## TABLE OF CONTENTS TO INDEX

| Index to Authors of Articles                      | III  |
| Title Index to Articles                           | III  |
| Index to Notes                                    | III  |
| Index to Recent Decisions                         | IV   |
| Index to Book Reviews                             | IX   |
| Topical Index                                     | X    |

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GENERAL INDEX

INDEX TO AUTHORS OF ARTICLES

APPLE, CHARLES A., JR.: Advances in Analysis of Questioned Documents 385
BISON, HENRY J., JR.: Economic Protective Powers of States under the Commerce Clause 590
COOLEY, THOMAS M., II and HENRY H. GLASSIE: Congressional Investigations—Salvation in Self Regulation 343
DU BOSE, EUGENE Z.: The Delivered Price Controversy and the O'Mahoney Bill 200
FAHY, CHARLES: Notes on Developments in Constitutional Law, 1936-1949 1
GLASSIE, HENRY H., and THOMAS M. COOLEY, II: Congressional Investigations—Salvation in Self Regulation 343
MACKEY, JAMES G., and BLACKWELL SMITH: Private Capital Under the “Point Four” Program 32
MASON, MALCOLM S.: Conflicting Claims to German External Assets 171
MCCARRAN, PAT: Three Years of The Federal Administrative Procedure Act—A Study in Legislation 574
SCHWARTZ, BERNARD: Jurisdiction to Determine Jurisdiction in Federal Administrative Law 368
SMITH, BLACKWELL and JAMES G. MACKEY: Private Capital Under the “Point Four” Program 32
SNEDEKER, JAMES: The Uniform Code of Military Justice 521

TITLE INDEX TO ARTICLES

Advances in Analysis of Questioned Documents: Charles A. Appel, Jr. 385
Conflicting Claims to German External Assets: Malcolm S. Mason 171
Congressional Investigations—Salvation in Self Regulation: Henry H. Glassie and Thomas M. Cooley, II 343
Economic Protective Powers of States under the Commerce Clause: Henry J. Bison, Jr. 590
Jurisdiction to Determine Jurisdiction in Federal Administrative Law: Bernard Schwartz 368
Notes on Developments in Constitutional Law, 1936-1949: Charles Fahy 1
Private Capital Under the “Point Four” Program: James G. Mackey and Blackwell Smith 32
The Delivered Price Controversy and the O'Mahoney Bill: Eugene Z. DuBose 200
The Uniform Code of Military Justice: James Sneeker 521
Three Years of The Federal Administrative Procedure Act—A Study in Legislation: Pat McCarran 574

INDEX TO NOTES

A New Trend in Subrogation 646
Compulsory Inauguration and Extension of Air Carrier Routes 106
Has There Been a Change in the Law on Acceptance of Contracts by Correspondence? 81

III
Imputing Bailee's Contributory Negligence Under Automobile Financial Responsibility Laws ................................................. 262
Legislative Counsel in Congress ........................................ 277
Loss of Use of a Motor Vehicle as an Item of Damage? ............. 635
Open Season on Tax Loopholes—Should Section 101 Be Modified ... 620
Procedural Aspects of the Terminiello Case ................................ 94
Rules of Proof Employed by Federal Appellate Courts in Reviewing Criminal Convictions .......................................................... 285
State Ownership of Fish and Game ....................................... 656
Substance, Procedure and Uniformity—Recent Extensions of Guaranty Trust Co. v. York ....................................................... 115
The National Health Insurance Plan ....................................... 248
The Scope of Review by the Court of Customs and Patent Appeals in Patent Interference Proceedings .......................... 400
What Are the Liberties of Citizens of Puerto Rico Under the Constitution? ............................................................... 471

INDEX TO RECENT DECISIONS

ADMINISTRATIVE LAW
Administrative hearings in deportation proceedings must conform to requirements of the Administrative Procedure Act. Wong Yang Sung v. McGrath, 338 U. S. 812 (1950) .................................................. 659

The Postmaster General may bar delivery of mail as fraudulent when advertising inducements tend to deceive the public despite subtle qualifying phrases included therein. Reilly, Postmaster of the City of Newark v. Pinkus, 70 Sup. Ct. 110 (1949) .................................................. 300

AGENCY
A private shipping company as general agent for the War Shipping Administration is not liable under the Jones Act for injury to a seaman employed on a United States owned ship. Cosmopolitan Shipping Co. v. McAllister, 69 Sup. Ct. 317 (1949) .................................................. 131

AIR LAW

CIVIL PROCEDURE
Appeal from final decree dismissed because earlier decree of trial court was final judgment as to appellant; effect and need of new Federal Rule 54(b) illustrated. Dickinson v. Petroleum Conversion Corp., 70 Sup. Ct. 322 (1950) ............................................... 662

Congress can give federal district courts jurisdiction, based on diversity of citizenship, of an action by or against a citizen of the District of Columbia. National Mutual Insurance Company v. Tidewater Transfer Company, 69 Sup. Ct. 1173 (1949) .................................................. 135

In a federal court action by a minority shareholder to compel the declaration of dividends, a majority of the corporation's board of directors are not indispensable. Kroese v. General Steel Castings Corp., 13 Fed. Rules Serv. 19a. 1-17 (3rd Cir. 1950) .................................................. 664

Material contained in Federal Bureau of Investigation files sought to be reached by interrogatories filed under the Federal Rules of Civil Procedure held to be unavailable to the party seeking it on the broad grounds of public policy. United States v. Kohler Co., 9 F. R. D. 289 (E. D. Pa. 1949) .................................................. 302

IV
Constitutional Law

A period of fifteen months storage at the port due to the unavailability of water transportation renders the export of goods uncertain so as to halt the process of exportation and bar immunity from the taxing power of the state. Joy Oil Company, Ltd. v. State Tax Commission, 69 Sup. Ct. 1075 (1949) ........................................ 306

Intra-District of Columbia carriage of passengers bound to and from defense establishments of the Federal Government located in Virginia is part of an interstate movement and therefore subject to Interstate Commerce Commission regulation throughout upon proper findings of that agency. United States v. Capital Transit Co., 70 Sup. Ct. 115 (1949) ......................... 485

Nationality Act provision which provides for loss of citizenship of naturalized citizens after five years residence in foreign country is constitutional. Lapides v. Clark, 176 F. 2d 619 (D. C. Cir. 1949) ........................................ 137

Security of privacy against arbitrary intrusion, guaranteed by the Fourth Amendment to the Constitution, is enforceable against the states through the Due Process Clause, but this right does not require state courts to suppress evidence unlawfully seized. Wolf v. Colorado, 338 U. S. 25 (1949) ......................... 142

Separation of the races in the public schools of the District of Columbia is not prohibited by the Federal Constitution, provided that there is substantial equality of treatment. Carr v. Corning, 18 U. S. L. Week 2377 (D. C. Cir. Feb. 14, 1950) ........................................ 669

State corporate net income tax discriminates against securities of the United States because interest received on these securities is included in tax computation while that received on securities issued by the state is not included. Commonwealth v. Curtis Publishing Co., 69 A. 2d 410 (Pa. 1949) ......................... 488

Summary dismissals in pursuance of provisions of the federal loyalty program are constitutional. Bailey v. Richardson, 18 U. S. L. Week 243 (D. C. Cir. March 22, 1950) ........................................ 672

The action of a state court in rendering judgment for the amounts due under a contract previously required by the Federal Communications Commission to be given "no further effect" does not contravene the Supremacy Clause of Article VI of the United States Constitution. Regents of the University System of Georgia v. Carroll, 338 U. S. 586 (1950) ......................... 675

Stay of stockholder's derivative suit in federal district court conditioned on defendants' agreement to allow same rights of discovery in suit in state court on same cause of action as plaintiff would have in federal court. Motolese v. Kaufman, 176 F. 2d 301 (2d Cir. 1949) ........................................ 303

Two dismissal rule under Federal Rules of Civil Procedure is operative as an adjudication upon the merits though the defendants be not the same in both actions. Robertshaw-Fulton Co. v. Noma Electric Corp., 84 U. S. P. Q. 221 (D. Md. 1949) ........................................ 666

Constitutional Law
While a racial restrictive agreement may not be specifically enforced, breach of contract action based on the restrictive covenant, held not to violate the Fourteenth Amendment. Weiss v. Leaon, 225 S. W. 2d 127 (Mo. 1949) .... 678

Contracts

Veteran who makes contract of employment to include on-the-job training on the basis of representation by employer that it is an approved on-the-job training institution can recover from employer the amount of subsistence payments he would have received from the Federal Government if employer’s representation had been true. Sparks v. Cater Electrical Construction Co., 39 N. W. 2d 274 (Neb. 1949) .................................................. 311

Creditor's Rights

Treasury regulation providing that surviving beneficiary of United States savings bonds will be recognized as the sole and absolute owner of bonds was not intended to prevent a legal representative from pursuing in the interest of creditors the proceeds of bonds fraudulently transferred to a beneficiary without consideration. In re Laundree's Estate, 195 Misc. 754, 91 N. Y. S. 2d 482 (N. Y. 1949) .................................................. 314

Criminal Law

Actual physical presence of a quorum at the time of the statements is an essential element of the crime of perjury before a congressional committee. Christofel v. United States, 69 Sup. Ct. 1447 (1949) .................................................. 145

Criminal Procedure

United States Court of Appeals may reverse with orders for a new trial even though error consisted in refusal of District Court to grant motion for judgment of acquittal. Bryan v. United States, 338 U. S. 552 (1950) .................. 680

Equity

Writ of sequestration used to enforce order of court although action filed did not seek any monetary relief. Ippolito v. Ippolito, 71 A. 2d 196 (N. J. 1950) . 683

Evidence

Duly authenticated suicide note in which the author before committing suicide admitted certain embezzlements and implicated another is not admissible to inculpate defendant mentioned in the note. Commonwealth v. Antonini, 69 A. 2d 436 (Pa. 1949) .................................................. 490

Evidence seized in search of premises, incident to arrest by federal officers acting under valid arrest warrant, held inadmissible as violative of the Fourth Amendment where search warrant could have been obtained. United States v. Rabinowitz, 176 F. 2d 732 (2d Cir. 1949) .................. 150

Police officer's conduct indicating it would be better for the accused to tell the truth makes confession obtained thereby inadmissible. Edwards v. Maryland, 71 A. 2d 487 (Md. 1950) .................................................. 685

Selection of evidence by federal agent at scene of illegal search and seizure conducted by local police renders evidence inadmissible in federal prosecution. Lustig v. United States, 69 Sup. Ct. 1372 (1949) .................. 148

Testimony against an accused husband by a wife who is not the victim of the offense is inadmissible in a federal criminal proceeding. United States v. Walker, 176 F. 2d 564 (2d Cir. 1949) .................................................. 316

VI
INSURANCE

Under a clause in an automobile insurance policy binding the company to defend all actions against the insured, the company may investigate the case, and if satisfied that the case is not within the policy may refrain from defending the action against their insured. Farm Bureau Mutual Automobile Insurance Company v. Hammer, 18 U. S. L. Week 2168 (4th Cir. Oct. 3, 1949) 318

LABOR LAW

A labor union may peacefully picket the home of an employer with whom it has a labor dispute. Zeeman v. Amalgamated Retail and Department Store Employees' Union, 18 U. S. L. Week 2375 (Cal. Super. Ct. Feb. 1, 1950) 687

A mere ultimate objective classifiable under § 8(b)(4)(A) of the Labor Management Relations Act of 1947 will carry peaceful picketing from the category of protected "persuasive" speech into the banned classification of "coercive" speech, unprotected by the First Amendment or § 8(c) of the Act. I.B.E.W., Local 501 v. NLRB, 18 U. S. L. Week 2410 (2d Cir. Feb. 21, 1950) 689

United States Court of Appeals has sufficient discretion under the National Labor Relations Act to refuse a decree of enforcement of a board order in the absence of any showing whatever, based on reasonably recent inquiry, that a decree of court is appropriate or necessary. NLRB v. Banet, 18 U. S. L. Week 2211 (D. C. Cir. Oct. 31, 1949) 321

The trustees of a welfare and retirement fund created by a collective bargaining agreement may bring suit thereon as donee beneficiaries to recover money owed to the fund under the terms of the agreement. Lewis v. Jackson & Squires, Inc., 86 F. Supp. 354 (W. D. Ark. 1949) 492

MUNICIPAL CORPORATIONS


NEGLIGENCE

Vendor of land who promises to look after purchaser's interest and give good title is liable in negligence when purchaser relies on such promise and good title in fact is not given. Brunelle v. Nashua Building and Loan Ass'n, 64 A. 2d 315 (N. H. 1949) 152

United States held liable under foreseeability for tenant's death from typhus, while tenant was excused from liability as having no knowledge of the specific disease. State of Maryland v. Manor Real Estate & Trust Co., 176 F. 2d 414 (4th Cir. 1949) 497

NEGOTIABLE INSTRUMENTS

Purported release from liability for payment through inadvertence, accident or oversight, obtained by bank from depositor as condition of order to stop payment on check, is void for want of consideration. Michaels v. First National Bank of Scranton, 18 U. S. L. Week 2223 (Pa. C. P., Nov. 4, 1949) 499

PATENTS

On Rev. Stat. § 4915 action invention is a question of fact, and on appeal the decision of the District Court will not be overruled unless clearly erroneous; the appellate court must find clear evidence of creative genius to reverse. Standard Oil Development Co. v. Marzall, 84 U. S. P. Q. 363 (D. C. Cir. 1950) 692

VII
The rule that a patent claim is invalid if its language is too broad at the precise point of novelty does not apply to combination claims. Faulkner v. Gibbs, 70 Sup. Ct. 25 (1949) .................................................. 323

PUBLIC UTILITIES


SALES

Selection by a customer of an article from the retailer's shelves in a self-service store is insufficient to pass title to the article and at that point in transaction there is neither an executed sale nor an executory contract of sale. Lock v. Confair, 63 A.2d 24 (Pa. 1949) ...................................................... 155

STATUTES

The leased military base at Newfoundland is in a foreign country within the meaning of the Federal Tort Claims Act. United States v. Spelar, 70 Sup. Ct. 10 (1949) ................................................................. 501

TAXATION

Author's assignment to wife of one-half interest in unpublished manuscript is denied validity for federal income tax purposes. Wodehouse v. Comm'r Int. Rev., 4 P-H 1950 Fed. Tax Serv. ¶ 72,333 (4th Cir. 1949) ...................... 503

Income payable to parent corporation under “agency” contract with wholly-owned subsidiaries held taxable to subsidiaries where they manufacture and sell products for their own account and where the usual incidents of an agency relationship are not present. National Carbide Corp. v. Comm'r Int. Rev., 336 U. S. 422 (1949) ...................................................... 157

TORTS

A minor child has a cause of action against one enticing its parents from the family home to recover damages sustained as a result of the enticement. Miller v. Monsen, 37 N. W. 2d 543 (Minn. 1949) .................................................. 160

Attorney General of the United States, Director of the Enemy Alien Control Unit of the Department of Justice, and District Director of Immigration are immune from liability in a suit by an alien Frenchman whom they wrongfully arrested as an enemy alien, even if they acted from personal spite and malice. Gregoire v. Biddle, 18 U. S. L. Week 2203 (2nd Cir. Oct. 24, 1949) ................................................................. 327

Contrary to the common law of the state and without statutory change, Missouri courts divide libel into libel per se and libel upon proof of special damages; heresy charged to a clergyman is not necessary libel per se. Creekmore v. Runnels, 224 S. W. 2d 1007 (Mo. 1949) ...................... 506

Contribution allowed between concurrent tortfeasors who are not intentional wrongdoers although one or both may have been personally negligent. Knell v. Fellman, 174 F. 2d 662 (D. C. Cir. 1949) .................................................. 161

Federal Tort Claims Act permits action against the United States by executrix of serviceman who was killed through negligence of army surgeons while on active but not combat duty. Griggs v. United States, 178 F. 2d 1 (10th Cir. 1949) .................................................. 508

VIII
Liability of domestic carriers under the Carmack Amendment does not extend to shipments arising in a foreign country and intended for through shipment to a point within the United States. *Reider v. Thompson*, 176 F. 2d 13 (5th Cir. 1949) ................................................................. 330

Privately conducted religious and charitable institution is not entitled to any immunity from liability for negligent injury. *Foster v. Roman Catholic Diocese of Vermont*, 70 A. 2d 230 (Vt. 1950) ......................................................... 510

Viable child has cause of action for injuries inflicted prior to birth. *Williams v. Marion Rapid Transit, Inc.*, 87 N. E. 2d 334 (Ohio 1949) ................................................................. 332

**INDEX TO BOOK REVIEWS**

*Titles of books are in italics; names of authors are in capitals; reviewers' names are in plain face and in parentheses.*

*Conflict of Laws*—by HERBERT F. GOODRICH (Al. Philip Kane) ........................................ 336

*Current Legal Problems*—by GEORGE W. KEETON and GEORGE SCHWARZENBERGER (Thomas H. Wall) ................................................................. 513

*Language and the Law*—by FREDERICK A. PHILBRICK (Victor S. Mersch) ..................... 165

*Law and the Executive in Britain*—by BERNARD SCHWARTZ (Thomas H. Wall) .................. 337

*Legal Philosophy from Plato to Hegel*—by HUNTINGTON CAIRNS (Francis E. Lucey, S.J.) ........ 701

*Living Law and Democratic Society*—by JEROME HALL (Joseph M. F. Ryan, Jr.) ............... 515

*Monetary Theory and Fiscal Policy*—by ALVIN H. HANSEN (Sam L. Brown) .................. 339

*Patent Law*—by CHESTER H. BISTERFELD (Bartholomew A. Diggins) ......................... 164

*Relations Between the Federal and State Courts*—by MITCHELL WENDELL (Alexander Holtzoff) ........................................................................................................ 704

*Tax Planning for Estates*—by WILLIAM J. BOWE (John W. Ahern) ................................. 700

*The Case of General Yamashita*—by A. FRANK REEL (Leo A. Huard) ....................... 696

*The Case of General Yamashita—A Memorandum*—by COURTNEY WHITNEY (Leo A. Huard) ........................................................................................................ 696

*War Crimes Trial—Vol. II—The Belsen Trial*—1949—Published by William Hodge & Co. Ltd. (George A. Finch) ................................................................. 168

*What's Behind a Financial Statement*—by R. G. RANKIN (Richard B. Buhrman) ............. 519

IX
Administrative Law:
Air carrier routes...81
Delegation of power...1
Deportation proceedings...659
Fraudulent advertisement inducements prohibited...300
Jurisdiction to determine jurisdiction...368
Legislative counsel in Congress...277
Loyalty dismissals...672
Review by Circuit Court of Appeals of NLRB order...321
State enforces contract declared unenforceable by FCC...675
Tax Loopholes...620
Administrative Procedure Act:
Application to hearings...578
Effect on Administrative Law...575
Examiners required by...581
Protection of private parties under...578
Public information required by...575
Right to judicial review...584
Agency:
Bailee, bailor relationship under Automobile Financial Responsibility Laws...266
Shipping company's liability under Jones Act...131
Air Law:
Liability of carrier under Warsaw Convention...133
Alien Property:
Conflicting claims to German external assets...171
Automobile Financial Responsibility Laws:
Imputing bailee's contributory negligence under...262
Statutes: District of Columbia...264
Iowa...264
Minnesota...264
New York...264
Basing Point Price System:
Meaning of "price"...222
Significant FTC cases...203
The O'Mahoney Bill...200
Unfair methods of competition under §5, FTC Act...232
Various geographic pricing systems...202
Civil Procedure:
Diversity of citizenship...135
Forfeiture of appeal right under Federal Rules...662
Indispensable parties in action to compel declaration of dividends...664
Privilege against discovery under Federal Rules...302
Voluntary dismissal under Federal Rules...666
Writ of sequestration used to enforce injunction...683
Common Carrier:
D.C. passenger buses operating in interstate commerce...485
Constitutional Law:
Civil liberties...17
Commerce Clause...5
Delegation of power...1
Discrimination of state income tax on corporation...488
Diversity of jurisdiction...135
Freedom of speech...94
Full Faith and Credit Clause...126
Fundamental Rights in courts martial...521
Interstate commerce, D.C. passenger buses operating in...485
Interstate commerce, economic protective powers of states...590
Jurisdiction of administrative agencies...368
Loyalty dismissals...672
National Health Insurance Plan...248
Nationality Act of 1940...137
Peaceful picketing restricted...689
Police power arbitrarily exercised in zoning ordinance...494
Privileges and Immunities Clause, Proprietary Interest Doctrine...656
Process of exportation...307
Puerto Rico citizens, rights of...471
Racial discrimination by lessor...309
Racial restrictive agreements...678
Search and seizure...139, 148
Segregation of students...669
Seizure of evidence as incident to lawful arrest...150
State suppression of evidence unlawfully seized...142
Supremacy Clause...675
Taxing power of state...306
Uniform Code of Military Justice...521
Contracts:
Acceptance by correspondence...106
Donee beneficiaries' right to sue on labor contract...492
Enforcement of by state and which FCC declared "unenforceable"...675
Liability under representations...311
<p>| Promises as distinguished from representations .311 | Testimony of wife against husband, admissibility of.316 |
| Racial restrictive agreement, action for breach based on .678 | Federal Legislation: |
| Sales in self-service stores .155 | Civil Aeronautics Act. .81 |
| Vendor of land liable for negligence for failure to convey good title .152 | Jones Act. .131 |
| <strong>Contributory Negligence:</strong> | Legislative Reorganization Act of 1946 .145 |
| See Automobile Financial Responsibility Laws | National Health Insurance Plan .248 |
| <strong>Corporations:</strong> | Nationality Act of 1940 .137 |
| Declaration of dividends, minority shareholders right to compel .664 | O'Mahoney Bill .200 |
| Eleemosynary institutions, tort liability of .510 | See Federal Tort Claims Act |
| See Point Four Program | Tax loopholes .620 |
| State income taxes on .88 | Federal Rules of Civil Procedure: |
| Taxation of income payable to parent corporation under agency contract .157 | Diversity Jurisdiction .128 |
| <strong>Creditor’s Rights:</strong> | Privilege against discovery of FBI files .302 |
| Bond’s beneficiary made creditor’s trustee .314 | Federal Tort Claims Act: |
| <strong>Criminal Law:</strong> | Foreign country, what constitutes .501 |
| Perjury before Congress .145 | Foreseeability, duty to foresee death from typhus .497 |
| Rules of proof employed by federal appellate courts .285 | Landlord’s obligation to keep premises safe .497 |
| <strong>Criminal Procedure:</strong> | Negligence of Army surgeons .508 |
| New trial under Federal Rule 29 .680 | <strong>Insurance:</strong> |
| Testimony, Federal Rules on .317 | Previous negligence actions .318 |
| <strong>Damages:</strong> | Subrogation .646 |
| Child’s right of, when parent enticed from home .160 | <strong>International Law:</strong> |
| Motor vehicle, loss of use .635 | Warsaw Convention, air carrier’s liability .133 |
| <strong>Domestic Relations:</strong> | Interstate Commerce: |
| Child’s right of action when parent enticed from home .160 | Air carriers .91 |
| <strong>Equity:</strong> | Direct and indirect burdens on .590 |
| Writ of sequestration used to enforce injunction .683 | D.C. passenger buses operating in .485 |
| <strong>Evidence:</strong> | Liability of domestic carriers under Carmack Amendment .330 |
| Analysis of questioned documents .385 | State exercise of police power affecting .603 |
| Confession, admissibility of .685 | State regulation of .590 |
| Illegal search and seizure by state, use in federal courts .148 | <strong>Labor Law:</strong> |
| Privilege against testimony by wife .316 | Decree of enforcement of NLRB order .321 |
| Reasonable hypothesis rule .288 | Discretion of Circuit Court of Appeals to review NLRB order .321 |
| Rule of proof employed by federal appellate courts in reviewing criminal convictions .285 | Picketing of employer’s home .687 |
| Seizure in lawful arrest, no search warrant .150 | Suit on collective bargaining agreement .492 |
| Substantial evidence rule .293 | Taft-Hartley Act, right to picket restricted by .689 |
| Suicide note, admissibility of .490 | <strong>Landlord-Tenant:</strong> |
| <strong>Test Topical Index</strong> | Obligation of landlord for safety of premises .497 |
| <strong>ALL REFERENCES ARE TO PAGE NUMBERS</strong> | <strong>Municipal Corporations</strong> |
| <strong>Promises as distinguished from representations .311</strong> | Restriction of public parking lots in fringe area .494 |
| <strong>Racial restrictive agreement, action for breach based on .678</strong> | <strong>Test Topical Index</strong> |
| <strong>Sales in self-service stores .155</strong> | <strong>ALL REFERENCES ARE TO PAGE NUMBERS</strong> |</p>
<table>
<thead>
<tr>
<th>Negligence:</th>
<th>Public Utilities:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assumption of risk distinguished from contributory negligence .497</td>
<td>Air carrier routes .89</td>
</tr>
<tr>
<td>Contribution between concurrent tortfeasors .161</td>
<td>Electric and gas cannot be combined under Act of 1935 .325</td>
</tr>
<tr>
<td>Foreseeability, duty to foresee death from typhus .497</td>
<td>Real Property:</td>
</tr>
<tr>
<td>Insurer not bound to defend previous acts of .318</td>
<td>Negligence action for failure to convey &quot;sufficient&quot; title .152</td>
</tr>
<tr>
<td>Vendor of land liable for, in failure to convey good title contracted for .152</td>
<td>Racial discrimination by lessor .309</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Negotiable Instruments:</th>
<th>Robinson-Patman Act:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank's liability after stop-payment order .499</td>
<td>Application to Basing Point Delivered Price .202</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Patent Law:</th>
<th>Sales:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Combination of claims in infringement suits .323</td>
<td>Passing of title in self-service stores .155</td>
</tr>
<tr>
<td>Invention a question of fact .692</td>
<td>Taxation:</td>
</tr>
<tr>
<td>Requirement of novelty in combination claims .323</td>
<td>Income tax avoidance by assignment .503</td>
</tr>
<tr>
<td>Review in interference proceedings .400</td>
<td>Payments to parent corporation under agency contract .157</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>&quot;Point Four&quot; Program:</th>
<th>Process of exportation .306</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Corporations, resident and non-resident .50</td>
<td>See &quot;Point Four&quot; Program</td>
</tr>
<tr>
<td>Holding Company and Securities Acts .65</td>
<td>State income tax on corporations .488</td>
</tr>
<tr>
<td>Private investments in foreign operations .74</td>
<td>Tax loopholes .620</td>
</tr>
<tr>
<td>Taxation on foreign earnings .47</td>
<td>Torts:</td>
</tr>
<tr>
<td>Trusts in relation to foreign operations .59</td>
<td>Bailee's contributory negligence, Automobile Financial Responsibility Laws .262</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Price Discrimination:</th>
<th>Child's right of action when parent enticed from home .160</th>
</tr>
</thead>
<tbody>
<tr>
<td>See Basing Point Price Systems</td>
<td>Contribution between concurrent tortfeasors .161</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Procedure:</th>
<th>Eleemosynary institutions, liability of .510</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diversity jurisdiction .115</td>
<td>Heresy, libel per se or per quod .506</td>
</tr>
<tr>
<td>In Congressional investigations .343</td>
<td>Immunity of governmental officials .327</td>
</tr>
<tr>
<td>Rules of proof employed by federal appellate courts in reviewing criminal convictions .285</td>
<td>Liability of domestic carriers under Carmack Amendment .330</td>
</tr>
<tr>
<td>Suggested rules for Congressional committees .363</td>
<td>Motor vehicle, loss of use .635</td>
</tr>
<tr>
<td>The Uniform Code of Military Justice .521</td>
<td>Pre-natal injuries, right to sue .332</td>
</tr>
<tr>
<td>Trial, Due Process Clause .97</td>
<td>See Federal Tort Claims Act</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Trusts:</th>
<th>Unfair Competition:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor welfare and retirement fund, as trust .492</td>
<td>Methods under § 5 of FTC Act .232</td>
</tr>
<tr>
<td>See &quot;Point Four&quot; Program</td>
<td></td>
</tr>
</tbody>
</table>
NOTES ON DEVELOPMENTS IN CONSTITUTIONAL LAW, 1936-1949

By Charles Fahey*

It is more than twelve years since President Roosevelt sent to Congress his famous message designed to bring legislation to change the composition of the Supreme Court by enlarging its number upon an incumbent reaching the age of seventy without retiring. In the intervening period no member of the Court of the winter of 1937 remains there; one only, Owen J. Roberts, is alive, in retirement from judicial labors though active in other public affairs. The Court today is composed of five appointees of President Roosevelt—Justices Black, Reed, Frankfurter, Jackson, and Douglas, and four of President Truman—Chief Justice Vinson and Justices Burton, Clark, and Minton. Until the recent sad deaths of Justices Murphy and Rutledge, seven members of the Court were appointed by President Roosevelt, and this number doubtless would have been eight except that Justice Byrnes, appointed by President Roosevelt in 1941, resigned at the President’s request, October 3, 1942, to aid the Chief Executive in the active conduct of the war. Yet from the time he first took his oath as President on March 4, 1933, until the retirement of Justice Van Devanter on June 2, 1937, President Roosevelt had no opportunity to fill a single

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vacancy on the Court. It was during this period of about four years that a divided Court struck down as unconstitutional numerous far reaching acts of Congress and several important acts of state legislatures.

I have been asked to review the changes, particularly in constitutional law, under decisions of the Court during recent years, and to compare the situation today with that which existed when the Court met for the October 1936 term which ended in June 1937. To undertake such a study in detail is a more formidable task than I am willing to attempt. A review of the more salient developments with some comments upon them is alone the purpose of this article.

I.

The change may be described in general terms as a greater receptivity by the Court to the validity of the exercise by legislative bodies of a discretion in adopting measures to cope with economic and social problems, and a willingness to use the judicial process more often in the protection traditionally accorded by the Supreme Court to individuals under the Bill of Rights. The change may also be described generally as a movement of the Court as a whole from "conservatism" to "liberalism"; so that notwithstanding continued sharp and close divisions, these are within a Court which as a whole must be considered in most matters as having moved to a more liberal position. This has occurred at a time when the political climate of the country has moved in the same direction, and when greater strength has come to reside in practice as well as in theory in the people, including organized labor and farmers. The great liberal decisions and dissents of an earlier era were, therefore, more noteworthy. The dissents of Justices Holmes, Hughes, and Day in Coppage v. Kansas,¹ and of Brandeis and Holmes in the Bedford Stonecutters’ case,² as examples, were more directly in opposition to the pervading views of the times. This sort of casual delving into the past, however, is beside the principal point. Suffice it to say that when the autumn of 1936 came to Washington and brought the Court back to begin a new term, its more conservative members no doubt looked with pride upon the Court’s recent record and viewed it with a tranquility which was unaware of forces which would soon de-

² 236 U.S. 1 (1915).
stroy both record and tranquility. No doubt other members of the Court, including Chief Justice Hughes, were troubled by this recent record and by the part the Court was playing in the momentous years through which the nation was passing. A remarkable series of steps of the executive and legislative branches of the Government had been undertaken in a responsible effort to cope with a great national crisis. This program was designed to benefit the people as a whole, business, farming, and laboring. The steps taken included the National Industrial Recovery Act, the Agriculture Adjustment Act, the Wagner Act, the Security and Exchange Commission Act, the Bituminous Coal Conservation Act, the legislation on gold clauses in public and private contracts, the Public Utilities Holding Company Act, the Tennessee Valley Authority Act, the Railroad Retirement Act, and in the states the Minnesota Farm Moratorium Act and the New York Milk Control Board Act, to mention some of the important parts of a massive legislative program. Soon to follow were the Social Security Act, the Fair Labor Standards Act, and others. Each was subjected to the scrutiny and possible veto power of the third great branch of the Government. The immediate and effective operation of this legislative program was hampered by an onslaught of constitutional litigation. Uncertainty and tensions mounted as the Court began to dominate the scene, and these uncertainties and tensions were sharpened by the close divisions within the Court itself and by the nature of those divisions as the Court began to speak as the final authority on the question whether or not these statutes were permissible under the Constitution.

When the Court reconvened in October 1936, it had already stricken down the following:

13 Minn. Laws 1933, c. 335.
14 N. Y. Laws 1933, c. 158.
Section 9(c), the "hot oil" provision of the National Industrial Recovery Act\(^\text{17}\)

The Railroad Retirement Act\(^\text{18}\)
The Frazier-Lemke Act\(^\text{19}\)
The National Industrial Recovery Act\(^\text{20}\)
The Agricultural Adjustment Act of 1933\(^\text{21}\)
The Bituminous Coal Conservation Act\(^\text{22}\)
The Municipal Bankruptcy Act\(^\text{23}\)
The New York Minimum Wage Law for Women.\(^\text{24}\)

This latter wielding of its power in the *Tipaldo* case against a state minimum wage law brought the country to a realization of how far the Court was going in rendering constitutional decisions of such doubtful correctness as to evoke the most vigorous and strongly reasoned protest from the Chief Justice of the United States, Hughes, and Justices Brandeis, Stone, and Cardozo. As Justice Stone said:

"There is grim irony in speaking of the freedom of contract of those who, because of their economic necessities, give their services for less than is needful to keep body and soul together. But if this is freedom of contract no one has ever denied that it is freedom which may be restrained, notwithstanding the Fourteenth Amendment, by a statute passed in the public interest."\(^\text{25}\)

The majority had said:

"The decision and the reasoning upon which it rests clearly show the state is without power by any form of legislation to prohibit change or nullify contracts between employers and adult women workers as to the amount of wages to be paid."\(^\text{26}\)

Chief Justice Hughes in his own dissent said in part:

"We have had frequent occasion to consider the limitations of liberty of contract. While it is highly important to preserve that liberty from arbitrary and capricious interference, it is also necessary to prevent its abuse, as otherwise it could be used to override all public interests and thus in the end destroy the very freedom of opportunity which it is designed to safeguard."

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\(^{17}\) Panama Refining Co. v. Ryan, 293 U.S. 388 (1935).
\(^{23}\) Ashton v. Cameron County Dist., 298 U.S. 513 (1936).
\(^{25}\) *Id.* at 632.
\(^{26}\) *Id.* at 611.
"We have repeatedly said that liberty of contract is a qualified and not absolute right. 'There is no absolute freedom to do as one wills or to contract as one chooses. . . . Liberty implies the absence of arbitrary restraint, not immunity from reasonable regulations and prohibitions imposed in the interests of the community.'"

Joining in the dissent of Chief Justice Hughes were Justices Brandeis, Stone, and Cardozo. Justice Stone's separate dissent was also joined by Justices Brandeis and Cardozo.

President Roosevelt was re-elected in November 1936, shortly after the Court reconvened. His legislative proposal for enlargement of the Court was sent down to Congress February 5, 1937. On June 2, 1937, at the end of the term, Mr. Justice Van Devanter retired, giving President Roosevelt his first appointment, which he exercised in favor of Senator Hugo L. Black.

In the meantime, during as dramatic a period of inter-governmental contest as has ever occurred in times of peace, a transition began. It is not sufficient to describe it as a change in constitutional interpretation compared with the immediately preceding period. It should also be described as a change in the balance of power.

II.

One of the principal focal points involved the interpretation of the Commerce Clause. In enlarging the power of permissible exercise by Congress over commerce the Court shifted the balance of power within our governmental structure. The Court permitted a larger exercise of Congressional power by restraining the exercise of its own power. At the same time, this naturally diminished the control by private enterprise permitted by Court decisions which had stricken down attempted governmental regulation.

The above is well illustrated by the history of such legislation as the Fair Labor Standards Act. I do not now discuss the constitutional basis for the Act but note that the effect of the decision of the Supreme Court upholding its validity was to shift to Congress the power which private enterprise had long enjoyed. Prior to the Act, plant A fixed the wages and hours of its employees. In effect the Supreme Court had decided in 1918 that Congress could not do so. The Court by the exer-

27 Id. at 627.
29 Hammer v. Dagenhart, 247 U.S. 251 (1918); Adkins v. Children's Hospital, 261 U.S. 525 (1923).
cise of its own power had defeated the attempt by Congress to control this vital area of influence upon the standard of living, the health, and the general well-being of the country. While, therefore, such decisions as United States v. Darby,\(^{30}\) wherein the Court expressly overruled Hammer v. Dagenhart\(^{31}\) and sustained the Fair Labor Standards Act of 1938, are, from a lawyer's standpoint, properly described as cases interpreting the Commerce Clause, yet through the medium of such interpretation power is transferred from private industry to the federal legislature, and by that body the power is delegated in considerable degree to the executive and to the courts. True, certain power resided in the states, but inaction must be attributed in part to such decisions as Adkins v. Children's Hospital,\(^{32}\) hereinafter considered under Due Process, until it was overruled by West Coast Hotel Co. v. Parrish.\(^{33}\)

It might be said that it is hardly accurate to imply that control of wages and hours was in the hands of private industry without noting that collective bargaining and the power of unions brought their influence to play upon the scale of such wages and hours. This is quite true. But the degree to which collective bargaining and the strength of unions affected minimum wages and maximum hours serves primarily to emphasize the inequities which existed, and to point to the need for legislation rather than to demonstrate that these elements constituted adequate means of bringing about the desired conditions. It must also be noted that exceedingly strong forces were opposed to the Wagner Act and by sustained opposition to it sought to weaken the power of unions and of collective bargaining in influencing the wage scale and the length of the working day. The primary effect of the Darby decision accordingly was to shift power from private industry to Congress.

