread knowledge, it is nothing like the commissions' accurate knowledge of the precise subject matter. Where are the courts to intervene? I am perfectly satisfied that somewhere along the line you cannot leave the last word with an administrative tribunal; I am sure that that will run in the end into a sclerosis that will be fatal. But how shall the judges, who do not know the intricacies, know when to intervene; and where and how? Do not say the Supreme Court will do it; they could not possibly do it. The amount of it is far beyond the power of any conceivable nine men. It must be somewhere further down and for ordinary judges. I wish I had some light on it; frankly I feel bankrupt.60

If courts are to be given additional review authority over substantive legislative decisions of regulatory agencies, the observations of Learned Hand have real meaning. The place of the judiciary in the regulatory picture is not susceptible of precise confinement or definition. But if, as seems to be generally recognized, the regulatory agencies are carrying out congressional policies, then the legislative policy responsibility must rest where Congress has placed it, or congressional purposes will be lost in a maze of ill-conceived and uncontrollable diversity.

V

OTHER CRITICISMS OF THE COMMISSIONS

Aside from the ethical questions covered, most of the other criticism of the commissions have to do with the expense, delay and red tape of commission procedures. Dean Landis also complained about the failure

59 Hearings on Administrative Process and Ethical Questions, supra note 32, at 63.
of the regulatory boards to use initiative in planning broad policy. This criticism would seem to be more confined to the federal agencies to which, of course, the Landis report was restricted. State regulatory commissioners are operating in fairly well-defined fields of jurisdiction and there has been little complaint of their failure to work out creative policies or to make recommendation thereon to the state legislatures.

In the federal area it might be mentioned that efforts of the commissions to do any bold planning might quickly bring them into confrontation, if not conflict, with Congress. Dean Landis suggested, for example, that the FPC might "use powers that it possesses" to get rid of thousands of producer cases which "clutter its docket." This suggestion is based on the fact that only a relatively few big producers do over 90 percent of the business, whereas the other 4,000 or more produce the balance. Only trouble with this implied suggestion that the FPC could dispose of all these little producer cases on a perfunctory or de minimis basis is that Congress itself has refused to do so. Could the FPC be expected to exercise powers which the Congress has expressly refused to enact? Even such a modest proposal clearly within the jurisdiction of the Federal Communications Commission, as one to authorize "pay TV" (television broadcasts paid for by subscription), has invariably been met by threats and grumbling in Congress that the FCC was attempting to usurp legislative functions.

As to complaints of delay and cost, whether court interference, or backseat driving or commission dilly-dallying is responsible, few would quarrel with the argument that commission procedures ought to be streamlined. There would seem to be little argument against the reforms Dean Landis proposes in the way of cutting down unnecessary or automatic appeals from examiner decisions to the commissions en banc, to reduce the number of unnecessary intervenors, and that hardly perennial—the curtailment of the record.

The commissions themselves have gone a long way in cutting through formal evidentiary requirements and courtroom rules. They allow

---

62 During the Senate consideration of the Harris-Fulbright Bill (S. 1853) to exempt producers, subsequently passed and vetoed, an attempted amendment by Senator Douglas (D-Ill.) to exempt the host of small producers was defeated by the Senate. 102 Cong. Rec. 2079 (1956).
63 The coal industry and affiliated mining labor interests have almost automatically intervened in every major pipeline certificate case before the FPC for the obvious reason that granting such certificates to build pipelines would mean delivery of gas to markets previously enjoyed by coal or other fuels.
"canned testimony" (previously prepared and published) so as to cut trial examination down to a minimum. They freely dispense with the courtroom restrictions on hearsay evidence, best evidence, and leading questions (actually encouraged). Dean Landis himself freely concedes that these advantages should be retained in the interest of streamlined procedure.

Unquestionably the federal regulatory agencies and federal administrative agencies, generally, have fallen into some slovenly habits resulting in a belated tendency to infuse trial-type processes into administrative proceedings, which is often called the "judicialization" of those proceedings. The fault lies in many quarters. The courts have said often that rules of evidence need not apply, thereby inviting abuse by counsel to the extent of their dumping many things into the record which courts of law would never allow under formal evidentiary requirements. Counsel with uncertain cases have sometimes not striven zealously for clarity of the record or issues. Commissions themselves, more intent on legislative aspects of their jurisdiction, have not always been particular about adjudicatory details. Even the law schools come in for some admonitory comments by Circuit Judge E. Barrett Prettyman of the Court of Appeals for the District of Columbia, who was chosen by former President Eisenhower to head the new Conference on Administrative Procedure:

The law schools contributed by failing to train law students in the craftsmanship of controversy and so produced a generation of practitioners who knew the answers but had not the foggiest notion of how to reach them. And so hearings which should have run days were too often running months, were costing tens of thousands of dollars when they should have cost hundreds, and were producing thousands of pages to be read when a hundred or two would have sufficed.65

Yet, as Judge Prettyman points out, even the Conference recognized that the use of such informal evidence as "canned testimony" would assist in cutting down the record and hearing time.

The conference adopted two or three recommendations in respect to the presentation of evidence. One was that all documentary evidence be submitted to the hearing officer and to all parties well in advance of the hearing. The other dealt with the troublesome problem of expert or opinion testimony. The nub of the recommendation was that such testimony be reduced to writing and

64 Fuchs, Fairness and Effectiveness in Administrative Agency Organization, 36 Ind. L.J. 1, 27 (1960).
exchanged prior to the hearing and that all underlying data be available for examination by all parties, but that only the necessary minimum of such data be formally placed in the record.66

Dean Landis, whose report backs up the splendid work of Judge Prettyman with a specific recommendation that it be continued on a permanent basis, had this to say about the importance of retaining the informality of regulatory procedures and of protecting them from the dangers of "judicialization":

Beginning about 1938 concerted efforts were made to deal with these [procedural] problems. At the outset, spurred on by an antagonism to the very powers exercised by the regulatory agencies, the bar as a whole sought to impose the straight-jackets of traditional judicial procedure on the agencies. They were countered by other forces which sought to retain the value of the administrative process but still advocated reforms that would assure fairness in the exercise of powers delegated to the agencies. Some eight years thereafter a compromise between these two opposing views was effected by the enactment of the Administrative Procedure Act of 1946. That Act, however one may evaluate it, is far from a definitive solution of the problems with which it dealt. It has achieved some uniformity of procedure, some assurance of the application of fairer standards, but with its emphasis on "judicialization" has made for delay in the handling of many matters before these agencies.

Very recently suggestions have been advanced that due to modern techniques for the assemblage of facts, the older "judicialized" forms may well be supplanted. The exact technology applicable to such a process has not as yet been clearly articulated. But if judgments of regulatory agencies in many fields such as rates are, in truth, business judgments rather than judgments conforming to a legal theory, techniques which do not rest upon the tedious process of examination and cross-examination and which underlie honest business judgments made by the industries may have a value in the handling of substantially the same problem by the agencies.67

Dean Landis is too old and too experienced a hand at regulation to fail to see the danger that could accrue from the imposition of the "straight-jackets of traditional judicial procedures" on these agencies.

Many remedies have been suggested along the lines of cutting down procedural proliferation, but the keystone of the hearing procedure is the examiner. Too often he has been governed by the understandable tendency to let questionable material go into the record so as to give the offering parties the "benefit of the doubt" and make his own position less vulnerable on appeal. This may result in a mass of extraneous material which commissioners and eventually appellate courts are sup-

66 Id. at 66.
posed to read. It takes real courage and a good deal of ability to kick
irrelevant material out of the record, to cut off counsel mid-flight in the
pursuit of testimony obviously not germane, and cutting through the
downright "gobbledygook" of obscure expert testimony. As Judge
Prettyman referred to the conference consideration of this important
problem:

The conference quickly recognized, as every researcher in the field quickly
recognizes, that the key to efficiency in adjudicatory processes is the hearing
officer. Just as the trial judge is the key to efficiency in the judicial system,
so the hearing officer is the key in the administrative system. If he is able,
industrious, and interested, the proceedings which he conducts move their
conclusions with accuracy, economy, and expedition. But if he is incompetent,
lazy, or uninterested, all the rules and policies which any tribunal can adopt
will not make that forum a place of effectiveness. Prehearing conferences,
preparation of counsel, model pleadings, plans for hearings, rules of evidence
are all so much academic exercise if there be not a competent official in the
presiding officer's chair. The conference also learned that, although the matter
has been the subject of long debates and much writing, no exhaustive research
job has ever been done on it as far as the federal government is concerned.
And so a committee set about to do that research task. The program was little
short of stupendous.68

No uniform rules of procedure are likely ever to be devised which
will be applicable to all the federal regulatory commissions in view of
their diversity, ranging from the Atomic Energy Commission to the
multiple-business practices supervised by the Federal Trade Commiss-
ion. Even as between the two Commissions concerned with interstate
gas-electric (FPC) and telephone-telegraph-radio (FCC) utility serv-
ces, respectively, there is a profound difference which has an inescapable
impact on procedural routines. The FCC, mainly preoccupied with
radio and television licensing, is more in the nature of a traffic policeman
of the airways who must decide the granting of valuable licenses to rival,
and therefore adversary, applicants. The FPC, in its job of certification
of gas pipelines and fixing of gas-electric rates, is more like the con-
ventional utility regulatory agencies operating in the several States.
Rate cases in particular are not truly adversary proceedings and should
not be made so by the Procrustean procedures carried over from court
trial practices.

Every public utility rate case is, or should be, in the public interest.
Those who bring up a case before the regulatory authorities should think
so, and be prepared to support that conviction, or else they should not

68 Prettyman, supra note 65, at 67.
1961] Regulation of Public Utility Enterprise 667

bring it up. Those who resist, oppose or question the pressing of a rate case should likewise be prepared to show that their resistance, questions or counterproposals are also bottomed upon a conviction of public interest. These are general statements. But they are far from empty platitudes, and unless case attorneys and other leading figures in a public utility rate case bear them in mind, the case can drift into confusion, delay and abuse of the regulatory process.

Viewed in this light, the public utility rate case theoretically does not have either proponents or opponents in the strict legal sense of contesting parties. It may, and generally does, inspire differences of opinion. These differences often require careful deliberation and finely wrought decisions before they can be resolved by the regulatory authorities. But it is nevertheless fundamental to the basic concept of public utility regulation that the over-all public interest is the prime objective and the ultimate goal of every rate case.

This is not to suggest that a rate case attorney should be any less aggressive in seeking relief sought by his client than in any other kind of a case. On the contrary, it is to suggest the additional responsibility of the rate case attorney to identify his client's interest in terms of the public interest. It is a matter of approach rather than of the content of case presentation.

This concept has an immediate impact on regulatory procedure because it is so unlike the basic concept of an ordinary civil case in the law courts. A lawsuit is essentially a contest—an adversary proceeding. The typical plaintiff sues the typical defendant for certain damages which he claims to have suffered by the defendant's wrongdoing. The defendant disputes this claim. Thus the issue is joined in fact or in law as the case may be. But both parties are seeking their own ends!

Even in cases, such as probate proceedings, where there is no ostensible opposition to the moving party's petition, it is necessary for the court to preserve the safeguards of a theoretical opposition. It does this by appointing administrators, guardians, trustees and the like to protect purely personal interests which might otherwise be damaged by default of representation. For this reason, the rules of evidence and procedure which have developed in regular courts of law and equity are geared to the basic premise of an adversary proceeding. They are based on a realization that adverse parties cannot, without check, be expected to establish the absolute trustworthiness of favorable evidence or to discover and bring forth evidence unfavorable to their cause. So, we find the courts equalizing restrictions on both parties by such devices as the
rule of best evidence, the requirement of sealed or acknowledged documents for certain purposes, the restriction against hearsay testimony, et cetera. These are the legalistic Marquis of Queensberry rules, so to speak. They are designed to equalize the courtroom contest so that one combatant cannot take unfair or unconscionable advantage of the other.

The public utility rate case, on the other hand, is not a contest of independent interests. This is true despite use of such legal terms as "complainant," "protestant," "petitioner," "intervener," and a number of other expressions which regulatory statutes have to use because they were taken over from conventional law practice. No other more precise terminology was available.

This over-all "public interest" concept of utility regulation throws an entirely new light on the conduct of a rate case. It has an important and immediate impact on the usages of procedure and evidence in rate cases. It may demand of the attorney in charge of the rate case a form of practice and procedure quite different in approach and objective from his trial court practice.

Procedure and evidence become more important than ever in a public utility rate case, as compared with a court trial. But these are specialized procedures designed for a definite end. That ultimate end is, or should be, to assist the regulatory commission to reach a conclusion which will, through the rate-fixing process, assure the public of the best quantity and quality of essential public utility service that can reasonably be produced for their use, under all the circumstances in the particular case.

VI

INDEPENDENCE OF THE COMMISSIONS

Much has been said and should be said about preserving the independence of the commissions. As to that the recommendation of the Landis report gives some ground for worry.

Conceivably the individual commissioners would find their own tasks made easier in the realm of policy-making and the determination of really important cases if they were relieved of housekeeping duties and unnecessary appeals of cases which could be disposed of at the examiner.

69 Bonbright, Principles of Public Utility Rates 27 (1961). In this recent brilliant work, Professor Bonbright sees the fixing of reasonable rates as primarily an instrument of social control. He states: "As used in this book and in most of the treatises on public utility economics, 'the theory of rates' is a normative, not a positive study. Its task is the systematic development of principles of rate-making policy, the complete or qualified observance of which would subserve 'the public interest' or 'the social welfare.'" Ibid.
level. But when the chairman of each commission, under the Landis recommendation, holds his job strictly "at the pleasure of the President," and where the proposed White House "Overseer" makes his contacts with these chairmen for purposes of "co-ordinating" policy, it is difficult to escape the suspicion that the independence of the commissions might be compromised.

"Co-ordination" is a vague word. Its exact meaning in any framework of reference is a matter of execution not definition. It could mean much or little, depending on the degree and mode of "co-ordinating." If the proposed White House "Overseer" would concern himself mainly with seeing that the regulatory commissions are keeping up with the case load, obeying procedural reforms, and otherwise tending to their business efficiently, there would be little objection. The Chief Executive has the duty and therefore the right to see that these regulatory tribunals are carrying out the laws which they were intended to administer. Congress has a parallel duty, as witnessed by the recent action of the House Committee on Interstate and Foreign Commerce in establishing a permanent Legislative Oversight Subcommittee.

But if the new White House "Overseer" is to use his post as a funnel for regulatory policies originating at the White House, what will happen to regulatory commission independence? Dean Landis suggests, for example, that he is not happy about the way the Federal Power Commission has not held the line in keeping down gas rates.

How would the White House "Overseer" (without participating in hearings or considering any evidence in any particular case) manage to convey his idea of the importance of holding the line on gas rates, without at the same time exerting some influence on the Commission's judgment? In other words, if the "Overseer" is to bring a pre-ordained policy down from Mt. Sinai to the working commission level, a compromise of its independent judgment seems inevitable. The courts have been jealous of the independence of the regulatory commissions, as witnessed by the Supreme Court's decision in Humphrey's Ex'r v. United States. Just how the role of an "Overseer" might work out, in the unlikely case that some future commission or commission chairman refused to take its marching orders from the White House on an issue of policy within its statutory jurisdiction, gives ground for interesting speculation.

---

71 1960 Landis Report 55.
72 295 U.S. 602 (1934). See also Parker, The Removal Power of the President and Independent Administrative Agencies, 36 Ind. L.J. 63 (1960).
On April 13, 1961, Congress received a special message from President Kennedy outlining his recommendations for changes in the federal regulatory agencies. Briefly the legislation called for would accomplish the following changes: (1) increase the number of Federal Power Commission members from five to seven; (2) permit division of the Commission's work among commission panels and increase the importance of the examiner; (3) authorize the exemption of some 3,800 small independent gas producers; (4) exempt interstate pipelines from Federal Power Commission licensing of extensions or replacements of existing lines; (5) establish a permanent Administrative Conference; and (6) require rate increases under suspension to be deposited in escrow.

The President also said there must be greater policy co-ordination among the regulatory commissions—such as the Interstate Commerce Commission and the Civil Aeronautics Board—so that they do not work at cross-purposes. The President's recommendations made no mention, however, of the establishment of any White House "Overseer" to act as a sort of controlling supervisor for the regulatory agencies.

CONCLUSION

With all the reports heretofore cited and with all the "reform" activity noted, we can be fairly sure that something will be done to improve the effectiveness of the federal regulatory commissions. It is also likely that the commissions will now exert themselves, as the Interstate Commerce Commission has recently done through its own rules and regulations, to answer much of the criticism that has been justly made about costly, wasteful and time-consuming procedures and other operations.

Congressional committees have spent too much time and money, there have been too many headlines, too many grave or petty scandals, according to the way one looks at it, for Congress to forget about the whole thing and do nothing. But we must bear in mind that there has been severe criticism of the regulatory commissions before, and there will be again. Commission regulation has its faults. Like all other human institutions it needs constant checking to keep from going off the track or just plain going to sleep. But all such criticism to one side, commission regulation is still the best way we know to control the so-called "inherent monopolies" without turning to outright socialist government operation. And it succeeded, too, in giving the United States

the best public service in the world, serving more people and in better fashion than all the publicly owned utilities in all the rest of the world.\textsuperscript{75}

So, the problem will be to keep needed reforms within bounds, to correct, improve and strengthen the commissions without hamstringing or crippling them with well-intended strait jackets or emasculating reorganization. If the past is any guide to the future, we have at least the reassurance that the outcome of these periodical investigations and overhauling of the commissions at both the federal and state levels will be beneficial. Year by year, since the turn of the century, the powers of the commissions have been broadened and bolstered to meet new and changing problems. From this standpoint, these investigations have been a good thing.

There is a clear and present danger, however, that some important critics in Congress, or extreme critics outside of Congress, may throw enough weight around the committees to get unwise or drastic plans started. In the confusion and hurry to get something done, such a "blockbuster" might conceivably be passed and signed into law.\textsuperscript{76}

\textsuperscript{75} Regulation of privately owned public utilities is virtually indigenous to the United States and Canada. Throughout the rest of the world, government ownership and operation is the rule rather than the exception and in those countries where privately owned utility operations are permitted, it is usually subject to ministerial control. It is noteworthy in this respect that the United States, with only 6.3\% of the land area and 6.1\% of the population of the entire world, see Rand McNally Co., The Consumer Atlas and Marketing Guide 4, 5, 42, 500 (1961), nevertheless possesses by far the great preponderance of public utility service facilities. Thus, 53\% of all the telephones in the world, American Tel. & Tel. Co., The World's Telephones 1960, at 2-4 (Dec. 21, 1960), and 38.8\% of all the generated capacity, Edison Elec. Inst., The Electric Industry 2 (Nov. 1960), are operated in the United States. In addition to this, by far the greater mileage of oil and gas pipelines, railroad and air-line routes are located in the United States than in any other country.

\textsuperscript{76} Developments in Washington during the first three months of 1961 indicate that the Kennedy administration is backing away from the regulatory "czar" idea, in the face of congressional resistance. P.U.R. Executive Information Service, No. 1420 (March 17, 1961). As early as February 8, 1961, President Kennedy said in a press conference that he was "not completely sure" that it would be wise to set up a new executive office to oversee the regulatory agencies. Washington Post, Feb. 9, 1961, p. 14, col. 3. On March 3, 1961, Representative Harris (D-Ark.) said that he had "no intention of abandoning or neglecting the responsibility of the Committee on Interstate and Foreign Commerce in this important field." P.U.R. Executive Information Service, No. 1420 (March 17, 1961). Previously, Harris announced the setup and membership of a permanent nine-man bipartisan Subcommittee on Regulatory Agencies to succeed the temporary Legislative Oversight Subcommittee. P.U.R. Executive Information Service, No. 1421 (March 24, 1961). On March 23, 1961, Harris introduced a bill to expand the membership of the Federal Power Commission from five to seven and the terms of members from five to seven years, with the President
Ministerial regulation, placing the commission under a Cabinet officer, or directly under the President, or in any event destroying their present independent status would be most unfortunate for the public utilities and for the public interest. Wherever it has been tried, and it has been tried often in foreign countries, it has been the inevitable prelude to public ownership and nationalization. We need look no further than Mexico or Castro's Cuba to see how "ministers" can turn into "managers" almost overnight.

The investigations have shown above all that commission regulation is not only here to stay but that it has never stood still. Regulation, like the Constitution under which it functions, is a living thing. It cannot be locked off into any permanent formula. It must change as the economic system in which it operates changes. The good, sound, practical regulation of one decade may not necessarily be the good, sound, practical regulation of another, and the United States Supreme Court has always wisely insisted upon preserving this elasticity.

The impartial student of regulation is struck by the fact that only in this country are the public utilities so much under the control and operation of private ownership. This is a strong indication that commission regulation has succeeded so satisfactorily in the public's mind that the continuation of privately owned and operated utilities under state regulation is generally accepted as being in the best interests of the public. Judged by actual performance, it must be admitted that the over-all results of our system have served the public remarkably well. Of course, this excellent record has not been due entirely to regulation. It is also the manifestation of the success of our American free enterprise system.

having complete control over the designation of the chairman. H.R. 5868, 87th Cong., 1st Sess. (1961). The bill was not, however, retroactive with respect to the present Commission. On March 25, rebellion against a White House "czar" broke out on the Senate side, where the chairman of a senate judiciary subcommittee, Senator Carroll (D-Colo.), said his group would oppose the appointment of such an official to oversee federal agencies. P.U.R. Executive Information Service, No. 1422 (March 31, 1961).
SOME OBSERVATIONS ON THE LAWFULNESS OF LONG-TERM CONTRACTS FOR THE PURCHASE OF ENERGY SUPPLIES BY PUBLIC UTILITIES IN INTERSTATE COMMERCE

JOHN T. MILLER, JR.*

Investigating the permissibility under federal antitrust law of long-term energy purchase contracts negotiated in interstate commerce by both public and private power supply sources, the author notes the conflict existing between antitrust policy and the public policy favoring the maintenance of a continuous and adequate supply of energy, and concludes that the Sherman and Clayton Acts should not be applied if a utility contract is offensive to competition solely because of its long-term clause but otherwise serves ends sought by the regulatory agencies in the power field.

INTRODUCTION

Public utilities1 supplying consumers with electricity and gas are substantial purchasers of energy. In 1959, privately owned public utilities paid over 6.5 billion dollars for natural gas, manufactured gas, electricity, coal, oil and liquid petroleum (LP) gas needed to meet their energy requirements.2 As a large part of these energy supplies is acquired in interstate commerce under long-term contracts, their acquisition involves a reconciliation of two policies, each of which in its proper sphere is clearly in the public interest. On the one hand, it is essential that there be continuity of gas and electricity supplies; on the other, that competition be stifled by as little foreclosure from markets as possible.

I

THE NATURE, SOURCES AND SIZE OF ENERGY REQUIREMENTS

(A) Electricity. The public utility retailing electricity might purchase some or all of its supplies of that form of energy. The seller might be a public utility, an agent or instrumentality of the United States Govern-

* A.B., Clark University; LL.B., Georgetown University; J.D., University of Geneva, Switzerland; Member of the Bars of the District of Columbia and the State of Connecticut.
1 By “public utility” or “utility” is meant a privately owned company selling or transporting electricity or gas, as the case may be, under regulation as to rates and service by state or federal regulatory commission.
2 Data cumulated from two publications of the Federal Power Commission: Statistics of Electric Utilities in the United States, Privately Owned (1959); Statistics of Natural Gas Companies (1959). This figure includes natural gas purchased by pipelines from regulated producers.
ment (such as the Tennessee Valley Authority), or a utility district organized under state law. In many cases the public utility itself generates the energy required to meet its electricity requirements using hydrostations, internal combustion engines fueled by gasoline or oil, or thermal plants\(^3\) fueled by oil, coal, natural gas and atomic energy.\(^4\)

In 1959 electric utilities purchased electric energy from outside sources at a cost of over 400 million dollars.\(^5\) The remainder was generated by the public utilities in their own facilities. Thermal plants in 1960 consumed in excess of 176 million tons of coal, 1.7 trillion cubic feet of natural gas and 85 million barrels of fuel oil\(^6\) at a cost in excess of 1.4 billion dollars.\(^7\)

\(B\) Gas. Depending on the type of gas sold to consumers, the retailing public utility may produce or purchase a supply of natural gas, purchase manufactured gas from another public utility or from blast furnaces, steel mills and coke plants, manufacture gas from coal or oil, or gasify LP products such as propane or butane. In some of the older communities, a mixture of manufactured and natural gas is distributed at all times. Many gas distribution utilities employ their own gas manufacturing facilities to meet peak-day requirements only as an adjunct to supplies purchased from a pipeline seller.

In 1960 public utilities purchased over 8 trillion cubic feet of natural gas at a cost in excess of 2.6 billion dollars from outside sources.\(^8\) During 1959 over 850,000 tons of coal, 123,000 tons of coke, and 92 million gallons of oil were used to manufacture gas.\(^9\)

The economic importance of these purchases and sales of energy, many of them made under long-term contracts, should be readily apparent.

---

\(^3\) In thermal plants, water is changed to steam by the application of heat, with the steam being used in turn to turn turbines which generate the electricity. For this reason the fuel is sometimes characterized as boiler fuel.


\(^5\) FPC, Statistics of Electric Utilities in the United States, Privately Owned xxii (1959). The relative insignificance of internal combustion engines is apparent from the fact that their fuel cost, in the same year, was less than two million dollars. Ibid.


\(^8\) FPC, Statistics of Natural Gas Companies xvi, xvii (1959).

II
THE NEED FOR CONTINUITY OF SERVICE

Gas which is distributed to consumers through pipelines underlying the streets of thousands of cities and towns must be always available at the burner tips to keep alive the pilot lights, ready at the command of a thermostat or the twist of a valve to heat a home, a hospital, a factory, to boil potatoes, bake glass, or freeze food. A temporary failure of such a gas supply is a dangerous as well as inconvenient matter. Restoration of service takes time. Meanwhile, industry may be dislocated; homes, schools and hospitals left without heat. Temporary interruptions present serious problems. Complete cessation of gas service may be a social disaster.

Electricity likewise must be there in the wire at all times, ready to spring to service at the flick of a consumer’s switch and counted upon to be available all of the time it is being used.

The electorate’s view of the importance of continuity of electric and pipeline gas service is written large in statutory provisions which forbid public utilities to reduce or abandon service without first obtaining prior consent of the appropriate regulatory commission. 10 Such consent is not ordinarily easy to obtain, the regulatory commissions taking an understandably jaundiced view of any attempt to abandon service where the consumers directly affected interpose objections.

Public utility service cannot be maintained by legislative fiat. Physical ability is a necessary prerequisite to service. No order of the Commission can ensure electric or gas service where claims on the public utility outstrip its ability to perform. When local natural gas supplies were exhausted in the Appalachian area, and in Ohio and Indiana during the past decades, natural gas service was supplanted by more expensive manufactured gas, or gas service was curtailed or terminated until technological developments and entrepreneurial enterprise pushed the giant pipelines from the Gulf Coast into Kentucky, West Virginia, Pennsylvania and New York, thereby providing substitute supplies of natural gas. 11 When requirements of war industries, commercial establishments

10 Section 7(b) of the Natural Gas Act provides in pertinent part:
No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

and homes for electricity exceeded the capabilities of the public utilities during World War II, brown-outs and blackouts ensued.

Energy interruptions can be avoided only by planning which anticipates load growths and harnesses needed additional energy supplies in time to meet consumer requirements. In some areas, regulatory commissions force this result by refusing to allow public utilities to attach new customers until they can demonstrate their ability to handle present loads plus proposed additional service on a long-term basis. Elsewhere public utilities are under an obligation to serve any potential commercial or household customer in the franchise area seeking a supply of gas or electricity and able to meet a minimum deposit requirement. In either event the responsibility for meeting its obligations to consumers is essentially that of the public utility. It has the duty to initiate energy supply negotiations and construction programs, subject to review and approval by the regulatory commissions.

Safeguarding service may be accomplished in many ways. An ideal means would be a tie-in with an inexhaustible source of energy supply. Hydrostations with their recurrent cycle of water flow approximate this standard, but they supply only twenty percent of the electricity being generated by electric utilities. Except in those cases where the public utility owns supplies of coal, oil, and/or gas in place (all of which are exhaustible and must be replaced in time), energy purchase contracts are the foundation stone of this continuous electric and pipeline gas service to which we have been referring. Under the circumstances, one might expect to find widespread use of long-term contracts for the purchase of energy by public utilities. As a matter of fact, long-term contracts are prevalent only in the purchase of electricity and natural gas supplies. Such service ordinarily requires large capital expenditures, the construction and operation of facilities designed and required in whole or in part to serve the particular customer, and the sale is made under governmental controls, at least as to rates. The short-term or "spot" contracts employed in purchasing coal, oil and LP products appear to reflect the idiosyncrasies of these supplies. Both coal and oil are in abundance,

For an account of the economic dislocation caused by the exhaustion of gas supplies, see Lynd & Lynd, Middletown 13-17 (2d ed. 1956).

12 See Birmingham Ry., Light & Power Co. v. Littleton, 201 Ala. 141, 77 So. 565 (1917).

easily transportable by train, truck, barge or ship, and they may be stored at the point of consumption. Prices are not regulated by government authority. Thus, the buyer is encouraged to trade for such supplies on a yearly or spot basis so as to be in a position to profit from a break in the market. Sellers do not appear interested in binding themselves for long periods of time at a price determined in a buyer's market, as such a price is apt to be lower than what the seller believes it ought to obtain. Moreover, in the case of coal, labor expenses which are a large part of total costs constitute a substantial variable. Nonetheless, coal is sometimes sold under long-term contracts.

Are long-term energy purchase contracts in interstate commerce lawful under the federal antitrust laws? Before we attempt to answer this question let us look briefly at the applicable statutes.

III
LONG-TERM ENERGY PURCHASE CONTRACTS CONSTITUTE RESTRAINTS OF TRADE

A single thermal plant may consume as much as one million tons of coal a year. A public utility may purchase under a single contract one-quarter trillion cubic feet of natural gas or 900 million kilowatt-hours of electricity in a single year. The supply of all or a large part of such energy requirements for even a short period of time is obviously a substantial business undertaking. It follows that a long-term utility energy purchase contract necessarily restrains trade. Competitors of the supplier are foreclosed from serving the same market during the life of the contract and the utility purchaser cannot as a practical matter turn to other sources for the supply covered by the contract.14 But the recognition of the restraint of trade involved does not provide us with any solution as to its legality; it has never been held that all restraints of trade are unlawful.

At common law a contract was not illegal or unenforceable simply because it was for a long period of time, covered a large volume of goods, or involved all of the buyer's requirements.15 Such contracts were the

14 Restatement, Contracts § 513 (1932), states: "A bargain is in restraint of trade when its performance would limit competition in any business or restrict a promisor in the exercise of a gainful occupation."

15 Twin City Pipe Line Co. v. Harding Glass Co., 283 U.S. 353 (1931); Gibbs v. Consolidated Gas Co., 130 U.S. 396, 409 (1889); Griffin v. Oklahoma Natural Gas Corp., 37 F.2d 545 (10th Cir. 1930); see cases cited in 6 Corbin, Contracts § 1412 n.89 (1951). In Elizabethan times the expression "contract in restraint of trade" referred to some voluntary restraint imposed by contract by an individual on his right to carry on his trade or calling.
product of freedom of contract. But contracts which had a clear tendency to create a monopoly, destroy a competitor or unreasonably restrain trade were held contrary to the public interest and unenforceable. Courts and legislators sought to forbid the evils of monopoly: the power to fix prices to the injury of the public; the power to limit production; and the danger of deterioration in the quality of the goods resulting from the exercise of such power.

In 1890, doubting the existence of a federal common law against monopolies and restraints of trade, Congress enacted the Sherman Act outlawing under section 1 thereof, "every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States . . . ." The act further provided that "every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor . . . ." This statute designedly went beyond the common law.

The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions. But even were that premise open to question, the policy unequivocally laid down by the Act is competition.

At first the Supreme Court read section 1 literally, holding every restraint of trade unlawful under the Sherman Act. But in 1911 the Court abandoned this rigorous view, substituting in its stead a "rule of

Originally all such contracts were held illegal, Colgate v. Bacher, Cro. Eliz. 872, 78 Eng. Rep. 1097 (Q.B. 1600), but in the interests of the freedom of individuals to contract, this doctrine was modified to apply only to general restraints on alienation, Standard Oil Co. v. United States, 221 U.S. 1, 51 (1911).


21 United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898); United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897).
reason”22 which permits the courts to inquire whether and to what extent the particular practice reviewed actually constitutes a restraint of competition and whether it is significant enough to be held illegal.23

The “rule of reason” with its vague standards of proof and decision rendered antitrust enforcement temporarily impotent.24 To undo the harm, Congress enacted the Clayton Act in 1914,25 supplementing the Sherman Act with a specific list of prohibited acts and establishing easier standards of proof designed to assist the Department of Justice in nipping in the bud monopolies and substantial restraints of trade. Congress also set up the Federal Trade Commission to concentrate on eliminating unfair methods of competition and to help enforce the Clayton Act.26 As a result of this combination of legislation, a public utility may find its energy purchase contracts scrutinized closely not only by its own regulatory commission and by its customers, but also by the Department of Justice, the Federal Trade Commission, its competitors and others who might be injured as a result of any antitrust violation in which the contract may play a part.27

For the purposes of our discussion, we must look at section 3 of the Clayton Act which provides in pertinent part:

[1]t shall be unlawful for any person engaged in commerce, in the course of such commerce, to . . . make a sale or contract for sale of goods, . . . supplies . . . for use, consumption or resale within the United States . . . on the condition, agreement or understanding that the . . . purchaser thereof shall not use or deal in the goods, . . . supplies . . . of a competitor or competitors of the lessor or seller, where the effect of such . . . sale, or contract for sale . . . may be to substantially lessen competition or tend to create a monopoly in any line of commerce.28

This provision was designed to make unlawful certain arrangements such as the “requirements” contract, whereby a buyer agrees for a certain
length of time to obtain all of his supply of fuel from the seller and not to use the fuel of a competitor of the seller,29 and the "tying-agreement," the essence of which is the "forced purchase of a second distinct commodity with the desired purchase of a dominant 'tying' product, resulting in economic harm to competition in the 'tied' market."30

The legality of such exclusive dealing contracts depends on whether the effect of such sales or contracts for sale " 'may be to substantially lessen competition or tend to create a monopoly in any line of commerce.' "31 In other words, not every lessening of competition was intended to be covered by the Clayton Act,32 just as not every restraint of trade33 or monopoly34 is forbidden by the Sherman Act.

The law of exclusive dealing contracts is very controversial. There is very little judicial precedent helpful in establishing the proof necessary to show that the effect of the contract "may be to substantially lessen competition." Is a violation of section 3 proved by evidence that a substantial portion of commerce is affected, or must it be shown that competitive activity has actually diminished? The Supreme Court employed the first criterion in a leading case,35 but the Federal Trade Commission has declined to follow suit. The latter invalidates exclusive dealerships only when it finds, on the basis of economic data, actual foreclosure of competitors from access to the market.36 Obviously, if the fact that a substantial portion of commerce is affected suffices to prove a violation, then long-term public utility purchase contracts of the sort we are discussing appear to fall outside the pale. But the particular facts and circumstances of such purchases must be considered because we are concerned with public utilities.

29 No affirmative promise not to use or deal in commodities of competitors is necessary to establish a violation of the section. Carter Carburetor Corp. v. FTC, 112 F.2d 722, 722 (8th Cir. 1940).


33 Standard Oil Co. v. United States, 221 U.S. 1 (1911).

34 See United States v. Columbia Steel Co., 334 U.S. 495 (1948); United States v. United States Steel Corp., 251 U.S. 417 (1920). It is not unlawful to be large, "but size carries with it an opportunity for abuse that is not to be ignored when the opportunity is proved to have been utilized in the past." United States v. Swift & Co., 286 U.S. 106, 116 (1932).


36 See Anchor Serum Co. v. FTC, 217 F.2d 867 (7th Cir. 1954); Dictograph Prod., Inc. v. FTC, 217 F.2d 821 (2d Cir. 1954), cert. denied, 349 U.S. 940 (1955).
Let us look at three possible twenty-year contracts:

(1) A public utility contracts to purchase all of its present electricity requirements from the United States at a hydrostation operated by the Secretary of the Interior.

