THE CONSTITUTIONALITY OF THE UNDISTRIBUTED PROFITS TAX

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On November 8, 1938, the electorate of the state of New York rejected\(^1\) the principle of undistributed profits taxation by amending their state constitution to insert a provision that "undistributed profits shall not be taxed". This action of the New York electorate prompts further consideration of the entire subject.

On May 27, 1938, a bill amending and modifying the federal tax on undistributed profits of a corporation\(^2\) became law without the President's signature. This tax is called an income tax and purports to levy rates at a graduated schedule upon corporate profits which are not distributed to the shareholders before the end of each fiscal year. The effect of the modification was to lower the rates theretofore in effect and to lessen the burdens, particularly as to small corporations. But the underlying principle of the tax was not altered, and its constitutionality is still open to question. While this modified law is to continue in effect for two years, the Senate Finance Committee has indicated that it might propose that the law be either further altered or repealed at the present session of Congress.

It is our purpose here to discuss the constitutionality of this tax from two related points of view: (1) That it may be an invalid penalty, having been enacted as an instrument of reform for the purpose of effecting a redistribution of wealth, and not primarily a revenue measure in so far as corporations are concerned; (2) that it may be, in effect, an invalid levy upon capital, not being apportioned as required by the federal constitution.

The Supreme Court of the United States has not yet been called upon

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\(^1\)Article XVI, Section 3 of the Revised and Amended Constitution of the State of New York.

to decide this question. The only reported decision on this point that we know of was promulgated by the United States Board of Tax Appeals on December 8, 1938, in Crane Johnson Company v. Commissioner. 3 The constitutionality of the tax was there attacked on three grounds: (1) that the surtax was not an income tax within the Sixteenth Amendment and was not apportioned among the states; (2) that the Tenth Amendment was violated as the surtax attempted to regulate the internal affairs of the corporation and interfered with the power to declare or withhold dividends, a power conferred by the State; and (3) that it discriminated unfairly between stronger and weaker corporations and corporations having certain contracts and those having none.

In upholding the constitutionality of the surtax the Board relied upon the recent decision of the Supreme Court in Helvering v. National Grocery Company. 4 The National Grocery Company case does not seem to be an authority on this point, however. In that case, the Court upheld as a constitutional and valid income tax Section 104, of the Revenue Act of 1928 4a, in force since 1921, which is based upon a guilty intent on the part of a corporation to accumulate surpluses and avoid the tax. This levy is entirely different from the new tax, in that intent is no criterion in the imposition of the new tax, all corporations, regardless of motive, being subject thereto. We will presently discuss this distinction at greater length. The Court held that the levy was not a penalty as contended by the taxpayer. But its decision has no weight in determining the issue we raise here, i.e., that the new act may be an unconstitutional capital levy and not a true income tax. 5

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3 38 B. T. A. 1355 (1938).
4 Helvering v. National Grocery Co., 304 U. S. 282 (1938). The court held: (1) that the statute did not violate the Tenth Amendment because of interference with the power to declare or to withhold dividends, a power which the State conferred upon the corporation; (2) that the statute was not a penalty on the ground that the sole owner of the business could not be conducting it as a corporation, and prevent Congress, if it chose to do so, from laying on him individually, the tax on the year's profits; (3) that purpose or state of mind may determine the incidents of an income tax; (4) the section was not unreasonable, arbitrary and capricious in that no standard or formula was specified to guide the Commissioner in assessing, or the corporate directors in avoiding, the additional tax or in that it was assessed retroactively or was unfair to non-assenting minority stockholders; and (5) that no legislative power was invalidly delegated to the Commissioner. The court decided, however, that there was ample evidence to support the findings of the Board of Tax Appeals and that the Circuit Court of Appeals erred in attempting to reach its own conclusion on the evidence and that, therefore, the judgment should be reversed.
5 In the recent case of Almours Securities Inc. v. Commissioner of Internal Revenue, 91 F.
I. A PENALTY

The mere penal nature of a tax alone is, of course, insufficient to condemn it if it is permissible under the Constitution. A penalty, if valid, may be levied to enforce the revenue laws. But we will show that the undistributed profits tax is a direct tax and not apportioned. Furthermore, it is an encroachment upon the power of the States to regulate the declaration of dividends. In both respects, it is apparently an invalid penalty, masquerading as a tax.

One acknowledged purpose of the undistributed profits tax was to force distribution of income to shareholders for the purpose of collecting additional taxes from the latter. But we must disregard this purpose in considering the rights of the corporation. Confining ourselves to the corporate entity alone, as distinguished from the shareholders, the whole history of the tax tends to show that the primary motive of the supporters of the tax was to procure reform and redistribution of wealth and raising of revenue was merely a secondary or incidental purpose.

President Roosevelt, as early as 1932, presaged drastic action with regard to corporate thrift when, in his speech before the Democratic Convention, he criticized corporate saving and declared that the tremendous corporate profits of the 1920s had largely escaped federal taxation. Furthermore, the hostility of the Administration to large

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(2d) 427 [C. C. A. 5th, 1937] cert. denied by the Supreme Court on January 10, 1938, 302 U. S. 765; rehearing denied (Feb. 7, 1938) 303 U. S. 666, the constitutionality of kindred earlier legislation, namely, the tax on surpluses of personal and family holding companies 49 Stat. 1732, 26 U. S. C. A., § 331 (1936), was upheld. Counsel for the taxpayer, in addition to the penalty argument, raised the question that this was not a true income tax, as we do here, but did not argue the matter at length. Moreover, the court did not expressly pass upon this point, but, in stating its decision, merely referred to the case of United Business Corp. v. Commissioner of Internal Revenue, 62 F. (2d) 754 (C. C. A. 2nd, 1933); cert. denied, 290 U. S. 635 (1933) and other earlier cases.

The fact that the United States Supreme Court denied review to the taxpayer in both the United Business and the Almours cases, is not deemed by that court an approval by it of the decisions of the Circuit Court of Appeals. Atlantic Coast Line R. R. v. Powe, 283 U. S. 401, 403-4 (1931). Therefore, we are continuing to deal with the matter of whether the surplus tax is a true income tax as an open question.

The Collector v. Hubbard, 12 Wall. 1, 17 (U. S. 1870) which may be relied upon by the Administration in support of the constitutionality of this tax, has been definitely overruled. Pollock v. Farmers' Loan & Trust Co., 158 U. S. 601, 627, 628, 637 (1895); Eisner v. Macomber, 252 U. S. 189, 218 (1920). See also Rhode Island Trust Co. v. Doughton, 270 U. S. 69, 83 (1926).


corporations had been manifested in numerous other ways. Soaking the rich and redistributing their wealth have been repeatedly emphasized as an object in the Administration’s tax policy. President Roosevelt himself has frequently inveighed against “entrenched greed”, “economic royalists”, “princes of privilege”, and “unjust concentration of wealth and economic power”.

On March 3, 1936, the President appeared before Congress in person and urgently recommended and exhorted Congress to pass this new form of taxation. He based his request upon the expected shortage of federal revenue as a result of the decision7a of the Supreme Court of the United States, declaring the Agricultural Adjustment Act7b unconstitutional and invalid, and of the enactment of the Veterans’ Bonus.7e The President, in urging this new tax, professed to be pointing at those persons and families who were making use of the holding company for the purpose of amassing wealth and avoiding the payment of any individual income taxes by withholding dividends and piling up surpluses. He wanted manifestly to prevent the wealthy from increasing their riches in this way and to obtain a redistribution of wealth.

This alleged aim of the new tax would seem however, to be without good foundation as there had been on the books since 1934, legislation8 designed to catch personal and family holding companies and prevent them by taxation from amassing surpluses. It was similar in effect to the new law, except that it was limited in its application to such holding companies. Moreover, the Revenue Act of 19378a by reason of the confiscatory rates levied upon personal and family holding companies, has practically done away with this excuse for the new law. Under the Act of 1921b still in force with respect to corporations other than personal holding companies, it was necessary for the Government to prove that the corporation was formed or availed of for the purpose of avoiding the imposition of the surtax on its stockholders, although the same statute created a presumption in the government’s favor.9a Guilty intent is of

8c 49 Stat. 1676, 26 U. S. C. A. § 104 b (Supp. 1938) provides: “The fact that any cor-
course, a very intangible and difficult concept and not easily susceptible of proof, and this earlier law was deemed inadequate for that reason.

In his zeal for the new tax, however, the President did not discriminate; and, under the new law, rich and poor alike must suffer, large and small corporations, good and bad corporations, regardless of their intent, whether they are amassing wealth or merely following a conservative policy for purposes of repair and expansion, or to meet adverse contingencies. Corporations are penalized for their thrift because, at least so the Treasury Department contended, a small indeterminate group accumulate surpluses and avoid tax liability by hiding behind the cloak of the corporate entity. Thus, although the end, as to those with guilty intent, may be desirable, the means, as to innocent and guilty alike, seems without question, destructive.

The Act of 1921\textsuperscript{10} imposed a surtax of 25\% on the first 100,000 of adjusted net income and of 35\% of the remaining with respect to all corporations. This law has been in force, in substance, since 1921. It has been upheld by the courts as constitutional and not a penalty.\textsuperscript{11} The results apparently achieved by a vigorous enforcement of this statute by the Treasury Department in the last few years seems to indicate that the prior difficulty is due, at least to some extent, to administrative inaction.

There is a difference, however, between this tax and the new tax. In the imposition of the new tax, intent is no criterion. The new tax is automatic in operation. All corporations withholding or “plowing back” profits are subjected to it, regardless of motive, even though their financial condition require profits to be retained in the best judgment of the management. This distinction disposes of cases such as \textit{Helvering v. National Grocery Company}, is so far as they may be claimed to be authorities on the constitutionality of the tax under discussion.

In \textit{Williams Investment Co. v. United States},\textsuperscript{12} the Court of Claims pointed out the distinction between the old law with the element of intent to accumulate and avoid and an arbitrary law\textsuperscript{13} such as the new one, although it was not then enacted, when it said:\textsuperscript{13a}

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\textsuperscript{10}Cited, \textit{supra}, note 9.

\textsuperscript{11}Cases cited in notes 4 and 5. Also Keck Inv. Co. v. Commissioner, 77 F. (2d) 244 (C. C. A. 9th, 1935); Williams Inv. Co. v. United States, 3 F. Supp. 225 (Ct. Cl., 1933).

\textsuperscript{12}F. Supp. 225, 233 (Ct. Cl. 1933).

\textsuperscript{13}An arbitrary presumption to prevent evasion of the Estate Tax Law was declared invalid in \textit{Heiner v. Donnan}, 285 U. S. 312 (1932).

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"The section does not make the accumulation of surplus an absolute test for classification, but merely a prima facie classification. It does not tax all corporations which accumulate their surplus, but classifies those as subject to the tax who make such accumulation for the purpose of preventing the imposition of the surtax on their stockholders, leaving each corporation free to establish as a fact, if such be the fact, that the accumulation was for the needs of the business."

Apparently, because of the alleged difficulty in enforcing this law, personal and family holding companies were struck at directly by the enactment of 1934, the element of guilty intent to avoid being dispensed with.

In his appearance before Congress, the President pointed out that the new undistributed profits tax had been suggested before. Professor Rexford Tugwell urged such a tax in his book entitled Industrial Discipline. Prior to Professor Tugwell's book, however, the tax had not only been mentioned, but it had been enacted in various forms.

The Revenue Acts of 1864, 1865, 1867, and 1870, taxed all corporate income to the shareholders according to their distributive share but their invalidity was probably determined by the Pollock case. The Civil War taxes were at the moderate rate of 10% as a maximum. They were distinctly revenue measures and were not intended to procure reforms.

Again, after our entry into the World War, every corporation was required to pay a tax of 10% on net income of the preceding calendar or fiscal year, remaining undistributed six months after the end of such year, unless such net income was: (1) actually invested and employed in the business, (2) retained for employment in the reasonable requirements of the business, or (3) invested in obligations of the United States issued after September 1, 1917. Under this Act, if any portion of the

133(1933) Chapter Eight.
13413 Stat. 281 (1864).
13514 Stat. 478 (1867).
13616 Stat. 257 (1870).
137In Pollock v. Farmers' Loan and Trust Company, 158 U. S. 601 (1895) the Supreme Court held that income taxes theretofore levied were unconstitutional. The Sixteenth Amendment allowing an income tax to be levied by the Federal Government was not approved until 1913.
net income for the taxable year retained for employment in the business
was not so employed, or was not reasonably required in the business, the
tax should be at the rate of 15%. However, these provisions were taken
off the books immediately, while the normal income tax remained.17 The
tax proposals at this time were apparently recommended by the late
Doctor Thomas S. Adams of Yale University, but the tax was then de-
sign as a revenue producer and not as an instrument for corporate reform.18

In 1924, an amendment to the Revenue Act of that year embodying
the principle of this form of taxation was passed by the Senate,19 but
proceeded no further.

In 1927, a tax on undistributed earnings was suggested again in Con-
gress, and the Joint Congressional Committee headed by Mr. L. H.
Parker, made a comprehensive study of such a tax and reported adversely
thereto,20 for the burden which it would place on legitimate and proper
business expansion, and because it might cause the making of unwise
distributions and prevent the accumulation of reasonable and proper
surplus.

The surplus tax has also been tried in Norway, Sweden and Belgium,
but has met with failure or indifferent success, mainly because of its
tendency to penalize thrift.21

Immediately after the President’s message there was a storm of pro-
test.22 Economists all over the country at once saw the inherent dangers
of the new proposal. Estimates were taken as to the amount of revenues
that could be taken in by the Treasury under such an act.23 Senator
Byrd of Virginia, in a letter to Secretary Morgenthau of the Treasury,
pointed out how the largest and strongest corporations in the country
such as the American Telephone and Telegraph Company, American
Tobacco Company, American Smelting and Refining Company, General
Electric Company, National Biscuit Company and others, would not be
obliged to pay any surtax at all under the new Act. On the other hand,

17Repealed by 40 Stat. 1149 (1919).
18Buehler, op. cit. supra, note 15, at page 31; and text pp. 8, 9.
20Quoted from page 21 of the Report of the Ways and Means Committee of the House,
dated April 21, 1936. 74th Cong. Sess. II.
21Note (1936) 50 Harv. L. Rev. 332. See testimony of Noel Sargent, Economist and
Secretary of the National Association of Manufacturers, Hearings before the Committee
22The New York Times, April 8, 1936, p. 1; April 14, 1936, pp. 1 and 5.
Treasury officials, under the domination of the Administration, predicted\textsuperscript{24} that sufficient revenues would be received from the stockholders to meet the additional expenses caused by the AAA decision and Veterans' Bonus legislation.

Throughout the arguments made against the tax, however, there prevails one theme, that is, that the revenue from corporations, under the proposed undivided profits tax could not possibly be accurately predicted. Even the majority of the supporters of the tax agreed that the increase in revenues would come primarily from individuals who would be taxable upon additional dividends which corporations would be compelled to pay out to avoid the tax.

In the debates in the House\textsuperscript{25} and Senate upon the proposed bill, the fact that the additional revenues the tax would produce from corporations were uncertain, was continuously commented upon.

For example, Representative Vinson of Kentucky, said:\textsuperscript{26}

"Now, there will be many corporations that will pay no tax."

Representative Snell remarked that there was no information as to the amount of revenue the bill would produce, saying:\textsuperscript{27}

"... The guess is that this bill will produce six hundred to eight hundred millions more than the laws it repeals. But no one actually knows... So far as I have been able to ascertain, no one has been able to predict with any degree of certainty the amount of revenues which this bill will produce..."

Representative Hollister of Ohio said:\textsuperscript{28}

"There are several provisions in the bill as drafted which have little to do with the raising of revenue and which would seem to indicate that the chief purpose of the bill has been forgotten."

Representative Reed stated:\textsuperscript{29}

"The pending proposal will not assure a reliable flow of revenue. On the contrary, it is a final step in the drastic regulation of American business rather than a workable proposal to produce revenue."

\textsuperscript{24}The New York Times, April 7, 1936, pp. 1 and 20.

\textsuperscript{25}At the time of the comments of members of the House, quoted herein, it was not proposed to impose a flat-rate normal income tax on all corporations. The undistributed profits tax was to be the sole income tax. The Senate amended the bill to impose a flat rate of 8% to 15%, 15% being levied on all normal tax net incomes in excess of $40,000 per annum. The old rate was 13\%\% of net income.

\textsuperscript{26}80 CONG. REC. 6434 (1936).

\textsuperscript{27}80 CONG. REC. 6441, 6444 (1936).

\textsuperscript{28}80 CONG. REC. 6450 (1936).

\textsuperscript{29}80 CONG. REC. 6314 (1936).
Although these statements were made in the House, when the sole corporate income tax proposed was the tax on undistributed profits and before the Senate added thereto a continuation of the flat rate normal income tax on all corporations to meet such objections, they are nevertheless, still applicable to the surtax on undistributed profits, the constitutionality of which concerns us here. The uncertainty of the revenue was also commented upon by the Ways and Means Committee of the House.\textsuperscript{30}

If the Administration had merely sought to increase revenues from corporations, it is self-evident that it could have raised the existing income tax rates for corporations sufficiently to accomplish that purpose. In fact, a substantially higher levy was approved by many in preference to the undistributed earnings tax. Instead, however, the Administration proposed a tax admittedly experimental in its nature, under which the largest and wealthiest corporations might escape entirely the payment of any federal undistributed earnings tax or surtax, by a complete distribution of all their earnings to shareholders. Consequently, it could not be accurately predicted what revenues might be collected from corporations by means of this surtax.

When we examine all the evidence in the light of the President's speech recommending the undistributed profits tax, there can be no doubt that reform and regulation, rather than revenue were uppermost in the mind of the President, and the Congressional supporters of the tax.

The Supreme Court of the United States has proscribed the use of a penalty in the guise of a tax as unconstitutional. Let us examine a few of the leading decisions of the Court and see how its definition of unlawful penalties befits the tax on undistributed earnings of corporations. We shall find that the possibility of the taxpayer avoiding entirely the imposition of the additional levy by following a prescribed course of conduct under the terms of the law is one of the most important indicia of an invalid penalty.

In \textit{United States v. Constantine}\textsuperscript{31} the Court held that Congress could not, in the guise of a tax, impose sanctions for violation of a state law respecting the local sale of liquor, and Mr. Justice Roberts pointed out that where, in addition to the normal and ordinary tax fixed by law, an additional sum is to be collected by reason of conduct of the taxpayer

\textsuperscript{30}Views of the Minority of the Ways and Means Committee; Report No. 2475; April 21, 1936, pp. 27, 28. 74th Cong. Sess. II.

\textsuperscript{31}296 U. S. 287, 294, 295 (1935).
violative of the law, and this additional sum is grossly disproportionate to the amount of the normal tax, the conclusion must be that the purpose is to impose a penalty as a deterrent and punishment of unlawful conduct, and that the regulation of the conduct of its own citizens belongs to the state, not to the United States.

In *Carter v. Carter Coal Company*\(^{\text{82}}\) the Supreme Court held that the excise tax imposed by the Bituminous Coal Conservation Act of 1935, based on the sale price at the mine of coal produced for sale on the fair market value of coal produced for the sole use of the producer, 90 per cent of which is rebated to producers who agree to and do abide by the scheme of regulation set up by the Act, is not a tax but a penalty, the constitutional power to impose which depends upon whether the regulatory provisions of the Act are within the powers of Congress. The Court decided\(^{\text{88}}\) that the "excise tax" was not imposed for revenue but exacted as a penalty to compel compliance with the regulatory provisions of the act, and therefore invalid.

In *United States v. Butler*\(^{\text{84}}\) in holding the Agricultural Adjustment Act invalid, the court found the tax a mere incident to the regulation of agricultural production and after reviewing the decisions, said: "These decisions demonstrate that Congress could not, under the pretext of raising revenue, lay a tax on processors who refuse to pay a certain price for cotton and exempt those who agree so to do, with the purpose of benefitting producers."

*Helwig v. United States*\(^{\text{85}}\) is a leading authority on the definition of a penalty. The question was whether the district court had jurisdiction of a suit by a collector to recover further sums levied on imports on the theory that such further sums were "penalties", it being conceded that the district court had jurisdiction of an action to recover a penalty. After defining penalties, Mr. Justice Peckham held that where the "additional duty" or "further sum" was so large in proportion to the value of the merchandise imported, as to show beyond doubt that it was a sum imposed not, in fact, as a duty upon an imported article, but as a penalty and nothing else, it was invalid.\(^{\text{86}}\)

\(^{\text{82}}\)298 U. S. 238, 289 (1936).

\(^{\text{83}}\)Id. at 289 where the court said: "The whole purpose of the exaction is to coerce what is called an agreement—which, of course, it is not, for it lacks the essential element of consent. One who does a thing in order to avoid a monetary penalty does not agree; he yields to compulsion precisely as though he did so to avoid a term in jail."

\(^{\text{84}}\)297 U. S. 1, 70 (1936).

\(^{\text{85}}\)188 U. S. 605 (1903).

\(^{\text{86}}\)Id. at 610, 611.
In Bailey v. Drexel Furniture Company61 (Child Labor Tax Case) the court held unconstitutional a federal statute providing that any mine or quarry, or mill, cannery, workshop or factory which permitted children under certain ages to work more than 8 hours a day or six days a week during any portion of the taxable year must pay an excise equivalent to 10% of the entire net profits received or accrued for such years from sale or disposition of products; but knowledge on the part of the employer was required. The court held it to be a penalty.

These authorities indicate that there is, under the Constitution as interpreted by the Supreme Court, a difference between a tax and a purely regulatory and penal measure. Under its powers to tax, Congress may not trespass where powers have not been conferred upon it elsewhere in the Constitution, and the States have sole authority.38

It is difficult to find the source of Congressional power to coerce the declaration of dividends and to regulate the management of corporations in the exercise of their wisdom as to the extent to which earnings may be plowed back into the corporate enterprise for any worthy purpose. And Congress certainly has no power to enact for penal and regulatory purposes a direct tax without apportionment.

II. A LEVY ON CAPITAL

The undistributed profits tax purports to be an income tax under the powers conferred by the Sixteenth Amendment to the Federal Constitution. But it is questionable whether it is an income tax within the meaning of that Amendment, or moreover, a valid tax within any of the taxing powers granted to Congress. Disregarding names and looking solely at substance, there would seem to be good grounds for holding that it is an unconstitutional levy on capital, or a penalty levied as a direct tax on the ownership of property and invalid under Article I, Section 9, clause 4, of the Constitution, as not having been laid in proportion to the census.

In determining Congressional powers, we find two classes of taxes, direct and indirect or excise taxes. The Constitution recognizes these two classes and "lays down two rules by which their imposition must be governed, namely: the rule of apportionment as to direct taxes, and the rule of uniformity as to duties, imposts and excises."39 The rule of

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61See also Hill v. Wallace, 259 U. S. 44 (1922).
38For example, many states have laws concerning the impairment of capital upon which the surplus tax is an encroachment. Such encroachment would be invalid under the Tenth Amendment. See Hopkins Federal S. & L. Assoc. v. Cleary, 296 U. S. 315, 335 (1935).
apportionment has been found especially difficult to comply with; the rule of uniformity simple in application.\(^4\) Both rules are held to be not so much limitations upon the plenary power to tax, as regulations concerning the mode in which such powers are to be exerted.\(^4\)

In 1895, in the famous Pollock case,\(^4\) the Supreme Court of the United States held unconstitutional a tax on incomes as it was a direct tax without apportionment in so far as it dealt with income from property, as distinguished from income from "professions, trades, employment or vocations." A tax on income from these latter sources, the Court held valid as an indirect or excise tax satisfying the requirement of uniformity. In spite of the partial validity of the tax, however, the court felt obliged to hold that the whole law was unconstitutional, because Congress could not have intended to discriminate in favor of property owners and to have contemplated the law as being enforced in part only.

In 1913, as a result of the Pollock case, the Sixteenth Amendment to the Federal Constitution was approved by the people. It provided that "Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

The whole purpose of this Amendment was to relieve from the requirement of apportionment all taxes on income from property, as well as from trades and professions.\(^4\) It did not seek to define income or to make taxable new objects.\(^4\)

This Amendment must be strictly construed, and not extended beyond

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\(^4\)By the second section of the first article of the Constitution, it is provided that direct taxes shall be apportioned among the several states, according to their numbers, to be determined by the rule prescribed. By the ninth section of the same article, it is further provided that no capitation or other direct tax, shall be laid, unless in proportion to the census or enumeration before directed. The rule of apportionment is very difficult to comply with. See Hylton v. United States, 3 Dall. 171 (U. S. 1796). Attempts have been made, but met with failure. See Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 572, 573 (1895). See Edward B. Whitney, The Income Tax and the Constitution (1907) 20 Harv. L. Rev. 280.

By the eighth section of the first article of the Constitution, it was declared that Congress shall have power to lay and collect taxes, duties, imposts and excises; but all duties, imposts and excises shall be uniform throughout the United States. Little difficulty has ever been encountered by the Federal Government with regard to uniformity.

\(^4\)Veazie v. Fenno, 8 Wall. 533, 541 (U. S. 1869).

\(^4\)Pollock v. Farmers' Loan & Trust Co., cited supra note 39.


its literal meaning. In Edwards v. Cuba Railroad the Supreme Court of the United States said that the Sixteenth Amendment "is to be taken as written and is not to be extended beyond the meaning clearly indicated by the language used."

Whether the surtax be deemed one on property or capital or one upon income, depends upon how we regard the item of undistributed profits of a corporation. Is it still income to a corporation or does it at some point become property or capital at rest? It does not matter that the tax is described as being a tax on income. It may be, nevertheless, an invalid direct tax on capital masquerading as an income tax. In determining its validity, we do not look to names or descriptions but to the substance of the tax.

The Act itself misleads us as it defines undistributed profits as "undistributed net income". To say that Congress has set up a new accounting item in "undistributed net income" which is something totally different from undistributed or undivided profits is to shadow box with terminology. It would not change the substance or essential characteristics of the item and make it income, rather than capital.

It would seem that after its receipt, income ceases to be such. It comes to rest or repose. It then becomes capital, just as any other property. It may then be invested in land, repairs, or capital improvements, or in stocks and bonds, but it is no longer income. It has taken the form of capital, from which further income may be derived. In other words, it is capital. The word income connotes the receipt of property, not its retention or ownership.

The leading judicial definition of income is found in Stratton's Independence v. Howbert, a case arising under the Corporation Tax Act of 1909, where the Supreme Court said: "'income' may be defined as the gain derived from capital, from labor, or from both combined...."

In Eisner v. Macomber the court further expanded upon the definition of income, especially the words "the gain derived from capital," saying:

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46268 U. S. 628, 631 (1925).
49231 U. S. 399, 415 (1913).
51252 U. S. 189, 207 (1920).
"Here we have the essential matter: not a gain accruing to capital, not a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested or employed, and coming in, being 'derived', that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal;—that is income derived from property. Nothing else answers the description." (Italics by the Court).

Thus, the Supreme Court emphasizes not only the idea of derivation and severability from property, in income and the sources of income, but lays great stress upon the coming in or receipt by the recipient, the taxpayer.

The undistributed profits tax, however, does not purport to be upon the receipt of income; it is on its retention, if it can still be called income after its receipt.\(^5^1\) The Sixteenth Amendment purported to permit a tax only upon the receipt of income. A tax on its retention and enjoyment was probably never conceived prior to its adoption.

For example, from a practical point of view, if undistributed profits are taxable at all, the line may not be drawn and the tax restricted to accumulated net earnings of the current year; years afterward a tax might be levied. The undistributed profits might change in form several times during a current year and become invested in new plant and equipment. However, even after it has been reinvested and become indubitably a capital item, "undistributed net income" is still taxable under the Act on the theory, we suppose,\(^5^2\) that dividends may still be

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\(^{51}\) The problem is also stated in a novel way by Homer Hendricks in an article entitled *The Surtax on Undistributed Profits of Corporations* (1936) 46 Yale L. J. 19, 48, where the writer says: "A redefinition of 'income' may be required if this tax is sustained. For the undistributed profits surtax is not imposed on the receipt of income, but on the disposition which a corporation makes of its income. The question here is whether an income tax must necessarily be imposed only with respect to income receipts and not with respect to income disbursements. A tax on spending, generally imposed on all spending and at rates varying according to the spending which Congress desired to encourage or discourage would, runs the argument, not be sustainable as a tax on 'income'. It is argued that a tax may not, unless clearly necessary to prevent evasion of the ordinary tax on incomes, be imposed as a result of the use which a taxpayer makes of the income. When the question reaches the courts, more analysis will be required than has as yet been made in any of the decisions regarding the nature of the income tax and the powers which Congress has with respect thereto. The income tax is in its nature an excise. Heretofore it has been imposed in respect of the receipt of income; whether, if imposed on disbursement or failure to disburse in a specified way, it becomes something other than a tax on income remains to be decided."

Thus, it is recognized that the surtax on undistributed profits is not one upon the receipt of income but upon its retention, if it may still be deemed income after its receipt.

\(^{52}\) *Kiekhoffer, Economic Principles, Problems and Policies* (1936) 592, observes
paid as long as there is a legal surplus. This would seem to be a most complete disregard of substance. Ordinarily, undistributed or undivided profits have never been considered income by accountants, courts, lawyers, legislators or laymen.

Ordinarily after its receipt, income is entered by the corporation in its profits and loss account. At the end of the fiscal year, when the statement is made up, earnings which have not been expended for capital, repairs, to pay off indebtedness or distributed to stockholders, are generally transferred to an undivided profits account or to an account called "earned surplus", which usually represents reinvested corporate earnings. The undivided profits or earned surplus are embraced within the item called "surplus" on the corporate account, this item being partly derived from other sources, such as contributions and cancellation of capital stock as well as accumulation of earnings. Surplus itself is not cash or its equivalent, as commonly supposed, but is merely the difference between the stated total value of the assets of the business and its total liabilities, including outstanding indebtedness and either the stated or par value of the outstanding stock. It is sometimes said to represent the "excess of proprietorship over the capital stock". Thus, it is the important balancing item of the financial statement. But this item has never been construed as income in any sense of the word; it is a part of the capital of the corporation. As we have indicated, in most instances, undistributed or undivided profits are not even in the form of cash so as to be distributable to stockholders, but are in some reinvested form,

"Surplus profits at any time invites the imposition of both regular income taxes and taxes on surplus profits."

In Williams v. Western Union Tel. Co., 93 N. Y. 162, 192 (1883), the court held that, where the surplus is invested in plant, the company could borrow money on the faith of it and divide that among the shareholders. However, this does not justify a tax on undistributed surplus for the purpose of forcing dividends. Even profits, though earned and remaining in the business, if insufficient to offset an impairment of capital, do not constitute "undivided profits" or surplus. Willcuts v. Milton Dairy Co., 275 U. S. 215 (1927).

I KESTER, ACCOUNTING, THEORY AND PRACTICE (3rd ed. 1930) 421; KILKHOFER, op. cit. supra, note 52, at 106.

PATON, ACCOUNTANT'S HANDBOOK (2nd ed. 1937) 965.

DEWING, FINANCIAL POLICY OF CORPORATIONS (3rd ed. 1934) 580; HATFIELD, ACCOUNTING (1927) 304.


HATFIELD, op. cit. supra, note 56, at 304.
serving either potentially or actually as a source of further income, or are property at rest for which the corporation has no immediate use.

The courts have consistently looked upon undistributed or undivided profits as a constituent part of the capital of a corporation, not as the income thereof. Although these cases are not decisive as to the invalidity of the tax in question, they are enlightening.

In *Gibbons v. Mahon*,\(^6\) the Supreme Court of the United States held that reserved and accumulated earnings, so long as they are held and invested by the corporation, are "part of its corporate property", and therefore, the interest therein represented by each share of stock is capital, not income, of that share, as between the tenant for life and the remainderman of a trust.

In *Southern Pacific Company v. Lowe*,\(^6\) the Court held that an accumulation of surplus earnings, received before the adoption of the Sixteenth Amendment and the effective date of the Income Tax Act of 1913,\(^6\) was to be regarded as a part of the capital, not the income of the corporation, for the purposes of that act.

In *Eisner v. Macomber*,\(^6\) the Court held that a stock dividend, evincing merely a transfer of an accumulated surplus to the capital account of the corporation, if taxable, would be a tax on capital increase and not on income, and must be apportioned under the Constitution.

In *Des Moines National Bank v. Fairweather*,\(^6\) there was involved a statute of the State of Iowa assessing a tax on shares of capital stock of national banks in conformity with the terms of federal legislation assenting to such taxation, and the court held that, in determining the value of such shares, the capital, surplus and undivided earnings of the bank were the substantial elements to be taken into account.

In *Appeal of City National Bank*,\(^6\) the Board of Tax Appeals was dealing with the excess profits tax and the meaning of the words "invested capital" in that tax and said that invested capital includes earned surplus and earned surplus is nothing more than the accumulated, undistributed earnings of prior years.

Congress itself has recognized at least indirectly that undistributed surplus or undivided profits are a part of the capital of a corporation.

The Revenue Act of Feb. 24, 1919\(^6\) levied a special excise tax with respect to carrying on business on every domestic corporation, equiva-


lent to one dollar for each one thousand of so much of the fair average value of its capital stock for the preceding year ending June 30th as was in excess of $5,000. The statute further provided that, in estimating the value of the capital stock the surplus and undivided profits shall be included. This statute was upheld in *Ray Consolidated Copper Company v. United States.*

Moreover, there are many decisions under statutes at the time of the Spanish War, and the World War, which levied taxes on banks for the use of and, to the extent that they employed, capital in the banking business. These statutes were not always specific in defining capital. For example, the Act of Congress of June 13, 1898, provided that banks using or employing capital not exceeding certain amounts should pay certain federal taxes, and that, in estimating capital, surplus should be included. Under this statute, undivided profits of a bank were considered surplus, "in the sense that they are a constituent of capital" and such undivided profits were included in the taxable capital of the bank. Like results were reached under a similar federal statute passed in 1914 which expressly provided that undivided profits shall be included in capital.

When does income become capital? At some point income ceases to be such and becomes undivided surplus or profits and capital. That transition would seem to take place immediately after the receipt thereof by the corporation. It thereupon loses its identity as income and becomes mingled with the other assets.

A good analogy is found in the case of the federal salary received by an officer of the United States Navy. There, a city in Massachusetts taxed the officer's bank deposit which consisted only of money received by the officer as his salary in the naval service. Although it was conceded that a state or municipality could not tax the salary of the officer as income, the tax was upheld as constitutional as the Massachusetts Supreme Court said, after the money was paid to the officer, it lost all federal nature and became indistinguishable from any other personal property taxable by the state. Thus, the salary ceased to be income after its receipt.

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65268 U. S. 373 (1925).
This principle was also applied in the case of *McIntosh v. Aubrey*,\(^7^6\) where, under the federal statute relieving from attachment money due from the government to a pensioner, the Supreme Court of the United States held that, after the money got to the pensioner, it was liable to seizure.

Other analogous problems arise with regard to taxation of goods in transit. The question is, at what point do the goods cease to be in interstate commerce, and become taxable by the state or local authorities? In these cases, it is held that, when the goods actually come to rest within the state, they are taxable by the state and there is no interference with the jurisdiction of the federal government under the interstate commerce clause.\(^7^1\)

By the same token, income must cease to be subject to taxation by the federal government under the Sixteenth Amendment after it is received and comes to rest and is held just as any other property of the corporation, as it has then become part of the capital.

A brief and chronological review of the leading decisions of the Supreme Court of the United States regarding unconstitutional direct taxes would seem to indicate the invalid nature of the undistributed profits tax as a capital levy. We have already referred to the famous *Pollock case*.\(^7^2\)

In *Knowlton v. Moore*,\(^7^3\) Mr. Justice White conceded that taxes "which are the essential equivalent of a tax on property generally, real or personal, solely because of its ownership, are direct taxes."

In *McCoy v. Minehill & Schuylkill Haven Railroad*\(^7^4\) the court held that a railway corporation which has leased its road to another company operating it exclusively, but maintains its corporate existence and collects and distributes to its stockholders the rental from the lessee and also dividends from investments, is not doing business within the meaning of the Corporation Tax Act of 1909,\(^7^4\) and that, to uphold the tax on this company, would be to levy a direct tax without apportionment, as the company was doing "no more than receiving the ordinary fruits that arise from the ownership of property."

In *Billings v. United States*\(^7^6\) and *Pierce v. United States*,\(^7^6\) the court held, under section 37 of the Tariff Act of August, 1909, imposing a

\(^7^6\)185 U. S. 122 (1902). Another analogy is found in *Spicer v. Smith*, 288 U. S. 430 (1933).

\(^7^7\)American Steel & Wire Co. v. Speed, 192 U. S. 500 (1904); General Oil Co. v. Crain, 209 U. S. 211, 231 (1908).

\(^7^8\)157 U. S. 429 (1895).

\(^7^9\)228 U. S. 295, 306 (1913).

\(^7^7\)232 U. S. 261 (1914).

\(^7^7\)178 U. S. 41 (1900).


\(^7^9\)232 U. S. 290 (1914).
tax on the use of foreign built yachts owned or chartered for more than six months by citizens of the United States, the use which renders the owner subject to the tax is active and actual use and not potential use arising from the mere fact of ownership; in other words, a tax on potential use would be a tax upon the privilege to use which would be void under the Constitution.