The constitutional argument itself in such cases was not made in the above terms; properly the legal question had to do with the relationship of the Act's regulations to interstate and foreign commerce, considered with regard to our dual system of government and the reservation to the states of authority not granted to the Federal Government. Was the relationship of wages and hours to interstate traffic in the goods of employees engaged in their production sufficiently significant to permit Congress to regulate such wages and hours as a regulation of

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\(^{30}\) 312 U.S. 100 (1941).
\(^{31}\) 247 U.S. 251 (1918).
\(^{32}\) 261 U.S. 525 (1923).
\(^{33}\) 300 U.S. 379 (1937).
such commerce? Or, under our dual system of sovereignty, did these matters pertain so predominantly to local affairs as properly to be left for the states alone? In the Schechter case, the attempted regulation of working conditions of employees there engaged in retail sales was held an overextended attempt by Congress to reach local affairs under the guise of the Commerce Clause; that this offended the dual system; and also that there was an excessive delegation to the executive. In the latter respect the statute was held to offend the latent constitutional principle that the laws are to be made by Congress, under the legislative power granted by Article I of the Constitution, and not left to be made into "codes" by executives.

There are well defined distinctions between the Schechter and Darby cases on the interstate commerce question, aside from the absence in the latter of a troublesome question of delegation. The statute involved in the Darby case was carefully worded to apply to employees engaged in interstate commerce or in the production of goods for such commerce, and the legislation took hold of the interstate commerce itself. It was not left in its application to depend upon effects on interstate commerce assumed or to be proved.

When in the Darby case the Court overruled Hammer v. Dagenhart, no Justice who participated dissented. The Court then consisted of eight members, Justice McReynolds having retired on the Saturday before the Monday on which the opinion was delivered by Justice Stone. Hammer v. Dagenhart was decided in 1918. It was twenty years later before Congress sought again to do in substance what the Supreme Court had said it could not do. The significance of the "power" aspect

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35 A few months earlier the Court for the first time in its history had invalidated a legislative act upon the ground that it delegated legislative authority to the executive. This occurred in the so called "hot oil case," Panama Refining Co. v. Ryan, 293 U.S. 388 (1935). Theretofore, the Court, when a challenge of this nature to legislation had been before it, had consistently held the standards laid down by Congress for the guidance of the executive in the particular statute to be a sufficient exercise of legislative authority by Congress, notwithstanding the fact that the details were to be filled in by the executive. E.g., Field v. Clark, 143 U.S. 649 (1892). Mr. Justice Cardozo wrote a brilliant and, to me, persuasive dissent in the Panama case, treading his way alone.
36 Justice McReynolds joined in 1918 with Chief Justice White and Associate Justice Day, who wrote the majority opinion, and with Justices Van Devanter and Pitney to invalidate the Act of Congress involved in Hammer v. Dagenhart, which prohibited inter-state commerce in products of child labor. The four dissenters were Justice Holmes, who wrote the dissent, and Justices McKenna, Brandeis, and Clarke.
of such decisions is thus well illustrated. It is probably true that for twenty years a large measure of inadequate wage standards were permitted to exist because the Supreme Court in holding the earlier congressional act unconstitutional had by the exercise of its own power left Congress stripped of effective authority which it had sought to exercise and had left the exertion of power in this respect primarily in private hands. And this occurred in the face of the following statement in Mr. Justice Stone's opinion in the Darby case:

"... Whatever their motive and purpose, regulations of commerce which do not infringe some constitutional prohibition are within the plenary power conferred on Congress by the Commerce Clause. Subject only to that limitation, presently to be considered, we conclude that the prohibition of the shipment interstate of goods produced under the forbidden substandard labor conditions is within the constitutional authority of Congress.

"In the more than a century which has elapsed since the decision of Gibbons v. Ogden, these principles of constitutional interpretation have been so long and repeatedly recognized by this Court as applicable to the Commerce Clause, that there would be little occasion for repeating them now were it not for the decision of this Court twenty-two years ago in Hammer v. Dagenhart, 247 U. S. 251. In that case it was held by a bare majority of the Court over the powerful and now classic dissent of Mr. Justice Holmes setting forth the fundamental issues involved, that Congress was without power to exclude the products of child labor from interstate commerce. The reasoning and conclusion of the Court's opinion there cannot be reconciled with the conclusion which we have reached, that the power of Congress under the Commerce Clause is plenary to exclude any article from interstate commerce subject only to the specific prohibitions of the Constitution. . . .

"The conclusion is inescapable that Hammer v. Dagenhart, was a departure from the principles which have prevailed in the interpretation of the Commerce Clause both before and since the decision and that such vitality, as a precedent, as it then had has long since been exhausted. It should be and now is overruled."37

Another decisive set of precedents is found in the Labor Board Cases,38 decided April 12, 1937, before the end of the fateful October 1936 term. These decisions were rendered by the unchanged Court, in the midst of the controversy over the President's legislative proposals. During the years immediately following these first Labor Board decisions, the scope of the commerce power was further discussed and elaborated in Santa Cruz Fruit Packing Co. v. National Labor Relations Board,39 National Labor Relations Board v. Fain-

37 312 U.S. 100, 115 (1941).
38 301 U.S. 1 (1937).
39 303 U.S. 453 (1938).
and Consolidated Edison Company v. National Labor Relations Board. The Santa Cruz and Fainblatt cases, particularly the latter, find frequent reference in Darby. In the clear language of Justice Stone the opinion in the Fainblatt case expresses perhaps as well as any delivered up to that time the Court's view of the breadth of the commerce power, and its rejection of abstract conceptions of what is local as a barrier to the exercise of power by Congress where in fact interstate commerce is involved to a significant degree. The case is interesting also in its reference to the maxim de minimis, I believe for the first and perhaps only time in a constitutional decision. The rationale of the constitutional basis of the Labor Act was restated:

“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 consequent upon strikes and labor disputes 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. National Labor Relations Board v. Jones & Laughlin Steel Corp., 301 U. S. 1, 38-40; National Labor Relations Board v. Fraehauf Trailer Co., 301 U. S. 49; National Labor Relations Board v. Friedman-Harry Marks Clothing Co., 301 U. S. 58; Santa Cruz Packing Co. v. National Labor Relations Board, 303 U. S. 453, 463 et seq.; cf. Consolidated Edison Co. v. National Labor Relations Board, 305 U. S. 197.”

As to the argument that the quantity of commerce was relatively small the Court concluded its discussion as follows:

“Examining the Act in the light of its purpose and of the circumstances in which it must be applied we can perceive no basis for inferring any intention of Congress to make the operation of the Act depend on any particular volume of commerce affected more than that to which courts would apply the maxim de minimis.”

41 305 U.S. 197 (1938).
42 This reference may be traced to a question asked of counsel during argument as to whether he thought the Labor Act applied to a pants presser who received and returned one pair of pants across the state line. Counsel replied that he thought the Act did not apply to such a situation because he supposed the rule de minimis had application to the Commerce Clause as well as to other areas of the law.
44 Id. at 607. The de minimis argument had a different development under the special
In the constitutional Labor Board Cases, as elaborated by the Chief Justice in Jones & Laughlin, Santa Cruz Fruit Packing Co., and Consolidated Edison Co., and by Justice Stone in Fainblatt, any change over previous decisions under the commerce power is not acknowledged by the Court as was done of course when Hammer v. Dagenhart was overruled. The majority consisted of Chief Justice Hughes and Justices Brandeis, Stone, Roberts, and Cardozo. No change in the membership of the Court had occurred since the appointment of Justice Cardozo by President Hoover in 1932. The Court treated the question as involving a new application of established principles. It is well worth recalling some of Chief Justice Hughes' language, such as the following from Santa Cruz Fruit Packing Co.:

"The power of Congress extends... to the protection of that interstate commerce from burdens, obstructions, and interruptions, whatever may be their source. Second Employers' Liability Cases, 223 U. S. 1, 51. The close and intimate effect which brings the subject within the reach of federal power may be due to activities in relation to productive industry, although that industry when separately viewed is local. It is upon this wellesestablished principle that the constitutional validity of the National Labor Relations Act has been sustained. National Labor Relations Board v. Jones & Laughlin Steel Corporation, 301 U. S. 1, 38. . . .

"It is also clear that where federal control is sought to be exercised over activities which separately considered are intrastate, it must appear that there is a close and substantial relation to interstate commerce in order to justify the federal intervention for its protection. However difficult in application, this principle is essential to the maintenance of our constitutional system. The subject of federal power is still 'commerce,' and not all commerce but commerce with foreign nations and among the several States. The expansion of enterprise has vastly increased the interests of interstate commerce, but the constitutional differentiation still obtains. Schechter Poultry Corporation v. United States, 295 U. S. 495, 546. 'Activities local in their immediacy do not become interstate and national because of distant repercussions.' Id., p. 554.

"To express this essential distinction, 'direct' has been contrasted with 'indirect,' and what is 'remote' or 'distant' with what is 'close and substantial.' Whatever terminology is used, the criterion is necessarily one of degree and must be so defined. This does not satisfy those who seek for mathematical or rigid formulas. But such formulas are not provided by the great concepts of the Constitution such as 'interstate commerce,' 'due process,' 'equal protection.' In maintaining the balance of the constitutional grants and limitations, it is inevitable that we should define their applications in the gradual process of inclusion and exclusion."45

45 303 U.S. 453, 463 (1938).

Then follows the Chief Justice's restatement of his theory of a dividing line:

"The direct relation of the labor practices and the resulting labor dispute in the instant law to interstate commerce and the injurious effect upon that commerce are fully established."46

My own view was at the time and is now that the Labor Board Cases constituted no departure from the past, unless the very recent past, and that indeed they were distinguishable from the Carter Coal case.47 The principles laid down in earlier cases, cited and quoted from in detail in the Labor Board Cases, seemed directly applicable. The contention that "manufacturing is not commerce", "mining is not commerce", gathered from earlier decisions had no relevancy when the burdens and obstructions to the interstate commerce itself were the constitutional hinges of the law. It also needs to be said, however, that these cases did bring about a broader application of old principles than had previously occurred.

The nearest approach to an equally extensive application of the control of local activities because of their relation to interstate activities is the Shreveport Rate Cases,48 in which Hughes as Associate Justice delivered the opinion of the Court. The Sherman Act49 is in terms also quite broad but in method of administration as well as in terms has actually not been applied in such widespread fashion,50 and the important decisions under the Packers & Stockyards Act of 1921,51 and other enactments under the commerce power dealing with particular problems have had a limited scope of practical application of the principles upon which they rely. It should be added, of course, that in the Labor Board Cases the sufficiency of the relationship of the forbidden practices to interstate commerce was the critical constitutional question under the Commerce Clause. One judge might see that relationship as sufficiently close to permit the exercise of federal power. Another might not. All that enters into such a decision is unknown. One's conception of what should be left to the states, or of private vis-a-vis

46 Id. at 468.
48 234 U.S. 342 (1914).
public, regulation of labor relations, might also unconsciously affect the legal decision. All that can be said with certainty is the obvious, that the majority saw a close enough relationship in the *Labor Board Cases*, bolstering their conclusion with the strongest practical arguments and illustrations drawn from the area of industrial disputes and their impact upon the commerce in question. Chief Justice Hughes referred to the “close and intimate” relation; he said it was a matter of degree—this direct or “close and substantial” relation. In determining whether the challenged application of the commerce power would “effectually obliterate the distinction between what is national and what is local and create a completely centralized government,”52 the question “is necessarily one of degree”.

The same question confronted the Court in new factual circumstances in *Wickard v. Filburn*.54 Justices Van Devanter, McReynolds, Butler, and Sutherland were no longer there. The Court was called upon to consider the validity under the Commerce Clause of federal regulation of the marketing of wheat under the Agricultural Adjustment Act of 1938. The Court pointed out that in view of the *Darby* case, there would be little difficulty “except for the fact that this Act extends federal regulation to production not intended in any part for commerce but wholly for consumption on the farm.”55 It is not possible in short compass to give the full flavor of this opinion of the Court written by Justice Jackson. It contains a review in somewhat broad lines of the scope of application of the Commerce Clause in the hands of the Supreme Court, beginning with the “breadth never yet exceeded” as the Court in 1942 referred to Marshall’s description of the reach of the clause in *Gibbons v. Ogden*,56 the long period of inactivity by Congress in exercising the power; the decisions concurrent with this period involving the validity of state regulation challenged as in conflict with the dormant federal power over interstate commerce; then the awakening by Congress to the need for its exercise.

“It was not until 1887, with the enactment of the Interstate Commerce Act that the interstate commerce power began to exert positive influence in American law and life.”57

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52 301 U.S. 1, 38 (1937).
53 Id. at 42.
54 317 U.S. 111 (1942).
55 Id. at 118.
56 9 Wheat. 1, 194 (1824).
57 317 U.S. 111, 121 (1942).
The Sherman Act followed. With respect to it, Justice Jackson's words are:

"When it first dealt with this new legislation, the Court adhered to its earlier pronouncements, and allowed but little scope to the power of Congress. United States v. E. C. Knight Co., 156 U. S. 1."58

Then follows this significant comment on more recent cases:

"These earlier pronouncements also played an important part in several of the five cases in which this Court later held that Acts of Congress under the Commerce Clause were in excess of its power...",59 referring in a footnote to First Employers' Liability Cases,60 Hammer v. Dagenhart,61 Railroad Retirement Board v. Alton R. R.,62 Schechter Poultry Corp. v. United States,63 and Carter v. Carter Coal Co.64

The Justice then points out, however, that during the period of the above decisions other cases giving greater scope to the Commerce Clause were decided, such as Swift Co. v. United States,65 Northern Securities Co. v. United States,66 Loewe v. Lawlor,67 Second Employers' Liability Cases.68 Then he refers to the extremely important Shreveport Rate Cases, as to which he comments:

"The Court's recognition of the relevance of the economic effects in the application of the Commerce Clause... has made the mechanical application of legal formulas no longer feasible."69

The significance of this opinion, in relation, for example, to the Carter Coal Company case, and to the history of the Commerce Clause, is that it redefined and steadied the status of the clause in the Supreme Court. "Indirect" or "direct" effect was no longer the necessary criterion. The "close and substantial" relation to interstate commerce of the local activity was sufficient; indeed, as Justice Stone's opinion

58 Id. at 122.
59 Ibid.
60 207 U.S. 463 (1908).
61 247 U.S. 251 (1918).
63 295 U.S. 495 (1935).
64 298 U.S. 513 (1936).
65 196 U.S. 375 (1905).
66 193 U.S. 197 (1904).
67 208 U.S. 274 (1908).
68 223 U.S. 1 (1912).
69 317 U.S. 111, 123 (1942).
in the *Wrightwood Dairy Co.* case\(^{70}\) had stated, the local activities need have only such effect:

"... as to make regulation of them appropriate means to the attainment of a legitimate end, the effective execution of the granted power to regulate interstate commerce ... the reach of that power extends to those intra-state activities which in a substantial way interfere with or obstruct the exercise of the granted power."\(^{71}\)

The Jackson opinion makes more specific the sufficiency of the economic effect of local activity on interstate commerce to bring the former within the reach of federal power over commerce:

"Whether the subject of the regulation in question was 'production', 'consumption', or 'marketing' is, therefore, not material for purposes of deciding the question of federal power before us."\(^{72}\)

*Wickard v. Filburn* goes beyond the Labor Board cases not in principle but in a willingness to apply principles previously established to a new and seemingly extensive area. Yet the national scope of the effects of wheat marketing and of the price and movement of wheat, which lay at the root of the regulation even of its local use, brought the subject well within the Marshall notion of "commerce which affects more states than one." Coming within this phase itself is a step in bringing within a broadly expressed power all that in reason is appropriate to its exercise.

Other cases should be mentioned\(^{73}\) but enough has been said to illustrate all that I want to conclude. The great advance was to return to the principles of earlier cases and to give these principles broad application in new forms of legislation. The inclusion within the commerce power of local activities affecting interstate activities had been the chief development in principle, but the newly composed Court was not its author. The great contribution of the transition period was to permit Congress to make greater use of this principle, to eliminate the fictitious character of the relationship between local and national involved by the use of "direct" and "indirect" concepts, to give proper scope to the economic relationship between local and national activities,

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and by overruling *Hammer v. Dagenhart* to remove the barrier created in 1918 to the proper exercise by Congress of its power over the actual movement of goods in interstate commerce, notwithstanding that the reason for the exercise of control is not the harmful character of the goods, intrinsically, but the harmful character of the manner of their making.

The change in trend of decision might be traced a few years to indicate the differences which occurred. Some of the statutes which had fallen at the hands of the Court were amended and sustained in their new form. No effort, however, was made to resuscitate the National Industrial Recovery Act. The Agricultural Adjustment Act was amended in 1938, with emphasis upon the regulation of marketing rather than of production; and was sustained in its wheat marketing provision in *Wickard v. Filburn*. Earlier the tobacco marketing provisions of the same Act had been sustained in *Mulford v. Smith*,\(^74\) decided in 1939. The Bituminous Coal Conservation Act, invalidated in the *Carter* case, was upheld (in amended form) in *Sunshine Coal Co. v. Adkins*.\(^75\) The regulation of "hot oil" was placed in a separate statute\(^76\) carefully drawn, and in its amended form has easily stood the test of time and constitutionality.

III

Other decisions, not under the Commerce Clause, should be mentioned to give a somewhat fuller view of developments in the light of earlier reference in this article to the cases which decided against legislative enactments.

The Frazier-Lemke Act\(^77\) was revised and reenacted. On March 29, 1936, the new act was sustained in *Wright v. Vinton Branch*.\(^78\) The Social Security Act, in its provisions for unemployment compensation and old age benefits, stricken down by the Circuit Court of Appeals for the First Circuit, was sustained in two decisions toward the end of the term, May 24, 1937. In *Carmichael et al v. Southern Coal & Coke Co.*,\(^79\) Justice Stone for himself and the Chief Justice, and

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\(^74\) 307 U.S. 38 (1939).
\(^75\) 310 U.S. 381 (1940).
\(^78\) 300 U.S. 440 (1937).
\(^79\) 301 U.S. 495 (1937).
Justices Brandeis, Roberts and Cardozo, upheld the Unemployment Compensation Act of Alabama, which was meshed with the federal Social Security Act; and in *Steward Machine Co. v. Davis*, Justice Cardozo for the same majority wrote the opinion upholding the federal tax imposed by the Social Security Act. In *Helvering v. Davis*, decided the same day, the provisions of the federal act relating to old age pensions were upheld. The Court said:

"Congress may spend money in aid of the 'general welfare'. Constitution, Art. I, § 8; *United States v. Butler*, 297 U. S. 1, 65; *Steward Machine Co. v. Davis*, supra. There have been great statesmen in our history who have stood for other views. We will not resurrect the contest. It is now settled by decision. *United States v. Butler*, supra. The conception of the spending power advocated by Hamilton and strongly reinforced by Story has prevailed over that of Madison, which has not been lacking in adherents."

Speaking of the choice of the manner in which the conceded power might be exercised the Court said:

"The discretion belongs to Congress, unless the choice is clearly wrong, a display of arbitrary power, not an exercise of judgment. . . . Nor is the concept of the general welfare static. Needs that were narrow or parochial a century ago may be interwoven in our day with the well-being of the nation. What is critical or urgent changes with the times."

It was only a few months before; January 6, 1936, that *United States v. Butler* had been decided. In the *Butler* case the Court had said for the first time in our history that the General Welfare Clause constituted a separate grant to Congress of a power to provide for the general welfare in addition to the other enumerated grants in the Constitution.

"It results that the power of Congress to authorize expenditure of public moneys for public purposes is not limited by the direct grants of legislative power found in the Constitution."

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80 301 U.S. 548 (1937).
81 301 U.S. 619 (1937).
82 *Id.* at 640.
83 *Ibid*.
84 297 U.S. 1 (1936). It was in this case that the Court held the Agricultural Adjustment Act of 1933 to be invalid because it was said to constitute a regulation of production, a local activity.
86 297 U.S. 1, 66 (1936).
But the Court, in rendering invalid the Agricultural Adjustment Act of 1933 held in the Butler case that the Act

"... invades the reserved rights of the states. It is a statutory plan to regulate and control agricultural production, a matter beyond the powers delegated to the federal government. The tax, the appropriation of the funds raised, and the direction of their disbursement, are but parts of the plan. They are but means to an unconstitutional end."87

IV

The new trend, as outlined above principally under the Commerce Clause, gave greater scope to the regulatory power of Congress over the actions of private persons or corporations. At the very time of these decisions permitting a variety of legislative regulations of an economic character the same Court adhered to a high standard of protection of individual freedom. In numerous cases it safeguarded the civil rights of individuals against abuse, whether at the hands of inferior courts, executives or police officials, or legislative bodies. These rights peculiarly need the Supreme Court as their guardian. This is perhaps the highest function of the Court, the according of protection to the individual and the insistent realization by the Court of his place in our society. The Supreme Court is better able in the long pull to do what is needed in this respect than is either the executive or the legislative branch of the Government. It is more insulated from the strong moods and passions of the day. The usual occasion for the Court's participation in this fundamental constitutional process is in setting aside the combined work of inferior courts and of police or prosecuting officers in their denial of safeguards placed by the Constitution around the individual accused or suspected of crime. The decisions in constitutional civil liberties cases have been numerous under the reconstituted Court. They range over a wide area. Not only is the suspected or the accused accorded his constitutional protection in full measure, but minority groups find the Court a haven for the vindication of unorthodox political and religious activities and beliefs. The American tradition finds no greater exemplification than in this area of our governmental operations.

Lest I seem to imply a previous lack of watchfulness in these regards by the Supreme Court, I hasten to add that the present Court is by no means unique in this respect. Some of the most penetrating decisions

87 Id. at 68.
in vindication of civil liberties were made many years ago. Where the question had an industrial or economic aspect, however, the individual had more difficulty. The emphasis was definitely on the other side in, for example, *Coppage v. Kansas,* and *Adkins v. Children's Hospital,* where, indeed, freedom of contract became a distorted freedom to employ men, women, and even children on substandard conditions denounced by legislatures. As already stated, Justices Holmes, Hughes, and Day dissented in the former, and Chief Justice Taft, and Justices Holmes and Sanford in the latter. It did not remain for the re-constituted Court to overturn these decisions, although the *Adkins* case was not overruled until the October 1936 term was close to its end. *Coppage v. Kansas* had been sapped of much of its vitality as early as the *Railway Clerks* case, in which Hughes as Chief Justice wrote for the unanimous Court in 1930. It was not, however, until the decisions in the *Labor Board Cases,* April 12, 1937, at the height of the controversy over the Roosevelt Court Plan, that the rule of the *Coppage* case became definitely a dead letter in terms of judicial decision.

Notwithstanding the historic role of the Supreme Court in vindication of the rights of the individual and of minorities in pure civil liberties unaffected by industrial or economic factors, yet it is true that the Court had never at an earlier period gone so far so often as in recent years. As an example, the present Court has been generous in granting review of cases of persons convicted with the use of confessions attacked as involuntary or otherwise inadmissible, or when not represented by counsel in varying circumstances, or on evidence procured in possible violation of the Fourth Amendment. The Court in recent years has been making an unwavering effort by repeated decisions to improve the administration of criminal law by both state and federal officials. Yet, when one has emphasized the number of times in which the Court has taken up cases of this kind it should be said too that perhaps never has the Court gone further in setting aside a confession than in the famous *Bram* case decided in 1897.

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88 E.g., Silverthorne Lumber Co. v. United States, 251 U.S. 385, 392 (1920); Weeks v. United States, 232 U.S. 383, 393 (1914); Boyd v. United States, 116 U.S. 616 (1886).
89 236 U.S. 1 (1915).
90 261 U.S. 525 (1923).
91 Justice Brandeis did not participate, but his position with the then minority is clearly established.
93 Bram v. United States, 168 U.S. 532 (1897).
Mr. Justice White then wrote an elaborate treatise on what "voluntary" means, especially but not entirely as applied to the peculiar facts of that case. Bram, accused of murder on the high seas, was told by the officer when taken in custody on landing, that Brown said "he saw you do the murder". Bram said, "He could not have seen me. Where was he?" The officer said that Brown said he was at the wheel. Bram then replied, "Well, he could not see me from there". This was held an involuntary statement on the ground not merely that Bram was stripped and was in the complete control of the police, but, primarily, because the Court said that if he had failed to answer, his silence might have been used against him, or so he might have reasoned; therefore he was under pressure to answer; therefore the answer was not a free and voluntary statement. In the equally famous *Wan* case\(^{94}\) of 25 years ago, the Supreme Court held, as the Court did at the present term in the *Watts* case\(^{95}\) that long continued questioning, mental coercion or compulsion even in the absence of a promise or threat rendered a confession inadmissible because involuntary. The *Wan* case arose from the District of Columbia. The Court was unanimous in reversing the conviction. It consisted of Chief Justice Taft and Justices McKenna, Holmes, Van Devanter, McReynolds, Brandeis, who wrote the opinion, Sutherland, Butler, and Sanford. In the recently decided *Watts* case the Court did not even cite the *Wan* case, referring for support only to the more recent decisions in cases arising from the states, as did the *Watts* case. Nor was the Court unanimous in the latter case in applying the principles of the decision to the administration of criminal law by the state court.

Some years ago Justice Brandeis told me that he had been disappointed that the *Wan* decision had not had a more lasting effect upon police methods. The fact that the opinion in that and comparable cases did not have a deeper impact upon police methods is no doubt accountable for the larger number of cases decided more recently in the effort to bring the administration of the criminal law in both federal and state courts within the Court's views of due process\(^{96}\) and the proper rules governing the administration of criminal law. The same reasons no doubt explain the controversial extension of the

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\(^{94}\) *Wan* v. United States, 266 U.S. 1 (1924).

\(^{95}\) *Watts* v. Indiana, 69 Sup. Ct. 1347 (1949).

rule excluding confessions to those which ensue after the accused has been unduly isolated from a committing magistrate in violation of the statutes requiring prompt arraignment after arrest.97

The right of an accused to counsel has been also a field of vast increase of opinions since 1937.98 The question of due process may vary, dependent upon whether it arises under the Fifth or the Fourteenth Amendment.99 This I do not discuss except to point out that the Court has extended to the states through the Fourteenth Amendment the most important rights protected by the Bill of Rights, including the First Amendment:

"Although the Constitution puts protection against crime predominantly in the keeping of the States, the Fourteenth Amendment severely restricted the States in their administration of criminal justice. Thus, while the State courts have the responsibility for securing the rudimentary requirements of a civilized order, in discharging that responsibility there hangs over them the reviewing power of this Court."100

Other aspects of civil liberties in constitutional law should be mentioned, especially those concerning questions of freedom of thought, expression and religion. A few years ago the religious cases revolved principally around the controversies of Jehovah witnesses with local and, during selective service, with federal regulations.101 What change has the past ten or twelve years wrought in this area of Supreme Court decision? Certainly one can say it has brought a larger number of decisions dealing with these questions; and it has made clear that religious freedom occupies, like free speech, so strong a position in the American scheme of constitutional democracy that any local regulation, either by requirement of a license or otherwise, which makes its exercise more difficult is liable to condemnation; and that the clause "prohibiting the free exercise thereof" in the First Amendment must be given a broad interpretation.102

The religious climate of America had not infrequently been re-

100 Watts v. Indiana, 69 Sup. Ct. 1347, 1348 (1949).
flected in the decisions of the Supreme Court in an earlier day.\textsuperscript{103} More recent decisions to vindicate freedom of religion under the First Amendment at the suit of minority groups, in the long line of Jehovah Witness cases,\textsuperscript{104} have remained consistent with these earlier approaches. The significances of the new Court’s action is primarily to be seen in a greater awareness of the need of deciding particular cases than in any significant extension of the principle of religious freedom. This may be arguable; but whether I am right or wrong in such a statement, it seems to me the Court has performed in this regard, as in the area of other civil rights already mentioned, a great service to the cause of freedom of religion protected by the second clause of the First Amendment.

The \textit{Everson}\textsuperscript{105} and \textit{McCollum}\textsuperscript{106} cases call for separate comment. In the latter for the first time in the history of the country the Court invalidated state action on the ground that it violated the “establishment of religion” clause of the First Amendment, made applicable to the states by virtue of the Due Process Clause of the Fourteenth Amendment. The \textit{Everson} and the \textit{McCollum} cases present an interesting contrast. A study of them shows the basis for their reconciliation. It is true that the Court in discussing the establishment clause of the First Amendment in \textit{Everson} went beyond the historical data available for support of such construction, and made the word “establishment” lose its historical meaning. It is true, in other words, that legitimate criticism on this ground may be leveled at the discussions of the meaning of the establishment clause. But the fact remains that the actual decision in \textit{Everson} adhered to the precedents so far as applicable, particularly \textit{Cochran v. Louisiana State Board of Education}\textsuperscript{107} (involving free textbooks) and \textit{Pierce v. Society of Sisters}\textsuperscript{108} (involving the right of parents to have their children educated in religious schools). The decision held the line, though by the narrowest of margins, for a broad construction of the “freedom of religion” or second clause of the Amendment. On the basis of such freedom the Court refused to exclude from the benefit of public welfare legislation,

\textsuperscript{103} See, \textit{e.g.}, Holy Trinity Church v. United States, 143 U.S. 457 (1892).
\textsuperscript{104} \textit{E.g.}, Cantwell v. Connecticut, 310 U.S. 296 (1940); Schneider v. State, 308 U.S. 147 (1939); Lovell v. Griffin, 303 U.S. 444 (1938).
\textsuperscript{105} \textit{Everson v. Board of Education}, 330 U.S. 1 (1947).
\textsuperscript{106} \textit{McCollum v. Board of Education}, 333 U.S. 203 (1948).
\textsuperscript{107} 281 U.S. 370 (1930).
\textsuperscript{108} 268 U.S. 510 (1925).
in the *Everson* case free bus transportation, children attending schools where religious instruction is given as well as secular education meeting state standards. The Court so held notwithstanding vigorous pressure from dissenting Justices on the ground that this constituted state law respecting "an establishment" of religion and was therefore invalid under the establishment clause of the Amendment. The basis for the decision had been laid in earlier cases above referred to and in such cases as *Prince v. Massachusetts*. The *Everson* case is of special interest, in terms of a comparison of the Court today with that of yesterday, because of two elements, (1) the narrowness by which the Court held both to the logic of earlier decisions and to a broad view of religious freedom; and (2) the interpretation of the establishment clause in broad terms prohibiting "aid" of any sort, apparently, whether or not any religion is preferred. When in *McCollum* the Court relied upon this broad interpretation in striking down the released time plan there involved, much controversy was evoked among lawyers and constitutional scholars. But it must be remembered that in *McCollum* the "aid" which condemned the released time plan consisted of what the Court, except for Justice Reed, considered substantial and affirmative acts of the public school authorities in furtherance of religious instruction and classes. While this "aid" could well be argued to have consisted of nothing more than permissible cooperation, there was nevertheless the difference from *Everson* in that in the latter the state had nothing to do with the religious classes themselves or their arrangement. It seems to me *McCollum* is not a ban upon all released time plans or comparable means of cooperation between state and religious groups permissible in the free exercise of religion; and that the actual holding in *Everson* is to be explained not only upon the basis of precedents of the older Court but on the basis of a liberal view by a majority of the present Court of the meaning of the "free exercise of" religion. To have excluded children from the free use of buses, available to public school children, because they were attending a sectarian school, accredited by the state, would seriously have impaired *Pierce v. Society of Sisters* and the rationale of that and other decisions, including the *Cochran* and *Prince* cases. More important, it would have weakened the "free exercise of" religion clause of the Constitution.

A review of civil liberties cases, however cursory, would be incom-

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plete without reference to *Schneiderman v. United States*.

This case imposed an extremely burdensome weight of proof upon the Government in denaturalization cases where revocation of citizenship on the ground of its illegal procurement is rested upon lack of attachment “to the principles of the Constitution of the United States.” Behavior for the five years preceding naturalization as one so attached is a statutory prerequisite of naturalization. To the majority of the Supreme Court it made no difference that two courts below had concurred in finding that Schneiderman “belonged to Communist Party organizations which were opposed to the principles of the Constitution” or that the proof to that effect was ample. The opinion of Justice Murphy for the Court says:

“If any provisions of the Constitution can be singled out as requiring unqualified attachment, they are the guaranties of the Bill of Rights and especially that of freedom of thought contained in the First Amendment. *Cf.* Justice Holmes’ dissent in *United States v. Schwimmer*, supra. We do not reach, however, the question whether petitioner was attached to the principles of the Constitution if he believed in denying political and civil rights to persons not members of the Party or of the so-called proletariat, for on the basis of the record before us it has not been clearly shown that such denial was a principle of the organizations to which petitioner belonged. Since it is doubtful that this was a principle of those organizations, it is certainly much more speculative whether this was part of petitioner’s philosophy.”

The Court treated the case as involving freedom of thought in so far as the evidence was directed to proof of beliefs less antagonistic to the Constitution than such denial of political or civil rights and held that belief in the use of force and violence was not adequately proved, even as to the Party itself, under a new rule that the proof must be “clear, unequivocal, and convincing”.

Chief Justice Stone, notable for his judicial appreciation of civil liberties, could not subscribe to the opinion. Indeed, he dissented with great vigor and with more clarity than I can glean from either the prevailing opinion or the separate concurring opinions. The Chief Justice’s opinion had the support also of Justices Roberts and Frankfurter. Justice Jackson did not participate. The Chief Justice in his elaborate dissent, documented by an appendix setting forth parts of the evidence, said in part:

110 320 U.S. 118 (1943).


113 *Id.* at 144.
"I think these findings are abundantly supported by the evidence, and hence that it is not within our judicial competence to set them aside. . . ."\textsuperscript{114}

In any event

". . . the evidence in this case to which I shall refer and on which the courts below were entitled to rely is clear, not speculative."\textsuperscript{115}

As to the principles of the Constitution,

". . . among them are at least the principle of constitutional protection of civil rights and of life, liberty and property, the principle of representative government, and the principle that constitutional laws are not to be broken down by planned disobedience. . . ."\textsuperscript{116}

"The evidence shows petitioner's loyalty to the Communist Party organizations; that as a member of the Party he was subject to and accepted its political control, and that as a Party member his adherence to its political principles and tactics was required by its constitution."\textsuperscript{117}

The Chief Justice reviewed the evidence and continued,

"It would be little short of preposterous to assert that vigorous aid knowingly given by a pledged Party member in disseminating the Party teachings, to which reference has been made, is compatible with attachment to the principles of the Constitution. . . .

"He spent his time actively arranging for the dissemination of a gospel of which he never has asserted either ignorance or disbelief."\textsuperscript{118}

The broad application of the commerce power and the numerous occasions on which the Court has expounded the rights of the individual under the Bill of Rights has been accompanied by a number of significant due process decisions other than those protecting individual liberties. The Court is very reluctant to restrict congressional or legislative efforts designed to remedy economic maladies. It is a formidable task at this time to sustain the argument that legislative action is arbitrary and therefore offensive to due process of law.

The standards of validity under the Due Process Clause of the Fifth Amendment correspond to those of the Fourteenth Amendment.\textsuperscript{119}

\begin{thebibliography}{10}
\bibitem{114} Id. at 170.
\bibitem{115} Id. at 178.
\bibitem{116} Id. at 181.
\bibitem{117} Id. at 183.
\bibitem{118} Id. at 194.
\bibitem{119} Bowles v. Willingham, 321 U.S. 503, 518 (1944); Carolene Products Co. v. United States, 323 U.S. 18, 23 (1944); Lincoln Union v. Northwestern Co., 335 U.S. 525, 536 (1948).
\end{thebibliography}
This standard has been stated in *Carolene Products Co. v. United States* as follows:

"... the methods which it [Congress] employs to carry out its purpose are beyond attack without a clear and convincing showing that there is no rational basis for the legislation; that it is an arbitrary fiat."\(^{120}\)

The oft-repeated criteria of the *Nebbia* case is that the guaranty of due process demands only that the law,

"... shall not be unreasonable, arbitrary, or capricious, and that the means selected shall have a real and substantial relation to the object sought to be attained. It results that a regulation valid for one sort of business, or in given circumstances, may be invalid for another sort, or for the same business under other circumstances, because the reasonableness of each regulation depends upon the relevant facts."\(^{121}\)

Before June of 1937 arrived, the refusal of a majority of the Court to permit New York to regulate the minimum wages of women, in *Morehead v. Tipaldo*, was in all substance overruled, *West Coast Hotel Co. v. Parrish*,\(^{122}\) upholding the state of Washington minimum wage law for women, and expressly overruling *Adkins v. Children's Hospital*, which since 1923 had lain across the path of minimum wage legislation. In the *Adkins* case Justices Sutherland, McKenna, Van Devanter, McReynolds, and Butler had held such a law offended due process. Chief Justice Taft and Justices Holmes and Sanford dissented. The majority, speaking through Mr. Justice Sutherland, held the Constitution protected "liberty of contract" and the legislature could not restrain that liberty unless in exceptional circumstances not presented in the instant case. The reply of Chief Justice Taft, in part, reads:

"Legislatures in limiting freedom of contract between employee and employer by a minimum wage proceed on the assumption that employees, in the class receiving least pay, are not upon a full level of equality of choice with their employer and in their necessitous circumstances are prone to accept pretty much anything that is offered. They are peculiarly subject to the over-reaching of the harsh and greedy employer. ... it is not the function of this Court to hold congressional acts invalid simply because they are passed to carry out economic views which the Court believes to be unwise or unsound."\(^{123}\)

\(^{120}\) 323 U.S. 18, 31 (1944).


\(^{122}\) 300 U.S. 379 (1937).