(2) A public utility contracts to purchase all of its present natural gas requirements from a regulated interstate natural-gas pipeline company.

(3) A public utility contracts to purchase all of the coal requirements of a new steam electric generating station from a single coal supplier.

Each of these contracts restraints trade, effectively forecloses competitors of the seller during the term of the contract to the extent of the volume covered by the contract. Each, we may assume, constitutes a prudent step taken by the purchaser to assure continuity and security of gas or electricity service to consumers. Each raises a question as to whether it runs counter either to the Sherman Act's prohibitions against restraints of trade and monopoly and/or to the Clayton Act's prohibitions against exclusive dealing contracts. Yet we know that contracts like these exist, are being adhered to voluntarily every day and are even specifically enforced by regulatory commissions and the courts.

The heart of this paradox lies in the circumstances and purposes of the sales and contracts of sale. Perhaps this can be better understood if we take up our three utility energy purchase contracts in order. It will be seen that they fall into three broad categories: (1) a purchase from a government agency or corporation; (2) a regulated purchase from another public utility; and (3) a purchase from a private, unregulated seller.

1. Purchases From the Federal Government Under Long-Term Contracts.

The federal government owns and operates both hydro- and thermal electric generating stations.37 This function is carried on through several departments, bureaus and agencies.38 There were 56 federal projects in operation during 1959.39 Surplus power from these projects is sold at

---

37 Some of these stations are among the largest of their kind in the United States. In 1959, TVA alone generated approximately 46 billion kilowatt-hours in steam stations and 12 billion kilowatt-hours in hydrostations. FPC, Statistics of Electric Utilities in the United States, Publicly Owned 41A (1959).

38 Corps of Engineers of the Department of the Army; Bonneville Power Administration, Bureau of Reclamation, Bureau of Indian Affairs, Southeastern Power Administration and Southwestern Power Administration under the Department of Interior; and the Tennessee Valley Authority. Id. at 106.

39 Id. at v.
wholesale or retail, depending on market conditions and subject to statutory limitations. TVA had 153 electric utility customers to which it sold over 19 billion kilowatt-hours and from which it received revenues of $85,108,970 dollars.\textsuperscript{40} In the same year, comparable figures for Bonneville Power Administration were: 84 utility customers, sales of over 15 billion kilowatt-hours and revenues of $39,527,221 dollars.\textsuperscript{41}

As might be expected in light of the long history of government sales of electricity, the power to make such sales has been upheld by the courts. The logic is this, in the case of water power. The dam is constructed on waterways subject to the jurisdiction of the federal government. It might be justified on the basis of flood control, national defense, navigation, or irrigation. The water power represented by the impounded waters is within the exclusive control of the Government. The electric energy produced from such power is property belonging to the United States, and under article IV, section 3 of the Constitution,\textsuperscript{42} Congress has the right to dispose of such property constitutionally acquired. While the constitutional provision is silent as to the method of its disposition, it must be appropriate to the nature of the property and conformable to the public interest, as distinguished from private or personal ends.\textsuperscript{43} The Government is not limited to a few or infrequent sales; it may seek out a market and assure it by attaching appropriate terms and conditions to the sale.\textsuperscript{44} The scope of the projects necessary for the disposition of public property is a question for Congress to determine.\textsuperscript{45}

Congress has been very specific in some of the statutes relating to federal electric generating plants. In the case of the Bonneville project on the Oregon River, Congress provided that an administrator, appointed by the Secretary of the Interior, may arrange for the sale of electricity in consultation with a board composed of several persons including a representative of the Federal Power Commission.\textsuperscript{46} Contracts for the sale of electricity may not exceed twenty years in length. Contracts with

\textsuperscript{40} Id. at 41.

\textsuperscript{41} Id. at 34. Bonneville Power Administration is marketing agent for power generated at ten federal projects. Id. at 34A.

\textsuperscript{42} "The Congress shall have the Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States . . . ." \textsuperscript{43} Ashwander v. TVA, 297 U.S. 288, 338 (1936).


\textsuperscript{45} Arizona v. California, 283 U.S. 423, 456 (1931).

resellers for profit (the category in which public utilities fall) must provide for cancellation on five years’ notice in writing.47

In the case of the Fort Peck project in Montana on the Missouri River, surplus electricity may be sold under the supervision of the Secretary of the Interior.48 No time limit on such contracts is specified in the statute. The schedules of rates for energy become effective upon approval by the Federal Power Commission.49

Legislation relating to the Boulder Canyon project on the Colorado River authorizes the Secretary of the Interior to enter into contracts for the sale of electrical energy for a period not longer than fifty years from the date on which such energy is ready for delivery.50 The Board of Directors of the Tennessee Valley Authority is authorized to contract to sell surplus power for a term not exceeding twenty years. However, all such contracts with private companies or individuals must provide for cancellation by the Board upon five years’ notice in writing, “if the board needs said power to supply the demands of States, counties, or municipalities.”51 By contrast, the Board may enter into contracts with non-profit purchasers who build transmission lines to the government plant for a term not exceeding thirty years.52

It is noteworthy that the Federal Power Commission has been given broad power to supervise the rates for electricity sold from most federal projects.53 As of June 30, 1960, rates of 35 federal projects producing and selling electricity were subject to Commission approval. South- eastern Power Administration is the marketing agent for 11 of these projects; Bonneville Power Administration, for 9; and the Bureau of Reclamation, for 6. Another 14 federal multiple-purpose projects which were to come under the Commission’s rate-approving authority were under construction as of the same date.54

It is not reasonable to assume that the Sherman and Clayton Acts could be employed to nullify the long-term features of contracts for the

sale of energy from federal projects entered into by the United States, its representatives and agents.

It is a matter of public importance that good faith contracts of the United States should not be lightly invalidated. Only dominant public policy would justify such action. In the absence of a plain indication of that policy through long governmental practice or statutory enactments, or of violations of obvious ethical or moral standards, this Court should not assume to declare contracts of the War Department contrary to public policy. The courts must be content to await legislative action.\(^55\)

Long-term energy sales contracts are commonly used by the federal government. They constitute a method of sale appropriate to the nature of electricity which requires substantial capital investments in facilities by the purchaser as well as by the ultimate consumer.

In any event it is plain that the Sherman and Clayton Acts are not intended to apply to the United States. The Supreme Court has declined to include the United States within the definition of "person" as employed in these federal antitrust laws.\(^56\)

2. Purchases From Public Utilities Under Long-Term Contracts.

For all practical purposes natural gas and electricity are the only forms of energy sold by one public utility to another in interstate commerce. In our example we refer to a twenty-year natural gas purchase contract between two public utilities. We use natural rather than manufactured gas as only the former flows in interstate commerce under circumstances where it is federally regulated today.\(^57\)

In 1924 the Supreme Court decided that the States did not have the power to regulate interstate sales of natural gas, the uniformity of federal nonaction being more conducive to equal access to natural gas supplies than provincial state regulation.\(^58\) In 1938 this regulatory gap

\(^{55}\) Muschany v. United States, 324 U.S. 49, 66-67 (1945). (Footnote omitted.)


\(^{57}\) The Natural Gas Act applies to natural gas alone or mixed with manufactured gas. 52 Stat. 821 (1938), 15 U.S.C. § 717a(5) (1958). Congress recognized in the 1930's that interstate sales of manufactured gas were practically nonexistent. 81 Cong. Rec. 9316 (1937) (remarks of Senator Wheeler). There is obviously even less manufactured gas sold today than was the case twenty years ago.

was closed by the enactment of the Natural Gas Act.\textsuperscript{59} As amended, the act today provides a comprehensive scheme of regulation designed to "protect consumers from exploitation at the hands of natural gas companies"\textsuperscript{60} by outlawing rate and service preference and discrimination by the regulated sellers and transporters of natural gas and establishing standards to assure that the rates charged are just and reasonable by public utility standards. The regulated company (called a "natural-gas company") is obliged by law to file with the Commission all of its agreements and contracts relating to the jurisdictional service which it is performing or is authorized to perform.\textsuperscript{61} Under prescribed procedures, the natural-gas company may initiate a change in rates,\textsuperscript{62} if it has the contractual right to do so.\textsuperscript{63} The Commission, either on its own motion or upon complaint, may start a rate investigation and, if it finds the rates unlawful, establish lawful rates.\textsuperscript{64}

A pipeline company may not undertake construction enlarging its capacity or undertake new jurisdictional service without prior consent of the Commission expressed through the issuance of a certificate of public convenience and necessity.\textsuperscript{65} Nor may it abandon a service without Commission authorization.\textsuperscript{66}

Let us now turn to our hypothetical problem. We shall assume that the natural gas supply in question is being purchased from a regulated pipeline company by a public utility for resale to the consuming public. The Federal Power Commission's consent must be obtained before the sale is made. The service agreement must be filed with the Commission. The Commission has complete jurisdiction over the rates and charges so long as the service continues. The pipeline company may not terminate the service when the contract term expires without Commission authorization. Indeed, the Commission has required service to continue long after the contract has expired\textsuperscript{67} and, in practice, never permits the service to be abandoned where: (1) the seller has the gas supply to continue the

\textsuperscript{60} FPC v. Hope Natural Gas Co., 320 U.S. 591, 610 (1944).
\textsuperscript{65} Natural Gas Act § 7(c), 52 Stat. 824 (1938), as amended, 15 U.S.C. § 717f(c) (1958).
service; and (2) the public utility buyer needs the gas supply and opposes the abandonment.68 Emphasis on the "service" rather than the "sale" aspect of natural gas contracts has appeared in recent Supreme Court decisions.69

There is no longer a regulatory gap insofar as the transmission and sale of either electricity or natural gas in interstate commerce is concerned.70 The degree and intensity of price and service regulation varies, of course, with the nature of the service involved, and the participation of state as well as federal regulatory authorities. But does this fact of regulation displace whatever prohibitions the antitrust laws have against such contracts? The question is not simply answered.

Regulated industries are not per se exempt from the antitrust laws, but they are exempt to the extent that the regulatory statute is clearly repugnant to the antitrust laws. Repeals of the antitrust laws by implication are not favored.71 The repugnance may be found in a specific statutory exemption from the antitrust laws or in an irreconcilable conflict between the means and purposes of the regulatory statute and the antitrust laws.72

There is no exemption from the antitrust laws specified in either the Federal Power Act or the Natural Gas Act.73 The only applicable provision is to be found in section 7 of the Clayton Act relating to mergers.74 Section 10(h) of the Federal Power Act specifically provides: "Combinations, agreements, arrangements, or understandings, express or implied, to limit the output of electrical energy, to restrain trade, or to fix, maintain, or increase prices for electrical energy or services are hereby prohibited."75

70 See FPC v. Transcontinental Gas Pipe Line Corp., supra note 69, at 8, 28.
While the Commission has not been given the power to enforce the antitrust laws,76 it may not ignore them.77 But there is very little case law to serve as a guide in applying the antitrust laws to the regulated activities of gas and electric companies regulated by the Federal Power Commission.78

There can be no doubt that certain activities performed by regulated companies pursuant to regulatory statute and with the sanction of the regulatory commission are contrary to specific prohibitions of the antitrust laws. For example, a natural-gas pipeline company serving as sole supplier to an area may intervene in the certificate proceedings before the Federal Power Commission, and oppose a proposed competing project. And it might very well persuade the Commission to turn down the competing project because it is not able to be financed, or is, from an economic or engineering aspect, unsound or lacks an adequate gas supply.79 Or it might convince the Commission, by presenting a comparative project, that the existing supplier should be authorized to serve the expanding market requirements.

Were a monopolist who had achieved that status by lawful means to seek by positive measures to block a potential competitor—absent the regulatory features just described—it might very well result in a prosecution for violating the Sherman Act prohibitions against monopolies and attempts to monopolize.80

In short, there are repugnancies between regulatory statutes and the federal antitrust laws that are not identified as such in any statutory provision but which inhere in the very purpose of the statute, the scope of the Commission's authority, and the manner of regulation provided. The function of recognizing and respecting supersession of the antitrust laws by a regulatory statute is a substantive question which rests with the courts, not with the Federal Power Commission.81

In a recent decision involving a claim that the Commission had im-

78 See antitrust discussion in Miller, Competition in Regulated Industries: Interstate Natural Gas Pipelines, 47 Georgetown L.J. 224, 251-54 (1958).
properly sanctioned a merger forbidden by section 7 of the Clayton Act, Circuit Judge Prettyman, writing for the majority, stated:

A determination that only one regulated utility should operate is not in contravention of the antitrust laws. The antitrust laws and the regulatory laws are not in conflict; they are complementary. Both have as their objective the public interest. They deal with different subject matters. They have been entrusted by the Congress to different enforcement agencies. When the Power Commission considers the policies and provisions of the antitrust laws in respect to the transactions of utilities under its jurisdiction, it is not required to—and indeed should not—begin with a general premise that competition is always and under all circumstances in the public interest. Its premise should be that the antitrust laws in certain areas of our economy and the regulatory laws in other areas are supplementary enactments and each must be given full effect in its area, recognizing always its concomitant body of law in other areas. The Commission must recognize the policies of the antitrust laws, but it must also recognize its own responsibilities under its own laws.82

The specific question before us is whether the courts ought to apply the Sherman and Clayton Acts for the purpose of nullifying the long-term features of public utility energy contracts with other utilities. As in the case with most antitrust problems, the solution must be found in the facts and not in the examination of theories.88 And it is the Commission’s function to gather all the relevant facts and interpret the regulatory statute, subject to court review.84

It is plain that the Commission has required pipeline companies to present evidence of a long-term market requirement before allowing the investment of substantial sums of money in transmission facilities. The criteria for the issuance of a certificate of public convenience and necessity include evidence of an adequate gas supply, market, economic and engineering feasibility and financeability.85 The Commission has gone so far as to deny expansion programs where there was not evidence of a long-term gas supply86 mirroring the pipeline company’s obligation to render long-term service.

Pipeline companies finance with a high percentage of debt87 which permits lower cost service to consumers. Financial feasibility turns upon evidence of revenues sufficient to meet bond sinking-fund obligations.

83 "Theories soon grow stale; but things continue to be fresh." G. K. Chesterton, Chaucer 28 (1949).
87 FPC, Statistics of Natural Gas Companies ix (1959).
In this regard, the Commission allows only a low rate of depreciation, assuming thereby that the pipeline company will be in business for over twenty years. In measuring the adequacy of dedicated gas supplies the pipeline company is ordinarily required to project the requirements of its utility customers twenty years into the future, even though contracts for such service terminate by their terms within the twenty-year period.

Thus, it is implicit in the Commission's approval of an expansion program or of a sale that it is also sanctioning the rendition of service for at least two decades. As a matter of fact, the Commission does not ordinarily specifically find that the long-term feature of the energy sales contract is in the public interest. As detailed findings of this nature are not called for or feasible in the ordinary case, approval is implicit.

The Commission has, as a matter of general policy, taken the position that utility service by pipeline companies must be provided under a certificate of public convenience and necessity unlimited as to time.88 This policy has been recently underscored by the efforts of producer-applicants to require the Commission to limit certificates of public convenience and necessity to twenty years, the usual contract term. The Commission has declined to so limit such certificates in the absence of proof that the limited certificate requested would be required by the public interest.89

Viewed in itself, the twenty-year feature of a regulated natural gas contract covering a sale by one regulated public utility to another regulated public utility for resale to the consuming public appears to be no violation of either the Sherman or Clayton Acts.90 And in view of the importance of integrity and continuity of such service, court interference would only be mischievous.91

The same conclusion would appear proper in the case of direct sales of

88 See Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. 137 (1960).
89 Ibid.
90 Needless to say, like any act or agreement innocent in itself, such a contract provision could be altered as a part of equitable relief granted by a court upon a determination that such relief was necessary to right a past violation of the antitrust laws brought about by other actions, agreements or conspiracies, or to preclude its revival. See United States v. Crescent Amusement Co., 323 U.S. 173, 188 (1944). See also Consolidated Gas Elec. Light & Power Co. v. Pennsylvania Water & Power Co., 194 F.2d 89 (4th Cir. 1952); Pennsylvania Water & Power Co. v. FPC, 89 U.S. App. D.C. 235, 193 F.2d 230 (1951), aff'd, 343 U.S. 414 (1952); Pennsylvania Water & Power Co. v. Consolidated Gas Elec. Light & Power Co., 184 F.2d 552 (4th Cir. 1949), cert. denied, 340 U.S. 906 (1950).
natural gas for use in thermal stations.\textsuperscript{92} A proposal to sell gas for such purposes must be passed upon by the Commission before it may be undertaken, inasmuch as the Commission has power to regulate the transportation of natural gas as well as the obligation to see to it that no direct sales impair the ability of the pipeline company to provide adequate service to jurisdictional customers.\textsuperscript{93} While the Commission lacks power to control the rate as such, its certificate power is a substantial one and obviously adequate to protect the public interest.\textsuperscript{94} There is here no regulatory gap.\textsuperscript{95}

We are led to similar conclusions in the case of long-term electricity contracts between public utilities in interstate commerce. In 1927 the Supreme Court held that the States have no jurisdiction over interstate wholesale electric rates.\textsuperscript{96} This regulatory gap was closed by Congress in 1935 by a statute vesting in the Federal Power Commission jurisdiction over interstate transmission of electric energy and public utility companies engaged therein.\textsuperscript{97} Today that Commission has jurisdiction over interstate sales, to the extent they are not regulated by the States.\textsuperscript{98} Rates and charges relating to sales subject to the jurisdiction of the Commission and all rules and regulations pertaining thereto must be just

\textsuperscript{92} The Commission has no jurisdiction over the direct sale as such. Panhandle E. Pipe Line Co. v. Michigan Pub. Serv. Comm'n, 341 U.S. 329 (1951).

\textsuperscript{93} Panhandle E. Pipe Line Co. v. FPC, 232 F.2d 467, 474 (3d Cir.), cert. denied, 352 U.S. 891 (1956).


\textsuperscript{95} See FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1 (1961). The rates charged under a direct sales contract are subject to regulation by local state commissions. On the one hand, the local regulatory commission might regulate the rate as such. On the other, it has an indirect effect upon the rate arising from its power to pass upon the costs of the local utility which are to be included in determining local electricity rates.


and reasonable.\(^9\) Public utilities are forbidden to make or grant any undue preference or maintain an unreasonable difference in rates, charges, services, facilities, or in any other respect, either as between localities or as between classes of service.\(^{100}\)

Under Part I of the Federal Power Act the Commission is empowered to issue fifty-year licenses authorizing hydroelectric projects on waterways which are subject to federal jurisdiction.\(^{101}\) In determining the length of the license period the Commission gives consideration to the size of the investment involved, and the method and period of financing. A license for as short a period as thirty-five years has been imposed where it was found not to impair the applicant's ability to finance construction.\(^{102}\) The rates charged for electric power from a licensed project which moves in interstate or foreign commerce must be reasonable, nondiscriminatory, and just to the customer. If no State commission regulates such rates, they are regulated by the Federal Power Commission.\(^{103}\)

It is readily apparent that the Federal Power Act envisions long-term contracts, at least in connection with licensed projects. Section 22 of Part I of the act provides that "whenever the public interest requires or justifies the execution by the licensee of contracts for the sale and delivery of power for periods extending beyond the date of termination of the license [which may last 50 years], such contracts may be entered into upon the joint approval" of the Federal Power Commission and the appropriate State commission, or if there be none, then upon approval of the former Commission only. Thereafter, in the event the license is not renewed, the United States or the new licensee, as the case may be, shall assume and fulfill all such contracts.\(^{104}\)

The large investment in hydro and thermal plants, transmission and distribution facilities supports the view that long-term electric sales contracts with other public utilities are not only desirable but even necessary. Evidence of a long-term market may be requisite to financing new generating facilities.\(^{105}\) With continuity and maintenance of service so very essential, there is no apparent justification for permitting the

federal government to enter into valid electricity sales contracts for twenty years or longer on the theory that such contracts are appropriate in view of the nature of the government property being sold, while the same right is denied privately owned public utilities selling electricity under substantially similar physical circumstances. The opportunity to enter into long-term contracts is essential to the sound economics of either a public\textsuperscript{106} or a private project.\textsuperscript{107}

We do not mean to suggest that public utility contracts for the sale of natural gas or electricity to public utilities should be without time limit. Under both the Natural Gas Act and the Federal Power Act contractual arrangements are initially established by buyer and seller\textsuperscript{108}—the statutes providing a review for the purpose of protecting the public interest. The resultant freedom of contract allows the buyer to obtain assurance of continuity of service by long-term features while, at the same time, reserving a right at stated periods (perhaps every five years, but in any event at the end of the contract term) to turn to another source of supply. While the seller may not be able to terminate the sale without regulatory commission consent, the buyer is free to discontinue the sale as provided in its contract. This provides incentive for the privately owned public utility to keep a sharp eye on the economics of service to its public utility customers as there is some competition in the picture.

3. Purchases From Nonregulated, Nongovernmental Sellers.

The producers and marketers of coal, oil, LP gas, gasoline and coke are not regulated as public utilities, nor is the federal government in the business of selling these forms of energy on a regular basis to public utilities. While oil production and marketing is regulated to some extent by state proration laws and federal import restrictions,\textsuperscript{109} and while all


> Every agreement concerning trade, every regulation of trade restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the courts must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.


\textsuperscript{109} Kronstein, Miller & Schwartz, Modern American Antitrust Law 222-23 (1958).
of the listed forms of energy are transported by regulated common carriers, the production and marketing of these fuels enjoy no statutory exemption from the antitrust laws. We might therefore expect a more literal application of the Sherman and Clayton Act prohibitions in cases where the courts are presented with public utility long-term contracts for the purchase of such forms of energy. Until very recently this was the case. New light has been cast on the law in this area by the decision of the Supreme Court in *Tampa Elec. Co. v. Nashville Coal Co.* As this is the latest word on the subject, we shall limit our discussion to the circumstances of that case.

Tampa Electric Company, a public utility producing and selling electricity in Florida, decided in 1955 to construct a new thermal electric-generating station (the Gannon Station) to meet the increasing demands of its customers. At that time no coal was used as fuel in any thermal station in peninsular Florida. Tampa itself burned only oil in its two existing thermal stations. The public utility decided to use coal as the fuel in its Gannon Station, despite the fact that the installation of coal-handling facilities would result in a capital expenditure of three million dollars more than if oil were used. To assure an adequate supply of coal, Tampa entered into a twenty-year contract with a coal supplier, the coal to be produced in western Kentucky. The arrangement required the coal supplier to make a capital expenditure in excess of 7.5 million dollars in order to effect deliveries.

The Gannon Station was designed ultimately to contain 6 generating units. The coal contract embraced the total requirements for fuel of the first 2 units to be installed in Gannon Station, "not less than 225,000 tons of coal per unit per year" and, if Tampa decided to use coal in any of the remaining 4 units constructed in the station during the subsequent ten years, the coal requirements therefor would be purchased under the same contract. However, Tampa could elect to use some fuel other than coal in these 4 units. Tampa also could elect to reduce its coal purchases for the first 2 units up to 15 percent of the amount of coal purchases covered by its contract in order to use as a fuel the by-products of its

---


112 "The original contract was with Potter Towing Company, and by subsequent agreements with Tampa Electric responsibility thereunder was assumed by respondent West Kentucky Coal Company." Id. at 322 n.3.
local customers. The minimum price under the contract was $6.40 per ton delivered, subject to an escalation clause based on labor costs and other factors.

It was anticipated that the coal requirements of the Gannon Station would rise to 2.25 million tons of coal per annum, a volume far in excess of the 700,000 tons of coal consumed in all of peninsular Florida in 1958. The record also showed that there were some 700 coal suppliers in the producing area where respondents, Nashville Coal Company, operated, and the anticipated maximum requirements of the Gannon Station would approximate 1 percent of the total of the same type produced and marketed from Nashville’s producing area.

A short time before coal deliveries were to begin, the seller advised Tampa that the contract was illegal under the antitrust laws and would not be performed. Tampa had to look elsewhere for coal, making provisional arrangements resulting in a maximum price of $8.80 per ton; it brought suit in a district court in Tennessee for a declaration that the contract was valid, lawful, and enforceable and sought enforcement according to its terms. The defendants pleaded that the contract was illegal, void and unenforceable because it violated the antitrust laws, and the district court agreed, holding that the contract was in violation of section 3 of the Clayton Act in that, within the meaning of that act, it requires a purchaser of goods not to use or deal in the goods of a competitor of the seller and has the effect of substantially lessening competition in a line of commerce. The Court of Appeals affirmed, with one judge dissenting. The Supreme Court reversed, unable to agree that the contract suffered from the claimed antitrust illegality.

The Supreme Court disposed of the case in a relatively brief decision. First, it reviewed the facts as set out above and then the history of section 3 of the Clayton Act in the prior cases decided by the Court. On the basis of these prior decisions, the Court defined the following guide lines:

First, the line of commerce, i.e., the type of goods, wares, or merchandise, etc., involved must be determined, where it is in controversy, on the basis of the facts peculiar to the case. Second, the area of effective competition in the known line of commerce must be charted by careful selection of the market area in which the seller operates, and to which the purchaser can practicably turn for supplies. In short, the threatened foreclosure of competition must be in relation to the market affected. . . .

114 276 F.2d 766 (6th Cir. 1960).
The Court further reasoned:

To determine substantiality in a given case, it is necessary to weigh the probable effect of the contract on the relevant area of effective competition, taking into account the relative strength of the parties, the proportionate volume of commerce involved in relation to the total volume of commerce in the relevant market area, and the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein. It follows that a mere showing that the contract itself involves a substantial number of dollars is ordinarily of little consequence.116

Respondents attempted to persuade the Court that the relevant market of effective competition was either peninsular Florida, the entire State of Florida, or Florida and Georgia combined. The Supreme Court did not believe "that the pie will slice so thinly."117 Instead, the Court looked at the area of supply of bituminous coal suitable for Tampa's requirements. It noted the evidence that there were 700 producers in Pennsylvania, Virginia, West Virginia, Kentucky, Tennessee, Alabama, Ohio and Illinois able to produce such coal. This was the area in which Nashville Coal and the other producers effectively compete. From further statistics set forth in its opinion, the Court concluded that the Tampa contract pre-empted less than 1 percent (0.77 percent, to be more precise) of the volume of total relevant coal product, which exceeded 290 million tons sold on the open market. This the Court found quite insubstantial.

More pertinent to our subject of inquiry, the Court noted: "It may well be that in the context of antitrust legislation protracted requirements contracts are suspect, but they have not been declared illegal per se."118

The Court was not impressed by the tonnage of coal involved.

[We seem to have only that type of contract which "may well be of economic advantage to buyers as well as to sellers." . . . In the case of the buyer it "may assure supply" while on the part of the seller it "may make possible the substantial reduction of selling expenses, give protection against price fluctuations, and . . . offer the possibility of a predictable market." . . . The 20-year period of the contract is singled out as the principal vice, but at least in the case of public utilities the assurance of a steady and ample supply of fuel is necessary in the public interest. Otherwise consumers are left unprotected against service failures owing to shutdowns; and increasingly unjustified costs might result in more burdensome rate structures eventually to be reflected in the consumer's

116 365 U.S. at 327-28. (Footnote omitted.)
117 Id. at 329.
118 Id. at 331.
119 Id. at 333.
bill. The compelling validity of such considerations has been recognized fully in
the natural gas public utility field. This is not to say that utilities are immunized
from Clayton Act proscriptions, but merely that, in judging the term of a re-
quirements contract in relation to the substantiality of the foreclosure of com-
petition, particularized considerations of the parties’ operations are not irrelevant.
In weighing the various factors we have decided that in the competitive bitu-
minous coal marketing area involved here the contract sued upon does not tend
to foreclose a substantial volume of competition.110

The Supreme Court never arrived at a consideration of whether the
c coal contract violated sections 1 and 2 of the Sherman Act, concluding
that if the contract did not fall within the broader proscription of
section 3 of the Clayton Act, it follows that it is not forbidden by the
Sherman Act, citing Times-Picayune Publishing Co. v. United States.120

It would appear that the reasoning employed by the Court in Tampa
Electric would be applicable to contracts for the purchase of the other
unregulated fuels, depending upon the number of sellers and the ratio of
the annual volume covered by the contract to the annual output of all
producers of the same fuel in a position to supply the requirements of
the public utility. However, the larger the pre-emption of the relevant
market the greater the possibility that section 3 of the Clayton Act will
apply.121

CONCLUSION

The maintenance of a continuous and adequate supply of energy to
meet the resale requirements of public utilities is a matter of great public
interest. Where long-term energy purchase contracts are employed for the
purpose of achieving those objectives, the federal antitrust laws ought
not to be employed for the purpose of nullifying the long-term features
if that factor alone is the sole basis for applying these laws. Such
judicial, executive and administrative restraint would simply recognize
that the regulatory statutes and the antitrust laws have proper spheres
of activity within which they serve the public interest. They must be
interpreted and applied in a complementary manner to better serve the
commonweal.

119 Id. at 334-35. (Citations omitted.)
120 345 U.S. 594, 608-09 (1953).
121 See the quantitative substantiality test set out in Standard Oil Co. v. United States,
337 U.S. 293 (1949).
STRUCTURE AND TAX ADVANTAGES OF FOREIGN SITUS TRUSTS

John Herbert Tovey*

Tracing with approval the rise of foreign situs trusts as a legitimate method by which estate planners have sought to insulate a settlor's assets from confiscatory taxation, Mr. Tovey analyzes the four fundamental components of the overseas trust and proceeds to detail the numerous steps requisite to its successful establishment.

INTRODUCTION

In the last session of Congress, the flurry of activity surrounding the ill-fated Trust and Partnership Income Tax Revision Act of 1960¹ spotlighted one of the most appealing and elusive devices generated by progressive income taxation, the foreign situs trust. While the bill fortunately died in committee, despite the efforts of many prominent individuals to secure its safe conduct,² the issue remained very much alive and, as to the foreign trust element, was given new impetus by the appointment of Professor Surrey to the Treasury and by the gold crisis.³ The White House, caught by the exodus of gold subsequent to an unfavorable trade balance, was quick to seize "tax havens" as a convenient scapegoat for the inability of high-priced and highly taxed American industry to compete in the world market. In fact, many of the pronouncements on the subject were sufficiently vehement to convince one that nothing short of the destruction of the tax haven and a virtual embargo on American capital would save the Republic. This article, however, does not purport to dissect international economic policy more than may be necessary to provide an explanation of the nature of the foreign trust.

The principal purpose of the foreign situs trust is to avoid an unfavorable law in the jurisdiction of a settlor. It is an escape valve, much as the petit jury in criminal cases is for those instances in which rigid application of particular statutes would lead to great injustice. Devices

* B.S., LL.B., Georgetown University; Member of the Bar of the City of New York; Associate of Martin, Clearwater & Bell, New York, N.Y.

² Surrey & Warren, Federal Income Taxation 1113 (1960). Professor Surrey assumed the passage of H.R. 9662 and included it as the law in his current casebook, with the comment that a supplement to the book would be issued later if the bill failed to pass.
of this nature are necessary because of the nature of man. In the field of taxation, it is obvious that humans will rebel at exactions that consume the majority of their substance. If some means is not provided to grant relief, criminal evasion of the tax is inevitable. The difficulty of enforcement, without a great measure of cooperation from the taxpayers, could readily lead to a national financial crisis.

Actually, this writer is surprised that the foreign trust has arrived so late in our law. Long before confiscatory taxation was in vogue, the estate planner was confronted with problems in the nature of dower, curtesy, spendthrift trusts, statutory heirs, marital difficulties and community property. As a solution to these difficulties, the insulation of assets by a foreign trust, possibly with the aid of a foreign, closely held corporation, would have merited serious consideration. For present purposes it suffices to note that mitigation of the rigid effects of statute or of common law is not without precedent. The development of equity, the origin of trust law, and many of the reforms in real property were made possible through a desire for relief from the strict application of legal principles.

The foreign situs trust carries with it several tax advantages: (1) reduction of the income taxable to the settlor; (2) avoidance of the capital gains tax; (3) reduction of the estate tax; (4) avoidance of the accumulated earnings tax; and (5) avoidance of the personal holding company tax. These advantages, it is to be noted, are not ripe fruit which will fall without hesitation into the hands of every casual visitor to the Bahamas. The use of the foreign trust is severely restricted in application by draftsmanship, by operation and by the individual problems and wishes of the taxpayer-settlor.

Chief among the problems in approaching the foreign situs trust is the precise determination of its necessary elements under the tax law. To be distinguished as without such difficulty are trusts created abroad by foreign settlers with foreign fiduciaries for the benefit of nonresident aliens so long as the trust is not engaged in a trade or business in the United States.4 These are clearly foreign situs trusts, but they are of little interest in this country outside of academic circles. Where these factors change, however, so as to strengthen the domestic relationship, the question arises as to whether the trust will lose its foreign status and preferential tax treatment.

4 Muir v. Commissioner, 182 F.2d 819 (4th Cir. 1950).
Elements of the Foreign Trust

For convenient analysis, the foreign trust may be broken down into four components: (1) the beneficiary; (2) the trust res; (3) the settlor; and (4) the fiduciary. These components will be discussed in that order.

The Beneficiary. Muir v. Commissioner,5 a significant decision handed down before the enactment of the Internal Revenue Code of 1954,6 contributed to the law on this point by indirection. In this case an English settlor established a trust with English fiduciaries holding title to a res consisting primarily of securities in a United States corporation. The beneficiaries were the settlor’s wife and son, both British subjects. After the death of the settlor, the son remained in England but the wife became a resident of the United States. The trust was held to be taxable on income from United States sources only, and the resident beneficiary was held taxable on trust income which would retain the same character it had in the hands of the trust. Significantly Internal Revenue Service, which usually employs a broadside attack in situations like this, made no effort in taxing the trust to reach more than the income the trust received from this country although foreign income was considered in determining the amount of the taxation of the resident beneficiary. Equally significant is the failure of the Service to raise any issue regarding taxation of the beneficiary on accumulations distributions. It was assumed that optimum liability could not extend to those factors.

It would seem that the beneficiary is in no worse position by reason of his relationship to the trust than he would have been otherwise. If he is subject to taxation by virtue of having received income, his position does not become more difficult because it is foreign trust income. The usual law of trust taxation apparently applies, i.e., if trust income is currently distributable, it is taxable to the beneficiary; if the fiduciary is to accumulate, it is taxable to the trust,7 and the situation of the trust is not affected by the nature of the beneficiary.

In American Trust Co. v. Smyth,8 foreign beneficiaries attempted to shield from the trust tax a California trust with a resident fiduciary solely by reason of their own status. The settlor was a citizen of California and the res consisted of assets held in the United States. The court brushed

5 Ibid.
6 Internal Revenue Code is hereinafter referred to as the Code; section citations are to the 1954 Code unless otherwise indicated.
8 247 F.2d 149 (9th Cir. 1957).
aside arguments of the taxpayer, which had been presented in the lower court, 9 that treaty provisions 10 which exempted the beneficiary protected the trust from taxation solely because of its effect on the beneficiary. It is noteworthy that this decision was made long after the adoption of the 1954 Code. The leading cases and the various rulings have all been grounded on the assumption that the nature of a trust cannot be determined by those for whom the trust was created. 11 This is in line with traditional trust law and reflects an extremely practical viewpoint. Enforcement of trust taxation on a contrary theory would be virtually impossible unless the fiduciary and the res, especially the latter, or the settlor, in the event of an inter vivos trust, were subject to the power of federal discovery rules. Exaction from the beneficiary of the tax on accumulated trust income would be manifestly unjust since, unlike a controlling shareholder in a foreign personal holding company, 12 he holds no power to compel distribution. It is well established, in addition, that taxation must be based on citizenship or residency—including presence within a jurisdiction by reason of activity there and power to control beneficial enjoyment. 13 None of these factors are present in a beneficiary in excess of distributions made to him by the trustee.