In *Eisner v. Macomber*,\(^7\) already discussed, the court held that a stock dividend, evincing merely a transfer of an accumulated surplus to the capital account of the corporation, takes nothing from the property of the corporation and adds nothing to that of the shareholders. Therefore, a tax on such dividends is a tax on capital increase and not on income, and to be valid under the Constitution such tax must be apportioned.

In *Dawson v. Kentucky Distilleries & Warehouse Company*,\(^8\) the state of Kentucky sought to impose a tax of 50c a gallon upon whiskey, either withdrawn from bond within the state or transferred in bond from the state elsewhere, described as an "annual license tax" on persons engaged "in the business of owning and storing" whiskey in bonded warehouses. The court held that this was not an occupation tax but a property tax, and invalid under the Kentucky Constitution which provided that property taxes must be uniform. Mr. Justice Brandeis said that to levy a tax by reason of ownership of property is to tax the property.

In one of the cases cited by Mr. Justice Brandeis for this proposition, *Thompson v. Kreutzer*,\(^9\) the Mississippi high court pointed out that no tax can be imposed on the right of ownership which is not also a tax on property.

In *Helvering v. Independent Life Insurance Company*,\(^8\) the court held that a federal income tax upon the rental value of the part of a building occupied by an insurance company, is a direct tax and invalid unless apportioned, and that the rental value of a building used by the owner does not constitute income within the meaning of the Sixteenth Amendment.

Thus, the surplus profits tax does not appear to be an income tax within the Sixteenth Amendment. Moreover, it is not an excise tax within the other provisions of the Constitution for two reasons. First, it does not purport to be a tax on the privilege of doing business measured by the amount of income retained by the corporation. The Corporation Tax Act of 1909 contained such a levy.\(^8\) Second, its validity is doubtful in

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\(^\text{72}52\) U. S. 189 (1920).  
\(^\text{73}255\) U. S. 288 (1921).  
\(^\text{74}112\) Miss. 165, 167, 72 So. 891 (1916).  
\(^\text{75}292\) U. S. 371 (1934).  
\(^\text{76}292\) U. S. 371 (1934).  
\(^\text{77}Flint v. Stone Tracy Co., 220 U. S. 107 (1911).\)
that it is a penalty as it regulates and compels the corporation to
do something which only the states have the power to compel.

It has been contended by some that since the Supreme Court has held
that capital gains are income within the meaning of the Constitution, it
will likewise hold that undistributed profits are income, economic and
accounting theory to the contrary notwithstanding.\textsuperscript{82} This argument is
not seriously regarded and the authors thereof seem to admit that, from
an accounting or economic standpoint, surplus profits are not true income.

Another contention advanced in behalf of the tax is that Congress
has the power to prescribe deductions and credits which are allowable
to the taxpayer, as Congress has the power to tax gross income, and there
is no constitutional limitation on this power.\textsuperscript{83} Pursuant to this power,
it is also contended that Congress may allow credits to a corporation for
dividends paid out by it so long as such dividends are taxable as income
in the hands of the stockholders. There are two answers to this con-
tention. One is that this income has already been taxed upon its receipt
at the regular normal rate and this constitutes an additional surtax upon
the same property on the theory that it is still income. The second is
that, not only has Congress called this "a surtax on undistributed profits",
but the primary purpose of Congress was to force distribution of profits
and the tax is in reality one upon the undistributed portion of the profits,
and not upon income. To uphold the tax under such a subterfuge would
be to allow Congress to do indirectly what it has no power to do directly,
and such attempts have been discountenanced by the Supreme Court on
several occasions.\textsuperscript{84}

CONCLUSION

It has been protested by some that the main object of the surplus tax
is to produce revenue, as, they say, when corporations are coerced into
increasing their dividends to individuals, these individuals must now bear
the normal tax rate to which they have not hitherto been subject, and
also a great many will receive incomes in the higher brackets, subject to
higher surtax rates. Thus, by these compulsory payments, individual
taxable income is increased and this was the sole purpose of the statute.
The answer to this clear. As to the corporate taxpayer, whose rights

\textsuperscript{83} Bailey \textit{v.} Drexel Furniture Co., 259 U. S. 20 (1922); Hill \textit{v.} Wallace, 259 U. S. 44
(1922); Frick \textit{v.} Pennsylvania, 268 U. S. 473, 494, 495 (1925); Nichols \textit{v.} Coolidge, 274
U. S. 531 (1927).
alone are at stake in this consideration, and which complains of the invalidity of the tax, the design to collect increased revenues from individuals is immaterial. The corporation must pay the tax, if it retains profits; if it does not retain profits, it may avoid the payment of any undistributed earnings tax at all by distributing all its profits to stockholders. As to it, the tax is purely penal and regulatory. From it, there could be no design to raise additional revenues. If that were the object, as we have pointed out, the normal income tax rates could have been substantially raised. Since it is a direct tax or capital levy without apportionment, it is not a permissible use of power under the Constitution.

Aside from multiple economic objections, and assuming that we have demonstrated that the undistributed profits tax was not passed as a revenue producing measure, and has not proved to be such a measure as a matter of fact, and that there are at least grave doubts as to the constitutionality thereof, it would seem that outright repeal of the tax by Congress, rather than further modification and experimentation, would be justified.\textsuperscript{85}

\textsuperscript{85}It is hoped that Congress will not forget the concern of the Treasury Department over the multiple claims for refunds of processing taxes after the Supreme Court had invalidated the AAA legislation. United States v. Butler, 297 U. S. 1 (1936) (invalidating AAA); Rickert Rice Mills Inc. v. Fontenot, 297 U. S. 110 (1936) (recovery of taxes deposited in courts; effect of amendatory act). 49 Stat. 1747, 7 U. S. C. \textsection 644 (1936) (provisions with regard to recovery of processing taxes); Anniston Mfg. Co. v. Davis, 301 U. S. 337 (1937) (holding limitation on refunds constitutional).
A COMMENT ON THE TRAYNOR PLAN FOR REVISION
OF FEDERAL TAX PROCEDURE

E. Barrett Prettyman*

IN AN Article recently appearing in the Columbia Law Review,† Professor Roger John Traynor, of the University of California School of Jurisprudence, advanced a comprehensive criticism of present administrative and judicial procedure for federal income, estate and gift taxes, and an equally comprehensive proposal for the revision of that procedure. Partly because of the position which the author and his gracefully acknowledged co-author, Mr. Stanley S. Surrey, hold or held in the Treasury Department, and partly because of the authority apparent in the data presented and the serious tone of the proposals, the Article has aroused enormous interest in tax circles. Discussion of it was a feature of the winter Tax Clinic of the American Bar Association.

Any interested reader of the Article must be vividly impressed by its frank statement and its exhaustive research into facts and figures. Moreover, it is a refreshing relief to find that the solution of a problem so well known is now to be undertaken, and in a manner which is calm, thorough and obviously earnest. At the same time, the scholarly tone and scientific approach of the Article invite discussion and criticism.

Beyond doubt all practitioners in the tax field will agree thoroughly with much of the analysis of conditions as made by Professor Traynor. It is true that there is at present an alarmingly dangerous delay in the final collection of many taxes due, that the eventual settlement of so many cases on the Board of Tax Appeals docket indicates that they did not require judicial determination, that it is difficult for the Board to function effectively under present circumstances, and that the chronic delay entails substantial losses of revenue. It is also true that multiple reconsiderations in the Bureau make for confusion, and that there is need for an objective analysis of controversies in the early administrative stages.

†Based in substance upon an address before the Tax Clinic of the American Bar Association, March 25, 1939.

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The Proposal involves three principal points of interest—(1) that a new procedure be devised whereby a taxpayer before the Board of Tax Appeals would be limited to the grounds, documents and facts outlined in his original protest to the Commissioner, and the Commissioner would be limited to the issues and facts contained in his own findings of fact; (2) that a bond be required for an appeal to the Board of Tax Appeals; and (3) that appellate jurisdiction be concentrated in a single Court of Tax Appeals.

It is well to explore for a moment the causes of the situation which gives rise to the suggested revision of the functions and proceedings of the Board, and submit a suggestion for remedy before submitting criticism of the suggestion in the Article. But before that, some preliminary observations are in order.

The concern here is not with the exercise of a regulatory power where- in the regulatory authority seeks to impose its own policy and will upon those to be regulated. The concern is with the collection of a tax, one of the eternal difficulties of government, and particularly a tax which involves countless disputes, big and little, simple and complex, of both law and fact.

Two premises are agreed—one, that the income and estate taxes involve an infinite multitude of legitimately disputable questions of fact and of law; two, that administrative solution of these disputes is far preferable to judicial solution.

Any attempt to devise an administrative governmental procedure in this country must meet a very practical fact, which is that so long as democratic government continues, the people will not accept what they consider unreasonable or unfair methods or rules. An individual simply will not accept an administrative ruling which he considers unfair or arbitrary. He will litigate every time. People in the mass come to a conclusion slowly, but whenever at last they conclude that a particular governmental activity is arbitrary or unfair, they have no mercy and little discrimination. The whole business must be repealed, destroyed. So deep-seated a conviction on the part of American citizens cannot be ignored. On the other hand we are simply foolish if we do not use and capitalize upon the natural attitude of these citizens toward their government and its agents. An American likes to be proud of his government and if encouraged, or even permitted to do so, will cooperate with its agents, short only of submission to what he may deem to be the unfair exercise of power. For some reason or other, government seems never to learn this lesson:—"Never?" Well, hardly ever.
An administrative program for the solution of disputable problems must have three elements—personnel, policy and procedure.

There is nowhere a question as to the competency or courage of the personnel engaged in federal tax collection. There is not in this country in any private agency or group of agencies a personnel comparable in experience, character and knowledge with the personnel of the Bureau of Internal Revenue. Nor, indeed, is there any law office in this country a trial staff comparable to the staff of the Chief Counsel’s office in the trial of tax cases.

Professor Traynor thinks that the present difficulty lies in the procedure pursued. My thesis is that it lies in policy—or, perhaps more accurately stated, in the attitude of approach by Bureau officials to the solution of the taxpayers’ factual and legal problems.

Between the summer of 1933 and the spring of 1934, cases pending before the Board of Tax Appeals were reduced from almost 19,000 to less than 9,000. That task was accomplished by a very simple method in two parts—first, a selected staff was assembled by the Commissioner of Internal Revenue and advised that they were to be personally responsible to him for their activities, a similar staff with a similar instruction was assembled by the General Counsel of the Bureau, and the members of the two groups were paired off, one and one together. Second, these men were sent into the field with the accumulated cases and told to find the right answers, assured that they would receive unstinted official support regardless of the dollar return from their efforts so long as the answers they reached were, so far as humanly possible, the correct answers to the problems presented. The men selected had little difficulty with the task. Once their judgment was released from the necessity of showing a tax in every case, from the embarrassment of having to work backward from the dollar column to the actual question stated, they knew pretty much what the right answers were or what the probable results of litigation would be. And the taxpayers’ counsel knew, also. The result was not only a dissipation of the jam, but it is absolutely certain that more money was put into the Treasury in actual cash dollars than would have been collected if all those cases had been litigated. That experiment indicated a solution of the administrative problem which could be employed profitably in all Bureau contacts with taxpayers. That policy could be made a permanent policy of the Treasury. And the main point is that a consensus of public opinion that “If the Bureau boys say this is right, it is right” would completely dissipate the problem of collecting the
tax. Moreover, such a state of mind on the part of the public could be created with very little effort on the part of the Treasury.

If the Treasury were to adopt the policy of finding the right answer to the problem in every case, and were to offer to its men in the field and in the conference room full support if the right answers are given to the best of the knowledge and the judgment of the officials concerned, the matter of procedure would solve itself. But so long as the men actually handling the cases are required, or think they are required, to show a tax in every case, and to show as much tax as the taxpayer will stand—and then just a wee bit more—an administrative procedure in this country will never develop which will satisfactorily collect the tax. The difficulty is not in the procedure. The difficulty is in the policy under which the government men in the field are working, or think they are working.

This is not said in a spirit of criticism. Many earnest and intelligent public officials hold to the view that the duty of taxing officers is to claim for the government the maximum possible upon the theory that the taxpayer will take care of himself. Our suggestion is that such a policy does not make for administrative disposition of disputed cases. It makes for litigation. Our suggestion is that the Treasury drill its officers in a policy of rendering the right answer to the question presented. The procedure and the revenue will amply take care of themselves under such a policy. One dollar actually in the Treasury, collected on an equitable is worth several dollars of possibilities dependent upon protracted litigation.

The Traynor Article stresses out of all proportion the Commissioner's lack of information in his consideration of disputed tax matters. The major premise of the Article seems to be that taxpayers as a class withhold vital information from the Treasury in these disputes. In candor we must submit that the Article is wrong in this assumption. In the vast majority of cases the examining agent is given everything he needs or asks for. The Commissioner makes his initial proposal of a deficiency upon his own discovery of a fact or a difference of opinion between himself and the taxpayer as to the proper rule to be applied to the agreed facts. The statutes contain no justification for the Commissioner's determination of a deficiency in tax unless he knows what he is doing. A presumption of validity is attached to his determination. A declaration of deficiency upon a mere vague suspicion that if he, the Commissioner, knew more about the situation, he might possibly find some tax due, is not contemplated by the statute. As a matter of fact, a general notion that such is the frequent practice of the Bureau is one of the chief rea-
sons for the widespread attitude of resistance to deficiency notices on the part of taxpayers.

The authors assert that "The complete innocuousness at the present time of the so-called 'protest' to the thirty-day letter and the vague inconclusiveness of many of the ninety-day deficiency letters are directly traceable to the absences of such counterbalances." The characterizations, but not the designation of cause, will meet with general agreement. It is true that in all too many cases officials in Washington are without full information, but the revenue agents and deputy collectors in the field have the facts in field cases and the auditors and conferees in office audits either have the full facts or have the power to get them. Both the Commissioner and the Collectors have the powers of examination and of subpoena. The paucity of factual data in office reports is not the fault of the taxpayers. It is the fault of the Bureau. The investigatory forces are led to put too much emphasis on the amount of the tax proposed, and too little on the revelation of the facts involved. The temptation to show a big tax and to skip the facts which indicate it to be not due, has been made too great. The combined wrath and antagonism thus aroused in the taxpayer does not make for sympathetic cooperation on his part to the speedy and correct solution of the problems raised by the agent. The Bureau ought to insist upon full revelation of all the facts by its field agents and its conferees. Those men are both able and willing to comply with such a policy if the judgment rendered upon them by their superiors were less influenced by the dollar amount of proposed additional taxes. Of course, the policy could conceivably be carried too far, but the proper balance is readily available in the insistence upon "Get the right answer" and "State all the facts", with the resultant esprit de corps created by public acclamation for efficiency and fairness. It is a fact that the public hates both a sissy and a bully, and respects the firm official who is fair; and all government work thrives on public approval.

As to lack of factual data at Respondent's side of counsel table before the Board, one may confidently venture the assertion that it is rare indeed for a trial attorney for the Bureau who has in his file a trial brief properly prepared, to be surprised by any new facts presented by his opponent upon the hearing, and a still rarer occasion when a member of that shrewd, skillful and schooled staff is thrown off balance by any such surprise. Of course, lawyers in private practice are prone to blame a lost case on a lack of facts, and government lawyers are human, too. But nobody should be alarmed by this universal frailty.
If the Commissioner is under a handicap on account of failure to know the material facts on consideration of the protest or in the preparation of the case for trial, he can readily be given a right of examination before trial.

In the next place, the Traynor thesis misconceives the reason why taxpayers withhold facts from the Bureau, when they do so withhold them. If the taxpayer has a fact which he knows will conclude the controversy in his favor, he does not withhold it if he thinks he will get a fair decision when he reveals it. Taxpayers do not litigate merely to be litigating. Taxpayers do not relish tax lawyers any more than, if as much as, the Treasury does. The only reason why a taxpayer withholds a favorable fact is that he does not believe that the official to whom the fact is revealed will render a fair and true decision upon the facts established, but will on the contrary bend every effort to the collection of additional tax regardless of the revelation of facts. The attitude of "What's the use?" is the reason for withholding facts favorable to the taxpayer. If the withheld fact be unfavorable to the taxpayer, it will in probability be revealed by the taxpayer no more readily in the course of litigation than in the administrative process.

If the Bureau's problem is in the failure of taxpayers to reveal facts, then let it relieve taxpayers' minds of the idea that Bureau agents will not render the right answer to the best of their knowledge regardless of the tax result, and this problem will promptly disappear.

It is true, as Professor Traynor says, that the many avenues open for the shifting of responsibility is a factor in the reluctance of officials to assume it, but a much more potent factor is the compulsion which they feel, real or imaginary, that it is to their best interest not to take too much responsibility if the situation seems to require a yielding toward the taxpayers' views—or, perhaps better expressed, seems to require a leaning away from an additional tax possibly but not probably due.

The gist of the problem is in the public attitude toward the tax. Every tax return involves disputable questions of fact or law, or both. The initial decisions are made by the taxpayer himself. The government is well-nigh helpless without cooperation at that point. Less than 200,000 returns can be actually examined in the field each year; some 5,000,000 income tax returns are filed. Millions in revenue are involved in this initial stage. If taxpayers have a frank and fair attitude, created by confidence in frank and fair treatment by the government, doubtful items will be fairly treated, to the great enhancement of the revenue.
If taxpayers believe the tax to be a game of self-protection the sufferer must inevitably be the government. The government, or at least the revenue, cannot win in a contest on that basis. The same principle holds in those cases in which field examinations give rise to active disputes. Confidence in the frankness and fairness of government officials in dealing with these problems will minimize litigation and ease the collection of the tax. Placing taxpayers in strait-jackets by procedural requirements will not solve any problems. It will only aggravate the difficulty and if pushed too far will react disastrously upon the whole tax. Extreme though the statement may appear, it is not beyond the realm of possibility that the income tax could follow the path of national prohibition. The answer to the situation so ably described by Professor Traynor, is for the Treasury to bend the utmost of its efforts toward public confidence in, and public reliance upon, the Departmental disposition of the disputes inherent in the tax itself. There will never be a reliance upon administrative processes until there is confidence in them. Nobody can create that confidence except the Treasury itself. It can be created only by policy, and not at all by procedural restrictions.

Of course, there are two classes of cases to which the foregoing general remarks do not apply. One class is that of the intentional outlaws, a small minority, and the other is that class of cases involving questions which should in any event be submitted to the judicial branch of government for decision. The former should be disposed of with annihilating brevity. The latter should be handled with deliberate care. Neither class presents any great problem so long as they are not magnified out of all proportion to their correct place in the general picture.

The remedy advanced in the Traynor Article embraces two radical procedural changes. The first is that the taxpayer be restricted throughout the administrative process, including the Board of Tax Appeals, to the points raised and the facts outlined in his protest to the "30-day letter". This letter is the initial tentative proposal of a tax deficiency by the Commissioner. The taxpayer's reply is his first statement of his position. The second change proposed is that the Commissioner make findings of fact and be thereafter, before the Board, bound by such findings; and further that the findings be presumed to be correct. Both suggested changes are subject to violent objection.

In the first place, while in theory the findings would be the findings of the Commissioner, in practice they would be the findings of a local examining agent, a subordinate employee, who might or might not be an attorney, and might be utterly incompetent to make appropriate find-
ings of fact, especially in difficult and close cases. Findings of fact, especially when made without a formal record, require a vast amount of technical skill. The time and energy to be demanded of the examining officers would be enormous. Either the field force would have to be greatly enlarged or the number of field inquiries greatly reduced. Such findings when made would be adopted by the Board as final, subject only to the taxpayer’s right “to prove before the Board that the conclusions and findings of fact of the Commissioner were erroneous.”

In the next place, the proposed procedure would deprive the taxpayer of the right of cross-examination. The examining agent would be permitted to include additional facts in his findings. Yet the taxpayer would have no right to test the accuracy of such facts by cross-examination and would be relegated to the right before the Board of negating the facts found by the examining agent. With right to appeal to a local federal Circuit Court of Appeals denied, a Board practice might readily grow up under which the Commissioner’s findings of fact would be upheld as conclusive in almost every instance.

Again, by limiting the taxpayer to the issues raised and the facts included in the protest (subject to certain exceptions in the case of after-decided cases), the taxpayer would be forced to make his case in every factual detail in a written protest under oath. In large actions, such as valuations and corporate reorganizations, this would result in an enormous written record, which, if the examining agent makes adverse findings, must be entirely remade before the Board of Tax Appeals. This would definitely delay and clog the disposition of such cases. Moreover, and of greater importance, to require a taxpayer upon his first statement of his case to raise all the points and to outline all the facts upon which he may ultimately want to depend, involves several startlingly revolutionary features. It would require every taxpayer in every case, however trivial, to have expert assistance at once. The Proposal is that the protest be required to contain a statement of all the facts, evidentiary and ultimate, a list of documents, etc., relied upon, and where located, and a list of the persons familiar with the material facts. If the taxpayer fail to state some material fact or point, obviously his protest must fail, and as he would be forever limited to his initial statement, he must likewise ultimately lose. Here indeed is a trap for the unwary, and a fortiori a boon for for the tax practitioner! Contemplate a case wherein an examining agent proposes that the depreciation on the corner grocery be two percent instead of three percent. Ordinarily, under present procedure, there is some one point of dispute in such a case which
is covered by the protest and is settled around the table in a conference. But in the proposed practice the taxpayer must at once contemplate the burden which he might ultimately face before the Board of Tax Appeals and against all the presumptions. Every fact essential to ultimate proof of a depreciation rate would have to be stated in the first protest—cost, accrued depreciation, estimated life, etc., etc., with the names of all the witnesses. As a matter of practical application to the vast mass of small cases, the proposal is far too extreme to be workable.

Some blame is frequently visited upon the Board of Tax Appeals for the difficulties described by the Article. The Board can readily consider and dispose of between 1,500 and 2,000 cases a year by hearing and decision. It ought not be called upon to consider more. There is no sound reason why more than that number of cases should be litigated in any one year. That four or five times that number of cases go to its docket and then three-fourths of those cases are settled before trial shows that somebody has been unnecessarily stubborn about something in the earlier stages of negotiation. The pending question is "Who?". Taxpayers may cry out "The Treasury" and the Treasury may cry out "The Taxpayer". But the true answer is probably a little of both, and probably if somebody not afflicted with a crying-out complex should calmly diagnose the cause of the pain, a cure could be effected.

The Board of Tax Appeals is too valuable an adjunct to the governmental tax procedure to be lightly condemned because its docket is clogged. It was intended by its creators to be a forum in which cases necessarily litigated could be expeditiously and expertly decided. It was not intended as a public resort for parties who have been, either one or the other or both, unnecessarily stubborn in negotiating a difficulty through administrative processes. It was not intended as a haven for fugitives from tax obligations. It was not intended as the buckee for government officials harassed with difficult problems. That it has been used for all these purposes is no reason for its destruction. It represents to the American taxpayer an assurance of fair and impartial adjudication of his troubles before he is compelled to meet with cash the demands of the government for additional taxes. Whether taxpayers need such an assurance is beside the point. They have thought they do and caused Congress to create the Board for that purpose. None of the present difficulties would be solved by its abolition. On the contrary, the difficulties would be thereby greatly aggravated by the suspicion and hostility created in the minds of taxpayers by the insistence
of the Treasury upon compliance in cash with its own determination without review. It is not as though taxpayers had never experienced the Board. They have had it for some fifteen years. The reasons why the Board is misused are partly because its docket is clogged and partly because one party or the other has failed to be frank and fair until the last moment. If these two troubles can be cured, the Board can resume the function for which it was created, a valuable function in orderly governmental tax processes. The cure lies in the initial thesis hereinabove.

There is much to be said for and against decentralization, both of the Bureau and of the Board. The short of it is that, like almost everything else, well designed it is good; improperly designed it is bad. Space is lacking here to probe its possibilities.

There is also much to be said both for and against jurisdiction over refunds to be given the Board, but here again space does not permit an exploration into that field.

The suggestion that bond be required for appeals to the Board of Tax Appeals arouses vehement disagreement, principally because of the injustice such a provision would entail. If litigated cases be reduced to a proper number, the mere fact that a case is litigable would deny that an unnecessary burden impede the right of the taxpayer to litigate. Bonds in large amounts are almost prohibitive in price, and bonds in small amounts on small taxpayers are a pointless obstacle to the adjudication of his rights. The recent Tex-Penn case may be cited as an example. Originally the Commissioner asserted a deficiency of some $68,000,000, which fell entirely upon two individual citizens since the corporation involved had long since been dissolved. A bond was out of the question and payment equally impossible. Any judicial review thus would have been definitely foreclosed. Yet the ultimate holding in that case in the Circuit Court of Appeals and the Supreme Court was that the taxpayers owed nothing in the way of a deficiency. Had such a case arisen under the suggested rule, the gravest injustice would have resulted. Other easy examples of this injustice are the transferee cases, wherein the Commissioner sends notices of the full amount of a deficiency to each one of a number of transferees. Under the Proposal each transferee would have to bond the full tax.

Furthermore, the requirement of a bond would tend to encourage unduly high assessments. In cases which involve very large deficiencies, the very existence of the requirement would tend to encourage an over-eager tax collector to raise the assessment by the stroke of a pen and
assert a figure which, on account of the consideration indicated above, would on the threat of insolvency preclude any recourse except a hat in hand. Under the statutes as at present drawn, the Commissioner has power to force a taxpayer to assume the burden of disproving a liability by the simple act of signing his name to a deficiency notice. This power must be balanced by providing for ready and inexpensive judicial review, in order to safeguard the rights of a citizen and insure approximate justice.

Bonds on appeals to the circuit courts of appeal from the Board are a different matter. A day in court has already been had. Moreover, appeal bonds to the court are merely for supersedeas, whereas the proposed bond to the Board would be jurisdictional.

The final phase of the Traynor Article is the proposed withdrawal of jurisdiction from federal district courts and circuit courts of appeal; the division of the Board into five regional divisions and the creation of a single Court of Tax Appeals. This is a fundamental and far-reaching change in our traditional judicial procedure. It should be scrutinized with utmost care. The following considerations appear:

(1) By depriving the district and circuit courts of appeals of all jurisdiction, leaving open only an administrative quasi-judicial tribunal closely identified with the Treasury, the confidence of the citizen in the justice of an adverse decision is definitely undermined.

(2) The elimination of all right of trial by jury deprives the citizen of a traditional local right, the existence of which, whether used or not used, is essential to preserve confidence in government. While jury trials are rare, the existence of the right is fundamental in such a vital field as taxation, and is sometimes availed of in the accomplishment of justice.

(3) The plan would completely eliminate the healthy approach and broad experience of the federal courts in the field of substantive law, upon which the large majority of tax cases turn—that the income tax is not “a distinct branch of the law” but must be applied in accordance with the broad principles of substantive law upon which it rests. The handling of tax questions exclusively by tax tribunals would definitely tend toward technicality of decision and ultimately confine all tax practice to so-called tax experts and “a specialized tax bar”, thus depriving a citizen of the benefit of representation by attorneys trained and experienced in the fundamental principles of jurisprudence. The complete segregation of tax law from the general body of our substantive law would be unwise.
(4) The procedure might be held not to constitute due process, on the ground that it would deprive the citizen of right of recourse to a constitutional court. This ground would, of course, not be valid if the taxpayer had an election to sue in a district court. The limited but discretionary review by *certiorari* to the Supreme Court does not cure the constitutional defect. Even though the Circuit Court of Appeals for the District of Columbia should be made the one appellate court, the same considerations would exist which underlie the constitutional requirement of a judicial remedy in a constitutional court, namely, that all citizens would be forced to journey to a distant point, thus depriving them of the right of trial and appeal in the local community before judges locally known, and greatly increasing the burden and expense of litigation.

(5) The existence of such a single court, without the possibility of differences of opinion, would tend strongly to eliminate final review by the Supreme Court on matters of vital and national importance, thus depriving the Treasury and the citizen of the broad vision and realistic quality of a decision of that Court, particularly in a field where the modern tendency is to cloak economic and political reform in the guise of taxation.

The main abuse toward the correction of which the Plan is directed is the existing diversity of decision among different circuit courts of appeals and the inability under present *certiorari* practice of obtaining speedy and final determinations by the Supreme Court. We do not agree that conflicts in decision in the circuit court are necessarily an evil. If the truly right answer is the ultimate goal of all concerned, a second consideration by a second tribunal often corrects an initial error. And moreover, the presence of the possibility of conflicting opinion by equal tribunals is a deterrent to arbitrary or hasty judgment on the part of everyone. Of course, too great opportunity for differing decisions is a torment devoutly to be avoided, but the eleven circuit courts of appeals and the Court of Claims seem not to involve too great difficulty in this respect. Moreover, the abuses are not really as great as the proponents of the plan assert. They are no worse in tax cases than in other matters. They could be largely corrected by improved supervision over pending cases in the various circuit courts through the Department of Justice, acting through one experienced attorney charged with this function. While the Solicitor General cannot control petitions for *certiorari* filed by defeated taxpayers, he can control petitions filed by the government.

If the difficulty incident to the existence of eleven circuits is real, the
problem could be much reduced by combining the appellate districts of two circuit courts of appeals and designating one of the two circuit courts to hear all appeals in tax cases arising within the combined geographical division, thus reducing the reviewing circuit courts to five instead of ten as at present.

An admirable suggestion of the Article is that both Commissioner and taxpayer be forced to acquiesce in a decision of the new Court of Appeals if _certiorari_ be denied. All have in mind the classic but apochryphal tale of the official who asserted the Commissioner’s non-acquiescence in a decision of the Supreme Court.

Every interested person will rejoice in the directness and frankness of the approach to the problem by Professor Traynor and Mr. Surrey, who by their attitude have indicated that the Treasury wishes frank discussion of its proposals to the end that a remedy be found for a problem vitally affecting all the taxpayers, and, in the larger sense, all the people of this, our country. In its deepest sense the discussion relates to the practicability of democratic administrative governmental processes. Policy, more than mere procedure, is the key to success.
STATE REGULATION OF INSURANCE RATES
RUSSELL H. MATTHIAS* AND CHARLES B. ROBISON†

INSURANCE principles had their beginnings in the commercial contracts of the early Greeks and Romans but it was not until the first decade of the present century that government gave serious attention to regulating premium rates charged by certain types of insurance companies. During the last quarter of the nineteenth century, however, several states had enacted anti-compact laws to prohibit insurance companies from combining to fix a standard rate for certain risks. These laws were part and parcel of the general popular wave against trusts and monopolies prevailing at that period.

Dissatisfied with the results under anti-compact laws, many states sought partial regulation of rates through anti-discrimination and anti-rebate statutes, which were aimed at preventing unfair charges or favoritism to insurants in the same class. More complete control over insurance rates followed by a general enactment of rating laws and licensing of rating bureaus between 1911 and 1920.

At the present time, therefore, the following types of regulation are in force: (1) anti-compact laws in eighteen states; (2) anti-discrimination laws in every state; (3) rating laws in about thirty-one states. Most states have both anti-discrimination and rating laws and a few have all three types. Every law dealing with rating places its enforcement in a state administrative agency.

It is proposed here to discuss each type of regulation and to suggest a rating law which would provide adequate state supervision without sacrificing freedom for companies to promulgate their own rates based on their own experience, thus reducing the cost of insurance to the public.

ANTI-COMPACT LAWS

An anti-compact law generally provides that no insurance company authorized to do business within the state, or agent thereof, “shall make, maintain, or enter into any contract, agreement, pool, or other arrangement with any other insurance company or companies, ... for the purpose of, or that may have the tendency or effect of, preventing or lessening competition in the business of insurance” transacted within the

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state. Provision for revocation of the license of the company violating the act is also made. In some states the application of the law is limited to companies writing specific kinds of casualty business. Later statutes prohibit combinations to fix rates unless through an approved rating bureau.

Such laws preserving competition have been held constitutional. But they were doomed to be replaced by some more adequate means of regulation. It was very uneconomical for each company to maintain a separate comprehensive rating department. Furthermore, unrestricted competition precipitated ruinous rate wars. The public should be protected against inadequate premiums as much as against excessive rates. In the field of life insurance this protection is guaranteed through reserve requirements based on scientific tables of mortality. No such scientific method can be used for fire and other types of casualty insurance, where the probability of loss is more uncertain and not definitely fixed.

**ANTI-DISCRIMINATION LAWS**

Statutes prohibiting discrimination usually take two forms. The first prevents any distinction or discrimination between insurants of the same class in the amount paid for insurance. The second prevents any company or agent from paying any rebate or premium on the policy, or any other valuable consideration or inducement, which is not specified in the policy, to or for insurance on any risk within the particular state. Nearly all states have both forms, applicable to all insurance companies. These laws protect against discrimination but they do not in any way control the rate to be charged initially. They are, therefore, ineffective as rate regulatory devices.

An anti-discrimination statute is primarily to prevent insurance companies from discriminating in favor of individuals of the same class, either as to premiums charged or other means of inducement, and such a statute should be given a reasonable interpretation and strict enforcement. A few examples will suffice to show what may constitute dis-
crimination.6

In General Insurance Company of America v. Bowen,7 the company had been issuing a fire policy for a term of five years, with a provision enabling the insured to pay the premium annually and to terminate the policy at the end of any year. The person was, in effect, insured from year to year, but he paid a less rate per year than if he had taken out a one-year contract. This was held to be a discrimination since the rate was not uniform as to the same risk. It has also been held that discrimination exists when the company gives an insured the option to purchase shares of its stock at lower than the market price, where such option formed the main inducement for the taking of the policy.8 Rebating exists when insurance is offered at a lower rate to a person who insures several automobiles than to one who insures only one automobile.9 So also, a fire company is guilty of rebating when it writes a large risk at a lower rate per $1,000 of insurance than a small risk of the same classification.10 Companies that write automobile fire policies and include in the same or in a separate policy, theft, property damage, liability, or collision insurance at less than normal rates have been held guilty of illegal discrimination.11

An insurance commissioner, however, does not have authority to entertain a complaint as to alleged discrimination until after it has been established that grounds for discrimination exist. In People ex rel. New York Fire Insurance Exchange v. Phillips,12 an inventor of fire sprinklers had refused to submit his device to the underwriters' laboratory for testing. Consequently, the underwriters refused to quote a low rate on this type sprinkler consistent with other sprinkling devices for fire protection. The inventor contended this was a discrimination against him. The court held that there could be no grounds for discrimination until it was shown that the laboratory refused to make the test or that the test was made unfairly, neither of which had occurred in this instance.

The precise evils of rebating and discrimination practices are not

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6For a good discussion of rebating and discrimination, see Patterson, The Insurance Commissioner in the United States (1927) 307-321.
7130 Ohio St. 82, 196 N. E. 774 (1935).
8People v. Commercial Life Ins. Co., 247 Ill. 92, 93 N. E. 90 (1910).
9173 N. Y. 167, 142 N. E. 574 (1923).
10Insurance Department Rulings, W. U. R. 1929, Mass. 5.
12Id. W. U. R. 1923, Mo. 3.
clear. Nevertheless, prohibition against such practices is firmly established in our law. A rationalization of the social ideals behind anti-rebate and anti-discrimination laws has already been advanced by one author.\textsuperscript{18} He explains the presence of such laws upon (1) "the ‘one-price’ idea, firmly rooted in the retail marketing traditions of the American people”, and (2) the idea of equality, treating all insured persons the same under like circumstances. The author concludes that these two ideals are "one more reason for likening an insurance company to a public utility."

**RATING LAWS**

It has been seen that neither the anti-compact nor anti-discrimination laws gave the states any supervision over the making of rates. Passage of legislation establishing some measure of state regulation over the making of insurance rates followed exhaustive reports filed by special legislative committees appointed to investigate rate making practices of insurance companies.\textsuperscript{14}

In 1909 the Illinois Legislature ordered an investigation of fire insurance rate making; a report was filed in 1911. Other reports were made in Illinois in 1913 and 1915. New York authorized an investigation in 1910 and a comprehensive report was filed the following year. North Carolina, Ohio and Wisconsin completed their investigations in 1913 and Pennsylvania in 1915.

These reports criticized the operation of the anti-compact laws and generally approved of combinations of insurance companies to fix basic fire insurance rates. The New York committee advocated closer supervision of rate making bodies, but advised against taking "the extreme steps of turning the rate making over to the state." Continuing, the report said that "the committee believes that state interference with rates has not been beneficial and has been brought about upon the wholly theoretical grounds that combinations in fire insurance were a menace to the people which an actual investigation of the facts fails to disclose."\textsuperscript{15} Reports in other states disapproved of state rate making and advocated only state supervision of rating bureaus established by private agencies. North Carolina alone reported that the state must be given the power, "when necessary, to protect the rights of the people of

\textsuperscript{18}Patterson, The Insurance Commissioner in the United States (1927) 309.

\textsuperscript{14}Extracts of several of these reports filed in numerous states, together with discussions of rate regulation, are reproduced in Proceedings of the National Association of Insurance Commissioners, Forty-sixth Session (1915) 119-187.

\textsuperscript{15}Id. at 127.
the State who cannot by combination protect themselves, to prescribe and promulgate rates for fire insurance."

The power of the state to regulate insurance rates was established in *German Alliance Insurance Company v. Lewis*.\(^{16}\) The Kansas statute involved in that case had been passed in 1909, and required every fire company to file with the superintendent of insurance general basis schedules showing the rates on all risks in the state; prohibited any change from such schedule except after ten days' notice; authorized the superintendent to direct a company to file a higher or lower rate when he should determine any rate excessive or inadequate for the safety of the company; prohibited discrimination within the same class of risks; provided for revocation of the license of a company failing to abide by such provisions.