\(^{123}\) Adkins v. Children's Hospital, 261 U.S. 525, 562 (1923).
As already indicated in references to such earlier cases as *Coppage v. Kansas* and *Adkins v. Children's Hospital*, the Court in recent years has given broad scope to the discretion of legislatures in regulatory controls.\(^{124}\)

Yet here again it must be pointed out that a long step forward had been made in *Nebbia v. New York*,\(^{125}\) decided early in 1934, in which the Court upheld the price fixing provisions of the New York state milk control statute in an opinion written by Justice Roberts in which Chief Justice Hughes and Justices Brandeis, Cardozo, and Stone joined against the dissenting views of Justices McReynolds, Van Devanter, Sutherland, and Butler.

The Court has rejected the earlier laissez-faire philosophy that only a limited number of businesses "clothed with a public interest" are subject to drastic regulation as to prices, wages, or commercial practice.\(^{126}\)

"The due process clause is no longer to be so broadly construed that the Congress and the state legislatures are put in a strait jacket when they attempt to suppress business or industrial conditions which they regard as offensive to the public welfare."\(^{127}\)

Indicative of the existing pronounced trend in the Supreme Court is the fact that not a single act of Congress has been held unconstitutional since 1937 under the Due Process Clause in substantive respects, or under the Commerce Clause.\(^{128}\)

In *Sunshine Coal Co. v. Adkins*,\(^{129}\) upholding the fair trade practice code for bituminous coal industry enacted subsequent to the invalidation of the Bituminous Coal Act of 1935, the Court said:

"... it [appellant] urges that the nature and use of bituminous coal in nowise endanger the health and morals of the populace; that no question of conservation is involved; that the ills of the industry are attributable to over-production; that the increase of prices will cause a further loss of markets and add to

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125 291 U.S. 502 (1934).

126 See note 125 supra.


128 The only federal legislation held squarely unconstitutional by the Supreme Court since 1937 is the bill of attainder condemned in United States v. Lovett, 328 U.S. 303 (1946), and the statutory presumption of guilt under the Federal Firearms Act, 52 Stat. 1250 (1938), 15 U.S.C. § 901-909 (1946), established by possession of a firearm or ammunition by one formerly convicted of a crime of violence. Tot v. United States, 319 U.S. 463 (1943).

129 310 U.S. 381 (1940).
the afflictions which beset the industry; and that the consuming public will be deprived of the wholesome restriction of the antitrust laws. Those matters, however, relate to questions of policy, to the wisdom of the legislation, and to the appropriateness of the remedy chosen—matters which are not our concern.

"... to invalidate this Act we would have to deny the existence of power on the part of Congress under the commerce clause to deal directly and specifically with those forces which in its judgment should not be permitted to dislocate an important segment of our economy and to disrupt and burden interstate channels of trade. That step could not be taken without plain disregard of the Constitution. ... It may single out for separate treatment, as it has done on various occasions, ... a particular industry. ..."

The scope of play allowed within the range of due process is further illustrated by Daniel v. Family Security Life Insurance Company, upholdning a South Carolina statute prohibiting life insurance companies and their agents from engaging in an undertaking business and prohibiting undertakers from serving as agents for life insurance companies. The Court said:

"We cannot say that South Carolina is not entitled to call the funeral insurance business an evil. Nor can we say that the statute has no relation to the elimination of those evils. There our inquiry must stop.

"This rationale did not find expression in Liggett Co. v. Baldridge, 278 U. S. 105, on which respondents rely. According to the majority in Liggett, 'a state cannot, 'under the guise of protecting the public, arbitrarily interfere with private business or prohibit lawful occupations or impose unreasonable and unnecessary restrictions upon them''; 278 U. S. at 113. But a pronounced shift of emphasis since the Liggett case has deprived the words 'unreasonable' and 'arbitrary' of the content for which respondents contend. See Lincoln Federal Labor Union v. Northwestern Iron & Metal Co., 335 U. S. 525, where the cases are reviewed."

The change in approach is thus frankly acknowledged by the Court itself where Justice Murphy's opinion compares the reasoning of the Court with that of an earlier day. This acknowledgement speaks also for the difference between the Darby case and Hammer v. Dagenhart; between the Labor Board Cases and Coppage v. Kansas; between West Coast Hotel Co. v. Parrish and the Tipaldo and Adkins cases, where the opinions themselves, contrasted with the dissenting opinions, expound the differences with equal clarity and certainty.

The cleavage between the two points of view was definitely struck

\[130\] Id. at 394.

\[131\] 336 U.S. 220 (1949).

\[132\] Id. at 224.
by the Court before the retirement of Justice Van Devanter initiated a newly composed membership. Chief Justice Hughes was joined in *West Coast Hotel Co. v. Parrish* by Justices Brandeis, Stone, Roberts, and Cardozo. When the Chief Justice rendered his triumphant opinion on March 29, 1937, while the Court fought raged, and two weeks later spoke for the majority again in the *Labor Board Cases*, the new climate of decision thus chiefly created was the principal factor in the failure of the court proposal for additional Justices, and at the same time marked the point where a narrow and strict construction of broad constitutional provisions came to an end. The differences are set in contrast with clarity in the majority and minority opinions in the *West Coast Hotel Co.* case. Justice Sutherland, who wrote for the majority in the *Adkins* case in 1923, wrote the dissent in the *West Coast Hotel Co.* case in 1937 joined by Justices Van Devanter, McReynolds, and Butler. In the *Adkins* case, as already stated. Chief Justice Taft had vigorously dissented with Justices Holmes and Sanford. The opinions in the *West Coast Hotel Co.* case furnish a remarkable exposition of the two sides of the long-standing judicial dispute in which ultimately a more liberal view of the area of permissible legislation prevailed; while Justice Sutherland and his associates, now in vain, continued to persist, stating that the new decision amended the Constitution. Apparently they felt that their view of the Constitution necessarily reflected its actual terms or meaning. In the majority opinion, the Chief Justice goes to some pains to outline the course of decision of the Court over a long period in the effort to demonstrate that such decisions as the *Adkins* and *Tipaldo* cases were departures, and that the Court was now reverting to better and longer established principles of constitutional law.

While, therefore, the decisions in the spring of 1937, before there was a reconstitution of the Court through retirements and new appointments, turned the tide of constitutional construction, the course then begun has been followed with greater ease and less difference of opinion. In moving along this route the Court has not been deterred by retroactive application of federal legislation to existing contracts or arrangements,\(^{133}\) or by legislation which singles out a particular industry, commodity or practice, leaving unregulated other industries, commodities or practices\(^{134}\) or by outright prohibition of a product or a busi-


ness. The decisions turn not on the nature of the prohibitive statute, as such, but on whether under all the circumstances it is so lacking in basis as to constitute an arbitrary fiat as understood in current decisions of the Supreme Court.

The present trend of decision is reflected in the recent case upholding state legislation outlawing closed shop contracts. Speaking for a unanimous Court, Mr. Justice Black said, in emphasizing the vital policy transformation on due process issues that has occurred since 1934:

"This Court beginning at least as early as 1934, when the Nebbia case was decided, has steadily rejected the due process philosophy enunciated in the Adair-Coppage line of cases. In doing so it has consciously returned closer and closer to the earlier constitutional principle that states have power to legislate against what are found to be injurious practices in their internal commercial and business affairs, so long as their laws do not run afoul of some specific federal constitutional prohibition, or of some valid federal law. See Nebbia v. United States, supra, at 523-524, and West Coast Hotel Co. v. Parrish, supra, at 392-395, and cases cited. Under this constitutional doctrine the due process clause is no longer to be so broadly construed that the Congress and state legislatures are put in a strait jacket when they attempt to suppress business and industrial conditions which they regard as offensive to the public welfare.

"Appellants now ask us to return, at least in part, to the due process philosophy that has been deliberately discarded. Claiming that the Federal Constitution itself affords protection for union members against discrimination, they nevertheless assert that the same Constitution forbids a state from providing the same protection for non-union members. Just as we have held that the due process clause erects no obstacle to block legislative protection of union members, we now hold that legislative protection can be afforded non-union workers."  

VI

There are other altogether pertinent areas of Supreme Court decision which have not been discussed in terms of change or evolution since the middle thirties. Omission is not intended to indicate that important evolutions have not occurred; but is due only to the limitations of this paper. An analysis of the anti-trust and kindred cases; tax questions including tax immunity from a constitutional standpoint; the

137 Id. at 536.
139 E.g., Graves v. O'Keefe, 306 U.S. 466 (1939), passim.
developments regarding rate fixing and the basis therefor, in the field of public utilities as well as other aspects of public utility regulation;\textsuperscript{140} construction and application of the full faith and credit provision\textsuperscript{141} of the Constitution may be mentioned. But to revert to a statement in the forepart of this article, this is but a limited review and not a detailed analysis of the course of decision. During the period discussed we passed through the Second World War. Many questions of profound importance came to the Court out of the War.\textsuperscript{142} These, too, including the first treason case ever to be decided by the Court,\textsuperscript{143} are not reviewed for the same reason.

VII

The differences within the present Court are relatively narrow and minor alongside the major policy differences among the Justices sitting on such cases as \textit{Coppage v. Kansas}, \textit{Adkins v. Children's Hospital}, and \textit{Hammer v. Dagenhart}. None of the present Justices would, if occasion offered, have supported those decisions or dissented in \textit{Nebbia v. New York} or \textit{The Labor Board Cases}. The treatment of the Commerce Clause in the \textit{Labor Board Cases} and in \textit{Wickard v. Filburn} are marks along the evolutionary lines drawn in Commerce Clause and Due Process cases. Actually to draw the lines would make a much more intricate and detailed graph. It is accurate also, I think, to say that in these areas the efforts of legislatures and executives to meet the issues of the times with measures which must conform with the Constitution have coincided with a movement of the Court to a position where some of its greatest Justices had stood many years ago. Greater intergovernmental harmony has been the result.

Under the Commerce Clause no novel theory or principle has evolved; there has come a broader application and acceptance of previously enunciated principles and their necessary implication; and this, of course, only after Congress itself has exercised its judgment. The developments have coincided also to a considerable degree with changes in our economic, industrial, and agricultural society, which has emphasized the need of

\textsuperscript{141} E.g., \textit{Estin v. Estin}, 334 U.S. 541 (1948).
\textsuperscript{143} \textit{Cramer v. United States}, 325 U.S. 1 (1945).
national control over much that had been only of local significance. This period has also had the salutary accompaniment of more careful congressional drafting and consideration in the light of the several powers granted to Congress by the Constitution.144 The Court in constitutional cases concerned with legislation has moved closer to the point of view of the elected representatives. When government has entered the field through legislative or executive action the entranceway has not been constructed by the Court so narrowly or rigidly as to leave no room for expansion required to meet national growth with its complexities.

The Due Process Clause has undergone similar development, including the return to the sound principles of an earlier period in Supreme Court history. The result has been to return to Congress and the state legislatures, in their respective spheres, the power to legislate against what those elected and representative bodies find to be injurious practices in commercial and business affairs and labor relations.

Where the liberties imbedded in the Bill of Rights are involved, the individual remains well protected. When the Court passes upon the validity of legislative action, its attitude towards the constitutionality of the views of the other branch of government is generous; but when it is appealed to by the individual who claims infringement of the guarantees of the Bill of Rights, the Court as a whole, with some occasional sharp differences of opinion in relatively narrow areas, moves with all its great power and prestige to grant that protection from intrusion upon individual freedom from whomever such intrusion emanates. The Court as a whole is a strong Court in protecting the individual in his fundamental rights at a time when in the history of the world, strength here is one of our principal sources of happiness as well as of example to governments and peoples everywhere.

PRIVATE CAPITAL UNDER THE "POINT FOUR" PROGRAM

JAMES G. MACKNEY* AND BLACKWELL SMITH**

I

INTRODUCTION

PRESIDENT TRUMAN opened a Pandora's Box when he espoused in his 1949 inaugural address the "bold new program" and appealed to private capital for support in his "Point Four" approach to development of underdeveloped foreign areas.

Speaking of the real need for this type of program, President Truman, in his address, said:

"With the cooperation of business, private capital, agriculture, and labor in this country, this program can greatly increase the industrial activity in other nations and can raise substantially their standards of living."3

However, the proposal is novel only in freshness of statement and level of sponsorship. Risk capital in the United States has long been concerned with the problem of how best to do business abroad.4 The first question in seeking to channel private investment abroad is what makes private capitalists willing to incur financial risk in overseas pioneering? Part of the answer for some few individuals is found in the romance of newness and strangeness of operations in far away places—the lure in situations involving gold, diamonds, mahogany, cocoa,

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** LL.B., 1929, Columbia University; Member of the New York Bar, New York City, N. Y.; formerly General Counsel, Assistant Administrator for Policy, Legal Advisor to National Industrial Recovery Board; formerly Legal Counsel, Industrial Materials Division, National Defense Advisory Commission; formerly Assistant Director, Industry Operation, Director Urgency Rating Division, War Production Board; formerly Chief, Lend-Lease Administration Mission to New Zealand; Member, Bar Association of the City of New York.

1 N. Y. Times, Jan. 21, 1949, p. 4, col. 2.
2 Ibid.
3 Ibid.
spices, oil palms, and tropical fruits. Then there is the history of great empires forged out of foreign trade and development, such as the East India, Virginia, Hudson Bay, Muscovy, and Levant Companies, Cecil Rhodes in the Colonial Empire, W. R. Grace in Latin America, the "Big Five Factors" in Hawaii, to name but a few. But U. S. private capital in the more recent past also has compiled an impressive record abroad. The list of achievements abroad includes oil drilling and the building of refineries and pipe lines in Venezuela, Saudi Arabia, Indonesia, Burma, and other countries; the mining and processing of bauxite, copper, lead, zinc, tin, tungsten, vanadium and iron ores in Latin America and Africa; lumbering and wood processing in Newfoundland, British Honduras, Costa Rica, and the Gold Coast; the operation of sugar plantations and mills in Cuba, The Dominican Republic, and Haiti; and the development of hydro-electric power in Canada, Mexico, Uruguay, and Portugal.\(^5\)

Romantic adventure without more is not an adequate inducement to risk capital abroad even for wealthy and adventurous individuals. As Secretary of Commerce Charles Sawyer said in his Cape Henry speech on April 24, 1949,\(^6\) the basic urge was to make a fortune in new fields in potentially profitable business ventures. But, apart from normal extensions of corporate interests in already developed countries, the lure for private capital today is not as great as before because of a multitude of obstacles that will be mentioned later. The President's recent recognition of the necessity for creating various tax and other incentives for American investors supporting his program for world peace and domestic welfare through development of underdeveloped areas, reflects realization of this fact. But American history has established that in many administrations executive wishes are not sure to be father to legislative thoughts.

Since helpful legislation may or may not emerge promptly from our Congress, it seems wise to see what could be done without new federal legislation on the subject. Examination of the American investors' tax position as to foreign operations under present law indicates certain U. S. tax advantages that could now be relied upon with reasonable legal security. Since, however, neither this article nor the views of private practitioners are the most solid basis for large foreign investment, both the law and the investors' position thereunder should, we

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\(^6\) Ibid.
submit, at least be made as secure as possible by a public policy declaration by the Treasury Department that it will interpret liberally existent law and regulations in favor of the foreign investors' tax position under "Point Four" operations, along with administrative amendments of such Regulations by the Bureau to the extent necessary to achieve a like result. This is the least the Administration can do, if it is seriously inclined to help the "bold new program." Such action is really important in view of the trend of administrative and judicial decisions against taxpayers.

But there are other considerations than tax status which private individual capitalists also must examine. Among these is the extent to which our Government will protect affirmatively the American businessman in foreign areas and the degree of financial guarantees and other aid which our Government will extend to cover abnormal foreign risks.

While the "Point Four" phase is new, our country has long followed the course of aiding overseas activity for benefit of our needy sister nations. But this course of action for the most part has been restricted to U. S. Government financing of foreign governments, without direct benefits or reference to private American capital. The following partial list of U. S. Government supported agencies devoting either all or a part of their resources to such purposes, typifies our national policy in this respect during the last fifteen years:

Export-Import Bank of Washington—February 2, 1934
Office of Lend-Lease Administration—October 28, 1941
United Nations Relief and Rehabilitation Administration—November 9, 1943
International Bank for Reconstruction and Development—December 27, 1945

10 Created by authority of Articles of Agreement between 44 nations represented at the
Economic Cooperation Administration (Marshall Plan)—January 27, 1948.11

We find, however, a discouraging picture when we look for specific means of encouragement for the strategically vital pure private risk capital needed from the private United States investor to help do the "Point Four" job. There are some supporting things that can and should be done without reference to U. S. financial grants-in-aid. Some of these things are the subject of this article, which in the main relates to what happens after a private investor has wrestled with his soul on the possibilities of profit from the straight business viewpoint and then wants to know what his tax position is with relation to his foreign operations under our present laws.

Corporate ventures already established in foreign territories whose prior preferential advantages are sought to be recaptured or whose export, trade or manufacturing positions are the subject of expansions, raise a multiplicity of important issues which are beyond the scope of this article.12

July, 1944, Bretton Woods Conferences. The bank came into existence December 27, 1945 when the Agreement was signed in Washington on behalf of governments with approximately 80 per cent of the total subscriptions. Of the 44 nations participating in the Bretton Woods Conference, only three have not yet become members of the Bank, Haiti, New Zealand, and the Union of Soviet Socialist Republics. Until recently the Republic of Liberia constituted the fourth nation, but its application for membership has now been accepted by the Bank, subject to the fulfillment of the customary specified conditions therefor.


12 Reference should be made to INT. REV. CODE §§ 131, 129, 45, and 251, all of which cumulatively postulate problems encountered in established corporate operations abroad as distinguished from issues arising through the use of corporate and trust mechanics by individual investors responsive to the "Point Four" appeal. Many commercial firms seem to have the erroneous impression that § 131 of the Code (which was designed by Congress to relieve domestic private capital from the burden of double taxation) permits a credit to be claimed by domestic investors, corporate and individual, for virtually every kind of foreign tax paid, except property taxes in the foreign area of operations. One need only refer to the decision in Biddle v. Comm'r Int. Rev., 302 U. S. 573 (1938) to appreciate the inaccuracy of this impression. Conversely, INT. REV. CODE § 45 stands as a congressional impediment to purely artificial adjustments of income to foreign entities (whether by subsidiary operations or inter-company transactions), the net effect of which effectively prevents tax-free accumulations of income and the shifting thereof by domestic organizations to foreign corporate agencies for the purpose of defeating our revenue exactions. And in a similar vein is the language of § 129 of the Int. Rev. Code, which principally was enacted for the prevention of specific instances of tax avoidance transactions in relation to excess profits cases, but which is susceptible of application to avoidance of income taxes as well. Rudick, Acquisitions to Avoid Income or Excess Profits Tax,
It is not enough that investors be asked to operate under a program merely logical in concept and noble in purpose. If the plan is to produce results of magnitude, there should be a marshalling of presently available protection to the greatest possible degree and a filling in of the gaps. This is important in view of the unavoidably abnormal risks and obstacles abroad. As Secretary of Commerce Sawyer also said in his Cape Henry speech:

"The profit motive is the sparkplug of American business and the fundamental influence behind the incredible results which the United States has produced in peace and in war for the benefit of all mankind."

II

United States Public Policy—Compliance Problems

The most significant facet of President Truman's inaugural address, in which he stressed this country's rapidly-growing responsibilities in world affairs, was the character of his challenge to Communism. Not a battle challenge in the military sense, but a test of economic effectiveness in the demanding worldwide struggle to develop the world's resources for the benefit of all. Informed observers have become increasingly persuaded that available government implementations will not alone redress the economic disequilibrium in the world today. Extirpation of Communism and the establishment of political stability cannot possibly be accomplished until living conditions in underdeveloped areas are improved "to a point where their millions of inhabitants will become less vulnerable to political extremism of one kind or another." Toward this end, both the United Nations and The International Bank for Reconstruction and Development have repeatedly urged in forceful fashion consideration of the problems of non-industrialized countries, including technical assistance, and related

58 Harv. L. Rev. 196 (1944). Although the Commissioner has ruled that formation of western hemisphere corporations are not interdicted by § 129 (and presumably China Trade Act corporations would receive a like amnesty under § 251) the impact of these several Code sections raises confusing issues which should be carefully examined. We commend attention to the article entitled Tax Planning for Foreign Trade, 3 Tax L. Rev. 23 (1947), in which these questions, their answers, and the supporting authorities are ably and comprehensively canvassed by Messrs. George S. Allan and Sidney S. Coggan.


14 XXVIII Foreign Policy Bulletin, No. 16 (1949).
issues of paramount importance to the economies of these areas.\textsuperscript{15}

That their concern in this respect is amply justified is evident from the circumstance that as late as the period 1926-1929, the underdeveloped areas of the world, \textit{i.e.,} Latin America, Africa, Eastern Europe, the Middle East, Oceania, and a large part of Asia (including Japan and the Union of Soviet Socialist Republics), comprising 75\% of the world’s population, together accounted for only 8\% of the world’s total production of manufactures. And during the same period (1926-1929), the annual supply of finished factory goods “averaged less than $7 per capita for two-thirds of the world’s population.”\textsuperscript{16} The advent of the worldwide depression and of World War II prevented any marked improvement in the productivity of these areas for their normal economies.

Although the obstacles to be overcome in elevating the standard of economic welfare of an underdeveloped country are so numerous and diverse as to require separate analysis in each area, a key factor in the process is certain to involve availability of risk capital. Efficient development, and hence efficient improvement of living standards, depends on installation of modern facilities and the use of modern machinery and technological skills, all of which will require large expenditures of funds in addition to the public cost for even minimum social services.\textsuperscript{17}

When President Truman advanced his “Point Four” program, almost the first question that aroused immediate interest was the source of funds for financing assistance to non-industrialized nations. Will the money come primarily from government sources, either national or international in scope, or from private capital investments? According to comments by Secretary of State Dean Acheson, and other government spokesmen, it appears that President Truman was not thinking in terms of large loans or credits by Federal agencies, but rather private undertakings along the lines of partnership capitalism (that is, joint ventures) of the type already initiated by Nelson Rockefeller in Brazil and Venezuela, in Liberia by the late Edward R. Stettinius,

\textsuperscript{15} Ibid.


\textsuperscript{17} XXIV \textit{Foreign Policy Reports}, No. 10, p. 112 (1948).
Jr. and his associates, the United Fruit Company in Latin America, and the Arabian-American Oil Company in Saudi Arabia. That no mention was made of the wisdom of minimizing the impact of federal taxes on income from foreign operations was indeed unfortunate.

United States tax precedent for encouragement of overseas activity includes the China Trade Act and the provision for western hemisphere trade corporations, but these offer little to encourage the pure risk capitalist. The whole picture is one of discouragement to private investment abroad because of the many obstacles in foreign countries, tax problems here and other hindrances, not the least of which is a so-called favorable trade balance which is really a disastrous trade imbalance which must be redressed if even earnings abroad are to be repatriated.

This trade imbalance obliges most foreign countries to protect their dollar reserves by drastic restrictions upon withdrawals of funds. This in turn has resulted in some American investors accumulating, unwillingly, large reserves abroad, where they are not needed.

Our public policy has made us leaders in efforts to correct this imbalanced trade through the Reciprocal Trade Act, Lend-Lease agreements, International Trade Organization negotiations, and the Economic Cooperation Administration.

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18 What Form Will Aid to Underdeveloped Countries Take? XXVII FOREIGN POLICY BULLETIN, No. 17 (1949).
21 In the first World War, the United States became a creditor nation. Since then our exports have exceeded our imports by the startling amount of one hundred billion dollars. Broken down into component parts, about 50% of this "favorable balance" comprises straight gifts by our people. Another eighteen billion represents government loans, which may or may not be repaid. Approximately ten billion consists of private credits, presumably valid, and about sixteen billion received in gold now is buried at its Fort Knox graveyard. Whaley-Eaton Service, No 1570. Before 1939, Europe and Asia sent the United States 58% of the value of its imported goods. Approximately 37% came from western hemisphere countries, and 5% from Africa, Australia, and Oceania. In 1944, however, those European and Asiatic countries which were still open for trade (England, Russia, Switzerland, Spain, Portugal, India, Ceylon, Turkey, Iran, Palestine and China) were furnishing only 15% of the total, the western hemisphere countries 74% and the rest of the world 11%. Our World Trade, Chamber of Commerce of the United States, August, 1946.
From the trade imbalance viewpoint, one result of developing under-developed areas is the prospect of opening new markets for American goods that do not increase the imbalance because the development involves for many years net investment abroad and in turn means, normally, more imports from overseas. This, of course, makes available in a normal way more dollars with which foreign countries may pay for our goods and redress the existent trade imbalance.

Among other reasons assigned for the virtual cessation of essentially private foreign investments by U. S. capital to date (insurance companies, banks, extensions of business by mineral, and some other established companies excluded) are Communism and the hostile conflicts in ideologies between the East and West; extreme nationalism, foreign anti-foreignism, and property expropriations of the type prevalent in Latin America; enforced and unequal partnerships between foreign governments and private investors with local foreign capital in preferential positions, as has occurred in India and Pakistan; burdensome labor legislation and racial discrimination; rigid restrictions on the percentage of profit realizable, i.e., either a ceiling on the total investment earnings yield or else a restriction on the percentage of profit which can be remitted to the investor's country; requirements in some countries that earnings be reinvested without freedom of earnings withdrawals; onerous currency exchange restrictions; and finally, burdensome taxation in foreign areas coupled with double taxation both there and in the U. S.27

In commenting upon these impediments, it has also been said that although taxes are generally heavy throughout the world, this is not really a special deterrent "since one would look in vain for more than a few places for investment opportunities where taxes are not heavy."28 A more accurate statement would be that this is a strong deterrent, even in the United States.

The question has been postulated, that since U. S. private investors are able to supply capital under acceptable circumstances, and since foreign countries need it, are they (foreign countries) willing to offer to private capital fair opportunities to make profits (with ownership security) for a reasonable period of time? In other words, are foreign

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26 Brazil has an 8% ceiling; only 8% of profits can be removed yearly. Others specify 10-12% maxima.
28 Id. at 241.
countries willing to meet these conditions by removal of existent hazards? 29 Similarly, it is a fair question to ask will the United States do its part by providing adequate legislative and administrative tax tonics to encourage our risk capital in foreign investments.

III

POSSIBLE HELP FROM EXISTING AND PROPOSED AGENCIES DEVOTED TO INTERNATIONAL PURPOSES

Initially, we observed that our Government previously enacted foreign assistance legislation creating or supporting the Export-Import Bank in 1934, Lend-Lease aid in 1941, United Nations Relief and Rehabilitation Association in 1945, the International Bank for Reconstruction and Development in 1946, and finally the Marshall Plan or Economic Cooperation Administration in 1948.

Recently the Thorpe Committee reported to the Senate Foreign Relations Committee that in requesting legislation providing an additional forty-eight million dollars for assistance to underdeveloped areas, it would recommend that Congress vest central responsibility in Washington to control the funds to be appropriated. The Thorpe Committee also intends to recommend establishment of a committee under the Economic and Social Council of the United Nations to see that all “Point Four” projects under the specialized agencies of the United Nations come under centralized review and administration. The Committee said that in some cases the United States would enter into negotiations directly with other governments on the terms of any arrangement between a foreign government and a private U. S. investor. In other cases, it said, the U. S. would attempt to make available its technical resources through the United Nations and its special agencies, such as the International Labor Office, the Food and Agriculture Organization, etc. 30

It would be nice to say that these instrumentalities and policies afforded private investors the support they need if asked to undertake foreign operations in underdeveloped areas. But, our governmental policy, as expressed by statutes aforementioned and interpreted by the administration thereof, actually affords the private investor but scant comfort or practical financial support in foreign operations.

29 Id. at 244.
30 Reston, Point Four's Cost Set At 48 Million Dollars, N. Y. Times, June 15, 1949, p. 14, col. 3.
One partial exception is found in the Export-Import Bank.\textsuperscript{31} According to statutory authority, the purpose of the Bank is to aid in financing and facilitating exports and imports and the exchange of commodities between the United States and/or any of its territories or insular possessions, including any foreign country or the agencies or nationals thereof. The Export-Import Bank Act of 1945 expresses a Congressional policy "that the Bank should supplement and not compete with private capital and that loans should generally be for specific purposes and offer reasonable assurance of repayment."\textsuperscript{32} As originally enacted, the Act reflected Congressional concern for Western Hemisphere countries. It was designed to assist in the development of resources, stabilization of economies, and orderly marketing of products of these countries. Since then, international developments have led to use of the Export-Import Bank facilities in other international transactions.

The American investor presently is obliged to look to the Export-Import Bank for all the aid he can procure under "Point Four" (apart from the overlap of ECA in European colonies). But, the investors' hopes under the present policy of interpretation of this law in private international transactions have to be narrowly limited.

It is said that the Bank\textsuperscript{33} makes loans and guarantees which serve to promote the export and import trade of the United States; that the institution promotes foreign trade by financing the exports in connection with productive developments, thus establishing the basis for the elevation of income levels of borrowing countries. This is regarded as creating better markets for American products and better suppliers of imports for the United States to aid in the correction of our existing trade imbalance. According to the Bank's policy statement\textsuperscript{34} it endeavors only to select for financing those projects most likely to improve the economies and the international financial position of the borrowing countries.

\textsuperscript{31} 59 Stat. 527 (1945), 12 U. S. C. § 635a. (1946). The history of this institution is that it was incorporated as a District of Columbia Bank Corporation under Exec. Order No. 6581 (Feb. 1934). It was continued as an agency of the U. S. Government by an act dated January 31, 1935, as amended and later reestablished under the so-called Second Export-Import Bank, of Washington, D. C., under Exec. Order No. 6638 (Mar. 1934). Thereafter, the Bank was made an independent agency of the Government by the Export-Import Bank Act of 1945, under which law the Bank has since operated. This Act was amended in 1947 to reincorporate the Bank under federal charter and extending its life to June 30, 1953.

\textsuperscript{32} General Policy Statement, Export-Import Bank, Revised August 1, 1947, at pp. 5-6.

\textsuperscript{33} Ibid.

\textsuperscript{34} Id. at 5-10 et seq.
The Bank does not compete with private capital and does not, therefore, extend credit when private credit is available in adequate amounts on reasonable terms. The Bank35 "does not engage as a rule in the financing of foreign trade on customary commercial terms or offer discount facilities on the same basis as commercial banks or commercial finance companies dealing in foreign drafts." Neither does the Bank engage in equity financing. Private investors are always required to produce36 evidence that there is an adequate equity interest in any project to be financed by Export-Import Bank credits.

It is obvious that activities under the "Point Four" program will require time, exploration, capital goods, operating supplies, and capital funds, full information on which requirements will not be available in a traditional banking sense at the beginning, or in the sense of policy requirements as above outlined. Seldom will an entrepreneur in the early stages of development in an underdeveloped area be in a position to present to the Export-Import Bank a project which is bankable in the sense of that institution's general policy. In the meantime all funds must be private risk capital.

Since, from the viewpoint of private capital, new foreign operations in compliance with President Truman's request for aid to underdeveloped areas are not appealing without risk sharing to a considerable extent by the Government, and since the Export-Import Bank is the only existing agency available to private foreign investors (again apart from ECA areas) it follows that it will have to have its powers and policy broadened by Congress if it is to furnish any of the sort of incentives which might induce private capital to expose itself more readily to the risk involved. This has been recognized by William McCchesney Martin, Asst. Secretary of State, and the National Advisory Council (the President's Cabinet Committee on fiscal matters), all of whom are said to feel that the Bank's powers should be amended under "Point Four" so as to give it authority to guarantee private investors up to the point of the original dollar investment involved.37

Current expression of this position is found in the bill introduced July 6, 1949 by Senator Maybank38 and referred to the Committee on Banking and Currency. The Bill declares it to be the policy of the

35 Id. at 5-10.
36 Id. at 7.
United States, both in the interest of its people as well as that of other people, to promote development of "economically underdeveloped areas of the world" by "encouraging productive investment in such areas." The Bill then states that "to this end section 2 (a) of the Export-Import Bank Act of 1945, as amended, is hereby amended by inserting after the words 'to borrow and to lend money' the words 'to guarantee United States private capital invested in productive enterprises abroad which contribute to economic development in foreign countries against risks peculiar to such investments.'"

The next question will then be what the Export-Import Bank will regard as an insurable risk under its amended powers, assuming such legislation is passed. But it seems reasonably certain from the Bank's policy to date that little aid along this front can be realized even with such insurance until the risk capital gap has been otherwise bridged so that bankable projects can be presented to the Bank during the exploratory project stage by those who have already taken the initial risks. It seems unlikely that the gap will be bridged by such an extremely liberal policy with respect to speculative ventures as to make these become bankable any sooner than before.

Among other U. S. and international aids, only ECA can help solve the problems of private capital for underdeveloped areas under "Point Four" and then only in ECA areas and with intervention of foreign governments. At date of writing with the ECA policy for European colonies still uncertain, there is little to say with certainty as to ECA's impact on underdeveloped areas. Likewise, in connection with loans made by the International Bank for Reconstruction and Development, these are for the most part government to government activities from which the private investor can expect at best only an advantage by indirection.

IV

Desirability of Expanded Federal Support

Today, it is said by responsible banking sources\(^{39}\) that Africa and the Middle East are the new magnets for American private capital seeking investment outside the United States. Other areas, formerly furnishing alluring outlets for U. S. private surplus monies, now are in disfavor either because of international political developments

deemed alarming or else by reason of excessive restrictions on currency transfers.

The malignant growth of Communism feeding on the weakened and diseased tissues of the body politic in the Far East, has already eliminated large parts of these areas from the potential investment objectives for those who might have risked their money and efforts there previously.

Although Latin America still has its quota of American investors, spearheaded by the Rockefeller interests, currency restrictions with the uncertainty of ability to transfer earnings and capital, and political instability, have acted as deterrents to a point where, despite the good neighbor policy (of 16 years standing), the capital stream has been reduced to a "mere trickle."40 And notwithstanding the Marshall Plan and ECA, threats of nationalized industry throughout Europe have had a similar effect in minimizing the investment attractiveness of that continent. By the same token, private capital generally is foreclosed in Eastern Europe and Russia by the Iron Curtain, which factor likewise tends to exclude private capital from previous outlets in what are now described as the satellite nations of Czechoslovakia, Poland, Rumania, and neighboring countries. This, coupled with the present favorable investment pattern in the United States, militates against individual private capital going foreign, except in extraordinary instances. For example, about 175 "blue chip" issues traded on either the New York Stock or Curb Exchanges within the past six months, were sold at close to or below their equity in net working capital, a favorable circumstance which has not existed for some time in the past. Availability of promising chances for gain in our American market, combined with the many obstacles to ventures in most foreign areas, is more than enough to cause individual U. S. capitalists to remain in our domestic field.41

There is a vast gap between requisite risk capital, necessary technical assistance promised by our Government and the requirements of underdeveloped countries. This chasm is described in the following manner by Edward P. Reubens who said:

"In order to produce a great effect relative to the needs, however, heavy expenditures would be inescapable. The implementation of technicians' find-

40 Ibid.
41 Cf: The Outlook, Standard and Poor's Corporation, Vol. 21, No. 51, Jan. 31, 1939, p. 954.
ings would require time, capital goods, operating supplies, and capital funds for the support of the new enterprises during the period of installation and adaptation. A number of existing developmental plans are unable to go into operation for lack of funds and reciprocal financial agreements. . . .

The problem must be solved on the basis of common sense to implement the practical idealism. What then, apart from romanticism, the battle call against Communism, and the vague general urge to make fortunes, are the incentives that are concrete?

American capital rightly is and will continue to be vitally concerned in advancing and safeguarding our system of free enterprise and democracy. Apart from this patriotic duty is the possibility of profit in serving our government's stockpiling policy as announced in the Strategic and Critical Materials Stockpiling Act, as amended. The law states three general policies: first, that the nation never should be jeopardized for lack of essential raw materials; second, that stockpile policy and programming should recognize existence of substantial new sources of raw materials available from overseas; and third, that in view of the continued shortage of these materials, steps should be taken, including the use of long range contracts, in order to stimulate the production of such materials. Little, so far as we are aware, has been done under this clause.

As a further approach, agitation has been mounting for accelerated action on reciprocal tax treaties designed to eliminate international double taxation on both corporate and individual income. Approval of tax conventions with Belgium and New Zealand has been requested. Suitable amendments to the South African treaty so as to give Americans tax rights co-equal with those of the United Kingdom also has been urged. Already effective are tax treaty conventions with Canada, Sweden, United Kingdom, Denmark, Netherlands, and France.

Can the risk capital gap be bridged on such a basis, or is more needed? The National Foreign Trade Council has said that "possibilities appear to have been overlooked for improving the climate for international capital investment and trade inherent in programs already

44 See also: Investment Opportunities in British Africa, Chamber of Commerce of the United States, p. 25 (April 1949).
45 N. Y. Times, June 14, 1949, p. 40, col. 3. (See also U. S. Dep't of State Releases, No. 446, June 13, 1949, announcing Norway treaty; No. 431, June 9, 1949, regarding negotiations with Columbia; No. 320, May 4, 1949, regarding conversations with Brazil.)
being carried forward."\(^{46}\)

It will not suffice to say that the mere policy to which we are committed under "Point Four" and the Marshall Plan furnishes adequate inducement for risk capital. The program of "practical idealism, breathtaking in the sweep of its possibilities and yet down to earth in its recognition of the concrete help we can give some other countries from our great storehouse of technical knowledge and private capital"\(^{47}\) is not, in our opinion, sufficient.

If the maximum flow of private U. S. capital to foreign underdeveloped countries is to be induced, our Government must step in to improve the chances in a positive manner. Otherwise, the President's appeal will fall upon deaf ears.