The problem of grantor trusts 14 will be discussed later, since special

9 141 F. Supp. 415, 416-17 (N.D. Cal. 1956).
10 Treaty With Great Britain and North Ireland on Taxation, April 16, 1945, art. XIV, 60 Stat. 1377 (effective Jan. 1, 1945). Article XIV of the treaty exempted United Kingdom residents not engaged in a trade or business in the United States from capital gains taxation. Section 22(b)(7) of the 1939 Code excluded from gross income, income of any kind which was exempted by treaty. This exclusion is reflected in the 1954 Code § 894.
11 See Freuler v. Helvering, 291 U.S. 35 (1934); Saulsbury v. United States, 199 F.2d 578 (5th Cir. 1952); Bryant v. Commissioner, 185 F.2d 517 (4th Cir. 1950); Peck v. Commissioner, 77 F.2d 857 (2d Cir. 1935); Hubbell v. Helvering, 70 F.2d 668 (8th Cir. 1944).
12 Under § 551(b) undistributed foreign personal holding company income is taxed to United States shareholders to the same extent that the company would have suffered taxation if dividends had been distributed on the last day of the company’s taxable year. The effect is, in this instance, to treat such foreign corporations akin to partnerships. Under § 551(a) this treatment is applied to all United States shareholders, regardless of their stock interest, if the definition provisions of §§ 552(a)(1) and (2) are met. Apparently, the only remedy for a minority shareholder who took his stock by operation of law is sale of his shares.
14 A grantor trust is one in which the settlor is treated as the substantial owner because of the interest retained by him in the income or in the corpus. Section 673 opens the grantor to the tax if his reversionary interest can be reasonably expected to take effect within 10 years of the transfer of that portion of the trust subject to the reversion; § 674 offers
problems are presented when the settlor and the beneficiary are the same person. In that instance, since the settlor is subject to the courts, there is no reason to suspect that he would be treated differently than he would have been had the trust been created under local law with the business operations, if any, being carried on in a foreign country.

The Res. The trust res usually consists of cash and securities. If the trustees are permitted to engage in a business by the trust instrument, they would be confronted by the general problems of Subchapter C of the 1954 Code which are beyond the scope of this article. Suffice it to say that a trust engaged in a trade or business in the United States would have little to offer in the way of tax planning. Cash held by trustees is invariably kept to a minimum since the trustee can be surcharged for failing to invest to maintain optimum trust income. The major problem is with securities. The Service has taken the position that the operation of an office in the United States for the trading and management of securities will make a foreign trust a resident alien and subject to the tax. This view, set out in Revenue Ruling 60-181, is in conformity with the general principle of tax law that conducting a business within a jurisdiction renders the business subject to the taxing power of the jurisdictional sovereign. The position appears to be sound since gainful activity would open the trust to all other forms of the exercise of sovereign power as well. The Service should not be in a position worse than that of a creditor or other litigant.

Trading in securities is recognized as income-producing activity in the similar consequences, without limitation as to time, if the grantor retains power to control beneficial enjoyment; § 675 provides likewise if administrative powers are retained; § 676 deals with a retained power to revoke; § 677 deals with application of income to the grantor; and § 671 includes trust income in the gross income of the grantor, and hence subject to his tax, if any of the §§ 673-77 are operative. It should be noted that § 677, relating to includability of income if it may be accumulated for the benefit of the grantor, is expressly limited by § 673 so that accumulation for over 10 years, even if demanded by the trust instrument, would not produce tax effect.

16 Section 7701(a)(3) defines a corporation as including associations. A trust which actively participates in business affairs is an association and subject to corporate taxation as indicated in § 11. Morrissey v. Commissioner, 296 U.S. 344 (1935).
17 Bogert, Trusts and Trustees § 707 (2d ed. 1960).
20 No individual who was present and operating within the country as were these trusts could claim to be a nonresident, and no corporation whose affairs were so handled could deny that it was present within the country on a permanent basis so as to subject it to service of process and other exercise of governmental power.

B.W. Jones Trust v. Commissioner, 132 F.2d 914, 916 (4th Cir. 1943).
1954 Code.\textsuperscript{20} Being akin to a trade or business, it carries with it the right to deductions apart from those permitted to the ordinary investor.\textsuperscript{21} If the trust were to trade securities in this country, it would invite exaction of the tax.

But what if the trust merely collected dividends or interest through its fiduciary? Would the physical presence of the securities in the United States generate a result similar to that of trading? According to \textit{B. W. Jones Trust v. Commissioner},\textsuperscript{22} the operation of an office, trading and collection of income would create tax liability. Unless the securities were those of a publicly held corporation, trading would be unlikely and there would be no need to maintain them here. Conversely, there is little likelihood that securities of a publicly held corporation would not be traded since the trustee would be continually reviewing the portfolio to cull investments that had lost their attraction. The \textit{Jones} rule suggests that the collection of income alone might be sufficient since collection itself is activity which realizes something.

\textit{I.T. 1885},\textsuperscript{23} which is of doubtful validity today, offered no protection to a trust \textit{res} held in this country. That ruling adopted the extreme position that a trust which owed its existence to the law of a foreign jurisdiction should be taxed as a nonresident alien. Even then, it did not afford blanket relief since a nonresident alien, for example, might retain his status in a general sense and yet be found in a jurisdiction by reason of activities within it. In I.T. 1885, the fiduciary was held to nonresident alien classification but was subjected to the tax on income from sources within the United States. The real issue is the definition of a “source within the United States.” Would Canadian securities held in New York by an English trustee yield income from a United States source? It would seem that the Service might contend, with a high degree of success, that the trustee was availing himself of the protection of the United States and should therefore pay for it. Although foreign securities do not produce actual income in this country, one who receives and transmits that income from here is “active” in the strict sense of the term.

Even more hazy is the situation of a fiduciary holding in a vault in New York discounted bonds which were issued by a foreign corporation and payable at some future date in the foreign jurisdiction. The “pro-

\textsuperscript{20} \textsection 1236.
\textsuperscript{21} A trader includes persons who buy and sell securities for their own account to such extent that they are held to be in a trade or business and may take gains and losses as ordinary rather than as capital in nature. L. T. Alverson, 35 B.T.A. 482 (1937).
\textsuperscript{22} 132 F.2d 914 (4th Cir. 1943).
tection” argument appears likely here, but the measure of the tax is questionable. Since no yield was produced by the bonds while they were in the United States, any tax would have to be determined by appreciation during the time they remained here. The prudent course would be to keep the securities in the jurisdiction under which the trust was created.

Another problem involves the use of brokers’ accounts in which securities remain in street name.24 Active trading is hampered if one must transfer the security certificates each time a sale is effected. Yet, might the Service claim that street name shares held by a resident broker for a foreign fiduciary thrust the fiduciary within the reach of the Commissioner on an agency theory? This seems unlikely although there are no authorities on the point. The issue could be avoided by trading the securities on foreign exchanges whose brokers’ accounts in New York would appear too remote in beneficial ownership for successful attack on this basis. And yet, remoteness and the traditional barrier of national boundaries have often failed to hamper tax gathering. In First Nat’l City Bank v. IRS25 the bank sought to resist the Commissioner’s efforts to obtain records of a customer of a foreign branch of the bank by the service of a subpoena duces tecum on the New York office. Chief among the arguments raised was that international business would suffer if one who entrusted his affairs to a foreign branch of a United States bank must bear the risk of scrutiny and possible disclosure by the American Government. The bank was manifestly unsuccessful.

Thus anything, it would seem, which falls within the physical power of the courts must risk that this power will be exercised—including securities accounts if the securities can be traced to a particular owner. On the other hand, if a trust were to own shares held in street name by a foreign broker who, in turn, owned shares held in street name by a broker in the United States, tracing would be virtually impossible since the Service, unable to reach the records of the foreign broker through American courts, probably could not do so through foreign courts if the purpose of the inquiry is collection of a domestic tax.26

24 The expression “street name,” as used in brokerage, means that a broker holds securities in his own name although the beneficial ownership is in one of his customers. The practice permits the customer to buy and sell without sending the certificates to the broker’s office for each transaction. The broker, the nominal owner on the corporate books, receives the dividends which he credits to the customer’s account for future purchases or for withdrawal. But see § 871(a).
25 271 F.2d 616 (2d Cir. 1959), cert. denied, 361 U.S. 948 (1960).
26 There is a traditional rule that one Government will not assist another in the en-
The Settlor. The status of the settlor, by itself, has never been used to subject a foreign trust to taxation either as a nonresident alien doing business in the United States or as a resident alien. This is eminently sound since a settlor has neither dominion nor control over the trust once he has surrendered it to independent trustees who must manage the corpus for the benefit of the beneficiary. Some problems are presented by the settlor who is also a beneficiary\(^{27}\) or a trustee\(^{28}\) or who will regain the corpus after a specified period of time.\(^{29}\)

It is certain that a trust created by a United States citizen in a foreign country would be a foreign trust provided that the trustee was a nonresident alien.\(^{30}\) The Senate Finance Committee found no problem in reaching this conclusion in the preparation of H.R. 9662\(^{31}\) and, in fact, had used that assumption as the basis of its recommendations for legislation to eliminate some of the tax advantages of foreign trusts. The Committee did not elaborate on the consequences of certain activities of the fiduciary, particularly those of a business nature, but no reason appears to suggest that special rules would apply in this area.

Probably the Service will agree with the Senate Committee, although there have been no rulings to date on the point. In the event of disagree-

---

27 Under §§ 673 and 677, the settlor-beneficiary must either pay income taxes on distributions he receives as they are paid to him, or on those paid to other persons on his behalf.

28 In general, the prohibited powers of the trustee are those which enable him to use the trust for his own devices. Treas. Reg. § 1.675-1(a) (1960). Particularly troublesome, especially in the case of closely held corporations, are Treas. Regs. §§ 1.675-1(b)(4)(i), (ii) (1960) which denounce the power to vote securities or to direct investment or reinvestment in corporations in which the holdings of the grantor and the trust are significant from a standpoint of control. The natural tendency of a grantor-trustee to treat a res as his own property generates great danger in any plan for tax reduction in the trust field. For the benefit of the grantor, the property should be placed beyond his reach. In this regard, it might not be sufficient to transfer property to a nonresident corporate alien trustee under an instrument giving the grantor a right to advise or to otherwise act in connection with trust investments. Powers reserving to the grantor the right to designate investment counsel, or to change such counsel, might likewise fall within § 675.

29 Helvering v. Clifford, 309 U.S. 331 (1940); see § 676.


ment, the problem of enforcing the tax perhaps might be insurmountable in instances where a resident settlor transferred property to a nonresident alien trustee to accumulate and pay over to nonresident aliens. There is no regulation or statute compelling persons creating trusts to inform the Treasury of their activity at the inception of the trust. In the absence of a transfer of assets of the kind which would normally leave some record available to the Service, such as securities of a corporation subject to American courts, it would be difficult to determine who had embarked on trust-creating activity. In the absence of tax-deferred retirement plans for the self-employed, other problems of enforcement would arise with respect to grantor-funded retirement trusts which a grantor could enjoy with impunity if he were willing to retire to the tax haven. Since most of these havens are far from unpleasant and enjoy an atmosphere comparable to that of Florida, the suggestion is not beyond reason. Passage of the Keogh or the Smathers Bills, now pending, would go a long way toward reducing the incentive to engage in such activity since either of the acts proposed would permit tax-free accumulation of some retirement income.

The Fiduciary. The status of the fiduciary would seem to be of paramount importance since he has legal title to the trust res as well as control, subject only to the limitations imposed by statute, case law and the trust instrument. The Service formerly took the position in I.T. 1885 that the nature of a trust was determined solely by the law under which it was created despite the status of the fiduciary and, therefore, that a foreign trust must necessarily be a nonresident alien. This view was unrealistic because it ignored the fact that a person is considered an alien or a citizen by reason of applicable law whereas his status as a

32 However, the transfer of securities to a foreign trust does subject the transferor to a tax of 27½% of the excess of the value of the securities transferred over the adjusted basis of those securities, for determining gain in the hands of the transferor, unless the transferor can convince the Service that the purpose of the activity was not to avoid the income tax. See § 1491. Needless to say, such rulings are infrequently requested or granted.

33 The Keogh Bill, H.R. 10, 87th Cong., 1st Sess. (1961), would roughly permit a self-employed person to deduct from gross income the lesser of 10% of his self-employment income or $2,500; the Smathers Bill, S. 59, 87th Cong., 1st Sess. (1961), would permit the lesser of 20% of earned income or $5,000 to be so applied, with a lifetime maximum on contributions. The adoption of either of these plans would discourage creation of the foreign situs trusts for pension plans, since a settlor may not deduct the contribution to his foreign trust but must make payments to it after payment of the income tax. Both bills provide that the deduction will be allowable only if the contribution is to an approved plan, and it is doubtful whether the Secretary would approve a foreign trust.

resident is traditionally dependent upon an issue of fact. The common-law rule of *jus terrae*, whereby a foreigner present in a jurisdiction must be governed by local law, has long been accepted in all other areas of jurisprudence and there seems to be no sound reason for applying a different standard in taxation. Indeed, less reason exists for a departure from the norm in tax law because the alien, by being present within the jurisdiction, derives benefit from the foreign sovereign, usually in the form of economic opportunity. In addition, a trust is not an entity distinct from the fiduciary. It does not exist as a separate legal being in the same sense that a corporation is acknowledged distinct from its shareholders. Rather, it is an indenture or contract whereby one or more persons agree to use property in a particular manner, with the obligation running from the promisors (fiduciaries) to the third-party beneficiaries, or to the beneficiary in the event of a grantor trust.\(^\text{35}\)

When the Fourth Circuit, in *B. W. Jones Trust v. Commissioner*,\(^\text{36}\) applied the usual test of residence, a factual issue, it did no more than bring the tax law in line with accepted legal concepts. The Service, in Revenue Ruling 60-181,\(^\text{37}\) amplified the *Jones* decision by holding that a resident, for federal tax purposes, was one in the United States with no definite intention of departure. The regulations subject resident aliens to the tax in the same manner as citizens.\(^\text{38}\)

Prudence would demand that the fiduciary be a nonresident alien. It would also suggest that unless one is assured the fiduciary will never travel, the nonresident alien should be a corporation rather than a natural person to avoid problems of presence within the United States.\(^\text{39}\)

\(^{35}\) See Bogert, trusts § 1 (3d ed. 1952); 1 Scott, trusts § 2.3 (2d ed. 1951).

\(^{36}\) 132 F.2d 914 (1943).

\(^{37}\) 1960 Int. Rev. Bull. No. 19, at 16. Under Treas. Reg. § 1.871-2(b) (1960) the Commissioner has stated what he means by residence. Of interest is the statement that an alien whose stay is limited by the immigration laws is not a resident in the absence of exceptional circumstances. The latter are not, of course, defined. On the face of the regulations, the Service could contend that a fiduciary status was an exceptional circumstance. The more frequently the fiduciary entered the country and the longer he remained, particularly if there were any remote business connection with his visit, the more tenuous his nonresident status might become.

\(^{38}\) Treas. Reg. § 1.871-1 (1960).

\(^{39}\) Under § 871(a)(2)(A), a nonresident alien present in the United States for less than an aggregate of 90 days during a taxable year is relieved from tax on capital gains unless the actual transactions take place while he is in this country. If he is present in the United States more than 90 aggregate days in any taxable year, he falls within § 871(a)(2)(B) and is taxed on all capital gains allocable to United States sources even though the transactions take place when he is outside the country.
With many tax havens located conveniently close to our shores, it is better to assume the possibility of travel.

Additionally, the fiduciary should not be a subsidiary or other entity controlled by a person resident in this country. As First Nat'1 City Bank indicated, the courts will apply their power over the source of control to reach the controlled entity.\textsuperscript{40} Though not foreseeable, it is not beyond the realm of possibility that the Service could persuade a court to disregard the separate corporate structures and hold the foreign corporate fiduciary to be an alter ego of the domestic corporation. Since the 1954 Code permits shareholders to be taxed on their respective shares of undistributed foreign personal holding company income\textsuperscript{41)—a statutory disregard of the corporate entity—it would be unwise to assume the principle could not be extended further.

\section*{II
Creation of the Trust}

Obviously, the foreign trust is not a device suitable to the tax planning of every individual. While it is one of the many tools available for use in lifetime and estate tax reduction, the decision to employ it should be made only after a careful analysis of the individual problems of the client, the amount of his property, and the skill of the tax counsel. At best, it is a method of tax planning which may be successful only if unfavorable climates are not created by treaty, by the courts or by the Commissioner. It is a calculated risk and should be clearly indicated as such.

The principles applicable to the foreign trust do not vary greatly from those governing a domestic trust. Of immediate importance is a country whose laws permit the trust, and this invariably means a common-law jurisdiction since the trust concept is unknown to the civil law.\textsuperscript{42} The choice is probably limited to Bermuda, the Bahamas or the British West Indies, all of which areas have the added advantage of stable

\textsuperscript{40} 271 F.2d at 618.

\textsuperscript{41} §§ 551-58. Despite the obvious disregard of the corporate entity, the Commissioner denies that any tax is imposed on the corporation. The Service contends that the levy is not a corporate tax since it is restricted to United States shareholders. Treas. Reg. § 1.551-1 (1960). However, since majority shareholders must be United States citizens or residents, the effect is to compel them to distribute corporate earnings to avoid seizure of their other assets in satisfaction of the tax.

\textsuperscript{42} Great care should be taken that civil-law devices which would be considered associations under the 1954 Code are not employed.
local government.\textsuperscript{43} The currency problem must also be considered since a complete blockage regulation would be a little less than attractive to the ultimate beneficiaries who do not desire to spend the trust proceeds in the area of its creation. Local governments have often exempted trusts and corporations from currency control under certain conditions.

The local income and capital gains taxation should be thoroughly explored to select an area with little or no tax on these items. In addition, gift and estate tax considerations must be taken into account.\textsuperscript{44}

The cost of creation and of operation should be given thought as well as the availability of a skillful corporate entity to act as trustee.\textsuperscript{45} The investment ability of the trustee is of great import if the trust is not to hold assets consisting solely of securities of a close corporation. An established, reliable trustee will have reports of its operations over the years which, if carefully scrutinized, would indicate the success or failure of the investment department. With respect to the latter, most corporate fiduciaries will accept a trust with the understanding that the portfolio will be varied only upon the suggestion of a designated investment adviser.

The trustee should agree that all assets of the trust are to be held outside of the United States. Although interest from bank deposits in this country are free from tax at the present time,\textsuperscript{46} and are likely to remain so in the present economic climate, some danger may exist in placing any assets where they will be subject to the power of the Commissioner.

The grantor and his tax counsel should travel to the foreign area to conclude the terms of the trust with the local trust officer and local counsel. In this field powers of attorney, while not subject to any attack by the Service to date, establish one more United States contact which

\textsuperscript{43} For an excellent summary of tax laws and costs of suitable foreign areas see Gibbons, Tax Factors in Basing International Business Abroad 118 (1957); Gibbons, Tax Effects of Basing International Business Abroad, 69 Harv. L. Rev. 1206 (1956).

\textsuperscript{44} The history of the tax system in the area may afford some insight as to the local law regarding taxation.

\textsuperscript{45} The Trust Corporation of Bahamas, Ltd., is an excellent institution which has been established for a number of years. For acting as a trustee, it charges £100 minimum per year plus 1\% of capital on distribution. The detailed charges which make up the minimum are \( \frac{3}{4} \) of 1\% of capital or 5\% of income, whichever is greater, plus \( \frac{3}{8} \) of 1\% on the purchase, sale or redemption of securities. Other services not connected with trust administration are charged at a separate rate schedule.

\textsuperscript{46} Section 871(a)(1) exempts interest on deposits with persons engaged in the banking business from federal income tax.
III

TAXATION AT CREATION AND TERMINATION OF THE TRUST

Assuming that counsel takes the proper measures to prevent the trust from being taxed as a resident alien or directly to the grantor, there remain several vital tax considerations to face before the task is completed. All of these must be foreseen at the time the initial conferences are held regarding the use of the trust. Failure to look ahead can produce serious tax results.

**Securities Transfer Taxes.** The securities transfer tax is designed to prevent the transfer of securities to a trust abroad with the expectation that the trust, if it later sells the securities, will avoid the tax on capital gains.\(^47\) Since the maximum tax exaction on capital gains is 25 percent,\(^48\) the transfer tax is set at \(27\frac{1}{2}\) percent. Absent considerations of control of the securities, the cheapest manner of transfer is to sell the stock prior to creation of the trust, pay the 25 percent tax on the gain, and transfer the cash to the trustee. This method, of course, carries with it the obvious disadvantage of loss of control of voting power and the equally unattractive prospect of immediate taxation, plus the loss of a favorite investment. If securities held by the settlor are, in themselves, sufficiently important to him, or greatly appreciated over his adjusted basis, he might consider funding the trust with cash borrowed on a pledge of the shares. Control of the shares would be retained, the interest would be deductible,\(^49\) and the out-of-pocket cost to the settlor could be spread

---

\(^{47}\) Section 1491 states:
There is hereby imposed on the transfer of stock or securities by a citizen or resident of the United States, or by a domestic corporation or partnership, or by a trust which is not a foreign trust, to a foreign corporation as paid-in surplus or as a contribution to capital, or to a foreign trust, or to a foreign partnership, an excise tax equal to \(27\frac{1}{2}\%\) of the excess of—

(1) the value of the stock or securities so transferred, over

(2) its adjusted basis (for determining gain) in the hands of the transferor.

\(^{48}\) § 1201.

\(^{49}\) Under § 163, there is a deduction allowed for all interest paid by a taxpayer. This may be taken in lieu of the standard deduction allowed by § 141. Note should be taken of § 265(2) which disallows deductions for interest to carry obligations exempt from the taxes imposed by Subtitle A, and care should be used to avoid borrowing to purchase securities to be transferred to a foreign trust if the securities bear interest. Treas. Reg. § 1.265-2 (1960). There is no specific disallowance of interest on money used to purchase securities whose dividends are exempt; but such would be forthcoming if the custom became popular.
over the loan period. Since the interest is computed as cost by deduction of the highest surtax rate of the settlor, the result would be a lessening of impact. If the trust were to revert to the grantor after nine years, he could repay the principal on the loan with the appreciated assets of the trust which accumulated tax free. Or, if the trust were for his heirs and he wanted them to take the stock, execution of an option contract giving the heirs the right to purchase the shares at fair market value at his death would accomplish his purpose. Since the shares would be encumbered by a loan, the fair market value for estate tax purposes would be limited to the decedent’s equity.

Gift Taxes. The gift tax will present itself whenever the settlor contemplates a transfer of the beneficial interest, or a part thereof, to one not exempt from taxation. The settlor has an annual exclusion from the gift tax to the extent of $3,000 per donee, or of $6,000 per donee if he is married and if his spouse joins in the gift. He also has a lifetime exemption of $30,000 or of $60,000 if married and if his spouse joins him in the gift. The annual exclusion, unlike the lifetime exemption, may not be used against future interests.

Assume that the settlor is in the 70% tax bracket and that he owns securities of a United States corporation with an adjusted basis of $100,000 and an appreciated fair market value of $500,000. The securities pay 6% per annum and he retains $9,000 of the $30,000 return, after taxes. A sale of the securities and a transfer in trust would involve a tax of 25% of the gain realized and recognized, or 25% of $400,000 which would be $100,000 in cash payable immediately to the Commissioner. Suppose he pledged the securities for $400,000 at 6% reducing his equity and potential estate tax liability to $100,000. The interest on $400,000 at 6% is $24,000 per annum, deductible under § 163 from his top bracket of 70% leaving an out-of-pocket cost to him of $7,200 per annum. The $400,000 is transferred in trust, tax free, and reinvested at 6% in other United States securities and building and loan associations, to insure that not more than $15,400 is received in dividends. Or, assume that the entire $400,000 is invested without the United States at 6% return with a 30% witholding tax. The net yield, before trustees’ fees, of $24,000 reduced by witholding of 30% or $7,200 would leave an increase to capital of $16,800. If the trust were to secure the retirement of the grantor, after 9 years, the accumulation in trust would offset the out-of-pocket interest expense by $9,600.

The gross estate includes all property in which the decedent had an interest at his death. This property is valued at the price the interest would bring in an arm’s length transaction on the open market between a willing buyer and a willing seller. Treas. Reg. § 20.2031-1(b) (1960).

See §§ 2501-04 for the measure of tax liability.

Under Treas. Reg. § 25.2503-3 (1960) any interest which does not carry the right to immediate use, possession or enjoyment is a future interest. This does not include notes receivable or bonds due at some future date subsequent to the gift.
Thus, if a settlor conveys in trust and gives the trustee power to accumulate for the benefit of A and, after a term, to pay the corpus to A, a future interest has been created and the annual exclusion and the lifetime exemption may not be used against the gift. The creation of such a trust obliges the settlor to report the gifts on a gift tax return as a trust interest and also will oblige his executor to advise the Commissioner of the trust in the settlor’s estate tax return. If the same result is desired, it might be better accomplished by making outright gifts of cash to A and having A establish the trust.

On the other hand, a settlor might wish to retain a life income, to be paid after a period of accumulation, with a vested remainder in A. This scheme embraces a future interest and would be subject to the gift tax without benefit of the annual exclusion. Care must be taken to appraise the potential estate tax liability since it may be cheaper to generate an immediate gift tax and thereby reduce the gross estate by the tax paid even though the gift itself remains includible.

It is crucial to remember that exemptions from income tax will not relieve a client from the gift tax since the latter is an excise tax on the transfer of property.

Estate Taxes. The estate tax will reach any property of the settlor to the extent of his interest therein at the time of his death. Consequently, a settlor who retains an interest in a trust must be prepared to have his estate reduced by taxes. Retention of a life estate, retention of the power to revoke, alter or amend, the creation of a joint life estate or the retention of a power of appointment can destroy the estate plan.

59 Treas. Reg. § 25.2503-3(c) (1960). Since the vested remainder will not be an estate in enjoyment until the death of the life tenant-settlor, a future interest is involved. This is so even though a vested remainderman might actually value his remainder and sell it upon receipt, thus commencing enjoyment of the estate in remainder, in effect, prior to the death of the life tenant.
60 A retained life estate, without power to revoke in the donor, is a completed gift under § 2501(a). It is also included in the gross estate of the donor under § 2036(a). However, although the gross estate has been reduced by the gift tax paid and the estate tax correspondingly reduced, a credit against the estate tax is allowed by § 2012(a). Thus, lifetime gifts are of tax value even though they are included in the estate for tax determination.
61 §§ 2031(a), 2033.
62 § 2036(a).
63 § 2038(a).
64 § 2040.
65 § 2041.
of the settlor by exposing his estate to the tax. It seems wise, in this context, to repeat that the foreign situs trust does not, by creation, avoid taxation of every nature without careful planning by the draftsman. There would be little point in following the earlier example of encumbering securities to reduce their estate tax value if the estate were increased by the accumulated value of the trust whose funds were used to purchase the securities. Likewise, little would be accomplished by reducing potential estate assets to zero or nearly zero unless the estate tax liability were reduced correspondingly. Under the theory of transferee liability, the Commissioner would follow the beneficiary to exact his due and would levy on him with each receipt of proceeds from the trust.

Even a departure from the jurisdiction might provide insufficient protection because the Commissioner, if he reduces his claim to judgment, might successfully sue on the judgment in the jurisdiction of the trust.

No plan that entails willful evasion of the tax has anything to commend it to the ethical tax practitioner or to the intelligent client. The solution is to reduce liability, not to evade the exaction.

This writer believes that a donor or a prospective settlor who would benefit potential heirs should not become a settlor in the legal sense. If he does not require the security of the corpus, his interests can best be served by cash payments to the beneficiary with the suggestion that the latter place the funds in a trust. The mechanics are made easy if one by assuming a course of conduct of donating amounts to the beneficiary at regular intervals establishes a pattern of lifetime giving to avoid the causa mortis rule and ensures that the heir actually makes the deposit. This course would free the donor from control of the gift or res and guarantee that the res was created.

If a retained life estate is indicated, the beneficiary could create the trust with the donor as life tenant and himself as remainderman. Or, the instrument created by the remainderman could leave it to the discretion of the trustee to make payments to the donor, the discretion to be exercised under certain designated conditions. Either method of establishing the trust would keep the donor from being a settlor on his estate tax return. In the extreme case, where the preservation of a large estate is

66 §§ 6901-04.
68 Section 2035 includes all gifts made in contemplation of death in the gross estate, and § 2035(b) gives the Commissioner the benefit of a rebuttable presumption that all gifts made three years or less prior to death were in contemplation of death. The estate must show other motives for the transfer, popular among which is the desire to insure financial independence of the donee by a series of lifetime transfers.
mandatory, the settlor could well retire to Bermuda rather than to Florida.

In the final analysis a client must be impressed with the familiar adage that he cannot have his cake and eat it. There is no way known to achieve maximum legal estate tax reduction with a foreign or a domestic trust unless some faith is placed in the ultimate recipient of the client's bounty. The client must balance his desire to control by legal means, as opposed to moral or persuasive, against his desire to benefit a loved one rather than the Commissioner. This part of the tax law is based on human weakness, the unwillingness of the parent to part with his dominion over the child. It must be overcome in any effective plan.

IV
TAXATION IN OPERATIONS

In operation, even though the trust is firmly established as a non-resident alien not engaged in a trade or business in the United States, tax problems remain. Proper use of the trust, however, can minimize these as well as reduce or eliminate other taxes which would perhaps beset the settlor or donor had he not caused the trust to be established. Chief among the troublesome taxes are: (1) the accumulated earnings tax; (2) the personal holding company and foreign holding company taxes; (3) the capital gains tax; (4) the individual income tax; and (5) the penalty taxes imposed by section 306.

Accumulated Earnings Tax. This tax is an exaction imposed on corporations that swell the corporate treasury with profits beyond the reasonable needs of the business.69 The so-called "unreasonable accumulations" are caused by the shareholders of closely held corporations in the hope that the value of the stock will increase by the amount of the undivided profits and that, upon dissolution or sale,70 they will be taxed at capital gains rates rather than at the ordinary income rates which would be applicable had profits been distributed in the form of salary or dividends.71 The tax is levied on the corporation, not the shareholders, giving the latter in effect, the option of declaring a dividend and paying

69 § 531. Treas. Reg. § 1.537-1(a) (1960) sets out the general rule that reasonable needs of the business include needs reasonably anticipated. Treas. Reg. § 1.537-3 (1960) extends this to hold that needs of the business include activities that the corporation might reasonably be expected to undertake. See S. Rep. No. 1622, 83d Cong., 2d Sess. 314-23 (1954).
70 Under § 392, redemption of shares under certain circumstances is treated as a sale or exchange under Subchapter P.
71 § 61(a).
the income tax or of having the corporation pay a heavy penalty ex-
action.

Transfer of a closely held corporation’s stock to a foreign trust would
create a limited escape valve. Dividends could be declared, subject to
the 30 percent withholding required by the Code to the extent of $15,400
per annum,72 and thus relieve the pressure on corporate surplus subject
to the accumulated earnings tax. Since the Code allows an accumulation
of $100,000 without the penalty,73 an additional $15,400 per annum
could be removed at comparatively low tax cost.

The accumulated earnings tax, however, should not be taken lightly.
The formation of another corporation to receive the dividends of a
primary corporation will not operate to avoid tax liability if the purpose
of either corporation is to shelter shareholders from income tax.74 Al-
though personal holding companies and foreign personal holding com-
panies are exempted,75 a regulation76 provides that the tax does apply
to nonresident aliens subject to section 871, which would include the
foreign trust. No litigation has yet been reported involving the use of a
foreign trust to avoid the accumulated earnings tax, but it is not beyond
reason that the Service would someday wish to test the matter. The ele-
ment of calculated risk remains, but the Commissioner’s position is by
no means firm. By the same regulation, the tax also applies to any foreign
corporation whose shareholders are subject to income tax as nonresident
aliens.77 On its face, the regulation indicates that the corporation must
pay dividends to the extent that its current or accumulated earnings and
profits exceed the reasonable accumulation allowed of $100,000.78 There
is nothing to suggest that this obligation may not be satisfied by pay-
ment to a nonresident alien. Also, the reference to nonresident aliens is
contained in a text dealing with foreign corporations.79 This would under-

72 § 871(a)(1).
73 § 535(c)(2).
75 §§ 532(b)(1), (2).
76 Treas. Reg. § 1.532-1(c) (1960).
77 Part I of Subchapter G is entitled “Corporations Improperly Accumulating Surplus.”
Since Treas. Reg. § 1.532-1(c) (1960) is contained in a group of regulations issued pursuant
to the Code sections in that part, one may assume that only corporations are being treated.
78 § 535(c)(2).
79 Treas. Reg. § 1.532(c) (1960). Section 531 is applicable to any foreign corporation,
whether resident or nonresident, with respect to any income derived from sources within
the United States, if any shareholders are subject to income tax on the distributions of the
corporation by reason of being (1) citizens or residents of the United States, or (2) non-
resident alien individuals to whom § 871 is applicable, or (3) foreign corporations if a
score the caveat that care must be exercised to avoid having the foreign trust classified as an association taxable as a foreign corporation.

**Personal Holding Company** and Foreign Personal Holding Company **Taxes.** These provisions are designed to prevent high bracket taxpayers from accumulating business profits for eventual capital gains treatment. The levy is 75 percent of the first $2,000 of undistributed personal holding company income and 85 percent of the excess over $2,000. Since the foreign trust insulates from ordinary income tax rates, there would seem to be no need for a settlor to create a personal or foreign personal holding company by design. Unexpected business developments can lead to the unfavorable status much against his will.

If 80 percent of corporate gross income for a taxable year is personal holding company income, and requirements of stock ownership are met, the tax is applicable to any corporation. Thus, a commercial manufacturing company with a substantial portfolio of securities and rental property could, in a poor business year, find itself with personal holding company status. Note that, unlike the accumulated earnings tax, there is no requirement here of an unreasonable accumulation; the statute is satisfied if the accumulation is present. Note also, that the tax applies even though the commercial concern would have a business need to reinvest in inventory, plant or equipment. The alternative to the penalty tax is distribution to the shareholders who might be in a bracket high enough to preclude return of much of the capital to the corporation.

A transfer of corporate securities to a foreign trust would permit distribution of accumulated personal holding company income as a dividend, subject to the withholding required by statute and the tax imposed on nonresident aliens. This would avoid the personal holding company penalty tax but would subject the transferors to the 27½ percent security transfer tax. If the corporation had operating losses to

---

beneficial interest therein is owned directly or indirectly by any shareholder specified in subparagraphs (1) or (2).

80 § 541.
81 §§ 551-52.
82 § 541.
84 O'Sullivan Rubber Co. v. Commissioner, 120 F.2d 845 (2d Cir. 1941).
85 § 871(a)(1).
86 § 871.
87 § 1491.
set off against its income from investments, the value of the stock and, consequently, the transfer tax, would be reduced. The chance of attack by the Service would best be minimized by transfer of the stock prior to the eve of the obligation to pay the penalty tax.

The foreign personal holding company tax is best avoided by the same means, although the basic problem here is somewhat different. The tax effect flows from inclusion, not from a specific tax exaction; no tax is levied on the corporation itself, but United States citizens and others subject to domestic income tax must include undistributed foreign personal holding company income in their individual gross income. The greatest danger here is that an imperfect trust, for tax purposes, would hold the settlor, donor, or beneficiary taxable on the trust property and subject to the tax on any securities held by the trust in a foreign corporation which might be in the status of a foreign personal holding company. Safety would demand that securities be held by the trust itself and not by corporations, particularly if the settlor or his family were officers or directors of the corporation.

**Capital Gains Taxes.** These are income taxes assessed at rates substantially lower than those imposed on ordinary income when a capital asset has been held for a period of six months or more. Gain on such an asset is a long-term capital gain. On the other hand, if an asset has a holding period of less than 6 months, the tax rate is the same as that for ordinary income. In the latter event, the gain is short-term capital gain. Long-term capital gains are taxed at a maximum of 25 percent, whereas an exaction of up to 91 percent may fall on short-term capital gain, limited by a maximum tax of 87 percent on any individual.

Under the 1954 Code a nonresident alien is taxable on his capital gains, long or short term, only if the transactions take place during his presence in the United States, provided his total presence in any one taxable year is less than 90 days. Problems involving the influence of

---

88 §§ 551-52. Imposition of the tax on a foreign corporation not engaged in a trade or business in the United States would have presented jurisdictional impossibilities. If the Commissioner did obtain a judgment for the tax, the problems of collection would be acute since a foreign court might refuse to permit suit on a decree rendered against a body not properly before the court in which the issue was determined. See Note, International Enforcement of Tax Claims, 50 Colum. L. Rev. 490 (1950).

89 § 1222(3).
90 § 1222(1).
91 § 1201.
92 Section 1(c) provides that the total tax shall never exceed 87% of the taxable income for the taxable year involved.

93 § 871(a)(2)(A).
this section on selection of a corporate, as opposed to an individual, fiduciary were considered earlier in this writing. Since the statute is clear, there seems to be no way to avoid the tax if the fiduciary is either present in the United States in excess of 90 days in any one taxable year, or at any time less than 90 days if an exchange of property takes place during his stay.