Here, then, was the first method of rate regulation: the companies were required to file their individual schedules of rates; they could not change them without first filing new schedules; and the state administrative agency was clothed with power to determine whether the rates were excessive or inadequate. This method—called schedule rating—was adopted in many states between 1911 and 1920. Such a system has the disadvantage of economic waste and duplication by making it necessary for each company to provide its own rating department.

Recognizing this disadvantage, some states amended their anti-compact laws to allow companies to establish a central bureau to make basis schedules for all the companies belonging to such organization. The state then placed supervisory power over these bureaus in the insurance department. Individual companies were allowed to file deviations from the bureau rates when their own experience warranted a higher or lower rate. Some states made it mandatory upon companies to belong to a rating bureau; others were purely voluntary.

The statute in Texas represents still another method for regulating rates.\(^{17}\) There the State Insurance Commission has sole and exclusive power to prescribe, fix, determine and promulgate the rates to be charged by fire insurance companies. The Commission also has authority to

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\(^{16}\)233 U. S. 389 (1914). The precise factors considered for establishing a rate, together with the legal problems presented, are ably discussed in a comment in (1932) 42 Yale L. J. 107. That feature of rate regulation forms no part of this present article.

\(^{17}\)Tex. Stat. (Vernon, Supp. 1937) art. 4878, passed in 1917. Texas is now seeking to amend this law so that the state shall also determine the rates of commissions to be paid local recording agents and solicitors of fire companies. See H. B. 169 in 13 Legislative Record 73 (Jan. 31, 1939).
alter or amend any rate, and to raise or lower the rates to make them reasonable. After a maximum rate has been established, companies may write insurance at a lower rate, but such lesser rate must be applicable to all risks of the same character situated in the same community.

The procedure used in Texas is unique. It is the method denounced by the various legislative committees which made a thorough study of the problem of rate making during 1911, 1912 and 1913. However, a bill in the recent session of the Oregon legislature, if passed, would have authorized a study of the Texas method of rate regulation. State supervision of rates should be limited to control over private rating, for the insurance people themselves are much more familiar with all the hazards and factors that go to make up the rate. They should be permitted to apply their own technical knowledge in the first instance, the state relegating itself to a supervisory capacity.

A new and insidious proposal for "regulating" insurance rates is the direct competition by government in the insurance business. In the Seventy-fifth Congress, a bill was introduced in the House on May 20, 1938, which would have provided for the organizing of "a governmental self-supporting insurance company for the purpose of furnishing insurance of all kinds to motortruck operators when such insurance cannot be procured from private companies at reasonable rates." The following portions of the bill are quoted in full to show the full danger of such a scheme:

"Sec. 5 (a). The Corporation is hereby authorized to write all classes of insurance and surety bonds and reinsurance therefor required of motortruck operators (in?) all cases where such operators cannot procure such insurance or bonds at reasonable rates. The term 'reasonable rates' shall be determined by the fact that no such private company can or will furnish such insurance or bonds at a rate equal to or less than the Government rate established by the provisions of this act.

"(c) The rates to be charged by the Corporation shall be standard rates as promulgated by the rating bureaus subject to such discounts as the Board of Directors of the Corporation shall determine". (Italics supplied.)

The board of directors were to be appointed by the President, by and with the advice and consent of the Senate. The bill died in committee.

Such a scheme, no doubt, springs from the current concept of establishing a governmental "yardstick" in the measurement of public utility

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18H. 10715. This bill is printed in full in 12 Legislative Record 120 (June 2, 1938). The bill may be reintroduced in the present Congress.
rates. Such a bill as quoted would permit the government to establish any rate it pleased even to the point of driving out of business all private companies writing motortruck operators’ insurance. Once the principle became established it could be extended to other lines of insurance, ad infinitum, until in the end we would have nothing but government insurance. Other instances of monopolistic government insurance are the state workmen’s compensation fund in Ohio and the numerous bills currently introduced in state legislatures to establish state automobile liability insurance funds.

**TYPES OF COMPANIES SUBJECT TO RATE REGULATION**

Thus far little has been said regarding the kinds of insurance subject to rate supervision. At first all rating legislation was directed only at fire insurance companies. The first rating law in Texas in 1913, however, included every marine, fire and marine, fire and tornado, and every other company issuing policies of insurance against loss by fire, whether the property be fixed or movable, stationary or in transit, including the shore-end of all marine risks insured against loss by fire.

A few states regulate the rates on fire risks without exempting any company writing such risk. Most of the states providing for rate regulation of fire and other companies exempt domestic mutual companies, though sometimes such exemption is limited to farm mutuals. Several states, such as Colorado, Indiana, Louisiana, Mississippi, South Carolina and Virginia exempt certain types of transportation risks, including rolling stock of railroads or other common carriers.

Ten states—Illinois, Indiana, Kansas, Louisiana, Massachusetts, New Hampshire, New York, North Carolina, Virginia and Wisconsin—expressly make provision for regulating motor vehicle insurance rates. Most of these laws relate solely to public liability and property damage insurance, though a few include collision insurance, and two also include theft insurance. New Jersey and Vermont have general rating laws applicable also to motor vehicle insurance. In Mississippi the rating law is applicable to fire insurance on motor vehicles, and in Oklahoma the fire rating act applies to all kinds of motor vehicle insurance, including liability. Most of these states regulate motor rates through the system of schedule rating. Virginia is the only state requiring motor vehicle insurers to belong to a rating bureau.

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19See a discussion of this idea in regard to the T.V.A. by Albertsworth, Constitutional Issues of the Federal Power Program (1935) 29 Ill. L. Rev. 861-864.

Utah has no rating law. However, in May of 1936, the insurance department of that state ruled that all fire companies in the state must file complete rates and schedules for approval. The department reasoned that since the statute required the filing of policy forms and agents' manual of instructions, rates and schedules were a component part of every agent's manual of instructions and must, therefore, also be filed for approval. A bill was introduced in the Utah legislature to amend that section requiring every life, accident, health, fire, automobile, marine or casualty insurance company to file for approval all their rate manuals, schedules of rates, and all information concerning their rate making and amendments.

In September of 1936 the Attorney-General of Louisiana advised the Casualty and Surety Rating Commission of that state it had jurisdiction to regulate rates of accident and health insurance. The ruling pointed out that the legislature apparently meant for the rating law to apply to every insurer transacting casualty business in the state.

A case just decided by the Supreme Court of Wisconsin has created such widespread interest that it will be discussed rather fully. In Wisconsin the anti-compact law of 1897 permitted the organization of local boards for the purpose of making rates. Local boards were formed in most cities, but only three actually made their own rates. The other usually adopted rates promulgated by the Wisconsin Inspection Bureau, which secured its rates from an out-of-state rating organization.

This procedure was unsuccessful and a rating law was passed in 1917, abolishing the local boards, and requiring every company licensed to insure against the loss or damage by fire, lightning, windstorm or sprinkler leakage, to be a member of a rating bureau. In 1937 this
section was amended to include those companies writing insurance against consequential as well as direct loss by fire, etc.

The Northwestern National Insurance Company of Milwaukee is a Wisconsin fire and marine company. It had been writing inland marine policies which included fire risks without regard to the rates established by rating bureaus for such fire risks. The Commissioner of Insurance challenged the right of the Company to make its own rate on a particular policy which included a fire hazard. The policy in question was an art gallery policy insuring paintings while at rest in the gallery and "also while in transit or elsewhere on exhibition" in the United States "when prior notice is given" to the Company and "additional premium paid". The Commissioner contended, first, that the policy was not inland marine insurance, but in reality a fire policy subject to the fire rating act; and second, even if it was an inland marine policy, the fire rating act applied to marine and inland marine insurance which included fire hazards. The Company filed its bill for an injunction against the Commissioner.

The lower court concluded that the policy in question was not inland marine insurance because the paintings were insured only at a fixed location. The Supreme Court affirmed, stating however, that "marine insurance relating to transportation by water is, by its very nature, excepted from the provisions of the rating law, but that inland marine insurance not relating to transportation by water is excepted only so far as it comes within the provisions of Section 203.49". That section provides that the rating law shall not be applicable "to the rolling stock of railroads or property in transit while in the possession of railroad companies or other common carriers, nor on the property of such common carriers used or employed by them in their business of carrying freight, merchandise or passengers." The court thus definitely limited the definition of inland marine insurance, but admitted that truly marine and inland marine insurances are not subject to the fire rating law, even though fire hazards are also covered.

Briefly, then, we find that states have set up supervision, in one form or another, over the rates of fire, lightning, windstorm, tornado, hail,

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28*Northwestern National Insurance Co. of Milwaukee v. Mortensen, 284 N. W. 13, 17 (Wis. 1939).
28*Several states have attempted defining marine insurance. In Idaho a bill, S-44, was recently passed by the legislature and signed by the Governor amending § 40-303 by defining in full what is marine insurance. See 13 Legislative Record 34 (Jan. 24, 1939).
motor vehicle, marine, and in a very few instances, accident and health insurance. Though control is exercised by most states over workmen's compensation rates and over surety rates in several states, regulation of these two types of insurance will not be discussed here. The precise coverages and exemptions may be found by ready reference to the statutes.\textsuperscript{30}

\textbf{ADMINISTRATIVE PROCEDURE AND COURT REVIEW}

A short discussion of a few of the questions raised as to the administration of rating laws may be helpful. In those states where schedule rating is permitted, a company may file either its own rating schedules as to all risks, or may adopt the advisory bureau rates, either as to certain classes or as to all classes.\textsuperscript{31} Whether a reduction in premium based upon a deductible clause in a policy constitutes a deviation is a question for the determination by the commissioner in the first instance, and may not be decided in a court action before the commissioner makes such determination.\textsuperscript{32} Though a company may file a deviation from the rates of a bureau, it may not deviate from the rules and regulations of the bureau of which it is a member.\textsuperscript{33}

A group of companies may not ask jointly for a flat increase in rates based upon their aggregate experience.\textsuperscript{34} Any justification for an increase must be based upon the experience of the individual company, for other companies have no joint interest in the risks of the particular company. On the other hand, a commissioner may order a general rate reduction after consideration of the experience and profits of all companies writing a certain kind of risk.\textsuperscript{35} The only question involved then is whether one company may justly urge that such a low rate as applied to it is confiscatory.

When numerous companies have simultaneously raised their rates on a certain class of insurance risk, an insurance commissioner must institute an investigation of such companies upon request of a citizen insured in one of the companies.\textsuperscript{36} Under most statutes the commissioner has

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  \item \textsuperscript{30}A general compilation of the coverages and exemptions in the various states may be found under §§ 416 and 424 in \textit{Illinois Insurance Code Annotated} (1939) 716, 726.
  \item \textsuperscript{31}See \textit{Insurance Department Rulings}, W. U. R. 1933, Wash. 9.
  \item \textsuperscript{32}Northern National Insurance Co. of Milwaukee \textit{v.} Mortensen, 284 N. W. 13 (Wis. 1939).
  \item \textsuperscript{33}\textit{Insurance Department Rulings}, W. U. R. 1936, Ind. 1.
  \item \textsuperscript{34}American Constitution Fire Assn. \textit{v.} O'Malley, 113 S. W. (2d) 795 (Mo. 1937).
  \item \textsuperscript{35}\textit{Aetna Ins. Co. v. Hyde}, 34 F. (2d) 185 (W. D. Mo. 1929), aff'd., 281 U. S. 331 (1930).
  \item \textsuperscript{36}Brand \textit{v. Safford}, 118 Ohio St. 56, 160 N. E. 464 (1928).
\end{itemize}
authority to make such an investigation upon his own motion. But a commissioner cannot entertain a complaint as to alleged discrimination until after it has been established that grounds for discrimination exist.\(^{37}\)

As respects penalties, it is generally provided by statute that the insurance commissioner must give notice of violations to the Attorney-General and that the commissioner himself cannot impose a penalty.\(^{38}\) In Illinois, where the statute stated that a penalty should be “sued for and recovered in the name of the people of the State of Illinois, by the State’s Attorney”, such method was held to be exclusive and to preclude any other procedure to recover a penalty.\(^{39}\)

In reviewing the action of a commissioner in framing insurance rates, a court will not disturb the order unless it appears that the commissioner has exceeded his constitutional or statutory powers; or his action has resulted from an unreasonable exercise of authority; or is based upon a mistake of law, or contrary to the evidence or without supporting evidence; or the rate so fixed is so low as to amount to a confiscation and deprivation of property without due process of law.\(^{40}\) Since a commissioner acts legislatively in determining rates, a company is entitled to a trial \textit{de novo} in a court of law on the issue of confiscation,\(^{41}\) the same as if the legislature had fixed the rates.

\section*{RECENT LEGISLATION AND BILLS ON RATING}

Before attempting to outline what we consider to be a proper rating bill, it might be well first to discuss the most recent progress made in rating legislation and to study several current bills on rating in various state legislatures. In this way we can see how our present legislatures are attacking this problem.

The Illinois Insurance Code of 1937 contains the latest complete statutory enactment on rating in the country with the exception of the New York Insurance Code. Articles XXVI\(^{42}\) and XXVII\(^{43}\) deal with motor vehicle rates and fire insurance rates respectively. Prior to this

\begin{footnotesize}
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\item \(^{39}\)\textit{People v. Ill. Life Ins. Co.}, 202 Ill. App. 38 (1916).
\item \(^{40}\)\textit{Aetna Ins. Co. v. Commonwealth}, 160 Va. 698, 169 S. E. 859 (1933).
\item \(^{42}\)\textit{Ill. Rev. Stat.} (1937) c. 73, §§ 1028-1035.
\item \(^{43}\)\textit{Id.} c. 73, §§ 1036-1052.
\end{itemize}
\end{footnotesize}
code, Illinois had no rating law, though legislative committees as early as 1911 advocated state supervision through a schedule rating system.

Section 416 defines the scope of supervision of motor vehicle rates: "covering loss or liability resulting from, or incident to, the ownership, maintenance or use of any motor vehicle (cargo insurance excepted)".

Section 417 requires every such insurer to file schedules showing all rates and other charges, rating plans, classifications, and rules and regulations under which such a policy is to be written. Provision is made for receiving such schedule from a rating bureau if a company so desires. All changes in the schedule must be filed and approved before effective.

By Section 419 discriminatory, unjust or preferential rates are forbidden, but special rates for fleet policies may be made. Penalty for violation of these sections is revocation of license. Penalties are also imposed upon rating bureaus filing for the companies.

The fire rating law of Illinois, by Section 424, applies to insurance against loss or damage to property or any valuable interest therein by fire. The following exceptions are made: (a) marine, inland marine and transportation insurance, except householders' personal property floater risks; (b) motor vehicle insurance (treated in the previous Article); and (c) insurance covering property of interstate common carriers. This section also contains a definition of the term "rating organization".

By Section 425, a rating organization must procure a license from the Director of Insurance, and in the application for such license the bureau must set forth the names of all company members and all schedules or methods to be used for the determination and promulgation of rates. Section 429 gives the Director power to secure various kinds of information from any rating bureau.

Section 430 prohibits any unjust, unreasonable, discriminatory or preferential rate, provided, however, "special schedules or methods and rules and regulations may be used for the determination and promulgation of rates for fire insurance on special risks if the rating organization maintains a special inspection service covering such risks". Rating bureaus are subject to inspection by the Director.

Section 432 requires every fire company to be a member of a licensed rating organization. Section 433 places certain limitations upon the powers of a rating organization in regard to its own members. Companies are permitted to charge membership fees, with the approval of the Director.

Each company must, pursuant to Section 436, obtain its rates for
fire insurance from a licensed rating organization of which it is a member. No company may belong to more than one rating bureau which promulgates rates applicable to the same property, with three special exceptions specifically mentioned.

A company may, however, under Section 437, deviate from the rate promulgated by the rating organization of which it is a member "provided its experience warrants such deviation", and has filed the same with its bureau and the Director. Such deviation must be a uniform percentage deviation to apply to all fire insurance written by the company in the state. Such deviation, if approved by the Director, is to remain in force for a period of one year. Rates higher than those promulgated by a rating organization may be charged if done with the knowledge and consent of the insured.

Provision is made for revocation of the license of the company which "knowingly violates" the statute. Provision is also made for hearings after due notice. Penalties are imposed upon any company, rating organization, agent or other representative of any company or rating organization failing to comply with the statutes.

Early in 1938 a bill was introduced in Congress which, if enacted, would have been the first rating statute for the District of Columbia.44 This bill was reintroduced this February. The law would apply to insurance against loss or damage to property or any valuable interest therein, by fire or lightning. The act exempts marine, inland marine, transportation, motor-vehicle insurance, and insurance covering property of interstate common carriers.

All companies subject to this law must be members of a rating bureau. Uniform percentage deviations from bureau rates could be filed for approval if the experience of the company warranted. The Superintendent of Insurance is given authority to investigate the necessity for an adjustment of rates and to order an adjustment whenever he determined that the profit derived by the companies from any or all fire and lightning risks for a period of five years was excessive, inadequate, unjust or unreasonable. Penalties for violations are imposed.

The Department of Insurance of New York, together with a joint legislative committee, has prepared and introduced into the legislature a revision of the New York insurance laws.45 The new article on rating,

44This bill, S. 3730, is reported in full in 12 Legislative Record 70 (March 29, 1938). It was reintroduced this February as S. 1124.

45An Act in Relation to Insurance Corporations, In Assembly, January 25, 1939, and has passed the legislature and is awaiting the Governor's signature. Introductory Number
similar to the present law, permits an insurer to make its own rate filings or through a rating organization. Detailed information concerning rate making is required, and rating bureaus are subject to strict supervision. The Superintendent of Insurance may order an organization or an insurer to remove discriminations in rates and to raise or lower them when he finds the rates excessive, inadequate or unreasonable. The article exempts from its provisions contracts of reinsurance, life insurance, including supplemental provisions for disability benefits, accident or health insurance, marine or inland transportation insurance, any assessment cooperative fire company, and insurance on property or risks located entirely outside the state.

A bill was introduced into the California legislature in January\textsuperscript{46} to establish comprehensive rate supervision over fire insurance companies. Every fire company would be required to maintain or be a member of an approved and regulated rating bureau. An insurer could file deviations for approval, uniform for all risks in the class for which the deviation is intended, discriminatory rates being prohibited. The bill does not apply to that portion of any company's business which relates to automobile fire insurance, cargo insurance, or property of interstate common carriers. Reciprocals and county mutuals are exempted. Another bill, however, seeks to regulate automobile insurance rates\textsuperscript{47} in a manner similar to the Illinois law, \textit{supra}.

A comprehensive rating bill was introduced into the legislature of Michigan in January,\textsuperscript{48} but was withdrawn the first week in May. A rating bill recently introduced into the Florida legislature provides for the regulation of rates for fire, windstorm, lightning, tornado, hail, shore marine and automobile fire and theft insurance.\textsuperscript{48} This bill requires every company writing one or more of the enumerated types of insurance to maintain or be a member of a rating bureau and that all rates upon risks in the state of Florida shall be filed with the Insurance Commissioner. Authority is given the Insurance Commissioner to examine any
rating bureau or any company maintaining its own bureau. The bill exempts insurance upon or in connection with marine insurance, other than shore marine, and does not attempt to regulate the rates of automobile public liability or property damage insurance, but is limited only to fire and theft insurance on automobiles.

However, another bill, Senate 1033, was introduced into the Florida legislature shortly after the above bill, and provides for the regulation of rates charged for insurance against "loss, expense or liability resulting from the ownership, maintenance or use of any automobile". This last bill is an attempt to regulate the rates of all forms of automobile insurance.

The regulation of automobile rates is also being sought in Michigan, Senate No. 193, and in Pennsylvania, House No. 1199. In Pennsylvania the provision for regulation of automobile insurance rates is made part of the Financial Responsibility Bill. No attempt is made by the bills to force automobile insurers into rating bureaus, but the companies must file their rating schedules with the Insurance Commissioner. Provision is made for the filing of rating schedules by a rating bureau if two or more companies wish to make use of a central filing body.

The trend is apparently toward more supervision of rate making, for several states that do not now have adequate regulatory power are considering comprehensive rating bills. Other states are seeking to extend their rating laws to include certain kinds of insurance not at present regulated by them. Since there is so much legislative activity concerning rating and the likelihood is for still more in the future, we offer our suggestions as to what kind of rate regulation should be adopted, having in mind the past and present circumstances necessitating such regulation. Our suggestions are not intended as final, for the situation may change so much in the future as to warrant an entirely different approach to rating supervision.

SUGGESTIONS FOR A MODEL RATING BILL

Everyone will admit that discriminations and preferences in rates should be subject to public scrutiny and control. Most others would also admit that insurance has now become so affected with a public interest that the public should have some supervision over excessive rates. Likewise, inadequate rates made in the heat of competition should be subject to supervision to protect the reserves of the company and the interests of the insuring public. Further than that the state should not go in its supervision of rates.
The practice of using rating organizations for filing rate schedules is now firmly established in the insurance field and is now generally approved by the public. But rating bureaus should be subject to strict supervision lest the evils of high-priced monopoly become sanctioned through inadequate or improper supervision of them.

A company which by its plan of operation is safely able to offer insurance at a lower rate than that set by a rating bureau should certainly be permitted to do so. The hazard of loss is not the only criterion for fixing rates, yet it is the one almost exclusively used by rating organizations. The type of company and its methods of doing business can often go far toward reducing the overhead costs that go into the making of the rate. These factors should be given full consideration, for it was never the purpose of rating laws to stifle genuine competition and \textit{bona fide} ingenuity in business operations.

It has not yet been proved that the policy of present rating laws to concentrate the business of rate making in rating organizations has been beneficial to the insurance-buying public. Examination of typical fire rating manuals prepared by rating organizations discloses that fire insurance rates are computed by adding the various losses in a particular community and apportioning them to determine the premium. To this rate is added an additional loading charge, called expense loading, to cover agents' commissions, taxes, fees and other expenses of the company, plus a reasonable profit. The base premium is fixed thus. At no place in the manuals or in practice is provision made for any adjustment of premium rates based upon the "moral" hazard of the particular individual seeking insurance. A person may have had a long record of no losses, yet he is subjected to a purely mechanical rate computed on aggregate losses. Where a fire insurance company by law is guaranteed a fair profit over and above all losses and expenses we find that its rates are made by a clerical force under a mechanical set of rules and regulations, without safety, fire prevention, and other engineering services that should be afforded for the protection of life and property. In other words, the mechanical process of ascertaining rates as prescribed by typical rating laws makes for a guaranteed profit without encouraging the practice of economy, safety and preservation of life and property, all of which ought to be necessary before a profit should be realized. The insuring public is thus compelled to pay an artificially high price for insurance or go without the benefits of insurance protection.

This is well illustrated by the Associated Factory Mutual Insurance Companies, the greater part of whose expenses are incurred in investi-
gating and providing for fire prevention and protection. It will be observed that this group of insurance companies has returned as unabsorbed premium from 90.84 to 95.66 per cent of the rates initially charged. Also certain large fire companies operating in Wisconsin and maintaining their own inspection engineers are able to make a return of unabsorbed premium to their policyholders of from 20 to 40 per cent.

Rating laws have not reduced the insurance cost of the ordinary citizen. In fact, they have been the cause of increasing his insurance cost and have resulted in legalizing the trust practices prohibited by anti-compact laws.

This is not to say that rating organizations cannot be beneficial if strictly supervised. They can and do make available to many companies a rating service that might otherwise be very costly or even prohibitive to the individual company. Membership in a rating organization, therefore, should be permitted, but should not be mandatory. There are still many companies better able to make rates themselves than through a rating organization.

A central filing body or rating bureau should be required to secure a license before doing business in a state. Copies of all the rules, regulations and other data used in promulgating rates and in governing member insurers should be filed, as should all amendments thereto. Provision should be made for filing detailed information by bureaus maintaining a special inspection service for merit rating.

Membership requirements in an organization should be made non-discriminatory, and no rating organization should be permitted to effect any rule or regulation which would prohibit a member company from issuing a policy providing for contingent liability or participation in earnings or profits.

A company should be required, either alone or through a rating organization, to file a general basis schedule of rates and other charges, rules, terms, privileges and conditions which in any way affect such rates or the value of insurance as issued to an assured. Such filings should be made separately for each class of insurance. Proposed changes in the filed schedules should also be required to be filed before becoming effective.

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49 See Bests Fire Insurance Reports (1938) 810.
50 Id. at 881, 907.
51 See the report of the 1929 Interim Committee on Fire Insurance in Wisconsin, filed with the legislature of that state in 1931.
The commissioner should not be required to approve the schedule filings. However, he should be given authority if he finds the schedules, rules, terms, privileges or conditions to be unjust, unreasonable, unfairly discriminatory or preferential, to order such changes as appear necessary and upon failure of the company or rating organization to make such correction as ordered, to suspend or revoke its license. In making such determination as above the commissioner should be required to consider the loss and expense experience of the particular company, within or without the state, and also the rates charged for like insurance in other states.

Deviations from filed schedules should be freely permitted, based upon considerations already mentioned. The latest illustration of permitting deviations by individual companies, based on their own plan and experience, is *American Druggists Fire Insurance Company of Cincinnati v. State Insurance Board of Oklahoma*.

The company in this case used what it called a uniform 25 per cent reduction rate plan. The Insurance Board of Oklahoma ordered it to adopt the rates of a rating bureau, of which it was a member, that promulgated rates for such risks as written by the company. The company appealed from the order, claiming that its own experience justified its low rate and that the order would do nothing more than raise the cost of insurance for its policyholders.

The insurance laws of Oklahoma require each fire company to file its general basis schedule individually or through a rating organization and give the Board power to raise or lower rates consistent with reasonableness and safety to the company. A company may not deviate from its filed schedule unless it first gives notice and files its amendments.

The court stated that the statute was designed to prevent unjust discrimination, but was also intended to permit fair competition among the companies. It vacated the order of the Board, holding that a company may deviate from bureau rates when its experience and method of operation so justified. The court said:

"... But where it appears by reason of special circumstances that a different rate for any one company is reasonable and safe, the collective experience of all the companies where that special circumstance may not exist need not be considered as applicable in that instance. These are matters for the consideration of the board in determining in a given case where the rate asked for is excessive, inadequate or reasonable. . . ."

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52* *84 P. (2d) 614, 617-618* (Okla. 1938).
"We do not think it necessary to burden this opinion with a detailed analysis of the financial condition of petitioner. We think it sufficient to say that the underwriting experience is wholly adequate for a determination of the reasonableness of the proposed rate under which the company has been operating for many years in this state and throughout the country. The record shows that the company is thoroughly solvent and has made a fair underwriting profit under its reduction plan. . . . We think that, considering the limited nature of the individual risks, the low commission paid to its agents, and its methods with respect to avoidance of the conflagration hazard, petitioner is justified in continuing to charge a rate which is 25 per cent lower than the manual rate without jeopardizing the safety or soundness of the company. . . ."

A rating law should not prevent any mutual or reciprocal companies from charging a membership or policy fee, nor prohibit any insurer from returning or crediting to its policyholders such proportion of its earnings or profits as its directors may determine, nor require any insurer to change its plan of its operation, its plan of premium payment or its policy period.

Provision should be made for adequate hearings before the commissioner after due notice and for appeal to the state courts.

Certain types of companies should not be subjected to rate control. Life insurance is one. The state has adequate supervisory power over such companies through reserve requirements based upon scientific tables of mortality and through anti-discrimination laws. Ocean marine insurance and inland transportation insurance, including transportation and navigation rolling stock equipment and property, should be exempt, even if a fire hazard is included, because the rate in such insurance is largely based upon factors too uncertain for stereotyped rating and also upon the "moral" hazard, already mentioned, that is not considered at all in present rating laws or by rating organizations. In other words, the hazards of such marine insurances are too uncertain and too "personalized" to be put into the straight-jacket of a rating law.

Similarly, because of the individualized nature of accident and health risks, such insurance should be exempted. Fidelity and surety obligations should be exempt for the same reason. It is impossible to make a fair rate for all in these types of insurances. Each company should be free to promulgate a separate premium cost based upon the particular risk involved, taking into account also the previous experience of the insurer.

Lastly, it is highly desirable that rating laws be uniform since most companies operate in many states. As far back as 1915 uniformity in rating laws was advocated by a legislative committee in Illinois which
said that "the day is coming when there will be a uniform system of rating throughout the United States. There is no doubt that a system of schedule rating that could be used throughout the United States can be created and that this can be made so fair and just that within a decade it will be adopted by all concerned."

Almost a quarter of century since then, and still there is no semblance of uniformity in rating laws! We urge serious consideration of this problem by all concerned so that a fair and equitable rating law may be produced that will gain nationwide support. Uniform and adequate state supervision of insurance companies is the one sure way to prevent agitation for complete federal regulation.

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58Proceedings of the National Association of Insurance Commissioners, Forty-sixth Session (1915) 144.
PLEADING CONDITIONS PRECEDENT
AND SUBSEQUENT

CARL C. WHEATON*

TO THE writer, one of the most fascinating studies has been that concerning the pleading of conditions precedent and subsequent. The purpose of this paper is to state the results of his research and thought on that subject.

AUTHORITIES

1. Definitions

Initially, the authorities will be examined, and our attention is first directed to the definition of conditions precedent and subsequent.

It has been said that a condition precedent is something essential to the right asserted.¹ It has also been decided that, where the defendant must perform his part of an agreement only if some act is done or forbore by the plaintiff, the doing or forbearance thereof is a condition precedent.² Professor Corbin has declared that a condition precedent is an operative fact that must have being prior to the existence of some legal relation in which one is interested.³ Bishop suggests that a condition precedent exists where a stipulation is to bind a party only on the transpiring of a designated event.⁴ Professor Williston writes that a condition precedent, when the question under consideration is the performance of duties arising under a contract, is a prerequisite to a duty of immediate performance under an existing contract.⁵ Professor Costigan may have meant the same thing when he asserted that a condition

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¹Hyder v. Metropolitan Life Ins. Co., 183 S. C. 98, 190 S. E. 239 (1937); 5 Page, Contracts (2d ed. 1921) § 2586; Editorial (1895) 51 Alb. L. J. 340.
²Metropolitan Life Insurance Co. v. Rutherford, 95 Va. 773, 30 S. E. 383 (1898).
⁴Bishop, Contracts (2d ed. 1907) § 586.
⁵Williston, Contracts (Rev. ed. 1936) § 666 (a). Accord: Restatement, Contracts (1932) § 250 (a).
precedent is a condition precedent to the vesting of any liability on the part of the other party to perform his portion of the contract.6

On the other hand, a condition subsequent has been held to be a condition the occurrence of which defeats an already established right.7 Professor Corbin, in keeping with his definition of a condition precedent, says a condition subsequent is an operative fact that causes the termination of some previous legal relation in which one is interested.8 Professor Williston, in giving a parallel definition, declares that a condition subsequent, as normally used, should mean a condition subsequent to a duty of immediate performance; that is, a condition which divests a duty of immediate performance of a contract after it has once accrued.8*

2. Who Pleads Occurrence of Conditions?

(a) In General

The general rule as to pleading conditions is simple. The one suing on a claim pleads conditions precedent which are still binding at the time of suit,9 and the one defending pleads conditions subsequent.10

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6Costigan, Conditions in Contracts (1907) 7 Col. L. Rev. 151.
7Knickerbocker Ins. Co. v. Tolman, 80 Ill. 106 (1875); Hyde v. Metropolitan Life Ins. Co., 183 S. C. 98, 190 S. E. 239 (1937); 5 Page, Contracts (2d ed. 1921) § 2586; Costigan, Conditions in Contracts (1907) 7 Col. L. Rev. 151.
(b) In Particular

In the setting of these general ideas, it is interesting to examine the conclusions of courts as to what are conditions precedent and subsequent. We shall, therefore, sample those decisions.

One suing on a contract must plead its existence and its breach.12

To enforce a promise to insure and pay a loss, which promise was conditioned on payment of a specified sum, the plaintiff must allege such payment.13

The defendant was to pay only upon the happening of a contingency. This occurrence must be alleged in the complaint in an action for the recovery of the money.14

The defendant agreed to repay the plaintiff money, if the plaintiff paid the defendant such money and the court did not authorize the payment. The doing of that thing is a condition precedent to the plaintiff’s having a cause of action.15

In a suit for breach of a contract giving the plaintiff the county printing, an agreement by the plaintiff to provide a bond was a condition precedent.16

A contractor was to be paid monthly upon rendition of a bill. He was obliged to render bills as a condition precedent to recovery of the sums due.17

Action for breach of a contract to pay on demand must allege a demand.18

When one is to provide work and material, if requested to do so, he cannot recover the price of such work and material without averring the request.19

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15Briggs v. Rutherford, 94 Minn. 23, 101 N. W. 954 (1904).
16Wheeler v. Hawkins, 101 Ind. 486 (1885).
In a suit on a note payable after a treaty is made, plaintiff should allege the making of the treaty.20

The defendant agreed to pay the plaintiff the amount due from D, deceased, out of the first proceeds of D's estate. The plaintiff was to relinquish his right to act as administrator in favor of the defendant. In an action on the agreement, the plaintiff must plead the relinquishment.21

In suing the defendant for his share of the cost of paving a street, the plaintiff should allege that notice to pave the street was given the defendant.22

Where material or work is to be satisfactory to a particular person, his satisfaction is a condition precedent to recovery of the price of the material or work.23

When one sues on a promise to deliver material if the plaintiff likes it, plaintiff must show he gave notice of his approval.24

An agreement was made subject to approval by a judge. Such approval is a condition precedent to liability on the agreement.25

The defendant was to pay the plaintiff a sum of money if the defendant did not obtain conveyance to the plaintiff of the land selected by the plaintiff. Selection of the land by the plaintiff was a condition precedent to the recovery of the money by the plaintiff.26

The defendant agreed to pay the plaintiff a certain sum if Texas prevented the location of, and passing of title to, designated property. Such prevention is a condition precedent to the recovery of the money.27

The defendant was to pay the plaintiff money after a transfer of property to the defendant. The plaintiff must, in an action to recover such money, allege the transfer of the property to defendant.28

In a suit on a breach of a promise to pay money when collected from a certain source, collection of the money is a condition precedent to recovery.29

20Thompson v. Houston, 31 Tex. 610 (1869); Harris v. Lewis, 5 W. Va. 575 (1872).
21Daniel v. Morton, 4 Munf. 120 (Va. 1814).
27Bruen v. Ogden, 18 N. J. Law 124 (1840).
29Dodge v. Coddington, 3 Johns. 146 (N. Y. 1808).
The plaintiff was to receive a commission only after goods sold by him were received and paid for by his subscribers. Such receipt and payment were conditions precedent to recovery of the commission.30

A contract provided for payment of rent after the other expenses of a business had been paid. The landlord must allege receipts above those other expenses in a suit for rent.31

In a suit on an obligation to pay only upon the return of an instrument duly recorded, such return is in the nature of a condition precedent.32

One agreed to pay a certain sum if a sale of land were confirmed. To recover the sum, one must allege the confirmation.33

In a suit on an agreement providing there could be no recovery for loss of an eye from an accident unless it occurred within 90 days after the accident, the plaintiff must allege the loss within the time mentioned.34

If a note is payable on condition the defendant becomes intoxicated or drunk or abuses a named person, the plaintiff must allege the intoxication or abuse.35

A lease provided that appraisors should settle the amount due from a lessee to a lessor for damage to leased property during the term in case of a dispute as to damage. Such settlement was necessary to a suit to recover for damage in case of dispute.36

In actions on insurance contracts, the usual rule that the existence of a contract and its breach are conditions precedent prevails. In addition to that, payment of premiums,37 and giving the insurer notice38 and

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32Root v. Childs, 68 Minn. 142, 70 N. W. 1087 (1897).
35Meyers v. Phillips, 72 Ill. 460 (1874).
proof of loss\textsuperscript{39} are deemed conditions precedent. It has been declared, however, that, if a policy does not provide for forfeiture if notice is not given,\textsuperscript{40} or if a policy provides that payment is to be made within a definite time after notice of loss,\textsuperscript{41} the burden is not on the plaintiff to plead giving notice or proving loss. There are decisions that fulfillment of provisions for notice to police of loss\textsuperscript{42} and for certificates by designated persons of honest loss\textsuperscript{43} are to be proved by the plaintiff. Arbitration provisions are most often treated as conditions precedent,\textsuperscript{44} but there are courts which hold to the contrary, unless a policy specifically says that there can be no successful action thereon until arbitration is had.\textsuperscript{45}

It will be noticed that, except for the provision relating to the payment of premiums, all of the insurance contract conditions already con-


\textsuperscript{40}National Surety Co. v. Julian, 227 Ala. 472, 150 So. 474 (1933).


\textsuperscript{42}Fidelity Casualty Co. v. Sanders, 32 Ind. App. 448, 70 N. E. 167 (1904).

\textsuperscript{43}Egan v. Merchants' Fire Ass'n., 40 Wash. 513, 82 Pac. 898 (1905); Moody v. Amazon Ins. Co., 52 Ohio St. 12, 38 N. E. 1011 (1894); Home Ins. Co. of New York v. Duke, 43 Ind. 418 (1873).


sidered relate to occurrences prior to the creation of the insurance contract or subsequent to loss. There are a very few cases which decide that conditions which deal with occurrences between the coming into existence of the contract and loss may be conditions precedent. This has been considered true of provisions that an insured boat should always have a complete crew, that a watchman should be provided for insured premises, that certain books should be kept and preserved in a particular type of place, and that insured property should not be permitted to become unoccupied.