This is the minimum, we submit, which will suffice if the "Point Four" program is substantially to be supported by our Government (including adequate security against double taxation both abroad and at home on profits realized from foreign investments by our people). Legislative guarantees appear imperative if the program is to be completely successful. However, such prospective encouragement to investment through the Maybank Bill\(^{48}\) is in the embryonic stage.

Since, however, our legislative mills grind slowly, it is important to examine what can be done with available legal materials by those investors whose enterprise remains unaffected and unintimidated by legislative reluctance to provide effective guarantees. Although responses to the President's appeal under such circumstances (i.e., present lack of positive guarantees) may be less than wholehearted, those who do respond are entitled to know the hazards and the inducements, such as they are.

While the picture is not too bright so far, it would be unfortunate if the American investor failed to realize the favorable aspects of his current potential U. S. tax status in foreign operations. Tax advantage, as one consideration, is perfectly legitimate. As Judge Learned Hand of the Circuit Court of Appeals for the Second Circuit has so aptly said when discussing this point:

"That is a doctrine essential to industry and commerce in a society like our

\(^{46}\) Ibid.


\(^{48}\) See note 38 *supra* and text to which it refers.
own, in which, so far as possible, business is always shaped to the form best suited to keep down taxes.”

Thus, there is judicial support for shaping foreign operations to a form best suited to keep down taxes. Succeeding sections of this article will attempt to initiate both a description of and the limitations upon tax advantages currently available in this sphere of foreign operations.

V

SOME BASIC U. S. TAX PRINCIPLES COVERING FOREIGN EARNINGS

This, and succeeding sections postulate a few of the U. S. tax advantages for the individual investor which can be used as part of the needed solution to the problem of the risk capital gap.

The basic premise upon which the Bureau of Internal Revenue and our courts operate in interpreting current laws relative to U. S. income taxes on foreign corporations, trusts and non-resident aliens, is two-fold.

The tax is imposed firstly upon the net income “of all persons within its jurisdiction [United States] regardless of the source of such income”, with certain exceptions, and secondly upon “all income arising from sources within the United States, regardless of whether the United States has jurisdiction of the recipient.” This two-fold tax theory has been defined as an exaction upon the individual, measured by his ability to pay on his net income, and as a tax on the income itself.

Our government claims tax jurisdiction over all residing within our borders. Thus, as to U. S. citizens and resident aliens, the tax


50 S MERTENS, LAW OF FEDERAL INCOME TAXATION § 45.03, 242 (1942); Angell, The Non-Resident Alien: A Problem in Federal Taxation of Income, 36 Col. L. Rev. 908; Berliner Handels-Gesellschaft v. United States, 30 F. Supp. 490 (Ct. Cl. 1939); cert. denied, 309 U. S. 670 (1940).

51 Brady v. Anderson, 240 Fed. 665, 667 (2nd Cir. 1917); cert. denied, 244 U. S. 654 (1917).


Impact is upon income coming to them from all sources, whether arising from or earned in the United States, or in a foreign country. Successful jurisdiction over non-resident foreign corporations, trusts, and non-resident aliens cannot be claimed,

"... but to the extent that their income is received from sources within this country, it is taxed, on the theory that the government has jurisdiction over the income, grants protection to the creation of such income, and is, therefore, entitled to a share thereof to defray the expenses of government."55

This approach is deemed necessary in order for the United States to maintain effective control over its international affairs, avoiding wherever possible, the international evil of double taxation, which Mr. Justice Holmes found so repugnant.57

In this connection, Congress has sought to mitigate the impact of double taxation by extending credits for income and profits taxes paid to foreign countries and U. S. possessions.58 This benefit is contained in the present Internal Revenue Code Section 131. Since, however, application of this section has been restricted both by amendments and judicial interpretations to a point where quite often credit is not obtained for more than a limited portion of the foreign taxes,59 the negative application of this section is beyond the scope of this article. As is also a specific review of sub-section (f) of Section 131 which permits domestic corporations, owning stock majorities in foreign corporate subsidiaries from which are received dividends in any taxable year, to claim credits for the proportion of any income or excess profits taxes paid by the foreign corporations to foreign governments or U. S. possessions upon the accumulated profits from which the

54 Fair v. Comm'r Int. Rev., 91 F. 2d 218 (3rd Cir. 1937); U. S. Treas. Reg. 111, §§ 29.22 (a)-1, 29.211-1 (1943).
58 H. R. REP. No. 767, 65th Cong., 2nd Sess. (1918); XVIII, 1939-1 CUM. BULL. (Part 2) 93.
60 Ibid.
dividends were paid. The credit allowed is in the form of the relationship of the amount which such dividends bear to the amount of such accumulated profits. The application of the benefits embodied in the legislation have been delimited sharply by the formula employed by the Commissioner for measuring the allowable credit to be claimed by the domestic parent corporation. This formula has been approved by the Supreme Court in American Chicle Co. v. United States, but its use "means that a full credit for the total taxes paid is never possible."

However, one circumstance in considering any foreign venture is inescapable. That is, that possible savings of U. S. taxes on income from foreign sources are so large a feature in potential benefits that no investor, manufacturer, trader or sales corporation doing business abroad can afford to overlook the opportunity of effecting these savings. And this is the course accented and given a new moral impulse

61 316 U. S. 450 (1942).
62 See Allan and Coggan, note 59 supra at 31.
63 Seghers, Tax Considerations in Doing Business Abroad, N. Y. U. SEVENTH ANN. INST. ON FED. TAX., 10 (1949).

From the viewpoint of the American investor, these principles add up to the following exclusions of income from the Bureau's basis for computing the tax with regard to foreign operations: U. S. citizens and domestic corporations that derive the bulk of their income from sources within a U. S. possession are exempt from the tax on such income, if not, in reality, received in the mainland. Int. Rev. Code, § 251 (b), U. S. Treas. Reg. 111, § 29.251-2 (1943).

Foreign corporations, even though doing business in the United States, are not taxable on income "from sources outside the United States." Int. Rev. Code § 231 (c). Foreign corporations, organized under the laws of a foreign country that exempts from its tax the income of U. S. corporations operating ships under their flag, obtain a corresponding exemption from our federal income tax. Int. Rev. Code § 231 (d). U. S. Citizens who are bona fide "residents" of a foreign country during the entire taxable year are exempt from tax on their earned "income" from sources outside the United States for such year. Int. Rev. Code § 116 (a); Swenson v. Thomas, 68 F. Supp. 390, (N. D. Tex. 1946); Bouldin v. Comm'r Int. Rev. 8 T. C. 959 (1947).

In general foreign corporations, as subsidiaries of American corporate entities, are not allowed to be included in consolidated returns, Int. Rev. Code § 141 (e) (1) (3), excepting foreign corporations owned completely by a domestic corporation and organized under the laws of Mexico or Canada and maintained solely for the purpose of acceding to the laws of such countries as to title and operation of property. U. S. Treas. Reg. 111, § 29.141-1 (e) (1943).

Under Sections 112 (b) (6) and other subsections of the Code, tax-free liquidations of foreign subsidiaries are not permitted, unless prior to such liquidations, the Commissioner of Internal Revenue is satisfied that the transaction is not a device or plan that has as
by the current Truman appeal for foreign development.

An important part of the problem is how to provide for safe accumulation of income. Foreign corporations, other than personal holding companies, are not exposed to the penalty surtax on improper accumulation of surplus on any income derived from sources "outside the United States." Therefore, citizens or resident aliens operating abroad through foreign corporations or certain trusts legitimately formed and operated can accumulate profits without liability for current U. S. income taxes, and if dividends are not withdrawn until final liquidation of taxpayer's interest, such profits when ultimately received by the United States taxpayer will only be subject to tax as capital gains.

In view of these principles, it is important that companies or individuals, desiring to respond to the "Point Four" program, select with care the appropriate legal vehicle best suited to their intended operations. With taxes at their present levels, failure correctly to appraise available tax inducements may make all the difference between foreign investment attractiveness and a decision not to respond to the "Point Four" appeal. Proper formation of corporations and trusts abroad, avoiding personal holding company pitfalls, can do much to make attractive many profitable foreign operations.

VI

THE NON-RESIDENT FOREIGN AND RESIDENT FOREIGN CORPORATION—COMPARISON OF ADVANTAGES

Almost the first question that must be decided is this: Shall the chosen instrumentality be a non-resident foreign or resident foreign entity?

Any discussion of the advantages of doing business abroad by means of a foreign corporation should be prefaced by a definition of the term. The fact that foreign corporations are separately taxed warrants such an effort. The Internal Revenue Code defines the term inversely, that

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one of its principle purposes federal income tax avoidance. INT. REV. CODE §§ 1250, 1251 et seq. According to at least one writer on the subject, See Seghers, note 4 supra at 936, this disadvantage, however, is more than offset by exemption under U. S. tax laws of all income realized by such a "foreign corporation from sources outside the United States."

64 INT. REV. CODE § 102.
65 Ibid.
66 INT. REV. CODE § 231 (c); See Seghers, note 4 supra at 935.
67 8 MERTENS, LAW OF FEDERAL INCOME TAXATION § 45.21 (1942).
is, by defining a domestic corporation as one "created or organized in the United States or under the law of the United States or of any State or Territory," and classifies a foreign corporation as any corporation which is "not domestic."

A resident foreign corporation is one "engaged in trade or business in the United States at any time during the taxable year." A resident foreign corporation is taxed on all income from United States sources at the maximum top normal tax rate of 24%, regardless of income amounts, and with respect to surtax exactions, at the same rates that apply to a domestic corporation up to and including 14% of such income. As a matter of legal mechanics, the taxable income of a resident foreign corporation is said to consist of its gross taxable income less statutory deductions and less certain credits allowed against net income, including designated United States bond interest and the 85% credit against dividends received from domestic (United States) corporations.

Conversely, a foreign company not "engaged in trade or business within the United States at any time during the taxable year", is treated as a non-resident corporation. Such an entity sustains the impact of our federal taxes only on income received which is fixed and determinable (dividends, interest, rents, compensation, etc.) and which, at the same time, emanates from sources within the United States. The rate imposed here against the U. S. income of a non-resident foreign corporation is 30% of the gross income without deductions of any type, and in addition, provision is also made for withholding such tax at the source.

The distinction is important where earnings accrue here, because in the case of non-resident foreign corporations, not only are they subject to federal taxes on income from U. S. sources (investments, property, etc., held here) at 30% of the gross, but also such an entity would not be entitled to a "dividends received credit" with respect to dividends received from domestic corporations.

Under certain specific circumstances, gearing operations to establish the entity as a resident foreign corporation, even though furnishing an

68 Int. Rev. Code § 3797 (a) (4) (5).
70 Int. Rev. Code § 14 (c) (1).
71 Int. Rev. Code § 14 (3) (1), 15, 26 (b), 231 (b).
72 Int. Rev. Code § 231.
expanded basis for allocating income to United States sources, might conceivably (in specific limited circumstances) be more favorable in overall tax result than the first treatment, i.e., non-resident foreign corporate status. For example, if a resident foreign company engaged in business here receives $100,000 in dividends from United States companies it is taxed on $15,000 of the dividends at 38%, the liability thus being $5,700. If the same company were a non-resident corporation it would be taxed at the rate of 30% on the full dividends or $30,000. Moreover, in the former case the recipient might have business deductions allocable to the United States which would reduce its tax even below the $5,700 figure.73

In the majority of cases, factual situations usually will impel an election to engage in foreign operations as a non-resident or non-resident alien instrumentality. However, in some instances such an entity, corporate or trust, may well desire to make substantial investments in America of its own reserves, etc. This normally would dictate an effort to have the entity treated as resident foreign, rather than non-resident foreign, in order to take advantage of the dividends received credit and the net rather than gross tax exaction. However, Section 102 would apply to U. S. income, and care would have to be taken to avoid prohibitions contained in the Personal74 and Foreign Personal Holding Company Acts.75

At this point there emerges the vital question when, and when not, an instrumentality is "engaged in trade or business" in the United States? Formerly, a resident foreign corporation embraced corporations "having an office or place of business" in the United States,76 and this phraseology was employed to effect substantial tax savings for foreign corporations in certain cases. Prior to the amendment of this statute, the Code language afforded a convenient mechanism for obtaining both the benefit of the dividend received credit and at the same time permitted a legitimate substitution of normal U. S. taxes on net for the withholding tax on dividends received from United States sources.77 At present, under the changed interpretation, merely opening an office does not constitute doing business for resident tax purposes, so care must be exercised to create the status desired.

73 Int. Rev. Code § 231 (b), 26 (b).
74 26 Int. Rev. Code § 500; See section VIII of text.
75 26 Int. Rev. Code § 331; See section VIII of text.
77 XVII The New York Certified Public Accountant 149 (March 1947).
Decisions in both federal and state courts, generally interpret, or at least imply, the phrase "engaged in trade or business" to mean what it ordinarily would connote from a common sense viewpoint. As the Court stated in substance in Comm'r Int. Rev. v. Scottish American Investment Co., Ltd.,78 mere ownership of property and investments in the United States, together with the receipt of income therefrom, does not in most instances constitute "conducting a business."79 Basically, the solution revolves around whether continuous and regular activities, corporate or trust-wise, are carried on in the United States. Recently (April, 1949) the District Court for the Southern District of New York, held that the non-resident alien status of a foreign corporation was not disturbed simply because a corporation maintained here a small staff of three to five employees to receive and deposit dividends in an account from which dividends were not withdrawn, and which staff did nothing more than answer written inquiries and advise the foreign entity concerning U. S. Federal Tax problems.80

Thus, preservation of non-resident corporate status depends upon the use of extreme caution in doing nothing more than a nominal service of foreign interests in the United States. As evidenced by the Scottish American, Linen Thread81 and Aktiebolaget82 cases, it is believed that the tendency will be to invalidate use of domestic subsidiaries of foreign non-resident corporations (the majority of whose stock is held by U. S. citizens), as a preventive tax measure,83 to avoid the conclusion of regular and continuous activities in this country.84

78 323 U. S. 119 (1944).
81 Linen Thread Co. Ltd. v. Comm'r Int. Rev., 128 F. 2d 166 (9th Cir. 1942).
82 See note 80 supra.
84 It should be mentioned in this connection that Int. Rev. Code § 212 specifically provides that the status of non-resident aliens is not otherwise affected simply because of an engagement in transactions in the United States in stocks, securities or commodities (customarily consummated on an organized commodity exchange) through a resident United States broker, commission agent, etc., U. S. Treas. Reg. 111, § 29.231-2 (a) (1943) further implement this by stipulating that if a foreign corporation is not otherwise engaged in "business in the United States, carrying on such activities do not make it subject to tax as a resident foreign corporation." Hence, in such a case, while dividends,
Apart from this, however, the Internal Revenue Code\textsuperscript{85} raises a variety of issues regarding the source of income and its relation to the status of resident foreign and non-resident foreign entities. It must be remembered that merely because an entity is engaged in trade or business in the United States is not necessarily dispositive of the issue whether its resulting income is taxable. Pursuant to Code Section 119, the problem is further divided into services rendered and sales made. Different tax consequences attach to each category. In connection with services rendered, the general rule is that the source of income (compensation) emanates from the place where services are rendered or performed, regardless of the residence or domicile of the payer, the place of payment, or any other factor.\textsuperscript{86}

Where goods are manufactured or produced by the taxpayer in a foreign country and sold in the United States, the income therefrom will be regarded as emanating from sources partly within the country of manufacture and partly within the country of sale. The situation is the same where personal property is processed and produced in the United States and sold abroad; the resulting income is apportioned partly to this country and partly to the foreign country.\textsuperscript{87} In the case of all other sales of goods, including those acquired or purchased here and sold abroad, the source of income derived is deemed to be the place where the goods are sold—usually the place where title to the goods actually passes. At least one case, Yardley & Co. Ltd.,\textsuperscript{88} suggests that the rule of apportionment will depend to a great degree on the basis of comparative costs (salaries, etc.) incurred in both the United States and abroad.

In the Yardley case the New Jersey subsidiary of a British Company made annual payments of 15\% of its net profits to the parent corporation for managerial and other corporate services which the parent British Company rendered. These services included testing and analyses of products, exploratory and developmental surveys, preparation of art etc., will be subject to a gross withholding tax, any capital gains with respect to such transactions will avoid United States income tax liability. Seghers, \textit{Foreign Trade and Federal Taxes}, XVII, The New York Certified Public Accountant 145, 151 (March 1947).

\textsuperscript{85} \textit{Int. Rev. Code} § 119 (1945).

\textsuperscript{86} \textit{U. S. Treas. v. Reg. 11}, § 29.119.4 (1943); Comm'r \textit{Int. Rev. v. Piedras Negras Broadcasting Co.}, 127 F. 2d 260 (5th Cir. 1943); \textit{cf}. also: Comm'r \textit{Int. Rev. v. Hawaiian Phillipine Co.}, 100 F. 2d 988 (9th Cir. 1939), \textit{cert. denied}, 307 U. S. 635 (1939).

\textsuperscript{87} \textit{Int. Rev. Code} § 119 (e) and (f) (1946).

work design and advertising layouts, and furnishing general policy advice at occasional executive conferences. Against this factual fabric, the Board of Tax Appeals ruled that 10% of the services rendered by the parent British Company were performed in the United States and 90% in England and therefore determined that the British Company should have included in its gross income return 10% of the payments from the New Jersey subsidiary. It appears that the rationale for this conclusion was based upon the circumstance that the parent British Company for many years rebated to officers of its subsidiaries the same percentage exaction paid it by the subsidiary for managerial services. This circumstance, rather than the actual value of services rendered, seemed to control.89

In instances involving income from the sale of personality not produced or processed by the taxpayer (as distinguished from the tax treatment of income from the manufacture or processing of goods, or income as compensation for the rendition of services), the determination of the place of sale is the important factor. According to the statute, income from goods sold is derived “within the country in which sold.” Under Treasury regulations, “the country in which sold” ordinarily means the place where marketed. Previously, the Treasury Department construed the place where the property was marketed as being the place where the contract of sale was made, that is, where the last act of the seller took place in making the contract of sale. However, it has been held that the place of sale, for the purpose of determining the source of income, is where the title, or all the substantial risks and benefits of ownership, pass from the seller to the buyer.90

For many years the Bureau maintained a contrary position. However, it finally acquiesced91 and espoused the view adopted by the

89 There are certain offsetting deductions allowable to companies denominated as “resident foreign” by reason of such activities partly within and without the United States under U. S. Treas. Reg. 111, § 29.119-10 (1943). All expenses that directly can be apportioned against income, from one source or another, must be so apportioned, and any other deductions which cannot be so apportioned must be allocated generally in the ratio of gross income from each source. This method of apportionment appears to be the formula that would be applied to those cases of foreign operations under the “Point Four Program” where income is received partly here and partly abroad. In the majority of cases, the tax in the final analysis, is not onerous.

90 Ron Rico Corp., 44 B. T. A. 1130 (1941).

courts on this subject. That is, the place where title (or all the substantial risks and benefits of ownership) passes from the seller to the buyer controls the source of income.

Thus, it is imperative in such cases that title to merchandise sold must pass in a foreign country. Particular caution should be exercised to avoid a circumstance whereby a given sale results from negotiations undertaken in the United States with the sale consummated here pursuant to an offer accepted in this country and transmitted to the foreign buyer by our customary method of commercial communication, such as cable advice, letter, etc. In such instances, even if title did pass abroad, these facts are such as to render uncertain the results tax-wise under our laws. Consequently, an individual operating through a newly formed corporate media or an established corporation whose activities abroad are either being resumed or expanded should exercise due care to insure, if possible, that offers for sales of merchandise and other property are always accepted in a foreign country. This may be either the buyers country or some other foreign area mutually convenient to the parties. The place of payment for the goods is immaterial. Naturally, if goods, wares or merchandise are manufactured and sold outside United States territorial limits, the title issue and our tax thereon may not arise.

However, discussions of tax considerations involving sales to foreign customers abroad necessarily would be incomplete without reference to ordinary foreign exchange and blocked currency features. In many

92 See Seghers, note 63 supra at 19.

93 If a United States domestic taxpayer effects foreign transactions (sales) through a branch, subsidiary or agent in a foreign country, our courts have held that current assets and current liabilities can be converted (at the close of each taxable year) from foreign currency to United States currency, at the rate of foreign exchange then prevailing. Victor & Achelis v. Salt's Textile Mfg. Co., 26 F. 2d 249 (D. Conn. 1929). The Treasury Department has acquiesced. O. D. 489, 500, C. B. June, 1926, pp. 60, 61. In all other cases, the exchange rate obtaining at the time the sale is consummated is the measure to be employed for determining the amount of resulting income. (O. D. 419, C. B. June 1920, p. 60). Neither subsequent currency value fluctuations in foreign currency, nor value adjustments related to arbitrage transactions are cognizable until realized either by actual collection or other disposition of the foreign currency, including the time when the right to receive same has actually accrued. Roessel & Co. Ltd., 2 B. T. A. 1141 (1925). In all such transactions, the exchange rate applied to currency conversion consists of the actual market rate on the valuation date at the time when consummated, and not a nominal or fictional exchange ratio. Credit & Investment Corp., 47 B. T. A. 673 (1942); cf. also: Mim. 5297, C. B. 1942-1, p. 84; I. T. 3568, C. B. 1942-2, p. 112.
foreign areas the risk incurred by private investors frequently exposes profits in the country of operations to what amounts to a tax in the form of fluctuating exchange values and controls which prevent capital withdrawals. In such instances it is of scant comfort to the investor to know that his foreign investment is profitable, if he is unable to receive income or effect the return of his capital. Not even liquidation of the investment will help, because in such instances the investor merely has a credit in the foreign countries.94 Although the Foreign Assistance Act of 194895 attempts a correction of this exchange and control problem by having the United States make dollar payments to American investors for purchases made in foreign currency, such action is only a temporary aid for limited purposes. The ability to get the foreign exchange into the form of dollars still remains a crucial problem.

As regards blocked currency it has been held that for Federal Income Tax purposes, foreign currency of this type is to be treated as property and not as money. B. F. Goodrich Co. v. Comm'r Int. Rev., I. T. C. 1098 (1943), and cases cited.

Generally the rule used is that admeasurement of taxable income realized from the receipt of such property (i.e., actual accrual of the right to same), depends upon its fair market value at that time, which all property has except in the most extraordinary cases. Mount v. Comm'r Int. Rev., 48 F. 2d 550 (2d Cir. 1939), reversing 16 B. T. A. 847; U. S. Treas. Reg. 111, § 29.111-1 (1943).

Foreign exchange can be devoid of fair market value if no means exist whereby receivers of exchange values can convert into United States dollars (available in this country) without violation of the currency control laws of the country where the foreign exchange actually has been received or the right to same actually has accrued. Int. Mortgage & Investment Corp., 36 B. T. A. 187 (1937); United Artists Corp. of Japan, Memo. Dec., DKT. 272, 1938-39; U. S. Treas. Reg. 111 Sec. 29.131.6 (1943). "In such a case it is clear that no taxable income arises at the time of receipt of such foreign exchange." Seghers, Tax Considerations in Doing Business Abroad, N. Y. U. SEVENTH ANN. INST. ON FED. TAX. 10 (1949). However, it is not entirely apparent in such instances whether taxable income subsequently is realized when it is legally permissible to convert into United States dollars, or, only when such foreign currency exchange is actually converted, or the right to so convert accrues. Examination of Treasury regulations on the subject suggests that the Bureau would adopt the position "that income arises at the earlier date." U. S. Treas. Reg. 111, Sec. 29.131-6 (1943). And finally we are confronted with the problem as to what happens when profits are realized from the repayment of loans of foreign currency after the exchange rate has been depressed? The Board of Tax Appeals and the Tax Court have said profits are not realized in such instances. North American Mortgage Co. v. Comm'r Int. Rev. 18 B. T. A. 418 (1929) ; B. F. Goodrich Co., 1 T. C. 1098 (1943); Re Coverdale, Memo. Dec., DKT. 3981, T. C., 1940.


The best approach would appear to get the profits into a foreign entity in dollars and if the foreign entity is non-resident in the United States, then face the U. S. tax whenever the dollars are returned either to American citizen investors or U. S. resident owners.

So far as we are aware, this arrangement presently is possible only in one foreign area—in Africa in the Republic of Liberia which has the actual U. S. dollar as its currency medium and has the English language as its mother tongue. The legislature of that Republic recently enacted three laws\(^96\) relating to corporate, marine and financial affairs which were designed to furnish a sound legal basis for commercial activities under laws familiar to American investors and their counsel and to make Liberia a financial center of Africa. Thus, in Liberia a non-resident alien entity effectively can isolate itself from the foreign exchange and control dilemma.

Conversion of profits into dollars in Liberia permits continued conduct of foreign operations in the actual U. S. dollar, which is not elsewhere possible even though Panama and others are in the U. S. dollar area and have pegged their currencies to our dollar.\(^97\)


\(^{97}\) Reference is made to a special exemption granted by Congress and designed "to encourage the international adoption of uniform tax laws affecting shipping companies for the purpose of eliminating double taxation." Finance Comm. Rep. No. 275, 67th Cong., 1st Sess. p. 14; \textit{Int. Rev. Code} § 212 (b). The exemption so granted is available both to income derived by non-resident aliens, as well as foreign corporations, from the operation of ships documented under the laws of a foreign country and engaged in or conducting transportation services, etc., between the United States points and destinations foreign thereto. \textit{Int. Rev. Code} §§ 212 (b), 231 (d). Under the Regulations, however, such an exemption evaporates if an equivalent exemption is not available to United States ships maintained and documented under our flag. U. S. Treas. Reg. 111, § 29.212-2 (1943). Absent such reciprocity, that portion of income from ship operations allocable to sources within the United States will be taxed in the manner identical with other income of a non-resident alien or foreign corporation "engaged in business" in this country. U. S. Treas. Reg. 111, § 29.119-13 (1943).

The situation in Liberia is unique. Having neither personal nor corporate income tax in that Republic, it would seem clear that ships documented under Liberian flag, pursuant to the new Maritime Code enacted there on December 18, 1948, are entitled to the aforementioned exemptions specified in our Code, §§ 212 (b) and 231 (d), and implementing U. S. Treas. Reg. 111, §§ 29.212-2 and 29.119-13 (1943).
VII
THE TRUST VEHICLE—RELATIONSHIP TO FOREIGN OPERATIONS

Existence of reputable financial institutions and agencies abroad, as in Switzerland, Panama, and Liberia, to name but a few, adequately equipped prudently to manage American capital invested abroad under the "Point Four" program, automatically focuses attention upon the desirability in certain circumstances of responding to President Truman's request through the trust mechanism, or by using this instrument in combination with a corporate vehicle.

Assuming an active and genuine rather than passive trust (the tax law does not address itself to trust fictions98), such estates are taxable as separate entities.99 Such separability for income tax purposes likewise attaches to the grantor, trustees and beneficiaries.100

The residence of the trust, and therefore its taxable status, usually is determined by the residence of the fiduciary, rather than by the domicile or residence of either the settlor, beneficiaries or even the source of income.101 Basically, as respects "Point Four" operations, the initial question is whether trusts or trust estates, are foreign trusts, regardless of the citizenship of U. S. parties thereto, and irrespective of settlor's or beneficiaries' residence. A more certain foreign status is provided if the corpus of the trust is located at a foreign situs for management and administration by a foreign trustee, provided, that the trust is not

With reference to partnership enterprises and tax consequences thereon, a non-resident alien is considered as being "engaged in trade or business in the United States" if partnership to which he belongs is likewise so engaged. INT. REV. CODE § 219; U. S. Treas. Reg. 111, § 29.219-1 (1943). Such a partner (non-resident) can, however, exclude from his taxable income that portion of the firm's net income which was derived from or earned in "sources outside the U. S." Craike v. United States, 31 F. Supp. 132 (Ct. Cl. 1940).

If a given partnership is not construed as "engaged in business" or trade within the United States but nevertheless has either fixed or determinable income from U. S. sources, said income is subject to the withholding tax. INT. REV. CODE § 143 (b). Obviously, the magic key to this problem is found in the phrase "engaged in trade or business in the United States".

98 Stoddard v. Eaton, 22 F. 2d 184 (D. Conn. 1927); Dascomb v. McCuen, 73 F. 2d 417 (2d Cir. 1934), cert. denied, 295 U. S. 737 (1935).
100 Anderson v. Wilson, 289 U. S. 20 (1933); Girard Trust Co. v. Helvering, 301 U. S. 540 (1937); 6 MERTENS, LAW OF FEDERAL INCOME TAXATION, §§ 36.15, 36.09, 36.13, 61.02 (1942).
101 INT. REV. CODE § 161.
regarded as doing business in the United States. If a trust is doing business here, it may be treated as a corporation and taxed as such. This result may be good or bad depending upon the facts in each case. Tax planning with regard to trust mechanisms in foreign operations involve considerations quite different from those which must be appraised if the corporate form is employed. Thus a determination that a trust is in reality a corporate venture could be both unexpected and disconcerting.

The question of residence is critical, because a resident trust is taxable upon accumulated income (including capital gains) received from any source, with the same deductions for income distributed to resident or non-resident beneficiaries as would apply in any other case. Conversely, a trust treated as a foreign trust is subject to tax only upon fixed or determinable income from sources within the United States. Otherwise stated, undistributed income from a trust under the control of a resident fiduciary, subject to the jurisdiction of one of the states of the United States, is taxable in the same manner as that of any resident individual, irrespective of residence or non-residence of the grantor or beneficiaries. But a non-resident alien trust and, by the same token, a non-resident alien fiduciary of a trust would be taxable upon undistributed income received only from U. S. sources. Foreign income is exempt, and this, irrespective of the residence or citizenship of the settlor or beneficiaries. As Judge Parker said in *B. W. Jones Trust for Brigadier General O. C. Herbert v. Comm'r Int. Rev.*:102

"It is the manifest intention of Congress, that alien trusts be subjected to the same rule as alien individuals, and such trusts are subject to Section 211 only under circumstances that would subject an individual to it."103

Since the "engaged in business" question usually determines whether the trust domicile is domestic or foreign for tax purposes, facts concerning trust residence carefully should be considered. Normally, the same considerations, the same facts and the same standards that apply tax-wise to corporate residence, likewise apply here.104

102 132 F. 2d 914 (4th Cir. 1943).
104 In Re Adda, 10 T. C. 273 (1948); In Re European Naval Stores, 11 T. C. 19 (1940); Amalgamated Dental Co., Ltd., 6 T. C. 1009 (1946); Comm'r Int. Rev. v. Piedras Negras
The Jones case,\textsuperscript{106} however, presents at least one decision which suggests that physical location of trust assets may well have a bearing on the trust residence and tax status. Here a trust was created by an English subject with income to be distributed to English beneficiaries and capital gains to be added to the corpus. Ninety per cent (90\%) of the corpus of the trust consisted of U. S. securities held in this country in the actual possession of an individual American citizen, as trustee. Three other trustees were also named but they were British subjects. The American trustee was the chief engineer of the property, collected income and remitted same to the British trustees from an office maintained here in the U. S. in the name of all trustees. Policy decisions regarding trust investments primarily were made by one of the British trustees, who periodically visited this country for conference purposes with the American trustee. All dividends and interest from American investments were paid directly to the American trustee, who kept records and accountings regarding activities in this country; thereafter transmitting a report to his British trustees, which later distributed abroad the income earned. The Fourth Circuit held that the trusts were resident trusts and, therefore, taxable on U. S. capital gains which were added to the trust corpus.

This opinion stresses the significance of the location of the trust assets, bank records and accounts, rather than the residence or domicile of the trustees. The case is important because it emphasizes dangers of having any substantial part of trust assets physically in the U. S. for custody in any case where the residence of a trust constitutes an important tax consideration.

Moreover, another possible impediment exists where the grantor and ultimate beneficiaries are residents of the U. S. This danger emanates from the possibility that the Treasury Department might, in such instances, contend that a trust is a resident trust whenever the grantor and ultimate beneficiaries reside in the United States. This danger arises from the untested and extreme rule of law in New York, that if the creator of a trust is domiciled within New York at the time the trust was created, it is a resident trust, irrespective of residence or situs of the fiduciary and regardless of other mitigating facts.\textsuperscript{106}

\textsuperscript{106} Maxfield v. Canadian Pacific R. R. Co., 70 F. 2d 982 (8th Cir. 1932), cert. denied, 293 U. S. 610 (1934); Mandel Bros. v. Henry A. O’Neil, Inc., 69 F. 2d 452 (8th Cir. 1934).

\textsuperscript{106} Supra at note 102.

\textsuperscript{106} N. Y. TAX. LAW § 350 (7).
While it is the opinion of the authors that neither the Jones case nor the possible contention under the New York law above mentioned are controlling in all sorts of varying fact situations, existence of these possibilities demonstrably establishes an unavoidable degree of uncertainty on this point. However, there is no real risk if the subject of the trust vehicle is truly an operation foreign. It appears reasonably certain that in most cases involving premature taxation by our government, these risks will be minimized, if not eliminated, by adherence to the general rules herein described and the use of a non-resident alien or foreign trustee in the majority of circumstances.

Assuming establishment of the foregoing trust instrumentality, and further assuming that the trust indenture contains directions for the accumulation or distribution of income to named beneficiaries, such income will not be accessible to the settlor or grantor of the trust. Problems, however, may arise if the trust is revocable or controlled, e.g., the income might be taxable to the settlor even though not paid to him.

Under the Internal Revenue Code\textsuperscript{167} the grantor may be taxable under a variety of situations where he retains an interest in the income, for example, if the income can, in the discretion of the grantor (or of any person not having a substantial adverse interest), be distributed to the grantor, or be held, or accumulated for future distribution to him; or where the grantor reserves a discretionary power to require distribution of the income due some person other than himself; or where a portion of the income is or may be applied to the payment of premiums on policies of life insurance on the grantor; or where part of the income is applied or distributed for support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain.

Likewise, the grantor could be taxed on trust income if he has retained a power to revest title to the corpus in himself under § 166 of the Internal Revenue Code. Similarly, the grantor would be taxed under the doctrine announced in Helvering v. Clifford\textsuperscript{108} if he is operating under a factual situation which could be interpreted as constituting the grantor the remaining owner of the property of income under § 22 (a) of the Code. All of these present issues of far reaching significance, a detailed discussion of which herein is prohibited by space limitations.

\textsuperscript{107} Int. Rev. Code § 167 (1946); see also Spiegel's Estate v. Comm'r Int. Rev., 69 Sup. Ct. 301 (1949).
\textsuperscript{108} 308 U. S. 331 (1940).
If the settlor is a non-resident alien, the income taxable to the settlor would normally be limited to income from fixed or determinable U. S. sources. But where the trust is of such a type (for example where the income is used to discharge an obligation in the U. S. of the settlor) then the settlor or grantor would be liable and this same rule is applicable even though said settlor or grantor is a foreigner. ¹⁰⁰

With respect to U. S. citizen or resident beneficiaries of a trust, the beneficiaries are, of course, generally taxable under § 162 of the Code either on (1) income which is to be distributed currently by the fiduciary, whether or not such income is in fact distributed, or (2) income which in the discretion of the fiduciary may either be distributed to the beneficiary or accumulated, and which is properly paid or credited to the beneficiary during the taxable year.

Normally if the beneficiary is a U. S. citizen or resident, income of the type aforementioned, if actually received, would be fully taxable regardless of its source. Some doubt exists whether, insofar as trust income from sources foreign to the U. S. is concerned, such a beneficiary is taxable on distributable income or taxed only on that which is actually distributed. So far as we are aware, this question has never been judicially determined. But at least one authority on the subject is of the opinion that the beneficiary in such instances would be taxable only upon income actually distributed. The rationale for this conclusion is as follows. Since a foreign trust is not subject to U. S. tax and, therefore, not entitled to deductions for income distributable to beneficiaries, it would seem that a beneficiary in the above situation would be taxable only on income actually received. ¹¹⁰

A non-resident alien beneficiary is taxable only upon the income distributed or distributable to him, insofar as said income is properly apportionable to U. S. sources. A non-resident alien beneficiary who receives income from sources outside the U. S., either directly or through a trust medium, is not taxed.

Here the problem could become complicated if the trust income consists of both U. S. and foreign income with distributions made to both non-resident alien beneficiaries and resident alien or U. S. citizen beneficiaries. If the trust instrument does not provide for a payment to the beneficiary from a particular trust income source, the trust income

¹⁰⁰ Princess Lida of Thurn & Taxis, 37 B. T. A. 41 (1938). But note the existence of problems of enforcing collection of this tax against such a grantor.

from sources within the United States, is to be prorated so that the amount allocated to each beneficiary shall bear the same relation to the total trust income from U. S. sources as the beneficiary's total distributable share bears to the total distributable trust income from all sources.\footnote{In the case of Wm. E. Muir, 10 T. C. 307 (1948), the court sustained in part the Commissioner's action in adding to the yearly income of a non-resident alien taxpayer the sum of $8,000 representing dividends paid on stock of a domestic corporation held by trustees of a foreign trust. The dividends were paid directly by the corporation to the resident alien beneficiary on authorization of the foreign trustee in satisfaction of annuity payments provided under the trust agreement. The remaining balance of dividends paid by the domestic corporation were remitted to the foreign trustee and eventually paid to the non-resident alien taxpayer, who was the residuary beneficiary. Based on these facts, the Court held that trust income from U. S. sources should be pro-rated so that the amount allocated to each beneficiary would bear the same relation to the total distributable share of each bore to the total distributable trust income from all sources. It therefore follows that as a non-resident alien beneficiary receives income which the foreign trust has derived from dividends paid on U. S. stocks, such income is from U. S. sources in the hands of the beneficiary. Bence v. United States, 18 F. Supp. 848 (Ct. Cl. 1937); Vondermohll v. Helvering, 75 F. 2d 656 (D. C. Cir. 1935); G. C. M. 9156, V-1 CUM. BULL. 166 (1926).}

As to capital gains, it appears that such gains by non-resident foreign trusts are not taxable, providing such trust is not "engaged in business" within this country. Therefore, capital gains received by foreign trusts will not be subject to the provisions for withholding of tax at the source, and would not be taxable to a non-resident alien beneficiary as distributable or actually distributed during the year.\footnote{I. T. 3495, 1941-2 CUM. BULL. 195; Gustave Kluehn, 46 B. T. A. 1211 (1942); U. S. Treas. Reg. 111, § 29.211-7 (1943).}

Insofar as trustees are concerned under a foreign trust, if the foreign trust indenture directs the accumulation of income, the trustee is still taxable as to a fixed or determinable income from U. S. sources, but this would not include capital gains. And this is true regardless of the status of the beneficiaries or the grantor. This ruling indicates that it makes little, if any, difference whether the income might eventually pass to a U. S. citizen or resident beneficiary. As to the possibility of a beneficiary being taxed on distribution of accumulated income, there is little danger, that income accumulated for a period of years and paid over to the beneficiary upon the attainment of a specified age or paid over pursuant to definite instructions, would be taxable to the beneficiary at the time of distribution.