If the fiduciary is taxable on capital gains, there is no reason to believe that the usual classification of long and short term would not apply. The 1954 Code is silent on this point, but as a practical matter the question should not arise if the fiduciary is chosen with proper foresight.

**Individual Income Tax.** Specific problems of income taxation arise with respect to the nonresident alien's receipts from investment or business activity in the United States. Taxation on the latter basis has already been considered in the discussion of insuring that the trust is not classified as an association and taxed as a corporation, but the question remains as to the imposition of the tax on investment income, which will most likely be the bulk of the annual trust receipts.

Under section 871(a)(1) a flat rate of 30 percent tax is imposed on gross income of not more than $15,400; income from interest on deposits with bankers is excepted from gross income. Significantly, this exaction is imposed in lieu of the tax imposed by section 1, provided the gross income limitation is not exceeded. Deductions from gross income to arrive at taxable income are determined by section 873. Of course, gross income is limited by section 872(a) to gross income from sources within the United States so that a nonresident alien does not subject his entire gross income from all sources to tax by having a part of it produced in this country.

If the gross United States investment income exceeds $15,400, the alien is taxable without regard to section 871(a) and is taxed at the ordinary rates specified in section 1, with the limitation that the tax cannot be lower than 30 percent. The obvious purpose of the latter provision is to impose a further restriction on the tax effect of business deductions.

**Section 306 Penalty Taxes.** The addition of section 306 to the 1954 Code reduced the growing attraction of the preferred stock bail-out.

---

94 § 871(b).
95 Section 871(a) imposes a tax of 30% on taxable income. If an alien's gross income was over $15,400, in the absence of § 871(b) his deductions might reduce taxable income below the $15,400 amount and, under § 1, result in a rate of tax less than 30%.
96 For a discussion of bail-out, see DeWind, Preferred Stock "Bail-Outs" and the Income Tax, 62 Harv. L. Rev. 1126 (1949).
Proper use of the foreign trust may reduce, to a limited degree, the harmful effect created by this amendment.

Section 306 stock comes into existence as the result of an effort to create shares which can be sold or redeemed in an exchange that yields capital gains treatment without reducing the voting power of the vendor.\(^7\) This purpose is accomplished by the declaration of a preferred stock dividend, which is not a taxable distribution,\(^8\) and a subsequent call for the preferred by the corporation. The holder takes accumulated earnings and profits at the capital gains rate thereby eliminating the danger of having imposed the ordinary section 1 tax rate on dividend distributions or the accumulated earnings tax had the dividend not been declared.

The tax treatment imposed by section 306 falls on the holder of the stock, not on the corporation issuing it or on the transferee, unless the latter takes as a donee on a substituted basis.\(^9\) The cutting edge of section 306 is subsection (a)(1)(A) thereof which treats of the gain received on the sale or exchange of property, not a capital asset, except for amounts which exceed the earnings and profits of the corporation at the time of distribution of the stock. Its effect is to impose ordinary income tax treatment on the proceeds to the extent of earnings and profits, a return of capital to the extent of the adjusted basis, and capital gains treatment on the excess.

A transfer of section 306 stock to a foreign trust would invite serious tax consequences, to the extent of the 27\(\frac{1}{2}\)% percent transfer tax,\(^10\) on the one hand, and offer great tax advantage on the other. If the transfer is a gift, it would not be a sale or exchange under section 306 and no tax would be payable. The trust would take the donor's basis.\(^11\) A subsequent sale or exchange outside of the United States would not subject the trust to tax because section 871(a)(1), which governs the taxation of nonresident aliens, limits its bite to income from sources within the United States. If the sale took place abroad, it would seem to avoid the capital gains tax as well since a section 306 transaction is not the sale or exchange of a capital asset.\(^12\) On the other hand, if the stock were sold in the United States it would probably generate income from a

\(^7\) For a discussion of this problem see Darrell, Recent Developments in Non-Taxable Reorganizations and Stock Dividends, 61 Harv. L. Rev. 958 (1948).

\(^8\) \$ 305(a).

\(^9\) \$ 306(c)(1)(C).

\(^10\) \$ 1491.

\(^11\) \$ 1016(b)(1).

\(^12\) Of course, even if the \$ 306 stock was a capital asset, it would avoid tax if a sale was not completed in the United States.
non-capital transaction and be caught by the 30 percent tax of section 871(a)(1).

An interesting transaction would be the redemption of section 306 stock by corporate agents of a foreign trustee if the actual redemption took place abroad. If the trustee was not present in this country, his only fear would be that the transaction could be held essentially the equivalent of a dividend under section 302(b)(1). In that event, the corporation would be obliged to withhold the 30 percent tax of section 871(a)(1). On the other hand, assume the trustee does not redeem the stock but sells it to a third party, also a nonresident alien. Section 301(c)(1) includes in gross income all corporate distributions which are dividends; section 316 defines a dividend as a distribution by a corporation to its shareholders. Could the Commissioner contend that the third party was an agent of the corporation and that he indirectly paid a dividend to the trustee when he purchased the stock? This seems unlikely, and it seems more unlikely that a foreign court would enforce the Commissioner's judgment against a trustee not before a United States court.

The third party, who purchased the 306 stock from the trustee, is not taxable by reason of his purchase under any section of the 1954 Code. He is, by assumption, a nonresident alien having no interests in the United States. If the 306 stock were his sole stock in the corporation, he could always claim that the redemption of it was a sale or exchange pursuant to sections 302(a) and 302(a)(3). This would characterize the transaction as a capital gain and tax free if he complied with section 871. The contemplated stock dividend and bail-out between the corporation and a foreign trustee is accompanied by numerous caveats. The Commissioner will not be restricted to section 306 in his attack. Each of them should be carefully considered before any course of action is determined.

**CONCLUSION**

More and more, Congress is beginning to realize that there is a limit to what the public will bear in the amount of tax exaction. If the revenue of the country is to be maintained at the all-time high we are presently experiencing, the sharp edge has to be withdrawn from the public purse string. In 1954 the new Code extended more relief to the individual taxpayers, thereby effecting a lower rate of tax. This was necessary if

---

103 The effect of § 302 has not been diminished by the addition of § 306, the latter being merely another approach to be utilized when necessary.

104 For example: the dividend credit of § 34, the dividend exclusion of § 116, the
proponents of the system of progressive taxation were to resist those who advocate some constitutional limitation on the taxing power of the federal government.

Tax reduction has become so popular that even those who favor an increase in rates must do it in an indirect manner. Professor Surrey, Assistant Secretary of the Treasury, in his classic text on tax\textsuperscript{108} indicated that the maximum effective rate on a married individual with two dependents was 37.8 percent in the $50,000 net income range and 51.9 percent in the $100,000 net income range. Yet this same gentleman is on record as arguing for elimination of capital gains treatment for relief of the definitional problems involved in capital gains.\textsuperscript{108} If the technical problem of definition were solved, Professor Surrey would advocate lowering the present rates which he concedes to be too high. Of course, his proposals would, in fact, increase the effective tax rate even with a reduction in rates.

The congressional problem has been to respond to genuine popular demand without antagonizing those of a contrary view. It has solved this issue by use of the so-called "tax loophole," one segment of which is the foreign situs trust. The "loophole" method of legislation is to create a code of taxation with provisions enabling taxpayers to avoid the total impact of the statute. A recent survey of the use of Curacao investment companies, from a tax standpoint, indicated that the Senate and the President extended the United States Income Tax Convention with the Netherlands to cover the Netherlands Antilles after the Treasury had completed a thorough study of the income tax laws in those islands.\textsuperscript{107} It would seem that the tax haven has achieved respectability.

Another example of congressional action in the tax haven area is the Trust and Partnership Income Tax Revision Act of 1960\textsuperscript{108} whose provisions recognized the foreign trust and penalized it only to the extent of removing its exclusion from the throwback rule. The latter measure appeared to be a seal of approval on the principle of tax reduction

\begin{itemize}
  \item scholarship and fellowship exclusion of § 117, exclusions relating to health insurance plans of §§ 105 and 106, the exclusion of meals and lodging furnished for the convenience of the employer of § 119, and a host of others.
  \item \textsuperscript{105} Surrey & Warren, Federal Income Taxation 27 (1960).
  \item \textsuperscript{108} Surrey, Definitional Problems in Capital Gains Taxation, 69 Harv. L. Rev. 985 (1956).
  \item \textsuperscript{107} Lowe, Curacao Investment Companies: Some Shoals in a Tax Haven, 16 Tax L. Rev. 177, 206 (1961).
  \item \textsuperscript{108} H.R. 9662, 86th Cong., 2d Sess. (1960).
\end{itemize}
through foreign intervention rather than by the trading company provisions in the present Code.109

Despite favorable congressional climate, the Treasury is not faced with a serious loss of revenue because of the foreign situs trust. The expense of creation and operation of the overseas trusts makes them unavailable for general use. Many of those whose assets are substantial enough to warrant the expense will be unwilling to send the assets outside the United States. Finally, experience in estate tax collection has demonstrated the reluctance of many individuals to divest themselves of final control over their property. These factors alone would make the trusts tolerable, but there is another that reduces the economic loss even more: the abortive attempts that will be made to create them. The latter, of course, lead to taxation.110

On the other hand, the expense and difficulty of policing tax havens would probably not be worth the return if Congress did take measures to prevent their use. The absence of records in this country, the lack of federal discovery rules, and the unlikelihood of international cooperation would make the effort relatively futile. There is also the matter of international trade relations to be considered. Foreign countries derive certain revenue from these trusts which they are doubtless unwilling to lose, and the United States seems committed to a policy of doing nothing to offend our friendly or "uncommitted" neighbors.

The foreign situs trust will most likely continue to be used, perhaps with less tax advantage if throwback is applied, as an instrument of tax planning. When regarded in its proper perspective it is a worthwhile instrument; viewed otherwise it is dangerous. Prohibitive legislation does not seem to be on the horizon but the present Code remains a major hurdle to be overcome in the mechanical process.

109 §§ 921, 941, dealing with Western Hemisphere Trade Corporations and with China Trade Act Corporations, respectively.

110 Examples of possible pitfalls are legion. One almost certain way to invite the Commissioner's attention would be to demonstrate the lack of independence of the foreign trustee by a continual course of conduct of exchanging securities with the trust, particularly if the exchanges were not such that would be made on the open market. Another way to disaster would be use of the trust to satisfy an obligation to support one's minor children.
COMMENT

THE DEFENSE OF ABANDONMENT IN PROCEEDINGS BEFORE THE FEDERAL TRADE COMMISSION

MARTIN F. CONNOR III*

Classifying the numerous criteria which a respondent in a Federal Trade Commission proceeding must meet to successfully advance the defense that it has sincerely abandoned a questionable business practice, the author criticizes the Commission's responses by way of belated cease and desist orders as inflexible and at variance with the Agency's fundamental purposes. Mr. Connor concludes by drafting the outlines of a rule of reason with which the Commission may henceforth judge the abandonment defense in a manner consistent with an unconfined exercise of its discretionary power.

INTRODUCTION

No elaborate statistical studies are required to demonstrate that a respondent before the Federal Trade Commission has little cause for optimism. The odds are better than eight to one that he will emerge subject to an order to cease and desist.1 In proceedings dominated by per se statutes and judicially eviscerated defenses, little remains to be said on his behalf. As a result, such respondents turn often to defenses which are, strictly speaking, extrinsic to the issue of antitrust violation. Of these, the defense most frequently invoked is that of "abandonment" or "mootness," in which the respondent contends that the complaint should be dismissed, since he has discontinued the challenged business practice and has no intention of resuming it.

Several circumstances commonly arising from the processes of the Federal Trade Commission contribute to the frequency with which this defense is advanced. First of all, objectionable and even borderline practices are often halted as soon as the Commission begins investigating a business concern, its competitors or the industry of which it is a part. While at times such a change in course may be attributable to the same instinct which prompts a motorist to slow down at the sight of a police car,

* LL.B., Georgetown University; Member of the Bar of the District of Columbia; Associate of Kyte, Conlon, Wulsin, & Vogeler, Cincinnati, Ohio; formerly Trial Attorney, Federal Trade Commission.

1 For example, of the 158 complaints issued in the period from January 1 to June 30, 1958, 5 have been dismissed, 20 are pending (4 on appeal from hearing examiners' orders to cease and desist), and the remaining 133 have terminated in orders to cease and desist.
it would be a mistake to assume that every such situation is tainted by insincerity. A Commission investigation often prompts a concern’s first thorough or serious appraisal of its *modus operandi* in light of the laws which the Commission enforces. Furthermore, a company may be truly convinced that a practice is defensible but prefer nonetheless to discontinue it in view of the Commission’s expressed doubts.

Secondly, there are occasions when the Commission’s staff has in its zeal simply disinterred a corpse for judicial dissection. Past violations unearthed while investigating a concern in some other connection generally fall into this category.

Finally, the investigative and adjudicatory processes of the Federal Trade Commission move at such a snail’s pace, and by such fits and starts, that a challenged method of competition can become impracticable, obsolete or stale long before any determination of its legality. Thus respondents find themselves exposed to the issuance of orders to cease and desist from practices long discontinued in the exercise of sound business judgment.

Despite the problems presented by these varying situations, the Commission and the courts, over the years, have developed fairly coherent criteria to test the validity of the defense in specific contexts.

**I PRELIMINARY OBSERVATIONS**

Before outlining these criteria and considering their application, some initial observations might appropriately be made with respect to their general character.

The defense of abandonment was raised in the very first Federal Trade Commission case to reach the courts, *Sears, Roebuck & Co. v. FTC*. In what has become a classic statement, the court adopted a perspective which prevails to this day:

> Petitioner insists that the injunctive order was improvidently issued because, before the complaint was filed and the hearing had, petitioner had discontinued the methods in question and, as stated in its answer, had no intention of resuming them. . . . But respondent [Federal Trade Commission] was required to find from all the evidence before it what was the real nature of petitioner’s attitude. . . . [N]o assurance is in sight that petitioner, if it could shake respondent’s hand from its shoulder, would not continue its former course.3

---

2 258 Fed. 307 (7th Cir. 1919).
3 Id. at 310.
What is perhaps the most significant aspect of this statement is only implicit in its wording. Despite the fact that the Commission’s proceedings are injunctive by nature, they are not to be disposed of by application of the historic principles which govern the granting of equitable relief. In this significant respect, therefore, they differ from suits for injunction under the Sherman Act.⁴ In such suits it is necessary, in the course of showing that the act’s legal remedies are inadequate, to establish that the objectionable methods of competition have continued to the date of the action’s commencement.⁵ But the implicit premise of Sears, Roebuck & Co. is that the Commission’s order to cease and desist is primarily regulatory, rather than injunctive in the traditional sense of that term; therefore there need be no showing that the practice continued to the time of the complaint.

It is also worth noting as an historical fact that the Commission has never distinguished between abandonment of practices violative of the Clayton Act⁶ and of practices in contravention of section 5 of the Federal Trade Commission Act,⁷ despite striking differences in the language of these two acts. Specifically, section 11 of the Clayton Act states:

Whenever the commission . . . shall have reason to believe that any person is violating or has violated any of the provisions of sections two, three, seven and eight of this Act, it shall issue and serve upon such person a complaint . . . .⁸

Section 5(b) of the Federal Trade Commission Act, on the other hand, provides:

Whenever the Commission shall have reason to believe that any such person, partnership, or corporation has been or is using any unfair method of competition or unfair or deceptive act or practice in commerce, and if it shall appear to the Commission that a proceeding by it in respect thereof would be to the interest of the public, it shall issue and serve . . . a complaint . . . .⁹

Each act makes explicit provision for proceedings to enjoin future

repetition of past misconduct, but the Federal Trade Commission Act confers upon the Commission a degree of discretion which the Clayton Act would seem on its face to withhold. Although this fact could be viewed as significant so far as the defense of abandonment is concerned, it has in practice made no difference whatsoever. The Commission exercises discretion in the administration of each act, as it surely must if it is to operate within the bounds dictated by common sense; but whether the Commission goes far enough in the exercise of this discretion is open to question.

Finally, use of the word "moot" to describe a Federal Trade Commission case which has been dismissed because of abandonment, while convenient and canonized by usage, is not altogether fortunate. Properly speaking, a case or controversy is moot if a judgment on it cannot, for some reason, have any practical legal effect. The term is applied to Federal Trade Commission cases by analogy, at best. Such cases are moot, not because an order to cease and desist would have no legal effect, though this may be incidentally true, but because an order to cease and desist is regarded, in light of all the attendant circumstances, as unnecessary.

II

Criteria Used in Adjudging Abandonment

In the four decades which have elapsed since Sears, Roebuck & Co., the Commission has evolved and elaborated a rather harmonious set of criteria for use in assessing the defense's merit in particular contexts. The Commission's viewpoint has, over the years, been consistent and unchanging. Two recent cases, today regarded as landmarks, announce no change in policy but merely synthesize what has gone before. Although it would be difficult to substantiate the suggestion, it may also be true that the Commission now applies these criteria more rigorously. While a majority of the cases dismissed in the 1940's were dismissed because of abandonment, this is surely not the case today.

These criteria are set forth below with citations illustrating typical cases in which they have been enunciated. For the most part the cited Commission cases are recent, since only recently has the Commission seen fit to accompany its decisions with reasoned opinions. With regard to the cited court decisions, it must be borne in mind that reliance on

11 For instance, of forty-one cases dismissed in the period from July 1, 1948, to June 30, 1949, twenty-seven were dismissed because of abandonment.
court cases alone will not provide a full statement of the law, since no Federal Trade Commission case can reach the courts unless the Commission has issued an order to cease and desist and hence found that the case was not moot. Thus the courts are never called upon to review the steps by which the Commission has found that a case is moot. Reading the court and Commission cases together, however, one finds that the following standards have been used to determine whether a case may properly be dismissed because of abandonment:

1. Dismissal of a complaint on the ground of mootness is never mandatory but lies within the Commission's discretion. This discretion is limited only in so far as it may be abused. 12

2. Cessation of a challenged practice is a condition sine qua non to mootness, but does not in and of itself render the controversy moot. 13

3. Dismissal for mootness is an unusual procedure and must be premised on a showing of truly extraordinary circumstances. 14

12 "But even if the practice had been discontinued, that did not deprive the Commission of power to enter such order as it determined necessary to prevent their [sic] revival, absent a showing of abuse of discretion." Consumer Sales Corp. v. FTC, 198 F.2d 404, 407 (2d Cir.), cert. denied, 344 U.S. 912 (1952). "The order to desist deals with the future, and we think it is somewhat a matter of sound discretion to be exercised wisely by the Commission . . . ." Eugene Dietzgen Co. v. FTC, 142 F.2d 321, 330-31 (7th Cir.), cert. denied, 323 U.S. 730 (1944). "In any case of the discontinuance of a practice, the Commission is vested with a broad discretion in the determination of whether . . . an order to cease and desist is proper. . . . This discretion is limited only to the extent that it may be abused." Ward Baking Co., 54 F.T.C. 1919, 1921 (1958). Goodman v. FTC, 244 F.2d 584, 594 (9th Cir. 1957); Dejay Stores Inc. v. FTC, 200 F.2d 865 (2d Cir. 1952); Deer v. FTC, 152 F.2d 65 (2d Cir. 1945); Gelb v. FTC, 144 F.2d 580 (2d Cir. 1944); Guarantee Veterinary Co. v. FTC, 285 Fed. 853 (2d Cir. 1922); Marlene's, Inc., 50 F.T.C. 460 (1953). Commission reversed for abuse of discretion, National Lead Co. v. FTC, 227 F.2d 825, 839-40 (7th Cir. 1955), rev'd, 352 U.S. 419 (1957).

13 "[A]n abandonment of the practices, even if clearly shown, does not render the controversy moot." Perma-Maid Co. v. FTC, 121 F.2d 282, 284 (6th Cir. 1941). FTC v. Goodyear Tire & Rubber Co., 304 U.S. 257 (1938); Hershey Chocolate Corp. v. FTC, 121 F.2d 968, 971 (3d Cir. 1941); Fairyfoot Prods. Co. v. FTC, 80 F.2d 684, 686 (7th Cir. 1935); Cannon Mills, Inc., No. 7115, FTC, March 12, 1959; Marlene's, Inc., supra note 12; Margood Publishing Corp., 44 F.T.C. 72, 78 (1947). The few dismissals for mootness in apparent disregard of this rule have occurred when a minor abandoned practice was all that remained in issue after the other allegations of a complaint had been dismissed. Merck & Co., 46 F.T.C. 1111 (1950); Home Serv. Co., 45 F.T.C. 831 (1949).

14 "The Commission, in the exercise of its proper discretion, may dismiss a complaint even after proceedings have been initiated, but we believe that a dismissal in any such circumstances should be limited to the truly unusual situation." Ward Baking Co., 54 F.T.C. 1919, 1921 (1958). "Dismissal of a complaint in cases of this general character is not the usual procedure. It should not be done unless there is a clear showing of unusual circumstances which in the interest of justice require it." Argus Cameras, Inc., 51 F.T.C.
4. These circumstances must be such as to give objective assurance, over and above the respondent's gratuitous promise, that the practice in question will not be resumed.15 Over the years, some definable categories of such circumstances have emerged which may be regarded as more reliable guideposts to future Commission action than any enunciation of abstract policy. Without any pretension to exhaustive synthesis, these categories may be summarized as follows:

(a) Death of an individual respondent16 or dissolution of a corporate respondent.17

(b) Change in ownership or control of a corporate respondent.18

(c) Discontinuance of the line of business in which the questionable practice was used.19

(d) Discontinuance of manufacture or sale of the product involved in respondent's challenged method of competition.20

(e) Drastic changes in the industry that preclude a return to the practice in question.21


15 "[T]he Federal Trade Commission would not be justified in relying upon a mere promise not to engage in these practices." Moir v. FTC, 12 F.2d 22, 27 (1st Cir. 1926). Sears, Roebuck & Co. v. FTC, 258 Fed. 307 (7th Cir. 1919); Ward Baking Co., 54 F.T.C. 1919 (1958); Automobile Owners Safety Ins. Co., 53 F.T.C. 956 (1957); Argus Cameras, Inc., 51 F.T.C. 405 (1954).

18 Hiram Johnson, 45 F.T.C. 778 (1949).

17 Alex J. Hadid, No. 7518, FTC, Nov. 24, 1959; Hood Rubber Co., 46 F.T.C. 1015 (1949); Truslow Poultry Farm, Inc., 45 F.T.C. 812 (1949); Whitehall Pharmacal, Inc., 44 F.T.C. 1099 (1947). But dissolution of a corporate respondent is no ground for setting aside an order of appeal when the respondent was in existence at the time the order was issued. Standard Container Mfrs. Ass'n v. FTC, 119 F.2d 262, 264 (5th Cir. 1941). Nor does dissolution of a subsidiary corporation, whose practices have been challenged, provide sufficient basis for dismissal of the parent on ground of mootness. Gelb v. FTC, 144 F.2d 580 (2d Cir. 1944).

18 Master Labs., Inc., 49 F.T.C. 1576 (1953); H. G. Hornibrook, 48 F.T.C. 1571 (1952). But corporate reorganization is no basis for dismissal where there is no change of control, Advance Realty Corp., 45 F.T.C. 145, 167 (1948); nor where control is transferred to relatives of the former controlling party, Goodman v. FTC, 244 F.2d 584, 594 (9th Cir. 1957).


21 Sheffield Merchandise, Inc., No. 6627, FTC, March 4, 1960; National Retail Furniture
(f) Passage of considerable time since cessation of the pertinent practice.22

(g) Agreement with or order of another government agency terminating the challenged practice.23

(h) Prompt discontinuance, when challenged by the Commission, of a competitive practice which the respondent had, over a period of years, been led to believe was approved by the Commission.24

(i) Cessation of a "fair trade" program to which the alleged violation was incidental.25

(j) Recent subscription to Trade Practice Rules proscribing the challenged practice.26

5. Abandonment must have been voluntary, and hence little or no weight may be attached to cessation of a challenged practice during the course of a Commission investigation or while a complaint challenging the practice is outstanding.27

6. Abandonment cannot be deemed to render a case moot, irrespective of the prevailing circumstances, so long as the respondent refuses to concede the illegality of the challenged practice.28 Pursuant perhaps


22 New Standard Publishing Co. v. FTC, 194 F.2d 181 (4th Cir. 1952) (nine years); Robert Salazar, 47 F.T.C. 1603, 1607 (1951) (eight years); Van Camp Sea Food Co., 46 F.T.C. 1087 (1949) (ten years). Issuance of order nine years after cessation of practice held abuse of discretion, Oregon-Washington Plywood Co. v. FTC, 194 F.2d 48 (9th Cir. 1952).

23 Irving A. Grubman, 49 F.T.C. 1553 (1952) (agreement with Post Office Dep't); James O. Keane, 45 F.T.C. 802, 809 (1949) (order of Post Office Dep't); David Rosenthal, 45 F.T.C. 755, 760 (1949) (agreement with United States Attorney's Office).


25 Bell & Howell Co., 54 F.T.C. 108 (1957). It might be possible to generalize this holding still further and predict that the Commission will favorably entertain a motion for dismissal when the allegedly illegal practice was a subordinate part or incidental by-product of some general marketing policy or program that has been discontinued under circumstances making its resumption unlikely.


28 Oregon-Washington Plywood Co. v. FTC, 194 F.2d 48, 51 (9th Cir. 1952); Galter v.
to this last criterion, one Commission opinion contains a curious dictum implying that the practice must have been halted as an act of pure repentance and not because it proved unprofitable or otherwise undesirable in the exercise of sound business judgment.29

III

THE PURPOSE OF A FEDERAL TRADE COMMISSION PROCEEDING

Any appraisal of the validity of these standards must be undertaken in the light of the objectives which are to be attained in a formal proceeding before the Commission. When the Commission has realized its proper objective prior to issuance of an order to cease and desist, it would appear that the case is moot, in the sense in which the term is used here, and that continuation of the proceeding cannot possibly be justified. The Commission's proper objective was accurately and succinctly stated in *Eugene Dietzgen Co. v. FTC*:

The object of the proceeding is to *stop* the unfair practice. If the practice has been surely stopped and by the act of the party offending, the object of the proceedings having been attained, no order is necessary, nor should one be entered.30

However, the crucial determination is whether "everything that could be accomplished by a cease and desist order has been accomplished."31 This phrasing of the question brings into sharp focus the real problem underlying every attempt to advance the defense of abandonment. What is this "everything" which the Commission believes it should accomplish by an order to cease and desist? Unfortunately, this ultimate question has been answered for almost a decade by recourse to *FTC v. Ruberoid Co.*:

If the Commission is to attain the objectives Congress envisioned, it cannot be required to confine its road block to the narrow lane the transgressor has trav-

---

30 142 F.2d 321, 331 (7th Cir.), cert. denied, 323 U.S. 730 (1944). (Emphasis added.)
eled; it must be allowed effectively to close all roads to the prohibited goal, so that its order may not be by-passed with impunity.\textsuperscript{32}

In line with the policy this statement is purported to have enunciated, the Commission so drafts its orders that (a) in proceedings brought under section 5 of the Federal Trade Commission Act the generic type of unfair practice is interdicted along with the specific acts challenged,\textsuperscript{33} and (b) in proceedings brought under the Clayton Act (excepting those under section 7, which are in most respects sui generis\textsuperscript{34}) the order to cease and desist simply enjoins, in most instances, future violations of the section or subsection of the act under which the complaint was brought.\textsuperscript{35} In the latter case, the order is invariably drafted in the very language of the statute involved.

In short, by an order to cease and desist the Commission attempts to accomplish far more than cessation of a particular practice. The object of its proceeding is to enjoin any future conduct that might violate the statutory provision under which the complaint was brought. In the majority of cases this prohibition will extend to all phases of the respondent’s enterprise, not simply to a particular product or to a particular operating unit or subsidiary.\textsuperscript{36}

Just last year in \textit{Grand Union Co.}\textsuperscript{37} the Commission’s view with respect to its orders and to the defense of abandonment was clearly

\textsuperscript{32} 343 U.S. 470, 473 (1952).

\textsuperscript{33} See, e.g., Maryland Baking Co. v. FTC, 243 F.2d 716 (4th Cir. 1957). Consistency would seem to demand that, in its deceptive advertising cases, the Commission should simply enjoin future deceptive advertising, but in this respect the Commission is, thank heaven, happily inconsistent.

\textsuperscript{34} Although no respondent in a litigated case has yet been ordered simply to cease and desist from violating section 7, the Commission staff has repeatedly requested such an order and the Commission has indicated that it might grant the request on a showing of sufficient need. Reynolds Metals Co., No. 7009, FTC, Jan. 21, 1960; Pillsbury Mills, Inc., No. 6000, FTC, Dec. 16, 1960. At least one consent order to cease and desist has included such a provision. Diamond Crystal Salt Co., No. 7323, FTC, Feb. 4, 1960.

\textsuperscript{35} See Order to Cease and Desist (Under Section 2(c) Clayton Act), in \textit{Beer, Federal Trade Law and Practice} 726-28 (1942).

\textsuperscript{36} There is still some latitude possible, it would seem, with respect to the \textit{products} as opposed to \textit{practices} embraced by a Federal Trade Commission order to cease and desist. Review of recent cases will show that three formulas are used. A party may be ordered to cease and desist from a practice in connection with the sale of (a) a particular product, \textit{e.g.}, “cigarettes,” or (b) a particular product “and related products,” or (c) “respondent’s products” generally. But unless there is some limitation with respect to product, an order can embrace all phases of a diversified enterprise, even though the alleged misconduct is chargeable to a single unit or subsidiary.

\textsuperscript{37} No. 6973, FTC, Aug. 12, 1960.
expressed. On August 6, 1952, Grand Union, a national grocery chain, entered into a contract with Douglas Leigh, Inc., an advertising agency, wherein Leigh granted Grand Union the use of a spectacular sign overlooking Times Square in New York City. Grand Union agreed to secure fifteen advertisers to use the animated panel of the sign for fifteen of every twenty minutes, the remaining five-minute interval being reserved for Grand Union. In 1953 the agreement was revised to permit Grand Union to sell its allotted time on the animated panel and to receive all monthly rentals paid for such time, as well as five percent of the payments made by purchasers of the other fifteen-minute intervals. Almost all advertisers on the animated panel were suppliers of Grand Union. On December 31, 1956, after the Commission had begun an investigation of this arrangement, Grand Union put an end to its participation in the project and the sign was dismantled.

Almost a year later, on December 5, 1957, the Federal Trade Commission brought a complaint against Grand Union, charging violation of section 5 of the Federal Trade Commission Act for knowingly inducing disproportionate payments by its suppliers in violation of section 2(d) of the amended Clayton Act. Neither the Commission nor the courts had ever held the inducement of such payments to be illegal. The hearing examiner in his initial decision held that the allegations of the complaint were sustained and ordered respondent to cease and desist from

knowingly inducing, receiving or contracting for the receipt of anything of value as compensation or in consideration for advertising, promotional displays or other services or facilities furnished by or through respondent in connection with the sale or offering for sale of products sold to respondent by any of its suppliers, when such payment is not affirmatively offered or otherwise made available by such suppliers on proportionally equal terms to all their other customers competing with respondent in the sale and distribution of the suppliers' products.

The language of this order is simply adapted from sections 2(d) and 2(f) of the amended Clayton Act.

In adopting the decision of the hearing examiner, the Commission said with respect to the proffered defense of abandonment:

The fact that the sign deal was terminated does not support the conclusion that respondent has abandoned the practice of knowingly inducing or receiving discriminatory allowances. . . . The fact that this program was terminated after

investigation had begun certainly does not create any inferences favorable to respondent. Moreover, respondent has not given any assurances that it will not again engage in the practice challenged by the complaint or some similar practice, nor can it be said that competitive conditions have so changed that respondent is not likely to engage in such practice.41

In other words, although "the practice has been surely stopped and by the act of the party offending,"42 and the object of the proceeding had therefore been attained, the case was still not moot so long as it remained possible for Grand Union knowingly to induce discriminatory allowances. The Commission clarified this position in its discussion of the order's scope.

The final question presented for our determination concerns the scope of the order to cease and desist. Although respondent does not suggest how the order should be modified . . . its contention seems to be that the order should go no further than to prohibit respondent from engaging in the illegal practice by the means which it had previously employed. We think that such a prohibition would be of little value . . . 43

It is submitted that this policy of the Commission does not result in "broad orders," to use one of the Commission's favorite expressions. By insisting upon an order in the language of the relevant statute, the Commission has reduced its function simply to that of finding those who have violated the law in the past and of marking them for punitive action if they violate the same law in the future. Of course, in proceedings under section 5 of the Federal Trade Commission Act, the Commission has the duty of deciding whether a particular method of competition is fair or unfair, but the categories of competitive misbehavior have calcified and the Commission has shown little tendency to innovate.44 By thus refusing to provide concrete guides for business conduct or to particularize in its orders what Congress had consciously left broad and indefinite, the Commission has abjured the administrative process in all respects save the observance of procedural formalities. This observation is not novel. It was made long ago by Mr. Justice Jackson in his dissent to FTC v. Ruberoid Co.45 There is little reason today, however, to think that this tide will ever turn, and it would be futile to argue here

42 Eugene Dietzgen Co. v. FTC, 142 F.2d 321, 331 (7th Cir. 1944).
44 The Grand Union case is a notable recent exception in so far as it held, subject to judicial review, that knowing receipt or inducement of discriminatory promotional allowances is an unfair method of competition.
45 343 U.S. 470, 483-87 (1952).
for such a turning. Hence the Commission's announced criteria for adjudging mootness must be interpreted and evaluated in the light of this settled state of affairs.

CONCLUSIONS

The specific circumstances listed above, which the Commission has found adequate to give objective assurance of discontinuance, are all such as to guarantee that a particular party will not again, at least in a particular competitive arena, engage in the class of conduct that the statute in question proscribes. Thus it suffices that an individual respondent has passed to a better life or that a corporate respondent has closed its doors, dropped a product or entered a new business. At times there is even grudging recognition of something akin to laches. In short, the listed criteria generally lead to the conclusion, not that an order is unnecessary, but that issuance of an order would be shocking or absurd. There is no locus poenitentiae, no place for disavowal of past mistakes or misinterpretations of the law. Furthermore, regardless of the circumstances under which the alleged misconduct has been discontinued, the Commission has expressly held that there is no burden upon its counsel to demonstrate the need for an order to cease and desist.

If the Commission continues to demand boiler-plate orders, conceived in vagueness and dedicated to doubtful ends, then elementary justice requires that a "rule of reasonableness" be used in evaluating the defense of abandonment. Even though the Commission has never been

46 It is submitted that many of the cases dismissed for abandonment on the ground, in whole or in part, that a considerable period of time had elapsed since the practice was stopped (cases cited note 22 supra) might more properly have been dismissed for want of prosecution. For an instance in which this was actually done, see American Cigarette & Cigar Co., 49 F.T.C. 1553 (1952). In justice to the Commission, however, it must be noted that in the past few years no cases have reflected the dilatoriness exemplified, for instance, by Motor Equip. Specialty Co., 48 F.T.C. 1574 (1952), wherein the complaint was dismissed eleven years after issuance, on a showing that respondent corporation had long since entered a business unrelated to the enterprise in which the alleged misconduct had occurred.


48 Cf. National Lead Co. v. FTC, 227 F.2d 825, 839-40 (7th Cir. 1955):

While the Commission is vested with a broad discretion to determine whether an order is needed to prevent the resumption of unlawful acts which have been discontinued, this "discretion must be confined . . . within the bounds of reasonableness." [Marlene's, Inc. v. FTC] 216 F.2d [356], 559 [1953].

This rule of reasonableness requires something more than a mere guess or suspicion contrary to the evidence . . . that a resumption of discontinued practices may not
noted for vigorous enforcement of its orders to cease and desist, no respondent can take lightly an order that will expose it in perpetuity to penalty proceedings for any future violation of the same provision of the law. This is particularly true in matters arising under section 2 of the amended Clayton Act, the so-called Robinson-Patman Act, for here the Commission’s orders are the least specific and their transgression by inadvertence or in good faith is more probable.

Thus a contention on behalf of respondent that a practice has been abandoned forever in good faith deserves the Commission’s serious consideration. The Commission should ask whether, in light of all the known circumstances, reason requires that such a respondent be burdened by an order to cease and desist. This proposition implies a shift in the basic orientation of such proceedings before the Commission. It assumes that, upon proof of discontinuance, the Commission will ask why an order is necessary, rather than why one is unnecessary.