But, even in relation to some of the few types of conditions which have been considered conditions precedent, there are authorities treating them as condition subsequent. Thus conditions relating to the paying of premiums, keeping a watchman, making certain records and guarding them in a safe, occupying premises, and proving loss have been said to be conditions subsequent.

Further examples of conditions in insurance contracts which have been declared to be subsequent are those dealing with death caused by narcotics, use of diligence for personal safety, care of an animal, maintenance of a sprinkling system, examination of books of bonded employee, increase in risk, use of liquid for light, change in title,

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46St. Louis Ins. Co. v. Glasgow, 8 Mo. 713 (1884).
49Aetna Ins. Co. v. Black, 80 Ind. 513 (1881).
50Green v. American Life & Accident Ins. Co., 93 S. W. (2d) 1119 (Mo. App. 1936);
4 Cooley, Briefs on Insurance (2d ed. 1927) 3545.
54Southern Travelers' Ass'n v. Masterson, 48 S. W. (2d) 771 (Tex. Civ. App. 1932);
Commonwealth Life Ins. Co. v. Caudill's Adm'r., 266 Ky. 581, 99 S. W. (2d) 745 (1936);
other insurance, and submission by the insured to an examination concerning a loss. Dean Clark appears to approve of this type of decision in insurance cases. He says that where the very promise sued on is of limited scope (as a promise to make payment out of particular money) the plaintiff should show that the facts were not outside of the limitation. But where the defendant, as in an insurance case, promises broadly, and then, with excessive caution, seeks to protect himself in the event of the happening of many contingencies which probably will not occur, he may well be expected to assume the burden of raising the question.

THE AUTHOR'S VIEWS

The trends of the authorities have been presented, but the question as to whether or not the judicial decisions are correct still remains to be considered.

The writer is in accord with the view that the one suing should plead the occurrence of conditions precedent, and that the party sued should have that duty in relation to conditions subsequent. But when are conditions precedent and when are they subsequent? Professor Williston analyzed the issue thoroughly when he said that it is futile to talk about conditions precedent or subsequent without determining to what a condition is precedent or subsequent. Professor Corbin has expressed the same opinion. What, then, should be the dividing line between conditions precedent and subsequent? The answer will be found in the correct response to the following question.

Should the pleading of one suing indicate that prima facie he has a cause of action when he sues? That is an innocent-looking question, and the first answer which the writer has always received to it has been an assured "Yes." Then factual situations arising in insurance cases have been put. Suppose, for example, a policy insuring one against embezzlement by an employee states that the policy shall be void if examinations of the employee's books are not made at stated periods. Must the insured, in suing for a loss, allege that he has made the examinations agreed upon? To that question, the response is a resounding "No. The examinations involve a condition subsequent." Yet, if the first reply is correct,
the second is wrong. But the first answer seemed proper when it was made. Can the second response have been given as a matter of habit?

To the writer, there is no question about the correctness of the initial reply. Let us prove this by an analysis of the situation arising under the simple set of facts set forth above.

The plaintiff desires to be compensated for his employee's peculation. First he must plead the existence of the contract, for, if there is never a contract, there can be no basis for a suit to recover for a loss under a contract. The authorities all agree to that. Now, if it is certain that there must at some time be a contract under which there can be a loss, must there not be a contract existing at the time of the loss? Otherwise, what would there be on which to recover? If this is correct, how could the contract be in existence at the time of loss unless the examinations were made as agreed upon? Was the policy not to be void if they were not so made? Therefore, is it not for the one suing to allege that he made the examinations agreed upon? Must he not do this even to show that at one time he had a cause of action?

Moreover, it is the usual law that, in actions on policies, he who sues must allege a loss and notice and proof thereof. If that is true, must he not certainly plead the occurrence of acts he agreed to do prior to loss? The writer feels sure that the reply should be in the affirmative.

Further than that, should not he who sues allege that his loss has not been satisfied up to the time of suit? If he does not plead this, he has not shown that he has a prima facie cause of action at the time he brings his suit.

But one is told that this view is iconoclastic. What of it, if it is the proper theory? And it is.

What has happened is that courts generally have failed to analyze the situation carefully and have, therefore, determined upon the wrong time division between the different types of conditions. In contract cases they have most often treated conditions as precedent or subsequent to the existence of the contract.

In suits on insurance contracts, the courts do a most amazing thing. They usually correctly state that what must occur to create the contract are conditions precedent. Then they declare that the plaintiff must allege a breach and the giving of notice and proof of loss. But who must show that the policy was kept effective between its coming into existence and its breach? The defendant. As proved above, this is without a shred of logic. Again, ordinarily it is unfair from a practical viewpoint. Who knows better whether or not the insured has inspected the accounts of
his employee; who can the more easily prove that gasoline has, or has
not, been kept on the insured premises? One could ask hundreds of
such questions the true answer to which would be the insured.

It appears, therefore, clear to the writer that one must, from view-
points of logic, fairness, and practicability, conclude that all conditions
are precedent which are necessary to the prima facie existence of a cause
of action at the time of suit.

Does someone suggest that this eliminates the doctrine of conditions
subsequent? If that were true, it would not change the author’s opinion,
but it is not so. Any occurrence destroying a cause of action which
exists at the time of suit thereon is a condition subsequent.

Of course, it is a foregone conclusion that these views will at this
time find acceptance in few quarters. The old ideas are too deeply rooted
in the minds of lawyers to be eradicated easily, or soon. However, they
are presented without apology and with a sincere conviction of their
correctness.
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THE SUPREME COURT OF THE UNITED STATES†
VALIDITY OF THE AGRICULTURAL ADJUSTMENT ACT OF 1938.*

THE validity of the essential features of the Agricultural Adjustment Act of 1938¹ was sustained when the Court, in Mulford v. Smith,² upheld the power of Congress to control the marketing of basic agricultural commodities. The case arose out of a suit by tobacco growers of Georgia and Florida challenging the constitutionality of the tobacco marketing quotas which had been promulgated by the Secretary of Agriculture under the Act.

The Act was attacked on three grounds: (1) The power delegated to the Secretary of Agriculture to proclaim marketing quotas was an unconstitutional delegation of legislative power. (2) The Act sought to regulate agricultural production, which had been held to be beyond the powers of Congress in United States v. Butler.³ (3) As applied to the 1938 crop, the Act deprived the petitioners of their property without due process of law.

The Court held, in regard to the first objection, that ample standards have been laid down by Congress to guide the Secretary of Agriculture in fixing marketing quotas, and that protection against arbitrary action has been given by affording both administrative and judicial review. The Act was held to comply with the established principles regarding delegation of legislative power,⁴ and whatever doubts which may have existed concerning the referendum provisions of the Act had been dispelled by the Court in the recent case of Currin v. Wallace.⁵

In upholding the marketing provisions of the Act, the Court held that they do not purport to control production of tobacco but rather to regulate the interstate commerce of tobacco.⁶ This regulation was held to

†Written May 1, 1939.
*Written by Philip Treibitch.
²59 Sup. Ct. 648 (April 17, 1939). Mr. Justice Roberts wrote the opinion for the Court. Mr. Justice Butler wrote a dissenting opinion, in which Mr. Justice McReynolds concurred.
³297 U. S. 1 (1936).
⁶Mr. Justice Butler, in dissenting, argued that since the primary purpose of production was to sell, the provisions were in effect a control of production.

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extend to the "throat" of that commerce—the marketing warehouse through which, as the record showed, most of the tobacco passed in going to other states or to a foreign destination. The record clearly showing that the flow of the tobacco through the marketing warehouse was interstate commerce, the power of Congress to "foster, protect, or conserve that commerce, or to prevent the flow of commerce from working harm to the people of the nation"7 is unquestioned. This was decided only recently in Currier v. Wallace and is reaffirmed in the principal case.

The marketing quotas were held to be valid even as to the 1938 crop, although the growers argued that they were retroactive in nature in that they had not received notice of their quotas until after they had already grown their crops. The Court held that, since the quotas operated upon the marketing of crops in interstate commerce and not upon production, they were prospective in operation, and not retroactive. The fixing of quotas, said the Court, did not prevent the growers from holding over the excess tobacco produced, or processing it and storing it for future sale. The fact that there were no facilities for these purposes was held to be without legal significance.

The decision in the case did not involve an overruling of United States v. Butler, in which the first Agricultural Adjustment Act8 was declared invalid, since the invalidated Act in the Butler case rested upon the taxing powers of Congress and not upon its commerce powers. However, very little of the Butler case now remains. Its principles were greatly weakened by the Social Security cases,9 and by Cincinnati Soap Co. v. United States;10 and as a result of the principal case its practical effect on the powers of Congress to cope with the major problems of agriculture is almost nil.

7Congress, in the Act, stated among its findings of fact that tobacco was a commodity moving almost wholly in interstate commerce; that the huge surpluses have burdened and obstructed such commerce, causing injury to it; and that these surpluses have resulted in a disparity of prices between agricultural and industrial products, with a consequent diminution in industrial products. These facts are matters of common knowledge. The sad experiences of the old Federal Farm Board have shown clearly the depressed and disorganized state of agricultural marketing resulting from huge agricultural surpluses.

8Recommendations for Legislation (Special Report to Congress) Federal Farm Board (1932); First, Second, Third Annual Reports of Federal Farm Board (1930, 1931, 1932); See also Ezekiel & Bean, Economic Bases of the Agricultural Adjustment Act (1933); Nourse, Davis, Black, Three Years of the A.A.A. (1937) Ch. I.

948 Stat. 31 (1933).

DEPORTATION OF ALIENS—LAPSED MEMBERSHIP IN THE COMMUNIST PARTY**

In Kessler v. Strecker,11 the Court was called upon to construe Section One of the Act of October 16, 1918,12 as amended by the Act of June 5, 1920,18 in order to determine the authority of the Secretary of Labor to order the deportation of an alien who had, since his arrival in this country, joined the Communist Party of the United States, although his membership had lapsed prior to his apprehension. The case originated in the District Court of Louisiana, where a petition for a writ of habeas corpus was denied. On appeal, the Circuit Court of Appeals for the Fifth Circuit reversed the ruling of the District Court and remanded the cause for trial de novo.14 The Supreme Court granted a writ of certiorari because of an alleged conflict and because of the nature of the order of the Circuit Court of Appeals.15

The Government contended that the respondent came within the class of undesirable aliens, as defined by the statute, by reason of his membership in the Communist Party, and that his subsequent severance from that organization did not operate to change his status. On the other hand, the respondent claimed that the Act is directed only against a person affiliated with a proscribed organization at the time proceedings are instituted against him. After examining the statute and studying its history, the Court concluded that the latter contention was well-founded and that the interpretation of the Act by the Department of Labor was erroneous.16

The Court found that evidence in the record supported the determination by the court below that the finding of the Secretary of Labor was insufficient basis for the deportation of respondent. However, the Supreme Court found it necessary to modify the order of the Fifth Circuit Court of Appeals. Mr. Justice Roberts, speaking for the Court, declared:

"If the hearing was fair, if there was evidence to support the finding of the

**Written by Harry B. Merican.
1149 Sup. Ct. 694 (April 17, 1939).
1559 Sup. Ct. 102 (Oct. 17, 1938).
16In so doing, the Court expressed its disapproval of the rule followed by the Circuit Court of appeals for the Second Circuit in United States ex rel. Yokinen v. Commissioner of Immigration, 57 F. (2d) 707 (C. C. A. 2nd, 1932), and United States ex rel. Mannisto v. Reimer, 77 F. (2d) 1021 (C. C. A. 2nd, 1935).
Secretary, and if no error of law was committed, the ruling of the Department must stand and cannot be corrected in judicial proceedings. If, on the other hand, one of the elements mentioned is lacking, the proceeding is void and must be set aside. A district court cannot upon habeas corpus, proceed de novo, for the function of investigation has not been conferred upon it but upon the Secretary of Labor."  

He added that only where an alien asserted citizenship in a deportation proceeding was a trial de novo proper and that such proceedings could apply only to that issue.

In the course of its opinion, the Court stated that, under the statute, an alien might be deported if he was member of an organization of the kind proscribed at the time of his admission, or thereafter became and remained a member. Whether the Communist Party of the United States came within the scope of the statutory definition was not determined.  

THE WAGNER ACT

Discharge of Employees Upon Breach of Contract*

The case of National Labor Relations Board v. Sands Mfg. Co.19 was one of the three cases20 decided on February 27 last which promise to have an important effect on the future administration of the National Labor Relations Act.21 The Court, in the Sands case, held that employees who refuse to work in accordance with an agreement with their employer may be lawfully discharged, and if, after they are replaced, their union no longer represents a majority of the employees, the employer has no further duty to bargain with it. It therefore affirmed the refusal of the lower court22 to enforce an order of the National Labor

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1759 Sup. Ct. 694, 700 (April 17, 1939). The Chief Justice and Associate Justices Black, Frankfurter, Reed and Stone concurred.
18Mr. Justice McReynolds, in a dissenting opinion concurred in by Mr. Justice Butler, declared that the contention of the Government should be upheld.
*Written by Philip Treibitch.
1959 Sup. Ct. 508 (Feb. 27, 1939).
Relations Board based upon what the Board considered an unlawful discharge and a refusal by the employer to bargain with his employees.

The language of the opinion suggests that, as in the Fansteel case\(^\text{28}\) which was decided on the same day, certain acts of employees subject them to lawful discharge and thus take them outside the scope of the National Labor Relations Act. Such a view restricts the discretion of the Board in labor disputes. It is clear that by Section 2 (3) of the Act,\(^\text{24}\) Congress sought to preserve the employer-employee relationship during a labor dispute for the purposes of continuing the affirmative duties which the Act imposes upon employers, and of continuing the remedial powers of the Board.\(^\text{25}\) Its power to do so has been upheld by the Court.\(^\text{26}\) Congress, in its desire to eliminate obstructions in interstate commerce which arise out of a failure on the part of the employer to bargain collectively with his employees,\(^\text{27}\) recognized that an employer's failure to bargain in good faith with his employees is pregnant with dangers to interstate commerce whether the employees remain at their work or are engaged in a labor dispute.\(^\text{28}\) It was, prior to the Supreme Court's decision, deemed desirable to permit the Board to exercise its discretion, in view of the Congressional purposes and the standards laid down to guide it, in determining whether in a particular situation the purpose of the Act could have been effectuated by a requirement to bargain collectively despite the existence of a technical breach by the employees of a labor contract.\(^\text{29}\) Certainly the terms of


\(^{26}\)Section 2 (3): "The term 'employee' shall include any individual whose work has ceased as a consequence of, or in connection with, any current labor dispute or because of any unfair labor practice, and who has not obtained any other regular and substantially equivalent employment . . ."


\(^{29}\)The report of the Senate Committee on Education and Labor, in discussing the language of Section 2 (3), quoted supra note 25, said: "The bill thus observes the principle that men do not lose their right to be considered employees for the purposes of the bill merely by collectively refraining from work during the course of a labor controversy. . . . To hold otherwise would be to withdraw the Government from the field at the very point where the process of collective bargaining has reached a critical stage and where the public interest has mounted to its highest point . . . " SEN. REP. No. 573, 74th Cong. 1st Sess. (1935) 6.

\(^{29}\)Cf. dissenting opinion in National Labor Relations Board v. Fansteel Metallurgical Corporation, 59 Sup. Ct. 490, 500 (Feb. 27, 1939).
Section 2 (3) do not preclude such a view. Of course, the discretion exercised by the Board must be reasonably supported by substantial evidence in the record. This suggestion of the Court, that employees may be discharged for breach of their labor contract, must be weighed in the light of the Court's view of the facts of the case.

In the instant case, the Board found that the dispute arose over the interpretation of a labor agreement and that there was confusion among the employees in regard to its application to the particular questions in dispute; that after an impasse with the employer over the interpretation and applicability of the contract there was a mutual understanding to cease work for a temporary period; and there was no thought on the part of the men either to leave their employment or submit to a discharge. Under such circumstances, the Board found that there was an honest difference of opinion between the parties which possibly could have been resolved by continued bargaining in good faith, and that the employer's failure to do so and his dismissal of the employees was a violation of the Act. The Court, however, took a different view of the situation. It felt that the employees' committee which had negotiated the contract well understood its terms, but that the men who were presumed to know its terms (though it is unlikely that they did) were nevertheless "irrevocably committed not to work in accordance with their contract."

In accordance with this view of the situation, the Court held, as it did in National Labor Relations Board v. Mackay Radio & Telegraph Co. that the employer did not have to keep his plant closed indefinitely while his employees refused to work. Whether the Board was palpably wrong in holding that continued bargaining should have preceded the reopening of the plant may be disputed. Undoubtedly, the existence of a breach of contract influenced the Court in its holding that the employer had waited a sufficient time before reopening his plant. But to consider that the breach of contract alone justified a refusal to continue further

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31 In the matter of The Sands Manufacturing Company and Mechanics Educational Society of America, 1 NRLB 546, 555 (1936).

32 Id. at 552, 557.

33 Id. at 557.

34 59 Sup. Ct. 508, 514 (Feb. 27, 1939).

35 Ibid.

36 304 U. S. 333 (1938).
discussions would impair the efficacy of the Act in disputes like that of the principal case.

Just how long the employer’s duty to bargain with his employees may continue after an impasse in negotiations is a question that can only be answered on the basis of the facts in a particular situation. Sound principles of practice in regard to administrative bodies would indicate that the Board should, within appropriate limits, be permitted to exercise its discretion, based on facts, in determining how long that duty should continue if there is to be collective bargaining in good faith. An employer does not, under the Act, incur a duty to be ready for an indefinite period to bargain with his employees, nor does the Act seek to solve all problems arising out of industrial relationships. In the instant case, the Court did not deny that the employer had a duty to bargain with the employees between the time they ceased work and the time he effectively discharged them, if the employees had requested him to do so. But this duty, it held, ceased when the employees were justifiably discharged after their breach of contract. The Board found that the employees’ conduct did not under the circumstances relieve the employer of his affirmative duty to continue to bargain in good faith. Nor did it feel that the duty to bargain implies only a duty to bargain when requested to do so. Concededly, in many cases, the duty can only arise when the employer is requested by his employees to bargain.

The language in the Sands case and in National Labor Relations Board v. Columbian Enameling & Stamping Co. suggests that collective bargaining can be initiated by employees only, but if this were regarded as a rule of law, the discretion of the Board in its determination whether collective bargaining is being carried on in good faith would be seriously limited. The Court held that the Board’s findings in the Sands case were not supported by any substantial evidence in the record, and that the situation in that case did not place upon the employer any duty to renew negotiations. The holding that collective bargaining must be initiated by the employees would seem to rest, therefore, upon the facts of these cases.

Concededly, the Sands decision, as well as the decisions in the Columbian and Fansteel cases go far in limiting the discretion of the Board in situations involving labor disputes. They raise important problems in

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39 Sup. Ct. 508, 514 (Feb. 27, 1939).
4159 Sup. Ct. 501 (Feb. 27, 1939).
regard to the future administration of the Act. The emphasis placed by the Court on the breach of contract in the Sands case, and the commission of torts in the Fansteel case, would seem to place upon the Board the burden of trying questions of tort and contract. It is doubtful that Congress meant to impose such a burden on the Board.  

Jurisdiction of National Labor Relations Board—Interstate Commerce

To the line of decisions defining the scope and meaning of the terms “commerce” and “affecting commerce” as employed in the National Labor Relations Act, has been added that in National Labor Relations Board v. Fainblatt. The Court had held that a concern, operating a great steel plant, to which the major portion of the raw materials used were imported and from which most of the finished products were shipped in interstate commerce, came under the jurisdiction of the National Labor Relations Board. It had found that smaller firms engaged in interstate commerce to a similar degree were likewise within the jurisdiction of the administrative body. It had further held that a large fruit-packing concern came within the purview of the Act although only 37 percent of its products was shipped out of the state in which they were processed. During the present term, the Court had sustained the jurisdiction of the Board over a public utility not at all engaged in interstate commerce, since it substantially affected such commerce by supplying power to interstate carriers and to firms producing goods for shipment outside the state and receiving raw materials from foreign sources. In the instant case, it decided that the Act was applicable to a concern which received from extrastate sources raw materials, title to which remained in others, processed them, and transferred them to an agent of an out-of-state purchaser, within the state where the processing took place, for shipment to other states.

The sole question before the Supreme Court was that of jurisdiction.

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*Written by Harry B. Merican.


*59 Sup. Ct. 668 (April 17, 1939).


*Consolidated Edison Co. of New York, Inc. v. National Labor Relations Board, 59 Sup. Ct. 206 (Dec. 5, 1938). In this case large quantities of fuels were brought into New York State by the petitioner but the Court chose to disregard this factor.
The Circuit Court of Appeals for the Third Circuit had denied enforcement of an order of the National Labor Relations Board on the ground that the employer was engaged only in processing goods to which he had no title and which were shipped by the owners. In its view, the activity of the respondent was entirely intrastate in nature. This the Supreme Court found to be error. Mr. Justice Stone, for the Court, declared: "It has been settled by repeated decisions of this Court that an employer may be subject to the National Labor Relations Act although not himself engaged in commerce. The end sought in the enactment of the statute was the prevention of the disturbance to interstate commerce... induced or likely to be induced because of unfair labor practices named in the Act. That those consequences may ensue from strikes of the employees of manufacturers who are not engaged in interstate commerce where the cessation of manufacture necessarily results in the cessation of the movement of the manufactured product in interstate commerce, has been repeatedly pointed out by this Court." The contention that the respondent was a small producer was dismissed. The Court saw no limit upon the power of Congress to regulate, except "to the extent that Congress may be taken to have excluded commerce of small volume from the operation of its regulatory measure by express provision or fair implication." In the present instance, neither an actual limitation in the Act itself, nor a constructive restraint produced by the circumstances of the case, was found to exist. In the view of the Court, the essential fact was that the free flow of commerce was obstructed, as the findings of the Board amply established.

Mr. Justice McReynolds dissented on the grounds that the effect of the unfair labor practices here treated was remote, and that respondent's enterprise was so small that to extend federal control to include regulation of his business was to encroach upon the powers reserved to the states. He asserted that "The Labor Board claims jurisdiction in re-

47 NLRB 596 (1937).
49 Sup. Ct. 668, 670 (April 17, 1939).
50 Sup. Ct. 668, 672 (April 17, 1939). It would seem that Mr. Justice Stone took this means of reconciling the ruling of the Court with the doctrine of Schechter Poultry Corp. v. United States, 295 U. S. 495, 550 (1935), to the effect that "the authority of the federal government may not be pushed to such an extreme as to destroy the distinction, which the commerce clause itself establishes, between commerce, 'among the several states' and the internal concerns of a State."
51 The Chief Justice and Associate Justices Black, Reed and Roberts concurred. Mr. Justice Frankfurter took no part in the consideration or the decision of the case.
52 Mr. Justice Butler concurred in this dissent.
spect of employment at his establishment upon the theory that the material and garments move in interstate commerce; that disapproved labor practices there may lead to disputes; that these may cause a strike; that this may reduce the factory output; that because of such reduction less goods may move across state lines; and thus there may come about interference with the free flow of commerce between the states which Congress has power to regulate. So, it is said, to prevent this possible result Congress may control the relationship between the employer and those employed. Also, that the size of the establishment's normal output is of minor or no importance." Such a construction, the minority opinion continued, "brings within the ambit of federal control most, if not all, activities of the Nation; subjects states to the will of Congress; and permits disruption of our federated system."

In the opinion of the dissenting justice, the ruling of the majority ran counter to the view expressed in Kidd v. Pearson, United States v. E. C. Knight Company, Oliver Iron Mining Company v. Lord, Schechter Poultry Corp. v. United States and Carter v. Carter Coal Co., none of which were so much as cited in the majority opinion. To the dissenting Justices, the decision of the Court marked one more step in the devitilization of the distinction between powers reserved to the states and those delegated to the National Government. "Perhaps," Mr. Justice McReynolds concluded, "the change of direction, no longer capable of concealment, will give potency to the efforts of those who apparently hope to end a system of government found inhospitable to their ultimate designs."

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59 Sup. Ct. 668, 673 (April 17, 1939).
6128 U. S. 1 (1888).
65156 U. S. 1 (1895).
66262 U. S. 172 (1923).
67295 U. S. (1935); see note 50, supra.
68298 U. S. 238 (1936).
69 Sup. Ct. 668, 675 (April 17, 1939).
FEDERAL LEGISLATION
THE FEDERAL CORPORATION LICENSING BILL:
CORPORATE REGULATION

The historical development of federal incorporation or licensing of corporations has been ably reviewed by a number of writers. In 1934 the Federal Trade Commission transmitted to the Senate certain of its studies in connection with its investigation of utility corporations, the studies containing a comprehensive compilation of proposals and views for and against federal incorporation or licensing of corporations. In recent years the subject has been revived with renewed interest; a series of bills has been introduced in Congress by Senators O'Mahoney and Borah; extensive hearings on these measures have been conducted; and the Temporary National Economic Committee has been authorized to conduct studies and is currently so doing.

Under the more recent measures for this type of legislation the definition of "commerce" has been extended to include the collection, production, and shipment of goods in interstate commerce. The power of Congress over matters affecting interstate commerce, i.e., the question of what is comprehended by the term "interstate commerce", has been hotly debated for some decades. It is not proposed in this discussion to become involved in such a highly controversial, albeit interesting, subject as the constitutionality of these proposed regulatory measures. Rather, the scope of this discussion will be limited strictly to the regulatory features of the current bill in Congress as they pertain to the


internal affairs of corporations. As a background for this discussion certain pertinent aspects of the bill will be briefly mentioned.

GENERAL PROVISIONS

The bill contains no provision for federal incorporation, as have many of its predecessors, but requires all corporations, unless otherwise exempt, engaged directly or indirectly in commerce to be licensed under the Federal Trade Commission, provided the corporation by itself or in consolidation with its subsidiaries has had, at any time during the three years immediately preceding the time when it so engages in commerce, gross assets the value of which exceeds $100,000. The exempt classes are common carriers (including carriers of property, persons, or messages), radio broadcasting corporations subject to the Communications Act of 1934, banking and insurance corporations, corporations engaged in publishing newspapers, magazines, or books, corporations organized under the China Trade Act of 1922, and corporations the majority of whose stock is held by the United States. The last-mentioned exemption is conditioned upon the corporation’s not acquiring, for the purpose of controlling or influencing the management, any interest in or control of a corporation, subject to the bill.

As a preliminary to obtaining a license, an applicant must file with

7The limitations of space do not allow a discussion of the restrictions placed upon the officers and directors of licensees by the proposed measure. As a result of these important restrictions, officers and directors: (1) Are required to be actual owners of stock in the licensee; (2) are prohibited from holding stock or office in competitors of the licensee; (3) are prohibited from employment by corporations which have advanced or loaned money or property to the licensee; (4) are regarded as trustees of the stockholders and liable to them in actual and punitive damages for any money or property paid to any other corporation in which such officers or directors hold office or own more than 5% of the corporate securities; and (5) are prohibited from taking any profit, other than regular compensation, as a result of the trust reposed in them. (§ 19).

8S. 330 defines “corporation” as “any body corporate, association, trust, joint-stock company, limited partnership, or syndicate”.

9S. 330 defines “commerce” as follows: “‘Commerce’ shall mean trade or commerce in all its branches . . . among the several States . . . It shall include also the collection of raw materials and equipment in commerce as above defined for the production, and the production therefrom, of any article or commodity to enter the flow of, or which affects, commercial intercourse . . . among the several States, . . . and the sale or transportation of any article or commodity so produced in the course of commerce, as above defined, to retail dealers in any State . . .”.

10As to the inclusion of air lines, Senator O’Mahoney states that if air lines are common carriers, they are exempt. Hearings before Subcommittee of the Committee on the Judiciary on S. 10, 75th Cong., 1st Sess. (1937) 45.
the Federal Trade Commission reports containing certain stipulated information as to its organization and financial structure. In general this information is similar to that required under the Securities Act of 1933,\(^1\) the Securities Exchange Act of 1934,\(^2\) and the Public Utility Act of 1935.\(^3\) These requirements have been strongly criticized by business men on the grounds of (1) expense, (2) the well-nigh impossibility of obtaining all the figures required in the case of a very old corporation, (3) the duplication of similar requirements of the Securities & Exchange Commission, (4) the inability of one organization such as the Federal Trade Commission to investigate the truth and accuracy of such reports, and finally (5) the danger of publishing confidential trade information to the general public.\(^4\) It is difficult to conceive of the licensing of corporations without some such requirement as this relating to information concerning organization and financial structure. However, the solution may be the filing of copies of the information required by some other commission in Washington, such as the Securities & Exchange Commission, if the corporation is registered with another commission. Another solution may be found in the separation of these corporate regulatory measures from the other provisions of the bill and administration of the former by the Securities & Exchange Commission.

A sharply criticized provision is that which grants to a licensee power under its charter, by mere act of its board of directors, to accept any charter restriction that Congress imposes as a condition of its right to engage in such commerce, the law of any state or the decision or order of any state authority to the contrary notwithstanding.\(^5\) It is contended that this controverts the very intent of the proposed corporate regulation, \textit{i.e.}, protection of stockholders, since it reposes complete power in regard to this matter in the board of directors.\(^6\)

\(^{2}\)Id. at 881, 15 U. S. C. at § 78a et seq.

\(^{4}\)Mr. Sinclair Weeks of Boston, in discussing this provision, said: “The point I would bring out here is that under this act you are not confronted with a situation covering the sale of securities to the public but are solely concerned with the operation of a business itself and, in effect, are opening wide the doors of every business in this country to the inspection of competitors, customers and prospective competitors.” \textit{Hearings before Subcommittee of the Committee on the Judiciary on S. 10 and S. 3072, 75th Cong., 3d Sess.} (1938) 492.

\(^{6}\)S. 330, 76th Cong., 1st Sess. (1939) § 3(e).

\(^{6}\)Mr. Daniel O. Hastings, former senator from Delaware, stated: “I have observed that during these hearings much criticism has been directed at the general corporations law of
Another provision which has been subjected to considerable criticism is that requiring a certificate by the applicant that by vote of its board of directors it intends to engage in commerce subject to all Acts of Congress regulating such commerce or limiting or affecting the rights, powers, or duties of corporations or associations engaged therein. It is contended that this prejudices the future standing of a corporation in court in connection with a law whose terms may be subject to judicial review as to constitutionality in whole or in part. To make such a commitment in advance is alleged to be neither reasonable nor fair.

Finally, the penalties imposed are criticized as being entirely too strict. For the bill provides that no applicant shall be entitled to a license if it is an unlawful trust or combination in violation of the antitrust laws. It is contended that this provision in effect places control upon control. The uncertainty as to what constitutes a violation of the anti-trust laws is held to put every licensee in jeopardy, however innocent it might be of any intent to violate such laws.

The bill is unusually extensive in scope, including in general three broad objectives: (1) the regulation of labor standards; (2) the regulation of fair and unfair trade practices of corporations; (3) the regulation of corporate practices. The following discussion will concern itself with the last of these general objectives.

THE NEED FOR CORPORATE REGULATION

The provisions relating to the regulation of corporate practices are set forth in Section 5 of the bill, which is founded upon a measure introduced by Senator John Sharp Williams of Mississippi in 1911. As expressed the State of Delaware because it gives so much freedom to persons in control of a Delaware charter. I would like to state, however, that the Delaware law does not permit any such change in its charter as is contemplated here, 'by mere act of its board of directors' and regardless of any act of Congress no reputable lawyer would advise a Delaware corporation that, merely because an act of Congress undertook to authorize the board of directors to use this method of complying with the act of Congress that would justify the board in taking such action, or that it would be legal if it were so taken. A corporate charter is a contract between the State and the corporation and between the corporation and its stockholders; no corporation can violate the provisions of such a contract. Assuming that the Congress can in its efforts to regulate interstate commerce place certain restrictions upon State corporations which desire to engage in such commerce, it does not follow that the Congress can change the status of that corporation with its own State." *Hearings before Subcommittee of the Committee on the Judiciary on S. 10 and S. 3072, 75th Cong., 3d Sess. (1938) 649.*

*S. 330, 76th Cong., 1st Sess. (1939) § 3(b).*

*Id. at § 4(a).*

*S. 1377, 62d Cong., 1st Sess. (1911).*
by Senator O'Mahoney, the purpose of the corporate restrictions is to abolish certain features of corporate practice and structure that are almost universally condemned. It is proposed that this be accomplished by requiring licensees to adhere to those principles which appear necessary in the public interest. The preamble to the bill recites "That a constantly increasing proportion of the national wealth has been falling under the control of a constantly decreasing number of corporations, . . . that many of the causes of such maladjustments of wealth have been and are national in their scope and effect and have been found to be beyond the practical or legal ability of the several States to control or eliminate effectively, and that such causes and effects can be effectively controlled or eliminated only through congressional legislation." The history of our corporate growth indicates the truth of this conclusion.

On December 3, 1888 President Grover Cleveland, in his annual message to Congress said: "Corporations which should be the carefully restricted creatures of the law and the servants of the people are fast becoming the people's masters." Early in the 80's the State of Maine, one of the pioneers in the development of liberal incorporation laws, amended its constitution so as to provide that corporations might be formed under general laws rather than by special acts of the legislature. A few years later James B. Dill invented the device known as the holding company—one corporation holding stock in another. New Jersey was quick to seize upon this new device as a means of enriching the state coffers, and in 1890 passed a holding company law which permitted one corporation to take stock in another corporation. Immediately there was a rush by corporations to incorporate in New Jersey and thus have the advantage of this new and highly prized type of corporate structure. A corporation was organized by the State which became the agent of New Jersey corporations and conducted the business of distributing charters.

In 1896 Delaware decided to join the liberal movement and amended her constitution so as to permit the granting of charters under a general statute. In 1899 the legislature of this State passed the first general corporate-practice statute, under which the Secretary of State or some bureau could issue these charters without specific authorization. Delaware rapidly became the "charter-mongering" state, and since then

See Berle and Means, The Modern Corporation and Private Property (1933) c.3.
has issued over 100,000 charters, most of them to corporations having their principal places of business elsewhere.22

Many firms set themselves up in the very lucrative business of corporators in this corporation "racket" and advertised extensively, stressing the liberal charter laws of their own states.23

However, to one state in the Union, it might be said that we have almost surrendered the power to create corporations in the United States. There has, of course, been competition from other states, but Delaware has remained supreme in its field. Maryland liberalized its charter in an effort to tempt some of the lucrative business away from Delaware, and the competition between these two states in granting powers to corporations has grown apace. The effect upon other states has been noticeable. The majority have been almost as bad as the several mentioned. Those few that attempted or have actually maintained strict laws succeeded only in driving corporations into other, more liberal jurisdictions.24 It is apparent that the existence of these "Corporate Renos"25 has effectively blocked any kind of local regulation of any of the larger corporations. As Professor William Z. Ripley has so aptly put it: "There is no check, let, or hindrance from a State which grants the charter even to see that the grants named under such charters, are observed."26 Justice Brandeis, in his famous and oft-quoted dissent in the Florida Chain Store Tax case,27 said:

"The removal by the leading industrial States of the limitations upon the size and powers of business corporations appears to have been due, not to their conviction that maintenance of the restrictions was undesirable in itself, but to the conviction that it was futile to insist upon them; because local restriction

22Hearings before Subcommittee of the Committee on the Judiciary on S. 10, 75th Cong., 1st Sess. (1937) 50.
23Ripley, MAIN STREET AND WALL STREET (1926) 29.
24Theodore Roosevelt challenged Governor Woodrow Wilson to reform his own State, New Jersey. Under the leadership of Governor Wilson, New Jersey then passed a series of laws eliminating corporate abuses. The immediate effect was a sharp decline in state revenues derived from corporation taxes; the corporations simply moved into other states. In time, the New Jersey legislature repealed its strict and prudent legislation and went back almost to its former standards. Hearings before Subcommittee of the Committee on the Judiciary on S. 10, 75th Cong., 1st Sess. (1937) 74.
25This expression is that of Judge John J. Burns, former General Counsel of the Securities & Exchange Commission. See Berlack, Federal Incorporation and Securities Regulation (1936) 49 Harv. L. Rev. 396, 404.
26Hearings before Subcommittee of the Committee on the Judiciary on S. 10, 75th Cong., 1st Sess. (1937) 276.
would be circumvented by foreign incorporation. Indeed, local restriction seems worse than futile. Lesser States, eager for the revenue derived from the traffic in charters, had removed safeguards from their own incorporation laws. Companies were early formed to provide charters for corporations in States where the cost was lowest and the laws least restrictive. The States joined in advertising their wares. The race was not one of diligence but of laxity. Incorporation under such laws was possible; and the great Industrial States yielded in order not to lose wholly the prospect of the revenue and the control incident to domestic incorporation."