The regulations prescribe the general rule that income once taxable
to and assessed against a trust is not, therefore, taxable to and assessable against the beneficiary upon distribution. So far as we are aware, the Bureau has never attempted in this type of situation (at least where a domestic trust was involved) to do more than tax the final year's income to the beneficiary. Even in this effort, the Bureau was unsuccessful prior to the 1942 Act. 113 Under the amendments to Section 162 of the Code, as added by the 1942 Act, the beneficiary in such situations cannot be taxed on more than the income for the preceding twelve months prior to distribution. Apart from the dangers previously mentioned, it would seem that the weight of judicial authority and administrative determination clearly supports and makes advisable, in cases where individuals prefer to respond to President Truman's call by individual action, that engagement in foreign operations be undertaken through the mechanism of a non-resident alien trust with income accumulation for beneficiaries. This procedure seems as safe as anything can be in this changing world.

It must, however, always be remembered that tax materials used to appraise a particular factual situation are ever changing and frequently lead to varying results that can not always be predicted with reasonable legal certainty. Because of this circumstance, facts relating to a proposed given foreign project undertaken responsively to President Truman's "Point Four" appeal possibly may have to be accommodated to existent law in order to insure maximum security for the investor. But, there is nothing wrong from a tax viewpoint in the employment of preventive legal measures to insure the maximum degree of tax security possible for the private investor in foreign areas. And certainly there should be no objection to fulfilling what Elihu Root described as the client's proper demand to know how to do what he legitimately desires to accomplish rather than to be the recipient of negative advice as to what can not be done. 114

VIII

THE BUSINESS PURPOSE ENIGMA—SOME ASPECTS OF THE HOLDING COMPANY AND SECURITIES ACTS

A parallel problem of equal importance to that of selecting the proper mechanism for operations abroad is found in the Congressional road blocks contained in the Code which prohibit tax-free exchanges, either

113 Spreckels v. Comm'r Int. Rev., 101 F. 2d 721 (9th Cir. 1939).
through reorganization, recapitalization, or other exchange of assets between domestic and foreign entities. Appraisal of these tax inhibitions is important because some responses to the "Point Four" appeal may well take the form of liquidation or transfer of domestic assets to a newly formed foreign entity in compliance with our declared public policy under "Point Four".

Prior to 1932, such exchanges, with few exceptions, were relatively free from the impact of income taxation.\(^{115}\) This result was accomplished by transfer of assets to a foreign corporation (generally Canada or Newfoundland), with such assets thereafter being sold or otherwise liquidated from outside the United States. Congressional reaction to this practice is found in §§ 1250 and 1251 \textit{et seq.} of the Internal Revenue Code.\(^{116}\) Now, the tax incidence is placed on the transfer or distribution of property to a foreign corporation. Section 1251 provides that, in resolving the extent to which recognizable gain attaches to exchanges or distributions (in reorganizations, etc.), a foreign corporation shall not be considered a corporation unless it is established to the Commissioner's satisfaction that each such exchange or distribution "is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal Income Taxes." (Emphasis supplied).

And, in addition, § 1250 was enacted for the purpose of imposing a special excise tax\(^{117}\) on the transfers of stocks or securities

". . . by a citizen or resident of the United States, or by a domestic corporation or partnership, or by a trust which is not a foreign trust, to a foreign corporation as paid-in surplus or as a contribution to capital. . . ."\(^{118}\) (Emphasis supplied).

However, in order to prevent bona fide exchanges or transfers from being excluded from the tax-free exchange area, § 1251 further provides that said section is inapplicable if the Commissioner's prior determination is obtained to the effect that a given exchange, transfer or distribution does not have for one of its principal purposes, tax avoidance. "This section has been criticized because no provision has been made for a judicial review of the Commissioner's findings as to whether tax avoidance is one of the principal purposes."\(^{119}\)

\(^{115}\) Helvering v. Curran, 114 F. 2d 1018 (2d Cir. 1940).

\(^{116}\) \textit{Int. Rev. Code} § 1250 \textit{et seq.}

\(^{117}\) \textit{Int. Rev. Code} § 1250.

\(^{118}\) Depending upon the year, between 25-27\(\frac{1}{2}\)% (present rate); 2 \textit{CCH 1949 Fed. Tax. Rep.} p751C; 4 \textit{CCH 1949 Fed. Tax. Rep.} 2292.

\(^{119}\) I \textit{Montgomery, Federal Taxes}, 208 (1948-9).
While foreign to the scope of this article, failure to provide for judicial review of the Commissioner's decisions in these respects presents an intriguing question of law. Suppose X executes the transfer (notwithstanding this action) and a tax is assessed and litigation results. Does the absence of provision for judicial review of Commissioner's rulings mean that the Commissioner's prior negative decision is not admissible in evidence against taxpayer on the point of avoidance? On the other hand, if such a denial is admissible, is such a determination by the Commissioner (i.e., that the exchange had for one of its principal purposes tax avoidance) binding upon the courts?\(^1\)

In a prophetic decision\(^2\) involving a tax year prior to the enactment of § 1250 and 1251, the Second Circuit struck down a transfer of assets to a foreign entity under a plan previously considered legal by piercing the corporate veil and taxing the stockholders on the theory that the transaction was a sale of assets rather than a bona fide exchange, apparently basing its conclusion on the rationale of *Higgins v. Smith.*\(^3\) Present law\(^4\) renders examination of these cases here unnecessary. Suffice it to say the tax plans for transfer of assets to foreign agencies in both Cases plainly espoused tax avoidance as their principal *raison d'être.* Obviously, if neither profit is realized nor loss sustained, the problem doesn't arise. Likewise, the problem is non-existent in cases where direct transfers of cash are made as an investment.

At present it appears to be the position of the Bureau of Internal Revenue\(^5\) and at least one court,\(^6\) that if it is desired by a taxpayer to establish that its or his primary or principal purpose is not one of either federal income or excess profits tax avoidance, notice *must* be given the Commissioner regarding the transactions, and a statement under oath concerning the facts of same, together with a copy of said plan, furnished the Commissioner. These requirements must, it is said, be adhered to strictly.\(^7\)

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2. Helvering *v. Curran*, 114 F. 2d 1018 (2d Cir. 1940).
Despite, however, this approach by the Bureau in interpreting the statutes, some courts still keep their foot in the door so as to sanction reasonable plans, conceived in good faith and legitimately executed. To determine when such a status exists, so as not to be foreclosed under either §§ 1250 or 1251 of the Code, there is squarely projected in every plan of foreign operations, where gain is involved in some transfer of assets, the issue: Does it have a legitimate corporate or business purpose?

The leading, and it might be added, most confusing case on the point is *Gregory v. Helvering,*127 a reorganization case. The decision was based upon a construction, that transfers, exchanges, reorganizations, etc., depended, almost exclusively, upon a taxpayer's *motive*, *intent* and/or *purpose*; there must be a *desire* to comply with the *spirit* of the law rather than lip service adherence to its form. This principle, and not an incidental tax advantage, which otherwise accompanies a sincere desire to conform to the substance of the law, controls.

Naturally, the *Gregory* case, and other decisions128 invested every transfer or exchange with an element of uncertainty, regardless of how conscientiously the taxpayer endeavored to comply with the statutory requirements. The situtation was deemed so disturbing, that the Special Tax Study Committee,129 appointed by the House Ways and Means Committee, recommended that the Treasury be foreclosed from applying the so-called business purpose test, unless it be clearly set forth beyond doubt, or at least by a clear preponderance of the evidence that the principal purpose of any given plan was tax avoidance.

Yet, fortunately, the *Gregory* case "business purpose" confusion is not nearly as misleading as we might think. For this we are indebted to the Courts of Appeals for the Second and Fourth Circuits, which in two decisions130 appear to have furnished a yardstick for measuring transactions under Code §§ 1250 and 1251 that seems to make sense.

In the *Hay* case,131 the taxpayer, a naturalized citizen, attempted

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128 Bazley, 4 T. C. 897 (1945), aff'd, 155 F. 2d 237 (3d Cir. 1946), aff'd, 331 U. S. 737 (1946); Adams, 5 T. C. 351 (1945), aff'd, 155 F. 2d 246 (3d Cir. 1946); aff'd, 331 U. S. 737 (1946); Heady v. Comm'r Int. Rev., 162 F. 2d 699 (7th Cir. 1942); I MONTGOMERY, FEDERAL TAXES, 256 (1948-9).
to escape estate and income taxes by repatriating himself as a British citizen, and thereafter forming a Bahama corporation to which he transferred in 1937 all the stock (worth two million dollars) of a California corporation, in which he was the sole stockholder. He became a domiciliary of Nassau at the same time. About a year later, he liquidated the California corporation and transferred its assets to the Bahama company.

The Fourth Circuit in an opinion by Judge Soper, held the first transfer valid and therefore non-taxable on the theory that no gain resulted from a mere transfer of assets by a non-resident alien outside of the United States from "one hand to another", but the second transfer and the gain therefrom was held taxable because of clear evidence that the taxpayer's scheme or plan of transfers had for its sole purpose tax avoidance. This was adduced from the circumstances that the taxpayer was suffering from tuberculosis and therefore unduly conscious of estate taxes, that he had been advised by his tax consultant with reference to the plan and its apparent immunity, and that he also desired, by the transfers, to escape the prohibitions of the Holding Company Act, which was then before Congress for action. All this was either proved or admitted at the trial below.

Although either transfer, standing alone, would not have been taxed, both when combined in relation to the scheme and the evidence were sufficient to defeat the plan. Speaking of this, Judge Soper said:

"We do not think that a taxpayer can avoid the incidence of an income tax by splitting a transaction into non-taxable parts if a taxable gain is derived from the transaction considered in its entirety."\textsuperscript{132}

However, it should be mentioned that the Tax Court apparently was unimpressed with the facts adduced in support of the contention that the plan was permeated with a legitimate business purpose, observing in this connection that to hold dormant the assets involved in the first transfer for a period of approximately five years while allegedly looking for suitable investments, scarcely demonstrated a sound business practice or plausible corporate purpose. "He intended at the outset to have Hay, Ltd., liquidate. That is what actually occurred and is, of course, what must govern here."\textsuperscript{133}

\textsuperscript{132} \textit{Id.} at 1004.

\textsuperscript{133} William C. Hay, 2 T. C. 460, 469 (1943).
In Chisholm v. Comm'r Int. Rev., Judge Learned Hand, speaking for the Second Circuit, and commenting upon the Gregory case said:

"It is important to observe just what the Supreme Court held in that case. It was solicitous to reaffirm the doctrine that a man's motive to avoid taxation will not establish his liability if the transaction does not do so without it. It is true that that court has at times shown itself indisposed to assist such efforts, Mitchell v. Board of Commissioners of Leavenworth County, 91 U. S. 206, 23 L. Ed. 302, and has spoken of them disparagingly, Shotwell v. Moore, 129 U. S. 590, 9 S. Ct. 362, 32 L. Ed. 817; but it has never, so far as we can find, made that purpose the basis of liability; and it has often said that it could not be such. The question always is whether the transaction under scrutiny is in fact what it appears to be in form; a marriage may be a joke; a contract may be intended only to deceive others; an agreement may have a collateral defeasance. In such cases the transaction as a whole is different from its appearance. True, it is always the intent that controls; and we need not for this occasion press the difference between intent and purpose. We may assume that purpose may be the touchstone, but the purpose which counts is one which defeats or contradicts the apparent transaction, not the purpose to escape taxation which the apparent, but not the whole, transaction would realize. . . ."134

Thus, it seems clear that the business purpose test under §§ 1250 and 1251 of the Code is adequately met, if the transfer, exchange or other distribution is not a perfunctory135 arrangement but is effected pursuant to a demonstrable intention to engage in a foreign enterprise with the assets involved being activated rather than being held dormant. Form and substance must coincide, and if they do, the mere fact that taxes are thereby avoided as an incidental part of the operations, is immaterial.

Certainly, it would seem, that if American capital answers President Truman's call to aid underdeveloped areas, it cannot later be contended plausibly that such a response lacked business purpose merely because one of the purposes was to regenerate the world together with inciden-


tal advantages under our U. S. tax structure. No one would incur the risk and accept the hazards of operating abroad (including foreign taxes) simply to avoid taxation. Prudent business judgment precludes such a course of conduct if the only purpose was tax avoidance. Consequently, a legitimate business purpose must necessarily accompany transfers of assets abroad responsive to the "Point Four" program.

Although reference to the business purpose requirement necessary to support a transfer under the Code causes one automatically to think of corporations, the same standards governing such entities apply with equal force to trusts. Perhaps the better and more accurate term as to both forms of operations abroad would be legitimate purpose. However, the circumstance that the vehicle selected for foreign activities is imbued with a valid business purpose within the meaning of §§ 1250 and 1251 of the Code does not eliminate the fact that a trust may in some cases be construed as a corporation or that a limited number of individuals may elect the corporate form through which to respond to President Truman's "Point Four" appeal. Either possibility presents serious legal problems involving dangers inherent in the Personal and Foreign Personal Holding Companies' Acts,136 prohibitions against unlawful accumulations of earnings,137 and to a limited degree, the Securities and Exchange Act.138

In view of the legislative history that holding company provisions were designed to attack the so-called incorporated pocket book139 situations, it behooves individual entrepreneurs to examine these U. S. investment controls with care.

A foreign corporation, whether resident or non-resident (other than a foreign personal holding company), may be a personal holding company with reference to income from U. S. sources. However, a foreign corporation is not treated as a personal holding company if:

(a) Its gross income from sources within the U. S. for a three year period is less than 50% of its total gross income from all sources; and

(b) All of its stock outstanding during the last half of the taxable

year is owned by non-resident alien individuals whether directly or indirectly, through other foreign corporations.\footnote{140}

Subject to the above, however, a corporation is deemed a personal holding company if the following circumstances are present simultaneously:

\((a)\) If at least 80\% (70\% after the first year) of its gross income for the taxable year consists of dividends, interest, capital gain or any of the other items specified in § 502 of the Revenue Code, and

\((b)\) If at any time during the last half of the taxable year more than 50\% in value of its outstanding stock is owned directly or indirectly by or for not more than five (5) individuals.\footnote{141}

The term foreign personal holding company includes only foreign corporations which fall into both of the categories below:

\((a)\) 60\% (50\% after the first year) of gross income for the taxable year is income from sources both within and without the U. S., consisting of dividends, interest, capital gains or other items mentioned in § 332 of the Code, and

\((b)\) If at any time during the taxable year the corporation has more than 50\% of the value of its outstanding stock owned directly or indirectly by or for not more than five individuals who are citizens or residents of the United States.\footnote{142}

Unlike personal holding companies, a “foreign personal holding company” is not itself taxed, but each of its stockholders who is a citizen or resident of the United States, domestic corporation, domestic partnership, domestic estate or trust, must include its proportionate share of the company’s undistributed “Supplement P” net income in his or its own returns. Moreover, such amount must be included as a dividend (even though consisting of long-term capital gains realized by the company) and the amount so includible is added to the stockholder’s basis for his or its stock.\footnote{143} In addition, gross income in such instances is computed as if the foreign corporation were a domestic company and,

\footnotesize{140} Int. Rev. Code §§ 500-511 (1946).
\footnotesize{141} Int. Rev. Code § 501 (a).
\footnotesize{142} Int. Rev. Code § 331 (a); Reg. 111, § 29.500-1 to 29-506.12 (1943).
therefore, not limited to income from sources within the United States.\textsuperscript{144}

In connection with the Securities and Exchange Act\textsuperscript{145} no real difficulty is encountered, unless the entrepreneurs, even though desirous of operating as a non-resident foreign corporation, elect to solicit stock subscriptions publicly in the United States by the use of the mails or some instrumentality in interstate commerce. In such cases, compliance with the Act and administrative regulations for registration is necessary.

The test whether registration under the Act is necessary, revolves around the nature of the offering, that is, whether it is public and therefore registerable, or private, and thus exempt from registration under § 77 (d). Early in January of 1935, the Commission's General Counsel ruled in effect that while the number of people to whom offerings were made was but one of the many facts to be considered in appraising this problem, nevertheless an offering or submission to a group of thirty or less people was private and therefore an exempt transaction.\textsuperscript{146} Since then, however, Commission policy has changed—mere arithmetic no longer is decisive. The relationship of the offeror to offeree and the character of the offering are the most important factors in the test.\textsuperscript{147}

Moreover, in the case of foreign corporations, whether resident in the United States or not, and in the case of foreign nationals resident in a foreign country, the Commission specifically has excluded them from the $300,000 exemption from registration privilege which domestic corporations enjoy.\textsuperscript{148} Thus, foreign corporations cannot avoid registration by restricting stock solicitations in the United States to offers of $300,000 or less.\textsuperscript{149}

These considerations (business purpose test, Holding Company and Securities Acts prohibitions) constitute pitfalls into which the unwary may stumble. Proper planning in devising the formula to be used in good faith response to the "Point Four" appeal should eliminate these hazards.

\begin{footnotesize}
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\item[\textsuperscript{144}] \textit{Int. Rev. Code} § 332; \textit{U. S. Treas. Reg.} 111, § 29.332-1 (1943).
\item[\textsuperscript{145}] \textit{48 Stat. 74} (1933), as amended, 15 \textit{U. S. C.} § 77 (a) \textit{et seq.} (1946).
\item[\textsuperscript{147}] \textit{Sec. v. Sunbeam Gold Mines Co.} 95 F. 2d 699 (9th Cir. 1938); \textit{Sec v. Chinese Consol. Benev. Ass'n.}, 120 F. 2d 738 (2nd 1941), \textit{cert. denied}, 314 U. S. 618 (1941).
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\end{footnotesize}
IX

SAMPLE PLAN FOR PRIVATE INVESTMENT IN FOREIGN OPERATIONS UNDER "POINT FOUR" AND EXISTING LAW

After due consideration of the tax and other factors previously mentioned, it is believed that the following structure for operations abroad by private American investors appears to provide a reasonably secure base for assuming calculated risks in response to our public policy appeal for foreign investments. Also it appears to afford maximum protection for the investor who wants to accumulate a new inheritance for his beneficiaries under our present laws.

The plan suggested embraces four proposals constituting an agenda for operations and is as follows:

1. Have the original investor form a group of American private investors who will subscribe capital to a pool to be used in foreign operations through the agency of a non-resident foreign corporation\(^{150}\) avoiding in the formation of such company a personal holding company situation. From a practical viewpoint, this means that the non-resident foreign corporation should have not less than ten (10), nor more than thirty (30) stockholders. Such a number of associates, if the proportion of ownership is distributed properly and if consummated as a result of a truly private offering, would seem to insure protection under both the Securities and Holding Companies Acts, providing the subscribers are of a class known as so-called sophisticated investors.

To insure maximum protection for the investors and to guard the investment against nationalization or surrender as a result of hostile legislation, the non-resident foreign corporation should be established in a country where there is no income tax, no local exchange problem (as against the U. S. dollar), no risk of confiscation, accompanied by a stable government free from Communistic or other anti-capitalistic revolutionary influences. As previously mentioned\(^{151}\) we are aware of only one such country—The Republic of Liberia. Where possible to obtain clearance from the Treasury Department that the company has a

\(^{150}\) It might be worth-while considering the use of a limited partnership for the first years in view of the probability that profits may be small in the beginning. Losses of such a partnership (as well as gains) could be reflected on the individual partner's income tax returns. The group could incorporate themselves later.

\(^{151}\) See note 96 supra and text to which it refers.
legitimate business purpose,\textsuperscript{152} the funds which this corporation would use might be created out of U. S. assets owned by the investors which could be liquidated favorably on a capital gains basis, thus making available a greater amount of investment funds than would normally be the case since no capital gains tax is payable by a non-resident foreign company or trust.

2. Each subscriber to the stock in such corporation as above described, if desirous of creating a capital stake for his beneficiaries, might well consider the establishment of a non-resident foreign trust for accumulation of income in such a country, which trust would own stock in the venture. It would appear desirable to give the funds or stock over to the trust at the beginning, paying the gift tax thereon under present law. This would appear to terminate the U. S. gift, inheritance and income tax problems with reference to foreign earnings from either the foreign corporation or trust until U. S. beneficiaries, at the end of the accumulation period, were entitled to receive earnings.\textsuperscript{153} This also would seem to have a like effect on the capital gains tax on the liquidation of U. S. assets and their subsequent transfer to foreign hands.

An American citizen or resident beneficiary under the trust, entitled to receive earnings in any year at the end of the accumulative period under the trust instrument would, of course, have to consider reporting and possibly paying the current U. S. tax thereon even though not received. But no capital gain would appear payable on transfer of the accumulation of income in the trust. It should be noted, however, that a U. S. stockholder in such a foreign company who continued to own stock himself and who sells or liquidates his corporate interest would be required to pay a capital gains tax if a profit is realized on the transaction.\textsuperscript{154}

3. Where available, a reliable foreign fiduciary institution apart from the investors' non-resident foreign corporation or other vehicle would prove of incalculable benefit to the investors under this suggested program. The foreign fiduciary institution should be used as resident agent for the corporation, or even for the limited partnership and also as trustee for any foreign trusts set up as

\textsuperscript{152} See note 135 supra and text to which it refers.

\textsuperscript{153} See, Section VI and Section VII of text.

\textsuperscript{154} See Section VII of text.
above suggested for beneficiaries of the investors. Such institutions, under American management, do exist.\textsuperscript{155}

In order to spread the risk capital in the pool to the maximum during the exploration phase and while calculating the risk, the managers of the foreign enterprise should next approach known governmental and private research sources for already available technical information and services bearing on their proposed activities to be obtained cost-free or in return for prospective assistance from the new venture or to be rendered at governmental cost under the proposed "Four Point" treatment, or under ECA. For example, the latter agency can and does use counterpart and other developmental funds to make pre-project surveys by arrangement with the governments involved and subsequent subcontracts with private agencies. By these devices overhead costs and initial exploration costs can be minimized. After these available data have been evaluated, the managers will then be in a position to determine the apparent extent of the risk to which the stockholder's funds are to be exposed.

As soon as a project has been developed to the measurable risk stage, the managers would want to seek additional Export-Import, ECA counterpart or other \textit{senior money} development funds, so as to provide leverage on capital in amounts adequate to support the pure risk capital available to them.

4. It is at this point also that any of the proposed guarantees against the abnormal foreign risk of currency non-availability, confiscation, etc., should be sought. That is, after the risk has been measured and before funds of magnitude have been actually invested, or prior to an irrevocable decision to invest, the investor should request his legal counsel to secure a Treasury Department ruling or, if possible, a closing agreement\textsuperscript{156} protecting him

\textsuperscript{155} The International Trust Company of Liberia, at note 96 \textit{supra}.

\textsuperscript{156} INT. REV. CODE § 3760 gives the Commissioner (or any officer or employee of the Bureau, including the field service, when authorized in writing by the Commissioner), authority to enter into an agreement in writing with any person relating to the liability of such person in respect of "any revenue tax" for any taxable period. If the investor is able to demonstrate sound business or policy reasons for desiring a closing agreement and it is established that the Government will not sustain a disadvantage by acceptance of such an agreement, then "an application for a closing agreement will not be rejected solely because no advantage to the Government is apparent." Mim. 4149; C. B. XIII-1, 162; \textit{Cf: Montgomery, Federal Taxes on Estates, Trusts and Gifts}, 926 \textit{et seq.} (1948-49).
to the maximum extent possible in acting in reliance on counsel's advice and acquiescing under the circumstances that such an investment and transfer of funds is in consonance with U. S. policy and taxable only as agreed in the closing agreement under the current interpretations of existing tax law.

When the Treasury ruling or closing agreement has been obtained and the funds subscribed, the corporate capital position should be reflected by the use of preferred stock and/or debentures, together with common stock in the proportions desired by the relative positions of subscribers and the degree to which they seek relative security (or measurable loss) from the senior securities and ultimate gain from the common stock. The common stock can then be used for making any gift in trust for beneficiaries, if it is desired to use the plan combining the non-resident foreign corporation with the non-resident foreign trust.

When the project has produced gains sufficient to warrant realization (or has failed and liquidation is indicated) let the stock owners consider selling in whole or in part for capital gains or losses. Or, if a trust has been established for certain beneficiaries, any gains available after accumulation can be returned for these beneficiaries at will, without capital gains.

In the plan above suggested, the assumption has been made that the investors are truly interested in undertaking foreign ventures in response to the "Point Four" appeal; that tax advantages are purely incidental. It is to be understood that tax impacts abroad are to be accepted where such exist and our federal liability incurred when proceeds of investment by way of capital gain or current earnings become the property of a U. S. resident or citizen as opposed to the foreign corporation or trust. But until such a phase in foreign investment projects has been attained, it should be enough that the investor is risking all the foreign hazards in doing a world important service, i.e., furnishing dollar risk capital for development of underdeveloped areas, without exposing him to greater hazards and tax liabilities than already exist.

The plan suggested may seem oversimplified because consideration of currency conversion and local tax problems abroad has been consciously omitted. As of this writing consideration of these complications are unnecessary if the underdeveloped area chosen for pioneering were the recently opened development field in The Republic of Liberia, because that country has no income tax and does not present a currency con-
version problem for an American, in view of its use of the actual U. S. dollar as its medium of exchange.

Where the plan is used for a country having high income or similar taxes and unconvertible or soft currency, the picture will look differently. One worth-while approach in such cases still would be to work through the instrumentality of a foreign corporation in Liberia, because of its favorable features, proceeding by all legitimate devices to accumulate profits in Liberia, in dollars. In such instances the plan would appear to be about the same as already suggested. It would unduly prolong this article to discuss all the ramifications of currency problems and answers, via such an intermediary, but sales to dollar buyers being made by the intermediary company in Liberia would enable an accumulation to be made in dollars, even though prior earnings may not be free from taxes in the other foreign country to the same extent.

Where operating in a high tax and soft currency situation a whole range of further alternatives would have to be canvassed, including the desirability of using one or more American companies to own the operation or own stock in the operating company, so as to incur and pay the foreign tax in such a way as to get maximum U. S. credit for it against U. S. taxes. Consideration of the many facets of the type of operation abroad would be mainly for U. S. operating companies which desire to extend their businesses, as opposed to the individual private investor of risk capital to whom we have given most of our attention in this article and whose needs are assumed to include accumulation for beneficiaries.

CONCLUSION

That the reaction of the U. S. investor to the "Point Four" appeal has been less enthusiastic to date, is patent. And understandably so, in view of the many obstacles mentioned herein as besetting the course of the risk capital investor in foreign projects. These hazards, coupled with the demonstrable circumstance that but little financial assistance to the private investor from existing U. S. agencies can be anticipated in the immediate future, unquestionably constitute a pernicious deterrent to risk capital investment.

It is believed that the suggested plan herein outlined will permit private investors to pioneer in foreign projects in such a way as to isolate federal tax problems until the capital employed is returned to our tax jurisdiction. But mere conception of a formula for operations under "Point Four" is not alone a magic elixir or irrevocable guarantee of
success. Its effective application will depend upon sound and imaginative planning, adequate funds adroitly employed, and prudent execution of projects, for all of which there can be no successful substitute.

But, if the maximum private capital is to be used with maximum effectiveness under “Point Four”, our government, at all appropriate administrative levels, must cooperate affirmatively with risk capital in any legitimate response to the “Point Four” appeal. Large sources of private capital now exist which could make the “Point Four” program an exciting and dramatic success in combating world insecurity. Until government cooperation is demonstrably forthcoming, it will be unreasonable to expect private capital to be anything other than significantly silent.

Such cooperation can, we submit, immediately be extended as outlined herein by administrative action in the form of closing agreements between the Treasury Department and the investor whereby the latter’s tax liability is reliably defined so as to permit foreign activities to be undertaken in confidence. The statutory authority to do this already exists—new legislation on this point, however desirable otherwise, is not necessary. Whether or not such cooperation is forthcoming will provide, we believe, an accurate test of the Administration’s seriousness of intent.

If the “Point Four” program is to be both “bold” and “new”, our government and private capital must get started—and now!
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80
ADMINISTRATIVE LAW

COMPULSORY INAUGURATION AND EXTENSION OF AIR CARRIER ROUTES

THE PROBLEM

The recently decided case of State Airlines, Inc. v. Civil Aeronautic Board\(^1\) has brought to the foreground the problem of the extent of the power of the Civil Aeronautics Board to compel air carriers whose economic functions it regulates\(^2\) to serve new or extended routes. This involves an examination of the questions of whether the Board may require such inauguration or extension where the carrier neither applies nor consents and whether it may enforce such a requirement where the carrier does not apply but does positively or negatively consent. It is to the solution of these questions, by a study of the law, the Board's cases, judicial decisions, and analogous situations found in the regulation of other carriers and public utilities, that this note is addressed.

THE LEGISLATIVE BASIS

Consideration of this problem involves constructions of the applicable portions of the Civil Aeronautics Act of 1938 in the light of constitutional limitations. The governing provisions of that Act are section 401,\(^3\)

\(^1\) 174 F.2d 510 (D.C. Cir. 1949).
\(^2\) Economic regulation functions are among those vested in the Civil Aeronautics Board by Section 7, Reorganization Plan Number IV, approved by Congress on June 4, 1940, to take effect on June 30, 1940. H.R. Doc. No. 692, 76th Cong., 3d Sess. (1940).
\(^3\) "(d) (1) The Board shall issue a certificate authorizing the whole or any part of the transportation covered by the application, if it finds that the applicant is fit, willing, and able to perform such transportation properly, and to conform to the provisions of this chapter and the rules, regulations, and requirements of the Board hereunder, and that such transportation is required by the public convenience and necessity; otherwise such application shall be denied.

"(2) In the case of an application for a certificate to engage in temporary air transportation, the Board may issue a certificate authorizing the whole or any part thereof for such limited periods as may be required by the public convenience and necessity, if it finds that the applicant is fit, willing, and able properly to perform such transportation and to conform to the provisions of this chapter and the rules, regulations, and requirements of the Board hereunder."

"(h) The Board, upon petition or complaint or upon its own initiative, after notice and hearing, may alter, amend, modify, or suspend any such certificate, in whole or in part, if the public convenience and necessity so require, or may revoke any such certificate, in whole or in part, for intentional failure to comply with any provision of this subchapter or any order, rule, or regulation issued hereunder as any term, condition, or limitation of
with respect to certificates of public convenience and necessity of air carriers (U. S. citizens), and section 402, controlling permits issued to foreign air carriers.

With respect to initial issuance of certificates and permits, the governing subsections of the act make it mandatory on the Board to grant the necessary authority to an applicant if the public convenience and necessity (or public interest) requires the proposed service and if the applicant is fit, willing, and able to perform the service. This language makes it clear that a qualified applicant must be awarded so much of any route as the Board finds to be necessary; it further suggests that the Board has no authority to issue a certificate or permit to an air carrier covering a new route or part thereof (1) for which it did not apply or (2) which is not required by the public convenience and necessity (the public interest) or (3) in connection with which the Board has determined that the carrier is not fit, willing, and able to perform the service. However clear the words of the statute may seem when so isolated, their exact import has for some time been obscure. Unfortunately, the legislative history does not provide any assistance. On the other hand, a literal reading of the remainder of statutory provisions regarding amendment would lead one to believe that the Board had carte blanche authority to change carriers' certificates or permits, hence to require any extension whatsoever it found to be required after notice and hearing, the only limit being that the Board could not act arbitrarily or capriciously. Again a review of the legislative history offered no explanation of congressional intent. As the Board so aptly noted in one of the cases before it, the material regarding the legislative history which the parties had submitted and stressed as significant "... seems about equally susceptible of being construed as supporting or as denying the existence of the power of extension."5

It remains, then, to examine the reports of administrative and judicial adjudication since the enactment of the Civil Aeronautics Act of 1938 in an attempt to determine from such reports the extent of the Board's power in the field under discussion.

such certificate. ... Any interested person may file with the Board a protest or memorandum in support of or in opposition to the alteration, amendment, modification, suspension, or revocation of a certificate." 52 Stat. 987, 49 U.S.C. § 481 (1946).

4 Similar provisions are set forth in Section 402 except that the public interest, rather than the public convenience and necessity, is the test. 52 Stat. 991, 49 U.S.C. § 482 (1946).

5 Panagra Terminal Investigation, 4 C.A.B. 670 (1944), at 674.
THE CIVIL AERONAUTICS BOARD'S CONCEPTION OF ITS AUTHORITY TO COMPEL NEW OR EXTENDED SERVICE

The Board early pronounced its opinion that it was to be guided by certain basic principles in the amendment of carriers' certificates of public convenience and necessity, these principles apparently applying whether the amendment be voluntary on the part of the carrier or compelled by the Board. The standard under which the Board will exercise its discretionary power is the public convenience and necessity. Furthermore, the requirements of section 401 (d) of the Act that the Board find the applicant "fit, willing, and able" to perform the service controls in the case of a route extension, even though the proceeding is one under section 401 (h). Likewise, the Board has held that it may amend a foreign air carrier's permit only if it finds such change to be in the public interest and, in the case of a route extension, if the applicant is fit, willing, and able to perform the service, a construction of sections 402 (g) and 402 (b) together. These holdings, then, mark the absolute limits beyond which the Board will not go in compelling an air carrier under its jurisdiction to extend its route, and indicate that the Board applies the same set of principles, the same yardsticks of public policy and economics, whether the question concerns new or extended service.

Two subordinate questions, however, remain unanswered, regardless of the extent of the Board's actual authority. Logically, the first of these is "Has the Board yet compelled any carrier to inaugurate or extend a route without the carrier's own application or consent?" If the reply to this is affirmative, then follows the query "To what extent has the Board so compelled the several carriers?" Actually, the answers to these questions are inextricably interwoven; they cannot be treated separately.

In one early case, the Board acted on its own initiative to determine the need for service to Huntsville, Alabama, the site of an important Army chemical installation, by either Eastern Air Lines or Pennsylvania-Central Airlines. The latter corporation did not apply for the service

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7 See note 3, supra.
9 Trans-Canada Airlines, Service to Windsor, 8 C.A.B. 138 (1947).
but was a party to the proceeding. The Board's order amended one of
the company's certificates of public convenience and necessity to in-
clude this service, an addition of twenty-seven flight miles per day, about
seven per trip. Pennsylvania-Central did not complain of the action. 10
In another case, Elizabeth City, North Carolina, petitioned the Board
to be included as an intermediate point on a Pennsylvania-Central Air-
lines route because the city was inadequately served by rail carriers.
This involved an additional fifty-six miles daily. Finding the public con-
venience and necessity to require such service (largely because the town
was a center for submarine chaser construction during the last war),
the Board amended the airline's certificate to include the new service,
but again the company, though not an applicant, did not protest. 11 In
a third case of this nature, the Board, apparently again motivated by
national defense considerations during the war, initiated an investiga-
tion into making Long Beach, California, a flag stop for members of
the armed forces. This, once more, involved minor extension of routes,
United Air Lines was the only carrier to ask for such an amend-
ment. Nevertheless, the Board ordered the temporary inclusion of Long
Beach as a flag stop on certain routes of American Airlines and Trans-
continental and Western Air, as well as on a United Air Lines route.
Neither of the non-applying carriers protested this action. 12 Further-
more, in a number of the "area cases" decided by the Board since the
cessation of hostilities, a comparison of the orders issued reveals that at
least one of the affected carriers in each case, although an applicant for
some new certificate and/or an amendment, was awarded a new route
or route extension for which it did not apply. 13 This was true of pro-
ceedings involving both interstate air transportation and foreign air

11 Pennsylvania-Central Airlines Corp., Service to Elizabeth City, 3 C.A.B. 370
(1942). For similar case, see International Air Service to Baltimore, 6 C.A.B. 621
(1945).
12 American Airlines, Inc., et al., Temporary Service to Long Beach, 3 C.A.B. 376
(1942).
13 An area case is a proceeding whereby the Board holds a single proceeding relative
to all applications for new certificates or permits and amendments affecting a geographical
area which is deemed to be a single economic region in order that the most efficient
transportation system can be worked out. See, for example: Service in the Rocky
Mountain States Area, 6 C.A.B. 695 (1946), West Coast Case, 6 C.A.B. 961 (1946), The
Texas-Oklahoma Case, 7 C.A.B. 481 (1946), Southeastern States Case, 7 C.A.B. 863
(1947), Mississippi Valley Case, 8 C.A.B. 726 (1947), North Atlantic Case, 6 C.A.B. 319
(1945).
transportation. However, it should be noted that in the cases cited, the certificates granted represented relatively minor changes from the application; all were within the area which the particular carriers undertook to serve, although the amendments in the North Atlantic Case\(^\text{14}\) involved greater distances than did those in the interstate air transportation cases.