Application of a rule of reasonableness to the defense of abandonment should lead to the following general conclusions:

(1) When a practice has been halted, for whatever reason, before commencement of an investigation, there should be a conclusive presumption that it has been abandoned in good faith and will not be resumed. Of course, inquiry into the reality of the prior discontinuance would not be foreclosed, since it is at times entirely fortuitous that a certain practice—sporadic perhaps by its very nature—is not being implemented at the precise moment the investigation begins.

Any other approach to practices discontinued before investigation

reasonably be anticipated . . . . [T]he Commission is not empowered to “enjoin one from doing what he is not attempting and does not intend to do.” New Standard Pub. Co. v. FTC, 194 F.2d 181, 183 (1952); FTC v. Civil Serv. Training Bureau, 79 F.2d 113 (1935).


50 Lest it be doubted that a point of view so consonant with common sense is inconsistent with present Commission policy, see Fred Bronner Corp., No. 7068, FTC, Sept. 29, 1960. In that case discontinuance of the practice had been voluntarily commenced before the start of investigation and was completed approximately eighteen months prior to issuance of the complaint. The practice, an unjustifiable price differential, was ultimately found devoid of anti-competitive effect by the hearing examiner. On the other hand, in Oneida, Ltd., No. 7236, FTC, April 9, 1959, the complaint was dismissed on a finding of voluntary discontinuance almost a year prior to investigation. Even here, however, a proper outcome neither explains nor justifies the complaint’s original issuance. It is difficult to give credence to the hearing examiner’s statement (initial decision, October 31, 1958) that the facts on which he based dismissal, before the receipt of any evidence, were not before the Commission at the time it issued the complaint.
would seem to make a mockery of the Commission's vaunted efforts to educate the business community in sound competitive standards. There is little reason for self-reformation if the hand of the law may, in the vivid image of Sears, Roebuck & Co., fall upon one's shoulder despite it.

(2) Discontinuance should be regarded in the light most favorable to respondent when the legality of the practice in question is a matter upon which reasonable men might differ. Reason surely requires that "hard core" violations be distinguished from practices which are challenged for the first time, or which do not fit foursquare into categories of business misconduct defined by decided cases, or which have been engaged in under such circumstances that a prudent businessman might believe they were defensible. Protestations of discontinuance under such conditions should not be dismissed casually on the "mere guess or suspicion" of the Commission. The Commission should have affirmative grounds for doubting either the respondent's good faith\(^{51}\) or its ability to withstand the pressures that evoked its previous practices.\(^{52}\)

(3) No inference of any sort should be drawn from the fact that a respondent stands ready to defend a challenged and abandoned practice. In view of the scope of the Commission's orders, it is absurd to impute \textit{mala fides} to a respondent who makes every effort to escape such an order while claiming a bona fide abandonment. It is often suggested that a respondent who has truly discontinued a practice should be indifferent to the Commission's attempt to buttress good intentions with an order to cease and desist. This contention would be valid if the order proscribed only the specific acts in issue, but not otherwise.

It is submitted that the acceptance of these proposals by the Commission would supply the frame of reference which a rule of reasonableness requires. But there is one unfortunate propensity of the Commission which appears to place such acceptance beyond the pale of prudent expectation, and which must be pointed out, even if briefly and somewhat apologetically, in order that these proposals might be appraised realistically. As its annual reports and year-end press releases attest,

\(^{51}\) For an instance in which the Commission rejected the defense of abandonment because respondent had in the past disregarded a stipulation into which it and the Commission had entered, see Philo Burt Mfg. Co., 50 F.T.C. 838 (1954).

\(^{52}\) Oftentimes practices of which the Commission complains have occurred as a result of persuasion, coercion or moral constraint exercised upon respondent by a third party, such as a more powerful buyer or seller. Under such circumstances the Commission may plausibly take the position that an order to cease and desist is advisable despite an avowed abandonment.
the Commission has long been wont to measure its progress and announce its success solely in terms of the number of complaints and orders it issues. Application of a rule of reasonableness to the defense of abandonment would doubtless curtail this number. This is not to accuse the Commission of conscious harassment for purposes of self-aggrandizement; all that is implied here is that the Commission, despite its occasional disclaimers, habitually views itself as a prosecuting agency and therefore gauges its effectiveness by the degree of its success in adjudicatory proceedings. So long as this mentality persists, it is most unlikely that the Commission will embrace a broad policy which would restrain it from instituting proceedings and ultimately from issuing an order to cease and desist against parties who have in fact, though at some time past, transgressed a provision of the laws it enforces. Thus, realism requires a conclusion that there is little likelihood that the Commission's present policy toward abandonment will be modified in accord with a rule of reasonableness until the Commission avails itself of qualitative, rather than merely quantitative, standards for ascertaining its effectiveness in maintaining a healthy competitive climate.
THE

GEORGETOWN LAW JOURNAL

Volume 49
Summer 1961
Number 4

THE BOARD OF EDITORS

Robert J. Elliott, of New Jersey
Editor in Chief

John J. Brandt, of Virginia
Managing Editor

Robert J. Clune, of New York
Max H. Crohn, Jr., of North Carolina
James P. Driscoll, of Connecticut
John J. Flynn, of Massachusetts

Kathryn V. Woodward, of the District of Columbia

ROBERT J. GAREIS, of New York
ROY E. HOFER, of Virginia
JOHN G. MCGOLDRICK, of New York
JOHN G. MURPHY, Jr., of the District of Columbia

STAFF

Paul P. Dommer
George K. Dunham
George V. Egge, Jr.
David F. Fitzgerald
Jerome C. Gorski
Alan D. Gross
Thomas V. Heyman
John P. Higgins

Leon T. Knauer
Patrick W. Lee
Charles R. Marcoux
Edgar H. Martin
E. Michael McCann
Charles J. McCarthy
William J. McNichols
Owen J. Murray, Jr.

Daniel J. O’Connor, Jr.
Francis J. Pelland
Richard S. Rebeck
Carey W. Royster
Bernard F. Sheehan
Joseph T. Sweeney
Robert H. Tucker
Francis E. Yeatman

Edwin J. Bradley, Faculty Adviser

737
NOTE

FEDERAL PRIORITY IN SECURITY TRANSACTIONS: THE FEDERAL TAX LIEN v. A MORTGAGEE'S PAYMENT OF TAXES ON THE MORTGAGED PROPERTY

INTRODUCTION

The study of the subject of federal tax liens has been referred to by one writer as "A Study in Confusion and Confiscation." One will find at least the first part of the sobriquet justified by the following inquiry, which this note pursues: The owner of mortgaged property fails to pay his federal taxes. After notice of a federal tax lien against the mortgagor has been filed pursuant to federal statute, the mortgagee pays ad valorem taxes assessed by the state against the mortgagor's property. The question is whether satisfaction of the amount so paid by the mortgagee has priority over the earlier recorded federal tax lien.

Increased emphasis on collection by the Internal Revenue Service together with the economy's recent depressionary tendency renders the general subject of tax collection one of growing importance. Five of nineteen Supreme Court civil tax decisions in the last term dealt with problems of tax collection; four of the five were concerned with tax liens. Particularly, the increasing number of foreclosures brings to the forefront problems involved in distributing the proceeds of foreclosure sales among several lien claimants, not the least of which is the problem with regard to what treatment is to be accorded taxes paid by the mortgagee. The importance of this problem is evidenced by the fact that over half of the cases in point arose within the past year.

The federal government's lien for taxes arises from section 6321 of the Internal Revenue Code of 1954⁶ which gives the Government a lien on the property of the delinquent taxpayer. The section does not define the nature of the lien, the scope of its operation, or its priority vis-à-vis the claims of other creditors. Section 6322⁷ provides that the lien, which arises after an unsatisfied demand for the taxes has been made upon the taxpayer, relates back to the time of assessment in the local collector's office.

Section 6323⁸ then deals with the validity of the tax lien as against mortgagees, pledgees, purchasers and judgment creditors. Subsection (a) thereof provides:

Except as otherwise provided in subsection (c) [exception in the case of securities], the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

Thus a mortgage which is recorded prior to the filing of the federal tax lien is accorded priority. But the subsection does not resolve whether a mortgagee's priority thus established should extend to ad valorem taxes assessed against the mortgaged property which the mortgagee pays after notice of the federal tax lien has been filed.

The legislative history⁹ of section 6323 discloses no manifestation of intent with regard to the extent to which a prior mortgage is to be protected. That the provision was intended to alleviate the injustice of the secret nature of the federal tax lien is made clear by a series of cases holding the lien superior to subsequent bona fide purchasers and mortgagees who had no ready means of discovering the existence of the federal lien.¹⁰ The latest manifestations of congressional intent¹¹ are of little avail in determining the extent to which a prior mortgagee is to be protected.

---

⁶ If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

⁷ Unless another date is specified by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.


In enacting the Internal Revenue Code of 1954, Congress left problems of deciphering the provision to the courts.\textsuperscript{12}

The United States Supreme Court has not clearly expressed itself as to the priority of a mortgagee with respect to property taxes he has paid to a local government in order to protect his security. Certiorari has been denied a case directly presenting the problem\textsuperscript{13} and when the question was indirectly presented in \textit{United States v. City of New Britain},\textsuperscript{14} the Court expressly reserved decision thereon. That case involved the relative priority of the city and the federal government to foreclosure sale proceeds in excess of the mortgage debt. The city in part contended its lien was superior to the federal tax lien since if the mortgagee had paid the taxes his claim arising from such payment would have been superior to the federal claim. The Court rejected the argument but expressly reserved decision on the question not before the Court, \textit{i.e.}, what are the mortgagee's rights if he pays city taxes levied against the mortgaged property.\textsuperscript{15}

Though the decisions of state and lower federal courts are in conflict, a trend in favor of priority for the federal tax lien is evidenced.\textsuperscript{16} Generally the courts have based their decisions upon an application of the choate lien test. The trend found its most detailed expression in \textit{United States v. Bond},\textsuperscript{17} where the Court of Appeals for the Fourth Circuit reversed a lower court holding that taxes paid by a mortgagee both prior and subsequent to notice of a federal tax lien became secured under the mortgage and enjoyed its priority since they were paid by the mortgagee to maintain the integrity of his lien.\textsuperscript{18} The appellate court denied priority as to taxes accrued subsequent to the filing of the federal tax lien notice, reasoning that the lien so acquired by the mortgagee was not perfected and choate at the time the federal tax liens were recorded.\textsuperscript{19}

Proper analysis of the court's reasoning in \textit{Bond} therefore requires review of the choate lien test's development and meaning together with consideration of the propriety of its application to the particular situation involved.

\textsuperscript{14} 347 U.S. 81 (1954).
\textsuperscript{15} Id. at 87 n.12.
\textsuperscript{16} Cases cited note 5 supra.
\textsuperscript{17} 279 F.2d 837 (4th Cir.), cert. denied, 364 U.S. 895 (1960).
\textsuperscript{19} 279 F.2d at 846.
I

DEVELOPMENT AND MEANING OF THE CHOATE LIEN TEST

The concept of choateness appears to have arisen through judicial interpretations in another area, that of the Government's statutory priority in claims involving insolvent debtors. On its face, the statute's determination that the "debts due the United States shall first be satisfied" would appear to admit of no exceptions, but the Supreme Court early engrafted a limitation when in Thelusson v. Smith it held that the priority applied only to property in the hands of the debtor at the time the Government's claim arose. This meant that

if, therefore, before the right of preference has accrued to the United States, the debtor has made a bona fide conveyance of his estate to a third person, or has mortgaged the same to secure a debt, or if his property has been seized under a fi. fa., the property is divested out of the debtor, and cannot be made liable to the United States.

Subsequently, consistent with the Thelusson rationale, the Court recognized a pre-existing mortgage as preventing the Government from reaching a debtor's mortgaged estate since the property had been divested out of the debtor before the claimed priority arose.

Had the Court rested here, the doctrine of choateness might never have arisen. But the Court went on to say, "[I]t has never been decided, that it [the statutory priority] affects any lien, general or specific, existing when the event took place which gave the United States a claim of priority." The statement outlined the possibility of further exceptions to the rule of preference, and a number of claimants seeking to compete with the priority of the United States on the ground of having an earlier lien soon confronted the Court with argument on the point. In response, the Court first found that of simultaneously arising state and federal liens, federal supremacy made the latter superior. Then, in County of

20 Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.
22 Id. at 426.
24 Id. at 611-12 (dictum).
Spokane v. United States,28 where the competing claim was for personal property taxes which under local law were a lien upon the specific property taxed and which arose prior to the federal lien, the Court initiated its concern with whether a competing lien was choate and perfected by finding that the particular lien involved did not partake of these characteristics since there had been neither a distraint nor a compliance with any of the procedures set out in the local statute. Federal priority was therefore obvious since, in effect, the Court determined that no competing lien existed. Similarly, in New York v. Maclay27 federal priority was found when the competing state claim was for taxes unassessed and unliquidated at the time the federal claim arose, despite the fact that under state law such taxes were a lien (1) in advance for the years in which they were due and (2) good against intervening claims of mortgagees and purchasers. The Court characterized the State’s lien as being of the nature of *lis pendens*, “a caveat of a more perfect lien to come.”28

But it was in *United States v. Waddill, Holland & Flinn, Inc.*29 that the Court gave fullest effect to the choate lien concept. There the competing claim was a landlord’s lien for rent arising under Virginia law, by which the landlord enjoyed authority to levy a distress for six months’ rent on any goods found in the rented premises. The goods could not be removed by another lienor or purchaser except by paying the rent due. The Supreme Court of Virginia had construed this to be a fixed and specific lien, not inchoate, existing independently of the attachment or distress which were merely remedies for enforcing it, and that it related back to the tenancy’s inception.30 But the United States Supreme Court found otherwise: “A state court’s characterization of a lien as specific and perfected, however conclusive as a matter of state law, cannot operate by itself to impair or supersede a long-standing Congressional declaration of priority.”31

The question of the applicability of the priority was held to be a matter of federal law. Testing the lien by its legal and practical effect, the Court found it to be neither specific nor perfected. On the date of the general assignment by the debtor-tenant, the event which gave rise to the federal priority, it was still uncertain whether the landlord would assert his lien, and until such assertion the six-month period to which the lien

26 279 U.S. 80 (1929).
27 288 U.S. 290 (1933).
28 Id. at 294.
29 323 U.S. 353 (1945).
30 182 Va. 351, 28 S.E.2d 741 (1944).
31 323 U.S. at 357.
would apply remained undefined. Possibly the lien would attach for an amount less than the six months' rent. The landlord may have been mistaken as to the exact amount of rent due or the tenant may have had a right of set-off. And as the extent of the lien was unknown, so too was the amount of the property affected. A prior mortgage may have existed upon any property found on the premises. Lastly, both legal title and possession of goods on the premises would remain vested in the tenant until attachment and assertion of the lien severed them from the debtor's estate.

In sum, it will be seen that choateness, at least for the purposes of the federal priority in the case of insolvent debtors, is composed of three elements: (1) the lien must be specific in amount; (2) the property to which it attached must be identified; and (3) the lienor must be known. This means that the exact amount of the underlying claim must be known; that there should be no contingency upon which the property subject to the lien could escape, e.g., a third party might have a superior claim; that the lien must be perfected, including compliance with all steps prescribed by the statute creating the lien, and if necessary, the execution of a levy or a distraint prior to the time the federal preference arises.

The requirement of perfection is, in reality, only an extension of the requirement of specificity since it would be only after the property was attached and sold, and the claim satisfied, that the requirements laid down by the Court as to definiteness could be fulfilled. Only then could the exact amount of the claim and the exact amount of property needed to satisfy it be known. And only then would there be no contingency which might defeat the lienor's right to gain satisfaction from a particular piece of the debtor's property.

The intrusion of the choateness concept into Supreme Court consideration of federal tax lien problems appears to have first occurred in United States v. Security Trust & Sav. Bank,32 wherein a creditor suing a debtor on an unsecured note commenced the action by attaching certain of the debtor's real property. Before the creditor recovered a judgment, the federal government filed its notice of a tax lien. The United States Supreme Court reversed the California decision33 that the creditor had priority over the federal tax lien. After asserting the federal court's power to decide a question dealing with the priority of a federal lien, the Court went on to hold that since the attachment lien was classified

by the state court as contingent, the subsequent federal lien was superior. The Court held that only a choate, i.e., a specific and perfected, lien could defeat the federal tax lien. As precedent it cited cases dealing with the federal priority in the case of an insolvent debtor. Noting the similarity between the lien and priority, the Court concluded: "If the purpose of the federal tax lien statute to insure prompt and certain collection of taxes due the United States from tax delinquents is to be fulfilled, a similar rule must prevail here."34 Justice Jackson, in a separate concurring opinion, felt that the history of federal tax lien legislation required the majority's result, but did not allude to any analogy with the priority provision.35

United States v. City of New Britain36 subsequently confirmed the presence of the choate lien test in the tax lien area. There a state court's award of priority to a city's pre-existing liens for taxes and water rents was reversed by the Supreme Court in subordination to a federal tax lien, even though the federal tribunal accepted the state court's finding that the local liens were specific. Indeed, the Court went on to say, "[T]he liens may also be perfected in the sense that there is nothing more to be done to have a choate lien—when the identity of the lienor, the property subject to the lien and the amount of the lien are established."37 However, the local tax and water rent liens failed because they had not assumed this choate character before the federal tax lien attached. In effect, the Court took the old rule of priority for competing liens of "first in time, first in right,"38 and appended a further requirement of choateness if the nonfederal lien was to be superior to that possessed by the federal government.

Thereafter, numerous tax lien cases came before the Court and in each the competing lien failed for lack of choateness at the time the federal lien attached. In United States v. Acri39 the competing lien arose from an attachment preparatory to a creditor's suit against the taxpayer for a wrongful death. As in United States v. Security Trust & Sav. Bank40 the federal lien arose after the attachment but prior to the judgment in favor of the competing lienor. As in Security Trust the tax lien was held

34 340 U.S. at 51.
35 Ibid.
37 Id. at 84.
38 Id. at 85.
superior. The only distinction in favor of the attaching creditor in *Acri* was that under the governing state law in his case, the lien was considered perfected as of the time of attachment, while in the *Security Trust* case the lien was considered contingent. The Supreme Court brushed by the distinction and concluded: "[T]he attachment lien in Ohio is for federal tax purposes an inchoate lien because, at the time the attachment issued, the fact and the amount of the lien were contingent upon the outcome of the suit for damages."41

For the same reasons the federal lien was held superior to a garnishment lien under substantially the same circumstances in *United States v. Liverpool & London & Globe Ins. Co.*, 42 and in *United States v. Scovil*43 a landlord's lien was found inchoate and junior to the federal lien at the time the latter arose. Finally, in a series of per curiam opinions the Court found a materialman's lien and several mechanic's liens to be junior to the federal tax lien.44

As these cases indicate, the application of the choateness test to the federal tax lien area has, in effect, made the lien of section 6321 substantially similar to the federal priority in the case of insolvent debtors.45 In the development of both lines of decisional law, it was first determined that the competing lien must be choate, and then, that the choateness required was to be measured by federal rather than state standards. Whether it has been proper, absent congressional direction, to strike such a parallel in interpreting the tax lien provisions, or whether such parallel development of the law has achieved a desirable result are questions not presented here. Of central interest only is the practical effect of the choateness requirement upon the particular situation where the federal lien arises after a mortgage is recorded but before a payment by the mortgagee of state taxes assessed against the mortgaged property.

As previously noted, courts reviewing such situations, as in *United States v. Bond*,46 have generally applied the choate lien test and have held the federal lien superior. Thus the *Bond* court after analyzing the origin and development of the test, stated: "We have derived an indelible impression from the cases . . . decided by the Supreme Court, which

---

41 348 U.S. at 214.
46 279 F.2d 837 (1960).
reveal the persistent application of the choate lien test, first in insolvency cases, then in statutory lien cases, and finally in nonstatutory contractual lien cases."47 The court went on to conclude that the choate lien test applied in the case of mortgages: "[W]e reach the conclusion in the instant case that the claimed priority ... must be subordinated to the federal tax lien because such lien so acquired by the mortgagee was unperfected and inchoate at the time the federal tax liens were recorded."48

In effect the choate lien test operates so that the mortgagee is protected for amounts secured by the mortgage up to the time the federal lien arises and notice of it is recorded. After that time any part of the mortgagee's lien which is not choate, "in the federal sense," will necessarily be junior to the tax lien.

II

Problems Involved in the Application of the Choate Lien Test to a Mortgage

Though Bond is the most complete and considered opinion on the subject, its application of the choate lien test to a mortgage raises a number of questions which the opinion does not answer.

The court in Bond applied the test upon the theory that the Supreme Court intended it to be applied in all cases where a federal tax lien is involved without regard to the nature of the competing interest. However, all but one49 of the cases the Supreme Court has considered have dealt with statutory liens. This pattern is significant, and the Bond decision's failure to account for it gives rise to the justifiable criticism that the court there transferred the choateness test developed in statutory lien questions to the altogether novel question posed by mortgage liens without sufficient regard for the reasons which prompted the test in the first instance. As noted, the test developed when the Supreme Court had to deal with claims competing with the federal priority in insolvency cases. A way had to be developed to protect the priority from dilution by constant subordination to a host of various nonfederal lien claimants. The choateness test, given the strict requirements of specificity and perfection, accomplished this purpose by requiring, in effect, that the lien reach the execution stage before it could withstand the federal priority. But so strict is the test thus applied that the Court, much as Diogenes in his quest for the honest man, has yet to find a choate lien. In the tax

47 Id. at 845.
48 Id. at 846.
delinquency area the purpose to be accomplished is somewhat less stringent, for in this field Congress did not create a priority, but only a lien. Still there is some purpose for the use of a restricting device, and that purpose, although the Court has been most reticent upon the subject, would seem to be the protection of the federal lien from the arbitrary manipulation of lien priorities by state statutes. Thus, the Court in New Britain indicates what might occur if such a protection were not available.

Such inchoate liens may become certain as to amount, identity of the lienor, or the property subject thereto only at some time subsequent to the date the federal liens attach and cannot then be permitted to displace such federal liens. Otherwise, a State could affect the standing of federal liens, contrary to the established doctrine, simply by causing an inchoate lien to attach at some arbitrary time even before the amount of the tax, assessment, etc., is determined.50

The Court’s concern is with the relation-back feature of statutory liens, and what it is seeking to prevent is the subordination of federal tax liens to an obligation which arises subsequently, but which by virtue of state law is transferred back in time to a point previous to when the federal claim attached.

In all the cases in which the Supreme Court has found the federal lien to be superior, with one exception,61 the competing lien has been contingent in the sense that it looked forward to a judgment to give it real meaning and effect. Or as the Court has characterized it, each has merely been “a caveat of a more perfect lien to come.” In Acri and Security Trust the competing interest was an attachment lien. In United States v. Liverpool & London & Globe Ins. Co.62 a pre-judgment garnishment lien was involved. In United States v. Scovil63 the competing interest was a landlord’s lien. In United States v. Colotta, United States v. Vorreiter, and United States v. White Bear Brewing Co. the competing interests were mechanic’s liens, while in United States v. Hulley a materialman’s lien was subordinated.64 In each of these cases an obligation legally enforceable against the property did not arise until a judgment was obtained by the lienor. In each the lien served merely to protect a portion of the debtor’s property, in effect to keep it available for satisfaction of a possible future judgment. Thus it would seem that

50 347 U.S. at 86.
64 Cases cited note 44 supra.
the choateness test is merely another way of saying that the real interest of the competing claimant vests when his claim is reduced to judgment, and it is only at this point that he will have an interest superior to a subsequent federal tax lien. On the other hand the lien for taxes vests the interest of the United States as of the time the tax is assessed in the collector's office. Hence where the Government's interest vests at a time when the competing claimant is merely in the first stages of perfecting his interest, i.e., where he has just attached or garnished, the latter will naturally have to be subject to the former. This theory is supported by the Court's action in White Bear Brewing Co., where the competing claimant had a mechanic's lien and had already brought suit upon the claim it secured when the federal lien attached. The Court, in a per curiam decision, held that the federal lien was superior, even though the mechanic's lien was specific in that the lienor was known, the property affected was identified, the amount of the lien was fixed, and all that remained to be done was to have final judgment entered on the lien. Clearly, the implication here is that, when the Court says a lien must be choate, it means that it must be reduced to judgment. Similarly explained is the language in New Britain wherein the Court states that what is meant by choate is that nothing more need be done.55

The mortgagee on the other hand does not look to the future for a judicial creation of his right. The obligation of the mortgagor is impressed upon the property at the time the mortgage instrument is executed. There is a conveyance of an interest in the property to secure the debt.56 Subsequent proceedings, whether a foreclosure in the strict sense, a judicial sale, a sale pursuant to a power contained in the mortgage, or, in the case of deeds of trust, a sale by the trustee, do not create the right, as in the case of a judgment, but serve merely as means of enforcement of that right.57 Since the obligation comes into being at the time of the execution of the mortgage, there is no problem of relation-back to be protected against by the application of the choateness test. The only uncertainty at the time the federal lien arises is the exact amount of the obligation.

The court in Bond, however, felt that the decision in United States v. R. F. Ball Constr. Co.,58 the single nonstatutory lien case which the Supreme Court has considered, indicated the latter Court's belief that

55 347 U.S. at 84.
56 1 Glenn, Mortgages § 5.1 (1943).
57 Id. §§ 5, 57.
the choate lien test was properly applied to mortgages. In the Ball case the claim competing with the federal tax lien was that of a surety company which had accepted an assignment from the taxpayer of retained percentages owed the taxpayer by a general contractor. The assignment was to stand as collateral to protect the surety company for all defaults under the bond given at the time of the assignment or under any future bonds. After the federal lien for taxes had been filed, the surety company became obligated upon one of the bonds given for the taxpayer and sought to reach the funds in the hands of the general contractor. The lower court held that the surety had a right to the funds superior to the federal tax lien, on the theory that the assignment was a mortgage under state law and was therefore given priority by section 6323(a). The Supreme Court reversed in a per curiam decision which stated that since the “instrument” involved was inchoate it was not protected by section 6323(a). Four Justices dissented. The majority opinion does not make clear whether or not it had accepted the lower court’s holding that the assignment was a mortgage. Its conspicuous avoidance of either term in using the word “instrument,” as if deliberately to obscure its meaning, leads to speculation that the Court may not have intended to hold that the choateness test would apply to mortgage situations. The mortgagee in Bond argued that the Ball Court could not have intended it to apply because it would have used a full opinion to announce so important a decision. Judge Haynsworth, the dissenter in Bond, speculates that the case may be interpreted merely as the Court’s way of saying that before a mortgage will be protected under section 6323(a), it must be a mortgage in the “conventional sense.” At any rate the decision is of questionable precedent value in the mortgage area since any interpretation that the majority of the Court intended to deal with a mortgage is conjecture.

If the choateness test, then, appears as the result of judicial effort to protect federal revenues from arbitrary manipulation by states of their lien laws, the question arises whether the rule should apply in an area in which Congress has spoken. Congressional interest in the relationship

---

59 279 F.2d at 845.
61 355 U.S. 587.
63 279 F.2d at 850-51.
64 It is interesting to note that the majority in Bond carefully avoid saying that the Ball case is an application of the choate lien test to a mortgage. They say only that it is authority for the use of the test in the “contractual lien” area. Id. at 845.
between the federal tax lien and the claim of the mortgagee is manifest from enactment of the forerunner to section 6323(a) of the 1954 Code which expressly made a prior recorded mortgage superior to the federal tax lien.65 Aside from purchasers, pledgees and judgment creditors, no other type of lien-holder has been thus protected. Since Congress has entered to balance the competing interests of the mortgagee and the tax collector, it can be argued that judicial balancing, such as is found in the case of the non-protected lien-holders, is not appropriate.

Strict application of the choateness test necessarily induces doubt as to whether any amounts secured by the mortgage will be superior to a subsequent federal tax lien. As noted, the time of attachment, with notice, of the federal lien is the reference point for the determination of what amounts of the competing claim are choate. Viewed from that aspect, the competing interest must be specific in amount, the property must be identified and the lienor must be known. Applying the test developed in the insolvency cases to the mortgage claim, it can be argued that neither the principal nor the interest is certain in amount, and in some cases, neither will the particular property be identified at the time the federal lien attaches. The principal is uncertain since at that time there is no way of knowing when the mortgagor will default, if at all. The mortgagee's claim for principal is rendered further uncertain in amount by the possibility that the mortgagor may have a right of set-off against the mortgagee. If several parcels of real estate are secured by the mortgage, identity of the particular parcels necessary to satisfy the mortgagee's claim will likewise be unknown because under the doctrine of "marshalling the assets," the court at the time of foreclosure is free to set aside one or two of such parcels to satisfy the mortgage claim, using the remainder to meet the demands of junior lien claimants.66 The interest accumulating on the principal is subject to even greater uncertainty since, in addition to the above factors, there exists the strong possibility that additional or penalty interest might accrue where the installment payments of the mortgagor are tardy or in default.

These observations make it evident that strict application of the choate lien test would render inchoate all amounts secured under a mortgage, including both principal and interest. But this result would hardly comport with the congressional intent supporting section 6323(a) since Congress, by no stretch of the imagination, could have intended by that section to hold the mortgagee safe from the secret lien only to allow

66 2 Glenn, Mortgages § 292 (1943).
his security to be devoured by the choate lien test. Nor does the court in Bond apply the test so strictly, but rather it avoids this unseemly result by applying the test only to that covenant of the mortgage providing that taxes paid by the mortgagee will be added to the mortgage debt.\(^\text{67}\) The distinction is arbitrary, however, because the provision for taxes paid is just a little less choate as measured by the standards of the Supreme Court than is the covenant which protects the principal and interest. Nor does the court in Bond suggest, in explanation, any basis for such a distinction. The atomization of the mortgage into a group of separate liens, with some susceptible and others immune to the choate lien test, appears unjustified and further indicates that the test of choateness is ill-fitted to the mortgage field.

III
THE FEDERAL LIEN AND THE MORTGAGOR'S PROPERTY

Another difficulty with the approach of those courts which give the federal tax lien superiority over the mortgagee's claim for taxes paid is that the property aspects of the problem are ignored.

Under section 6321, the Government's lien for taxes attaches to the "property" or "rights to property" of the delinquent taxpayer. Consequently, the first step in measuring the extent to which the Government may impress its lien upon mortgaged property is to determine what property or rights to property the delinquent mortgagor has. Since section 6321 creates no property rights, but merely attaches federally defined consequences to rights created by state law, resort to the latter is essential in making this determination.\(^\text{68}\)

The special property interest created by a mortgage is distinct from that created by any other lien. Originally, the mortgage was a conveyance of the land vesting full legal title in the mortgagee.\(^\text{69}\) Over the years, however, the mortgagor's rights have so developed as to embrace a considerably larger estate in the mortgaged property, to the point that today, in a majority of states, the mortgagor has a full legal estate and the mortgagee has only what is termed a "security interest."\(^\text{70}\)

For convenience, courts generally have come to refer to this interest as a lien because of a similarity of appearance. However, this judicial shorthand should not be taken to mean that the mortgagee's interest is

\(^{67}\) The court also applied the choate test to subordinate a claim for attorney's fees paid by the mortgagee and secured by the mortgage. 279 F.2d at 846.


\(^{69}\) 1 Glenn, Mortgages § 2 (1943).

\(^{70}\) Id. § 31.
nothing more than an ordinary lien. Unlike the ordinary lienor the mortgagee is conveyed an interest in the property by the mortgagor. A recognition of the conveyance in a mortgage is implicit in the Thelusson case where, it will be remembered, the Court refers to mortgaged property as property which has been divested from the debtor's estate.

What the mortgagor conveys is an interest sufficient to cover the obligation he has incurred to the mortgagee. That obligation includes not only the principal and interest but also the debt which may be incurred by virtue of the mortgagee's rights either expressed in the mortgage or arising by virtue of state law. Such rights include the right to pay taxes on the property in order to prevent foreclosure by local authorities. The interest the mortgagor retains after the conveyance, regardless of whether designated as an equitable or legal estate, is his equity of redemption. This equity of redemption is nothing more than the excess of the value of the property over what is necessary to pay the mortgage obligation. During the life of the mortgage the exact value of the equity will fluctuate with the value of the property and the amount of the obligation. The value of the equity at the time it is cut off by judicial sale, foreclosure, or other method recognized by local law, is represented by the surplus remaining after payment of the debt secured by the mortgage. This quantum is the measure of his property interest.

Since the federal lien attaches to the equity of redemption, it attaches only to the surplus after the mortgage obligation is satisfied. The vice of decisions allowing the federal lien priority over the local taxes paid by the mortgagee is that the Government ends up with a greater interest than the mortgagor enjoyed since the latter's equity of redemption would be reduced by the amount of taxes paid by the mortgagee.

Two recent decisions illustrate the Supreme Court's awareness that earlier recorded federal tax liens will not always enjoy priority over competing liens when state law affects the taxpayer's property interest in the corpus sought by the liens. In both United States v. Durham Lumber Co. and Aquilino v. United States a federal tax lien arose prior

71 United States v. Commonwealth Title Ins. & Trust Co., 193 U.S. 651 (1904); Flagg v. Walker, 113 U.S. 659 (1885); Terrell v. Allison, 88 U.S. (21 Wall.) 289 (1874); 1 Glenn, Mortgages § 3 (1943).
73 Osborne, Mortgages § 173 (1951).
74 1 Glenn, Mortgages § 37 (1943).
75 3 Powell, Real Property § 467 (1952).
77 363 U.S. 509 (1960).
to the filing of notice of a competing mechanic's lien. In holding in favor of the competing lien in the first case, on the ground that under North Carolina law the taxpayer's property interest to which the federal lien could attach was limited to the amount left over after the satisfaction of subcontractors' claims, and in reversing the Government's judgment in the latter and remanding for purposes of clarifying the nature under New York law of the taxpayer's property interest in a corpus concurrently sought by subcontractors and the Government, the Court stated:

In answering that question [what is the taxpayer's property interest in the fund], both federal and state courts must look to state law, for it has long been the rule that "in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property . . . sought to be reached by the statute."78

The Court went on to establish the relative role of federal and state law in the tax lien field:

The application of state law in ascertaining the taxpayer's property rights and of federal law in reconciling the claims of competing lienors is based both upon logic and sound legal principles. This approach strikes a proper balance between the legitimate and traditional interest which the State has in creating and defining the property interest of its citizens, and the necessity for a uniform administration of the federal revenue statutes.79

IV

Congressional Purpose: Justice and Practicality

The express language of Congress in section 6323, it must be noted, significantly employs the term "mortgagee." In interpreting this section,80 the Court in United States v. Gilbert Associates81 states that the terms therein must be assumed to have been used in their usual and conventional sense. The dissent in Bond, taking this view, maintained:

Congress did not prefer the principal of the mortgage debt, it preferred the mortgagee. If the word is to be given its usual meaning the preference cannot be limited to the mortgagee's right to repayment of the principal of the mortgage debt. It extends to all those rights which the Congress must have known the mortgagee commonly and usually possesses.82

Commonly and usually, taxes paid by the mortgagee enjoy the priority

78 Id. at 512-13.
79 Id. at 514.
81 345 U.S. 361, 364 (1953).
82 279 F.2d at 851.
of the mortgage.\textsuperscript{83} The law is well settled that if the mortgagor fails to pay taxes on the property, the mortgagee may pay the taxes and add the amount so paid to the mortgage debt. The amount due for taxes and the amount due on the mortgage are regarded as a single indivisible debt.\textsuperscript{84} Though this characteristic of indivisibility has been criticized on the grounds that the debt is technically divisible because the debt for taxes is quasi-contractual while the mortgage debt is consensual, the propriety of the result attained by the courts in overlooking the technicality is not denied.\textsuperscript{85} Furthermore, this technical criticism would apparently cease to exist when tax payments are so provided for in the mortgage as to render the debt for taxes consensual.

The difficulty in according such common and usual rights to the mortgagee in tax lien cases appears to be that the mortgagee is thereby given power to defeat the federal tax-lien priority over a later accruing city tax lien. The root of the problem, of course, stems from the refusal of some States to postpone their taxes in order to allow the individual mortgagee superiority. Nevertheless, the courts must accomplish the reasonable purpose of the federal statute within the framework of existing state law without regard to the foresight which has been used by individual state legislatures.