It is not necessary to review in any great detail the corporate abuses which arose during this period of concentration of wealth and economic resources. The Senate hearings on stock exchange practices which resulted in the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934 disclosed to an amazing degree the various abuses which existed in these internal corporate affairs. Logically, it might be reasoned, regulation of corporate practices should have been comprehended in the provisions of these two acts, but such is not the case. The Securities Act of 1933 requires a full and fair disclosure of all material facts and extends only to the initial public offering and distribution of securities in interstate commerce. The Securities Exchange Act of 1934 regulates practices on national exchanges and trading of securities on those exchanges and in the over-the-counter markets; jurisdiction over corporations extends only to companies whose securities are registered on national exchanges, and like the 1933 Act, there are no provisions for the control of corporate affairs or structure. Under the provisions of the Public Utility Act of 1935, applicable to certain classes of utility holding companies, the Commission is granted certain powers to protect the different classes of security holders, but under none of these three Acts is it granted power to revise the corporate structure, reform the charter provisions, or regulate the internal affairs of the corporation. The O'Mahoney bill of 1938 deals with a certain set of relationships which have not yet been covered by any existing federal legislation, i.e., the relationships between the owners (stockholders) and the management.  

Senator O'Mahoney emphasizes that the intent of the bill is not "to give the Federal Trade Commission or any Federal bureaucracy the

28 Hearings before Committee on Banking and Currency on S. Res. 84, 72d Cong., 2d Sess. (1933); Hearings before Committee on Banking and Currency on S. Res. 56 and S. Res. 97, 73d Cong. (1933).

29 Hearings before Subcommittee of Committee on the Judiciary on S. 10, 75th Cong., 1st Sess. (1937) 270.
power to set the terms and conditions on which corporations may operate” but “that Congress shall set the terms and conditions”.

He regards the function of the Federal Trade Commission under these provisions as purely ministerial.

A safe conclusion is that abuses have existed in corporate structures and the management of the corporation’s internal affairs which have neither been controlled nor eliminated by the states as a whole. It remains to be seen whether the specific proposals in this measure effect the desired result.

RESTRICTIONS AS TO PLACE OF BUSINESS

“That, in the case of any licensee organized after the date of enactment of this Act, it shall have its chief place of business and its executive offices, and the meetings of its board of directors or trustees shall be regularly held, within the State, Territory or possession under the laws of which it is organized, and if organized under the laws of the District of Columbia it shall have its chief place of business and its executive offices, and the meetings of its board of directors or trustees shall be regularly held, in the said District.”

The general purpose of this provision is to destroy the use made of the general corporation laws of many states. Since the restrictions apply only to licensees formed after the enactment of the bill into law, it is apparent that a new company incorporating will have no choice of jurisdiction whereas an older company may continue to operate under its liberal charter laws, regardless of the location of its chief place of business. All companies desiring to reincorporate will be prohibited from doing so except in the state where their chief places of business are located. While this will eliminate certain undesirable practices which have resulted from this freedom, it will also prevent certain equitable practices which might be followed for the benefit of the stockholders. Examples of the equitable use of reincorporation in more liberal jurisdictions are afforded by the Worthington Pump and Machinery Corporation and the Gaylord Container Corporation.

In the former case the corporation was originally formed in Virginia in 1916. A recapitalization seemed necessary in the interests of the stockholders, but under Virginia laws the approval of 90% in amount of each class of stock

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^Hearings before Subcommittee of Committee on the Judiciary on S. 10 and S. 3072, 75th Cong., 3d Sess. (1938) 581.

^Hearings before Subcommittee of the Committee on the Judiciary on S. 10, 75th Cong., 1st Sess. (1937) 45.

^S. E. C., Registration Statement No. 2-3117.

^S. E. C., Registration Statement No. 2-3325.
affected was required to effect the recapitalization. Under Delaware laws the recapitalization could be effected by an amendment to the charter which required the approval of only 66-2/3% in amount of each class of stock. As a practical matter it was impossible to secure the 90% approval required under Virginia laws; so a new company was organized in Delaware in 1937 to effect the recapitalization. In the Gaylord case a new corporation was formed to effect a merger of three corporations which had enjoyed a contractual relationship for some years.

Many examples may be found in which the more liberal charter laws have been used to serve the ends of a powerful minority group, to the great detriment of certain classes of security holders. The following examples will suffice to indicate the general practice: In 1929 the Cleveland Terminals Building Company, a Van Sweringen corporation formed in Ohio in 1921, was practically bankrupt, its liabilities exceeding its assets by some $803,000. In 1930, following the stock market crash, a new company was formed in Delaware known as the Van Sweringen Corporation. The stock of the Ohio company was written up to $25,000,000 and transferred to the Delaware company in exchange for $30,000,000 of bonds which the new company issued. The bonds were then used by the bankrupt Ohio company for general credit purposes in speculative activities. A particularly glaring example is that of the Equity Corporation, infra, where the consolidation of twelve companies was effected through incorporation in another state, to the great detriment of the rights of the preferred stockholders.

On the other hand, as previously indicated, there are undoubtedly many legitimate advantages to be derived through choice of the state of incorporation. Hence a better solution to the problem of eliminating the undesirable practices might be found in restrictions on the management. Such a solution would be more equitable in that it would eliminate the fraudulent or undesirable practices at their source, without disturbing the more desirable practices, which might be continued.

Viewing from a more practical aspect the proposed restrictions as to place of business, one sees that the hardships which might result may far outweigh any possible benefit to the stockholders. For the measure provides that the corporation shall incorporate in the state where it has its chief place of business and its executive offices, and it is well-known that many corporations have their executive offices far removed from their

\(^{34}\) Hearings before Subcommittee of the Committee on the Judiciary on S. 10, 75th Cong., 1st Sess. (1937) 53.
chief places of business, particularly in the case of mining and manufacturing companies whose sales outlets are in different sections of the country from their production centers. To require such a corporation to have its executive offices in the same state as its chief place of business might well curtail sales to an unprofitable level. There is also presented the problem of determining the location of the chief place of business. In a small company no problem is presented, but in a manufacturing company the size of General Motors or United States Steel, or a mining company the size of Anaconda, the large number of plants may present serious difficulty as to the location of the principal place of business.

LIMITATION ON POWERS AND REPORTS TO STOCKHOLDERS

"That the licensee shall have only such powers as are incidental to the business in which it is authorized to engage, and these powers shall not include any power to hold the stock of any other corporation unless it had such power on the date of the enactment of this Act, or unless such other corporation is a subsidiary of the licensee, nor shall it have any power outside of the jurisdiction of its incorporation which it does not have within such jurisdiction. A full accounting of the affairs of such subsidiary corporation shall be made annually to the stockholders of the licensee, and a full accounting of the affairs of the licensee shall be made annually to the stockholders of such subsidiary corporation, and a duly certified copy of all such accounts shall be filed with the Commission."35

This provision is aimed at the huge corporate structures, or "economic states" 36 which have grown up in recent years, whose powers extend into many, non-related fields. A single example will suffice to illustrate this growth. General Motors Corporation was organized to manufacture automobiles and related products, and such business is still its predominant activity. However, it also manufactures Diesel engines, automobile radios, household appliances, electric refrigerators, air-conditioning equipment, electric ranges, and electric power units for home and farm use.

The prohibition against permitting any licensee to have powers other than those incidental to the business in which it is authorized to engage would have a drastic effect upon many large corporations. In effect, the clause is a "death-sentence" upon the non-related activities of a

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[35] "Subsidiary," as defined in S. 330, § 2(e), means "any corporation subject to the direct or indirect actual or legal control of any other corporation, whether by stock company or in any other manner".

[36] This expression is that of Senator O'Mahoney. See Hearings before Subcommittee of the Committee on the Judiciary on S. 10, 75th Cong., 1st Sess. (1937) 38.
large corporation. In the example of General Motors given above, the question would immediately arise as to what powers would be incidental to the business in which that corporation is authorized to engage. If the non-related activities were ruled out, the “unscrambling” of the huge corporate structure would require many years. But as the clause is written, General Motors would be prohibited from engaging in interstate commerce until it had divorced all of its activities which were not incidental to its authorized business. Possibly a time limit might be set upon such simplification of corporate structure, as has been done in the case of public utility holding companies, but the provision as now drafted does not appear practical or feasible.

By far the most important restriction on newly formed corporations is the prohibition against stock ownership in other corporations, other than subsidiaries. This prohibition is absolute, and applies regardless of size of holdings or the temporary nature of such holdings. Serious consequences may be envisioned as a result of such a wide prohibition. Some corporations today are organized for the express purpose of loaning money to others, receiving in exchange securities of the other corporations as collateral. This would be prohibited under the proposed restrictions. Under Chapter 10 of the Chandler Act, a creditor corporation might receive securities in exchange for its claims. This, likewise, would be prohibited under the proposed bill. However, the latter situation might easily be remedied by inclusion in the bill of a clause exempting a creditor corporation from the restrictions imposed by this provision.

Many corporations have idle funds for investment purposes, and a large number set up a sinking fund to retire bond issues. Under the broad prohibition contemplated here, not a single share of stock could be purchased for investment, despite the fact that low returns on bonds might well justify investments in equities. The far-reaching effects of this restriction can easily be seen by a brief glance at the investments reported by any large corporation. It is true that these restrictions do not apply to corporations already in existence, but it cannot be denied that a pronounced discrimination would be shown in the case of newly formed companies. While such discrimination might be justified if the results achieved were particularly advantageous, the possible effects set forth above would not appear to justify it.

The provision requiring a full accounting annually to stockholders is undoubtedly intended to correct the lax state laws on the subject. Many

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registration statements filed under the Securities Act of 1933 show that
a large number of corporations make no reports whatsoever to their
stockholders, and in many instances where reports are made, the informa-
tion contained therein is inadequate to inform the stockholder of the
true condition of the business, if it is not actually misleading.38 It has
been contended that such reports as required in this provision would
merely duplicate the reports already filed with the Securities & Exchange
Commission,39 but the Commission to date has exercised no authority with
respect to stockholders’ reports. Able witnesses before the Senate hear-
ings on these measures have testified that state laws already afford
stockholders adequate rights to financial information, and that no such
provision as this seems necessary,40 but the experience of the Securities
& Exchange Commission has been otherwise.41 While it will undoubtedly
work a financial burden upon licensees to conform to these particular
provisions, the ends to be accomplished would appear to justify the means
employed.

VOTING RIGHTS

“That all stockholders or members of the licensee shall have an equal right
to vote the number of shares held by them, respectively, at all stockholders’
meetings and for all directors, subject to any general limitation on the number
of votes that may be cast by a single stockholder, notwithstanding any pro-
vision of its charter for the issuance of nonvoting stock: Provided, That no
other corporation or association shall be entitled to any such vote or voice, di-
rectly or indirectly, at any meeting of its stockholders, except that the stock-
holders of any such other corporation or association shall be entitled to act
their pro rata share of the stockholding of such other corporation. The owners
of all nonvoting stock that may heretofore have been issued shall be notified
by the licensee of this provision.”

The provision granting equal voting power to all stockholders appar-
ently is chiefly designed to protect the holders of senior issues from
some of the unfair and fraudulent practices which have been all too fre-
quently indulged in by holders of the voting shares. The practice has
become rather general, in the formation of new companies, of issuing

38Hearings before Subcommittee of the Committee on the Judiciary on S. 10 and S. 3072,
75th Cong., 3d Sess. (1938) 360.
39Id. at 495.
41Hearings before Subcommittee of the Committee on the Judiciary on S. 10 and S. 3072,
75th Cong., 3d Sess. (1938) 426. An interesting study of the deficiencies which currently
exist is furnished in the registration statement of Bagdad Copper Corporation, No. 2-2690,
filed with the Securities & Exchange Commission.
voting stock to the promoters, or others furnishing property or services. In numerous cases such stock is issued for little or no cash, the company's working capital being furnished by the general public, who subscribe to the non-voting preferred stock.\textsuperscript{42} Voting power remains in the hands of those who are closely concerned with the management or who have actually originated the business. This group assumes a large risk, receiving as compensation certain voting rights, and the opportunity to have a large equity in the earnings. The preferred carries with it certain preferences as to assets and dividends, partaking partly of the nature of bonds and also having some of the aspects of the common stock. These preferences as to fixed income and lesser degree of risk compensate the preferred holder for the loss of voting rights. Illinois is the only state in the Union which requires that all stock have the right to vote; in four states, Arizona, Kansas, Nebraska, and Texas, there are no statutory provisions with respect to the voting rights of stockholders. In the remaining 43 states and the District of Columbia the issuance of non-voting stock is expressly authorized.\textsuperscript{43}

Unfortunately experience has shown that the controlling interests have not exercised their voting power to the best interests of all classes of stock. Frequently the preferred holders, oft-times by devious means, are deprived of some of their original charter rights. This practice is well illustrated \textit{In the Matter of the Equity Corporation}.\textsuperscript{44} Here the Equity Corporation, incorporated in Delaware in 1932, proposed to bring under its control twelve corporations having net assets of some $50,000-000. It was proposed to merge four of these companies, all organized in Delaware, into Equity. The remaining eight, seven of which were incorporated in Maryland, were to be consolidated into a new company, American General Corporation. Under Delaware laws a merger could be effected by a two-thirds vote of all the capital stock. Since Equity had voting control of three of the four Delaware companies through common stock holdings, it was able to consummate the merger.

But some difficulty was experienced in effecting the consolidation of

\textsuperscript{42}Such a case is illustrated by the former Sinclair Oil Corporation (now the Consolidated Oil Corporation), which issued 100,000 shares of non-voting Class A stock to the public at $2.50 a share, and sold 10,000 shares of voting Class B stock to the promoters at 1\$ a share. The promoters thus obtained complete control of the company for $100, as compared with a contribution of $250,000 by the Class A stockholders. See S. E. C., Registration Statement No. 2-1520.

\textsuperscript{43}\textit{Hearings before Subcommittee of the Committee on the Judiciary on S. 10 and S. 3072, 75th Cong., 3d Sess.} (1938) 659.

\textsuperscript{44}2 S. E. C. 675 (1937)
the Maryland companies. Under Maryland laws a two-thirds vote of each class of voting stock is required to approve a merger or consolidation, as distinguished from the Delaware statute which requires two-thirds of just the aggregate. Of the seven Maryland companies five had preferred stock outstanding, and while Equity controlled virtually all of the common stocks, control of the common alone would not suffice to effect the consolidation. Since Equity's holdings in the preferred issues were relatively small, and far from sufficient to control the requisite two-thirds vote, some other means was necessary to effect the consolidation. Advantage was taken, therefore, of a provision in the Maryland charter laws which stated that irrespective of statutory requirements for action by vote of holders of two-thirds of each class of stock, "such action shall be effective and valid if taken or authorized by such vote of its stockholders or members as may be required for such action by its charter". The charters of the five Maryland corporations contained no provision on the point but they did contain general authority to adopt charter amendments by a majority vote of all the stock outstanding and entitled to vote. The respective charters were amended, therefor, since Equity had control of two-thirds of the aggregate of shares outstanding of each company, so as to authorize the approval of a merger or consolidation agreement by a two-thirds vote of "the shares then issued and outstanding and entitled to vote". Equity's own holdings were sufficient to adopt these amendments, and the consolidation was effected. A count of the votes showed that the preferred holders voting for approval of the plan were far less than two-thirds of the preferred outstanding.

The effect of the merger and consolidation upon the rights of the preferred holders was rather startling. Before the merger the preferred holders had been entitled to approximately $9,800,000 upon liquidation, but after the merger their preference in this respect dropped about $3,600,000 to $6,200,000. In addition a substantial loss was suffered in the asset value of the senior securities. The preferred stockholders of the consolidated companies had their annual dividend preferences reduced in amounts varying from $0.25 to $4.10 per share, and dividend arrearages of about $4,000,000 were eliminated. The remarks of Commissioner Healy in this case are enlightening.

"In concurring in this opinion I cannot resist commenting upon the bewildering maze of corporations involved in the transactions described and upon the labyrinthic course of the transactions themselves among these artificial beings, these corporate slaves, called into existence by those who move them about and control them more completely than ever a master ordered the lives and acts of human slaves. The most remarkable aspect of it all is that through our legis-
latures' 'liberalizing' of corporation laws and changing by statute the common law rules against intercorporate holdings, it is we ourselves who have made it possible."45

Another practice which has been resorted to by the controlling common stockholders to the great detriment of the rights of preferred holders is that of paying dividends out of capital surplus. By the payment of such dividends on the preferred stock the way is paved for payments on the common. But such payments, since they are made out of the capital surplus, reduce the assets applicable to the preferred. Registration statements on file with the Securities & Exchange Commission have disclosed this situation in many instances.46 Contributions of capital by one class of holders are used as a source of dividend payments to other classes of securities. Sometimes these dividends have been paid despite the fact that by such payment the net assets of the company were reduced below the aggregate amount payable to the senior stockholders upon liquidation.47

Various objections have been made to this proposal for equal voting rights,48 including the contention that the granting of voting rights to non-voting stock already outstanding would be a taking of property without due process.49 It would seem that the primary consideration should be whether the proposed legislation will accomplish the object sought, i.e., prevent the inequitable practices which have resulted in substantial detriment to the interests of non-voting stockholders.

If all classes of stock are given equal voting rights, there will still be no assurance that the practices complained of will be eliminated. The former non-voting stockholders will then have a right of representation, it is true, but to what purpose? If the aggregate shares of preferred outstanding exceed the aggregate common outstanding, control will, of course, be transferred from the common to the preferred. This will serve to eliminate the particular practices complained of, wherein the preferred interests are sacrificed to those of the common, but we might well have a situation now where the condition will be reversed, and common divi-

45Id. at 689.
46Hearings before Subcommittee of the Committee on the Judiciary on S. 10 and S. 3072, 75th Cong., 3d Sess. (1938) 405. Cf. also, e.g., S. E. C. Registration Statements No. 2-3316 (Olympic Forest Products Co.), No. 2-3314 (Grays Harbor Pulp & Paper Co.), and No. 2-3387 (Dewey and Almy Chemical Co.)
47Hearings before Subcommittee of the Committee on the Judiciary on S. 10 and S. 3072, 75th Cong., 3d Sess. (1938) 405.
48Id., at 495, 571, 657, 661.
49Id. at 571.
dends be restricted in order to conserve the asset position of the preferred. It is conceivable, therefore, that, far from elimination of the inequitable practices, they would be continued simply at the expense of another class of stockholders.

Under such assumption of equal voting rights, if the aggregate common outstanding exceeds the aggregate of the preferred also outstanding, the voting control will remain where it was before—in the hands of the common stockholders—and no practical change will be accomplished. Hence, it appears that the broad provisions contemplated here would not fully accomplish the desired result, but that a more feasible method would be to restrict or eliminate the practices themselves rather than attempt to regulate the means through which they have been effected (e.g., as regards the practice of paying dividends out of capital surplus, prohibition of such payments unless they are made out of earnings). The practices involving mergers, reorganizations, and consolidations might be eliminated by requiring the approval of a certain percentage of each class of stockholders before the corporate change could be effected.

The Committee on Stock List of the New York Stock Exchange will not accept common stock for listing, which does not have voting rights. There does not seem to be any valid reason for the issuance of non-voting common stock, since it is subject to all the risks of any class of common, and has none of the preferences of a preferred. Hence, the equal-voting-rights provision might well apply to this class.

The second provision embodied in the above-quoted section on voting rights apparently is intended to prohibit any corporation or association that holds stock in the licensee from voting such stock. It is provided, however, that the stockholders of such other corporation may cast their pro rata share of the stock so held. The object seems to be to vest voting rights in the stockholders, rather than in the corporation owning the stock. From a practical point of view, the provision does not seem feasible. The proclivities of stockholders to be absent from meetings are well-known. If they will not attend meetings of their own company, it is difficult to visualize their attendance at the meetings of another company in which their own company owns stock. On the assumption, however, that the stockholders would actually vote their pro rata amounts, it would seem that the management of their own company would be in far better position to vote the stock intelligently, since the management is familiar with the reasons for the initial acquisition and is in a better position to know what the policies of the stockholding company may
require in connection with such stock ownership. The difficulties encountered in having a quorum present at stockholders' meetings would be aggravated by this provision, and the actual result would probably be that if any stock is held by another corporation, it would not be voted unless by proxy.

COMPENSATION OF OFFICERS AND DIRECTORS

"That no bonus or commission or emolument of any kind or character in addition to his regular compensation shall be paid to any officer or director of the licensee except by vote of the stockholders at a regularly called meeting."

The object of this provision is to prevent the management from voting itself large additional compensation, in many cases quite disproportionate to the actual value of the individual officers' services, and in some cases amounting to an actual fraud upon the stockholders.

The provision has been called the "Anti-Grace" section of the bill for the reason that it attempts to prevent the practices followed by President Grace and his associates in the Bethlehem Steel Corporation during the period 1917-1930, inclusive. In 1917 Bethlehem began to distribute bonuses to its management. For the thirteen year period 1918-1930, inclusive, the bonuses to President Grace alone averaged $814,933 a year. During the period of 1925-1928, inclusive, no dividends were paid on the common stock but Mr. Grace received over $3,000,000 in bonuses, and total bonus disbursements amounted to $6,800,524. From 1917 through 1928 there was paid out of the corporate treasury for bonuses $31,878,255 as against $40,886,996 distributed in common dividends; in other words, bonus payments totalled about 80% of the amount distributed to common stockholders. During 1930, when the company failed to earn the dividends paid on its common stock, a bonus of $1,015,591 was paid to Mr. Grace.

An example of a more reasonable bonus policy, and certainly one far more equitable to the stockholders, is that of the United States Steel Corporation. In 1930 $3,122,168 was paid in bonuses, which approximated the amount distributed by Bethlehem during the same year. The Bethlehem bonus, however, was paid to twenty-one men as compared with 2,574 executives who received the United States Steel bonus. The largest bonus paid by United States Steel to any one individual during

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40Id. at 541. The expression is credited to Willis J. Ballinger, economic adviser to the Federal Trade Commission, Washington, D. C.

41Hearings before Subcommittee of the Committee on the Judiciary on S. 10 and S. 3072, 75th Cong., 3d Sess. (1938) 541.
this year was $70,000; the largest single distribution by Bethlehem was over $1,000,000. Bethlehem bonuses were paid irrespective of earnings, and irrespective of the fact that earnings in 1930 were practically cut in half and were not sufficient to cover interest and dividend payments. The United States Steel bonuses were paid only when net income, after all charges, taxes, and depreciation, reached $100,000,000 for the year. More important is the fact that United States Steel has reported its bonuses in full to its stockholders, while the bonuses paid by Bethlehem have been a closely guarded secret and were not even known by some of the directors at the time they were paid.52

It will be noted that the provision under discussion does not provide any restrictions upon the authority of the directors to pay special compensation to employees of the company other than officers and directors. Apparently, therefore, this provision is specifically aimed at the additional compensation which might be voted by the management group to themselves.

The fact that abuses have existed in this practice can scarcely be denied. On the other hand, there are many advantages offered by these forms of compensation, if the latter are properly and fairly used.53 The purpose, therefore, must be to curb the specific abuses without impairing the useful function of these methods of compensation. Is this accomplished by requiring the vote of the stockholders at a regularly called meeting? The apathy of stockholders towards attendance at such meetings is too well-known to need elaboration. On the assumption, however, that the requisite quorum could be assembled, can it be expected that the stockholders will better understand the peculiar qualifications of the individual officer, or his particular value to the company, than do the directors? The directors are elected by the stockholders as their representatives; if the stockholders repose sufficient confidence in them to manage the many important affairs of the company, it might be expected that the less important matters of special remuneration could likewise be intrusted to their discretion. As a practical matter, moreover, the difficulty of efficiently transacting such business at a large stockholders' meeting would be almost insurmountable. The probable

52Ibid.

53A few readily apparent are: (1) That the company may be newly organized, or for other reasons find itself with little cash to pay salaries; (2) such bonus, being based upon the company's earnings, is an added incentive to the recipient; (3) it protects the corporation from loss, since in many cases actual payment will depend upon favorable operating results.
result, therefore, would be a vote affirming the suggestion of the management.

Also, on the basis of the more likely view that the stockholders would not attend the meetings, their votes would then be mostly cast by proxy-holders, and since the majority of proxies sent in designate some officer or director, or their agent, as proxy, in the final analysis, therefore, no real change in policy would probably be effected. But there would be considerable delay and expense involved which might seriously interfere with the efficient operation of the company.

In view of these considerations it does not appear that as a practical matter the special-compensation provision in the bill would accomplish the desired object.

What, then, of other remedies? The Federal Trade Commission (or whatever body may be designated to administer this bill) might be given the power to determine whether or not a certain officer is entitled to a particular bonus or emolument, but such a provision would defeat the intent of the measure, as often expressed by Senator O’Mahoney, that no discretionary power will be vested in the Federal Trade Commission, but that its function will be purely ministerial. Moreover, even granted such a provision, the Commission would be under the same disadvantages as the stockholder in not knowing the relative merits of a special-compensation proposal, and the investigation necessary to render an intelligent opinion would probably be prohibitive in time and expense.

The provision aforesaid includes any bonus, commission, or emolument to an officer or director, no matter how small. Certainly it would seem that the size of the compensation would be of the utmost importance in this matter. If the compensation proposed were small, the effect upon the stockholders’ rights would be insignificant, even if the compensation amounted to an actual fraud upon such rights. A possible solution, consequently, might be found in requiring that all such compensation exceeding a certain limitation be submitted to the stockholders for a vote. This would eliminate the expense and delay necessarily resulting from submission to the stockholders, in cases where the proposed remuneration is small, and the very fact that the larger sums could not be paid without some such inconvenience would tend to deter such proposals on the part of the directors. In view of the complete lack of uniformity in the size of corporations, no specific limit would be practical. However, a

\[54\] Hearings before Subcommittee of the Committee on the Judiciary on S. 10, 75th Cong., 1st Sess. (1937) 45; Hearings before Subcommittee of the Committee on the Judiciary on S. 10 and S. 3072, 75th Cong., 3d Sess. (1938) 581.
limit based upon gross assets or upon average net earnings over a period of years might well be devised.

There is also the question of penalties. The penalties provided for violation of any provisions in the bill\(^5\) include a fine and a perpetual injunction against engaging in interstate commerce. It would seem that these penalties apply to the corporation and thus penalize the innocent stockholders, rather than the wrongdoer, the management. Certainly a corporation's right to do business in interstate commerce should not be forfeited by reason of the breach of such a condition as that relating to special compensation.

**FULLY PAID STOCK**

"That the stock of the licensee shall be fully paid, or payable in cash or in property or in services where the issuance of such stock for such property or services has been authorized upon application to a competent court and under its order finding upon competent and specific proof that such stock has been or is to be issued on a fair valuation of such property or services."

The plain object of this provision is to prevent the issuance of stock unless the consideration is adequate. To effect this, a "competent court" is required to evaluate the property or services to be exchanged for the stock, and only upon its authorization may the stock be issued.

A brief review of this phase of the proposed bill indicates that there have been many abuses. With the exception of two states, charter laws provide that stock may be issued not only for cash but for property or services; the two exceptions do not recognize services as a consideration for stock.\(^6\) But the determination of the value of the property or services has been left to the discretion of the directors, with the result that in many cases the consideration is wholly inadequate and the stockholders have suffered. In other cases the management has sold to the company at fictitious values property in which it had an interest. As a general rule the management are not precluded from entering into contracts on behalf of the corporation with themselves or with corporations in which they are also interested. Frequently, moreover, articles of incorporation have a provision covering this point, usually requiring, though, that the interest of a director in such a transaction be disclosed to the other directors, though not necessarily prohibiting the interested director from voting.\(^7\)


\(^6\)Hearings before Subcommittee of Committee on the Judiciary on S. 10 and S. 3072, 75th Cong., 3d Sess. (1938) 656.

\(^7\)Examples are furnished in registration statements filed with the Securities & Exchange
These abuses are particularly prevalent in the formation of new companies and in mergers although they have been found to exist also in the acquisition of property by going concerns. The Securities & Exchange Commission, for example, has discovered numerous instances of such practices. While that Commission has no authority to evaluate the property so acquired, nevertheless, if the valuation of the property or services is so grossly and unreasonably excessive as to be outside the range of reasonable difference of opinion, the Commission may find that it is equivalent to a misleading statement and may require full and adequate disclosure in the registration statement. Thus, In the Matter of Brandy-Wine Brewing Co.,\(^{68}\) the Securities & Exchange Commission found that stock ostensibly issued for property and services was actually issued as a gift to the promoter. In other companies the Commission has found that shares issued ostensibly for property of the value of the aggregate par value of the securities issued actually were issued in accordance with the predetermined arrangements of the promoters to assure themselves control of the corporation.\(^{59}\)

Frequently a company issues stock to affiliated or controlling interests, in consideration for the acquisition of tangible property, mining claims, patents, license agreements, or rights. The valuation of the property acquired may represent solely a valuation by a board of directors whose purpose is to issue to the vendor a predetermined number of shares as fully paid in accordance with governing statutes.\(^{60}\)

Another practice which has been quite prevalent is that of issuing stock for certain property and concurrently having the stock "donated back", the effect of such a transaction being to render such shares

\(^{59}\) In Dejay Stores, Inc. (Registration Statement No. 2-2302) the interest of such director was required to be disclosed and he was allowed to vote although there had to be present a quorum of directors not thus interested, and the contract or transaction had to be approved by a majority of such quorum; in R. H. Macy & Co., Inc. (No. 2-3305), Koppers Gas & Coke Co. (No. 1-555), and Tampax, Inc. (No. 2-2498) such director could vote, but in Addressograph-Multigraph Corporation (No. 1-683) he was barred from voting.

\(^{60}\) In the Matter of Snow Point Mining Co., Inc., 1 S. E. C. 311 (1936); In the Matter of Franco Mining Corporation, 1 S. E. C. 285 (1936).

\(^{68}\) This practice is well illustrated in the registration statement of American Cereal Food Corporation (No. 2-2242) filed with the Securities & Exchange Commission. The balance sheet here was footnoted as follows: "While the sum is considered a fair value for the value received by the registrant, such valuation was arbitrarily fixed and considered with a view to issuing stock to the vendors of the intangibles in an amount sufficient to assure them control of the registrant".
"fully paid and non-assessable".61 In a number of states statutory provisions make the values fixed by the directors conclusive for certain purposes. Under Colorado law, for instance, shares issued in exchange for property are regarded as fully paid despite the concurrent donation back to the issuing company of part of the stock,62 the courts apparently not deeming such simultaneous donation back as sufficient evidence to overcome a presumption of honesty on the part of the directors. But other states have regarded such donations back from the vendors as evidence raising a presumption of fraud or gross overvaluation sufficient to permit rejection of the directors' valuation.63 The Securities & Exchange Commission has held that the value of stocks issued for property and concurrently donated back to the issuer as required by the purchase contract are improperly included in the original cost of the property even if the effect of such a transaction under the applicable state law is to render such shares "fully paid and non-assessable".64 The Commission may thus rule, under its authority, that such an entry is false and misleading, but it cannot prevent such practices.

The practice has also been followed of valuing stock at par when purchasing property, even though all other sales of such stock have been at prices considerably under par.65

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61 The purpose of such a transaction, of course, is to comply with the law and at the same time facilitate the raising of working capital by making the treasury stock more readily marketable. The conditions of the security market are such that it is usually difficult to issue common stock at par value. This is a more or less unreasonable state of affairs—and furnishes another illustration of the objectionable character of par value as employed in American corporate finance—but the fact remains that the investor is attracted by the offering of a discount. That is, the investor seems to believe that stock bought at a discount is a bargain." Paton, Accounting (1930) 713.

62 Buck v. Jones, 18 Colo. App. 413, 70 Pac. 951 (1902); Spier v. Bordeleau, 20 Colo. App. 413, 79 Pac. 332 (1905). These cases involved suits by creditors against stockholders on the theory that stock thus donated back was not fully paid. The court held that such a transaction, concerning property as to whose value there was no independent evidence, represented a valuation put upon the property by the directors at the total amount of the stock, which valuation would be presumed to have been honestly made, and hence would not be upset unless some evidence were favorable to overcome the presumption.

63 Libby v. Tobey, 82 Me. 397, 19 Atl. 905 (1890); Douglass v. Ireland, 73 N. Y. 100 (1878); Blake v. Griswold, 103 N. Y. 429, 9 N. E. 434 (1886); Enright v. Heksher, 240 Fed. 863 (C. C. A. 2d, 1917); Hasson v. Koehler, 180 Cal. 359, 181 Pac. 387 (1919); Atwell v. Schmidt, 111 Ore. 96, 225 Pac. 325 (1924).

64 In the Matter of Unity Gold Corporation, 1 S. E. C. 25, 18 F. T. C. 649 (1934).

65 Ibid. In the Matter of Yumuri Jute Mills Company, 2 S. E. C. 81 (1937), intangibles, consisting of franchises, leases, and grants, were valued at $1,000,000, and 1,000,000 shares of $1 par common stock were issued to promoters in return for them. At the same
The provision in this bill attempts to prevent such practices by removing from the board of directors the discretionary powers of evaluating such property or services and vesting them in a competent court. The opinion has been advanced, however, that such determination is not within the judicial power of the state courts, as defined in the state constitutions. Also, the actual mechanics involved in such a procedure as proposed would, to say the least, be discouraging to the applicant or licensee. For the applicant or licensee would need to apply to a duly authorized court, which would then proceed to gather data and determine the fairness of the valuation. The bill does not specify who shall bear the expenses of such a proceeding, but it is apparent that the licensee would undergo considerable expense in furnishing the information necessary to enable a court to arrive at a finding, in addition to the delay in completing the transaction. Those familiar with the securities business will appreciate the importance of time in the issuance of stock. The daily fluctuations in the prices of securities and the swift change of economic conditions might well have disastrous effects upon any such plan, if long delayed. It is probably true in many cases, furthermore, that the particular services or intangible property desired to be acquired cannot be evaluated with any definite degree of accuracy, and in such cases their particular value to the company is much better known to the management that it would be to a court.

There would appear, therefore, to be considerable question as to the effectiveness of such a procedure. On the assumption, however, that it is necessary and expedient to remove the discretionary authority of the directors in such cases, are there more effective means of accomplishing the desired result than by submission to a competent court? Under Section 172 of the Chandler Act, the court may, if the indebtedness of the bankrupt does not exceed $3,000,000, and shall, if such indebtedness does exceed $3,000,000, submit the reorganization plan to the Securities & Exchange Commission for investigation and an advisory report. In such a case as contemplated in the provision under discussion, it would seem that either the Federal Trade Commission or the Securities & Exchange Commission might replace the courts.

The company secured an option to repurchase 250,000 shares of its common stock at 20¢ a share. The Securities & Exchange Commission held that inasmuch as the company's own valuation of the stock was substantially less than the par value, the figure set up was misleading.

By Frederick S. Kellogg, representing the Manufacturer's Association of New Jersey. See Hearings before Subcommittee of the Committee on the Judiciary on S. 10 and S. 3072, 75th Cong., 3d Sess. (1938) 640.

change Commission would be a more appropriate body to determine the question of fair value than would a "competent court".

But is it necessary to remove this discretionary authority from the directors? May not the power of the directors be so restricted that these practices may be prevented? Under Section 19 of this bill restrictions are imposed upon the management which would seem to prohibit their taking any undue profit for themselves. If this personal incentive for fraud is removed, the fraud itself would seem to be cured.

**PROXY REPRESENTATIVES**

"That any stockholder of the licensee may deliver his proxy to any person who may be certified by the Civil Service Commission, in accordance with the provisions of section 20 of this Act, as a certified corporation representative; that such corporation representative shall be entitled to all the rights and privileges of the stockholder whose proxy he may hold with respect to the examination of the books and affairs of the licensee and the transaction of business at any meeting of the stockholders or any meeting of the board of directors in which said stockholder might himself participate; and that every licensee to which this paragraph is applicable shall notify all of its stockholders of the provisions of this paragraph."

The object of this provision is to eliminate the dictatorial powers enjoyed by corporate managements as a result of control over proxy machinery. The lack of interest displayed by stockholders in the annual meetings of corporations has been mentioned earlier in this discussion; the management solicits proxies, at the stockholders’ expense, of course, and the major number of stockholders who reply to such solicitation designate as proxy the name suggested on the proxy certificate. Frequently the management has control, through majority ownership of the voting stock; in other cases where it does not have actual control, control is obtained through proxies. The management has every incentive to retain control of the company’s affairs, and often resorts to devious means to abridge the exercise of whatever participation in management the security holders may specifically be granted under the charter. This fact is evidenced by the place selected for the annual meeting (frequently remote and inaccessible to the average stockholder), the nature of the contents of the required notice of such meeting, and the lax provisions for the constitution of a quorum.

By the provisions of this section of the proposed bill an attempt is made to furnish the stockholder with a supposedly unprejudiced representative, if he so desires. This gives the stockholder no right which he did not have before, but it does provide a representative who may be more readily
reached by the stockholders than would otherwise be the case, and one who has satisfied certain preliminary qualifications before receiving his certification from the Civil Service Commission. There are important details relative to the use of such a corporation representative, however, which are not entirely clear from the provisions in the bill. Who will pay the expenses of the representative? The fact that no limitation is placed upon the number who may be certified by the Civil Service Commission would indicate that such number may be unlimited, and hence a certified representative would probably be used at the individual stockholder's expense. Conceivably, if the number is unlimited, the pressure upon the stockholders to secure their patronage may be burdensome and result in an unwholesome condition. It is also within the limits of theory that the representative might amass a large number of proxies, and use such power to his own interests, in which case the stockholder would be in no better position than if an unscrupulous officer or director had secured the same power.