Another facet of the question of compelling a carrier to extend its route without that carrier's application or consent is seen in earlier cases of the Board. In one instance, for example, Eastern Air Lines applied for a certificate to operate what it termed a new route, citing section 401 (d) of the Act.\(^\text{15}\) The Board amended one of Eastern's existing certificates and used these words:

"... Insofar as it may be necessary or desirable to alter any of Eastern's existing certificates of public convenience and necessity to accomplish this purpose, we interpret Eastern's request as invoking the provisions of section 401 (h) of the act whereby the Authority after notice and hearing may alter, modify, or suspend any certificate of public convenience and necessity in whole or in part, if the public convenience and necessity so require."\(^\text{16}\)

Another case involving the same company, along with other applicants, resulted in the Board's amending an existing certificate. In this case the opinion states:

"... While Eastern's application herein was filed under section 401 (d) of the Act, it requests, on brief, that it be authorized to furnish air transportation between Evansville and Louisville and that the certificate authorizing such service be separately granted or that the segment be attached to route No. 47 or route No. 10. We interpret this request as invoking the provisions of section 401 (h) of the Act under which we are empowered to amend existing certificates. ..."

Braniff Airways, in another proceeding,\(^\text{18}\) applied for a Texas-Oklahoma route in a new certificate application but also applied for such further relief as the circumstances warranted and expressed a willingness to operate all or any part of the route applied for. The Board im-

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\(^{14}\) 6 C.A.B. 319 (1945).


\(^{16}\) Id. at 808. Reaffirmed in Northwest Airlines, Inc., Green Bay-Wassau-Eau Claire Service, 4 C.A.B. 119 (1943).

\(^{17}\) Braniff Airways, Inc., et al., Houston-Memphis-Louisville Route, 2 C.A.B. 353 387 (1940).

\(^{18}\) Trans-Southern Airlines, Inc., et al., Amarillo-Oklahoma City Operation, 2 C.A.B. 250 (1940).
Immediately stated that this catch-all clause invoked section 401 (h) and
treated the proceeding as a petition for an amendment. The Board took
an identical position with respect to a catch-all clause in a later Braniff
application for a Texas route\(^{19}\) and in an Eastern Air Lines proceeding
involving service from the Great Lakes region to Florida.\(^{20}\)

It will be noted that the number of decisions unequivocally alleging
the Board's power to amend has in recent years decreased in spite of
the tremendous increase in commercial air operations and growth in
numbers of economic cases handled by the Board. It is believed that
this is attributable to (1) the "education" of the carriers in procedural
matters so that they now petition for amendment wherever possible
rather than apply for a new certificate, (2) the automatic inclusion of a
catch-all clause in applications, (3) the recently developed procedure
of the Board of handling a number of dockets pertaining to the same
region on an "area case" basis, (4) a feeling by the Board that its
position relative to section 401 (h) had been reiterated so frequently
in earlier decisions that it no longer requires restatement, and (5) the
decision in the Panagra Terminal Investigation.\(^{21}\)

The Panagra case is the sole Civil Aeronautics Board opinion which
states the Board's official understanding of the limits (within the con-
fines of the required findings referred to at the outset of this note) of
its power under the Act to compel a carrier to extend its route without
the latter's application or consent. This case was started on the Board's
own initiative but included a petition by W. R. Grace and Company,
half-owner of Pan American-Grace Airways, Inc., to have the Board
amend the carrier's certificate so as to extend its route from its Canal
Zone terminal to a terminal in the United States, a distance of approxi-
mately 1200 miles. This carrier was certificated to serve principally
the west coast of South America from the Canal Zone; connections
with the continental United States were largely provided by Pan Ameri-
can Airways, Inc., a subsidiary wholly owned by Pan American Airways
Corporation, Panagra's other half-owner, and by other wholly owned
subsidaries of the Pan American Airways Corporation. Panagra wouldn't
apply for an amendment because of the opposition of the half of the
board of directors representing the Pan American Airways Corporation

\(^{19}\) American Airlines, Inc., et al., San Antonio-Laredo Service, 4 C.A.B. 64 (1942),
reaffirmed in National Airlines, Inc., et al., New Orleans-Dallas-Forth Worth Service,
4 C.A.B. 278 (1943).


\(^{21}\) 4 C.A.B. 670 (1944).
in the joint company; there was a deadlock because these directors refused to agree to any compromise solution. In the proceeding, in which all interested parties (including competitors) participated, the Board dismissed the Grace petition and concurrently put on record its authority in such cases in the following words:

"We are of the opinion that this section (401 (h)) of the Act does authorize the Board to add new points or services to the certificate of a carrier on the Board's own initiative and without an application by, and the consent of, the carrier; but this authority does not include the addition of new service which would be so extensive as to amount to a new air transportation route, or of such a kind as to substantially change the character of a carrier's system. . ."\(^{22}\) (Emphasis supplied.)

"While in our opinion neither the Constitution nor the principles of statutory construction restrict the power of the Board under section 401 (h) to order compulsory extensions which are within the undertaking of the air carrier, nevertheless, as we have pointed out earlier, the controlling statutory words are not unlimited in meaning. We believe that the fair construction of the scope of the terms 'alter', 'amend', or 'modify' can be best expressed in the language used by the dissenting opinion in the Oregon\(^ {23} \) case to define the term 'extension':

"'. . . (They do) not fairly connote a prolongation so vast and sudden as to work an utter transformation of the character of the road, making what was extended the incident and the extension of the principal. The action of the Commission must have a basis in reason, and its order must be viewed with reference to the length and other conditions of the line or lines to be enlarged. No doubt there is a point at which the enlargement of a road becomes 'the construction of a new line' rather than the extension of an old one.'\(^ {24} \)

The Board then proceeded to make a "square" finding on its extension power in these words:

". . . We find, therefore, that the extension of Panagra's route from the Canal Zone to the United States would not be an alteration, amendment, or modification of its certificate within the meaning of section 401 (h) of the Act in the sense that the Board could compel such an extension in the absence of an application from Panagra."\(^ {25} \)

**THE COURTS' PRONOUNCEMENTS ON THE BOARD'S AUTHORITY**

Thus far, there appear to be but two cases bearing on the question of initiation or extension of an air carrier's route without its application

\(^{22}\) Id. at 673.


\(^{24}\) Note 21, supra, at 677.

\(^{25}\) Note 21, supra, at 678.
or consent which have reached the courts; both of these have been decided by circuit courts of appeal. The earlier case was the appeal by W. R. Grace and Company from the Board’s order in the *Panagra Terminal Investigation.* However, the court refrained from either affirming or overruling the Board’s conclusions relative to its extension power. Instead, the court determined that the *Panagra* case was not a continuation of earlier proceedings involving the Grace petition, but rather an entirely new proceeding on the Board’s own initiative to determine for itself whether or not Panagra’s certificate should be amended. In addition, on petitions for rehearing, the court stated:

"... we adhere to the view that a consent by a carrier to a 401(h) extension proceeding begun by the Board is the legal equivalent of a petition for the same extension initiated by the carrier."26

Accordingly, the court remanded the case to the Board and foreclosed consideration of the crucial question during that particular series of legal actions.

The other case in point is very recent, an appeal by a disappointed applicant from the Board’s order in the *Southeastern States Case.*

In brief, the successful applicant, Piedmont Aviation, Incorporated, which had been carrying on non-scheduled (and hence non-certificated) service for some time, applied to the Board for certain north-south routes in the southeastern states region; most of the routes applied for were on a pick-up service basis. State Airlines, Incorporated, had applied mainly for east-west routes in the same general locale on a conventional service basis. The Board’s orders, collectively, awarded most of the east-west routes to Piedmont, on a conventional service basis although a substantial portion of these had not been included specifically in Piedmont’s application. The order required initiation of entirely new route by Piedmont which, if covered at all by the application, could have come in only under a catch-all clause. State was awarded nothing and consequently perfected its appeal as an aggrieved party after having exhausted its administrative remedies. The court here found in favor of

26 W. R. Grace and Co. v. Civil Aeronautics Board, et al., 154 F.2d 271 (2d Cir. 1946) and State Airlines, Inc., v. Civil Aeronautics Board, et al., note 1, supra.
27 W. R. Grace and Co. v. Civil Aeronautics Board, et al., note 26 supra. See also notes 21-25, supra.
28 *Id.* at 287.
State Airlines, Inc., the petitioner, expressly indicating that the Board, in the court's opinion, went beyond the limits of power delegated by section 401 (h). Speaking through Clark, J., the court says:

"Respondent tacitly concedes that Piedmont did not specifically apply for the awarded routes but directs the bulk of its argument on this issue to its claim that Piedmont's application was 'sufficiently broad' (by virtue of a so-called 'catch-all clause' in the Piedmont application) to justify its being considered an applicant. This 'catch-all clause' as contained in Piedmont's amended application states that Piedmont applies 'for the authorization to engage in scheduled air transportation as an air carrier of passengers, mail and property, in local and feeder passenger service and mail, express and property pick-up service on the routes detailed herein, or such modification of such routes as the Board may find public convenience and necessity require.' (Emphasis supplied.) We do not read this clause as requesting, in any sense, authority to operate on the routes ultimately awarded in this case. We do not agree with the Board and with Piedmont that . . . the routes represented by the solid lines are a mere modification of the routes represented by the broken lines. Such a claim seems to us to be a distortion of reality and a totally unreasonable, capricious, and arbitrary interpretation of the word 'modification'. To be sure, the word 'modification' normally connotes change or altering, but such change or altering must not be great and must not result in so transforming the original thing to be modified as to make of it something entirely new and different in substance. . . ."\(^{30}\)

In addition, the court determined that it was beyond the Board's delegated authority, as expressed by the "fit, willing, and able" criterion, to issue a certificate to a non-applicant and that the Board's finding that Piedmont was so qualified was erroneous. Consequently, the case was reversed and remanded. Since this decision, the Supreme Court has granted certiorari;\(^{31}\) should the Court affirm the Circuit Court's decision on the same grounds, the outer boundary of the Board's power in this field will be more clearly established.

**Compulsory Inauguration and Extension of Routes of Other Regulated Carriers and Public Utilities**

In view of the paucity of court decisions with respect to air carriers, an appraisal of the situation prevailing with regard to other regulated carriers and public utilities was made. In the field of aviation law, court decisions in point were scarce. Furthermore, the statutory provisions governing them are sufficiently different as to weaken any conclusions and parallels derived therefrom.

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The Transportation Act of 1920 first brought in the concept of certificates of public convenience and necessity and amendment thereof at the Interstate Commerce Commission's own initiative. Section 1 (21) of the Interstate Commerce Act (incorporating the Transportation Act of 1920) governs. It will be noticed here that the criteria in this Act are different from those the Board had held to be imposed on it by the Civil Aeronautics Act of 1938 in that expense to the carrier is expressly made a consideration for rail carrier compulsory extensions, but the rail carrier need not be "ready, willing, and able" to perform the service. In the case of the United States v. Pennsylvania R. Co., decided by the Supreme Court in 1924, the first statement touching on the extension power in the Interstate Commerce Act was made. Therein it was implied that all exercises of the power would be valid if made in strict conformity with the act and if reasonable, but this discussion was entirely unnecessary to the case and is entitled to little or no weight. In 1929, the Supreme Court held that the Interstate Commerce Commission did not have the power, despite the cited provision, to order the construction of a union station in Los Angeles. And in 1933 the Court came out with the most categorical statement to date on the compulsory extension power; in a case where the Commission had ordered the extension of a rail carrier in the Pacific Northwest area a distance of one hundred eighty-five miles into unserved territory, the Court held that the ordering of this extension was in excess of the Commission's statutory authority, which is confined to extensions within the undertaking of carriers to serve and does not embrace new lines reaching new territory.

The Commission also regulates motor carriers under the authority of the Motor Carrier Act of 1933, which became Title II of the Interstate

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32 "The commission may, after hearing, in a proceeding upon complaint or upon its own initiative without complaint, authorize or require by order any carrier by railroad subject to this chapter, party to such proceeding ... to extend its line or lines; Provided, That no such authorization or order shall be made unless the commission finds, as to such extension, that it is reasonably required in the interest of public convenience and necessity; or as to such extension or facilities, that the expense involved therein will not impair the ability of the carrier to perform its duty to the public..." 24 Stat. 379, as amended by 41 Stat. 474-479, 49 U.S.C. § 1 (21) (1946).

33 266 U.S. 191 (1924).


Commerce Act. The appropriate provisions of this act use broad language.\textsuperscript{36}

Apparently, the statutory construction of these provisions has never been passed upon in connection with an involuntary route extension. The closest precedent is the decision in 1944 in which the Court upheld the right of the Commission to issue certificates of public convenience and necessity authorizing service not specifically requested by the applicant.\textsuperscript{37}

In 1940, Part III of the Interstate Commerce Act, giving the Interstate Commerce Commission regulatory powers over water carriers engaged in interstate and foreign commerce, was enacted.\textsuperscript{38} Although section 201 (d) of that Act authorizes the issuance and amendment of certificates of public convenience and necessity by the Commission, the sole court holding on the section in question was that there is statutory authority neither for revocation nor for alteration of certificates.\textsuperscript{39} However, since the case involved commodities rather than routes, its utility as a precedent in this field is highly questionable.

Congress has passed other legislation of a similar nature—requiring a certificate or license as a condition precedent to entering interstate or foreign commerce in some carrier or utility field. The important Acts are: the Federal Communications Act of 1934,\textsuperscript{40} the Natural Gas Act,\textsuperscript{41}

\textsuperscript{36} "304 (f) Notwithstanding any other applicable provisions of this chapter and chapters 1 and 2 of this title, to the extent that it may be in the public interest, the commission may modify, change, suspend, or waive any order, certificate, permit, license, rule, or regulation issued under this chapter."

"312 (a) Certificates, permits, and licenses shall be effective from the date specified therein, and shall remain in effect until suspended or terminated as herein provided. Any such certificate, permit, or license ... may upon complaint, or on the Commission's own initiative, after notice and hearing, be suspended, changed, or revoked, in whole or in part, for willful failure to comply with any provision of this chapter, or with any lawful order, rule, or regulation of the Commission promulgated thereunder, or with any term, condition, or limitation of such certificate, permit, or license. ..." 49 STAT. 546, 49 U.S.C. §§ 304 (f) and 312 (a) (1946).

\textsuperscript{38} 54 STAT. 929, 49 U.S.C. §§ 901 et seq. (1946).
\textsuperscript{40} Section 214 (d) provides for compulsory extension of telephone and telegraph service if the expense to the "carrier" isn't unreasonable and section 312 (g) allows the Federal Communications Commission to modify radio licenses after notice and hearing. 48 STAT. 1075, as amended, 47 U.S.C. § 214 (d) (1946) and 48 STAT. 1086, as amended, 47 U.S.C. § 312 (b) (1946).

\textsuperscript{41} Section 7f (a) permits the Federal Power Commission to compel extensions of natural gas pipelines in the public convenience and necessity unless it would unduly burden service to existing customers. 52 STAT. 824, 15 U.S.C. § 717f (a) (1946).
and the Federal Power Act. While there have been numbers of cases alluding to the acts cited, none has had a court case directly involving the point of compulsory inauguration or extension of facilities.

While federal judicial action has been small in this field, state action has been voluminous. As was pointed out above, although it can generally be said for example, that illuminating gas companies can be compelled to extend their service within the boundaries of their franchise, but not outside, the variations of statutory provisions on which such state regulatory actions are based are so great as to discredit conclusions drawn from the state cases.

Conclusions

Strict statutory interpretation appears to give the Board almost unlimited power to compel an air carrier to extend its routes without the carrier's application or consent, subject only to such action's being in the public convenience and necessity (the public interest in the case of foreign air carriers). As a further limitation, the Board has imposed upon itself a restraint that the carrier be "ready, willing, and able" to perform the additional service, although this is a rather flexible check-rein (like equity and the Chancellor's foot). In addition, the Board has stated in an opinion which it has yet to overrule, modify, or circumscribe, that it does not consider itself to have the power to compel, without the carrier's application or consent, an extension of a kind which would substantially change the character of the carrier system. Yet, the Board has frequently compelled inauguration of new routes or extensions, all relatively short in distance, usually without protest on the part of the operating carrier. Finally, the courts have held that the Board cannot award routes not specifically applied for despite a catch-all clause in the petition or application.

In summary it may be said that the bare outline of the Board's power in the field under scrutiny has become visible. It may not extend the route of a non-consenting carrier, but almost any affirmative action on

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42 Section 213f allows the Federal Power Commission to require electricity producing and wholesaling companies to render better service but not to demand enlargement of generating facilities. 49 Stat. 853, 16 U.S.C. § 824f (1946).


the part of the carrier will constitute an assent. It may not extend the route so as substantially to change the nature of the service without the carriers' application, but it may order extensions which are less than "substantial" when compared to the carrier's existing route pattern, location, operating capabilities, and capital structure. It may not award a new route to an applicant not applying specifically therefor even if a catch-all clause appears in the application, because under such circumstances it is difficult to conclude that the applicant is "fit, willing, and able" to perform the service.

As a practical matter, however, what more may be expected in the nature of more certain judicial definition of the Board's powers to compel new and extended service? In all probability little will be added to the present picture. Because of the present mail payment provisions, which compensate air carriers for more than the mere postal service whenever required by the policy of the Civil Aeronautics Act, few carriers which are ordered to start new routes or extend old ones will complain; under honest management they can't lose. Only the disappointed competitor will ever raise the issue. Furthermore, the country has probably passed its peak of rapid expansion in air carrier mileage; the next few years will in all likelihood be a period of more gradual growth, trafficwise, accompanied by a decrease in the number of routes served (through abandonment of supplicative services presently certificated) and carriers operating.

In short, if the Supreme Court upholds the intermediate appellate court in the State Airlines case the outer boundary of the Civil Aeronautics Board's power to compel inauguration or extension of routes will be firmly fixed to the effect that, regardless of consent, a carrier may not be awarded routes for which it has not specifically applied, a holding apparently designed to protect the property of both the carrier directly concerned and its potential competitors; other limits, within this boundary, must be left to speculation and future litigation.

A. STUARD YOUNG, JR.
NOTES

PROCEDURAL ASPECTS OF THE TERMINIELLO CASE.

FEW decisions handed down by the Supreme Court of the United States during the October 1948 term evoked as much public discussion as *Terminiello v. Chicago.*1 Across the nation, the press and the popular periodicals rushed into print with comments and criticisms as closely divided as was the Court itself in rendering the 5-4 decision.2 Few viewed the effect of the decision with moderation. Editorial comment ranged from agreement with the angry dissent of Mr. Justice Jackson3 and viewing the consequences with alarm,4 through cynical soberly concluded that “The importance of the decision rests on the fact that it apparently does alter the historic relationship between the Supreme Court and the state courts.”5 Another, convinced that the Court deliberately avoided deciding a fundamental issue, stated with annoyance: “It is difficult to suppress the impression that the court has dealt with a vital case in a cavalier manner likely to win popular applause instead of really coming to grips with a serious problem of our day in the best constitutional tradition.”6 A distinguished columnist, convinced that the majority of the Court had abandoned principle to decide the case in favor of an “unworthy beneficiary”

1 337 U. S. 1 (1949).
3 *Ibid.* quoting the Atlanta Constitution: “We join in the Jackson dissent, but regret the necessity for it.”
4 *Ibid.* quoting the St. Louis Globe Democrat: “... the decision ‘would justify agitators who incite to riot.’”
5 *Ibid.* quoting the Chicago Daily News: “At least the Supreme Court avoided the position that a man with bitter enemies is guilty of disorderly conduct if he appears in public where they have a chance to get at him.”
6 *Ibid.* Louisville Courier Journal: “We believe the Supreme Court ... acted wisely in setting aside his conviction.”

New York Post Home News: “... proclaims the strength and self-confidence of democracy.”

Miami Herald: “The decision is along the historic path we have moved as a people.”

8 *Washington Post,* May 22, 1949, p. 4B, col. 2. “Those who are interested in delving into the case before the court, however, will find that in this instance it has applied a gloss of impeccable generalities to one of the ugliest riots that totalitarianism has produced in the United States in recent years.”

94
laid his views before his readers on three separate occasions. At least one local bar association, convicted that "the decision had been widely misinterpreted both by the public and, with a few exceptions, by the press" adopted a resolution to arrange a forum in which the Terminiello decision would be interpreted to the lay public. Meanwhile, the popular periodicals reached their readers with their delayed versions of the case, fanning anew the fires of discussion. They characterized the decision as "a formidable set-back," a troublesome precedent, begging the question, and "the well and the stars." The final opportunity to spread editorial oil upon the troubled waters of public thought fell to the Journal of the American Bar Association. The September 1949 issue carried a full two column editorial on the Terminiello case. The editorial considered the point on which the Court split—whether the inadequacy of the trial court's instructions to the jury to sustain a conviction where constitutional rights were claimed had been properly raised in the courts below— not to be "a matter of world shaking importance." It did consider

9 Krock, In the Nation, N. Y. Times, May 19, 1949, p. 28, col. 5; N. Y. Times, June 28, 1949, p. 26, col. 5, "... the majority was willing to break through sound judicial principle to fish out the noble doctrine of the Bill of Rights for an unworthy beneficiary." Krock, Constitutional Issues Raised in Washington, N. Y. Times, May 22, 1949, § 4, p. 3, col. 1, "The justices divided over whether their review of Terminiello's sentence should be dominated by an issue outside the pleadings below in order to stretch an abstract Constitutional doctrine, or by the extra-Constitutional excesses of the speech and their violent effect on the community."


12 New Republic, May 30, 1949, p. 7: "... the decision ... represents a formidable set-back to those who, in the name of national security, have tried to restrict our liberties."

13 Newsweek, May 30, 1949, p. 21-2: "... the majority set a precedent that may trouble constitutional lawyers for years. By raising an issue that had never been raised in the state courts, the Supreme Court appears to have altered its historic relationship with the lower courts."

14 The Nation, May 28, 1949, vol. 168, p. 599-600: "Our own regretful conclusion is that the majority of the court begged the question of where the line may be drawn between freedom of speech and incitement to riot."

15 Time, May 30, 1949, p. 15: "Justice Jackson had a bigger and broader objection. In his angry dissent, the man who was chief U. S. counsel at the Nurnberg trials brought into focus the dilemma of democracy: how to keep its freedoms without delivering itself to its enemies. ... Some men looked at the stars. Some men looked in the well. Terminiello saved his $100."

16 35 A. B. A. J. 754.

17 Ibid.
of serious moment the "specially favorable treatment" Terminiello received when "on the facts there was no reason for particular tenderness toward him."\(^{18}\) The editorial concluded by suggesting that the majority of the Court succumbed to the tendency which is said to be the occupational disease of those who live in a world of papers; that of substituting words for things, language for reality, and obscuring thereby Terminiello's unworthiness [sic] while submerged in the facts at bar.

An examination of the propriety of this "liberal procedural ruling"\(^ {19} \) is the formal object of this note.

**The Facts of the Case**

Arthur Terminiello, a Catholic priest under suspension from the privileges of his office by his bishop, spoke at a meeting called by Gerald L. K. Smith and held under the auspices of the Christian Veterans of America at a private auditorium in Chicago. Announcements of the meeting had been mailed over Smith's signature to a select mailing list, and described Terminiello as "the Father Coughlin of the South." On the evening of the meeting, a turbulent crowd had gathered outside the auditorium. By 7:15 a picket line of 500 persons was parading in front of the building. When Terminiello arrived at 8:15, a surging crowd of 1,500 was outside of the hall. The interior was filled by persons who had been admitted upon presentation of admission cards which had been mailed with the announcement. Before Terminiello's arrival, the crowd had become a howling, cursing mob. Cries of "Fascists," "Hitlers," and "damned Fascists" were heard. Bottles, bricks, and stink bombs were frequently in the air. Some crashed through auditorium windows. Persons seeking entrance were assisted by police in breaking through the picket line. The disturbances outside continued throughout the meeting. Windows were smashed, loud noises, chanting, and cursing were heard from without by the audience in the hall. Smith and others spoke before Terminiello, who did not speak until after 9:30. His speech was a crude, rambling, rabidly anti-Jewish, anti-New Deal, anti-communistic harangue. It was recorded by a public stenographer. The executive secretary of the Chicago Civil Liberties Committee attended the meeting, and filed the complaint charging Terminiello with disorderly conduct in violation of subsection 1, § 1, Chap-

\(^{18}\) Id. at 755.

\(^{19}\) Id. at 754.
ter 193, Revised Code of 1939, as amended, of the ordinances of the City of Chicago. At the trial, the three principal witnesses for the prosecution were the complainant, the wife of a director of the Chicago Civil Liberties Union, and a member of the Jewish faith. For the defendant, in addition to his own testimony, the principal evidence was the testimony of the wife of the director of the Christian Veterans of America, who collected tickets at the door of the hall, a man who assisted her there, and two members of the audience who had received tickets as a consequence of having their names on the mailing list. Witnesses for the defendant testified that the meeting inside was orderly, while those for the prosecution described the audience as being angry and upset. An incident occurred during one of the speeches when a man rose to his feet and in profane language shouted that the speaker was a liar. There is conflict of testimony as to whether this occurred while Terminiello or Smith was speaking. Although there were many policemen stationed inside the hall during the meeting, none of them testified.

Procedural Points in the Lower Courts

In construing the ordinance for the jury, the trial judge instructed them that a breach of the peace might consist of misbehavior which "stirs the public to anger, invites dispute, brings about a condition of unrest, or creates a disturbance, or if it molest the inhabitants in the enjoyment of peace and quiet by arousing alarm." Defendant did not except specifically to that portion of the charge, nor did he assign it as error in his appeals subsequently to the appellate courts of Illinois. The jury returned a general verdict of guilty. Defendant filed motions for directed verdict and for judgment notwithstanding the verdict.

20 "All persons who shall make, aid, countenance, or assist in making any improper noise, riot, disturbance, breach of the peace, or diversion tending to a breach of the peace . . . shall be deemed guilty of disorderly conduct."

21 See 332 Ill. App. 17, 50, 74 N. E. 2d 45, 60 (1947) (dissenting opinion).

22 Ibid.

23 337 U. S. 1, 3 (1949).

24 Transcript of Record, p. 126, Terminiello v. Chicago, 337 U. S. 1 (1949). "... I move for a directed verdict for the defendant on the ground that the charge as construed in connection with the speech alleged, which is the subject of arrest, would be in contravention of the 14th Amendment, the 'due process' clause, and further, that to charge this defendant with committing a misdemeanor because he gave the speech in question is a contravention of the First Amendment to the Constitution."

25 Id. at 55. "4. No other violation was alleged in the complaint and no other violation of said ordinance was proven by the evidence, except said alleged speech of defendant and
on the grounds that to be constitutional the ordinance could not prohibit free speech, and to apply it to defendant’s speech would violate the freedom of speech safeguarded by the Fourteenth Amendment of the Federal Constitution. Before the lower appellate court in Illinois, Terminiello included among the “Errors Relied on for Reversal” the contentions that “The speech of defendant was not a violation of the ordinance in question and was protected by the First Amendment . . .,” and “To charge a violation of said ordinance is in contravention of the due process clause of the 14th Amendment . . .,” and that “The court improperly instructed the jury and also refused to give proper instructions requested by the defendant.”

In the statement of points and authorities in his petition to appeal from the judgment of the lower appellate court to the Supreme Court of Illinois, Terminiello stated: “To charge that petitioner transgressed the disorderly conduct ordinance . . . was a violation of . . . the due process clause of the Fourteenth Amendment . . ..”

In his brief in support of his statement of points, he stated: “. . . in the case at bar, it is not necessarily the city ordinance in question that is unconstitutional but the application sought to be made of it to deny to petitioner his rights of free speech and free assembly.”

The questions presented by Terminiello in his petition to the Supreme Court of the United States for a writ of certiorari were: (1) “Whether the construction of a so-called ‘Disorderly Conduct Ordinance’ may be so perverted and distorted by courts as to deprive one of the constitutional protection afforded by the First and Fourteenth Amendments . . .,” and (2) “whether the judgments of the Supreme Court of Illinois . . ., and (2) “whether the judgments of the Supreme Court of Illinois . . .,

said speech was protected by the First Amendment to the Constitution of the United States . . .

“5. That to attempt to charge a violation of said ordinance by the making of said alleged speech of defendant is in violation of the due process clause of the 14th Amendment to the Constitution . . .

“6. The court improperly gave to the jury the instructions objected to by defendant.

“7. The court erred in refusing to give certain instructions requested by defendant.” It is interesting to note that among the instructions which the defendant requested the trial judge to give the jury was: “The court further instructs the jury that they must consider whether there was a clear and present danger flowing from the defendant’s speech that said speech would tend to breach the peace . . .” That instruction was not incorporated into those delivered to the jury by the trial judge. (Record, p. 127 et seq.)

26 Petition for Writ of Certiorari to the Supreme Court of the State of Illinois and Brief in Support Thereof, p. 7.
27 Transcript of Record, supra note 24, at 31.
28 Id. at 51.
nois, the Illinois Appellate Court for the First District, and the Municipal Court of Chicago, herein, are not directly in conflict with and repugnant to the law of the land, as laid down by this Court in its prior decisions.

The Supreme Court, speaking through Mr. Justice Douglas, decided (5-4) that the trial judge's instruction to the jury construing the ordinance was binding on the Court in its review as a conclusive statement of the local law, citing Hebert v. Louisiana and Winters v. New York, and that as construed the ordinance was unconstitutional because portions of the jury charge defined a standard of conduct more restrictive of freedom of speech than the clear and present danger test of Bridges v. California when the charge classed speech which stirred people to anger, invited public dispute, or brought about a condition of unrest, as a breach of the peace. Since the instructions were stated in the disjunctive and the verdict returned was general, it could not be known that the jury's verdict was not based on those portions of the charge offending constitutional guarantees of personal liberty. On the authority of Stromberg v. California, the judgment was reversed.

THE SAFEGUARDS FOR FREEDOM OF SPEECH

Freedom of speech is an essential part of the liberty safeguarded by the due process clause of the Fourteenth Amendment against encroachment by the states. But it is not an absolute right, and the state may, in the exercise of the police power, punish the abuse of freedom of speech. That power, however, is an exception to the rule and is justified only in the reasonable apprehension of danger. The "dangerous

29 400 Ill. 23, 79 N. E. 2d 39 (1948).
31 Petition for Writ of Certiorari, supra note 26, at 8.
32 272 U. S. 312, 317 (1926).
33 333 U. S. 507, 514 (1948).
34 314 U. S. 252, 262 (1941).
35 U. S. Const. Amend. XIV § 1: "... nor shall any State deprive any person of life, liberty, or property, without due process of law."
36 283 U. S. 359 (1931).
tendency” alone of the words is not sufficient. Only a clear and present danger of destruction of life or property, or a breach of the peace will warrant the use of a state’s power in abridging personal liberties. A breach of the peace includes not only violent acts, but acts and words likely to produce violence in others, even though such a consequence is not intended. For example, certain well defined and narrowly limited classes of speech—the lewd, obscene, profane, and libelous; the insulting or “fighting” words—by their very utterance tend to invite a breach of the peace and are not protected by the Fourteenth Amendment. But the substantive evil must be extremely serious and the degree of imminence extremely high before speech may be punished. In short, it is the American tradition to allow the widest room for discussion and the narrowest range for its restriction, especially when exercised in conjunction with peaceable assembly. Restraint of orderly discussion and persuasion must have clear support in actual, impending public danger. Only the gravest abuses will provide such support. Rousing people to anger, provoking public dispute, or causing a condition of unrest are consequences insufficiently grave in themselves to approximate the imminence and gravity of substantive evil to warrant suspension of constitutional safeguards under the tests laid down in the foregoing settled constitutional doctrine.

STROMBERG v. CALIFORNIA: A PROPER PRECEDENT?

In Stromberg v. California, supra, the statute under which petitioner there had been convicted prohibited the display of a red flag for any of three purposes, which were stated in the statute in the disjunctive. The charge in the information stated the purposes conjunctively, but

40 Thornhill v. Alabama, 310 U. S. 88, 105 (1940). The “clear and present danger” test of Schenck v. United States, 249 U. S. 47, 52 (1919) was discussed in Gitlow v. New York, 268 U. S. 652, 671 (1925) in connection with police power statutes, and there held to apply where the state has merely prohibited certain acts involving the danger of substantive evil without specific reference to the utterances themselves.
43 Bridges v. California, 314 U. S. 252, 263 (1941).
45 283 U. S. 359, 361. The information charged that defendants therein “did . . . display a red flag . . . in a public place . . . as a sign, symbol and emblem of opposition to organized government and as an invitation and stimulus to anarchistic action and as an aid to propaganda that is and was of a seditious character.” (Italics supplied).
the trial court's instruction to the jury was couched in the language of the statute, with the three clauses expressing the purposes proscribed being stated disjunctively.46 Stromberg made no exception and assigned no error to the instruction, but challenged the constitutionality of the statute. The state appellate court conceded that the first of the purposes mentioned in the statute for which the display of a red flag was prohibited was unconstitutional, but held that the clause was separable, and affirmed the conviction under the remaining two grounds.47 The Supreme Court of the United States reversed because the trial court's charge to the jury had stated the three purposes disjunctively, and, a general verdict having been returned, it was impossible to determine that the jury had not convicted the defendant solely on the unconstitutional clause.48

Mr. Justice Frankfurter in a dissent in the instant case in which Justices Jackson and Burton joined, and with which the Chief Justice agreed so far as it applied to the Stromberg case, insisted that Stromberg v. California offered no precedent because "It was urged throughout the proceedings, and finally at the bar of this Court, that one of the proscriptions of the statute was invalid under the Fourteenth Amendment. . . . All that the case holds is that where the validity of a statute is successfully assailed as to one of three clauses of a statute and all

46 Id. at 363. "... you are instructed that if the jury should believe . . . that the defendants . . . displayed, or caused to be displayed, a red flag . . . in any public place . . . and if you further believe from the evidence . . . that said flag . . . was displayed . . . as a sign, symbol, or emblem of opposition to organized government, or was an invitation or stimulus to anarchistic action, or was an aid to propaganda that is of a seditious character, you will find such defendants guilty. . . ." (Italics supplied).

47 62 Cal. App. 788, 290 Pac. 93 (1930).

48 Cf. Williams v. North Carolina, 317 U. S. 287, 292 (1942): "To say that a general verdict of guilty should be upheld though we cannot know that it did not rest on the invalid constitutional ground on which the case was submitted to the jury, would be to countenance a procedure which would cause a serious impairment of constitutional rights." See Haupt v. United States, 330 U. S. 631, 641 n. (1947): "But where several acts are pleaded in a single count and submitted to the jury, under instructions which allow a verdict of guilty on any one or more of such acts, a reviewing court has no way of knowing that any wrongly submitted act was not the one convicted upon. If acts were pleaded in separate counts, or a special verdict were required as to each overt act of a single count, the conviction could be sustained on a single well-proved act. As the acts were here pleaded in a single count, and the jury were instructed that they could convict on any one, we would have to reverse if any act were insufficient. . . ."

On the problems incident to the general verdict, see Frank, The Case for the Special Verdict, 32 J. Am. Jud. Soc'y 142.
three clauses were submitted to the jury, the general verdict has an infirmity because it cannot be assumed that the jury convicted on the valid portions of the statute and not on the invalid. There was no question in that case of searching the record for an alleged error that at no time was urged against the State judgment brought here for review.  

Accordingly, decision jury definitely counsel by lighted statute. But as instruction "Appellant, stated: "The said, the of the same ment to any in the court, any in the statute. . . ." The similarity of that case with the instant case is highlighted by the dissents. Mr. Justice McReynolds there said, "Below, counsel definitely 'stated that he was satisfied that the instructions [to the jury] were correct, and waived any claim of error on that account.' Accordingly, decision was not requested upon any question arising out of the charge; no such question was decided." Mr. Justice Butler said, "The record fails to show that, aside from having the trial judge give to the jury these instructions suggested by her, the defendant did in any manner separately challenge in the trial court the validity of the first clause." Stromberg's assignment of errors in the petition for appeal to the Supreme Court of the United States contained no reference to any error in the trial court's instructions to the jury, nor was reference made to the invalidity of any of three clauses separately considered. The defendant there did include as assignment of error No. 4, "That the said District Court of Appeal of the State of California . . . erred in holding that the statute . . . as construed and applied in this case by the State courts of California, does not and did not deprive any person or persons, including this appellant, of their or her liberty without due process of law in violation of sec. 1 of the 14th Amendment of the Constitution of the United States." That is virtually the same contention made by Terminiello before the courts of Illinois, and in the question carried up to the Supreme Court in the writ of certiorari.

49 337 U. S. 1, 10 (1949).
50 283 U. S. 359, 364 (1931).
51 Id. at 371.
52 Id. at 373.
In the statement of points relied upon before the Supreme Court in *Stromberg v. California*, the appellant there contended that the statute "inherently and as construed and applied in this case, violates the 14th Amendment to the Constitution of the United States in that it: . . . 2. Deprives appellant of her liberty without due process of law." No reference was made whatever to the instructions of the trial court. No separate clause of the statute was challenged as being invalid, although the statute as a whole was challenged as being so broad in its terms as to proscribe lawful conduct under each of the three clauses, and so, it was claimed, was void for uncertainty. The Supreme Court there concluded that a statute which on its face and as authoritatively construed is so vague and indefinite as to prohibit the fair use of the freedom of political discussion is unconstitutional.