At first blush it would seem that the mortgagee should not be allowed to defeat the priority of the federal lien by payment of the local ad valorem taxes, thereby raising such taxes to the preferred position of a mortgage. However, it is submitted that where such payments are necessary to protect the mortgagee’s security, priority should be accorded them if the express purpose and language of the statute\textsuperscript{86} is not to be flouted by the courts. This minimum protection requires that a determination be made as to when payments are necessary for preservation of the mortgagee’s security, which in turn requires a determination as to whether amounts due the mortgagee could be recovered by him through foreclosure at the time of the first default occurring after a federal tax lien has been filed. The amount to be considered as recovered for the purposes of this comparison would have to be net of all charges against the proceeds of sale which could not have been prevented by the mortgagee. Among such items should be taxes due on the property at the time of

\textsuperscript{83} Osborne, Mortgages § 173 (1951); Annot., 123 A.L.R. 1248-49 (1939); Annot., 84 A.L.R. 1366, 1379 (1933).
\textsuperscript{84} Osborne, Mortgages § 173 (1951).
\textsuperscript{85} Ibid.
\textsuperscript{86} Int. Rev. Code of 1954, §§ 6321, 6323(a), (c).
foreclosure. If amounts due can be recovered by foreclosure, then it might be argued that the mortgagee has been afforded the protection intended by Congress since any subsequent payments could be said to have been incurred with notice that a federal tax lien had attached.

Even this solution presumes that the mortgagee is to be burdened with a search of the records for tax liens filed against the property each and every time he chooses to pay the ad valorem taxes. It likewise presumes that Congress intended to burden the mortgagee with making a determination as to whether he could recover his investment by immediate foreclosure at the time of the first default and at each subsequent date that he elects to pay the taxes. More importantly it ignores the fact that

when the mortgage was entered into, the mortgagee, in good faith and for value, risked the money loaned, partially on the strength of being able to protect itself against steadily mounting interest and penalties on unpaid local taxes, which are . . . [under state] law, liens prior to the mortgage. Now that the principal has been loaned, the Federal government is asserting its right to terminate this protective feature of the mortgage and appropriate to itself the increase in the proceeds of the sale brought about by the foresight and risk assumed by the mortgagee.

If the government's contention is to prevail, this penalty is to be inflicted although the mortgagee has done nothing to diminish the proceeds available for distribution, and has not profited from the activities which gave rise to the Federal tax lien.87

Thus it would not seem amiss to suggest that ad valorem taxes paid by the mortgagee should be allowed the priority of the mortgage debt regardless of when such taxes are paid.

A strikingly inequitable situation obtains in states such as New York where real estate taxes due at the time of foreclosure sale have been held to be expenses of sale, whereas taxes paid by the mortgagee are not awarded similar priority. The court in Co-operative Loan & Sav. Soc'y v. McDermott had termed this situation indefensibly inconsistent, explaining that:

[T]he mortgagee who fails to advance the money to pay delinquent local taxes will be protected out of the proceeds of the sale, although those proceeds are diminished by the local tax penalties which it has suffered to accrue, but the mortgagee who advances these tax payments, thereby increasing the proceeds available for distribution, is to be denied all protection.88

Another interesting situation is that created by virtue of the holding

88 Id. at 121, 204 N.Y.S.2d at 921.
of the *New Britain* case on the problem of circular priority, *viz.*, a local government may more readily collect its real property taxes when a mortgage is involved than when the taxed property is owned free and clear.\(^9\) A circular priority situation involves three liens: \(A\) which is prior to \(B\); \(B\) which is prior to \(C\); and \(C\) which is prior to \(A\). Commonly, \(A\) is a mortgage; \(B\), the federal tax lien; and \(C\), the city lien for taxes. The first case dealing with this problem held that since Congress made the mortgage prior to the federal tax lien, it must have intended all those liens which were by state law prior to the mortgage lien to be also prior to the federal tax lien.\(^6\) The Supreme Court held in *New Britain*, however, that Congress was not concerned with whether the state received its taxes or not and that accordingly, that portion of the proceeds in excess of the mortgage debt should be given to the federal government and the city’s tax lien should be satisfied from the amount awarded the mortgagee.\(^9\) Although the mortgagee thereby suffers less than full protection, this solution has been hailed as the least objectionable in so far as local legislation is respected and federal tax collection is not obstructed.\(^9\) Nevertheless, the conspicuous deficiency in the proposal is its inconsistency with clear congressional intent fully to protect the mortgagee.

By contrast, allowing the mortgagee priority as to taxes paid would be consistent with the ostensible purpose underlying the priority accorded his mortgage, *viz.*, the policy of encouraging credit to maintain the country’s economic well-being. In *Rikoon v. Two Boro Dress, Inc.*,\(^9\) which held local taxes due on the property at the time of foreclosure to be expenses of sale and thus superior, the New York court gave expression to this policy when it observed that a contrary holding "would jeopardize the entire mortgage market, both present and future. Mortgagees would hesitate to advance funds needed in such business transactions in the fear that on foreclosure they would not be made whole."\(^9\) Moreover, Congress in enacting the provision requiring notice as a condition precedent to federal tax lien priority, recites as one of its objectives the facilitation of business transactions.\(^9\)

---

\(^9\) This peculiarity is noted by Plumb, Federal Tax Collection and Lien Problems, 13 Tax L. Rev. 459, 516 n.783 (1958).


\(^9\) 347 U.S. at 88.

\(^9\) 67 Harv. L. Rev. 358-59 (1953).


\(^9\) Id. at 595, 171 N.Y.S.2d at 24.

An additional reason for allowing priority to the mortgagee is founded in the proposition that the mortgagee should not be penalized for attempting to maintain the floundering mortgagor in a position from which he may not only pay his mortgage debt, but the federal taxes as well. The justice of allowing the mortgagee recovery is further emphasized when it is remembered that the Government is a mere creditor, being neither a reliance creditor nor a purchaser.

In final response to the contention that if the mortgagee gains superiority as to local taxes paid in lieu of foreclosure, he may thereby reduce the assets available for satisfaction of the federal government's lien, suffice it to say that the federal failure to exercise the remedy of levy or foreclosure renders the Government equally responsible if additional claims against the estate are allowed to accrue after the federal tax liability arises.

**Conclusion**

From the foregoing it seems evident that under any reasonable interpretation of section 6323 and the choate lien test, as well as by proper recognition of the property rights involved, the mortgagee who has paid ad valorem taxes on the mortgaged property should be allowed a lien with respect thereto which would enjoy priority over the federal tax lien.

There is no reason to suppose that the Supreme Court of the United States will not so hold in the light of the justice of the rule and in view of the implications in the *Ball* dissent. Nor, as has been previously pointed out, is there any valid reason to imply from the decisions of the Court in the *Ball* and *New Britain* cases that a different rule prevails.

Significantly, the four-man dissent in *Ball* emphasized that the instrument involved was a mortgage. The emphasis would seem to indicate that one or more of the Justices constituting the majority did not consider the instrument involved to be a mortgage. Accordingly, were a case to be presented in which a mortgage is clearly the competing lien, it seems reasonable to assume that the choate lien test would not be applied and the position of the dissent would become the opinion of the majority. With respect to a mortgage lien, the dissent opined that the uncertainty of the amount secured thereunder is of no consequence, and pointed out that the obligation was sufficiently identified and that therefore, it was of no moment that such obligations were contingent and unliquidated.

Aside from the specific implications of the *Ball* decision, a generally...
liberal view towards competing liens is evidenced by recent decisions of the Court. The *Aquilino* and *Durham* decisions view the problem as one of determining the property interests to which the federal lien can attach rather than determining choateness. Moreover, the Court has held that federal tax liens on real estate which are junior to defaulted mortgages held on the same properties by other parties may be effectively extinguished by state proceedings to which the United States is not a party.\(^97\)

Therefore, it appears likely that, if not pre-empted by the legislature, the Supreme Court will allow the mortgagee priority when and if the issue is clearly presented. Legislative relief, however, from the harsh decisions of the *Bond* and other cases dealing with the problem appears even more imminent than does judicial relief. The American Bar Association Committee on Federal Liens has recommended to the ABA that local real property tax liens be accorded super-priority over the federal tax lien regardless of the time such lien accrued.\(^98\) The Committee notes that the United States has consented to the taxation of property which it acquires by foreclosure of insured mortgages. The Committee reported that “the rule of the *New Britain* case, as applied to state and local real property tax priorities, has caused the Government itself some administrative difficulty.”\(^99\) The report explains that in administratively discharging the federal tax lien by voluntary payment to the Government, the amount of money the Government is able to obtain for the discharge is lessened by virtue of the fact that state and local tax liens, subordinate to the federal tax lien, will become prior liens upon discharge of the federal tax lien. The report continues to say that some of the Internal Revenue Service offices will take cognizance of this fact and allow super-priority to state and local tax liens in computing the amount required for discharge. Also in favor of super-priority is the resulting decrease of circular priority cases which often arise by virtue of real property tax liens.\(^100\)

On the basis of the Report of the ABA Committee on Federal Liens, a bill has been submitted to amend the Internal Revenue Code of 1954 with respect to the priority and effect of federal tax liens,\(^101\) and a pro-

---

99 Id. at 30.
100 Ibid.
vision is included which gives priority to “a lien upon immovable or real property for any tax of general application levied by any taxing authority according to the value of such property” regardless of when such lien arises.\textsuperscript{102} Should this provision be enacted into law the question of the effect of payment of real property taxes by the mortgagee would become moot. Even if the super-priority provision is rejected, the bill, since it additionally provides that reasonable expenditures by the mortgagee to protect his security are to be accorded the priority of the mortgage debt,\textsuperscript{103} leaves open the question of what is a reasonable expenditure for purposes of forecasting the priority to be accorded taxes paid by the mortgagee. It is probable that under the latter provision ad valorem taxes assessed against the property would be considered such an expenditure.

In the absence of either judicial or legislative relief, reference to the analogous area of future advances is suggested as a means of self-help. The Government has indicated it would not claim a priority over obligatory advances made subsequent to the federal lien.\textsuperscript{104} Therefore, where advances have been made under a provision in the mortgage whereby the mortgagee is obligated to advance up to a specified amount for future ad valorem taxes assessed against the property, such advances would probably be held secured as a part of the original mortgage debt.\textsuperscript{105}

\textbf{George K. Dunham}  
\textbf{Mitchell J. Rabil}


\textsuperscript{103} H.R. 4319, 87th Cong., 1st Sess. § 6323(g) (1961).

\textsuperscript{104} See Plumb, supra note 89, at 496.

\textsuperscript{105} Id. at 525 n.843. This article, together with Plumb, Federal Tax and Collection Problems, 13 Tax L. Rev. 247 (1958), is highly recommended to those seeking a comprehensive coverage of the general area of federal tax liens.
Petitioning labor unions sought review of an order of the Atomic Energy Commission granting the Power Reactor Development Company (PRDC) a permit to construct an experimental nuclear power reactor at Lagoona Beach, Michigan, a site thirty miles southwest of Detroit. This construction permit was provisional, in that no operating license was to be granted until further safety findings had been made to supplement the qualified findings of safety which the Commission deemed presently adequate to allow construction. The petitioners challenged the permit on the grounds that insufficient safety findings had been made, in violation of the Atomic Energy Act of 1954. Their standing to seek court review was based on the safety hazard and consequent economic injury which would ensue from the future operation of the power plant. PRDC contended that petitioners lacked standing until presently affected by the grant of an operating license. The United States Court of Appeals for the District of Columbia, one judge dissenting, set aside the Commission’s grant of a construction permit and remanded the case for additional findings. Held, issuance by Atomic Energy Commission of construction permit following safety findings insufficient under statute for future grant of operating license constitutes sufficient aggrievement to give petitioners standing for court review of commission action.

At issue in the instant suit were the standing of the petitioning labor unions to seek court review and the reviewability of the Atomic Energy Commission’s interpretation of the Atomic Energy Act as to the safety standards required prior to the issuance of a permit to construct a nuclear reactor plant. Section 10(a) of the Administrative Procedure Act extends judicial review of ad-

---

3. PRDC is a non-profit corporation, consisting of fourteen public utilities and seven equipment manufacturers, organized to develop peaceful uses of nuclear energy. The Lagoona Beach reactor would be the largest developmental “fast breeder” type in the United States. Its mission is to utilize nuclear energy for the generation of electrical energy.
ministrative action only to those persons suffering legal wrong or aggrieved or adversely affected by agency action. The petitioners' opposition in the instant case to the construction permit did not stem from a present aggrievement, but was based upon one which could arise only in the future after the grant of an operating license by the Commission. The apparent remoteness of injury was accentuated by the fact that the construction permit provided for a further administrative finding prior to the grant of an operating license. By hearing the petitioners' case, the court rejected the strict interpretation of standing, which requires an immediately pressing impact, ⁶ in favor of a more liberal interpretation which is satisfied even when the alleged impact is insulated by and contingent upon future agency action.

This liberal approach to standing was suggested in *FCC v. Sanders Bros. Radio Station*, ⁵ where, although the petitioning broadcasting station had suffered no present infringement of a legal right, it was allowed standing to review the Commission's grant of a permit for the construction of a new station. In that case, the Supreme Court found adequate aggrievement in the fact that the petitioner was "likely to be financially injured by the issue of a license." ⁷ *Sanders* was the harbinger of other cases finding standing in future economic injury due to the increase in competition which would be effected by present, allegedly illegal administrative action. ⁸

The instant court was reluctant to overstep the economic injury test and consequently granted the petitioners standing "because it [the Commission's final order] threatens them with economic injury," citing *Sanders*. ⁹ The fact of the matter is, however, that the ultimate and principal aggrievement of the petitioners was the danger to the public health and safety which would be presented by an unsafe nuclear plant operating in close proximity to Detroit. For, if there had been no safety hazard there would have been no economic injury, insofar as the latter was predicated on the depreciation of real estate values which would have accompanied an unsafe plant. In effect, then, the court has extended the future economic injury test of *Sanders* and, pending action by the Supreme Court, has established standing whenever the aggrievement consists of future danger to the public health and safety.

In order to dispense with the argument that the petition was premature because the future aggrievement was contingent upon a further, affirmative safety finding, ¹⁰ the court restricted its recognition of standing based on safety

---


⁶ 309 U.S. 470 (1940).

⁷ Id. at 477.

⁸ E.g., *FCC v. NBC*, 319 U.S. 239 (1943).

⁹ 280 F.2d at 646.

hazards by noting that in the instant case there was a high degree of probability that an operating license would follow.\textsuperscript{11} This restriction prompted, in great part, Judge Burger's dissent\textsuperscript{12} in which he suggested that his colleagues overstepped the limits of judicial discretion by even considering the high probability of the issuance of the license, based as it was on the pressure which investors would bring to bear upon the agency to authorize operations once they had poured millions of dollars into construction.\textsuperscript{13}

It was the dissenter's contention that the court should have judicially restrained itself and acquiesced in the step-by-step procedure prescribed in the act; that it should have made an act of natural faith both in the Commission's interpretation of the act as to the degree of safety required at each stage, as well as in the Commission's determinations as to whether these safety standards were actually being met. To do otherwise, it was urged, is to judicially legislate and to impugn the integrity and ability of the Commission. At the heart of this conflict is the question of the extent to which a court can challenge the ruling of an administrative agency without overstepping those limits of judicial discretion which forbid encroachment upon an agency's congressionally granted powers. The instant court's answer, in effect, is that the court can challenge an administrative ruling whenever the agency, in its turn, has so transgressed its boundaries in applying the act as to effect "administrative legislation" on its part.

Section 182 of the Atomic Energy Act, entitled "License Applications,"\textsuperscript{14} and section 185, entitled "Construction Permits,"\textsuperscript{15} prescribe a two-step procedure requiring the issuance of a construction permit as a condition precedent to issuing an operating license. However, while section 182 requires that adequate protection be given to the health and safety of the public before an operating license is issued, section 185 mentions nothing of safety requirements other than what may be implied in the words: "For all other purposes of this chapter, a construction permit is deemed to be a 'license.'"\textsuperscript{16} This unfortunate failure of section 185 explicitly to require minimal safety standards antecedent to authorization of a construction permit enabled the Commission to read into the act the authorization of a double safety standard: one adequate to grant a permit, and a further one prerequisite to granting a license.

The Commission found this consonant with section 50.35 of its regulatory provisions\textsuperscript{17} which authorizes issuance of a provisional construction permit

\begin{footnotesize}
\begin{enumerate}
\item 280 F.2d at 647.
\item Id. at 652.
\item The court adopted the petitioners' estimate of $45,000,000 as the approximate cost of constructing the Lagoona Beach Reactor. 280 F.2d at 647.
\item Ibid.
\item 10 C.F.R. § 50.35 (1959).
\end{enumerate}
\end{footnotesize}
subject to the furnishing of further technical information which presently is not available. Given this leeway and tempted by the time which could be saved by a concurrence of research and construction, the Commission granted the construction permit based on its qualified finding "for the purposes of this provisional construction permit, that a utilization facility of the general type proposed in the PRDC Application and amendments thereto can be constructed and operated at the location without undue risk to the health and safety of the public." The Commission's awareness of the uncertain ground upon which it was treading was belied by the fact that this final ruling of May 26, 1959, amended an initial decision made on December 10, 1958, in which it had authorized construction only after it had unqualifiedly found that the plant could be both constructed and operated without danger to the public.

Far from being the result of a correct interpretation of the act, the safety requirements which the Commission adopted in the amendatory final ruling directly contravened it. Nowhere does the act either explicitly or impliedly authorize a double safety standard; to the contrary, it clearly intends that the safety requirements be uniform at both the permit and license stages. The two-step procedure outlined by Congress was not meant to authorize a double safety standard, but rather to prevent the harm which would ensue if a double standard were adopted. A double standard would absolutely deter investors from risking a costly venture whose very operation is contingent upon future agency approval, or encourage them to build now and, if needs be when the time comes, exert pressure to obtain a license. On the other hand, an identical standard, demanding the same safety requirements both at the time of construction and of operation, at once would encourage nuclear projects by assuring investors that operation would follow construction, and would entirely eliminate the possibility of pressures ever being employed, for there would be no need to employ them.

This single standard of safety required by the act would also preclude any pragmatic balancing of interests as was attempted by the Commission below. For it implicitly recognizes that this is a monster which we are harnessing, and public safety should not be subordinated to any carpe diem considerations of saving time. That this was the intent of the legislators was plainly indicated

18 The court quoted the Commission's observation that: "By proceeding with construction and further research and development simultaneously, rather than awaiting complete research and development results[,] Applicant will save several years in the time required to place in operation its demonstration power reactor." 280 F.2d at 650.

19 Id. at 649. (Emphasis added by the court.)

20 Id. at 649.

while the bill was pending, when Senator Humphrey, wishing to eliminate the dangers attendant upon a double standard, withdrew a proposed remedial amendment only after he had been assured that it was the intention of the act that the construction permit was equivalent to a license to operate.\textsuperscript{22} It is further indicated by regulation 50.35 which specifically requires reasonable assurance, \textit{not limited to the purposes of a provisional construction permit}, that the proposed reactor can be constructed \textit{and operated} without undue risk to the health and safety of the public.\textsuperscript{23}

Judge Burger's dissent notwithstanding, then, the majority holding did not judicially legislate, nor did it impugn the integrity and ability of the Commission. Rather, it preserved the act against the attempted interpolations of the Commission; it recognized the \textit{obstat principiis} principle embodied in the single standard of safety required by the act for the purpose of eliminating any situation where one would have even the occasion to pressure the Commission into authorizing operations at the expense of safety requirements.

The decision in the instant case was both sound and significant. It extended standing to parties whose rights to safety could be aggrieved in the future owing to present, illegal agency action, and it subjected to judicial review administrative action which contravened the obvious intent of congressional legislation. In its review, the court did not usurp the Commission's role by questioning the scientific validity of its safety findings; rather, it accepted these findings and then proceeded to remand the case for those further findings required by the act itself. Once the court had so decided, it indulged by way of dictum in judicial legislation by suggesting that it was the intent of Congress to require compelling reasons antecedent to locating a reactor near heavily populated areas.\textsuperscript{24} Although the requirement of "compelling reasons" is not found in the act, the court's suggestion indicates that undoubtedly PRDC's proximity to a heavily populated area influenced it to regard the Commission's liberal ruling with that cautious scrutiny which accompanies the "hasten slowly" philosophy which should characterize nuclear advancements.

Finally, the instant decision has brought into focus the shortcomings of the Atomic Energy Act with respect to safety standards. In view of the intrinsic danger presented by a reactor of this type, the act should spell out with maximum clarity the prerequisite safety requirements so that no doubt can exist as to what these are and so that there will be no twilight zone from which can emerge in the future a similar conflict between agency and judiciary.

\hspace{1cm}SALVATORE A. MAZZOTTA

\hspace{1cm}\textsuperscript{22} 100 Cong. Rec. 12014 (1954) (remarks of Senators Humphrey and Hickenlooper). III Legislative History, supra note 21, at 3759.

\hspace{1cm}\textsuperscript{23} 10 C.F.R. \textsection 50.35 (1959).

\hspace{1cm}\textsuperscript{24} The court adopted the Commission's finding that the "population distribution for given distances from the site is as follows: 1 mile, population 175; 2, 600; 5, 1,800; 10, 31,300; 20, 187,100; 30, 2,001,700." 280 F.2d at 651.
CIVIL PROCEDURE—District Court May Not Transfer Civil Action on Defendant's Motion to Another District or Division if Defendant Could Have Objected to Venue or Avoided Service, Had Action Been Brought There Originally. Hoffman v. Blaski, 363 U.S. 335 (1960).

Respondents Blaski and others, residents of Illinois, filed a patent infringement suit in a United States district court in Texas against a Texas resident and a Texas corporation not doing business in Illinois. Although defendants were not amenable to process in Illinois and statutory venue lay solely in Texas, the Texas district court, pursuant to defendants' motion for transfer of venue under section 1404(a) of the Judicial Code, removed the case to a district court in Illinois on the grounds that the latter court provided a more convenient forum. The Court of Appeals for the Fifth Circuit declined to vacate the removal order. Upon commencement of the action in Illinois, the district court there also declined to remand the proceeding to the Texas court where it had originated, but on writ of mandamus was reversed by the Seventh Circuit Court of Appeals. The Supreme Court granted certiorari and affirmed the Seventh Circuit's decision. Held, a district court may not transfer a civil action on defendant's motion to another district or division if defendant could have objected to venue or avoided service, had the action been brought there originally.

The question presented to the Court in the instant case was one that had confronted lower federal courts almost from the enactment of the transfer-of-venue statute: i.e., whether it is prerequisite to a proper transfer of venue at defendants' instance that the transferee court be one in which statutory venue and amenability of defendants to service of process existed at the time the action was originally commenced in the transferor court. Complicating the problem is the practical consideration that despite the plaintiff's disabilities respecting venue and jurisdiction, the transferee court in numerous instances will unquestionably provide the most convenient forum for hearing the action. Although a majority of the lower federal courts, who treated the question, had held that the defendant could waive objections to venue or service of process as a condition precedent to transfer, the Court in the instant case adopted the

1 28 U.S.C. § 1400(b) (1958) provides for venue over patent infringement actions: "(b) Any civil action for patent infringement may be brought in the judicial district where the defendant resides, or where the defendant has committed acts of infringement and has regular and established place of business."
2 28 U.S.C. § 1404(a) (1958) provides: "For the convenience of parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district division where it might have been brought."
3 Ex parte Blaski, 245 F.2d 737, 739 (1957).
absolute standard that both elements, as of the time suit was originally begun by plaintiff, were prerequisite to a change of venue.\footnote{8}

Critical to the resolution of the problem raised in \textit{Hoffman} was the significance of the closing phrase of section 1404(a): transfer is permitted to any district or division where the action "might have been brought."\footnote{9} Prior to enactment of this section, the forum non conveniens doctrine permitted dismissal of an action whenever the court in which it was commenced concluded that the case could best be heard in another jurisdiction.\footnote{10} Dismissal was discretionary with the trial judge, although an alternative forum necessarily had to be available to the plaintiff before such discretion might be exercised.\footnote{11}

Transfer could additionally occur where, although originally no alternative forum existed for plaintiff due to lack of both venue and opportunity for proper service of process, a defendant agreed to waive his venue rights and to submit to the necessary service in such alternative forum.\footnote{12} Because of the injustice that occasionally accompanied dismissal under forum non conveniens,\footnote{13} Congress in 1948 substituted a transferal procedure in dismissal's place, with the limitation attached that such transfer could be made only to a district or division where the action "might have been brought."

Two reasons led the majority of the Court to conclude that transfer was permitted only to those jurisdictions where defendants could have been served and in which statutory venue would have existed, that is, to be precise, where the action "might have been brought" \textit{originally}: (1) the "plain words" of section 1404(a)\footnote{14} and (2) the discrimination an opposite result would introduce against parties-plaintiff who would lack equal opportunity to change venue.\footnote{15} As to the first, the Court reasoned that since the statute spoke of transfer only to districts where the action "might have been brought," it would do violence to the language of the statute to allow transfer to any court in which plaintiff was without a right to bring suit. In contrast, the lower federal courts generally had not found the meaning of the statute so obvious; these held that since the requirements of venue and service of process were intended to protect defendants from vexatious forum shopping by plaintiffs, defendants

\footnotesize{\bibliography{bib}}
might waive them as a condition to obtaining a transfer. Thus where the action “might have been brought” was interpreted as “might have been brought at the time of transfer.” Justice Frankfurter, dissenting in the companion case of Sullivan v. Behimer, noted that the literal interpretation adopted by the majority, while grammatically plausible, was not the only interpretation available. “On the face of its words alone the phrase may refer to . . . venue, amenability to service, or period of limitations, to all of them or to none of them, or to others as well.”

The majority’s belief that a conclusion opposite to that which they reached would discriminate against plaintiffs rested on the assumption that to allow transfer on defendant’s motion to a district where plaintiff was originally closed from suing, because of venue and service of process requirements, would be to grant the defendant greater power in the selection of a forum than that enjoyed by ‘be plaintiff. Inherent in this rationale, however, is the fallacious belief that it was the intent of Congress in passing section 1404(a) to establish such mutuality of election; not only does this intent fail to appear in the legislative history of the section, but from the same source it is inescapably clear that 1404(a) was “drafted in accordance with the doctrine of forum non conveniens” which permitted dismissal on defendant’s motion even though an alternative forum had not been open to plaintiff as a matter of right. And certainly with transfer now substituted for dismissal, less reason appears for rigid insistence on an availability to plaintiffs of more than one forum at the time the action was originally commenced.

It would appear that the only meaningful mutuality sought by the statute is that the parties litigate in a forum which accommodates their mutual interest in convenience and justice. As the law now stands, plaintiffs generally enjoy the wider ability to litigate in a forum of their choice; it is incumbent on defendants who seek transfer to carry the burden of showing that “convenience” and “justice” may lie elsewhere. This discrimination, which, arising as a natural incident of adversary proceedings, has been happily minimized heretofore through the liberal interpretations of lower courts dealing with transfer, would appear to have been enormously amplified by the present ma-

---

18 Id. at 352.
19 Id. at 344.
20 Reviser’s notes immediately following 28 U.S.C. § 1404 (1958). This short comment is the only source of relevant legislative history.
majority in their very effort to avoid it. Better, perhaps, is the remedial interpretation advocated by Justice Frankfurter in his dissent, to the effect that the underlying conception of the statute is to provide for that forum which best ensures "fair dealing between litigants." This standard, however broad, would operate to protect not only defendants but plaintiffs as well in those instances where a defendant's motion for transfer under 1404(a) appears as forum shopping in reverse.

The most obvious result of the instant decision is the frustration of the statute's fundamental purpose. Hereafter, where a party forwards the strongest conceivable argument for transfer on the basis of convenience, the court will nevertheless be compelled to deny the removal if venue and service requirements could not have been met in the first instance in the transferee court. Furthermore, whatever discretionary power the statute assigned to the wisdom of lower federal court judges appears effectively obliterated by this decision. Moreover, the judicial practice of transferring causes with the consent of the parties from districts burdened with a prohibitive backlog of litigation to districts where hearing will be accelerated would now appear to face a serious impediment. Rather than imprison litigants in these statutory venue requirements, when defendants for whom such requirements were devised for protective purposes have for some time possessed the right to waive them, it is submitted that greater trust and confidence should be reposed in the ability of trial judges to act in the best interests of the parties. Abuse of such trust and confidence may be effectively remedied by appellate review. Considering the number of cases in which the issue of transfer will arise, a re-examination and articulate revision of the venue statutes by Congress to the end of curing the Court's narrow analysis in the instant case is thus to be highly desired.

WAYNE EMERY


Plaintiff's intestate, a New York domiciliary, was killed when defendant's plane on which he was a passenger crashed in Massachusetts on a flight from New York where the intestate's flight ticket was purchased. Suit was brought in New York. The first of three causes of action by the complaint was

23 For an analysis of the remedial character of section 1404(a), see Ex parte Collett, 337 U.S. 55 (1949).
24 363 U.S. at 365.
based upon the Massachusetts wrongful death statute which limits recovery to $15,000. The second, alleging a breach of defendant's contract for safe carriage, claimed damages in the amount of $150,000, the estimated loss of decedent's cumulative prospective earnings.

The trial court's denial of defendant's motion to dismiss the second cause sounding in contract for insufficiency was reversed by the Appellate Division, which was in turn upheld by the Court of Appeals, all seven judges agreeing that the cause sounded not in contract, but in tort, and that moreover a cause in contract could not survive the death of plaintiff's intestate. But two separate concurring opinions objected to the further holding, 

\textit{su a sponte}, by the majority, which granted the plaintiff leave to amend the first count to conform to his desire for damages beyond the $15,000 limit imposed by the Massachusetts wrongful death statute. \textit{Held}, a limitation of damages in a foreign wrongful death statute is a procedural provision not binding upon the forum whose public policy requires unlimited recovery for the wrongful death of its domiciliaries.\footnote{1 Kilberg v. Northeast Airlines, Inc., 9 N.Y.2d 34, 172 N.E.2d 526, 211 N.Y.S.2d 133 (1961).}

A majority of American authorities holds that a foreign damage limitation measuring the extent of a right to sue for wrongful death under a foreign statute is not procedural or remedial, but substantive law, irrefragably a part of the right itself and therefore applicable by the forum court.\footnote{2 Western Union Tel. Co. v. Brown, 234 U.S. 542 (1914); Northern Pac. Ry. v. Babcock, 154 U.S. 190 (1894); Leichti v. Roche, 198 F.2d 174 (5th Cir. 1952); Barnes v. Union Pac. R.R., 139 F. Supp. 198 (D. Idaho 1956); Manhattan Credit Co. v. Skirvin, 228 Ark. 913, 311 S.W.2d 168 (1958); Jackson v. Anthony, 282 Mass. 540, 185 N.E. 389 (1933); Rodney v. Staman, 371 Pa. 1, 89 A.2d 313 (1952). See generally Goodrich, Conflict of Laws § 105 (3d ed. 1949); Restatement, Conflict of Laws §§ 391, 412, 417 (1934); Stumberg, Conflict of Laws 152 (2d ed. 1951); Goodrich, Damages for a Foreign Wrong, 3 Iowa L. Bull. 1 (1917), and collection of older cases cited therein at 16 n.49.}

One argument supporting the thesis states that since the right to sue for wrongful death is granted by statute in derogation of the common law,\footnote{3 No right to sue for wrongful death existed at common law. Statutory relief was obtained with the passage of Lord Campbell's Act in England, Fatal Accidents Act, 1846, 9 & 10 Vict., c. 93, which has served as the prototype for similar wrongful death statutes adopted in all fifty states.} a limited-damage provision has the effect of defining the right, by measurement, and impliedly carries with it the caveat that beyond X dollars there is no right of recovery for wrongful death.\footnote{4 9 N.Y.2d at 46, 172 N.E.2d at 532, 211 N.Y.S.2d at 142 (concurring opinion).} The more negatively conceivcd argument has been made that damage limitations are not procedural, because they do not meet the definition of laws which relate "to the process or machinery by which the facts are made known to the courts."\footnote{5 Lorenzen, The Statute of Frauds and Conflict of Laws, 32 Yale L.J. 311, 325 (1923).} A third motivation for re-
garding such limitations as substantive was expressed in *Slater v. Mexican Nat'l R.R.*, where the United States Supreme Court found it "unjust to allow a plaintiff to come . . . absolutely depending on the foreign law for the foundation of his case, and yet to deny the defendant the benefit of whatever limitations on his liability that law would impose." It was against an array of massive authority employing these or analogous arguments that the *Kilberg* court threw itself in refusing to follow the damage-limitation provision in the Massachusetts wrongful death statute under which suit had been brought.

The New York Court of Appeals employed two instruments to perpetrate its heresy, either one of which alone would probably have been sufficient for the purpose: (1) New York public policy, constitutionally expressed, against any limitation on damages recoverable for personal injury resulting in death, and (2) the forum state's long-sustained power to determine by its own standard which foreign law advanced by a litigant for application is substantive and which procedural, irrespective of what the foreign state may have said, and the concomitant power to discard all foreign law consequently denominated procedural in favor of the procedural provisions of the forum.

The court first decided that New York should venture to protect her own people "against unfair and anachronistic treatment" at the hand of foreign laws, since the location in which air passengers engage catastrophe under contemporary transport conditions is "entirely fortuitous." In legal support for this urge the court then summoned the New York constitution, revised in 1894 to forever prohibit abrogation of the right to recover damages for wrongful death, a revision which overrode earlier legislatively imposed limitations on the amount of recovery permissible under the New York wrongful death statute, and which therefore evinced by implication probably sufficient contrariety of public policy in New York to justify a refusal to honor the Massachusetts limitation. Moreover, the court was able to advert to two of its earlier opinions which lent some support to its present

---

6 194 U.S. 120, 126 (1904).
7 "The right of action now existing to recover damages for injuries resulting in death shall never be abrogated; and the amount recoverable shall not be subject to any statutory limitation." N.Y. Const. art. I, § 16 (1938) (formerly art. I, § 18 (1894)).
9 9 N.Y.2d at 39, 172 N.E.2d at 528, 211 N.Y.S.2d at 135.
10 Id. at 39, 172 N.E.2d at 527, 211 N.Y.S.2d at 135.
12 N.Y. Deced. Est. Law § 130.
conclusions; unsurprisingly, the court bypassed citation of a number of subsequent lower New York court cases which, together with federal interpretations of New York law, have suggested an opposite result.

But if any question, constitutional or otherwise, could exist as to the propriety of denying effect to the Massachusetts limitation on public policy grounds, the court took the further step of exercising the forum's prerogative to define the nature of foreign law, and thus by finding the Massachusetts limitation procedural easily precluded its application under traditional conflict-of-laws theory.

Despite several practical difficulties foreseeable in the aftermath of this decision, little argument can be offered against its constitutionality. The concurring opinion's tantalizing statement that "we have grave doubts as to the constitutionality of the majority view in light of the decision of the Supreme Court of the United States in Hughes v. Fetter . . ." is without merit, since in a footnote to the Hughes opinion the Court appears to have said there that once having recognized a foreign right arising under a foreign statute, and accepted suit to enforce it, the forum court may constitutionally apply its own law rather than that of the foreign state "to measure the substantive rights involved." If "to measure the substantive rights" may be interpreted to mean the forum court may determine, for example, the limitation or lack of limitation on damages for the foreign injury, that is, may determine what procedural law to apply, Hughes does no more than restore the Kilberg critic to his original vantage point where he pondered what is substantive law, and what procedural or remedial; for the Hughes opinion, denying Wisconsin's power to refuse to entertain a suit for wrongful death under the Illinois wrongful death statute, presupposed that substantive rights had been defined, whereas exactly whether to include or exclude the foreign measure of damages in the substantive right category was the major question in the instant case.