The objective, while commendable, therefore, would not be accomplished by this mere privilege accorded to the stockholder. It might well provoke rather keen competition between the management and the corporation representatives, but would not accomplish the real purpose, i.e., to give the stockholder a more direct vote in the company's affairs. A possible solution might be found in restricting to the owners themselves the right to vote stock—the right being non-transferable. In such case the stockholder need not attend the meetings (in large companies, where the number of stockholders reaches many thousands, it would be a physical impossibility, anyway, to care for a large attendance). But the management could be required to submit in writing the various questions to be voted upon, with pertinent comments, to the stockholders for their votes, the answers to be duly certified and the final ballot to be duly audited by independent auditors. If the stockholder failed to utilize his voting rights, they would be unavailable to others. By such a procedure the proxy abuses complained of would be eliminated more directly, and possibly more effectively, than by the proposed measure.

CONCLUSION

There can be no doubt but that there have existed for many years, and there exist today, many corporate abuses which the states have not effectively controlled or eliminated. On the contrary, the policy of the majority of the states has been such as to foster and promote the growth
of these "loose" internal corporate affairs, rather than to stamp them out.

That these serious predatory practices indulged in by corporations today should be effectively regulated may be conceded. As a practical matter, moreover, the states are unable to cope with the situation, and hence federal regulation becomes a necessity. While the power of Congress to regulate certain corporate practices may be questioned, there is little doubt but that Congress would be held to have the power to regulate those practices which have a direct or substantial effect upon interstate commerce. The particular provisions of the present bill which relate to corporate practices do not, in many respects, accomplish the desired results. These provisions do serve the purpose, however, of outlining the broad objectives to be sought in the regulation of the internal affairs of corporations, and doubtless afford some indication of the trend that future measures will follow.

Winston S. Brown.
NOTES
STATE PUBLIC POLICY AND THE FEDERAL COURTS

It is a general common law rule of this country that if a person is liable for an act under the lex loci delicti he should be held liable in the forum; and the substantive law to control in a suit to enforce such liability is that of the place of the transaction. The reason for determining the existence of liability by this law is that it is the only law in effect where the transaction took place, and since legislative jurisdiction is territorial, the laws of any other state would be ineffective in the jurisdiction of the act. To label an act wrong by the law of another jurisdiction, thereby imposing liability on a defendant who had violated no law of the place of the transaction, would be manifestly unjust and would be giving a most offensive extra-territorial effect to the laws of the forum. In the same manner it is only proper that the plaintiff's right to recover should be ascertained by the law of the jurisdiction in which the asserted wrong was committed.

One of three theories is generally relied upon by a court as the basis for applying the rules of law established by some other state when deciding a cause of action which originated in that foreign jurisdiction. These are: the comity theory which is based on the comity of nations doctrine, and places this action on the ground of voluntary consent by one nation to the obligation of the laws of another within the territory of the former when there will be no prejudicial effect upon its public policy or interests; the vested rights theory, advocated by many able jurists, and based on the thesis that it is not the foreign law which is enforced in the forum but only the rights created under that law; and

2Story, Conflict of Laws (8th ed. 1883) § 38.
4This theory has been criticized chiefly because it fails to indicate clearly what foreign laws will be adopted, and also because its basis is comity which means courtesy between nations and is not appropriate to the enforcement of purely private rights. See Dodd, supra, note 1, at 536.
5An excellent statement of this theory was made by Mr. Justice Holmes in Slater v. Mexican National R. R., 194 U. S. 120, 126 (1904): "The theory of the foreign suit is that although the act complained of was subject to no law having force in the forum, it gave rise to an obligation, an obligatio, which, like other obligations, follows the person,
the local law theory which is founded on the idea that a court may enforce only the law of the forum, and that both the right and the remedy are really created by the forum when the cause of action sued on occurred in another jurisdiction, the forum, in some cases, to do justice, creating a right as nearly identical as possible with that created in the foreign jurisdiction. The courts according to this theory are bound by no definite rules of conflicts.

Regardless of which theory the forum may follow there are three well-established limitations upon the plaintiff's right to recover, any one of which, if proven, is sufficient to defeat his cause of action. These limitations are that the court of the forum will not enforce a foreign cause of action if it is penal in nature; if the forum lacks the proper legal machinery; or if the right is offensive to the public policy of the forum. Still another obstacle to the suit may be encountered in the doctrine of forum non conveniens.

and may be enforced wherever the person may be found. . . . But as the only source of this obligation is the law of the place of the act, it follows that that law determines not merely the existence of the obligation . . . , but equally determines its extent." Accord: Cuba R. R. v. Crosby, 222 U. S. 473 (1912); Spokane R. R. v. Whitley, 237 U. S. 487 (1915); Loucks v. Standard Oil Co., 224 N. Y. 99, 120 N. E. 198 (1918).

This theory has been strongly advocated by Judge Learned Hand, who has stated the rule as follows: " . . . no court can enforce any law but that of its own sovereign, and, when a suitor comes to a jurisdiction foreign to the place of the tort, he can only invoke an obligation recognized by the sovereign. A foreign sovereign under civilized law imposes an obligation of its own as nearly homologous as possible to that arising in the place where the tort occurs." Guinness v. Miller, 291 Fed. 769, 770 (S. D. N. Y. 1923). Accord: Direction Der Disconto-Gesellschaft v. United States Steel Corp., 300 Fed. 741 (S. D. N. Y. 1924); Siegmann v. Meyer, 100 F. (2d) 367 (C. C. A. 2d, 1938). See, de Sloovere, The Local Law Theory and Its Implications in the Conflict of Laws (1928) 41 HARV. L. REV. 421.

GOODRICH, CONFLICT OF LAWS (2d ed. 1938) § 94.


The scope of this paper is limited to an examination of this condition upon the plaintiff's suit when presented in a federal court.

The public policy which may be invoked to defeat this type of action is an elusive concept not lending itself to precise definition. However, some idea of its nature may be ascertained from the treatment it has received in various courts. In *Loucks v. Standard Oil Company*, Judge Cardozo examined the doctrine to determine whether a cause of action arising in Massachusetts could be enforced in New York. In deciding that such enforcement would not offend the local sense of justice or menace the public welfare, the fact that New York did not have legislation on the subject similar to that of Massachusetts was considered immaterial and it was stated, "They [Courts] do not close their doors, unless help would violate some fundamental principle of justice, some prevalent conception of good morals, some deep-rooted tradition of the common weal." Generally the forum will not hold the right presented too offensive to local policy merely because a similar right is not granted by its law. Such a condition might be inferred from some decisions which declare categorically that the public policy of a state is to be found in its constitution and laws, but the majority of the courts lean more towards a construction of public policy by which the foreign right may be enforced. This was done in *Veytia v. Alvarez* where the court found that if the transaction was not inherently vicious, wicked, or immoral, or if the enforcement of the right would not be detestable and shocking to the prevailing moral sense of the forum, there would be no violation of local public policy. Public policy is therefore by nature indefinite and subject to change with varying conditions.


39No general statement as to the scope of this term can be made. Goodrich, Conflict of Laws (2d ed. 1938) § 8. Westlake, Private International Law (6th ed. 1922) § 51.

40224 N. Y. 99, 120 N. E. 198 (1918).

41Id. at 111, 120 N. E. 198, 202 (1918). A similar explanation appears in Herrick v. Minnesota & St. L. Ry., 31 Minn. 11, 14, 16 N. W. 413, 414 (1883): "To justify a court in refusing to enforce a right of action which accrued under the law of another state, because against the policy of our laws, it must appear that it is against good morals or natural justice, or that for some other such reason the enforcement of it would be prejudicial to the general interests of our own citizens."

42However this has been held to be necessary in England. The Halley, L. R. 2 P. C. 193 (1868); Phillips v. Eyre, L. R. 6 Q. B. 1 (1870).

43Mertz v. Mertz, 271 N. Y. 466, 3 N. E. (2d) 597 (1936), but here after making this statement Loucks v. Standard Oil Co., 224 N. Y. 99, 120 N. E. 198 (1918) was cited with approval.

4430 Ariz. 316, 247 Pac. 117 (1926).
Because of the different ways in which public policy may appear before a court, it is necessary to extend it varying degrees of consideration, depending upon the party presenting it and the particular cause before the court. If the forum, in an assumed case, is also the place of the transaction, and it is determined that the right asserted is in violation of the public policy, there, of course, would be no cause of action. In this case the public policy would be controlling. However, in cases where the public policy of the forum is urged by the plaintiff to overcome a defense, the opposite result is often obtained, because to allow the policy of the forum to strike down a defense, valid under the law controlling the case, would be to hold the defendant liable for an innocent act. This is quite different from the refusal of a court to enforce a foreign right because under those circumstances the right remains unimpaired. The court's action is merely the denial of a remedy which the plaintiff is free to seek elsewhere, while the denial of a defense, available under the foreign law, subjects the defendant to irremediable liability and amounts to a denial of due process of law. In certain cases involving the choice of the correct law to be applied, the public policy of the forum is very often of paramount importance. But with reference to actions brought on judgments obtained in other states the rule is clear that the public policy of the forum cannot be invoked to deny enforcement regardless of how offensive the original cause of action might have been. The most usual case in which public policy is invoked is that in which a foreign acquired right is presented for enforcement and the defense is that the granting of relief to the plaintiff will result in a

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19This was the situation in Black and White Taxicab Co. v. Brown and Yellow Taxicab Co., 276 U. S. 518 (1928). If the action had been brought in a state court of Kentucky it would no doubt have been dismissed as being in violation of the local policy and therefore failing to state a good cause of action. The defendant had committed no wrong under either the laws of Kentucky or of the United States, yet he was held liable by a federal court when it failed to give effect to the common law of Kentucky and applied federal common law rules. Similar action by any court after the decision in Erie R. R. v. Tompkins, 304 U. S. 64 (1938), would amount to a denial of due process of law. Cf. Hartford Accident and Indemnity Co. v. Delta & Pine Land Co., 292 U. S. 143 (1934).


violation of the public policy of the forum. That a state court in a proper case of this type may deny relief is not doubted. 23

With these general statements concerning the treatment a party may expect to receive when suing in a state court upon a cause of action arising in another state, we may consider whether the result would be different if the suit were brought in a federal court under its diversity of citizenship jurisdiction. At the threshold of this investigation we are confronted with the opinion in Erie R. R. v. Tompkins 24 construing Section 34 of the Judiciary Act of 1789 25 and holding: "Except in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state. And whether the law of the state shall be declared by its Legislature in a statute or by its highest court in a decision is not a matter of federal concern. There is no federal general common law. Congress has no power to declare substantive rules of common law applicable in a state whether they be local in their nature or 'general', be they commercial law or a part of the law of torts." Prior to this decision the federal courts had felt themselves free to apply an independent judgment in cases involving general common law principles and had refused to be bound by the common law as construed by the state of the transaction. As a result of this, a large body of federal general law has been established which may no longer be considered controlling. The application by federal courts of an independent general common law was the subject of much criticism, one of the chief objections being that it fostered discrimination by non-citizens of a state against citizens, 26 which clearly was neither contemplated nor intended by Congress. 27 Naturally, the result of a decision as momentous and

23 Cf. Mondou v. New York, N. H. & H. R. R., 223 U. S. 1 (1912), where it was held that the public policy of Connecticut could not be the basis for denying relief in a cause of action brought under the Federal Employers Liability Act because Congress had, by passing this act, established a public policy paramount to that of the state and binding on all states.

24 Stat. 92 (1789), 28 U. S. C. § 725 (1934) which provides: "The laws of the several States, except where the Constitution, treaties, or statutes of the United States otherwise require or provide, shall be regarded as rules of decisions in trials at common law, in the courts of the United States, in cases where they apply."


26 Warren, New Light on the History of the Federal Judiciary Act of 1789 (1923) 37 Harv. L. Rev. 39, 83: "The chief and only reason for this diversity of citizenship jurisdiction was to afford a tribunal in which a foreigner or citizen of another state might have the law administered free from the local prejudices or passions which might prevail
revolutionary as that of *Erie R. R. v. Tompkins* is to disrupt the law temporarily and foster many novel arguments during the period of readjustment.

The case of *Siegmann v. Meyer,*\(^28\) decided during this period, may in a State Court against foreigners or non-citizens. The Federal Court was to secure to a non-citizen the application of the same law which a State Court would give to its own citizens and to see that within a State there should be no discrimination against non-citizens in the application of justice. . . . The idea that a Federal Court in a State was to administer any other than the law of that State or was to discriminate in favor of a non-citizen, and against a citizen, or to administer law as an entirely free and independent tribunal, never appear to have entered the mind of anyone.\(^29\)

\(^{28}\)100 F. (2d) 367 (C. C. A. 2d, 1938). This was a suit brought in a federal court of New York by Siegmann, a citizen of Germany and former maid of the defendant's wife, against Meyer a citizen of New York. The alleged tort consisted in an assault made upon the plaintiff by the defendant's wife while the two women were in Florida. The common law prevailed in Florida and by this law a husband was made liable for the torts of his wife. The law of New York was shown to have been altered by statute which relieved the husband of the common law liability and rendered the wife suable separately, and alone liable for her tortious acts. The District Court dismissed the complaint as being too repugnant to the law of New York to be tolerated in that State. On appeal it was argued for the plaintiff that the liability of the husband rested on the status of coverture and therefore his non-presence in the state was immaterial; that the federal courts were bound to apply the law of the place in all cases involving tort law; and that these courts must apply the *lex loci* irrespective of the public policy of the state in which the court resides.

Assuming that this common law rule of Florida is substantive rather than procedural it is apparent that the parties conceded a vested right existent in the plaintiff and the controlling issue would be the determination of the question whether a federal court must follow the public policy of the jurisdiction in which it resides, followed by the determination of the public policy of New York if this became necessary.

Judge Learned Hand in delivering the opinion of the court once more championed the "local law" theory of conflict of laws, stating that although the case had been argued on the ground of whether or not New York Courts would enforce a liability created in Florida, strictly speaking, a court could enforce only those liabilities created by the law of the state in which it sits. And, that while a state may take for its model a liability created elsewhere, and usually does when the other state is civilized, the liability enforced is the creature of its own will; its law of conflict of laws alone determining when such a liability would be fashioned from a foreign liability. "Thus, except as the law of Florida furnished a pattern which New York accepts, it has nothing whatever to do with the case. . . ." *Id.* at 367. The Court assumed in the plaintiff's favor that the Florida law was substantive, that it was not too violent a departure from New York mores, and that Florida intended to charge absentee non-resident husbands with liability. Then it was decided that New York would not accept as a standard any liability created in Florida against one who was never actually present in Florida, or domiciled there, and who did not in any degree procure, incite, or in other way make himself a party to the tort. *Young v. Masci*, 289 U. S. 253 (1933) and *Scheer v. Rockne Motors Co.*, 68 F. (2d) 942
properly be included within this classification. The argument was that a federal court in New York presented with a cause of action whose origin was Florida was bound to apply the law of the latter state, by the force of Erie R. R. v. Tompkins, and that the court was not free to dismiss the action because it might be violative of the public policy of New York. The basis of this argument was that the federal courts must apply the *lex loci* and that the avowed purpose for conferring diversity of citizenship jurisdiction on these courts was to prevent discrimination against non-citizens. Another ground relied on was that if the suit had been brought in a federal court in Florida that court would have applied the *lex loci* and the mere fact of securing service and suing in another federal court did not make available to the defendant any special defenses available under the law of the forum. In other words, all federal courts should uniformly apply the *lex loci* and disregard any special defenses available under the policy of the state in which they sit. Although it is conceded that uniformity in the law is generally a desirable standard of achievement, it would seem that in this field the probability and advisability of the uniformity sought would be doubtful.

At this point an examination of the former attitude of federal courts to state public policy might cast some light on what these courts may be expected to do when confronted with this subject in the future. Generally speaking, the policy of a state was confined to narrower bounds when before a federal court.29 However, a number of decisions indicate

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(C. C. A. 2d, 1934) were distinguished from the present case on the ground that in both of these cases there existed the relationship of agency. It is submitted that the real basis for the decision in the Siegmann case was the dislike of the court to enforce an obligation which it considered inconsistent with the local policy of New York. Other than the cursory distinguishing of the above-mentioned cases, no attempt was made to refute the argument that the liability claimed was a result of the marital status. It must be conceded that a strong argument could be presented on the proposition that because of the marital relationship a husband is sufficiently connected with the tortious conduct of his wife in the foreign jurisdiction to be held liable for the damage done, when one considers his probable direction, consent, and financial backing of the trip, as well as the social benefits inuring to him. The case is novel in this respect and the point would no doubt have received more careful consideration in a jurisdiction more in harmony with the law of Florida. Analogy may also be had to the "family car" doctrine.

Assuming the success of such an argument and the substantive character of the Florida law, the federal court would be faced with the interesting argument that the law of the place of the tort should be enforced and the public policy of the state in which the court sits should not be allowed to affect their decisions.

29See Mr. Justice Butler's discussion in Black & White Taxicab Co. v. Brown & Yellow Taxicab Co., 276 U. S. 518, 528 (1928), "Care is to be observed lest the doctrine . . . be
that the state policy of the forum as settled by either its statutes or judicial decisions, is binding on the federal courts under Section 34 of the Judiciary Act of 1789. With these decisions should be contrasted those indicating that state policy is persuasive on the federal courts and entitled to due respect but in no way binding. It was also generally true that federal courts were not prone to uphold an asserted policy of the forum which had for its basis a local statute not judicially held by the state courts to embody a fundamental policy. The public policy feature in Union Trust Company v. Grosman would not come within any of these groups because it was considered by the court only as a part of the law of the state which previously had been determined as governing the transaction, and which, coincidentally, was the forum. It is plain that while there have been some conflicting views in the federal courts as to the proper application of local public policy when urged on these courts as a ground for declining jurisdiction, this conflict has been primarily due to varying constructions of Section 34 of the Judiciary Act. In the future a more uniform application of this doctrine may therefore be expected in view of the Tompkins case.

The uniform disregard of local public policy by federal courts proposed in the Siegmann case hardly seems to be a reasonable inference to be drawn from the Tompkins case. That decision requires the courts to apply the entire law of the lex loci when considering a cause of action which arose in another state. It deprives these courts of an independent determination of the common law, and was a return to the principle that federal courts were granted diversity of citizenship jurisdiction in order

unreasonably extended. Detriment to the public interest is not to be presumed in the absence of showing that something improper is done or contemplated.” The public policy of the lex loci was in this case disregarded. Citizens National Bank v. Waugh, 78 F. (2d) 325 (C. C. A. 4th, 1935); Ireland v. Craggs, 56 F. (2d) 785 (C. C. A. 5th, 1932).

Dougherty v. Gutenstein, 10 F. Supp. 782 (S. D. N. Y. 1935). Cf. Missouri Ry. v. Larussi, 161 Fed. 66 (C. C. A. 7th, 1908); and St. Bernard v. Shane, 220 Fed. 852 (C. C. A. 6th, 1915), where the state courts were without jurisdiction and the federal courts assumed jurisdiction on the ground that this did not indicate that the respective forums had public policies opposed to the maintenance of suits for wrongful death.

Boyce v. Tabb, 18 Wall. 546 (U. S. 1873); Dexter v. Edmands, 89 Fed. 467 (D. Mass. 1898); Swett v. Givner, 5 F. Supp. 739 (E. D. Ill. 1934). Compare: Fidelity-Phenix Fire Ins. Co. v. Cortez Cigar Co., 92 F. (2d) 882 (C. C. A. 5th, 1937), cert. denied, 303 U. S. 636 (1938) in which it was said that a failure on the part of the courts of Georgia to enforce recovery in a suit upon a valued fire insurance policy, valid in Florida where made, and where the property was located, because it was in violation of local public policy would be contrary to the full faith and credit clause.

245 U. S. 412 (1918).
to prevent rather than foster discrimination, and to secure to a non-
citizen suing in the forum the same degree of justice which the state
courts would administer to a citizen.

Neither the question as to whether the judicially declared rules of
law of a state fall within the full faith and credit clause,\textsuperscript{33} nor the ques-
tion as to the choice of law rule which should be applied by a federal
court\textsuperscript{34} are important here because it is only after these questions are
answered that the effect to be given the public policy of the state in
which the court sits may be raised. And although this doctrine would
not fall strictly within the rule that the forum will apply its own laws of
procedure, it is a rule similar in nature, affecting only the remedy within
a state and it has been customary for the federal courts to apply the pro-
cedural rules of the forum.

From the viewpoint of practical justice, considering the ever increas-
ing number of interstate transactions due in a large part to the ease and
accessiveness of transportation, the de-emphasis being placed upon state
lines, and the trend toward uniformity of laws within the states, it would
seem that the paramount public policy, should be towards the enforce-
ment of all rights acquired under the laws of a sister state. A judicial
enunciation tending towards this result is found in the \textit{Loucks case},\textsuperscript{35}
where it is said: "The fundamental public policy is perceived to be that
rights lawfully vested shall be everywhere maintained. At least that is
so among the states of the Union. . . . There is a growing conviction that
only exceptional circumstances should lead one of the states to refuse
to enforce a right acquired in another." Indeed, it is difficult to see how
the awarding of money damages in one state for an act committed in an-
other, when there are no acts actually performed or to be performed
within the forum,\textsuperscript{36} could be so shocking to its citizens as to convince
the court that the acknowledged right of the plaintiff should be denied.\textsuperscript{37}
It is a sad commentary on the unity of a nation that one state is per-
mitted to decline enforcement of rights arising under the law of another
because, for provincial reasons, they are considered violative of sound
principles of justice or notions of morality. The uniform rule in federal
courts respecting public policy sought in the \textit{Siegmann case} in the ma-

\textsuperscript{33}Smith, \textit{The Constitution and Conflict of Laws} (1939) 27 \textsc{Georgetown Law Journal} 536.
\textsuperscript{34}Note (1939) 52 \textsc{Harv. L. Rev.} 1002.
\textsuperscript{35}224 N. Y. 99, 113, 120 N. E. 198, 202 (1918).
\textsuperscript{36}Cf. Bothwell \textit{v.} Buckbee, Mears Co., 275 U. S. 274 (1927).
\textsuperscript{37}See: \textit{Beach, Uniform Interstate Enforcement of Vested Rights} (1918) 27 \textsc{Yale L. J.} 656.
jority of the cases would appear desirable. Uniformity has been accomplished, not only in federal courts, but in all courts in the field of judgments by virtue of the full faith and credit clause together with the rule that a court cannot go behind a judgment to find whether the original cause of action was opposed to its concept of public policy, although a court may go behind a judgment to determine whether the cause of action was civil or penal in nature. However, language has been used indicating that it may be possible for a state to have a policy which will suspend the command of this clause with reference to a foreign statute and the same result could be expected if foreign judicial laws were held to be within its terms.

However desirable a general system of enforcement of vested rights may be, it could not be thrust upon the state courts by the federal government without their consent because of the dual character of our government and the sovereign status attributed to each state. In the federal field under existing legislation as interpreted by the Tompkins case, and in view of the fact that prior to that decision the necessity to give effect to the public policy of the forum was considered in connection with Section 34 of the Judiciary Act, it is apparent that the federal courts need enforce the lex loci only to the extent that the non-citizen is afforded the same relief that a state court in the state in which the federal court is sitting would grant in a similar case. The public policy of the forum can no longer be classed as "general law" to be applied as the federal court sees fit, but must be considered as part of the law of the state in which suit is brought and effect given thereto in a proper case. To hold otherwise would be to flood the federal courts with this type of litigation and to permit a new type of discrimination by non-citizens against citizens depending again only upon the court in which the action was brought. Even though the discrimination in these cases would be less subject to criticism than that which resulted from the existence of two systems of common law within one jurisdiction it cannot be contended successfully, in view of the present accepted

38See note 22, supra.
41See note 27, supra.
legislative history of Section 34 of the Judiciary Act, that Congress intended such results.43

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43No comment is made on the power that Congress may possess under the Judiciary Article and Article 1, § 8 of the Constitution to relieve the federal courts of the restraint of local public policy.
THE USE OF THE "AUTHORITY" IN PUBLIC HOUSING

RECENT years have seen the Authority reach a high degree of development in connection with public administration. But it has taken the low price public housing program of federal and local governments to use this special public corporation to the best advantage.

The authority has been defined as a special public corporation, whose obligations are payable solely from its revenues or property, or both without recourse to taxes and special assessments.\(^1\) It is this functional freedom of the authority which has caused its wide adoption. The authority is to be distinguished from the improvement district by its financing method. Whereas district obligations are paid either by special assessments on the property benefited or by exercise of the general taxing power, the authority depends solely on its revenues to meet obligations.\(^2\) Where constitutional or statutory bars keep municipalities from incurring further debts, the authority operating as a separate corporate entity enables the improvement to be made without obligations on the part of the municipality or tax payer.

Before turning to the use of authority in the housing program a survey of its general use is in order. Authorities have on the whole been organized in one of three ways by the legislatures. By the first method the state legislature by special act establishes a specific corporate instrumentality for carrying out a particular purpose. This is illustrated by a special authority for the construction and operation of a bridge. By the second method the legislature, by a permissive general statute, authorizes the incorporation of an improvement authority in areas of a given population to accomplish a variety of purposes. The third method is by a permissive general statute which enables the electorate of a defined geographical area to incorporate as a public corporation by vote at a special election.

The authority device as an aid to municipal government is best illustrated by the set-up of metropolitan New York. Operating in its area is a group of authorities carrying on a variety of functions. Typical is the Port of New York Authority, which has succeeded in carrying out a scientifically determined program of regional planning.\(^3\)

\(^2\)Williams and Nehemkis, *Municipal Improvements As Effected By Constitutional Debt Limitations* (1937) 7 Col. L. Rev. 177, 203.
Financing of low-rent housing by the states presented many legal difficulties. New York was the first state to make notable use of the authority in a housing program. As has been pointed out by a recent writer, the Empire State has been a pioneer in housing development. The first housing authority program in New York followed the general use of the authority—the authority would issue its own bonds as a method of obtaining necessary capital and repay the indebtedness so incurred completely out of revenues derived from the operation of their projects. But the advancement of the Federal government into the field has brought about a change in the financing method of the housing authority, which has put the housing authority in a category apart from other authorities, in that emphasis has been taken off of the self-liquidation feature.

The public housing program was one of the first social schemes taken into its bosom by the New Deal. The Public Works Administration handled this at first for the Federal Government. PWA officials aided many of the states in organizing their authorities and suggested the creation of housing authorities in many municipal corporations, rather than a state-wide authority. The plan advised by the PWA was to set up a body corporate managed by commissioners appointed by the head of the municipal government. The housing authority would be given power to plan, construct, reconstruct and operate housing projects. It also could take over projects by lease or purchase and act as agent in the acquisition, construction, operation or management of housing projects. Most important of all it was given the right of eminent domain to acquire real property. The authority would also be empowered to issue bonds which would be the obligation of the authority, to be secured by mortgage or pledge of the income from such project, but it could not issue bonds which would be obligations of the state or municipality.

The experience of the PWA ripened into the United States Housing Act of 1937. The United States Housing Authority under this Act could aid state or local public housing authorities financially with loans and grants. Loans are made to cover capital costs on a self-liquidating basis, secured by the revenues of the projects.

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7The financial aid programs of the USHA are explained in a speech which was delivered by Leon H. Keyserling of the USHA, before the Section of Municipal Law, American Bar Association at Cleveland on July 26, 1938, entitled The United States Housing Authority in The Framework of American Government and Law.
Grants under the Act are of two types. The capital grant under which is paid part of the capital cost of the project. No capital grant can be more than 25% of the total capital cost of the authorities project, and to add to this the President may give to the authority from relief funds an additional capital grant, not to be more than 15% of the project, to go for labor in the project. But the bulwark of the Federal aid comes under the annual contribution type of grant, under which the Government makes no subsidies until the project is completed with loan funds. Under this the local authority will receive from the Federal Authority annual contributions to aid in meeting the difference between debt retirement, rentals which slum dwellers can afford to pay and other annual charges on the project. The Act requires that local sources must match the Federal Government in a ratio of 1 to 5 in annual contributions. Under this type the Federal loan for the original capital development must not exceed 90% of the capital cost, the other 10% to be raised locally. This brief view of federal aid to the housing program shows how the emphasis has been taken off of the self-liquidation program and why the housing authority is on a plane different from other authorities.

At this writing there are a total of 233 housing authorities in the United States in the 38 states which have adopted enabling legislation. The constitutionality of the local housing acts have been attacked in ten of these states and the act has been upheld in each instance. The Court of Appeals of New York set the pace in 1936 when they held that the New York City Housing Authority could condemn land for use as a site for a low-rent housing project. The court stated that low-rent housing is a public use for which property may be condemned. The Kentucky act which was the next one upheld was treated more elaborately by the court and has been followed in tone by the other courts. The Kentucky court found that the law related to one subject;

9N. Y., Ky., N. C., La., Pa., Fla., Ga., Tenn., S. C. and Ind.
10New York City Housing Authority v. Muller, 270 N. Y. 331, 1 N. E. (2d) 153 (1936).
12Wells v. Housing Authority of the City of Wilmington, North Carolina, and the City of Wilmington, North Carolina, 197 S. E. 693 (N. C. 1938); Dornan v. Philadelphia Housing Authority, City of Philadelphia and the School District of Philadelphia, 331 Pa. 209, 200 Atl. 834 (1938); Marvin v. The Housing Authority of Jacksonville, Florida, 183 So. 145 (Fla. 1938); State v. Housing Authority of New Orleans, 190 La. 710, 182 So., 725 (1938); Williamson v. Housing Authority of Augusta, 199 S. E. 43 (Ga. 1938); Knoxville
it further held that an authority may exercise the power of eminent domain, also that there was no delegation of legislative power and that the property and bonds of the authority are tax exempt. The court also held that the debts of the authority are not debts of the state or of any political subdivision thereof and that a city can make an appropriation to an authority to enable it to meet its preliminary functioning expenses.

Although the constitutionality of the United States Housing Authority itself has not been attacked, from a study of other decisions of the United States Supreme Court it is within reason to say that the Act is within well defined constitutional bounds. 13

So it can be seen that the use of the authority has given a widening effect to the field of public administration, and it is certain that it will play a greater part in the public law of tomorrow.

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Housing Authority Inc. v. City of Knoxville, 123 S. W. (2d) 1085 (Tenn. 1939); McNalty v. Owens, 188 S. C. 377, 199 S. E. 425 (1938) and Edwards v. Housing Authority of City of Muncie, 19 N. E. (2d) 741 (Ind. 1939). The Justices of the Supreme Court of Alabama in an advisory opinion upheld the Alabama Housing Authorities Law, 179 So. 535 (Ala. 1938). So in reality Housing Authorities have been upheld in 11 states.

13Leon H. Keyserling in his speech, note 7, supra, went into this matter in detail.
RECENT DECISIONS

ADMINISTRATIVE LAW—Federal Equity Jurisdiction—The Johnson Act and Its Limitations

Plaintiff, a public utility, brought suit in federal district court to enjoin the enforcement of a municipal ordinance prescribing rates alleged to be confiscatory. The ordinance had not been legally enacted because of the failure to afford a hearing, required by a state statute. Held, the federal district court ought not to have entertained the suit because of the failure of the utility to pursue its administrative remedy in the state, an appeal to the railroad commission, although the failure to provide a hearing rendered the Johnson Act inapplicable. El Paso v. Texas Cities Gas Co., 100 F. (2d) 501 (C. C. A. 5th, 1938).

The Johnson Act, 48 Stat. 775, 28 U. S. C. 41 (1) (1934), deprived the federal district courts of jurisdiction to restrain any order of a state rate-making body “where such order (1) affects rates chargeable by a public utility, (2) does not interfere with interstate commerce, and (3) has been made after reasonable notice and hearing [which in the instant case was lacking], and where a plain, speedy, and efficient remedy may be had at law or in equity in the courts of such State.” The Act was designed to prevent the duplication of proceedings in state and federal courts, to remove the expense and delay occasioned thereby, and to permit the state courts to pass on the validity of the state’s regulatory action. See: Notes (1934) 44 Yale L. J. 119, (1934) 20 Iowa L. J. 128.

Prior to this enactment it was a well-settled principle that the federal courts would not assume jurisdiction of a controversy in regard to administrative action, state or federal, until the complaining party had exhausted his administrative remedies. Myers v. Bethlehem Shipbuilding Corp., 303 U. S. 41, 50, 51 (1938) and cases cited; Utley v. St. Petersburg, 292 U. S. 106 (1934). When the review afforded by the courts of the state is “legislative” it is considered to be an administrative remedy, and an appeal to such court is required before the federal district court will take jurisdiction. Porter v. Investors Syndicate, 286 U. S. 461 (1932), aff’d on re-hearing, 287 U. S. 346 (1932); Prentis v. Atlantic Coast Line Co., 211 U. S. 210 (1908). But when the review of state action by the state courts is “judicial”, i.e., when the action of the court is limited to affirmation or reversal, there being no power in the court to substitute its own order, it is not required that such an appeal be taken before application for relief to the federal district court. Porter v. Investors Syndicate, supra; Railroad and Warehouse Commission of Minnesota v. Duluth Street Ry., 273 U. S. 625 (1927). The same rules governed suits in the federal courts to restrain the assessment or collection of taxes by a state. City Bank Farmers Trust Co. v. Schnader, 291 U. S. 24 (1934); Kansas City Southern Ry. v. Cornish, 65 F. (2d) 671 (C. C. A. 10th, 1933). The reason for the distinction between the necessity of taking an appeal administrative (or “legislative”) in nature, and not having to take an ordinary judicial appeal is to be found in the well-settled test of the equity jurisdiction of federal courts, viz., that in order for a remedy at law to defeat the jurisdiction of a federal equity court it must be an adequate remedy on the law side of the federal court. Di Giovanni v. Camden Fire Association, 296 U. S. 64, 69 (1935); Smyth v. Ames, 169 U. S. 466, 516 (1898). The
sixteenth section of the Judiciary Act of 1789, 1 Stat. 82, providing that “suits in equity shall not be sustained in either of the courts of the United States where a plain, adequate, and complete remedy can be had at law” was said to be merely declaratory of the pre-existing law, Parker v. Winnipiseogee Lake Co., 2 Black 545 (U. S. 1863), and to necessitate a comparison of the adequacies of equitable and legal remedies only as such remedies existed in the federal courts. Di Giovanni v. Camden Fire Association, supra. The Johnson Act takes a departure from this rule, since it makes the criterion of equity jurisdiction of the federal courts in public utility rate-fixing cases the adequacy of the remedy in the state courts. In a recent case it was held to be immaterial that the state statute did not require notice and hearing if, de facto, reasonable notice and hearing had been afforded. East Ohio Gas Co. v. Cleveland, 94 F. (2d) 443 (C. C. A. 6th, 1938); cf. Mississippi Power and Light Co. v. Jackson, 9 F. Supp. 564 (S. D. Miss., 1935). Judicial determination of the requirements necessary for a remedy to be a “plain, speedy, and efficient” one is the crux of the problem in an attempt to evaluate the Act. In Corporation Commission of Oklahoma v. Cary, 296 U. S. 452 (1935), aff’d. 9 F. Supp. 709 (W. D. Okla. 1935), it was held that the Johnson Act did not apply so as to prevent recourse to a federal district court to enjoin a rate order alleged to be confiscatory where there was a serious uncertainty, due to conflicting decisions of the highest court of the state, whether the review afforded by the state court was legislative or judicial in nature. The rationale behind the decision seems to be as follows: (a) a legislative review is not sufficient to satisfy due process, for the United States Supreme Court is constitutionally inhibited from reviewing the actions of a court acting in a legislative or administrative capacity, Federal Radio Commission v. General Electric Co., 281 U. S. 464 (1930); Keller v. Potomac Electric Power Co., 261 U. S. 428 (1923); if only a legislative review is afforded in the state there is a denial of the right to be heard in a federal court on a federal constitutional question if such a remedy is held to be one which will oust the jurisdiction of the federal district court, as there would then be no possibility of review in any federal court; (b) if the remedy in the state courts includes a judicial review, the right to the heard in a federal court on the issue of confiscation is preserved, since the utility could petition the United States Supreme Court for certiorari, and the remedy is “plain, speedy, and efficient” and, under the Johnson Act, will defeat the jurisdiction of the federal district court; (c) when the nature of the review available in the state is not clearly established, it is not a “plain” remedy so as to defeat the jurisdiction of the federal district courts under the Act, and the mere possibility that the state court might treat the review provided for as though it were an administrative or legislative one was felt by the district court to render the remedy in the state court so uncertain as to suspend the operation of the Johnson Act.

In similar vein is the decision of the Supreme Court in Mountain States Power Co. v. Public Service Commission of Montana, 299 U. S. 167 (1936) where it was held that a state statute prohibiting the stay of a rate order until final determination of its reasonableness by the court having jurisdiction prevented the remedy from being a “plain, speedy, and efficient” one, and that the Johnson Act did not apply. This was held to be true even though such a statute was clearly unconstitutional under the decision in Pacific Telephone and Telegraph Co. v. Kuykendall, 265 U. S. 196 (1924), and its invalidity would most probably be recognized by the courts
of the state. It has been decided that a federal district court may grant a stay of a rate order alleged to be confiscatory when a state court having discretionary power to grant a stay pending appeal has in fact denied it. Oklahoma Natural Gas Co. v. Russell, 261 U. S. 290 (1922). In view of this decision it appears that the principle of the Mountain States case will be applied to cases in which a state court having a discretionary power to grant a stay pending appeal has in fact denied one. If this doctrine is followed in the application of the Johnson Act the effect will be substantially to restrict its scope, for in nearly three-fourths of the states a stay is obtainable only in the discretion of the state court. See: Legis. (1937) 50 Harv. L. Rev. 813, 818; (1934) 44 Yale L. J. 119, 122.