In the instant case, the court likewise held that the statute at bar as authoritatively construed deprived appellant of liberty without due process of law. In the *Stromberg* case it was the instruction stating the three clauses of the statute disjunctively which made it impossible to determine that the general verdict had not been returned by a jury applying defendant's conduct to the invalid portion of the statute as so construed. In the *Terminiello* case, it was the instruction construing the statute in a series of clauses stated disjunctively which made it equally impossible to determine that the jury's general verdict did not go solely to certain of those clauses expressing a standard which is repugnant to the due process clause of the Fourteenth Amendment and the settled construction of that clause in relation to freedom of speech. Terminiello consistently contended that the statute as construed and applied to his conduct was unconstitutional. The application of the statute to Terminiello's conduct lay in the tests which the trial judge formulated in construing the statute, and which he charged the jury to follow in weighing the defendant's conduct.

Whether the state court erred in its construction of the local statute is not a federal question. If that construction is consistent with the

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54 *Id.* at 22-23.
55 *Ibid*.
56 *West v. Louisiana*, 194 U. S. 258, 261 (1904). The issue to be determined by the Court where state law is involved is not what interpretation should be given the state statute, but whether, accepting the settled construction of that statute by the court of last resort in the state, its provisions as interpreted are repugnant to the federal constitution. *Castillo v. McConnico*, 168 U. S. 674, 684 (1898).
Fourteenth Amendment, the Supreme Court will go no further.\textsuperscript{57} The Supreme Court's inquiry is "What construction has been put on the local statute by the highest court of the state, and as construed, does it violate a federal right?"\textsuperscript{58} \textit{Hebert v. Louisiana}\textsuperscript{59} and \textit{Winters v. New York},\textsuperscript{60} relied on by the majority of the court in the instant case as authorizing acceptance of the trial court's instructions as a conclusive statement of the state law, following the doctrine just enumerated are concerned with statutory constructions by the highest court of the state. The instant case extends the principle to include jury instructions formulated by the state trial courts in construing local ordinances where the constitutionality of the ordinance as construed and applied has been timely challenged and the claim denied in the state appellate courts. In view of the \textit{Stromberg} case, that extension is not unwarranted.

The burden of this note is to suggest that the Court was not searching the record for errors not explicitly highlighted in assignments of error below merely, but rather was upholding a federal claim adequately raised and erroneously denied below. But there is even precedent for examining the record for a determination of issues not precisely pinpointed in the courts below. In \textit{Near v. Minnesota},\textsuperscript{61} the appellee insisted that where appellant's sole attack had been on the constitutionality of a statute, the question of its application to the appellant's newspaper was not subject to review by the Court. The Supreme Court there held, however, "that in passing upon constitutional questions the court has regard to substance and not to mere matters of form, and that, in accordance with familiar principles, the statute must be tested by its operation and effect. . . . That operation and effect we think is clearly shown by the record in this case."\textsuperscript{62}

Nor is the technique of the majority inconsistent with the Court's own rules. Par. 2, Rule 38, Rules of the Supreme Court, requires that the petition for a writ of certiorari shall contain the questions pre-

\begin{itemize}
  \item \textsuperscript{57} Rawlins v. Georgia, 201 U. S. 638 (1906). A decision of a state court is not an infraction of the 14th Amendment merely because it is wrong or reverses well settled earlier decisions. Patterson v. Colorado, 205 U. S. 454, 461 (1907).
  \item \textsuperscript{58} Lindsley v. Natural Carbonic Gas Co., 220 U. S. 61, 73 (1911). The doctrine that the Supreme Court of the United States will follow the decisions of state courts in the interpretation and construction of local statutes has ancient origins, having been announced as early as Shelby v. Guy, 11 Wheat. 361, 367 (1826).
  \item \textsuperscript{59} 272 U. S. 312, 317 (1926).
  \item \textsuperscript{60} 333 U. S. 507, 514 (1948).
  \item \textsuperscript{61} 283 U. S. 697 (1931).
  \item \textsuperscript{62} Id. at 708-9.
\end{itemize}
sented, and that only the questions specifically brought forward by the petition for writ of certiorari will be considered. And one having obtained a writ of certiorari to review specific questions is not entitled to obtain a decision on any other issue.\textsuperscript{63} The questions brought up by Terminiello in his petition for writ of certiorari, \textit{supra}, presented the precise issue decided by the Court—the unconstitutionality of the ordinance as construed and applied to the appellant’s conduct.

\textbf{Conclusion}

In summary, the case of \textit{Terminiello v. Chicago} is a proper holding, following \textit{Stromberg v. California}, that where constitutional immunity is claimed against a state ordinance as applied to defendant’s conduct, a general verdict of guilty will be set aside where the trial court’s instructions to the jury construing the local ordinance expresses in disjunctive order tests or standards, some of which if applied singly would conflict with the constitutional safeguard claimed.

\textbf{Postscript}

Had the Court decided the case by applying the law to the facts of the incidents which occurred at the meeting, the result should have been the same. These facts deserve emphasis: the mob was in existence at least one hour before Terminiello arrived; his speech could not be heard outside the hall; the sole incident which might qualify as a breach of the peace inside the hall was that of the man rising and shouting profanely that the speaker was a liar. But there is a conflict of evidence whether that incident occurred while Smith or Terminiello was speaking. There was conflict of evidence as to whether the audience was calm or upset. A witness who testified as to the latter also stated that she attended another Terminiello meeting, and may have had them confused. The picket line outside the hall was organized and disciplined in turbulent group action. To hold Terminiello responsible for the disturbances of the peace which occurred outside the auditorium would in effect make the extent to which radical hostile groups are determined to obstruct opposed ideologies by unlawful interference, the measure of the extent to which freedom of speech and assembly may be enjoyed in a community.\textsuperscript{64}

\textsc{Eugene L. Stewart}


\textsuperscript{64} Cf. Beatty v. Gillbanks, 9 Q. B. D. 308 (1882).

\textsuperscript{64} The sound constitutional doctrine is that the public authorities have the obliga-
HAS THERE BEEN A CHANGE IN THE LAW ON ACCEPTANCE OF CONTRACTS BY CORRESPONDENCE?

In the recent decision of Dick v. United States, the United States Court of Claims has suggested that a 1913 change in Postal Regulations may have altered the law on acceptance of contracts by correspondence. The court, speaking through Chief Judge Jones, inferred that the rule of the historic Adams v. Lindsell case, i.e., where a contract is accepted by correspondence the acceptance is binding and the contract is consummated the moment the letter of acceptance is properly deposited in the mails, has been modified to the extent that the posted acceptance is not binding if the offeree contacts the offeror prior to the arrival of the posted acceptance and indicates that he does not choose to be bound by it.

Factually, the following situation was presented by the Dick case:

The United States Coast Guard was desirous of obtaining two ships of a certain kind of propeller and auxiliary equipment of a type that the plaintiff's company had been manufacturing for the Navy. Knowing that the plaintiff was engaged in this type of work, the Coast Guard requested the plaintiff to submit a bid giving the price for which

2 1 B. & Ald. 681 (1818).
3 When referring to the general rule regarding acceptance of contracts by correspondence, for the purposes of this article it will be assumed that all of the requisites for the application of this rule have been complied with, such as that the mails have been expressly or impliedly authorized as the channel of communicating the acceptance and that all postal regulations regarding mailing of letters have been followed.
he would manufacture the required equipment. The plaintiff complied; however, he erroneously submitted a bid for the cost of manufacturing one shipset instead of the required two. After an interchange of telegraphic correspondence the Coast Guard telegraphically accepted, subject to the execution of a formal contract. Shortly thereafter, the Coast Guard forwarded to the plaintiff a purchase order which he, still unaware of his error, filled out according to the terms of his telegraphic bid and mailed to the Coast Guard. The day after mailing the purchase order he discovered his error and immediately sent the Coast Guard a telegram which arrived before the purchase order, advising that his original telegraphic bid and subsequently sent purchase order were in error. The Coast Guard contracting agent then revised the contract but this revision was held to be invalid by the Comptroller General, who ruled that the plaintiff was bound by his original bid. The plaintiff furnished the two sets of equipment but was paid only the amount set out in his original bid, so he sues for the cost of the additional equipment.

The defendant moved for a dismissal, contending that the plaintiff’s act of filling out and mailing the purchase order constituted an irrevocable acceptance and completion of the contract and, since he had been paid according to the terms of that contract, he had no cause of action. In overruling this motion, the court held that before the plaintiff’s petition could be dismissed there were several factual questions which had to be answered, including the questions arising from the circumstances and conditions surrounding the plaintiff’s act of depositing the purchase order in the mail, and the effect of the subsequently sent telegram which reached the defendant before the purchase order and advised that the purchase order had been sent in error. In other words, the court is saying that even if the plaintiff’s act of filling out and mailing the purchase order was an acceptance of the defendant’s offer, it might not be a binding acceptance because of the telegraphic notification revoking the acceptance which reached the defendant before the letter of acceptance.

To substantiate this holding, the court said,

"Under the old authorities the depositing (of the letter of acceptance) in the mails was final as to both parties"

and pointed out that the rule was predicated on reasoning that

"... when a letter was deposited in the mails it was beyond the control of the person mailing it."
The court then cited Corpus Juris Secundum to the effect that the rule was modified by a postal regulation change in 1913 to the extent that when the letter of acceptance is reclaimed it does not constitute an acceptance.4

In addition to the Corpus Juris Secundum quotation, the court quoted liberally from a Tennessee case and an old English case which support the same conclusion, i.e., if the posted acceptance is reclaimed then the acceptance is not binding.

It is important to note at the onset of this analysis that the operative facts of the Dick case present a situation where an acceptance was mailed, after which the acceptance was purported to be cancelled by telegram while the letter of acceptance was en route, whereas the doctrine of the cases discussed in the Dick case concern the situation where the mailed acceptance has been reclaimed. It would therefore be possible that the law has been modified where the acceptance has been reclaimed, but not so far as to include a situation as presented in the Dick case. It appears, however, that the court in the immediate case felt that if the doctrine was modified to apply where the acceptance was recovered, it would by analogy apply also to a set of facts such as presented in the Dick case. Consequently, in this examination of the status of the doctrine we must first determine if the law has been modified and then establish the extent of modification.

**DID POSTAL REGULATION CHANGE MODIFY DOCTRINE?**

According to the court, Corpus Juris Secundum, and cited precedent in the Dick case, the doctrine was modified due to a postal regulation change. This statement is subject to scrutiny. In the first place, they state that postal regulations were changed in 1913 to permit the recovery of mailed matter; however, this statement is erroneous. As early as 1887, postal regulations permitted mailed matter to be recovered by complying with certain formalities.5

Conceding, however, that there has been a change in postal regulations since the rule was originally formulated, there is still a second point of objection. The court states that the reasoning behind the rule was that the sender lost control of the mailed acceptance but this statement is, if not wrong, at least not completely right, for there is a decided difference of opinion as to the rationale behind the rule. Therefore, since

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4 17 C. J. S. 405.

5 4 Postal Laws and Regulations §§ 531-533 (1887).
a postal regulation change would not affect the doctrine unless the doctrine was based on the loss of control reasoning, the basis for the rule must be determined.

According to Williston, the doctrine that an acceptance is binding as of posting was originated in the case of Adams v. Lindsell because of necessity rather than logic. The truth of his statement is more than apparent, for in that case it was reasoned that a contract by correspondence could never be justly consummated except at the time the acceptance was mailed. This was on the theory that if the offeror had a right to receive the acceptance before bound, then the offeree had a right to receive notice that the offeror had received the acceptance, and so on ad infinitum. Subsequent cases greedily grasped the Adams v. Lindsell case as a precedent but the reasons put forth in support of the doctrine were both numerous and diverse.

In the United States, the early cases which adopted the doctrine supported it on the "meeting of the minds" theory. They reasoned that the offeror, after once making an offer, was at all times receptive to an acceptance until he had notified the offeree to the contrary. Thus, when the offeree dropped the letter in the post, he had decided to accept and the courts reasoned that at that moment the minds met. But, since the "meeting of the minds" theory has been exploded, that thesis is of little help here.

When the doctrine was extended to cover a situation where the letter of acceptance was lost in the post and never actually reached the offeror, an English court brought forth the reasoning that the Post Office was

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6 Williston, Mutual Assent in Formation of Contracts, 14 ILL. L. REV. 85, 86 n. 6 (1919).
7 1 B. & Ald. 681, 683 (1818). Reasoning that by a contrary rule " . no contract could ever be completed by post. . . . For if the defendants were not bound by their offer when accepted by the plaintiffs till the answer was received, then the plaintiffs ought not to be bound till after they had received the notification that the defendants had received their answer and assented to it. And so it might go on ad infinitum."
8 Tayloe v. Merchant's Fire Insurance Co., 9 How. 390, 400 (U. S. 1850). "On the acceptance of the terms proposed, transmitted by due course of mail . . . the minds of both parties have met . . . and the contract becomes complete." Wheat v. Cross, 31 Md. 99 (1869); Mactier v. Frith, 6 Wend. 103 (N. Y. 1830).
9 Anson, Contracts, § 36 (Corbin's ed. 1924); Restatement, Contracts § 20 (1932); Ashley, Mutual Assent in Contracts, 3 Col. L. REV. 1 (1903); Williston, Mutual Assent in Formation of Contracts, 14 ILL. L. REV. 85 (1919).
10 Household Fire Insurance Co. v. Grant, 4 Ex. D. 216, 221 (1879) " . . . as soon as the letter of acceptance is delivered to the post office, the contract is made as complete and final and absolutely binding as if the acceptor had put his letter into the hands of a messenger sent by the offeror himself as his agent to deliver the offer and receive the acceptance."
the agent for the offeror and the placing of the letter of acceptance in the mails was giving the acceptance to the agent of the offeror and thus binding him. Other courts\textsuperscript{11} were quick to accept this reasoning but Lord Hershell, in the \textit{Henthorne v. Fraser} case,\textsuperscript{12} ably revealed the false logic in that theory. Many other courts\textsuperscript{13} also took the agency idea to task and now the idea that the offeror, in sending an offer through the mails, implicitly designates the mails as his agent is definitely in disrepute.\textsuperscript{14}

In the case of \textit{Household Fire Insurance v. Grant},\textsuperscript{15} another basis for support of the rule was also suggested. Here the court reasoned that if the rule were such that the acceptance wasn’t binding until it reached the offeror much fraud would be perpetrated and considerable delay in commercial transactions would result. Story likewise saw merit in such reasoning and commented that, “A different rule would evidently be productive of great mischief, and clog the facility of commercial intercourse.”\textsuperscript{16} As far as the fraud aspect is concerned, it has been pointed out that by a contrary rule fraud would be just as likely to result.\textsuperscript{17} However, the commercial aspect, as pointed out by Story, has found support. Kent reasoned along like lines, although his favorable evaluation of the rule was predicated more on the certainty element in designating the time of posting\textsuperscript{18} as the moment the acceptance should become binding.

Justice Holmes supported the doctrine on still another theory. He maintained that the depositing of the letter of acceptance in the mail is “the doing of an overt act, which by general understanding \textit{renounces}


\textsuperscript{12} (1892) 2 Ch. 27, 33. “It strikes me as somewhat artificial to speak of the person to whom the offer is made as having the implied authority to transmit the acceptance through any particular channel; he may select what means he pleases, the post office no less than any other.”

\textsuperscript{13} McDonald v. Chemical National Bank, 174 U. S. 610, 620 (1899). “When letters are placed in the post office they are within the legal custody of the officers of the government and it is the duty of the postmaster to deliver them to whom they are addressed.” \textit{In re} London and Northern Bank. \textit{Ex parte} Jones, [1900] 1 Ch. 220.

\textsuperscript{14} Hodel, \textit{Communication of Acceptance Between Parties at a Distance}, 15 \textit{Conn. L. Q.} 273 (1930).

\textsuperscript{15} 4 Ex. D. 216 (1879).

\textsuperscript{16} 1 \textit{Story, Law of Contracts} 452, n. 1 (5th ed. 1874).

\textsuperscript{17} See \textit{Salmond and Winfield, Principles of the Law of Contracts} 73 (1927).

\textsuperscript{18} 11 \textit{Kent, Commentaries on American Law} 477 (14th ed. 1896).
control over the letter." Lord Blackburn also considered this point and in substance supported the Holmes view. He believed that as soon as the acceptor put the letter in the mail he had put it beyond his control, and as Holmes pointed out, had done an extraneous act which clinched the agreement.

It is submitted that the rationale in support of the rule as put forth by Holmes was the forerunner of what has become widely accepted as the basis for support of the Adams v. Lindsell doctrine, that being that when the offeror makes an offer he expresses his assent to make a contract and when the offeree deposits his acceptance in the mails he does an overt act which indicates his assent to accept. At that instant both parties have expressed their assent to contract, hence the concluding prerequisite, the expression of the mutual assent, is present and at that instant the contract is consummated. Consequently, since the loss of control element is not the modern rationale in support of the rule, it would appear that the postal regulation change would have no effect upon the rule. Furthermore, there have been countless cases handed down since the postal regulations have changed which have dealt with the acceptance by correspondence doctrine and in only a few cases has there been a suggestion that the rule should be altered. It is upon these cases, however, that the Dick case relies for precedent, so it is necessary to investigate the reasoning employed which enabled them to hold contrary to the accepted rule.

Rationale of Cases Holding Contrary to Adams v. Lindsell

There are two channels that may be followed in examining cases holding contrary to the doctrine laid down in the case of Adams v. Lindsell. There are cases and discussions by authorities holding contrary on the reasoning that the doctrine is supported by false logic and there are cases holding that the doctrine of Adams v. Lindsell has been changed or at least modified due to the postal regulation change since the development of the rule. Due to limitations of this article,

20 Brogden v. Metropolitan Railway Co., 2 App. Cas. 666, 691 (1877). In 1 Paige, Contracts § 208 (1920), this point is also considered.
22 See cases compiled in 1 Williston, Contracts § 81 n. 4 (rev. ed. 1936).
23 In 1 Williston, Contracts § 86 n. 2-8 (rev. ed. 1936), these cases are cited and discussed. There it is said that "it is not important that the acceptor has the power to withdraw his acceptance from the mail."
discussion herein will be limited to an examination of those cases holding that the postal regulation change has modified or changed the old doctrine.

Cases which have held that the postal regulation change has altered the rule rely heavily on the old English case of Ex parte Cote. In this case, it was held that the posting of a letter in France, where it was subject to be reclaimed by the sender until its dispatch from the office of transmission, did not transfer title to certain bills of exchange inclosed. It is of note that while the Dick case relies on Ex parte Cote as a precedent for their suggestion that the rule has been altered, Williston explains that the case is not a proper precedent for holding that the rule has been changed because it concerns the question of bills of exchange and not the formation of bilateral contracts.

The chief case which is cited for support in the Dick case is Traders National Bank v. First National Bank. In that case reference is made to the postal regulation change and its effect upon the rule. The court does not, however, state that the rule has been changed. Instead they develop what is an exception to the general rule for they say that they would follow the general rule except where there has been an actual physical withdrawal of a previously mailed acceptance, as was the situation presented by the operative facts in that case.

It is submitted that even though the holding in the Traders case suggested an exception to the general rule, such an exception is not logically supportable. If such were the rule, it would be the same as saying that the offeror was conclusively bound by a posted acceptance but that the offeree was only bound if he did not choose to withdraw his acceptance. Or conversely, as is pointed out by Judge Madden in his dissent in the Dick case,

“If that distinction were followed it would mean that the person mailing the acceptance had a binding contract from the time of mailing, but that the party to whom he mailed the acceptance would not have one until he received the letter, his rights being subject to the sender's power to withdraw his letter from the mails at any time before it was delivered to the addressee.”

Judge Madden went on to say,

“I think little can be said in justification of such a doctrine.”

Furthermore, since the reasoning used in the Traders case to develop
what they call an exception to the general rule is that postal regulations have changed so that the mailed acceptance doesn’t pass beyond the control of the acceptor, it would seem that their original justification for the exception is unsound for, as is pointed out earlier, most authorities agree that the rationale behind the rule is not predicated on loss of control of the mailed acceptance.  

That the change in postal regulations has altered the general doctrine, has also been suggested in a recent Indiana case, although, in this case a new line of reasoning was put forth. The Indiana court argued that since the mailed acceptance can be withdrawn by the party mailing it, the post office is in effect its agent. This reasoning is tenable and it does follow that if the post office was in reality the agent of the acceptor, a mailed acceptance while still in the hands of the acceptor’s agent could not be considered to be delivered to the offeror, or even constructively communicated to him. However, the conclusion that the post office is the agent of the sender of letters is not commensurate with the views held by the majority of the cases nor the authorities on the subject.

Conclusion

The question presented by the majority of the court in the Dick case is whether a change in postal regulations has caused the law on acceptance of contracts by correspondence to be altered or modified. It is submitted that in the majority of the jurisdictions the law has not been either changed or modified. In Tennessee there is a possibility that an exception to the general rule has been developed and in Indiana where it has been held that the post office is the agent of the acceptor there is precedent for holding that the rule has been completely changed.

Notwithstanding the inroads that have been made on the rule in these two jurisdictions, there is ample evidence that these two jurisdictions are not keynoting what will in the future become the accepted rule. In reality the cases in these two jurisdictions are not sound precedents for they are supported by the false reasoning that the postal regulations change is alone sufficient reason for altering the rule.

In the Tennessee case it is said that an exception to the rule should be developed because the acceptance when mailed is no longer beyond

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27 See note 21, supra.
29 Addison, Law of Contracts (11th ed. 1911); 1 Mechem, Agency § 26 (2d ed. 1914).
the control of the acceptor, but this point is unimportant for the fact that the acceptance passed beyond the control of the party mailing it was not the reason which caused the doctrine to be developed or supported. Secondly, while the postal regulation was changed in 1887, the rule has still continued to be followed and supported for other reasons.

In Indiana where the court has adopted the reasoning that the post office is the agent of the acceptor because the mailed acceptance can be recovered, there is much more plausibility to the holding that the rule has changed. Still that holding is not sound, for, as was earlier pointed out, the post office is not in a technical sense considered to be an agent for either party.

It is therefore submitted that the mere fact that postal regulations have changed does not in reality afford a logical basis for changing the old doctrine of the Adams v. Lindsell case.

Independently of the postal regulation feature, there is and has been much criticism of the rule in toto and there is probably ample logical justification for altering the rule. However, such a change appears remote. It can also be said that there are situations where hardships do result from the operation of the doctrine, but such is the case with any law. Furthermore, these hardships that do result can be avoided by adding a clause in all offers to the effect that the offeror will not be bound until receipt of acceptance is in his hands. Most modern contract lawyers today advise their clients to follow that procedure. In any event, as Williston points out, the rule is so well embodied in our law that discussions of it are academic.

ROBERT R. Dickey

30 Langdell, Summary of Law of Contracts 1-31 (2d ed. 1880); 1 Paige, Contracts § 199 (2d ed. 1920); Pollock, Principles of Contract 38 (9th ed. 1921); 1 Williston, Contracts § 81 (rev. ed. 1936); Stimson, Effective Time of Acceptance, 28 Minn. L. Rev. 776 (1939); Nussbaum, Comparative Aspects of the Anglo-American Offer and Acceptance Doctrine, 36 Col. L. Rev. 920 (1936).

31 As was pointed out by Pollock, a man may make his offer expressly conditional on actual receipt of acceptance and avoid the application of this rule. Pollock, op. cit. supra note 30, at 39.
SUBSTANCE, PROCEDURE AND UNIFORMITY—RECENT EXTENSIONS OF GUARANTY TRUST CO. v. YORK

"But since a federal court adjudicating a State-created right solely because of the diversity of citizenship of the parties is for that purpose, in effect, only another court of the State, it cannot afford recovery if the right to recover is made unavailable by the State nor can it substantially affect the enforcement of the right as given by the State."

Guaranty Trust Co. v. York\(^1\)

"The essence of diversity jurisdiction is that a federal court enforces State law and State policy."

Angel v. Bullington\(^2\)

DEVELOPMENT OF THE CONCEPT OF UNIFORMITY

The majority opinion of Mr. Justice Brandeis in Erie R. Co. v. Tompkins,\(^3\) overturning the nearly century-old interpretation of the Rules of Decision Act\(^4\) enunciated by Mr. Justice Story in Swift v. Tyson,\(^5\) set forth two significant pronouncements: first, the rule of conformity, that federal courts when exercising jurisdiction based solely on diversity of citizenship\(^6\) must follow state substantive law; and secondly, the policy of uniformity, "that for the same transaction the accident of a suit by a non-resident litigant in a federal court instead of in a State court a block away should not lead to a substantially different result."

Although the policy of the Erie case was reasonably clear, the rule as to the application of state substantive law was general and ambiguous.

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3. 304 U. S. 64 (1938).
4. Section 34 of the Federal Judiciary Act of September 24, 1789, c. 20, 28 U. S. C. § 725. "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 decision in trials at common law, in the courts of the United States, in cases where they apply."
5. 16 Pet. 1 (U. S. 1842).
6. Although the majority opinion in Erie R. Co. v. Tompkins did not specifically confine the application of the doctrine to cases where the sole basis of federal jurisdiction was diversity of citizenship, subsequent decisions effectively so limited its scope. Holmberg v. Armbricht, 327 U. S. 392 (1946); Clearfield Trust Co. v. United States, 318 U. S. 363 (1943); D'Oench, Duhme and Co. v. Federal Deposit Ins. Corp., 315 U. S. 447 (1942); Note, 59 Harv. L. Rev. 971, 972; Clark, State Law in the Federal Courts: The Brooding Omnipresence of Erie v. Tompkins, 55 Yale L. J. 267, 280 (1946).
No indication was given as to how federal judges were to determine the "substantive" law of the state wherein they were situated. No criteria were set out for distinguishing state "substantive" law from state "procedural" law. Apparently the initial approach to the problem was to rely on the established abstract categorizations\(^8\) of principles as substantive or procedural in the tradition of conflict of laws or similar fields where the substantive-procedural dichotomy had been employed.\(^9\) The policy of Erie was considered merely as a make-weight factor in the determination. Thus the policy was considered as aiding but not controlling the interpretation of the rule.

It was apparent however that, in view of this policy underlying the decision—that the accident of diversity of citizenship should not lead to a substantially different result by a state and federal court within the same area—the substantive-procedural classification required by the Erie doctrine was quite different from that required for other purposes.\(^10\) It is the purpose here to discuss the development of uniformity as the primary criterion for distinguishing substance and procedure under the principles of Erie R. Co. v. Tompkins.

From the outset the Supreme Court was required to pass on the applicability of the principles of Erie to specific elements of state law. The outlines of the doctrine developed gradually. The same year in which it was announced (1938) saw its extension to equity.\(^11\) In 1939 it was held in Cities Service Oil Co. v. Dunlap\(^12\) that state rules as to burden of proof must be followed by federal courts under Erie. In 1941 the Court declared in Klaxon Co. v. Stenter Electric Mfg. Co.\(^13\) and Griffin v. McCoach\(^14\) that the conflict of laws rules to be applied by a federal court must conform to those prevailing in the courts of the state wherein it sat.\(^15\) In 1943 it was held in Palmer v. Hoffman\(^16\)

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10. Sampson v. Channell, 110 F. 2d 754, 756 (1st Cir. 1940).
15. These decisions held conflict of laws issues to be substantive per se for the purposes of Erie. This eliminated the necessity of a federal judge first deciding for himself whether or not a particular conflicts question was in itself "substantive"—the very fact that it was a conflict of laws question rendered it ipso facto substantive.
that state rules on burden of establishing contributory negligence were binding on federal courts. Although varying criteria were employed to bring these matters within the application of *Erie*, the Supreme Court consistently emphasized the basic policy of uniformity throughout this period. It was not until 1945, however, in the case of *Guaranty Trust Co. v. York* \(^{17}\) that this guiding principle was released from the entanglements and confusion inherent in the use of the abstractions of "substance" and "procedure". There, in holding that federal courts should apply the bar of the state statute of limitations or laches, Mr. Justice Frankfurter discarded the conventional bases of classification and firmly established uniformity of adjudication as the primary criterion for effecting the policy of the *Erie* case. No longer was the problem to determine whether a state rule of law was by its metaphysical nature inherently substantive or procedural, or whether, by historical application, it was of "general" or "local" import. Henceforth the question was to be whether a state rule—statutory or decisional—"is a matter of substance in the aspect that alone is relevant to our problem, namely does it significantly affect the result of a litigation for a federal court to disregard a law of a State that would be controlling in an action upon the same claim by the same parties in a State court." \(^{18}\)

By this course and by this course alone could the Court assure that the accident of diversity of citizenship would not effect the result of the litigation. \(^{19}\)

Subsequently, in *Angel v. Bullington*, \(^{20}\) Mr. Justice Frankfurter, in declaring that a North Carolina statute prohibiting recovery of a deficiency judgement in the state courts of North Carolina likewise barred recovery in the federal courts in that state, reaffirmed his pronouncement in *Guaranty Trust* that for purposes of diversity jurisdiction a federal court is "in effect only another court of the state." The *Angel* case, however, placed stress on the additional consideration of "state policy". While state law and state policy may be considered synonymous it would seem that when a close question arises as to the substantial effect which a state rule may have on the outcome of a litigation, a showing that the rule in question embodies a definite public policy of the state may well be the crucial factor in bringing the rule of *Guaranty Trust* into operation.

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\(^{17}\) 326 U. S. 99 (1945).

\(^{18}\) *Id.* at 109.


Thus had the course been run. Thus were federal courts charged
to conform completely to state law and the standard of conformity was
to be uniformity of result with state courts. To ascertain the "substant-
tive law" of the Erie mandate the federal courts had but to inquire—
will it significantly affect the results of the litigation? An affirmative
answer rendered the matter substantive and hence applicable by the
federal courts irrespective of any label previously applied for other
purposes.

DECISIONS OF JUNE 20, 1949

On June 20, 1949 the Supreme Court handed down three decisions21
which may be taken as establishing the present status of the doctrine
of Erie as extended by Guaranty Trust Co. v. York and Angel v. Bull-
ington. In each case the decision turned on what would have been the
result of the litigation had it been brought in a state court. In each
case the federal court was required to conform to this result to achieve
uniformity of decision with the courts of the State wherein it sat.

Woods v. Interstate Realty Co.22 fell squarely within the authority
of the Guaranty Trust and Angel decisions. Interstate Realty Co., a
Tennessee corporation, had filed suit in the United States District
Court for the Northern District of Mississippi to recover on a com-
mision contract for the sale of Mississippi real estate belonging to
Woods, a resident of Mississippi. In his answer Woods set out that
Interstate was a foreign corporation which, because it had never quali-
fied to do business in Mississippi as provided by the state law,23 was
not entitled to maintain any suit in any court in the state. The District
court found that Interstate was doing business in Mississippi within
the purview of the statute and therefore held the contracts sued upon
utterly void and "Being void there would be no right in this court or

21 Woods v. Interstate Realty Co., 69 Sup. Ct. 1235 (1949); Ragan v. Merchants Trans-
fer and Warehouse Co., 69 Sup. Ct. 1233 (1949); Cohen v. Beneficial Industrial Loan Corp.,
69 Sup. Ct. 1221 (1949).
22 69 Sup. Ct. 1235 (1949).
23 Miss. Code 1942 § 5319, "Every foreign corporation doing business in the state of
Mississippi, whether it has been domesticated or simply authorized to do business within
the state of Mississippi shall file a written power of attorney designating the secretary of
state or in lieu thereof an agent as above provided in this section, upon whom service
of process may be had in the event of any suit against said corporation; . . . Any foreign
corporation failing to comply with the above provisions shall not be permitted to bring
or maintain any action or suit in any of the courts of this state."
any other court to enforce them". On appeal the Circuit Court of Appeals for the Fifth Circuit reversed, holding that under the laws and statutes of the state of Mississippi the contracts sued upon were not absolutely void but merely unenforceable in the state court and consequently the suit might be maintained in the United States District Court. The state law closing the doors of the state courts extended no further than those courts, for Mississippi was without power to limit or extend the jurisdiction of the federal courts under the authority of David Lupton's Sons Co. v. Automobile Club of America. On granting a motion for rehearing the circuit court considered the then-recent declaration of the Supreme Court of the United States in Angel v. Bullington that cases like Lupton's Sons were obsolete insofar as they were based on a view of diversity jurisdiction which came to an end with Erie R. Co. v. Tompkins. In affirming its original decision, the Circuit Court declared that since the Angel case had been decided on the basis of res judicata the remarks therein concerning the Lupton case were merely dictum. Certiorari was granted and the case was argued before the Supreme Court squarely on the issue of the interpretation of the Guaranty and Angel decisions. The Court, speaking through Mr. Justice Douglas, reversed and held that:

"... Where a decision rests on two or more grounds, none can be relegated to the category of obiter dictum. ... The York case was premised on the theory that a right which local law creates but which it does not supply with a remedy is no right at all for purposes of enforcement in a federal court in a diversity case; that where in such cases one is barred from recovery in the state court, he should likewise be barred in a federal court. The contrary result would create discriminations against citizens of the State in favor of those authorized to invoke the diversity jurisdiction of the federal courts. It was that element of discrimination that Erie R. Co. v. Tompkins was designed to eliminate."
Although the decision was five to three, only the dissenting opinion of Mr. Justice Rutledge registered a basic disagreement with the principles of *Guaranty Trust*. The dissent of Mr. Justice Jackson in which Mr. Justice Burton concurred was based entirely on a difference in interpreting the effect of the Mississippi statutes and supported the substantive holding of the majority that a cause of action barred in the state courts is likewise barred in the federal courts sitting within that state.

In *Ragan v. Merchants Transfer and Warehouse Co.* 32 Ragan sued the Transfer Co. for injuries received in a highway accident occurring on October 1, 1943. The suit was instituted in the United States District Court for Kansas on September 4, 1945 by filing the complaint with the court—as provided by Rule 3 of the Federal Rules of Civil Procedure. 33 Jurisdiction was based solely on diversity of citizenship. Summons was issued but effective service was not had until December 28, 1945. The Transfer Co. pleaded the Kansas two year Statute of Limitations applicable to such claims. 34 The District Judge, in granting Ragan’s motion to strike the plea, 35 held that the Kansas Statute of Limitations was tolled by the filing of the complaint pursuant to Rule 3 rather than by the actual service of summons as required by a Kansas statute. 36 The United States Court of Appeals for the Tenth Circuit reversed, holding that the requirement of service of summons within the statutory period was an integral part of that State’s Statute of Limitations and accordingly that *Guaranty Trust* governed. 37 The United States Supreme Court granted certiorari 38 and affirmed the

32 69 Sup. Ct. 1233 (1949).
33 "A civil action is commenced by filing a complaint with the court." 28 U. S. C. foll. § 723c (1946).
36 Kan. Gen. Stats. 1935, sec. 60-308, "An action shall be deemed commenced within the meaning of this article, as to each defendant, at the date of the summons which is served on him, ..."
37 170 F. 2d 987 (1948).
38 Respondent’s own summary of argument clearly reveals the basis upon which the case was argued before the Supreme Court—"Since the petitioner conceded in the trial court and reiterates that concession at page 6 of his brief herein ‘that if the case were pending in the State court . . . then the cause of action would have been barred . . .’ we might as well close at this point by citation of Guaranty Trust Co. v. York, . . ." Brief for Respondent, p. 4.
decision of the Circuit Court. The Court, speaking through Mr. Justice Douglas, declared:

"It is conceded that if the present case were in a Kansas court it would be barred. The theory of Guaranty Trust Co. v. York would therefore seem to bar it in the federal court, ..."

Then followed what is perhaps the most important single passage in the three opinions, concisely setting forth a criterion for uniformity which may be considered as establishing the guide for future application of the principles of Erie and Guaranty Trust by federal courts—

"But in the present case we look to local law to find the cause of action on which suit is brought. Since that cause of action is created by local law, the measure of it is to be found only in local law. It carries the same burden and is subject to the same defenses in the federal court as in the state court... It accrues and comes to an end when local law so declares... Where local law qualifies or abridges it, the federal court must follow suit. Otherwise there is a different measure of the cause of action in one court than in the other, and the principle of Erie R. Co. v. Tompkins is transgressed."39

In Cohen v. Beneficial Industrial Loan Corporation,40 Hannah Cohen was plaintiff in a shareholder's derivative action before the United States District Court for New Jersey. Jurisdiction rested solely on diversity of citizenship. The corporate defendant, Beneficial, a Delaware corporation, filed motion to require Cohen to give security for the reasonable expenses including counsel fees which might be incurred by it in defending the suit pursuant to Section 15, Chapter 3, Title 14 of the Revised Statutes of New Jersey.41 Security was estimated at $125,000 and it was contended that the statute created a right of

40 69 Sup. Ct. 1221 (1949).
41 "In any action instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars ($50,000), the corporation in whose right such action is brought shall be entitled, at any stage of the proceedings before final judgment, to require the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, ..."
substantive character which must be enforced under the *Erie* doctrine. The District Judge denied the motion on the ground that the statute was remedial in intent and therefore not binding on a federal court in a suit based on diversity.\(^{42}\) On appeal the Court of Appeals for the Third Circuit found that the statute, although phrased in procedural terms, created a substantial right and that it embodied an important public policy of the state of New Jersey, and therefore, citing *Guaranty Trust* and *Angel v. Bullington*, it must be applied by a federal court in New Jersey.\(^{43}\) The Supreme Court granted certiorari and in affirming the decision of the Circuit Court declared through Mr. Justice Jackson that:

"... *Erie R. Co. v. Tompkins* and its progeny have wrought a more far-reaching change in the relation of state and federal courts and the application of state law in the latter whereby in diversity cases the federal court administers the state system of law in all except details related to its own conduct of business. *Guaranty Co. v. York...*"

"Even if we were to agree that the New Jersey statute is procedural, it would not determine that it is not applicable. Rules which lawyers call procedural do not always exhaust their effect by regulating procedure. ..."