The resolution of this question, at least with respect to statutory provisions relating to measure of damages, time limitations for suit, burden of proof and


16 See generally Ailes, supra note 8; Cook, supra note 8.

17 9 N.Y.2d at 51, 172 N.E.2d at 535, 211 N.Y.S.2d at 146.

the like, does not involve constitutional considerations, as the Supreme Court pointed out in \textit{Wells v. Simonds Abrasive Co.}\textsuperscript{19} when it found that the full faith and credit clause does not compel the forum state to apply the statute of limitations promulgated by a foreign state. The \textit{Wells} Court went on to remark that the fact that the foreign limitation on the right to suit was integrated to the same statutory section which granted that right, as compared with a general limitation arising from the common law, was a difference “too unsubstantial to form the basis for constitutional distinctions under the Full Faith and Credit Clause,”\textsuperscript{20} an observation pertinent to \textit{Kulberg} where the discarded Massachusetts provision for damages was integrated to the section granting the right to sue for wrongful death.\textsuperscript{21} Thus it is generally correct to observe that no constitutional provision compels the forum to include certain types of foreign law in the substantive category, and until a foreign law is so included, and then not applied on policy grounds, the concurring opinion’s reliance here on \textit{Hughes} in disapproval of the majority’s conclusion is inappropriate.

The court’s several references to protecting “the traveling citizen of our State,” “our own State’s people,” and to disregarding a ceiling on damages “at least as to our domiciliaries” unavoidably raise the question whether a non-domiciliary (non-citizen) suing in New York under a foreign wrongful death statute which contains a limitation on damages will receive the benefits of New York public policy commensurate to that obtained, by way of opportunity for unlimited damages, by the domiciliary decedent’s estate in the instant case. If unlimited damages in derogation of the foreign statute are allowed in a suit brought on behalf of the decedent non-domiciliary, the undesirable result will be the promotion of forum-shopping which conflict-of-laws principles are concerned with minimizing. If on the other hand, recovery in a suit on behalf of the non-domiciliary is limited in accordance with the foreign statute, this arbitrary discrimination would seemingly run afoul of the privileges and immunities clause of article IV of the federal constitution. For while a State may discriminate against non-residents in favor of residents when some rational and reasonable basis for discrimination exists,\textsuperscript{22} the Supreme Court has clearly indicated that the discrimination may not be based solely on plaintiff’s out-of-state citizenship without violating privileges-and-

\textsuperscript{19} 345 U.S. 514 (1953).
\textsuperscript{20} Id. at 518.
\textsuperscript{22} Douglas v. New York, N.H. & H.R.R., 279 U.S. 377, 387 (1929); cf. Missouri ex rel. Southern Ry. v. Mayfield, 340 U.S. 1 (1950). Here Mr. Justice Frankfurter noted that “if a State chooses to ‘[prefer] residents in access to often overcrowded Courts’ and to deny such access to all non-residents, whether its own citizens or those of other States, it is a choice within its own control.” Id. at 4. (Emphasis added.) See Canadian No. Ry. v. Eggen, 252 U.S. 553 (1920).
immunities protections afforded by the Constitution. Of course, the spectre posed by the privileges and immunities clause can be entirely avoided if the next time the New York court has opportunity to speak on the point it interprets its current emphasis on New York "domiciliaries" and "citizens" as meaning only "residents" as opposed to "non-residents." In fairness it is to be observed that those jurisdictions which hold general foreign statutes of limitations procedural visit greater depredation on conflict-of-laws theory than does the Kilberg court by this decision, because while a damage limitation never goes to extinguish the right of suit entirely, but rather only measures its effect, a time limit placed on that suit threatens the continued existence of the right itself, and in this respect will be seen as much more approximating "substantive" law than does the former. A damage provision merely limits the exercise of a right; a statute of limitations can prevent its exercise altogether. But if the court's decision contains a relatively smaller evil, that character does not minimize the legal weakness of the conclusion reached. Since New York's wrongful death statute has no extraterritorial application in cases where death occurred outside the State, no right to sue for wrongful death existed whatever except as it was granted and defined by the Massachusetts statute under which suit was brought. In applying its own damage rule to the Massachusetts creation of a right to sue, New York was doing precisely what it could not have done but for the existence of that Massachusetts law. And in effect the court's act of ignoring the Massachusetts limitation contravened its own rule against the extraterritorial application of the New York wrongful death statute, for it channeled the greater force of that statute through the convenient conduit of the Massachusetts legislation.

The subterranean rationale disclosed by this effort is clearly the court's legitimate wish to provide relief for persons in whom New York has a strong interest, not only as their prospective guardian, but equally as the public power concerned with the current social and economic well-being of all its citizens. Whether such admirable motivation must always be implemented by decisions marred by a provincialism which hampers the growth of nationally uniform conflict-of-laws rules remains unanswered. It simply always has been. One alternative response to situations such as that posed by Kilberg lies with New York, L.E. & W.R.R., 98 N.Y. 377 (1885).

25 E.g., Jones v. Jones, 18 Ala. 248 (1850); Barbour v. Erwin, 82 Tenn. 716 (1885); Annot., 146 A.L.R. 1356 (1943); Annot., 68 A.L.R. 217 (1930).
York frankly reversing itself and either giving extraterritorial application to its own wrongful death statute or simply refusing to follow further the common-law denial of recovery for wrongful death, in the absence of statute, regardless of where death occurs. No constitutional prohibitions appear to prevent this latter possibility, and the transient surprise which students of the common law will experience hardly compares with the muddling effect which continued judicial excision of unwanted portions of foreign law may be expected to have.

ROBERT H. TUCKER

CRIMINAL LAW—(1) SECOND TRIAL FOLLOWING SUCCESSFUL APPEAL FROM FINDING OF NOT GUILTY BY REASON OF INSANITY DOES NOT CONSTITUTE DOUBLE JEOPARDY, DESPITE DISCLAIMER OF INTENT TO WAIVE PLEA OF FORMER JEOPARDY; (2) ON APPEAL FROM FINDING OF NOT GUILTY BY REASON OF INSANITY ON BOTH COUNTS OF TWO-COUNT INDICTMENT, EVIDENCE SUFFICIENT TO SUPPORT CONVICTION ON ONE COUNT, INSANITY ASIDE, REMOVES NECESSITY FOR APPELLATE REVIEW OF SUFFICIENCY OF EVIDENCE ON SECOND COUNT. Rucker v. United States, No. 15989, D.C. Cir., Feb. 9, 1961.

Defendant Rucker was found not guilty by reason of insanity in a federal district court on a two-count indictment charging, respectively, a felony and a misdemeanor. In his first appeal from the ensuing compulsory commitment to a mental institution, Rucker contended that the government had failed to sustain its burden of proof, and requested that he be acquitted and released. The appellate court, agreeing that the evidence supporting the felony charge was insufficient, and finding that it did not appear Rucker had realized his guilt was being tried, remanded. 1 A new trial ensued following denial by the district court, at the outset of the second proceeding, of Rucker’s motion to dismiss the indictment on grounds of double jeopardy. Evidence adduced at the new trial resulted in an identical finding, as to both charges, of not guilty by reason of insanity. On his second appeal Rucker urged (1) that he had been jeopardized twice, pointing out that he had earlier requested acquittal, not a new trial, and had disclaimed waiver of his former jeopardy; and (2) that the evidence on the second trial did not establish guilt, the question of insanity aside. Affirming the district court’s refusal to dismiss for double jeopardy, the United States Court of Appeals for the District of Columbia went on to find that since the evidence supported the misdemeanor, that supporting the felony need not be reviewed. Held, (1) second trial following successful appeal from finding of not guilty by reason of insanity does not constitute double jeopardy, despite disclaimer of intent to waive plea of former jeopardy; (2) on appeal from finding of not guilty by reason of insanity on both counts

of two-count indictment, evidence sufficient to support conviction on one count, insanity aside, removes necessity for appellate review of sufficiency of evidence on second count.2

Under the Judicial Code of 1948, federal appellate courts, after reversing a conviction in a lower court for trial errors, "may . . . require such further proceedings to be had as may be just under the circumstances."3 Under this statute and others of a similar purport which preceded it, appellate courts have reversed a conviction based upon insufficient evidence and granted a new trial,4 or in other cases dismissed the indictment and discharged the defendant.5 That a person acquitted of a crime cannot be tried again in a federal court is not open to question.6 No case appears, however, which has specifically dealt with an appellate court's power to remand for a new trial where the accused was neither convicted nor acquitted, but rather was found not guilty by reason of insanity. But the court of appeals in Rucker summarily found that the appeal was in effect from a conviction based on insufficient evidence in that a general verdict of not guilty by reason of insanity "'carried with it a finding that, except for the question as to his sanity defendant was guilty as charged.'"7

Placing this characterization momentarily to one side, and assuming without deciding that the same rules apply to an appellant who has been found not guilty by reason of insanity as to one found guilty, the basis upon which there may be a second trial without violating the double jeopardy provision remains to be determined when, as in Rucker, the appellant expressly disclaims waiver of his former jeopardy. Despite a strongly worded dissent by Mr. Justice Holmes to the effect that a retrial upon the same indictment after a prior conviction has been reversed upon appeal constitutes one continuing jeopardy,8 "most courts [have] regarded the new trial as a second jeopardy but justified . . . on the ground that the appellant had 'waived' his plea of former jeopardy by asking that the conviction be set aside."9 The Supreme Court has termed "waiver" in this context a "voluntary knowing relinquishment of a right."10

---

4 E.g., United States v. Di Genova, 134 F.2d 466 (3d Cir. 1943); Pines v. United States, 123 F.2d 825 (8th Cir. 1941); Rivera v. United States, 57 F.2d 816 (1st Cir. 1932); Buhler v. United States, 33 F.2d 382 (9th Cir. 1929).
5 E.g., United States v. Bonanzi, 94 F.2d 570 (2d Cir. 1938); Cemonte v. United States, 89 F.2d 362 (6th Cir. 1937); Klee v. United States, 53 F.2d 58 (9th Cir. 1931); Romano v. United States, 9 F.2d 522 (2d Cir. 1925).
6 E.g., Green v. United States, 355 U.S. 184, 192 (1957); Kepner v. United States, 195 U.S. 100, 133-34 (1904); United States v. Ball, 163 U.S. 662, 669 (1896).
8 Kepner v. United States, 195 U.S. 100, 134 (1904).
10 Id. at 191.
The element of Rucker's express disclaimer in the instant case would have irremediably complicated the otherwise clear meaning of "voluntary relinquishment," if attempt had been made to reconcile the concepts without denying the force and effect of either one or the other; the conflict is too evident. Fortunately, the Rucker court did not essay to find voluntary relinquishment on Rucker's part, but appears to be on equally tenuous ground when it cites Bryan v. United States\(^{11}\) as authority justifying a remand for new trial, since neither Bryan nor the decisions cited therein involved a defendant's express disclaimer.

Curiously, the most plausible justification for remanding despite the disclamant's protest lies with an authority alluded to by neither the government nor the court. In Forman v. United States\(^{12}\) the Supreme Court had stated that a "Court of Appeals has full power to go beyond the particular relief sought," and that when the defendant "opened up the case by appealing from his conviction, he subjected himself to the power of the appellate court to direct such 'appropriate' order as it thought 'just under the circumstances.'\(^{13}\) Particularly useful on the point of what effect is to be given an appellant's disclaimer is Mr. Justice Harlan's concurring opinion "that the right of an appellate court to order a new trial does not turn on the relief requested by the defendant . . . .\(^{14}\) Extending Forman to cases involving an express refusal to waive the plea of former jeopardy would thus free an appellate court reversing a decision for insufficient evidence from necessarily acquitting and releasing—an undesirable result which the Supreme Court observed "would create an insuperable obstacle to the administration of justice in many cases in which there is no semblance of the type of oppressive practices at which the double-jeopardy prohibition is aimed.\(^{15}\)

The second holding in Rucker dubiously extends the Supreme Court's rule in Hirabayashi v. United States\(^{16}\) which stated that where a defendant is convicted on two counts of an indictment and sentences are ordered to run concurrently, it is unnecessary on review to consider the validity of the sentence on both of the counts if the sentence on either one is sustained. Justifying the rule is the theory that since the sentences are to run concurrently and are of equal duration, the fact that one may not have been properly supported is harmless error.\(^{17}\) Applied to a case where insanity is not in issue and the charges carry an equal punishment, the rule works no injustice, unless it be the relatively minor detriment a defendant might suffer from the presence of a second, unfounded conviction on his record. Where, however, the unreviewed

\(^{11}\) 338 U.S. 552 (1950).
\(^{13}\) Id. at 426.
\(^{14}\) Id. at 428.
\(^{16}\) 320 U.S. 81, 85 (1943).
charge, because of its aggravated character, calls for a longer period of confinement, applying the Hirabayashi rule potentially deprives a defendant of freedom upon an unsupported charge. Translated into a concrete example, where as in Rucker, the two charges are a felony on the one hand and a misdemeanor on the other, and the evidence supporting the felony conviction stands without review, a patent distortion of the Hirabayashi rule is made evident; incarceration may ensue of a duration commensurate with the gravity of the felony, despite the fact that only the misdemeanor conviction is supported by the evidence.

The Rucker court misleadingly saw D.C. Code provisions which compel indefinite commitment for insanity irrespective of the nature of the offense as causing incarceration analogous to that caused by concurrent sentencing; outright acquittal on the unreviewed charge would have no effect on the defendant. But in fact the defendant’s insanity does not avoid or mitigate the distortion of Hirabayashi outlined above; for although the defendant goes not to a penitentiary but to a mental hospital, the length of his commitment there may in the view of public officials charged with his care and the community’s safety be measured in part by the gravity of the offense which his disease compelled, and which thereby has lingering bearing on whether he “will not in the reasonable future be dangerous to himself or others.”19 This connection between the offense and the length of commitment was recognized by Judge Fahy concurring in Ragsdale v. Overholser,20 where he stated: “[T]he continued danger to society which warrants continued deprivation of liberty under section 24-301 alone must be, at least, a danger comparable to the seriousness of the offense of which the committed person was acquitted.” It requires no elaboration to point out that an inmate of a mental institution found not guilty of a felony by reason of insanity stands less chance of being released at a relatively early date than one charged with a misdemeanor. Lastly, whatever post-commitment disabilities obtain with respect to employment and social opportunities because of a felony conviction on the ordinary defendant’s record will be recognized as following with equal effect the extraordinary defendant acquitted by reason of insanity. The propriety of reviewing the support for each count on which he was charged becomes, therefore, even more evident.

Perhaps most worthy of attention in the instant decision is the court’s re-affirmation of the earlier Rucker opinion’s unsupported statement that a trial finding of not guilty by reason of insanity “‘carried with it a finding that, except for the question as to his sanity defendant was guilty as charged.’”21 Translated, the statement probably means that the court believes

the defendant committed the particular acts charged. But such a finding is in American jurisprudence quite apart from a finding of guilt, a condition which has traditionally presupposed criminal intent in crimes of the Rucker caliber.22 It is precisely this criminal intent element requisite to guilt which all defenses of incapacity, including insanity, remove, thus causing a verdict of not guilty, i.e., without guilt. "It is settled that an offender is not criminally responsible for an act, if he was [so] insane . . . [that] he was incapable of entertaining a criminal intent."23

Nevertheless, the penumbral category into which an "acquittal" by reason of insanity falls precludes a doctrinaire approach to the question whether subjecting a man so "acquitted" to a second trial for the same offense amounts to double jeopardy. The instant court is not a little justified in its footnoted approval of the British terminology "guilty, but insane,"24 and in its observation that "a judgment of acquittal by reason of insanity is not by any means to be regarded as the equivalent of an unqualified acquittal,"25 since in fact a legally sound commitment to a government hospital26 following a trial finding of not guilty by reason of insanity presupposes the quasi-jurisdictional determination by the court that the defendant participated in the acts charged. And insofar as an appeal is from this determination, it is "in substance, therefore, like an appeal from a guilty verdict not based on sufficient evidence."27

But it must be noted that, unlike the ordinary acquittal, discharge from responsibility because of incapacity does not necessarily involve, and did not involve in the Rucker case, a litigated finding that the defendant did not commit an unlawful act; acquittal for insanity, for example, means rather that the accused offended, but is not legally responsible for the offense.28 He lacks guilt, though the specific acts charged stand proved. In this respect the British designation of "guilty, but insane" is little more than an appealing self-contradiction, since insanity eliminates capacity which in turn eliminates intent, and finally the lack of intent eliminates guilt. Indeed, insanity on

22 Judge Learned Hand has written: "Ordinarily one is not guilty of crime unless he is aware of the existence of all those facts which make his conduct criminal. That awareness is all that is meant by the mens rea, the 'criminal intent,' necessary to guilt . . . ." United States v. Crimmins, 123 F.2d 271, 272 (2d Cir. 1941). See also Perkins, Criminal Law 650-63, 725 (1957).


25 Ibid.


the part of the offender goes to the very existence of a crime, since it prevents concurrence of the actus reus and the mens rea. In Blackstone's view, "to constitute a crime against human laws, there must be first, a vicious will; and, secondly, an unlawful act consequent upon such vicious will."30

Thus, while the court's refusal to entertain the double jeopardy argument appears to be perfectly defensible on practical grounds, as well as under the Judicial Code of 1948, its rather free use of the guilt concept provides weak support for the conclusion it reaches. If traditional legal understanding of the significance of incapacity is to be maintained, the court might well substitute for its current wording the statement that a finding of not guilty by reason of insanity carries with it a finding that the defendant "committed the physical acts charged," not that, except for the question as to his sanity, he is "guilty as charged."31

DONALD J. FLUEGEL


Defendant Thomas was a director of Tide Water Associated Oil Company and a partner in the investment banking firm of Lehman Brothers. The partnership had purchased Tide Water common stock, and after converting the same into an equal number of new dividend-paying preferred, sold the latter at a profit within a six-month period. On learning of the partnership's intentions, Thomas had disclaimed any part in the transaction, waived his interest in all potential profit, and asserted notice of both activities on proper forms filed with the Securities Exchange Commission. A Tide Water stockholder sought to hold the director and partnership jointly and severally liable under section 16(b) of the Securities Exchange Act of 19341 for recovery of the short swing profits. The partner-director urged as a defense to his liability for any and all profits the express waiver and disclaimer. The district court granted judgment for the defendant firm, but held defendant Thomas liable in the amount of what would have been the individual partner's proportionate

30 4 Blackstone, Commentaries *21.

share of the profits. The Court of Appeals for the Second Circuit affirmed. Held, director-partner whose firm makes short swing profits from transactions involving his corporation’s stock has realized and must account for his proportionate share, though not actually received, irrespective of express waiver or disclaimer.2

Section 16(b) of the Securities Exchange Act of 1934 provides that short swing profits realized by a director, officer or ten-percent stockholder on the purchase and sale or sale and purchase of an equity security of his corporation shall be recoverable by the corporation or by any security owner. The purpose of the section is to minimize the temptation of corporate insiders to profit from advance and confidential information.3 In Smolowe v. Delendo Corp.,4 and subsequent cases5 liability has been imposed not upon the basis of an actual unfair use of such information but upon the mere showing of access to knowledge which could lead to abuse because of the insider’s relation to the corporation. The net result has in effect been the creation of a conclusive presumption that those designated in section 16(b) have received and abused inside information.6 Good faith affords no defense to an action based on this section, which is not penal, but of a remedial7 and deterrent nature.8

Once the court determines the existence of a “purchase” and “sale,” within the meaning of section 16(b), the extent of the fiduciary’s liability is fixed by what is commonly called the “lowest price in, highest price out” rule—the only measure “whereby all possible profits can be surely recovered.”9 Accord-

---

4 136 F.2d 231 (2d Cir.), cert. denied, 320 U.S. 751 (1943).
7 Adler v. Kalawans, 267 F.2d 840, 844 (2d Cir. 1959); Smolowe v. Delendo Corp., 136 F.2d 231, 239 (2d Cir. 1943).
9 136 F.2d at 239.
ingly, the lowest priced shares that are bought within the six months will be matched against the highest priced sold over the same period,10 with intermediate purchase and sale prices similarly paired off. In the instant case, where the conversion from common to preferred stock constituted the statutory purchase, the "cost" of the shares to Lehman Brothers was the lowest price at which the Tide Water common stock was selling on the conversion date.

In 1952 the Second Circuit had decided in Rattner v. Lehman11 that a literal reading of the section gave rise to no cause of action when a defendant director, upon learning of his firm's short swing transaction, paid to his corporation his proportionate share of the profits realized by the partnership; further, as the concurring opinion there pointed out, the remaining partners would not be liable "whenever one of their members is a director, and only because he is a director."12 In this context the court was not prepared to consider the partnership a jural person.

The majority in Blau predicated its dismissal of the claim against the firm upon the Rattner rationale, once again noting the conspicuous absence of any provision in the statute as enacted which would hold the partnership or any recipient of the insider's information to an accounting of profits.13 Contrary to the rationale that recovery of any greater amount would be at the expense of non-insider partners are basic partnership law principles. In his dissent in Blau, Judge Clark contended that each partner retains an undivided interest in the entire partnership profit and therefore each partner "realizes" the entire profit.14 A policy consideration buttresses the argument of the dissent: if a full recovery is not had, the efficacy of the section can be diluted by the practice of merely exchanging information among partners who have been on the boards of different corporations; the partnership would suffer the loss only of the particular director's share, and this loss would be minimal to both the partnership and the director-partner in view of profits from other short swing dealings. The incentive to use inside information would not be diffused. Judge Learned Hand's statement in Rattner suggests a potential remedy within the framework of section 16(b), although it would require a subjective standard of proof:

[B]ut I wish to say nothing as to whether, if a firm deputed a partner to represent its interests as a director on the board, the other partners would not be liable. True, they would not even then be formally "directors"; but I am not prepared to say that they could not be so considered ....15

10 Rubin & Feldman, supra note 8, at 482-83.
11 193 F.2d 564.
12 Id. at 566-67.
13 286 F.2d at 789; 193 F.2d at 566. Such early provisions are recorded in Hearings on H.R. 7852 and H.R. 8720, supra note 3, at 135-37.
14 286 F.2d at 794.
15 193 F.2d at 567 (concurring opinion).
Unfortunately, the dictum went untested when the trial court in *Blau* found evidence of "deputization" by the firm lacking.

The precise question of whether a director has "realized" a profit and incurred liability under section 16(b) when he has made an express waiver of his interest in the purchase and sale of the corporation stock by his partnership offered a question of novel impression to the court in the instant case. The majority summarily approved the district court's reasoning that Thomas' waiver was in effect an assignment of his profits to his partners. By making such an allocation, Thomas was subjecting to his own will and control that which, except for his waiver, would have been actually possessed by him. Such a characterization of the waiver is sound as a tax law principle and was considered relevant by the lower court.

The controlling premise for determining tax liability for income realized was set out in *Helvering v. Horst*: "The power to dispose of income is the equivalent of ownership of it. The exercise of that power to procure the payment of income to another is the enjoyment, and hence the realization, of the income by him who exercises it."\(^{17}\) Thus, in *Frank v. Commissioner*\(^ {18}\) a beneficiary was held liable for the full percentage of trust income to which she was entitled though a part of the income was diverted to charitable purposes. Although the taxpayer made no showing of a waiver of that portion contributed to the charity, the court indicated that recent decisions would militate against the merit of such a defense and that "where one disposes of something which he has legally coming to him by giving it away ahead of its receipt he is, nevertheless, subject to income taxation thereon . . . ."\(^{19}\) Similarly, the partner-director in the instant case was held in contemplation of law to have "realized" his waived share of the partnership's profits.\(^ {20}\)

In settling section 16(b) litigation the courts have adhered to the rigid construction laid down in *Smolowe*:

The statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, . . . and the faithful performance of his duty.\(^ {21}\)

Following this thesis, the courts have adopted a "crude rule of thumb"\(^ {22}\) whose impact has been especially heavy on the individual insider. Thus, an insider may be compelled to disgorge profits though he be technically less than an

---

16 Loose v. United States, 74 F.2d 147, 150 (8th Cir. 1940); see Helvering v. Horst, 311 U.S. 112 (1940).
17 311 U.S. 112, 118 (1940).
18 145 F.2d 413 (3d Cir. 1944).
19 Id. at 415.
20 286 F.2d at 791.
21 136 F.2d at 239.
22 An expression used by T. G. Corcoran, a draftsman of section 16(b) in *Hearings on S. 84*, supra note 3, at 6557.
In Adler v. Klawans the insider was liable for profits on stock purchased prior to his becoming a director and sold after his election to the board. Likewise, in Rattner liability attached even though the director had not actively traded any of the stocks involved and, in fact, had no personal knowledge of the transaction. The focus of enforcement has centered upon the access to inside information which might be used and any possible conflict with the statute's effectiveness.

The most recent disclosure of the meaning and extent to which courts will enforce section 16(b) appeared in Gratz v. Claughton where the court said that "nobody is obliged to become a director, . . . but, as soon as he does so, he accepts whatever are the limitations, obligations and conditions attached to the position." This regard for the fiduciary relationship and the disposition to safeguard against possible abuse of confidential information, to the detriment of both the corporation and the outside-shareholders, are the bases of the present court's disallowance of the waiver. The alternative would be clearly violative of Congress' purpose, for to hold otherwise would result in "wholesale waivers" with the consequence that "profits waived by one partner would increase the profits of the others and in the end each would have about the same amount of profits he would have received from such transactions had there been no waiver and disclaimer.

Admittedly, the "crude rule of thumb" was originally designed to dispose of the need for proof of the insider's intent when he bought or sold the stock. The Blau case accomplishes this design, in that liability of the insider was not made to depend upon an intention to share or not share in profits nor upon any intention of the insider to instigate negotiation of a short swing transaction at the time of the first purchase or sale by his firm. The real justification for the holding is the larger policy of section 16(b), i.e., the avoidance of conflicts of interest in fiduciary positions, the prevention of manipulation of corporate affairs and the insurance of a market that will honestly and fairly reflect the value of securities in the light of all information available to the investing public.

In computing profits by the "lowest price in, highest price out" rule, it is settled that a "purchase" is any transaction that could possibly "lend itself to the speculation encompassed by section 16(b)." This includes a volun-

23 Colby v. Klune, 178 F.2d 872 (2d Cir. 1949).
24 267 F.2d 840 (2d Cir. 1959).
25 Meeker & Cooney, supra note 6, at 979.
26 187 F.2d 46, 49 (2d Cir. 1951).
27 286 F.2d at 791.
28 Ibid.
29 Ibid.
tary conversion of securities. Accordingly, despite defendants' urging, the amount of profits in Blau was determined by subtracting from the receipts of the sale the "purchase" price of the preferred, using the lowest price of the common stock at the time of conversion rather than the price at which the commons were first purchased. This computation attributed to the partnership a profit of $98,686, instead of the $30,386 computed by defendants, and a corresponding increment to the profit of the individual director. This judicially created method of measuring profits is clearly in accord with the decided cases and the purpose of the section.

Prompted by a distinction appearing in Roberts v. Eaton, Lehman Brothers denied joint and several liability on the ground that it had received a newly created stock rather than a seasoned security that formed part of a pre-existing class with independent value, and that, having merely exchanged an equivalent value, the firm was not chargeable with an unfair use of information. Because of the present disposition of the courts to treat the partnership as a non-insider and to hold liable only the director-partner, the defense offered, in the absence of a strong case of fraud, appears misplaced. Although it has been stated that section 16(b) was not intended to cover all areas of opportunity for insider profit, dicta in both Rattner and Blau indicate that the possibility of the firm's liability under some circumstances has not been eliminated. Any attempt to affix such a liability, however, must assume a standard based upon an actual deputation of the partner or actual communication by the partner-director to his firm.

The Rattner case held that a director-partner need not account for more than his proportionate share of his firm's short swing profits, and that his partners do not come within the scope of 16(b); Blau holds that such an individual cannot escape the purview of section 16(b) by disclaimer and waiver. Still unanswered are the questions which would arise in the event the partnership were to deputize a member to represent its interests, or if such a partner were to be instrumental in effecting the transactions.

Blau, however, does indicate solutions to some practical problems facing the director-partner who discovers that his firm has derived short swing profits from transactions involving his corporation's stock. Within the framework of a fact pattern similar to that in the instant case, there would seem to be

32 286 F.2d at 792; 173 F. Supp. at 595 n.3.
34 136 F.2d at 239.
36 See Adler v. Klawans, 267 F.2d 840, 845 (2d Cir. 1959).
37 193 F.2d at 567.
38 286 F.2d at 790-91.
no advantage, and in fact a financial disadvantage, in disclaiming interest or
waiving rights.

The director-partner who rejects the profits which constitute his propor-
tionate share still may have to pay that amount to his corporation. On the
other hand, the partner who has accepted the profits and is held liable to that
extent, in effect passes on to the corporation substantially the amount received,
and personally suffers no adverse effect (except, perhaps, to a relatively unim-
portant extent by taxation).

Even if it be assumed that the court in the instant case did not allow
interest because of good faith manifested by the waiver and disclaimer, such
a possible limitation on the amount of the judgment would hardly justify
unreimbursed assumption of the entire amount. The director-partner, therefore,
who stands to gain from short swing profits would seem well advised to accept
his share and, if demand is made, be prepared to pay the money over to his
corporation.

PAUL P. DOMMER

Mr. Robert H. Montgomery’s recent book *Sacco-Vanzetti: the Murder and the Myth* is, as its title indicates, a debunking of the party line, namely that two innocent men were executed after an hysterical and unfair trial. The book is likely to cause great pain in ultraliberal circles and has already been given an imperial call-down by people like Professor Edmond Cahn of New York University.1 After stating that “Robert H. Montgomery’s new interpretation will be useful and interesting though scarcely in the way the author intended,” Professor Cahn ignores the book from then on and attacks Mr. Montgomery:

Few are so well qualified as Mr. Montgomery to defend the prosecutors of Sacco and Vanzetti. He is a successful corporation lawyer, a member of the Massachusetts Sons of the Revolution and an experienced public-utility executive; a partner of his sponsored anti-anarchist laws in the Massachusetts Legislature of 1919 and was among those whose homes were bombed that year.2

The notion that legal standing and a decent ancestry somehow downgrade a book is peculiar to the modern addled liberal. The windup of Professor Cahn’s review is a complaint against Mr. Montgomery’s “omissions,” one, believe it or not, being his failure to recommend abolition of capital punishment, the other being that “he provides no information about the two defendants as concrete human personalities.”3 Professor Cahn adds the tag: “Perhaps it is necessary to depersonalize a human being before one can despise him enough to execute him or keep him executed.”4

The inference from this slur is that Mr. Montgomery despised the two defendants, and this is made a mark against him. Mr. Montgomery is remarkably temperate in his references to Sacco and Vanzetti, who could well have been despised as cheap draft-dodgers and perjurers without ever getting into the big-league area of holdups and murder.

Professor Cahn’s review was quickly caught up by our old friends *pro bono publico*, Messrs. David Felix of New York and Edward Winsor of Providence, Rhode Island, whose letters appeared in the *New York Times,* Sept. 18, 1960, § 7 (Magazine), p. 28.

---

2 Ibid.
3 Ibid.
4 Ibid.
"Times" on October 9, 1960. Mr. Felix pointed out the "troublesome fact" of the witnesses who put the defendants at the scene of the crime. He might have added the overwhelming circumstantial evidence. He gently suggested that Vanzetti's "magnificent credo" proudly quoted by Professor Cahn, was in reality written by an unreliable newspaper reporter. Mr. Winsor, the second commentator, states that he lived through the controversy firsthand at the foot of Gamaliel at Harvard, and having read the record came to Mr. Montgomery's conclusion. Professor Cahn's review is also commented on in the National Review of October 8, 1960, which asks pointedly why Professor Cahn was given the review job at all.

It will take more than Professor Cahn's olympian rebuke to down this book. For one thing it states the evidence and the evidence is massive in impact. For another it gives for the first time the details of the post-trial maneuvers. Like the woman who charges not one rape but three, the wholesale charges of perjury destroy each other by sheer improbability. The case is a melancholy tribute to the technique of the Big Lie, the gullibility of college professors and the ease with which a democracy can be imposed upon by spurious erudition.

The Sacco-Vanzetti case was not one case but two. At the time of the murder trial, Vanzetti, the poet of Professor Cahn's "magnificent credo," had already been convicted of a holdup and attempt to murder on December 24, 1919, at Bridgewater, Massachusetts. His only defense was an alibi, which was riddled. Vanzetti prudently remained off the witness stand. The mythmakers later blamed this on Vanzetti's counsel; there is not a word of truth in it, as Montgomery shows. Conviction

---

5 § 7 (Magazine), p. 53.
7 Not the least of the defendants' crimes was the rash of cheap verse they provoked. The Sacco-Vanzetti Anthology of Verse published in 1927 contained poems like "Two Crucified," "Jesus Also Sinned," "To Slay These Christs"—the very titles of which seem lunatic. The Rev. John Haynes Holmes likens Vanzetti's letters to the "Apology" and "Crito" of Plato and the Gospels generally. Montgomery, Sacco-Vanzetti, The Murder and the Myth 61 n.1 (1960) [hereinafter cited as Montgomery].
8 Montgomery 36-38. This canard originated in an article by Beffel, Eels and the Electric Chair, The New Republic, Dec. 29, 1920, p. 129, which was swallowed whole by Justice Frankfurter (The Case of Sacco and Vanzetti 7 n.1 (1927)). James M. Graham, Vanzetti's counsel, stated clearly that only three people in the world knew the truth about this decision—Vanzetti, co-counsel Vahey and himself—and that Vanzetti had made the decision. This led to a correspondence between Montgomery and Frankfurter in an effort to get Frankfurter to retract his accusation against counsel. Frankfurter, however, stood adamant
followed before the same Judge Webster Thayer who was later to try both Sacco and Vanzetti. The transcript of the first trial shows that Vanzetti’s counsel twice assured the court of their confidence in Judge Thayer’s fairness and no exception was taken to his charge to the jury. Professor Edmund M. Morgan, who was later to denounce the second trial, said of the first trial, “[T]here is nothing to support a charge of unfairness or prejudice on the part of the trial judge.” Vanzetti was sentenced to twelve to fifteen years in the State Prison and was actually serving that sentence when the second trial opened.

The second trial at Dedham, the cause célèbre, came about under the following circumstances.

On April 15, 1920, Parmenter, a factory paymaster, and his guard Berardelli, were shot down and killed in cold blood in South Braintree, Massachusetts, by two men leaning on a fence waiting for them. The two men picked up two black boxes containing $15,776 and leaped into a passing automobile. This car was abandoned the same day and turned out to be the bandit car used in the earlier Vanzetti holdup. During the investigation of the earlier case, the police became suspicious of a group that included Sacco and Vanzetti. On a tip-off they arrested the two on a streetcar and the myth started. The prize for a completely untrue account of the arrest goes to Professor Arthur M. Schlesinger, Jr. who states: “In May 1920, following the murder of a paymaster in South Braintree, Massachusetts, Brockton police picked up two Italians in an automobile filled with the innocent and febrile literature of anarchistic propaganda.”

There was no automobile and no literature, anarchistic or otherwise. However, there were, significantly and omitted by Schlesinger, these facts: when arrested Sacco had on his person a .32 caliber Colt containing nine bullets and in his pocket twenty-three additional .32 caliber bullets. The fatal bullet found in Berardelli’s body had been fired from a .32 caliber Colt and probably from this particular gun. The bullet that killed Berardelli was of such a rare type that when later a defense expert wanted to make ballistics tests none like it could be found anywhere in

and refused to retract. He comes off very poorly in the exchange of letters. Montgomery 36-43.

9 Montgomery 231.
10 Joughin & Morgan, The Legacy of Sacco and Vanzetti 56 (1948).
11 Montgomery 4.
12 Ibid.
New England. Yet several of the bullets found on Sacco were of this rare type.\textsuperscript{14} The jurors said later that this was the single most damning piece of evidence. Also, when arrested, Vanzetti had in his pocket a .38 caliber revolver, fully loaded, which was of the same make and caliber as the revolver customarily carried by the dead Berardelli and never found at the scene of the crime. Finally in Vanzetti’s pocket were found 12-gauge shot-gun shells of the type which had figured in the abortive first holdup. This put Vanzetti for the first time under suspicion for the earlier crime. Eyewitnesses promptly identified him and he was later convicted of the first holdup.\textsuperscript{15} This is ignored by the mythmakers who have had the effrontery to argue that the murder at South Braintree was out-of-character, Sacco being a fine family man and Vanzetti an industrious fish-peddler.\textsuperscript{16} Anyone might have a good character if we ignore an attempted murder in a holdup.\textsuperscript{17}

At the trial of the main case, for the murder of Parmenter and Berardelli, the prosecution’s evidence fell into these categories: (a) eyewitnesses; (b) Sacco’s pistol and the fatal bullet; (c) Sacco’s cap; (d) Berardelli’s gun; and (e) consciousness of guilt. The eyewitnesses were ferociously attacked, then and later. Moore, the defense counsel, some years later tried to blackmail one of them, Goodrich, into a repudiation of his testimony. Montgomery is fair enough to concede “the identification evidence at the trial, while sufficient to justify submission of it to a jury, cannot be called strong.”\textsuperscript{18} There was other evidence, though, of the gravest character.