By and large the Johnson Act has suffered, at the hands of the courts, a treatment, restrictive to a high degree, suggesting the similarly narrowing construction given the statutes imposing, or attempting to impose, limitations upon the jurisdiction of the federal courts to enjoin the assessment and collection of: (a) a federal tax, Rev. Stat. § 3224 (1875), 26 U. S. C. § 1543 (1934); see Miller v. Standard Nut Margarine Co., 284 U. S. 498 (1932); and, (b) a state tax, Act of August 21, 1937, passed as an amendment to the Johnson Act of 1934, 28 U. S. C. § 41 (1); see City of Springfield v. United States, 99 F. (2d) 860 (C. C. A. 1st, 1938). The principle of exhaustion of administrative remedies, which antedated the Johnson Act, stands as firmly entrenched after the Act as it was before. Rochester Telephone Corp. v. United States, 59 Sup. Ct. 754 (1939). If the Johnson Act has added anything to the restriction imposed upon the courts by adherence to this principle (a restriction, it should be noted, self-imposed by the courts), it is this: Where it is perfectly plain that an appeal from the determination of the utility commission to the state courts is in the nature of a judicial appeal (so that the federal question of confiscation may reach an ultimate review in the United State Supreme Court), whether it takes the form of a regular appeal from the administrative body's finding with the court giving the completeness of review on the issue of confiscation required by Ohio Valley Water Co. v. Ben Avon Borough, 253 U. S. 287 (1920), or the form of a bill for an injunction,—then the Johnson Act will oust the federal courts of jurisdiction. Where, on the other hand, such plainness is not clearly demonstrated, the Act will be inapplicable.

The principal case indicates the relationship of the principle of exhaustion of administrative remedies to the principle upon which the Johnson Act is premised. Finding the Johnson Act inapplicable because the hearing required by the Act to be given before the Act becomes operative was lacking, the court nevertheless determined that the district court should not have entertained jurisdiction until the utility had exhausted its administrative remedy of appeal to the superior utility commission.

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ADMINISTRATIVE LAW—Finding of Fact—Fraud Orders of Postmaster General

Appellee was engaged in selling, by mail, cartoon booklets, pictures, jokes, double-meaning letters, and a book entitled "Secrets of Love Making". He published advertisements in a number of pulp magazines of the salacious type. After a hearing, the Solicitor of the Post Office Department found that the advertisements were
intended to induce readers to believe that lewd, lascivious, and obscene cartoon books and photographs were being offered for sale, whereas actually furnished, upon receipt of orders, was innocuous matter not at all obscene, lewd, or lascivious in nature. It was therefore determined that appellee was conducting a scheme for obtaining money through the mails by means of false and fraudulent pretenses, representations, and promises. Upon the Solicitor's recommendation the Postmaster General, pursuant to REV. STAT. § 3929 (1875), 39 U. S. C. § 259 (1934), and REV. STAT. § 4041 (1875), 39 U. S. C. § 732 (1934), issued a fraud order which, in the usual terms, forbade the postmaster at New York City to pay any postal money order drawn to the order of the appellee's companies or their officers or agents; directed the postmaster to inform the remitters of such postal money orders that payment thereof had been forbidden and that the amounts would be returned to the remitters upon a proper application by them; and instructed the postmaster to return all letters and mail matter directed to the appellee's companies or their officers and agents to the postmasters in the offices from which such letters and mail matter were originally mailed, to be marked "fraudulent", and returned to the original sender. The appellee sued to enjoin the enforcement of the fraud order, and the district court issued the injunction prayed for. On appeal, held, the principal question being one of fact, the determination of the head of an executive department, committed to him by law, was reviewable judicially only to ascertain whether it had been fairly arrived at and was supported by substantial evidence, so that it could not be said to be palpably wrong and therefore arbitrary. Farley v. Simmons, 99 F. (2d) 343 (App. D. C. 1938).

REV. STAT. §§ 3929 and 4041 authorize the Postmaster General to issue fraud orders in two classes of cases: first, lotteries, gift enterprises or schemes for the distribution of money, or of any real or personal property by lot, chance, or drawing of any kind; second, all schemes or devices for obtaining money or property of any kind by means of false or fraudulent pretenses, representations, or promises. Public Clearing House v. Coyne, 194 U. S. 497 (1904); Degge v. Hitchcock, 35 App. D. C. 218 (1910), aff'd 229 U. S 162 (1913). The statutes vest in the Postmaster General the power to bar the use of the mails to any scheme which, upon evidence satisfactory to him, is determined to be within the purview of the statutes. This grant of power to the Postmaster General, though broad, is the only effective means of purging the mails of objectionable matter, since "to say that the use of the mails must go on until judicial proceedings have been concluded is to say that the mails may thus be used until sharpers and rascals have become wealthy by crime", Donnell Mfg. Co. v. Wyman, 156 Fed. 415, 415, 416 (C. C. E. D. Mo., 1907). The question of fact to be decided in each case, whether the scheme under investigation falls within the prohibition of the statutes, can conveniently be decided only by those charged with the administration of the postal laws. Missouri Drug Co. v. Wyman, 129 Fed. 623 (C. C. E. D. Mo., 1904).

The rule announced in the principal case, that the decision of the Postmaster General upon such a question of fact is conclusive and will not be disturbed by the courts, unless palpably wrong, is supported by an overwhelming majority of the cases. Otherwise stated, the courts will refuse to substitute their judgment for that of the administrative officer. Louisiana v. McAdoo, 234 U. S. 627 (1914); Chicago v. Kirkland, 79 F. (2d) 963 (C. C. A. 7th, 1935). Even upon mixed questions of
law and fact, or of law alone, the administrator's decision carries with it a strong presumption of correctness. Bates & Guild Co. v. Payne, 194 U. S 106 (1904). But cf. American School of Magnetic Healing v. McAnnulty, 187 U. S. 94 (1902), where the complainants, who were engaged, through use of the mails, in the business of treating physical ailments by mental influences, and in instructing students who wished to practice their healing methods, sought an injunction against a fraud order. In their bill of complaint they charged that their business was conducted upon the theory that "the mind of the human race is largely responsible for its ills, and is a perceptible factor in the healing, curing, benefiting and remedying thereof, and that the human race does possess the innate power, through proper exercise of the faculty of the brain and mind, to largely control and remedy the ills that humanity is heir to . . .". They alleged also that their treatment was "confined to practical scientific treatment" emanating from the alleged faculty of the brain and mind to control and remedy human ills. To this the Government demurred generally, thereby admitting the allegations of the bill. The Supreme Court held, in effect, that the truth or falsity of the complainant's theory of medical treatment was wholly a matter of opinion, not susceptible of proof as an ordinary fact; that, in view of the admission made by the Government, it was legally impossible to say that the complainant was engaged in a scheme to defraud; that the Postmaster General had made an error of law; and that his action was reviewable, therefore, and the execution of the fraud order could be enjoined by a court of equity.

In issuing the injunction appealed from in the principal case, the district court indicated that in its view the case was governed by American School of Magnetic Healing v. McAnnulty, supra, but the court of appeals, in distinguishing the latter case, said, "And the representations in that [McAnnulty] case lay in a field of scientific or pseudo-scientific knowledge. There was no question as to what the representations were. In the instant case the representations and promises of the appellee lie in no field of scientific or pseudo-scientific knowledge. If the finding of the Postmaster General . . . is supportable, there is no question as to the untruth of the representations and promises, because it is without dispute that the material furnished by the appellee was of a non-salacious and non-obscene nature". Farley v. Simmons, supra, at 347.

JEREMIAH F. MAHONEY

CONFLICT OF LAWS—Res Judicata—Jurisdiction over Subject Matter

A bondholder filed suit in the Municipal Court of Chicago for judgment on the personal guaranty on bonds held by him. The guarantor defended on the ground that the Federal District Court for the Northern District of Illinois, prior to the present suit and in approving a plan or reorganization under § 77B of the Bankruptcy Act, had cancelled the bonds sued upon and extinguished the personal guaranty; and further that during the pendency of the present action, the bondholder had petitioned the district court to vacate its order confirming the reorganization plan contending that it had no jurisdiction to extinguish a guaranty on bonds, which petition was denied, with the result that the issue of the guarantor's liability was res judicata. Notwithstanding this plea, the municipal court gave judgment against the grantor, which was reversed on appeal. The appellate court was in turn reversed
by the Illinois Supreme Court, which on its part was reversed by the United States Supreme Court. Held, since the question of the federal court's jurisdiction over the subject matter, namely, the extinction of the personal guaranty, had been raised in actual controversy, the issue was res judicata and, in the absence of fraud, could not be collaterally attacked in the state court. Stoll v. Gottlieb, 59 Sup. Ct. 134 (1938).

The problem of settling a question once and for all is an ancient thorn in the side of the American judicial system. Forty-eight independent judiciaries functioning in the ever growing shadow of the distinct and separate federal courts make perfect hatching grounds for controversies over jurisdiction. On the one hand, courts are ever eager to uphold the sphere of their own authority and to protect those coming under their jurisdiction from unsympathetic handling by foreign tribunals; and on the other hand, the problem of maintaining uniformity in decisions and of preserving the integrity of the judicial function as a whole is a pressing one.

The Founding Fathers recognized the problem and wrote the full faith and credit clause of Article 4, Section 1, into the Constitution. This was soon supplemented and broadened by the section of the Judicial Code which required as much validity to be given everywhere to judicial pronouncements as they had in the forum where rendered. Rev. Stat. § 905 (1875), 28 U. S. C. § 687 (1934).

Soon a weakness was found in the efforts of the Congress to achieve harmony and it became the settled rule that judgments of the courts of sister states are conclusive only if those courts had jurisdiction of the subject matter and of the parties. Thompson v. Whitman, 18 Wall. 457 (U. S. 1873); Pennoyer v. Neff, 95 U. S. 714 (1877); Haddock v. Haddock, 201 U. S. 562 (1906). From this it followed that the jurisdiction of a court rendering a judgment or decree is always open to inquiry where its conclusiveness is questioned in the court of another state.

Then the settled rule itself was nibbled at by distinctions concerning its application in ex parte hearings and on contested issues. The door once wide open was closed inch by inch with exceptions.

The question of jurisdiction has been held conclusive when the issue has been contested and the aggrieved party heard on the question in the court rendering judgment. Sipe v. Copwell, 59 Fed. 970 (C. C. A 6th, 1894); Hall v. Wilder Mfg. Co., 316 Mo. 812, 293 S. W. 760 (1917). See Chicago Life Ins. Co. v. Cherry, 244 U. S. 25 (1917).

A further exception appears in the situation where subsequent to the judgment it is attacked on the ground of lack of jurisdiction by motion made in the court of rendition or in another court of the same state. If the jurisdiction is upheld, the issue is conclusive. Chamblin v. Chamblin, 362 Ill. 588, 1 N. E. (2d) 73 (1936); contra: Howard v. Smith, 3 Jones & S. 131 (N. Y. 1872).

But again, the door may be opened by exceptions granted on the exceptions. Even a judgment contested on jurisdictional grounds may be opened upon proof of extrinsic fraud. United States v. Throckmorton, 98 U. S. 61 (1878). Still another possibility is revealed in the dicta of Chicago, Life Insurance Company v. Cherry, supra, at 30, where in holding that a wrong judgment rendered against a defendant is not a denial of constitutional rights “if the mistake is not so gross as to be impossible in a rational administration of justice.” In this connection, the Illinois Court of Appeals in the present case held that the judgment of the federal court
could not be disturbed on collateral attack "unless it is clear that the District Court is wholly without jurisdiction." Gottlieb v. Crowe, 289 Ill. App. 595, 599, 7 N. E. (2d) 469, 471 (1937). Even here it might be that the proper place for ferreting out the gross mistake and the total lack of jurisdiction would be by direct attack and not collateral attack at all.

In deciding the instant case the Supreme Court of Illinois drew a distinction between an issue of jurisdictional fact, which would be conclusive once contested, and the determination of a question of law, which would not. It held that it was decided law that a federal court had no power under the statute creating it to cancel a guaranty in a bankruptcy proceeding and that such jurisdiction of the subject matter could not be conferred by consent or waived by appearance, and might be raised at any time. Gottlieb v. Crowe, 368 Ill. 88, 12 N. E. (2d) 881 (1938).

This contention might be sound if the all important factor had not been ignored that the point in issue had been adjudicated by a federal court under a federal statute, and when a federal court determines a right under such conditions, the decision is final until reversed or modified in the court of rendition or set aside by a federal court of appellate standing. Deposit Bank v. Frankfort, 191 U. S. 499 (1903).

The decision in the present case may be narrower than appears at first glance since the prestige of federal courts was at stake and because the Supreme Court left the issue open as to whether it applied to cases involving status and titles to real estate, in which cases the question most frequently arises. The Restatement refuses a direct commitment on the question of "how far a party participating in a court of any State is precluded from subsequently questioning the jurisdiction of the court over the subject matter of the action in the courts of that state or any other state if the court in which he appeared purported to render a judgment against him." Restatement, Conflict of Laws (1934) § 451.

However, Davis v. Davis, 305 U. S. 32 (1938), holding that a determination of a state court upon a contested issue of jurisdiction is conclusive constitutes a step towards the desired harmony in decisions of different forums, and the instant case, upholding a like determination of a federal court, strides vigorously in the same direction.

JAMES H. HYNES

CORPORATIONS—Equitable Stockholders—Right to Recover Secret Profits from Promoter

In 1923, the stockholders of a California Ferry Company, being desirous of constructing bridges to handle the vehicular traffic served by the company's ferries, agreed that a new company should be formed to finance the construction of the bridges and to operate them. It was agreed that the holders of the Ferry Company's stock should exchange their shares for shares of the new corporation, when formed, on a dollar for dollar basis. For the purpose of carrying out this plan, the certificates of the Ferry Company stock were entrusted to Klatt, an officer and director of the Ferry Company, so that he could effect the organization of the new corporation, with the understanding that the shares of the Ferry Company would be replaced in the hands of the shareholders by shares of the new corporation when issued.
Klatt organized the American Toll Bridge Company of California with a capital structure of seven hundred fifty thousand Class A shares of one dollar par value, and ten thousand Class B, no par value shares. The Class B shares carried all the voting rights and special dividend rights. Upon the organization of the new corporation, Klatt exchanged the stock of the Ferry Company for all of the stock of the new corporation, and caused the Class A stock to be issued to the shareholders of the Ferry Company, retaining the Class B stock for himself without disclosing to the Class A shareholders the details of the issuance of the Class B stock. In furtherance of the scheme, the dividend rights of the Class B shares were waived for the first two dividend distributions in order to conceal the true situation from the Class A shareholders. Upon a dividend distribution in 1936, the true facts became known. A bill in equity was filed by the former Ferry Company stockholders against the Bridge Company and the holders of the Class B shares for the surrender and cancellation of the Class B shares. Held, for the plaintiffs. Birbeck v. American Toll Bridge Co. of California, 2 A. (2d) 158 (Del. Ch. 1938).

The right of recovery from a promoter of "secret" profits obtained in the formation of the corporation is predicated upon the fiduciary relation of the promoter to the corporation. The corporate cause of action is based upon want of full consent by the corporation and injury to the corporation or its shareholders. In situations, as in the present case, where at the time of the transactions complained of the promoter is in control of all of the existing stock of the corporation, the corporation may be said to fully consent to the transactions with the promoter since the promoter is fully in control on both sides of the transaction. And where the promoter receives from the corporation his secret profit in the form of no par value shares for property no matter how much overvalued, no financial injury may be said to be done to the corporation.

The courts in their efforts to handle this problem may allow a recovery of the secret profits upon one of two theories. See McGowan, Legal Controls of Corporate Promoters' Profits (1937) 25 GEORGETOWN LAW JOURNAL 269. One theory, not well defined nor established, proceeds upon the reasoning that where future shareholders are contemplated at the time of the fraudulent transaction, the corporation is to be protected as to their interests. This theory is strengthened by the holding in McCandless v. Furlaud, 296 U. S. 140 (1935), rehearing denied, 296 U. S. 664 (1935).

The other theory, the ratio decidendi of the present case, is applicable when there are others not yet stockholders nor subscribers of the corporation at the time of its formation but who are persons having a real interest in its formation. This theory considers these latter persons as equitable subscribers of the corporation. Few cases have been decided solely on this theory. In Arnold v. Searing, 78 N. J. Eq. 146, 78 Atl. 762 (1910) and in Tilden v. Barber, 268 Fed. 587 (D. N. J. 1920) there were actual subscribers to the corporation or to the promotional syndicate at the time of the fraudulent transaction.

In the present case the important question decided was whether the stockholders of the Ferry Company bore such relation to the Bridge Company at the time of the issuance of the Class B shares as to entitle them to maintain this action.

It is to be noted that at the time of the organization of the Bridge Company all of its authorized stock was under the control of a dummy board of directors, and Klatt in his own name exchanged the Ferry Company stock, some of which he owned
but most of which he held for the other stockholders, for the combined Class A and Class B shares of the Bridge Company. Thus as a result of this transaction, when Klatt obtained the Class B stock, the Ferry Company stockholders were not actually legal shareholders of the Bridge Company. Neither were they strictly subscribers to the stock of the Bridge Company, since they had entered into no contract of subscription. But by reason of the fact that the Bridge Company stock when issued was to be paid for by the shares of the Ferry Company stock, and also because Klatt was holding the Ferry Company shares as agent of the stockholders, they were considered to be equitable subscribers to the stock of the Bridge Company. In *American Barley Co. v. McCourtie*, 150 Minn. 460, 185 N. W. 506 (1921), the promoters of a corporation, formed for the purpose of taking over the stock of another company, obtained secret profits by reason of transactions made while they were the only owners of the new corporation and before the stockholders of the other company became stockholders of the corporation. In that case, as in this one, the company stockholders, being real parties in interest, were held to be equitable stockholders of the corporation at the time of the fraudulent acts. This principle, when the facts can be found to support it, seems to accomplish substantial justice.

FRANK B. SHERRY

CONSTITUTIONAL LAW—Fifth Amendment—Taking of Property by Diversion of Stream

Action to recover compensation for the washing away of 1000 acres of plaintiffs' farm by the Mississippi River, caused by the construction of dikes into the stream from the opposite bank by United States engineers for the purpose of improving navigation, allegedly with knowledge that the dikes would cause this destruction of the farm by directing the river current against it. *Held*, that a demurrer to the declaration was properly sustained, since this did not amount to a compensable "taking" of plaintiffs' property within the purview of the Fifth Amendment. *Franklin v. United States*, 101 F. (2d) 459 (C. C. A 6th, 1939), *af'tg*, *Franklin v. United States*, 16 F. Supp. 253 (W. D. Tenn., 1936).

In general, the United States may not be sued for the tortious acts of its officers. See (1938) 27 *Georgetown Law Journal* 91.

The Fifth Amendment to the Constitution provides "... nor shall private property be taken for public use, without just compensation". Therefore, if property is appropriated to public use by the United States, a contract on the part of the Government to pay for it, on which suit may be brought, will be implied in fact. *Jacobs v. United States*, 290 U. S. 13 (1933).

These considerations often lead to the question whether a particular act of a Government officer is an authorized taking upon which suit may be brought or a mere trespass, redress for which may be had only by petition to Congress.

The Government has authority under the Commerce Clause, U. S. Const. Art. I, § 8, to improve navigable waterways. *South Carolina v. Georgia*, 93 U. S. 4 (1876); *Ashwander v. T. V. A.*, 297 U. S. 288, 328 (1936). It has, therefore, absolute control for this purpose of the beds of navigable rivers, and is entirely free from liability for damage done to property within the river bed in the exercise of its

However, when projects for the improvement of navigation cause injury to property not within the river bed, recovery may sometimes be had; a consideration of some of the cases may be of interest.

Where land is required for the site of a dam or dike its taking is compensable. United States v. Archer, 241 U. S. 119 (1916); United States v. Chicago, B., & Q. R.R., 90 F. (2d) 161 (C. C. A. 7th, 1937), cert. denied, 302 U. S. 714 (1937). Furthermore, when the building of a dam by the United States raises the normal level of a stream so that it overflows its banks this is held to amount to a taking of the inundated land and action may be brought for its value. Pumpelly v. Green Bay Co., 13 Wall. 166 (U. S. 1872); United States v. Lynah, 188 U. S. 445 (1903); United States v. Cress, 243 U. S. 316 (1918).

Both of these cases fall within the rule that “Whenever there has been an actual physical taking of a part of a distinct tract of land, the compensation to be awarded includes not only the market value of that part of the tract appropriated, but the damage to the remainder resulting from that taking, embracing, of course, injury due to the use to which the part appropriated is to be devoted”. United States v. Grizzard, 219 U. S. 180, 183 (1911), in which the value of a convenient access to a public road destroyed by flooding of part of Grizzard’s farm was compensated for. Similarly, in United States v. Chicago, B., & Q. R.R., 82 F. (2d) 131 (C. C. A. 8th, 1936), cert. denied, 298 U. S. 689 (1936), and in United States v. Chicago, B., & Q. R.R., 90 F. (2d) 161, supra, the railroad was compensated for the expense of protecting its track against waters of the Mississippi which were raised by dams so as to extend across one side of its right of way against its embankments.

On the other hand, when a dam raises the normal level of a river insufficiently to injure land, but offers enough obstruction to flood waters to cause them to overflow the land more seriously than before, it is held that the damages are consequential and no taking is involved; therefore no recovery can be had in the absence of a special statute. L. J. House Co. v. United States, 81 Ct. Cl. 661 (1935), cert. denied, 296 U. S. 611 (1935); cf. Sanguinetti v. United States, 264 U. S. 146 (1924); Jacobs v. United States, 45 F. (2d) 34 (C. C. A. 5th, 1930). Likewise, the building of a high levee on one side of a river which renders a lower, but previously adequate, levee on the other side inadequate because of the confining of flood waters, resulting in higher stages, gives no cause of action against the Government. Jackson v. United States, 230 U. S. 1 (1913).

However, a decision handed down just after that in the principal case held that the deliberate use by the United States of the Boeuf River valley in which plaintiffs’ lands were located as an alternate channel for carrying off Mississippi River flood waters amounted to an appropriation of an easement and required compensation for the resulting decrease in value of the land. In carrying out a comprehensive scheme of flood control the Government deprived the plaintiffs of their common-law right to protect their lands by raising their own levees. Sponnenborger v. United States, 101 F. (2d) 506 (C. C. A. 8th, 1939); cf. Hurley v. Kincaid, 285 U. S. 95 (1932).

The only case found which involved the actual erosion of a plaintiff’s land is
that of *Bedford v. United States*, 192 U. S. 217 (1904). There, after the river had cut a new channel through a neck of land, the Government laid revetments along the banks of the new channel to prevent their being washed out further. On account of its new direction of flow the river gradually ate away the opposite shore below the cutoff, six years later reaching plaintiff's plantation and in a few more years eroding 2300 acres of his land. The Court denied recovery, stating that the damages were consequential, the Government acted only to preserve the river as it was, any riparian landholder having the right to protect his banks and the United States no less right, and that in any event the revetments had probably done no more than accelerate to an undeterminable extent an erosion which would have occurred without them.

The *Bedford case* differed from the principal case in that (1) the works were along the bank instead of across the channel, (2) the erosion would probably have occurred if they had not been constructed, and (3) it is doubtful whether the effect of the revetments on Bedford's land six miles downstream could have been predicted, while the present declaration alleged the damage was foreseen. Nevertheless, that case was apparently regarded as controlling, as Judge Allen said "We are unable to see any difference in principle between the Bedford and the instant case". It is clear that the distinctions mentioned are significant and that this case goes considerably beyond the *Bedford case*.

The court also relied upon the *Jackson case*, supra, and *Gibson v. United States*, 166 U. S. 269 (1897), in which it was held that building a dike which closed off the navigable channel from plaintiff's landing was not an invasion of her property. These cases are much less in point than the *Bedford case*, supra.

It is submitted that the present declaration set out a "taking" of the plaintiffs’ land under the Fifth Amendment. If the Government had dug a channel through the land, or had forced water through a nozzle and washed it away as is done in hydraulic mining, it would undoubtedly have been so held; and it can hardly be material that the force of the water was used in a different but no less effective manner by placing dikes in the river to cause it to erode a new channel where plaintiffs' farm had stood. It is certainly as much an appropriation to divert a river through a farm as to divert occasional floods over it.

As Judge Hamilton implied in his lucid dissenting opinion, backing up of water behind a dam is just as much "consequential" as the injury in the present case. In *United States v. Chicago, B., & Q. R.R.*, 90 F. (2d) 161, supra, damages of a much remoter nature than those of the principal case were treated as proximate. The fact that the United States is defending instead of suing should not affect the landowner's rights. As was said in *Pumpelly v. Green Bay Co.*, supra, at 177: "It would be a very curious and unsatisfactory result, if in construing a provision of constitutional law, always understood to have been adopted for protection . . . of the individual as against the government, . . . it shall be held that if the government refrains from the absolute conversion of real property to the uses of the public it can destroy its value entirely, . . . without making any compensation, because, in the narrowest sense of that word, it is not taken for the public use."

A liberal construction of the Fifth Amendment is the only one which accords with principles of justice, the only one which prevents it from actually restricting common law rights (*Pumpelly v. Green Bay Co.*, supra, at 179), and the one which
is in accordance with the trend of modern legislation and decisions [United States v. Chicago, B., & Q. R.R., supra, at 82 F. (2d) 139].

In view of the absence of an earlier case directly in point the principal case might well have been a step in the right direction. Instead, it is a greater step in the wrong direction.

PAUL FITZPATRICK

CONSTITUTIONAL LAW—Motor Carrier Act of 1935—Bona Fide Operator Under Grandfather Rights Clause

Petitioner brought suit in the Federal Court for the Northern District of Texas to restrain the Texas Railroad Commission from enforcing against him the state Motor Truck Law, Tex. Rev. Ann. Civ. Stat. (Vernon, Supp. 1938) art. 911b. Petitioner was operating in interstate commerce over the Texas highway pursuant to authority from the Interstate Commerce Commission by virtue of his having filed a seasonable application for "grandfather rights" under the Federal Motor Carrier Act of 1935, 49 Stat. 543, 551 (1935), 49 U. S. C., § 306 (a) (Supp. 1938). In effect the "grandfather clause" of this Act provides that any common carrier who was in bona fide operation on June 1, 1935, and who has so operated since that time, will be issued a certificate without being required to prove public convenience and necessity for the operations. In May of 1934, before the passage of the Federal Act, petitioner had applied to the state commission for a certificate as provided by the state law, which was denied him on the ground that the proposed operation would unduly burden the highways and would interfere with the safety of the traveling public. The district court issued a permanent injunction against defendant commission, which on appeal was reversed. On certiorari, held, a common carrier operating in defiance of state law is not in bona fide operation within the meaning of the "grandfather" proviso of the Federal Motor Carrier Act, supra, and is not entitled to a certificate as provided therein, McDonald v. Thompson, 305 U. S. 264 (1939).

It should be noted that the Court did not pass on the question of whether or not the federal enactment superseded state regulation in the field of interstate motor carriers. This is in accord with the established doctrine that the Court will not pass upon a constitutional question, although properly presented by the record, if there is present some other ground upon which the decision may be pegged. Arkansas Oil Co. v. Louisiana, ex rel. Muslow, 304 U. S. 197 (1938); Ashwander v. Tennessee Valley Authority, 297 U. S. 288 (1936); Light v. United States, 220 U. S. 523 (1911); Siler v. Louisville & N. Ry., 213 U. S. 175 (1909).

Worthy of comment, is the feature that the Court did not hesitate to consider the mixed questions of fact and law involved in a determination of "grandfather rights" under the Federal Act, notwithstanding that the petitioner had an application pending before the Interstate Commerce Commission, which would of necessity involve the identical questions. At first glance, this appears to be a judicial determination of a matter, which at least in the first instance, was properly the subject of an administrative decision. There is strong authority to the effect that the Court will not ordinarily anticipate the decision of an administrative tribunal on matters properly within its primary jurisdiction, but will defer judicial or reviewing powers until
that tribunal has made its findings of fact and conclusions based thereon, as required
by statute; and further that the desired uniformity in administering the statutes
under which the tribunals were empowered to act could only be met through a
recognition by the courts of the initial duty on those bodies to make their pre-
liminary inquiry into the questions of each particular case. Prentis v. Atlantic Coast
Line, 211 U. S. 210 (1908); Texas & Pacific Ry. v. Abilene Cotton Oil Co., 204
U. S. 426 (1907); Federal Trade Comm. v. Royal Milling Co., 288 U. S. 212 (1933);
Brown v. Hitchcock, 173 U. S. 473 (1899); Great Northern Ry. v. Merchants
Elevator Co., 259 U. S. 285 (1922); Proctor & Gamble Co. v. United States, 225
U. S. 282 (1912); Robinson v. Baltimore & O. R. R., 222 U. S. 506 (1912); Texas

It is difficult to reconcile the reported case with past decisions of the Court.
However, it should be noted that the precise point in this case, i.e., the determination
of bona fide operation under the Federal Motor Carrier Act, is one of first impres-
sion with the courts. To what extent the judiciary will litigate "grandfather rights"
in advance of administrative determination by the Interstate Commerce Commission
remains to be seen. The entrance of the courts into this field would appear in-
compatible with the legislative intent behind the Motor Carrier Act of 1935, supra.

JESSE HAWLEY, JR.

TAXATION—Federal Income Tax—Limitation on Deductions Available on Joint
Return of Husband and Wife

The petitioners, husband and wife, filed a joint return for the year 1933. The
husband in that year realized profits on the sale of securities which were not capital
assets [i.e., did not conform to the statutory definition of capital assets as property
held for more than two years, Revenue Act of 1932, § 101 (c) (8), 47 Stat. 192] in
excess of his losses on similar sales, but for the same year his wife sustained a
loss on like sales but realized no profit. In their joint return the wife's loss was
taken as a deduction to offset her husband's profits. The Commissioner disallowed
the deduction, assessing a deficiency tax on the petitioners. This action was affirmed
by order of the Board of Tax Appeals from which the petitioners appeal. Held,
in a joint return of husband and wife, losses sustained by one spouse from the sale
of securities may not be offset against gains realized by the other spouse from
similar sales under the Revenue Act of 1932, § 23 (r) (1), 47 Stat. 183. (Learned
Hand, dissenting.) Pierce v. Commissioner of Internal Revenue, 100 F. (2d) 397
(C. C. A. 2d, 1938).

In the Revenue Act of 1932, § 23 (r) (1), 47 Stat. 183, Congress limited deduc-
tions for losses on sales or exchanges of non-capital securities to the "extent of the
gains from such sales or exchanges." The court in the reported case had the problem
of determining whether for a joint return the words, "gains from such sales or
exchanges" referred to the separate gains of the spouse sustaining the loss or to the
combined gains of both spouses.

Judicial decisions indicate beyond all doubt that Congress in enacting income tax
legislation looks on husband and wife as separate and distinct taxable subjects. Thus
a wife may report separately income accruing from her property. Poe v. Seaborn,
Neither spouse can be taxed on the income of the other. *Hoeper v. Wisconsin*, 284 U. S. 206 (1931). Where the Commissioner redistributes the income of husband and wife, increasing the husband's and decreasing the wife's, and determines a deficiency in the husband's tax which is redetermined by the Board of Tax Appeals, the wife is entitled to a refund even though the Commissioner is unable to collect the deficiency from the husband. *Krug v. United States*, 18 F. Supp. 242, 84 Ct. Cl. 502 (1937).

It has been contended that husband and wife lose their separate identities as taxpayers by exercising the option to file a joint return. [Where a joint return is filed, § 51 (b) (2) of the Revenue Act of 1932, 47 Stat. 188, required that “... the tax shall be computed on the aggregate income,” and Article 381 of Treasury Regulations 77 provided that “... all deductions or credits to which either is entitled shall be taken from such aggregate income.”]. However, this view is not sustained by judicial authority. The courts hold that although the incomes and deductions of both spouses are listed as though belonging to the one making the return they remain the separate deductions and incomes of each spouse and are computed by considering separately the transactions of each. *Frank B. Gummey*, 26 B. T. A. 895 (1932); *Commissioner v. Brumder*, 82 F. (2d) 944 (C. C. A. 7th, 1936); *Commissioner v. Behan*, 90 F. (2d) 609 (C. C. A. 2d, 1937). Three cases closely analogous to the case under discussion support this finding. They are *Reynolds v. Glenn*, 353 C. C. H. 1935 Fed. Tax Serv. ¶ 9415, *Cole v. Commissioner*, 81 F. (2d) 485 (C. C. A. 9th, 1935), and *Van Vleck v. Commissioner*, 80 F. (2d) 217 (C. C. A. 2d, 1935).

In *Reynolds v. Glenn*, supra, husband and wife filed a joint return under the Revenue Act of 1928, § 51 (b) (2), 45 Stat. 808. The Commissioner notified the husband of a deficiency on the joint return but failed to send a separate notice to the wife. A bill of review filed by the husband and wife in the Federal District Court for the Western District of Kentucky was dismissed as to the husband but the court found for the wife under the statute of limitations, holding that notice of deficiency sent to the husband is not notice to the wife.

In *Cole v. Commissioner*, supra, a deficiency was found in the tax paid by husband and wife on a joint return. The deficiency arose from the failure to compute the tax on all the taxable income of the wife. The Commissioner assessed the deficiency as a joint and several liability against the estate of the deceased husband, and the Board of Tax Appeals, 29 B. T. A 602 (1933), sustained the Commissioner's position. The court, however, reversed this holding declaring that under the Revenue Act of 1928, § 51 (b) (2), supra, the income of one spouse is not chargeable with a deficiency arising out of the income of the other. Moreover, it denied that administrative difficulty in determining against whom the deficiency should be assessed justified a joint and several liability.

In *Van Vleck v. Commissioner*, supra, the husband on a separate return showed a net loss for 1929. For the year 1930, he and his wife filed a joint return and he deducted his net loss for 1929 from the aggregate income [§ 117 (b) of the Revenue Act of 1928, 45 Stat. 825, permitted a taxpayer to deduct a net loss for one year from the gross income of a subsequent year.] The court held that the husband could not apply his net loss for 1929 against his wife's income for 1930.

If federal income tax legislation is to be taken as contemplating the husband and wife as separate taxpayers, and their incomes and deductions as more or less distinct
even on a joint return, it follows that the allowance for deductible losses under § 23 (r) (1) of the 1932 Act, supra, must be limited to the gains of the spouse suffering the losses and not the combined gains of both. The Commissioner is pressing this construction of Congressional intent in regard to charitable contributions. He has ruled that on a joint return the limitation of 15% of net income for charitable contributions is 15% of the separate net income of the spouse making the contributions. I. T. 2872, XIV-1 Cum. Bull. 71 (1934). The same limitation would undoubtedly be placed on deductions for wagering losses which are allowed to the extent of the gains from such transactions, Revenue Act of 1938, § 23 (h), 52 Stat. 461, 26 U. S. C. § 23 (h) (Supp. 1938). It may well be asked, when then is the advantage in filing a joint return? As pointed out in the reported case, only when the allowable deductions of one spouse exceed his or her income. And this advantage is gradually being lost to the taxpayer as the Government continues to limit by administrative interpretation (finding support from the courts) the types of situations in which the allowable deductions of one spouse may be taken against the income of the other.

JAMES F. FOLEY

TORTS—Negligence—Liability of Cigarette Manufacturer

A cigarette given to the plaintiff by a man with whom he was conversing, from a new and unopened package, tightly wrapped and sealed, and of defendant's manufacture, which the man had purchased factory intact from a dealer in the ordinary channels of trade, flared up, when lighted, into tiny sparks and greenish-blue flame, burning plaintiff's face. Held, the manufacturer was liable in damages to the plaintiff. De Lape v. Liggett & Myers Tobacco Co., 25 F. Supp. 1006 (S. D. Cal. 1939).

Of the two general approaches to liability in such cases, viz., negligence and warranty, the principal case follows that of negligence, adhering to the theory of liability of MacPherson v. Buick Motor Car Co., 217 N. Y. 382, 111 N. E. 1050 (1916), that liability is no longer based solely on contract, but is based on duty imposed by law. The older cases, notably Winterbottom v. Wright, 10 M. & W. 109 (Ex. 1842), had held that the manufacturer of a defective article was not liable to a third person with whom he had no contract. The harshness arising from this rule was ameliorated by Thomas v. Winchester, 6 N. Y. 396 (1852), which led to the introduction of the "dangerous instrumentality" doctrine as later worked out by Huset v. Case Threshing Machine Co., 120 Fed. 865 (C. C. A. 8th, 1903). Then, in 1916, the MacPherson case expanded this doctrine so as to apply to an injury resulting from articles not inherently dangerous but made so by defective construction, and removed the requirement of privity. Cf. Jeanblanc, Manufacturers' Liability to Persons Other Than Their Immediate Vendees (1937) 24 Va. L. Rev. 134.