When Sacco was arrested on the streetcar this fine family man, this doctrinaire anarchist, had in his waistband a fully loaded .32 caliber

\textsuperscript{14} Montgomery 7.
\textsuperscript{15} Id. at 7-8.
\textsuperscript{16} Id. at 268-69.
\textsuperscript{17} Frankfurter reduces the first crime to a footnote in his book, The Case of Sacco and Vanzetti 7 n.1 (1927). Montgomery 17. Closing his eyes to Vanzetti’s Christmas holdup, Frankfurter says: “There was no claim whatever at the trial, and none has ever been suggested since, that Sacco and Vanzetti had any prior experience in holdups . . . .” Frankfurter, The Case of Sacco and Vanzetti, Atlantic Monthly, March 1927, p. 416; revised and reprinted in Frankfurter, The Case of Sacco and Vanzetti 59 (1927); reprinted in Frankfurter, Law and Politics 155 (1939). Of course, the mythmaker’s answer as to Vanzetti’s first crime is that the State got the wrong man. No one, however, has ever taken this seriously. Vanzetti was convicted on overwhelming evidence at a trial at which “radicalism was not even mentioned.” Montgomery 16. Even Professor Morgan admits the first trial was entirely fair: “There is nothing to support a charge of unfairness or prejudice on the part of the trial judge.” Joughin & Morgan, op. cit. supra note 10, at 56.
\textsuperscript{18} Montgomery 95.
nine-shot Colt revolver. In his hip pocket were twenty-three steel-jacketed bullets that fitted the Colt. Sacco gave a particularized story of how he got the Colt and the bullets, all of which he admitted was false when he took the witness stand.19 Two .32 caliber steel-jacketed bullets were found in Parmenter's body; four, in the body of Berardelli. Of the thirty-two bullets found in the Colt and on Sacco when arrested, sixteen were Peters, three were Remington, six were Winchester and seven were U.S.20 The fatal Winchester bullet found in Berardelli's body, bullet number III, was of a type so obsolete that Burns, a defense witness working with two assistants, could find none like it anywhere in New England. Yet the same obsolete type of bullet was found in Sacco's pockets on his arrest.21 This type of evidence was devastating. Asked later what evidence impressed him most, juror Parker said: "The bullets, of course. That testimony and evidence on it sticks in your mind. You can't depend on the witnesses. But the bullets, there was no getting around that evidence."22

The obsolete bullet evidence was particularly effective because it was brought into the case by the defense witness Burns. The similarity between fatal bullet number III and the obsolete bullets found on Sacco was so obvious that it could be seen with the naked eye.23

As to whether the fatal bullet was fired from Sacco's gun, the experts divided. Two prosecution experts testified diffidently that "it is consistent with being fired by that pistol" and "I am inclined to believe."24 Two defense witnesses said the contrary. Neither side made much point of this testimony in the closing arguments. Professor Morgan said the prosecution "insisted that the jury might and should practically disregard the expert testimony . . . ."25

As to Sacco's cap, when the killer ran away from the scene of the murder he was bareheaded. A cap was found near the murdered Berardelli's body; his wife testified it did not belong to Berardelli. Kelley, Sacco's employer, said the cap was in general appearance and color like one he had seen Sacco wearing. It had a tear or hole in the lining, caused,

19 Montgomery 96; II The Sacco-Vanzetti Case, Transcript of the Record 1900 (1928) [hereinafter cited as Transcript].
20 Montgomery 96; I Transcript 783.
21 Montgomery 97-98; V Transcript 5378w-x.
22 Montgomery 98. (Unless otherwise indicated, quotations are taken from Montgomery.)
23 A defense protagonist admitted this. Fraenkel, The Sacco-Vanzetti Case 375 (1931); Montgomery 99.
24 Montgomery 100; I Transcript 896, 920.
25 Joughin & Morgan, op. cit. supra note 10, at 106.
the State claimed, by a nail on which Sacco used to hang it, near his workbench. Another cap found in Sacco's kitchen had the same kind of hole. When Sacco was on the stand he was asked to try on both caps, which he did so ineptly that the spectators laughed. Both defense lawyers ignored the cap in their closing argument.26

The fourth item, Berardelli's gun, pertained to Vanzetti. When arrested this peaceful fish-peddler had in his pocket a five-shot .38 caliber revolver fully loaded. It was the same make and caliber as the revolver usually carried by Berardelli when he accompanied the paymaster as guard and which was not found on Berardelli's body. On the evening of the arrest Vanzetti was asked about the revolver. He said he bought it five years before for $18 or $19; he could not remember the store; he bought it under a false name; he could not remember the name; he bought at the time a full new box of cartridges; he threw the box away when only six cartridges were left. The story was a tissue of lies and abandoned at the trial. Eighteen dollars was too much to pay for a five-dollar revolver; six cartridges could not be loaded into a five-shot revolver and the cartridges could not have come out of a new unopened box—two of them were Remington and three U.S.27

As to consciousness of guilt, it is well known that false statements made at the time of arrest or later are of probative value, the reason being that they are not characteristic of innocent men. From the moment of arrest on the streetcar, Sacco and Vanzetti told one lie after another. Sacco denied he had a gun and one was found on him; Vanzetti told the cock-and-bull story already recited as to the source of his gun; Vanzetti admitted on the stand his prior false statements; he admitted also that many of his previous denials were false. The honest fish-peddler admitted he did not even peddle fish when he said he had.

At the time of his arrest Sacco denied he had ever heard of Berardelli, the murdered guard. Later he admitted on the stand reading about the murder in two newspapers which he read every day. He admitted talking to friends about the murder the very day after it was committed. With the murder gun in his pocket it is no wonder that he denied any knowledge of Berardelli.

Sacco's lies about the revolver and the bullets have already been referred to. Montgomery cites a long list of Sacco's lies about key figures and past movements. His most significant lie was his statement

26 Montgomery 111-14.
27 Id. at 118-19; I, II Transcript 757, 889, 1748-51, 1801.
on the day after his arrest that he had worked all day on the day of the murder. He admitted on the stand that this was a lie.

Both Sacco and Vanzetti freely admitted their lies. Their excuse was that they lied, not because they were worried about the murder, but to conceal radical literature and draft-dodging.28

Sacco and Vanzetti’s principal defense was an alibi. Neither alibi was convincing. Montgomery gives a detailed analysis of each and riddles them. A curiosity of Vanzetti’s alibi is Frankfurter’s statement that it was “overwhelming,” that “thirteen witnesses either testified directly that Vanzetti was in Plymouth selling fish on the day of the murder, or furnished corroboration of such testimony.” As a matter of fact only four witnesses testified directly and these four were singularly unconvincing—so weak that the defense in closing arguments hardly mentioned Vanzetti’s alibi. Nor, after the trial, with thousands of dollars available, could the alibi be improved on.29

As to Sacco, his first alibi was that he was working all day on the day of the murder. He admitted this was a lie and produced another alibi which put him in Boston on the fatal day. Montgomery does a surgical job on this version which, to this writer at least, is convincing.

Up to now we have been dealing with an ordinary criminal case. The cause célèbre, however, the American Dreyfus case, the trial of Christ, in brief the myth, must now be discussed. We can give no better introduction than to quote an early commentator, now prominent, Justice Frankfurter. In his The Case of Sacco and Vanzetti first published in 1927 and now, unaccountably, reprinted, he states:

By systematic exploitation of the defendants’ alien blood, their imperfect knowledge of English, their unpopular social views, and their opposition to the war, the District Attorney invoked against them a riot of political passion and patriotic sentiment; and the trial judge connived at— one had almost written, co-operated in— the process.30

Hardly anyone familiar with the trial would agree with any one of these statements, much less the sum total. Since then, though, it has become the party line. Montgomery says: “Frankfurter’s discussion of this subject inflamed the world against Massachusetts justice and against two honorable men, Judge Thayer and District Attorney Katzmann, and is inexcusable.”31

28 Montgomery 123-30. Both Sacco and Vanzetti went to Mexico in 1917 to dodge the draft. Montgomery 159-60; II Transcript 1726-27.
29 Montgomery 131-41.
30 Frankfurter, Law and Politics 164 (1939) (reprint of The Case of Sacco and Vanzetti).
31 Montgomery 166.
These are harsh words and we need not go so far. Frankfurter was simply as misled as the others. In 1927, at the time he wrote his indictment of the trial, he had been away from the actual trial of cases for almost fifteen years. Points that a trial lawyer would see at first glance, Frankfurter never saw at all. As an example, the lies told by the two defendants on the day of their arrest are treated by him *diminuendo*, as "ambiguous behavior." In fact there was nothing ambiguous in their lies. They were not in the ambiguous area of radicalism but in the highly sensitive area of guns and bullets. Well might a defendant lie about the murder gun actually found on his person when arrested! Something spectacular, in the way of lying, was obviously demanded of the other defendant when the murdered guard's gun was found in his pocket.

Frankfurter however makes one very accurate statement and it is interesting to note its accuracy. Popular folklore, radical brand, has it that Sacco and Vanzetti's trial started off on the theme of radicalism and they never had a chance from the start. The stark fact is that radicalism never entered the case at all *until the defense put it in*. Not a word was said about the defendants' radicalism or draft-dodging during the prosecution's case in chief. When the prosecution rested, Judge Thayer called counsel for both sides into conference and informed them that he could see no reason why radicalism should enter the trial.32 It was not until Vanzetti took the stand that radicalism was introduced and Vanzetti himself on direct examination by his own attorney introduced it.33 Here is Frankfurter's entirely accurate statement:

*Up to the time that Sacco and Vanzetti testified to their radical activities, their pacifism, their flight to Mexico to avoid the draft, the trial was a trial for murder and banditry . . .* 34

The defense decision to try radicalism was not hurriedly made. Subsequent to Judge Thayer's advice defense counsel told him they all felt it necessary to go into radicalism to rebut the "consciousness of guilt" argument based on the defendants' lies on the day of arrest. Once more the judge told them to think it over and to talk to John W. McAnarney, one of the State's leading lawyers. Defense counsel did so and reported back the next morning. Radicalism was elected. Later, President Lowell of Harvard, head of the Governor's special Advisory Committee appointed to report on the trial, asked defense counsel:

32 V Transcript 4767.
33 II Transcript 1721-22.
34 Frankfurter, op. cit. supra note 30, at 159. (Emphasis added.)
Do you mean by this, that if the radical purposes of the prisoners doesn't [sic] account for their conduct, there would be no question of their being innocent?38

To this defense counsel replied:

There wouldn't be any defense in my mind. . . . [N]o explanation by which to justify the lies they gave to the district attorney.38

Frankfurter, naively we think, falls for this argument, forgetting that the force of defendants' lies lay in their references to guns and bullets, which are only mildly relevant to radicalism but are deadly on a charge of murder. What really happened, we think, as to the decision to put radicalism into the case was the sudden realization by defense counsel of what we may call the trial lawyer's nightmare, namely, a long trial and, at the end, nothing to argue to the jury. A trial lawyer doesn't worry too much at losing a case, even a big case. But to struggle in court for weeks and months and then have nothing on which to make a $50 jury speech—this is a personal fiasco. It was therefore absolutely essential to get radicalism into the case for personal and tactical reasons, to say nothing of that well-known legal fish—the red herring.

Once the defense put radicalism into the case what was the district attorney to do? Was he supposed to take it on the chin? Apparently Frankfurter thinks so—he refers to the "special duty of a prosecutor and a court engaged in trying two Italian radicals . . . to keep the instruments of justice free from the infection of passion and prejudice"337—the passion and prejudice artificially inseminated into the trial by a group of not-so-clever defense lawyers. I say not so clever because the radical issue opened up by Vanzetti allowed the prosecutor, if he cared to do so, to ask him about draft-dodging, radical literature, Vanzetti's opinions, the deportation of alien radicals and a number of other embarrassing things. But the prosecutor did not ask Vanzetti a single question about his political or social views or about his anarchist opinions and activities. He did ask eleven questions about draft-dodging and he did refer to the radical literature to test Vanzetti's avoidance of the "consciousness of guilt" argument based on his lies about the guns and bullets.38 Nothing the jury heard about Vanzetti's radicalism came from the prosecutor's cross-examination; it was all volunteered by Vanzetti on direct! Indeed in his closing argument he referred to Vanzetti's trip to New York and said: "That issue is not being tried here. Neither is

35 Montgomery 158.
36 Montgomery 158; V Transcript 5057.
37 Frankfurter, op. cit. supra note 30, at 164.
38 Montgomery 160.
Radicalism being tried here. This is a charge of murder and it is nothing else . . . ."39

Sacco's direct examination followed the pattern of Vanzetti's. He told of his draft-dodging trip to Mexico and his use of an assumed name, and then discussed concealment of radical literature and his fears of the authorities. The lies he told on the night of his arrest he admitted but explained by saying he thought he had been arrested on a radical charge and so did not tell the truth.40 The prosecutor's cross-examination was an impeachment of Sacco's credibility. Sacco said on direct that he loved this country; on cross he was asked whether he loved it when he went to Mexico under an assumed name to avoid being drafted. In answer to a further question Sacco launched into a long anticapitalist harangue which the prosecutor did not interrupt. He did, however, bring out that telling lies about the gun and bullets had nothing to do with radical literature or fear of deportation.41

Conceding as Frankfurter does that the defendants, not the prosecution, put radicalism into the case,42 his point reduces itself to the argument that the prosecution and the court were from then on under the moral and legal compulsion of protecting the defendants against themselves. But how were they to do this? Any effort to eliminate or tone down the chosen line of defense would have been taken as ground for a mistrial or error on appeal. The defense would have been quick to assert it and a new ground for martyrdom would be created. Once more Frankfurter is out of his element, in the unfamiliar atmosphere of a court trial.43 In any event there appears to be no justification for the oft-quoted statement in his book: "By systematic exploitation of the defendants' alien blood, their imperfect knowledge of English, their unpopular social views, and their opposition to the war, the District

39 Montgomery 161; II Transcript 2198.
40 Montgomery 162; II Transcript 1865-66.
41 Montgomery 164-65.
42 Frankfurter, op. cit. supra note 30, at 158-60.
43 In his maturity Justice Frankfurter frankly faced this point. In withholding his approval to the Rules of Criminal Procedure, he stated:

From the beginning of the nation down to the Evans Act of 1891 . . . the members of this Court rode circuit. They thus had intimate, first-hand experience with the duties and demands of trial courts. For the last fifty years the Justices have become necessarily removed from direct, day-by-day contact with trials in the district courts. To that extent they are largely denied the first-hand opportunities for realizing vividly what rules of procedure are best calculated to promote the largest measure of justice. Prescription of the Federal Rules of Criminal Procedure, 323 U.S. 821, 822 (1944).
Attorney invoked against them a riot of political passion and patriotic sentiment . . . "44

Frankfurter states his book was "the product of the most minute care for securing accuracy" and refers to it as "a historic document."45 The above statement, however, is inexplicable to those who admire and respect the present Justice and pay full tribute to his substantial contributions to the cause of freedom and security. It can only be put down to the heat of prospective controversy.

As already indicated, the Sacco-Vanzetti trial has been converted into the American Dreyfus case, into the folklore of Communism. As Justice Holmes remarked, it has been "turned into a text by the reds."46 It is a complete mystery to the present generation how so much could have been made out of so little; no one can read over the transcript and emerge indignant or even doubtful. The case was reviewed by the Governor's Advisory Committee which included the President of Harvard and the President of M.I.T. In a letter to President William Howard Taft dated November 1, 1927, President Abbott Lawrence Lowell of Harvard stated: "[N]one of us had the least question about the men's guilt. The proof seemed to be conclusive. On the other hand, there was gross misstatement in the propaganda in their favor . . . ."47

Seven of the surviving jurors were interviewed in 1950 and the consensus was that their verdict was a just one and that they would vote the same way today; that the trial judge was fair and radicalism played no part at all in their verdict.48 Juror Dever, who later became a lawyer said:

I can repeat it over and over again. That talk of radicalism is absurd. Radicalism had nothing whatsoever to do with it.

. . . .

The judge was A-1. He never in any way, shape or manner let us know what his views were.49

44 Frankfurter, The Case of Sacco and Vanzetti, Atlantic Monthly, March 1927, pp. 409, 421; revised and reprinted in Frankfurter, The Case of Sacco and Vanzetti 59 (1927); reprinted in Frankfurter, Law and Politics 141, 164 (1939).
46 Id. at 318. Holmes also wrote: "But I have not had a very high opinion . . . of such extremists as I have known or known about. . . . I always am uncertain how far Frankfurter goes." Ibid.
47 Id. at 38-39.
48 Id. at 179-80.
49 Id. at 180.
Juror Ganley stated:

I was impressed by one aspect of the trial especially. That was that Judge Thayer was absolutely fearless and absolutely on the level. He was trying to do his job, thoroughly and not leaning either way.

At the final showdown, when the jury was reaching its verdict, there were no objectors. It was Guilty. Nobody had to put up an argument at all. Every member of the jury thought they were guilty.

The more I've seen and heard, even after the trial, the more I am convinced they were guilty.\textsuperscript{50}

Juror Gerard stated:

The outstanding thing about that trial was the judge. You can quote me on that. The fairest judge I ever saw or heard of.\textsuperscript{51}

Juror Marden's clearest impression of the trial was "the outstanding fairness of Judge Thayer." He also recalled the fairness of the prosecuting attorney. He said:

I never have had a bit of reason to think the trial was anything but fair. I don't think we jurors thought of the defendants in any way except as two persons accused of murder.\textsuperscript{52}

Juror Parker referred to it as "a very fair trial by a good judge." He said:

I can't understand why the trial went around the world. They talked of Reds being involved in it, somehow ... why should we want to pick up two Reds and try to convict them of murder? We did not know if they were Reds and we did not care.\textsuperscript{53}

Juror Atwood said the outstanding evidence was that of the obsolete Winchester bullets, one found in the murdered guard and others on Sacco when arrested. As to Judge Thayer, "he never showed any bias to us. ... He never showed favoritism. If I remember anything with absolute clarity, it was the judge's fairness."\textsuperscript{54}

Juror McHardy after receiving crank letters had his house demolished by a bomb. His son said he greatly admired Judge Thayer and that there wasn't much talk about radicalism at that time. "We didn't hear about radicals until those who wanted Sacco and Vanzetti to be martyrs went to work."\textsuperscript{55}

Juror Waugh said that the defendants were convicted on the evidence,

\textsuperscript{50} Id. at 180-81.
\textsuperscript{51} Id. at 181.
\textsuperscript{52} Id. at 182.
\textsuperscript{53} Id. at 182-83.
\textsuperscript{54} Id. at 183-84.
\textsuperscript{55} Id. at 184-85.
that radicalism played no part in the verdict and that the judge was eminently fair.56

One of the two official court reporters at the trial said in 1950: "You can't put it too strongly, my belief in the justice of the verdict and guilt of the men and fairness of the trial." As to the judge, "there was no question of his fairness."57

The answer of the mythmakers to these statements by the jurors is: "Naturally they'd say they were guilty and had a fair trial." The answer to this is that naturally the mythmakers would say the opposite. The mythmakers in reality make an assault upon the human mind, including the mind of the mythmakers.58

After conviction, the inevitable post-trial assaults were made, upon the judge, the jurors, the prosecution and the witnesses. These are examined in detail by Montgomery. The boldest canard was the confession of the convicted murderer Madeiros and the Morelli hypothesis, by which a whole new gang was nominated as the murderers by defense counsel. These contentions are demolished by Montgomery59—temporarily only, until the next assault.60

For the case will not, regrettably, down. A libertarian claque keeps it going, with dreary iterations of alleged public hysteria (jury) and sadism (judge). The high-water mark for intemperate accusations is established not by the propaganda of Red Square but by Justice Frankfurter:

I assert with deep regret, but without the slightest fear of disproof, that certainly in modern times Judge Thayer's opinion stands unmatched, happily, for discrepancies between what the record discloses and what the opinion conveys. His 25,000 word document cannot accurately be described otherwise than as a farrago of misquotations, misrepresentations, suppressions, and mutilations. The disinterested inquirer could not possibly derive from it a true knowledge of the new evidence that was submitted to him as a basis for a new trial. The opinion is literally honeycombed with demonstrable errors, and infused by a spirit alien to judicial utterance.61

56 Id. at 185.
57 Id. at 185-86.
58 These mythmakers are part of a fashionable school of irrationality whose leaders are Wittgenstein and Professor A. J. Ayer. See generally Ayer, Language, Truth and Logic (1936).
59 Montgomery 237-88.
60 There is a recent reprint of a 1933 book which vainly argues for the Morelli hypothesis. It is fathered by Professor Edmund M. Morgan whose introduction is replete with things like "the triumph of prejudice over reason" and "perversion of justice" and it may "happen again." Ehrmann, The Untried Case xvii (1960).
61 Montgomery 283, quoting from Frankfurter, The Case of Sacco and Vanzetti 104 (1927).
This broadside had no effect on the Supreme Judicial Court which affirmed Judge Thayer's denial of Madeiros' motion for a new trial. Also Justice Frankfurter's book does not specify the misquotations, misrepresentations, suppression and demonstrable error. In "A Note on Judicial Biography" Justice Frankfurter refers to "deep understanding of the judicial process, delicate analysis of character, and the creative humility of the artist." His attack on Judge Thayer shows none of these characteristics. It is not the Frankfurter of the great decisions, or the equally great dissents, who speaks.

It remains to hazard a guess as to the birth, growth and possible life cycle of the Sacco-Vanzetti canard. The birth is easy: the fateful decision of defense counsel to put radicalism into the case—to convert it into a trial of radicalism instead of a trial of the defendants. The growth is traceable to the Sacco-Vanzetti Defense Committee; the New England Civil Liberties Committee; and the American Civil Liberties Union. There is an interesting letter dated 1927 from the Director of the ACLU, quoted in Joughin and Edmund M. Morgan's book, reading as follows:

"The Civil Liberties Union has been connected with the Sacco and Vanzetti matter, but has hidden its participation under various false fronts. We are at present instigating a nation-wide movement among lawyers in the various university faculties to join as signatories... for a review of the case de novo. This work is being done behind the name of a group of lawyers at Columbia."

In June, 1925, the International Labor Defense (ILD) Committee, the American section of a Moscow-controlled organization, entered the case and cooperated from then on with the ACLU. It was critical of the Defense Committee for cooling off on the case as a class struggle. From then on the case proliferated into an international cause célèbre.

---

62 Frankfurter, Of Law and Men 107, 109-10 (1956).
64 Montgomery 67.
65 Id. at 72-74.
66 Joughin & Morgan, The Legacy of Sacco and Vanzetti 255 (1948). (Emphasis added.)
67 Montgomery 78.
68 Shachtman, Sacco and Vanzetti, Labor's Martyrs 49-50 (1927). The book referred to "the slow poison of middle-class treachery." Id. at 50.
Montgomery gives credit to the Frankfurter book for draping the robe of spiritual honor about the drooping shoulders of the "Two Crucified." He adds that the book "has done incalculable harm":

President Lowell himself said that, after reading it and before his own investigation, he had some doubts about the trial. Certainly the book was the basis for the faith of intellectuals, academicians, and clergy who could not but be impressed by what seemed on its surface to be an impartial and accurate survey by a professor of law at Harvard.

We do not agree with Mr. Montgomery in his strictures; at any rate it is impossible to believe that Justice Frankfurter acted from any but the best motives. Any other hypothesis would, on the basis of his prior and subsequent life, be out of character.

The interesting question suggests itself: How did the intelligentsia happen to fall for the defense propaganda? The answer can only be found in imponderables. There is a certain type of mind—Luther's, Voltaire's, Nietzsche's, which from birth is in revolt against the accepted, which operates on the grand radical maxim well expressed half a century ago by Stuart P. Sherman, namely, "the fact that all the best qualified judges agree that a thing is true and valuable establishes an overwhelming presumption that it is valueless and false." Also, it took courage in the Twenties to assail the established order of things even in the minor aspect of assaulting a court trial. The era was probably the nadir of American intellectual life; its chief characteristic a rampant materialism. The thinking people instinctively leaned toward a revolt. It was pre-eminently the era of conformism and convention, the country club set and the big Cadillac. As Van Wyck Brooks has pointed out, minor revolts from conformity are themselves characteristic of the Conformist State. Referring to that era he says:

What people admire is eccentricity, a partial deviation from convention that recognizes convention in the act of deviating from it. This is a result of urban life, which insensibly draws everyone into a herd. The desire not to be of the herd is in itself a herd-desire.

The most likely explanation of the intellectualist viewpoint is simply the smart-alecky of the half-educated. Justice Frankfurter himself de-
nounces this type of person, the woman he knew who went about telling everybody how wrong the trial was but could give no reasons; in fact she had not even taken the trouble to read Frankfurter's book.\textsuperscript{75} The written critiques of the trial are mostly hypercritical analyses—a nick here and a nick there, followed by sweeping conclusions.

Montgomery's book has lasting clinical value in its elaborate citation and analysis of the multitudinous assaults on the trial. It shows that fault can be found in all human testimony, particularly if there is incentive enough and money enough to stage the campaign. The case was really tried three times, once by the jury, next by the Governor and Joseph Wiggin, his eminent legal adviser, and lastly by a committee composed of the President of Harvard, the President of M.I.T. and a judge. We agree with Professor Samuel Williston that rarely, if ever, have defendants in a criminal case been so repeatedly and unanimously convicted by such competent tribunals.\textsuperscript{76}

The book, in the end, leaves us with an abiding confidence that no miscarriage of justice occurred and that the judicial processes of democracy are still respectable and secure.

\textbf{WILLIAM J. HUGHES, JR.*}


In the last few years there has been a rebirth of intense interest in the life and writings of Frederic William Maitland. In 1957 Maitland's daughter Ermengard wrote her personal tribute to her father in a short but moving portrait published by the Selden Society.\textsuperscript{1} In the same year Professor Warren O. Ault of Boston University published "The Maitland-Bigelow Letters."\textsuperscript{2} Although mostly personal in nature, the letters afford deep insight into Maitland's scholarly habits as well as presenting his own views on his works. \textit{Frederic William Maitland Reader} by Professor V. T. H. Delany of Queen's University of Belfast published in

\textsuperscript{75} Phillips, op. cit. supra note 72, at 204.

\textsuperscript{76} Professor Williston's view was set forth in a biography in the late 1940's. Yeomans, Abbott Lawrence Lowell 491 (1948).

* Professor of Law, Georgetown University Law Center.

\textsuperscript{1} E. Maitland, F. W. Maitland, A Child's-Eye View (1957).

1957 is a collection of selected writings by and about Maitland. Professor Helen M. Cam’s Historical Essays (1957) is perhaps the first real attempt, by means of a brilliant Introduction, to place some choice essays by Maitland in their historical perspective. In this respect, Professor Cam’s work differs substantially from both the Delany book and Robert Livingston Schuyler’s Frederic William Maitland Historian—Selections from His Writings published last year.

In his presidential address before the American Historical Association in 1951, Robert Livingston Schuyler spoke of Frederic William Maitland as the one historian who “has meant more to me than any other … not primarily for the subjects he dealt with, but for his methods, his insights, and his superb historical sense.” Nine years have passed since his address was given, yet the publication of Frederic William Maitland Historian is testimony to the continued reverence in which Maitland is held by the contemporary historian.

In his Introduction the author has relied heavily on his 1951 address. Rather than adopting Professor Cam’s technique of using the Introduction as an explanation of the writings selected by the editor (or indicating why certain selections were chosen over others), Schuyler presents a biographical sketch followed by an excellent general essay on Maitland as an historian. Even though the Introduction may not be fully integrated with the selections, when compared with the Cam book this paperback edition is a gem.

Maitland’s writings total about 140 items including reviews, articles in learned journals, his Selden Society publications and his major volumes. Professor Schuyler has chosen passages from those works of Maitland that have received the widest acclaim, using chapter headings for classification purposes.

---

3 The Delany book follows the pattern of the other Readers (e.g., The Holmes Reader, The Marshall Reader, The Brandeis Reader and the Alexander Hamilton Reader) published by Oceana Publications.

4 Cam, Selected Historical Essays of F. W. Maitland (1957).


6 For a bibliography of Maitland’s writings see Delany, Frederic William Maitland Reader 235-42 (1957).

7 Schuyler has included selections from: Introduction to Memoranda de Parlamento (1893), The History of English Law before the Time of Edward I (1895), Domesday Book and Beyond (1897), English Law and the Renaissance (1901), Pleas of the Crown for the County of Gloucester (1884), Praerogativa Regis (1891), Why the History of English Law Is Not Written (1888), Township and Borough (1898), The Suitors of the
If one were to ask what Maitland's chief impact on scholarship has been, we should, I suppose, say that Maitland brought law to bear on history and history to bear on law. To Maitland, "the history of law was not a specialised subsection of the history of England; it was an integral part of it; it was the key to the whole story." "Whether we like it or not," Maitland wrote, "the fact remains that, before we can get at the social or economic kernel of ancient times, we must often peel off a legal husk that requires careful manipulation."

Maitland felt that law was in history. He emphasized the danger of imposing legal concepts of a later date on facts of an earlier time. He protested against reading either law or history backwards. Conversely Maitland abhorred selecting a legal concept from the past and applying it to a present situation without regard to the setting in which it was originally born. In this he found the major difference between the historian and the lawyer. Maitland wrote:

[W]hat is really required of the practising lawyer is not, save in the rarest cases, a knowledge of medieval law as it was in the middle ages, but rather a knowledge of medieval law as interpreted by modern courts to suit modern facts. A lawyer finds on his table a case about rights of common which sends him to the Statute of Merton. But is it really the law of 1236 that he wants to know? No, it is the ultimate result of the interpretations set on the statute by the judges of twenty generations. The more modern the decision the more valuable for his purpose. That process by which old principles and old phrases are charged with a new content, is from the lawyer's point of view an evolution of the true intent and meaning of the old law; from the historian's point of view it is almost of necessity a process of perversion and misunderstanding. Thus we are tempted to mix up two different logics, the logic of authority, and the logic of evidence. What the lawyer wants is authority and the newer the better; what the historian wants is evidence and the older the better. This when stated is obvious; but often we conceal it from ourselves under some phrase about "the common law."

An eminent contemporary history professor, George O. Sayles of Aberdeen (Scotland), has said much the same thing:


8 Cam, op. cit. supra note 4, at xi.
9 Id. at x.
10 3 Maitland, Collected Papers 459 (1911).
11 "[A]ny one who really possesses what has been called the historic sense must, so it seems to me, dislike to see a rule or an idea unfitly surviving in a changed environment. An anachronism should offend not only his reason, but his taste." Id. at 486.
The lawyer is not in consimili casu: for the most part he does not need to know what the law used to be or even how it came to be what it is. The truth he seeks is contemporary to himself, the law as it is today, and if only he can ascertain that, then he may rest content.\(^\text{13}\)

Perhaps lawyers deserve Professor Sayles' gentle rebuke that they are interested in some venerable doctrine only to the extent that they feel compelled to find the last case that interpreted it. The fact of the matter is, for example, that the history of procedural reform in the Anglo-American legal system gives ample evidence of, if anything, an excessive attachment to the past.\(^\text{14}\) However, should we as lawyers subscribe to a view which in essence asserts that lawyers can function independently of a sense of history?

A knowledge of legal history is important to the practitioner. The lawyer can use legal history to illustrate that a current legal concept was established in response to necessities which have now disappeared or been greatly modified and should therefore no longer be applied.\(^\text{15}\) Legal history can indicate that a contemporary legal rule now regarded as "established" is not of ancient lineage but originated in fairly recent times by way of judicial aberration; or that a general rule has evolved not by common-law principles but by a process of "legal metamorphosis."

For those of us who wish to see the tradition of Maitland, Pollock and Holdsworth transplanted here, wide use in the law schools of Schuyler's paperback collection of Maitland's essays is—in view of the bleak spectre of contemporary indifference by the American law schools to legal history—encouraging and welcome.

It was Maitland's dream that law students study legal history.\(^\text{17}\) At Cambridge University, Maitland's alma mater, his vision has in some degree been realized. Unfortunately in this country law schools primarily teach current practice and doctrine. As Judge Wyzanski has

\(^{13}\) Sayles, The Court of King's Bench in Law and History 3 (1959).

\(^{14}\) See generally, Bodenheimer, The Inherent Conservatism of the Legal Profession, 23 Ind. L.J. 221 (1948).

\(^{15}\) See, e.g., the history of the rule limiting the admissibility of a confession of a crime in 3 Wigmore, Evidence §§ 817-20, 865 (3d ed. 1940).

\(^{16}\) See Professor Steffen's discussion of the general rule which requires "a servant or other agent to indemnify his master or principal who has paid damages to a third person injured by the unauthorized tort of the servant or agent," Restatement, Restitution § 96, comment a (1937), in Steffen, The Employer's "Indemnity" Action, 25 U. Chi. L. Rev. 465, 471-72 (1958).

\(^{17}\) Schuyler, op. cit. supra note 12, at 141-42.
pointed out, "[H]istory is a negligible part of the required reading. . . . We no longer believe either that the forms of action do, or that they should, rule us from the grave."18 And the bald and unhappy truth is that perhaps we no longer care.

SANFORD N. KATZ*


An invitation to review a book gives one an interesting choice: he may use the opportunity to vent some pet ideas more or less pertinent to the subject of the book, or he may resist the temptation and tell what the book is about. I shall describe the book.

Although it has been estimated that in one-fourth of the cases on the civil dockets of the federal courts the United States is a party, lawyers tend to regard government litigation as a mysterious specialty hardly resembling the ordinary grist of the judicial mill. This case book, assembled by two whose qualifications as specialists are beyond dispute, illuminates the unique features of actions by or against the Government. At the same time, however, it gives the generalist a new perspective and a measure of assurance by pointing out the many similarities between Government and private litigation.

The authors modestly disclaim any purpose to elucidate procedure, for the stated reason that books already exist which do this; but en-passant they teach important lessons in federal procedure, and particularly furnish useful hints of practical wisdom pertaining to out of court negotiations with government officials. Materials along this line are not readily found in textbooks on federal procedure. In fact, I regard as extremely valuable the opening chapter which explains the organization of the Department of Justice and other agencies, the functions of United States Attorneys and others in various types of cases, limitations on attorneys’ fees arrangements and illustrations of the “square corners” a person must turn when he deals with the Government.

When may a plaintiff sue in the district court, when must he go to the Court of Claims, and when should he resort to the Comptroller General for relief? And when, in litigating with the United States, is he


* Assistant Professor of Law, The Law School, Catholic University of America.
entitled to trial by jury? To what extent may administrative action be judicially reviewed under various enactments? What are the outlines of the doctrine of "implied agreement" as it relates to officers of the Government? Throughout the land there has been a steady increase in litigation under the Tort Claims Act,1 in which the United States has consented to be sued for a "negligent or wrongful act or omission," assuming liability with certain reservations "as a private individual under like circumstances." One of the reservations is "discretionary conduct." But what is discretionary? Where does the area of immunity in the exercise of discretion end and liability for lack of due care begin?

The lawyer who represents a claimant may want to know who is an "employee of the United States," and is there a special status of "non-appropriated funds instrumentalities" in respect to their torts or their contracts. He may have to inform himself as to when he may get his desired remedy by suing a government officer, and when this will not be permitted. Before bringing an action it may become necessary to inquire into the unique operation in respect to the Government, of statutes of limitations, sometimes found in federal legislation, sometimes in state law. The relation between the United States and its employees may present other problems—where the question is discipline of the employee, indemnity to reimburse the Government for losses he occasioned, promotions, trials upon charges, or perhaps dismissal without trial.

These and hundreds of other questions which will arise to puzzle the general practitioner are treated in this volume of illustrative cases. It is a rich storehouse of information, carefully selected, to which student or lawyer can turn for a quick reference and at least a start in his research. The contents are logically and conveniently arranged and well indexed. Editorial notes are appended, concisely pointing out the impact of the cases, and where a decision has been significantly qualified this is carefully noted to avoid misleading the reader.

Professor Schwartz and Professor Jacoby must have expended a prodigious amount of labor and patience in producing this compilation. A new and useful tool has been fashioned for which the profession is deeply indebted to them.

Simon E. Sobeloff*

---

* Chief Judge, United States Court of Appeals for the Fourth Circuit.
BOOKS RECEIVED


807