Thus, resting its decision, as do the majority of courts, on a theory of negligence, the court invoked, as the test of foreseeability the "reasonable man" test adopted by the Restatement of the Law of Torts, which allows the standard of care required of the manufacturer to vary with the character of harm that is likely to result. Restatement, Torts (1934) § 395. The principal case expressly stops short of holding the manufacturer's liability to be that of an insurer. Said the court: "The
liability is not that of an insurer, but the care that is to be exercised, and the duty that is to be discharged are correlative to the likelihood of harm that results from lack of constant vigilance in fabricating articles for human consumption". Thus, this principal case declines to follow what Waite calls a "... marked tendency in such cases to hold the manufacturer liable as an insurer, on the fiction of negligence, whether there is any evidence of negligence in fact or not", Waite, Law of Sales (1927) 200, n. 105.

In cases like the principal one, involving articles intended for human consumption and sold in sealed containers, the weight of authority is opposed to requiring the subpurchaser to prove actual negligence. Try-Me Beverage Co. v. Harris, 217 Ala. 302, 116 So. 147 (1928); Coca-Cola Bottling Co. v. McBride, 180 Ark. 193, 20 S. W. (2d) 862 (1929); Campbell Soup Co. v. Davis, 163 Va. 89, 175 S. E. 743 (1934); Fisher v. Washington Coca-Cola Bottling Works, 66 App. D. C. 7, 84 F. (2d) 261 (1936). Such cases, generally, apply the doctrine of res ipsa loquitur, though in different ways. Of the courts which apply the doctrine of res ipsa loquitur the majority draw an inference of negligence on the part of the manufacturer when evidence is introduced showing an injury caused by deleterious substances in the product. Even more, some give evidentiary weight to this inference of negligence, and some give effect to it even if the defendant shows exercise of scrupulous care. Pillars v. R. J. Reynolds Tobacco Co., 117 Miss. 490, 78 So. 365 (1918). Other courts arrive at the same result by statute. Clark Restaurant Co. v. Simmons, 29 Ohio App. 220, 163 N. E. 210 (1927); Tate v. Mauldin, 157 S. C. 392, 154 S. E. 431 (1930); Culbertson v. Coca-Cola Bottling Co., 157 S. C. 352, 154 S. E. 424 (1930). Among the latter the principal case may be classed. For, as the court declared, while the doctrine of res ipsa loquitur was probably sufficient, under the facts of the case, to impose liability upon the defendant manufacturer of the defective cigarette, as was the situation in Liggett & Myers Tobacco Co. v. Rankin, 246 Ky. 65, 54 S. W. (2d) 612 (1932), (where the manufacturer was held liable when the ultimate consumer bit into a worm that had been pressed into a plug of tobacco) nevertheless, the California Civil Code itself declares rules of law sufficient to make the manufacturer liable in this action. Cal. Civ. Code (Deering 1937) §§ 1708, 1714, 3281. The court held that the correct and applicable rule under the California Civil Code was that the duty to use ordinary care in fabricating products that are made for the purpose of being used in contact with the human mouth, such as tobacco or cigarettes, extends to everyone, without regard to contract, and a failure to perform such duty which proximately causes injury to another normally using such products constitutes negligence by the manufacturer, for which the injured party, in the absence of contributory negligence, may recover compensatory damages. The doctrine of res ipsa loquitur is freely applied in these cases involving food and other articles intended for human consumption, and it is to be noted that this wide application is a deviation from the limits set by the MacPherson case, which distinctly required negligence as an element of the plaintiff's case.

PETER J. BRENNAN, JR.
A SESQUI-CENTENNIAL BIBLIOGRAPHY

SOME BOOKS ABOUT THE CONSTITUTION, ITS MAKERS
AND ITS INTERPRETERS

HERE, with brief mention and some attempt at appraisal, are listed two dozen books, most of which bear the publication date of the sesqui-centennial year of the adoption of the Federal Constitution and of Georgetown University. It is expected that each of these books will be more adequately reviewed in volume twenty-eight of the Journal.

I. A TREATISE

Professor Rottschaefer has given us a new treatise upon Constitutional Law. Its 875 pages of text present a carefully digested and well-written summary by a careful scholar. This new work replaces Black in the Hornbook Series and that is well. Black’s work, even for its day, was inadequate. Even those older books which made a fairly adequate presentation of the principles of Constitutional Law are fast on the way to becoming museum pieces. No finer small book was ever written upon the law of our Constitution than that by Professor Burdick—yet today because of shifts and changes e.g. in the definition of interstate commerce and in the outlines of reciprocal tax immunity—what a need for revision it presents. The ink is scarcely dry upon the pages of Professor Rottschaefer’s book and, yet some rephrasing or revision might be in order even now. So rapidly is the subject moving!

The author has shown excellent judgment in his space allocation to various topics. It is fortunate that much of Professor Rottschaefer’s study, over the years, has been given to the law of Taxation. That experience is reflected in the present work and the best performances in the book are the discussions of constitutional problems in the law of Taxation. One misses the citation to law review material in the footnotes. It is true there is a bibliography of such material in an appendix but that bibliography, inadequate in some particulars, is no substitute for the careful citation to such material in footnotes to the text.

On the whole the method employed by the author may be said to be

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2Such would seem to be called for, for instance, by the decision, among other cases, of Graves v. People of State of New York ex rel. O’Keefe, 59 Sup. Ct. 595 (1939).
3Pp. 877-93.
over-analytical. Constitutional Law is after all probably more history (i.e. experience) than it is law in the Austinian sense!

II. Monographs upon Particular Phases of Constitutional Law

1. Commerce

Professor Ribble first delved into the ideas which ultimately found their way into this fine book as a graduate student under Professor Dowling at Columbia. It is an excellent and illuminating study of one of the most important and elusive phases of American Constitutional Law. The author traces the origin and the development of the law governing the division of power between state and nation in the constantly growing field of commerce. He tells us that "changing construction is manifestly affected by innumerable factors. These factors are present in economic forces, in social and ethical ideals, in outstanding individuals whose personalities have marked the law and in other ways." And then he tells us that he is not attempting to consider this melange of interacting forces which has dictated the law but the law itself—the resultant of all these forces.

Professor Ribble first surveys the early period (about a century) of the regulation of commerce and finds it to be a period of judicial activity and comparative legislative inaction, until changed conditions dictated a legislative awakening. Roughly this period ended with the adoption of the Interstate Commerce Act in 1887.

Some attention is devoted to due process insofar as that principle touches the regulation of commerce. For a full century, we are told, due process was nothing more than a matter of procedure. Only recently has it been expanded so as to reach into substantive law. He finds in the Schechter case a turning back to states' rights and to the judicial invention of direct and indirect interference with interstate commerce. Therein he finds also a victory for Jefferson and Madison and a defeat for Marshall and Hamilton. But things have happened since Professor Ribble wrote!

Even so no one who seriously studies interstate commerce today can pass by Professor Ribble's able book.

5P. 5.
Professor Wright has given us an authoritative history of the rise and decline of the Contract clause together with an analytical digest of the decisions of the Supreme Court thereunder. By far the greater portion of the book is concerned with this analysis and the analysis is instructive indeed. Long since the author has demonstrated his peculiar ability to analyze soundly, to frame honest judgments thereunder and to express the whole in interesting fashion. Illustrative of his skillful handling is the account of the decisions on private contracts from Sturges v. Crown-inshield\(^8\) to Richmond Mortgage and Loan Corp. v. Wachovia Bank and Trust Co.\(^9\)

He seems to be guilty of some errors of statement, e.g. in connection with Marshall's decision in Providence Bank v. Billings.\(^10\)

One chapter of Professor Wright's book is devoted to a consideration of the cases emanating from Gelpcke v. Dubuque\(^11\) dealing with the problem of the impairment of Contract by judicial decision.

In his concluding chapter, he develops an historical theory to explain the rise of the contract clause as a safe-guard of property rights by the fact that it happened to correspond with developing ideas among the body politic upon the subject and for its decline by the rise of the due process clause to take its place. He wrote just a year ago. Has not the commerce clause got a new lease on life since then?

It should be said that the book does not pretend to be a treatise on the law of the contract clause. It is the history of ideas, understandably done.

3. Equality\(^12\)

Mr. Warsoff's thesis in his book on Equality seems to be that natural equality is the very basis of our Constitution. He labors the proposition that the doctrine of equality has been made the sacrificial victim upon the altar of private property.

He has divided his book into two parts. The first is concerned pri-


\(^8\)Wheat. 122 (U. S. 1819).

\(^9\)300 U. S. 124 (1937).

\(^10\)4 Pet. 514 (U. S. 1830).

\(^11\)1 Wall. 175 (U. S. 1863).

marily with the history of the Fourteenth Amendment and the second part deals with the application of the equal protection clause.

The author shows himself fairly conversant with the literature of the Fourteenth Amendment, but all of this is the retelling of an oft-told tale. His thesis in Part Two is that the Supreme Court has consciously refused to precisely define the term equality. But how can the Court, or any human or group of humans give the term precise definition in a constantly changing industrial economy? We ought not to want any such thing.

There is a certain hurried slap-dash about the last part of the book, e.g. the analysis of the cases under the caption Laissez Faire and the brief case notes under the heading The Last Four Years (1933-1937). There was a philosophical battle being waged on the bench during the nineteenth century—the battle between "freedom of contract" and "police power." Mr. Warsoff has not convinced us that he has got behind the smoke of that battle.

4. The Administrative Process

This little book is based upon the Storrs lectures delivered at Yale early in 1938 and in it Dean Landis speaks from his wide experience both as a scholar and as practical administrator.

His first lecture concerns itself with the effect of the doctrine of separation of powers upon administrative law. While today we think of administrative tribunals as answering to a separate category all their own, Dean Landis reminds us that the characteristic administrative agencies are either of legislative or judicial origin and that results in two types of tribunals and in two types of administrative agencies. True, the dual functions are invariably combined in one and the same agency, but with infinitely varied gradations of the mixture of legislative and judicial functions. Dean Landis omits certain agencies, which he does not regard as the typical administrative tribunal, from his discussion. These omissions include agencies such as the Civil Service Commission which deal primarily with the internal management of the government and such "proprietary agencies of government" as the TVA and the RFC.

Successively, the Dean voices his faith in detailed economic surveys as a means for grounding sound administrative decision; he discusses policy making and thereunder takes up the question of delegation of

powers, the Federal Register Act and the methods for exercising control over the rule making process, the combination of prosecutor and judge in the same agency and the weaknesses of judicial review (locking the barn after the horse has been stolen).

The lecturer's illustrations are well chosen and well calculated to illustrate the impact of administrative agencies on everyday life. It is not designed as an introduction to the study of administrative law. It is rather the record of a very able man's experience in this field. And therein lies its value.

III. STUDIES IN INTERPRETATION

1. Mr. Lewis on Interpretation

This small book reprints the lectures given by former Dean Lewis in 1937 on the William H. White Foundation at the University of Virginia. Not only is the subject with which Mr. Lewis deals of interest to both lawyers and laymen but stylistically the book is a little masterpiece.

In the first chapters, the lecturer calls attention to the absence of any provision in the Constitution for its own authoritative interpretation. This, of course, accounts for the present position of our Supreme Court. He says that the Court's position is due to the fact that "the people have made it a part of the unwritten Constitution." But Mr. Lewis himself does not unqualifiedly accept the "unwritten Constitution." Let him tell you. "Personally, were I a member of Congress, I would regard myself as having the duty to support the Constitution as I understood it, not necessarily as the Supreme Court interpreted it, though, of course, my opinion might and generally would be influenced by the decisions of the Court." Further Mr. Lewis thinks the members of the Court usually behave that way too.

In his fourth chapter, entitled Characteristics of Interpretation Problems, the author illustrates from *McCulloch v. Maryland*, *Gibbons v. Ogden* and the *Dred Scott case* the several choices which the Court may pursue in deciding important constitutional questions.

Mr. Lewis' final chapter deals with some recent matters, the problems of federal price control, the control of production and government in

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13 P. 38.
14 Wheat. 316 (U. S. 1819).
15 Wheat. 1 (U. S. 1824).
business. On these, he offers that "the answer to most important doubtful questions of constitutional interpretation . . . depends largely on the political, social and economic theories and background of the person asked."20

We all ought to read Mr. Lewis' lectures. We can learn many self-evident truths from them, which might spare us considerable indulgence in unwarranted vituperation.

2. The Meaning Today21

No bibliography of the Constitution could be counted adequate should it fail to include the latest edition of Professor Corwin's little handbook. This little work, by one of our leading scholars, is far different from the first edition published in 1920 and re-edited in 1921, 1924 and 1930. Professor Corwin succeeds admirably in presenting a concise, up-to-date commentary on the judicial interpretation of the various clauses in the Constitution. It is a layman's guide primarily and so, of purpose, it is sketchy. But the important thing is that it is an accurate piece of work. The little book reflects careful scholarship, cites abundant cases and periodical articles. Next time, why not give the dates of cases in the footnotes? It does illustrate a point of view, the dissemination of which has been the chief concern of Professor Corwin's efforts. We mean his insistence that the commerce, contracts and due process clauses have no definitely settled meaning. Professor Corwin believes with Chief Justice Hughes that "the constitution is what the judges say it is."22 According to Professor Corwin, judicial interpretation of these controversial clauses often becomes political. But then Mr. Dooley beat Professor Corwin to it, for many years ago he said "the Supreme Court follows the election returns!"

3. Court Over Constitution23

This book is a collection of some five more or less independent law review articles and lectures. For all that, the book achieves a surprising

20P. 79.
22This was, of course, said by Mr. Hughes while he was serving as Governor of New York.
degree of unity. Why did Professor Corwin choose so inflammatory a title? His subtitle rather accurately styles his effort as "a study of judicial review as an instrument of popular government." The appraisal of judicial review is critical in the true Corwin manner. He feels that judicial review ought to be used and that it can be used as an instrument of popular government. He seems to eke out a rather inglorious history of judicial review.

The validity of judicial review has been settled, of course, by firmly entrenched constitutional practice, but Professor Corwin insists that neither doctrine nor experience have settled the problem of its scope.

Professor Corwin's third chapter deals with the doctrines that have centered around our federal system. If he be correct, the history of constitutional ideals may be followed through as a struggle between the "cooperative" and "competitive" ideas of federalism. This particular essay does offer a fresh interpretation of the old controversy between states' rights and nationalism and Corwin does make out a fairly convincing case for the constitutional, administrative and moral justification of a system of grants-in-aid.

He may be over-optimistic in his assurance that this concept of a cooperative federalism will be sustained by the Court. You remember what the Court did to some of the ideas which he set forth in his Twilight of the Supreme Court.

Professor Corwin does not believe that the judicial power itself stands in the way of his concept of effective popular government—he thinks it is only the abuse of judicial power and so he goes on forever hoping for more and more liberal interpretation of national power. There are certain apparent weaknesses in this hope.

4. A New Federalism

Traditionally we have thought of federalism in either one of two ways, either as the central authority appropriately exercising certain powers to the exclusion of the states, or as the states exercising certain power to the exclusion of the central authority. We have lately come to realize that this division, despite its traditional statement, has many non-exclusive aspects and we now believe that in many matters the two sovereignties, state and federal, ought to act together.

And so the "new federalism" of which Miss Clark writes is the federalism of cooperation. The author does not approach this new federalism through its possible delineation in judicial decisions, but rather through a study of legislative action and of the conduct of administrative agencies and officers.

She discusses "informal cooperation", such as results from the exercise of good will on the part of officials as well as formal cooperation which results from contract. The incidence of legislation upon all this is carefully considered, as is the grant-in-aid and the device of federal credits for state taxation. These latter two devices occupy half the book.

The book is uniquely valuable. Nowhere else can you find so fine an introduction to the idea of joint action in American federalism today.

5. An Attorney General's Papers

The able Mr. Swisher has here abridged hundreds of papers and addresses of Mr. Cummings written during his six years as Attorney General. A few communications to the Attorney General are included and the editor has supplied a biographical note and an introduction.

Of particular interest to us is one of the major divisions of the book entitled The Courts, the Constitution and the New Deal. The papers are illuminating in that they record the human element in the nation's largest law office. These papers bespeak the calmness, the courage, the good nature, the shrewdness and the skill of the nation's legal strategist and advocate. They breathe life and understanding into much that has been written about the Constitution in its sesqui-centennial year and the time immediately proceeding. He who would have an insight into the last six years of the history of our Constitution must not pass over at least this minimum of source material from the papers of Homer Cummings.

IV. APPRAISAL AND OVERHAULING

1. Twenty-seven Reconsider the Constitution

Under the arresting title, The Constitution Reconsidered, we find a collection of twenty-seven papers delivered at the meeting of the Amer-


ican Historical Association in Philadelphia in December, 1937, the occasion being the sesqui-centennial anniversary of the Constitution. These papers have been grouped into three parts: (1) The background of political, economic and social ideas behind the Constitution; (2) The Constitution and its influence upon American thought; and (3) Repercussion of the Constitution outside the United States.

Perhaps the first part of the book is the most valuable. The first two papers, Professor McIlwain's *The Fundamental Law Behind the Constitution* and Professor Thorne's *The Constitution and the Courts: A Re-examination of the Famous Case of Dr. Bonham* are the best performances. The third part of the volume discussing the influence of our Constitution in other lands consists of nine papers for the most part well done.

Some of the papers in the second part of the volume under the heading of *The Constitution and Its Influence Upon American Thought* leave much to be desired. Too much of inaccuracy, straining at cleverness and propaganda peddling mars some of these papers and yet their publication is sponsored by the American Historical Association.

2. *An English Appraisal*\(^{27}\)

Sir Maurice Sheldon Amos has given us the opportunity to learn how an Englishman, learned in the law, reacts toward American Constitutionalism. Sir Maurice has mastered American constitutional law doctrine more than creditably well. He avoids routine matters in these lectures delivered at Cambridge in Lent term of 1938 and gives his attention to the live issues arising under the commerce, due process and contract clauses with some attention to the origins of the New Deal.

Perhaps he underestimates the personal equation of the judge in our system. Sir Maurice chastens us by a reminder that we lag behind England in social legislation and he has some difficulty in understanding all our to-do about judicial review when Englishmen manage so well without it.

3. *The Shape of Things to Come*\(^{28}\)

Mr. Hugh L. Hamilton has been impressed with the seemingly never ending criticisms directed against existing provisions of our Federal


Constitution. He is impressed with the sum total of this criticism but he is disturbed by the fact that nothing much is done about it. Our Constitution, he believes needs over-hauling, but nobody seems to propose anything fundamental in character looking toward the modernization of the instrument. The author believes that the time is ripe for calling a constitutional convention. The Congress is unwilling to propose it and the legislatures of the necessary two-thirds of the states will not apply for it. All the more reason then for Mr. Hamilton to express his opinion and prod the lawmakers into action.

And so he gives us definite proposals for modernizing the Constitution from the preamble to the method of adoption. The book is divided into two parts, the first being devoted to a discussion of the particular clauses of the Constitution which stand in need of revision or repeal. He likewise suggests the addition of several clauses. No mere negative critic is Mr. Hamilton, for he gives you the exact text that he would have his added clauses and his revised clauses assume. In Part Two of the book you may find the complete text of his Second Constitution. There is an Appendix and there you will find the present Constitution with notes indicating proposed changes, modifications, revisions or deletions. Let Mr. Hamilton tell you about the wide scope of his suggestions. After describing our present Constitution as a jigsaw puzzle of one hundred and forty-nine pieces he says: "But thirty-one pieces are rotted and have to be thrown away; forty-four of them are badly in need of repair; thirty-seven of them have to be repainted; and we have to make eighteen new pieces to complete the picture. Only thirty-seven of the original pieces are left intact."

It sounds like a large order—but if you examine what Mr. Hamilton wants to do, you'll find him quite conservative. Agree or disagree with his proposals, his exercises in constitution drafting make stimulating reading.

V. BIOGRAPHY

1. A BIOGRAPHY OF THE CONSTITUTION

An institution has had its biography written. The technique of the biographer as applied to the Constitution by Mr. Burton J. Hendrick has achieved most pleasing results. In the new and revised edition of his

29Pp. 4-5.

Bulwark of the Republic, Mr. Hendrick has demonstrated that he who knows not the men who made an institution, he who knows not the men who operate the institution, understands not that institution. The book, wittingly or unwittingly, proves more. It should serve to prove that law as mere rules is meaningless and that the lawyer who is not an historian is but a poor lawyer indeed.

Mr. Hendrick's first edition appeared when the black pall of President Roosevelt's proposed reorganization of the Supreme Court was over the ancient document. That fact contributed to the popularity of the earlier edition.

That which the author describes as "the one arresting paradox"—i.e. that this the youngest of the great nations of the world is at the same time the oldest government—furnishes the theme of his "biography." The Abbe Sieyes, when asked what had been his chief accomplishment during the turbulent period from 1748 to 1836, answered "I have survived." So too has the American Constitution survived even a bloody Civil War. Why? For all the reasons that Mr. Hendrick tells us. Not the least of these reasons is the fact that we have made our Constitution our great symbol of national cooperation. What the Royal Family is to the Englishman this historic piece of parchment is to us in the United States.

Mr. Hendrick makes the Constitution a thing of flesh and blood. His narrative holds one's interest as though it were the first recital of a thrilling epic. It is a book to fire the imagination of every American.

2. Among the Founding Fathers

The Philosopher of the Constitution

In his monograph, Dr. Burns has given us an organized summary of Madison's writings, together with a scholarly interpretation thereof. His book is easily the most satisfactory account we have of Madison's political works. Perhaps the author has over-stretched to achieve inclusiveness. It would seem that the years 1787-1788 merit more detailed treatment than they receive. The division of Dr. Burns' book into six chapters—Biographical Introduction, General Theory of the State, Views

31Lord Bowen: "Mere legal terminology may seem to you a dead thing. Mix history with it and it clothes itself with life." Quoted by Lord Macmillan, LAW AND OTHER THINGS (1937) 129.

on Democracy, Theory of the Union and the Constitution, Theory of Legislative, Executive and Judicial Powers, Conclusion (Sources of Madison’s philosophy and an appraisal of his influence)—minimizes the non-systematic character of Madison’s work. In his theory of judicial review, the author tells us, Madison differed pointedly from the Hamilton-Marshall doctrine which the Supreme Court espoused. Has not the Court often borrowed trouble for itself by its zeal in the application of Marshall’s doctrine, only to have to mend its ways along the line suggested by James Madison?

Perhaps Dr. Burns’ book might have been the better had he given a bit more attention to Madison’s contemporaries. For all that, this is one of the best studies of an American political philosopher we have met to date. And that is high tribute when one remembers that Madison presents certain peculiar difficulties to the student of American Constitutionalism. One cannot summarize Madison quite as simply as one may summarize Tom Paine or for that matter, Hamilton. If one attempts to do so, Madison becomes what he decidedly is not—platitudinous. Though he did not write as voluminously as did Adams or Jefferson, one must spend more time in the interpretation of his work. Madison’s literary product is by no means of uniform quality, the product of 1787-88 being far superior to anything that followed. That fact does not seem to be sufficiently emphasized by Dr. Burns. By the author’s fine work, the understanding of Madison’s political philosophy should be immeasurably aided.

A Presbyterian Thomist

Father Obering has in this interesting study traced the parallel between the views of James Wilson and those of the Scholastic philosophers. The work establishes without doubt the close intellectual kinship between the legal philosophy of Wilson as illustrated in his Philadelphia lectures and the Aristotelianism of Saint Thomas and Saint Robert Bellarmine, but it does seem that Father Obering has somewhat soft-pedalled some of the differences between Wilson and the Scholastics.

It is regrettable that the author did not devote more attention to the work of Wilson in the Constitutional Convention of 1787, for Wilson was perhaps the most influential man at the Convention and certainly

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his work at the Convention merits as much attention as do his uncom-
pleted law lectures.

Dr. Obering has done a worthy service, however, in pointing to the
influence of the Scholastics upon the thinking of the Revolutionary
Fathers and in pointing to the kinship of the mediaeval doctrine of
natural right with the American doctrine of natural rights. In doing so
he finds it necessary to de-emphasize the influence of the Massachusetts
Puritans and to exalt the influence of the men from Pennsylvania, New
York and Virginia. Of course, all this means some pretty blunt criticism
of the historical explanations of Professors Becker, Corwin, Dewey,
McIlwain and Pound.

Father Obering's book is more timely that its title might indicate.
There is not a little justification for the belief that the principles of
public morality are being at present sacrificed to the expedient satis-
faction of today's material needs. It is at just such a time as this that a
study of a sound juristic philosophy may be a somewhat efficacious cor-
rective. To rub shoulders with a man who made the juristic philosophy
of natural law work on the bench and in the class room is an enobling
experience. Every lawyer ought to read Father Obering's book.

There is a fine bibliography, but the omission of an index in this day
and age justifies the disgust of any reader.

The Squire of Gunston Hall84

Miss Hill describes George Mason, who was a neighbor to General
Washington, as "perhaps the ablest constitutionalist of the Revolutionary
period." And that seems justified, for perhaps no one in America con-
cerned himself more with the anatomy of political organization. How
the times fitted his talents! He it was who wrote the Virginia Declara-
tion of Rights—the prototype of our Declaration of Independence—and
also the first Constitution for the Old Dominion. Though an esteemed
member of the Philadelphia Convention of 1787, and one who remained
to the very end of its deliberations, Mason did not sign the document for
reasons which now seem trivial. He returned to Virginia for the pur-
pose of opposing ratification. Mason was a scholar and no demagogue.
His practical utility to the anti-ratificationists in Virginia seems doubt-
ful for they stood chiefly in need of a demagogue.

We have long been in need of an able account of George Mason and

84GEORGE MASON: Constitutionalist—by Helen Hill. Harvard University Press, Cam-
bridge, 1938. Pp. xxii, 300. $3.50.
Miss Hill has gone fairly far toward filling that need. We wish she had given us more in the way of an account as to the origin of her subject’s political ideas. Like his illustrious neighbor, Mason was a planter born to wealth, a prudent man who regarded slavery as a wicked institution. Miss Hill characterizes him as the American manifestation of the “Enlightenment”, but that does not tell us much. We ought to have more light on why Mason disliked sitting on the Burgesses, why he would not become a delegate to the Continental Congress and why he would not serve in the Senate after his neighbor became President. Mason does not seem to have shared Jefferson’s religious heresies, though he proved to be something of a zealot in disestablishing the Anglican Church. He was a member of the committee appointed to revise the legal system of Virginia and his was the deciding vote which resulted in the retention of the common law rather than the adoption of a system of codes imitative of the Civil Law.

Miss Hill has described Mason. She has not shed too much light upon his thought processes. To some of us he is still part enigma.

_A Maker of the Constitution_\(^{25}\)

Not much was known about William Samuel Johnson until Mr. Groce wrote his biography. The study is illuminating in that it places Dr. Johnson in fine perspective among the more familiar Connecticut immortals who are better known—Roger Sherman, Oliver Ellsworth and Luther Martin. From the comparison, Dr. Johnson “the father of Connecticut bar” comes off very well. Until Mr. Groce wrote his account, we had only the account of the Reverend Mr. Beardsley.\(^{36}\) Particularly illuminating is the chapter which describes Johnson’s role in the deliberations of the Philadelphia Convention. The author has shed much light upon the opposition of Federalism as it existed in the interior of Connecticut among those of “rather indifferent” education, who lived in places “remote from the opportunities of information”.

Dr. Johnson’s role was not that of a crusader for a cause. He studiously—and I think wisely—avoided taking a position upon certain issues. In so doing he took on a peculiar stature as a national statesman bent upon effecting such maneuvers only as would result in the adoption of the Philadelphia Constitution by his own Connecticut. His fellows in

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\(^{36}\)BEARDSLEY, LIFE AND TIMES OF WILLIAM SAMUEL JOHNSON (1876).
the convention came to characterize him by his "sweetness of temper" which meant, in the main, that he had learned to control his temper. He assumed the role of the great conciliator between those states which favored the Virginia or "large state" plan and those which favored the New Jersey or "small state" plan. While he probably did not author the final plan, he does deserve much of the credit for persuading the Convention to a favorable view of the "Connecticut Compromise". He was uniquely qualified to serve as the great conciliator of the South, being at once "friendly, tolerant, episcopalian" and "generally beloved by southerners." Mr. Groce has convinced us that this illustrious and too little known president of Columbia College did much to achieve a system so inviting to his law-loving self whereby the national sovereignty over states would rest ultimately with intelligent and learned Federal justices.

_A Critic of the Constitution_37

Mr. Spaulding, who is assistant chief of the division of research and publication of the Department of State, has given us a scholarly account of one of the eminent early opponents of the Constitution, George Clinton. His biography is based upon many original letters and papers, upon newspapers of the day and upon numerous other sources all of which are carefully indicated. The result is an admirably vivid picture of Clinton's life and times. Mr. Spaulding convinces his reader that Clinton ought to be remembered for something other than his opposition to the ratification of the Federal Constitution by the State of New York. Clinton's long career as a Revolutionary soldier, as Governor of New York for seven terms, and as vice-president of the United States for two terms is discussed in detail. His great influence upon the "masses" is constantly emphasized. One may also learn much about Clinton's personal characteristics and appraise his interest in that important enterprise of his day—land speculation.

Mr. Spaulding has in his authoritative biography placed Clinton in proper perspective and, for the first time, has accorded him the historical importance he deserves as "foremost opponent" of the Constitution of 1787. It was Clinton, after all, who helped to make the American Revolution something more than a political movement; to make it a democratic movement as well. Clinton never ceased to be a sincere democrat even at the risk of being accused of rank Jacobinism. He came

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near to achieving the presidency of the United States. True, he remained a local figure throughout his life; but he was perhaps the most important local figure in all the Union. To date Clinton has not been a favorite with historians—perhaps because he found himself at odds with Hamilton, Burr, Jefferson and Madison. That affords no excuse for neglecting him. We are glad Mr. Spaulding stepped into the breach.

3. Among the Judges

The Qualifications of Supreme Court Justices

In his Judges of the Supreme Court, Professor Ewing has given us a statistical appraisal of the membership of the Court. Such an appraisal has the value of satisfying our curiosity about a great institution. Several things are established thereby; the average age of appointees is greater than it was in the early days of the Court; the South contributes an increasingly diminishing proportion of the Court's membership; Senate resistance to Presidential nominees reached its height during the Jackson era and that prior political service rather than prior judicial service is likely to characterize the appointee.

Professor Ewing relates such facts in delightful fashion, charted against four convenient periods in our history and against four convenient geographical regions. The author claims no more than informational value for his work. He does not posit controversy, he does not speculate and he builds no superstructures upon his data. He has done a useful piece of work and he is a wise man in recognizing its limitations.

The Chief Justices

Mr. Umbreit has written thumb-nail biographies of each of our eleven Chief Justices, together with some appraisal of the opinions which each has written. His book bears the sub-title, "A History of the Supreme Court in Terms of Their [the Chief Justices'] Personalities." The book is not that at all. It is rather a collection of studies in the personality and achievements of the men who have successively presided over the Supreme Court.

The author stresses the diverse background of all of these men, seeing

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reflected in this diversity of background the growth of our nation, for these men have been severally colonial aristocrats. Yankee farmers, frontiersmen, young New Englanders who went West, politicians, Confederate soldiers and corporation lawyers. Mr. Umbreit, after pointing to all this diversity of background and temperament, is duly impressed with the phenomenon of how little of what may be described as the judges' individual prejudices have found their way into the decisions. All this, he finds, constitutes a fairly satisfactory repudiation of the gastronomic theory of Jurisprudence.

Mr. Umbreit has given us a fairly successful evaluation of the contribution of each man to the development of the Court and of our Constitutional law. And what a group these men have been! Jay who brought to the infant bench good character and prestige, Marshall, who loved good Madeira and brought courage; Waite who brought a much needed nationalism following the Civil War and White who brought the most scholarly appreciation of the common law.

The author makes no claim to originality of material, but he does tell us that much of the material from which he has drawn is found in out-of-print books and in obscure periodicals. These sketches are written for those who cannot or will not seek out the more obscure material and that includes most of us. The book does represent a good job of condensation and retelling with a certain amount of skillful interpretation. Not the least valuable, is the fine bibliography which is appended.

A Defender of the Public Interest  

To most men of this age, Chief Justice Waite is unknown. Among lawyers he symbolizes only a few respectable (though perhaps outmoded) opinions of our Supreme Court. Waite went into eclipse in the days when laissez-faire climbed into the saddle. But he is emerging from his eclipse. Problems in the public control of business are looming large before us and the police power threatens to overshadow due process in importance; all of which should serve to focus attention upon the importance of Waite's contribution. When the Supreme Court decided the Nebbia case it harked back to the landmark decision of Waite and all but disregarded many intervening cases. And so it is that Chief Justice Waite's opinion may be again well on the way to becoming "a standard of judicial orthodoxy."  

Professor Trimble devotes about half his pages to Waite's career upon the bench. Our criticism of the author's method concerns itself largely with the materials he has employed. He has used the United States Reports and the older books. That is well. But there has been a wealth of material in the legal periodicals—to mention but one further source—which, apparently, has been but sparingly used.

Despite the author's sticking to the coldest of cold source material, we do learn much not only of Waite's work but of Waite the man from this book. Waite, it would seem, was an ordinary man but he did have the fine ability to rise above prejudice and to rise above the instant case to the greater issue. He had neither the talent nor the years of service of either Marshall or Taney, but in many ways he assumes equal importance as a law-giver. He was probably the intellectual inferior of many of the justices who sat upon his own court and yet he sensed that the times were out of joint and that he had been born to set them right. And so it fell to him to restate the ancient doctrine of the common good.

And that alone is enough to make us welcome to our shelves the only full length biography of Morrison R. Waite.

*A Liberal Conservator*43

Professor Levy drives home to us the magnitude of our loss in the passing of Mr. Justice Cardozo, particularly so, inasmuch as his study emphasizes Cardozo's contributions to law and social well-being. The author's examination is, for the most part, confined to the decisions on private law which confronted Judge Cardozo while a member of the Court of Appeals of New York. Even so, that record constitutes an epic in honesty and courage. Much is made—and properly so—of the grace of expression through which the great intelligence of the master jurist was transmitted.

Mr. Levy points a paradox. He calls attention to the much heralded liberalism of Cardozo, but he also reminds us that few of Cardozo's contemporaries did so much toward conserving the ideals of the masters who had gone before. He dedicated his life to the correlation of law and justice, the better to satisfy the needs of an ever shifting society. Cardozo probably will not be remembered as a breaker of precedents. He realized the importance of *stare decisis* as a link binding us to the wisdom of the past, but he did insist upon the examination of precedent in the light of present needs. Perhaps no man ever employed the law to better ad-

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vantage as a means of safe-guarding and of satisfying human interests.

Rightly, under the caption The Judge As Artist, Professor Levy predicts the lasting value of Cardozo's efforts. The ability to set creative thought to musical rhetoric always does much to insure the lasting value of a judicial opinion. Professor Levy has not given us a definitive appraisal of Justice Cardozo. It is too early for that, but he has given us a fair picture of Cardozo's thought, and the layman, especially, may be led by it to appreciate the contributions of this great jurist.

The second portion of the book consists of some of the notable opinions of Justice Cardozo. I would quarrel somewhat with Mr. Levy's selection.

_The Opinions of Justice Holmes_ 44

Mr. Justice Frankfurter, in the brief compass of three lectures, has drawn a definitive picture of a great jurist. The Holmes pictured in these lectures is a judge supremely conscious of his duty to do justice according to law and a master of juristic method. Mr. Justice Frankfurter in these pages makes of Justice Holmes testimony to the fact that the personality of the judge may well be the basic guaranty of justice and that to be a good judge one must possess both mental and moral greatness.

The author has portrayed Mr. Justice Holmes as something more than a common law judge, indeed, as a judge dedicated to the special business of making the common law of the American Constitution.

Mr. Justice Frankfurter deals with Holmes' decisions on constitutional issues in three sections. First he treats of property, secondly, of civil right and finally, with the federal system.

We are fortunate that we have as interpreter a man whose long and intimate friendship with Justice Holmes makes it ever a labor of love for that man to talk of Holmes. With admirable skill, Justice Frankfurter, has set down the legal philosophy of Holmes, his aloofness from political currents, his vision of the place which the judge should occupy in our system and his method of approach to the constitutional questions with which he dealt for thirty years. Holmes, we are told, was "essentially the philosopher who turned to law." In the second lecture, Justice Frankfurter shows how in cases involving civil liberties, the old master "laid down cautionary limits against inroads upon freedom of speech

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not actually embarrassing the nation's safety." He explores the varied considerations which influenced Holmes' judgment upon economic legislation and on laws curbing freedom of speech. Just as he would allow experiments in economics which he himself viewed with doubt and distrust, so he would protect speech that offended his taste and wisdom."

In his third lecture, Mr. Justice Frankfurter deals mainly with the Fourteenth Amendment which he says was used in over two hundred cases "to strike down State action".

Mr. Justice Frankfurter summarizes by saying: "From the constitutional opinions of Mr. Justice Holmes there emerges the conception of a nation adequate to its national and international duties, consisting of federated states in their turn possessed of ample power for the diverse uses of a civilized people."

Perhaps Mr. Justice Frankfurter can be criticized for just one thing. After all, Justice Holmes, great though he was, yet was something less than deity. That Mr. Justice Holmes, an able mortal, "has written himself into the slender volume of the literature of all time" is undeniable.

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A number of the books listed below will be reviewed in the November issue of the Journal


Hoar, Roger Sherman—Patent Tactics and Law: What the Industrial Executive and Engineer should know about Patents. A Revised
Pp. xv, 315. $4.50.