"We do not think a statute which so conditions the stockholder's action can be disregarded by the federal court as mere procedural device."\(^{44}\) (Italics supplied).

A partial dissent to the majority opinion was rendered by Mr. Justice Douglas in which Mr. Justice Frankfurter concurred. In view of the part played by these Justices in the formulation and application of the doctrine of *Guaranty Trust* the dissent must be considered as most significant. It contains what may be considered as an authoritative indication of the limitations on the principles of *Guaranty Trust* as conceived by the author and by the foremost exponent of those principles:

"This New Jersey statute does not add one iota to nor subtract one iota from that cause of action. ... Each state has numerous regulations governing the institution of suits in its courts. They may favor the litigation or they may affect it adversely. But they do not fall under the principle of *Erie R. Co. v. Tompkins* ... unless they define, qualify or delimit the cause of action or otherwise relate to it."\(^{45}\)


\(^{43}\) Beneficial Industrial Loan Corp. *v.* Cohen, 170 F. 2d 44 (1948).

\(^{44}\) 69 Sup. Ct. 1221, 1230 (1949).

\(^{45}\) *Id.* at 1231.
According to this view the criteria of uniformity would concern only the cause of action considered in itself and are applicable only where that cause of action will be affected by non-application of the state rule. Mr. Justice Douglas also emphasized the "cause of action" aspect in his opinion in the Ragan case, supra.

It would seem however that the New Jersey statute was as much a qualification or delimitation of Cohen's right as were the state rules of burden of proof and contributory negligence previously declared substantive. As in the Woods case, supra, the basic disagreement between Justices Jackson and Douglas was not over conflicting principles of law but rather concerned a difference of statutory interpretation. Mr. Justice Jackson conceded that the New Jersey statute did not affect Cohen's cause of action—"With it or without it the main action takes the same course." The conflict stems from the view taken of the corporation's status under the act. The Circuit Court below and Justice Jackson interpreted the statute as granting a new and substantial right in the corporation to protection against losses incurred in defending unsuccessful suits and this was the state-created right to be enforced by the federal courts. Further in support of Justice Jackson's position it should be noted that considerations of state policy were here involved, although not alluded to in either the majority or minority opinions as affecting the applicability of Guaranty Trust. The Circuit Court had based its decision as much on the fact that the statute represented a strong public policy of New Jersey as on the substantial right created thereby. The respondent's argument before the Supreme Court was based largely on the public policy aspect. It is submitted that the Cohen decision is correct as a logical result of the application of the principles of Guaranty Trust for, theory aside, there can be no question that the New Jersey statute substantially affected the outcome of the litigation; indeed for all practical purposes, it decided it.

The Cohen case, it is submitted, represents the furthest extension of Guaranty Trust Co. v. York. Certainly it raises a grave question of whether the federal judiciary may not effect a federal policy on certain

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46 Cities Service Oil Co. v. Dunlap, 308 U. S. 208 (1939).
48 69 Sup. Ct. 1221, 1230 (1949).
49 Beneficial Industrial Loan Corp. v. Cohen, 170 F. 2d 44 (1948).
50 Brief for Beneficial Industrial Loan Corp., pp. 25-34.
issues of national import that may override conflicting state policy. True it may be that the states are the fountainheads of substantive rights under diversity jurisdiction, but this should not necessarily preclude the existence and the effective application of a national judicial policy in matters where the effects of state policies extend far beyond the state boundaries. This is especially applicable to the field of corporate control.

A literal application of Mr. Justice Jackson's declaration that "in diversity cases the federal court administers the state system of law in all except details related to its own conduct of business" would constitute a definite extension of the principles of Guaranty Trust as delimited by Mr. Justice Douglas' dissent. Thus virtually all state law irrespective of its applicability to or effect on the cause of action would be binding on federal courts. Further, if the administration of the "details" conflicted with substantial state rights it seems clear that also must give way. Whether this will be the trend of the future is not clear since the basic split in the Court concerned interpretation of the effect of the New Jersey Statute.

STATE-CREATED RIGHTS

It is clear that when a cause of action is before a federal court solely on the basis of diversity of citizenship the principle of conformity to state law to reach uniformity of decision with state courts is applicable under Erie R. Co. v. Tompkins because that cause of action is derived from a state. "The source of substantive rights enforced by a federal court under diversity jurisdiction, it cannot be said too often, is the law of the States."\(^{52}\) Since the right of action is created by the state, federal courts must enforce it as given—neither extending nor diminishing it. The measure of the cause of action is to be found only in the local law—statutory and decisional—and, as there found, must be enforced by the federal courts in substantially the same manner and to the same extent as it would be enforced in the courts of the state.

The soundness of this policy is obvious when it is considered that the historical basis for the establishment of diversity jurisdiction in federal courts was "assurance to non-resident litigants of courts free

from susceptibility to potential local bias". The sole basis, therefore, for federal courts presently hearing the type of cases to which the *Erie* principles are applicable was an apprehension—an apprehension that never materialized and which ceased to have significance even as an apprehension some eighty years ago. Failure to apply the state rule of law to a state-created cause of action is clearly discriminatory.

Thus more was at issue in the decisions of June 20 than a mere rule of substantive-procedural dichotomy. A fundamental reorientation of our dual judicial system was heralded by *Erie R. Co. v. Tompkins*. The divergent systems of independent determination of rules of decision previously existent under *Swift v. Tyson* were to be replaced, at least in so far as diversity jurisdiction and non-federal rights were concerned, by a single system of uniform determination. *Swift v. Tyson* had envisioned uniform rules of decision throughout the nation—to be attained by the establishment of a body of federal "general" or "common" law. It was anticipated that the state courts would adopt the "superior" interpretations of the federal judiciary and hence a national uniformity would be achieved. The state courts, however, did not readily adopt the "superior" federal principles and in the resultant confusion were sown the seeds which brought forth the fruit of *Erie R. Co. v. Tompkins*. The *Erie* decision retained the goal of uniformity, but it was a different type of uniformity that was sought. For the concept of uniformity in rules of decision throughout the nation there was substituted that of uniformity within each state. The methods of effecting the policy were completely reversed. In place of anticipation that the state courts would conform to the federal rules of decision there was given a command that the federal courts should conform to all state rules which significantly affected the cause of action. This policy conclusively confirmed the States in their historical and constitutional role as the sole source of substantive rights enforced by a federal court under diversity jurisdiction. The logic of the principle is inescapable—since the state gives and defines the right of action, that right should only be enforced as so given and defined. The justice of the principle is not open to question.

During the years between the *Erie* and *Guaranty Trust* decisions the extent to which this policy was to be carried was only dimly indicated.

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54 *Erie R. Co. v. Tompkins*, 304 U. S. 64, 74-78 (1938).
Guaranty Trust Co. v. York and Angel v. Bullington gave teeth to the policy just as Fauntleroy v. Lum did with regard to the Supreme Court’s policy on the Full Faith and Credit Clause of the Constitution. Indeed the principle of uniformity in diversity rules of decision is but another phase of the trend by the present Court toward effecting national unity in judicial matters. It must be considered in this aspect along with recent advances in the doctrine of res judicata as applied in relation to the Full Faith and Credit Clause.

The decisions of June 20 clearly reflect the determination of the Supreme Court to carry out the full extent of the policy expressed in Guaranty Trust Co. v. York. In order to enforce this policy the Court was required to make significant advances in the basic fields of law involved in the three cases—Erie for the moment aside. The Woods case should result in a substantial strengthening of state control over foreign corporations. Heretofore corporations doing intrastate business in “foreign” states often decided not to qualify because they could always sue in the federal courts. Now if a state, to compel compliance with its registration or licensing statutes, closes its courts to non-qualifying corporations “doing business” in the state, the federal courts of that state are also closed—with the qualification of course, only insofar as rights derived from the states are involved. The Ragan case stands as an apparent inroad on the Federal Rules of Civil Procedure—established and promulgated by this very Court. That this inroad is more apparent than real will be considered hereafter. The social-economic consequences of the Cohen case may far overshadow its present significance in extending the Erie doctrine. Prior to this case the federal district courts of the Second Circuit had held a similar New York statute procedural and declared its application to be discretionary with the federal judges. The present decision of the Supreme Court opens the way for elimination of the shareholder’s derivative suit as a significant weapon against corporate mismanagement and exploitation.

The decision in the Woods case will be open to criticism on the same grounds as was Angel v. Bullington—that it delegates the plenary

55 210 U. S. 230 (1908).
57 Chapter 668 Laws 1944, General Corporation Law § 61-b.
58 Aspinook Corp. v. Bright, 165 F. 2d 294, 295 (2d Cir. 1947), cert. denied, 333 U. S. 846 (1948); Boyd v. Bell, 64 F. Supp. 22 (S. D. N. Y. 1945); Craftsman Finance and
power of Congress to determine the jurisdiction of the federal courts to the state legislatures and is therefore unconstitutional. It is submitted that this is not an accurate statement of the situation. This is not a question of state legislatures exercising power over federal diversity jurisdiction. Rather it is a question of a federal policy, declared by the highest federal court, based upon interpretation by that Court of the constitutional relationships between the dual sovereignties; of the judicial powers conferred by the Constitution; and of the congressional mandate embodied in the Rules of Decision Act. The policy and the principles by which it is effected are sound, just and constitutional. The technical jurisdiction of the federal courts in Mississippi was not affected by the Mississippi statute in the *Woods* case. As pointed out by counsel for petitioner, the plea of the Mississippi statute was not to the jurisdiction of the court but was a plea in bar in defense of the action. Interstate's suit was dismissed not on any ground of jurisdiction but because it had no cause of action under the laws and statutes of the state of Mississippi. In other words Interstate had and exercised the right to go into the federal court in Mississippi and be heard on the merits—but once before that court it was face to face with the same Mississippi law which it would have found in the state courts and, since that law barred it in the state courts, it likewise barred it in the federal courts in that state. It is interesting to note that the very result achieved in the *Woods* case was presaged by then-Professor Frankfurter in an article wherein he advocated legislative overruling of the doctrine of *Swift v. Tyson*. Discussing the *Swift* doctrine, he wrote:

> "The system leads to evasion of state legislation embodying legitimate state policies. Thus, foreign corporations which do business in a state without complying with constitutional conditions imposed by the state, bar themselves from enforcing rights in the state courts, but they may sue in the federal courts of that state.""  


UNIFORMITY AND THE FEDERAL RULES

It was perhaps with an irony born of coincidence that the decision in *Erie R. Co. v. Tompkins* was announced midway between the promulgation and effective date of the Federal Rules of Civil Procedure.63 Ever since the *Erie* doctrine has cast its shadow over the rules and the inevitable clash long has been anticipated and prolifically discussed.64 The clouds of *Erie* have hung heaviest over Rule 3 and Rule 23b.65 The effect of the decisions of June 20 on these two rules should not characterize this particular engagement as more than a skirmish. Rule 3 provides that an action is commenced when the complaint is filed in the District Court. In the *Ragan* case a Kansas statute provide that an action was commenced in state courts by service of summons.66 The Kansas Statute of Limitations required that an action be commenced within two years. A consideration of these facts independently of each other would lead to the conclusion that compliance with Rule 3 would toll the statute of limitations in an action before a federal court and it is submitted that this would be the result in most states. However the crux of the *Ragan* case was that the Kansas statute providing for commencement of actions in the state courts was construed by Kansas Courts to be an integral part of the statute of limitations. Once this was conceded, reason compelled application of *Guaranty Trust*. This was a state right. Its measure was established in state law. The Kansas statute of limitations qualified the right and part of that qualification was that service of summons must be made within the statutory period. The federal courts could neither extend nor diminish the right as given and qualified by Kansas. Application of Rule 3, on the facts in this case would have operated to revive a cause of action considered as expired under state law and which would have been unenforceable on the facts had the litigation been originally before a state court instead of the federal court. This would constitute a substantial extension of Ragan's cause of action and conversely would op-

63 Rules promulgated December 20, 1937; *Erie* decision announced April 25, 1938; Rules effective September 16, 1938.


65 See Advisory Committee notes to Rule 3 and Rule 21b, 28 U. S. C. foll. § 723c (1946).

erate as a substantial restriction on defendant's rights. The point is admittedly close and it is submitted that the fundamental issue before the Supreme Court was a choice between two of its own policies. It is significant that the Court considered its policy in *Guaranty Trust* paramount to its policy in promulgating the Federal Rules.

What Rule 3 may have lost in the *Ragan* case, Rule 23b gained in the *Cohen* case. Heretofore Rule 23b had been considered as the rule most open to attack on the basis of the *Erie* decision. It was generally conceded that it affected substantive matters and consequently violated the provisions of the Enabling Act that "Said rules shall neither abridge, enlarge, nor modify the substantive rights of any litigant." 68

Yet in the *Cohen* decision Rule 23b was expressly upheld by both majority and minority opinions even though through the medium of *obiter dictum*. Mr. Justice Jackson declared for the majority that, none of the provisions of Rule 23b "conflict with the statute in question and all may be observed by a federal court, *even if not applicable in state court*." 69 (italics supplied). There appear to be anomalous implications here. Thus although a state grants a shareholder's derivative right of action free of the requirements of Rule 23b, the federal courts may insist on compliance with the rule before hearing the cause. This in many cases will operate to substantially affect the result of the litigation as between state and federal courts and thus contravene *Guaranty Trust*. Yet the same sentence implies that if, and insofar as, Rule 23b had conflicted with the provisions of the New Jersey statute it would have been superseded by that statute. Apparently the final status of Rule 23b must await decisive litigation.

The position of Mr. Justice Douglas in upholding the rule has the merit of consistency. Since Rule 23b, like the New Jersey statute, is considered not to affect the "cause of action" its application is not affected by the doctrine of *Erie R. Co. v. Tompkins*.

Considering the historical basis for diversity jurisdiction in federal courts; the restriction in the application of the principles of *Guaranty Trust* and its successors to only state-created rights; and the vital issues of national policy underlying those principles, it would seem that whenever the principle of uniformity in adjudication which underlies *Guar-

67 *Tunks, op. cit. supra* note 9; *Note*, 41 Col. L. Rev. 104, 115-116 (1941); 3 *MOORE'S FEDERAL PRACTICE* 3496 (2d ed. 1948).


69 69 Sup. Ct. 1221, 1230 (1949).
anty Trust Co. v. York conflicts with the principle of uniformity in the mechanics of procedure which underlies the Federal Rules, it is proper that the former prevail.

Conclusions

In the decisions of June 20, 1949, the Supreme Court of the United States decisively confirmed Mr. Justice Frankfurter’s interpretation of the policy of Erie R. Co. v. Tompkins as set forth by his opinions in Guaranty Trust Co. v. York, and Angel v. Bullington. The general rule of the Erie case that in cases where federal jurisdiction is based solely on the diversity of citizenship of the parties the federal courts must follow state substantive law has been made specific by the mandate that there will be conformity by federal courts to state rules of law which significantly affect the result of the litigation to the end that there may be uniformity of adjudication within the state. The criteria to be applied by the federal courts is no longer “substance” in an abstract sense but rather that of “uniformity” in a concrete sense—if failure to apply the particular state rule will lead to a result of the litigation different from that which would obtain had the action been brought before a state court, the state rule must be applied.

Whether or not Mr. Justice Jackson's declaration in the Cohen case concerning the administration of "details” by federal courts represents an extension of this principle must await future application. Certain it is that if indeed the “cause of action” is to be abandoned as the preserve of Erie R. Co. v. Tompkins there has been a significant extension of the principles enunciated in that case.

FRANK J. DENNY
RECENT DECISIONS

AGENCY—A PRIVATE SHIPPING COMPANY AS GENERAL AGENT FOR THE WAR SHIPPING ADMINISTRATION IS NOT LIABLE UNDER THE JONES ACT FOR INJURY TO A SEAMAN EMPLOYED ON A UNITED STATES OWNED SHIP.

Plaintiff McAllister was procured from the union hiring hall by defendant corporation and made available for employment to the master of the S.S. Edward B. Haines, who signed him on as second assistant engineer. During the ensuing voyage plaintiff was stricken with poliomyelitis and suffered permanent injury. He sued defendant shipping company under the Merchant Marine Act of 1920 as amended, 41 Stat. 1007 (1920), 46 U. S. C. § 688 (1946), also known as the Jones Act. The jury returned a verdict for the plaintiff. The Circuit Court of Appeals affirmed, and the Supreme Court granted certiorari. Held, under the General Agency Agreement defendant general agent is not liable to a seaman aboard a War Shipping Administration owned vessel for injury caused by the negligence of the master or crew of such vessel in a suit under the Jones Act, since the United States and not the general agent was the seaman's employer. Cosmopolitan Shipping Co. Inc. v. McAllister, 69 Sup. Ct. 1317 (1949).

On the same day in companion cases, the Court affirmed decisions of the Supreme Court of Oregon and the United States Court of Appeals for the 3d Circuit, denying liability of the general agent to a seaman employee on the same grounds. Fink v. Shepard Steamship Co. and Gaynor v. Agwilines, Inc., 69 Sup. Ct. 1330 (1949).

The decision in the instant case settles the conflict which has arisen in both federal and state courts as to whether the private shipping companies, as general agents of the United States during the war, were liable under the Jones Act to seamen injured in the course of their employment. For previous discussion of the question of the general agent's liability to an injured seamen see 34 Geo. L. J. 367 (1946); 55 Yale L. J. 584 (1946); and 16 Ford. L. Rev. 106 (1947). It is clear that seamen had an action against the United States under the Suits in Admiralty Act, 41 Stat. 525 (1920), 46 U. S. C. § 741-752 (1946), and the War Shipping Administration (Clarification) Act, 57 Stat. 45 (1943), 50 U. S. C. App. § 1291 (1946), in an action in admiralty without a jury. The injured seamen, however, preferred to sue the general agent if possible, in order to gain the advantage of a jury trial at law under the Jones Act.

The lack of agreement on this question primarily arose out of two previous decisions of the Supreme Court which in logic were clearly in conflict. In Hust v. Moore-McCormack Lines, Inc., 328 U. S. 707 (1946), the Court ruled that, under an agency agreement identical to the one in question in the instant case, the shipping company as general agent was liable to an injured seaman in an action under the Jones Act. The decision was based in part on
the theory that the Jones Act required that the general agent be held liable as employer, regardless of the strict common law definition of the word. (See NLRB v. Hearst Publications, Inc., 322 U. S. 111 (1944), for a similar enunciation of the doctrine of liberal statutory construction of welfare legislation). A year later the Court materially changed its position on the question, holding that the general agent was not liable to a longshoreman for injuries incurred aboard the vessel. Caldarola v. Eckert, 332 U. S. 155 (1947). Following the rationale of the latter case, the Court in the instant case overruled Hust v. Moore-McCormack Lines, supra, and settled the question clearly in favor of the general agent defendant.

Since a suit by an injured seaman under the Jones Act is limited to an action against his employer, The Norland, 101 F. 2d 967 (9th Cir. 1939); Nolan v. General Seafoods Corporation, 112 F. 2d 515 (1st Cir. 1940), the primary issue upon which the case turned was whether for the purposes of such action the general agent could be considered the employer of a seaman employed on a War Shipping Administration owned ship. Under the terms of the standard wartime General Agency Agreement, form GAA 4-4-42, 46 Code Fed. Regs. § 306.44 (Cum. Supp. 1943), the defendant private shipping company was designated "General Agent of the United States" and "not as an independent contractor . . . to manage and conduct the business for the United States, in accordance with such directions, orders, or regulations as the latter . . . may prescribe". It was a working arrangement whereby, in the interests of national security, the United States took over control of routes, cargoes and priorities, and assumed responsibility for costs of operation and losses, yet left a large measure of the normal working details to the shipping companies who had previously operated the lines. (See Executive Order 9054 of February 7, 1942, 50 U. S. C. App. § 1295, establishing the War Shipping Administration, and the letter of the General Counsel, United States Maritime Commission to the Assistant Attorney General dated April 28, 1947). Although technically the United States was operator of the ship and employer of the crew, much of the control of the ship, including procurement of crew members and master, actually remained in the hands of the shipping company which acted as general agent.

The decision is based on well established rules of agency in determining who was the seaman's employer. Who is the employer depends upon " . . . whose enterprise the operation of the vessel was." Cosmopolitan Shipping Company v. McAllister, supra, p. 11. This is an established common law test for determining the employer under a given situation. Stevenson v. Lake Terminal R. Co., 42 F. 2d 357 (6th Cir. 1930). Furthermore, it has long been settled law that servants chosen by a general agent with the master's approval, to perform the master's work, become employees, not of the general agent, but of the master. Story, Agency § 201, 386 (9th Ed. 1882); Mechem, Agency § 332 (2d Ed. 1914). The majority of the Court excluded the possibility that the seaman-plaintiff at the same time could have two employers, and used the above com-
mon law tests to show not only that the United States was the plaintiff's employer, but also that the general agent could not be his employer. Although not discussed by the Court, the facts show that, even if plaintiff did have two employers his injury was due to his employee-employer relationship with the United States, not because of his relationship with the defendant.

The case is significant in that it settles the question of whether war-time seamen on United States owned ships had an action against the general agent under the Jones Act, in addition to their right to sue the United States. The results of the decision have been harsh on seamen who, in choosing to sue the general agent have now lost their right of redress against the United States due to the operation of the Statute of Limitations. This has been recognized in Congress, where a bill, H.R. 483, 81st Cong., 1st Sess. (1949) has been introduced to extend the time in which suit may be brought against the government. The case also represents a retreat from the Court's recent policy of liberal construction of welfare legislation in derogation of common law rules and definitions.

RICHARD L. BRAUN

AIR LAW—ASSUMING WARSAW CONVENTION APPLICABLE, WILFUL MISCONDUCT PRECLUDES INTERNATIONAL AIR CARRIER'S CLAIM OF LIMITED LIABILITY UNDER ITS PROVISIONS.

Ulen, a passenger on board an American Airlines' plane en route from Washington, D. C. to Mexico City, was severely injured when the plane crashed into Glade Mountain in Southwest Virginia. Ulen brought suit in the United States District Court for the District of Columbia alleging that her injuries were the direct result of negligence on the part of American's agents in carelessly planning and approving the flight plan and in unskillfully operating the plane. Answers to Ulen's interrogatories showed that American's agents were executing a flight plan calling for the plane to fly at an altitude of 4000 feet on the leg of the flight on which the crash occurred and that the plane crashed at an elevation of 3910 feet. Further the answers admitted that according to a chart in American's possession Glade Mountain is more than 3500 feet high but less than 4000 feet above sea level. American, in its amended answer, included the defense that under the Warsaw Convention the total recovery, if any, was limited to $8,291.87. After trial a jury awarded Ulen $25,000. On appeal to the United States Court of Appeals for the District of Columbia Circuit, American Airlines urged, inter alia, that liability, if any, was limited in amount by the applicable provision of the Warsaw Convention. Held, assuming, without deciding, that the Warsaw Convention applies here, appellant's claim for limited liability is precluded by Article 25 of the Convention itself. American Airlines, Inc. v. Violet Ulen, (D. C. Cir., Sept. 26, 1949).
On Oct. 12, 1929, there was concluded, at Warsaw, Poland, a "Convention for the Unification of Certain Rules Relating to International Transportation by Air," more commonly known as the Warsaw Convention, and adherence thereto on the part of the United States was proclaimed by the President on Oct. 29, 1934. 49 Stat. (Part 2) 3000 (1934). The purpose of this Convention was to regulate in a uniform manner the conditions of international air transportation in respect, among others, of the liability of the carrier. Accordingly, Article 22 thereof provides that the liability of the carrier for each passenger shall be limited to 125,000 francs which, at the time of the instant case, was equivalent to $8,291.87. However, the Convention further provides, in Article 25, that the carrier shall not be entitled to avail himself of the provisions limiting his liability, if the damage is caused by wilful misconduct on the part of him or his agents, or by such default as, in accordance with the law of the court to which the case is submitted, is considered to be equivalent to wilful misconduct.

The Warsaw Convention, being an international treaty to which the United States adheres, is part of the law of the land, and supersedes state law. Wyman et al. v. Pan American Airways, Inc., 43 N. Y. S. 2d 420 (1944). Consequently it has been held that public policy against contractual limitation of liability on the part of a common carrier is overruled by this treaty. Indemnity Ins. Co. v. Pan American Airways, 58 F. Supp. 338 (1944). Although limited liability under Article 22 of the Convention has been applied, Grein v. Imperial Airways, Ltd., 1 K. B. 50 (1937), and the provision limiting liability (Article 22) and the provision precluding limited liability because of wilful misconduct (Article 25) have received the attention of many writers, see Parker, The Adequacy of the Passenger Liability Limit of the Warsaw Convention of 1929, 14 J. Air L. and Com. 37 (1947), and Wetter, Possible Simplification of the Warsaw Convention Liability Rules, 15 J. Air L. and Com. 1 (1948), there appears to be no prior authoritative adjudication of the correctness of the term "wilful misconduct" as translated from the French word "dol" used in the official language of the treaty, and no previous adjudication in which a carrier was denied the protection of the limited liability provision because of his wilful misconduct.

The instant decision thus extends the ruling case law concerning the Warsaw Convention on two points. First, it holds that the term "wilful misconduct" is a proper translation, making reference to the statement of an English delegate to the Conference that he believed the expression "wilful misconduct" covered all that was desired to be said. Second, the instant case enforces, apparently for the first time, the provision of the Convention which operates to preclude limited liability because of the wilful misconduct of the carrier, ruling that the flight plan formulated and partially executed by appellant was a direct and intentional violation of a safety provision embodied in Civil Air Regulation 61.7401, 8 Fed. Reg. 6589, (now Civil Air Regulation 61.261(b),
14 Fed. Reg. 4315) which states that no air carrier shall be flown at an altitude of less than 1000 feet above the highest obstacle located within a horizontal distance of five miles from the center of the course to be flown, and that such violation of a safety rule was ample evidence to support a finding of willful misconduct by a jury.

This case, in assuming the Warsaw Convention to be applicable, appears to be a logical interpretation of the meaning of Articles 22 and 25 of the Convention, and is important as a first authoritative adjudication wherein the provisions of these two articles were put in issue.

EDWIN T. BEAN, JR.

CIVIL PROCEDURE—CONGRESS CAN GIVE FEDERAL DISTRICT COURTS JURISDICTION, BASED ON DIVERSITY OF CITIZENSHIP, OF AN ACTION BY OR AGAINST A CITIZEN OF THE DISTRICT OF COLUMBIA.

A corporation of the District of Columbia brought suit against a Virginia corporation in the federal district court for Maryland. The jurisdiction of the court was based upon the amendment of the Judicial Code, 54 Stat. 143 (1940), 28 U. S. C. § 41 (1) (b) (1940), which extended the jurisdiction of the district courts of the United States in diversity cases to suits between citizens of the District of Columbia and those of a state or territory. The defendant moved to dismiss on the ground that the 1940 amendment unconstitutionally enlarged the federal judicial power beyond the limitations of Article III of the Constitution. The district court granted the motion without opinion and was affirmed by the Court of Appeals for the Fourth Circuit. Certiorari was granted. Held, Congress may extend the jurisdiction of the federal district courts so that citizens of the District of Columbia may sue or be sued in those courts on the basis of diversity of citizenship. National Mutual Insurance Company v. Tidewater Transfer Company, 69 Sup. Ct. 1173 (1949).

The holdings of unconstitutionality by the lower courts were based upon the decision of Chief Justice Marshall in Hepburn and Dundas v. Ellzey, 2 Cranch 445 (U. S. 1805). In that case a suit was brought by a resident of the District of Columbia under the Judiciary Act of 1789 granting jurisdiction to the federal district courts where the controversy “... is between a citizen of the State where the suit is brought and a citizen of another State.” Arguing by analogy between the constitutional use of the word “state” and its use in the statute, Marshall decided that members of the American “Confederacy” are the only states contemplated by the Constitution, and consequently by the statute. The suit was dismissed. Although strictly speaking only a statute was there construed, the case has been accepted as pointing out a constitutional bar to extension of diversity jurisdiction. See Chafee, The
Interpleader Act of 1936, 45 Yale L. J. 963, 977 (1936). The Chief Justice recognized that some discrimination was being worked against citizens of the District but thought that this matter should be adjusted by the legislature and not by the judiciary. It may be noted that Article III of the Constitution granting judicial powers, was not mentioned in the opinion of Marshall. The doctrine of the Hepburn case has been followed, usually as a settled rule of stare decisis, by a long line of decisions, collected in Winkler v. Daniels, 43 F. Supp. 265 (E. D. Va. 1942), n. 1. Although accepted, the Hepburn decision was strongly attacked in Watson v. Brooks, 13 Fed. 540 (C. C. Ore. 1882).

The effect of the Hepburn case is obviously eliminated by the 1940 amendment if the latter is constitutional. It reads in part, 28 U. S. C. § 41 (1) (1940): “The district courts shall have original jurisdiction as follows: of all suits of a civil nature at common law or in equity . . . where the matter in controversy . . . (b) is between citizens of different States, or citizens of the District of Columbia, the Territory of Hawaii, or Alaska, and any State or territory. . . .” The constitutionality of the amendment was assailed soon after enactment and decisions taking either possible view shortly became available. When certiorari was granted the score stood at three cases upholding, as opposed to nine cases denying, the constitutionality of the act. These twelve decisions are cited in the principal case, supra, page 1174, n. 4.

In adopting the view that the 1940 amendment was constitutional the Supreme Court declined to overrule the Hepburn case, relying rather upon the argument that Congress, in enacting a statute different in terms from the old statute, possesses plenary powers over the governmental functions of the District of Columbia, and also authority “to make all laws necessary and proper for carrying into execution,” such powers, U. S. Const. Art. I, § 8. In other words Congress may constitutionally find it necessary and proper to extend the jurisdiction of federal district courts in order to carry out its exclusive jurisdiction over the District of Columbia. See National Mutual Insurance Co. case, supra page 1185 of the concurring opinion. The argument that congressional powers over the District are not to be exercised outside its territorial limits is met by reference to Cohens v. Virginia, 6 Wheat. 264, 269 (U.S. 1821) where Chief Justice Marshall decided that Congress, even where legislating for the District of Columbia, remained a national legislature and could exercise on a national scale those powers incidental to proper government of the District.

Mr. Justice Rutledge, concurring, seeks flatly to reverse the Hepburn case or at least to confine it as a mere statutory interpretation. Recognizing the great prestige of Marshall’s name, the opinion, supra, at 1191, recites: “The Hepburn decision was made . . . at the beginning of Marshall’s judicial career . . . the master hand which later made his work immortal faltered.” This Justice felt that the “majority” here, three members of the Court, would
too greatly enlarge the jurisdiction of the constitutional courts and wipe out the differences long held to exist between these and the legislative courts, such as the Court of Claims, created under the powers of Congress enumerated in Article I, Section 8 of the Constitution.

The great conflict of opinions presented by the principal case is best shown at p. 1200, where Mr. Justice Frankfurter says:

"A substantial majority of the Court agrees that each of the two grounds urged in support of the attempt by Congress to extend diversity jurisdiction to cases involving citizens of the District of Columbia must be rejected—but not the same majority. And so, conflicting minorities in combination bring to pass a result—paradoxical as it may appear—which differing majorities of the Court find insupportable."

The net result of this case is to leave the Hepburn decision, supra, intact but restricted as an interpretation of the 1789 statute. The word "state" appearing in Article III of the Constitution no longer excludes by implication the District of Columbia. However, it is still questionable that the majority reasoning based on the exclusive jurisdiction of Congress over the District of Columbia coupled with the necessary and proper clause can be extended to other sections of Article I. If so, then Congress can use the necessary and proper clause to grant any court any jurisdiction whatsoever, since the provisions of Article I cover most of the powers attributable to a sovereign. Here six Justices opposed such reasoning and refused to adopt it. It appears unlikely that they will soon agree to it.

JAMES H. RYAN

CONSTITUTIONAL LAW—NATIONALITY ACT PROVISION WHICH PROVIDES FOR LOSS OF CITIZENSHIP OF NATURALIZED CITIZENS AFTER FIVE YEARS RESIDENCE IN FOREIGN COUNTRY IS CONSTITUTIONAL.

Plaintiff was naturalized in 1928 and in 1934 went to Palestine. On July 3, 1947 he presented his certificate of citizenship to the authorities who excluded him, ruling that he had expatriated himself under § 404 of the NATIONALITY ACT OF 1940, 8 U. S. C. 804 which provides that "A person who has become a national by naturalization shall lose his nationality by . . . residing continuously for five years in any . . . foreign state", except as provided in Sec. 806. None of the exceptions apply. Plaintiff brings this action for a judgment declaring him to be a national of the United States contending that the section under which he was excluded is unconstitutional. Held, Section 404 is constitutional and plaintiff was rightly excluded. Lapides v. Clark, 176 F. 2d 619 (D. C. Cir. 1949), cert. denied 18 U. S. L. Week 3132 (U. S. Oct. 24, 1949).

Section 404 of the NATIONALITY ACT OF 1940 developed from the act of March 2, 1907, 34 STAT. 1228 (1907)) which was as follows: "When any
naturalized citizen shall have resided for two years in the foreign state from which he came, or for five years in any other foreign state, it shall be presumed that he has ceased to be an American citizen." The 1907 act was repealed in 1940 when Congress passed the NATIONALITY ACT which codified and reenacted all prior legislation on this subject. The new law changed the rebuttable presumption into a conclusive rule of law. This was done at the request of the State Department which found the old law difficult to administer and a source of much embarrassment. Naturalized citizens returned to their own or other foreign countries resided there for extended periods of time and later asked the United States for diplomatic protection. Such requests were a source of great difficulties to the department since the status of the applicants was not easily ascertainable. *Hearings before Committee on Immigration and Naturalization on H. R. 6127 superseded* by H. R. 9980, 76th Cong., 1st Sess., (1940) 134-141. To alleviate this situation and clarify the status of such persons Congress enacted Sec. 404. The instant case is the first test of the constitutionality thereof.

Appellant's principal contention is that Congress has discriminated against naturalized citizens by Sec. 404, there being no such provision applicable to native born citizens. Such discrimination, he contends is not permitted at all except as specifically provided in the Constitution, and even if some discrimination is permitted, in this case it is arbitrary and thus violates the due process clause of the Fifth Amendment.

Appellant's contention that Congress may not make any discrimination between naturalized and native born citizens, save as provided in the Constitution, is based on a much quoted dicta of Chief Justice Marshall that "He [a naturalized citizen] becomes a member of the society possessing all the rights of a native citizen and standing, in the view of the Constitution, on the footing of the native." *Osborn v. United States Bank*, 9 Wheat. 737, 827 (U. S. 1824). Later courts have impliedly affirmed his view, albeit only by way of dicta. *Knauer v. United States*, 328 U. S. 654, 658 (1946); *Luria v. United States*, 231 U. S. 9, 22 (1913). The question, however, has never been squarely before the Court. An answer favorable to the appellant would preclude any discussion of the reasonableness of Sec. 404.

The power of Congress to classify in regard to expatriation has been upheld in *Mackenzie v. Hare*, 239 U. S. 299 (1915). There the law provided that an American woman who married an alien lost her citizenship thereby. The Court felt that the peculiar relationship involved with the common law concept of the unity of husband and wife furnished sufficient basis for the discrimination. Although the *Mackenzie* case does not authorize, per se, discrimination as is provided in the instant case, it does affirm the power of Congress to distinguish in this type of legislation.

Thus the problem is whether the classification is a reasonable one. The norm which the majority used to determine the reasonableness of the statute is apparently that which is ordinarily applied to regulation of economic affairs,
since the Court cites *Steward Machine Co. v. Davis*, 301 U. S. 548 (1936), which concerned the power of Congress to classify for purposes of taxation and *Nebbia v. New York*, 291 U. S. 502 (1934), which involved a state regulation of the milk industry. In that field the widest latitude would be given to Congress in its classification since “regulatory legislation affecting ordinary commercial transactions is not to be pronounced unconstitutional unless ... it is of such a character as to preclude the assumption that it rests upon some rational basis . . . .” *United States v. Carolene Products Co.*, 304 U. S. 144 (1938).

On the other hand, the norm which is applied to legislation involving certain fundamental rights is an extremely rigorous one. Thus the legislature may be required to go so far as to demonstrate a clear and present danger of substantive evil which the legislation is designed to prevent. *Thornhill v. Alabama*, 310 U. S. 88 (1940).

What standard should be applied in the instant case appears to be an undecided question for the Supreme Court. No definitive holding has been made which would put the right of citizenship into the fundamental rights category. Yet it seems certain that it warrants more stringent protection than the economic affairs test. For example, the Supreme Court requires that the proof necessary for denaturalization, though a civil suit, must approximate that of a criminal action—"clear, unequivocal and convincing" evidence which does not leave "the issue in doubt". *Schneiderman v. United States*, 320 U. S. 118, 158 (1943), *Knauer v. United States*, 328 U. S. 654, 657 (1946). The court clearly indicated in this past term the gravity of depriving a man of citizenship and the need for safeguards to surround such action. *Klapprott v. United States*, 69 Sup. Ct. 384 (1949). It thus seems desirable that the Supreme Court should determine which of the two approaches discussed above should be followed or whether a third test is appropriate in determining the validity of a statute cancelling citizenship.

MICHAEL A. SCHUCHAT

CONSTITUTIONAL LAW—ATTEMPT BY HEALTH AUTHORITIES TO INSPECT A PRIVATE DWELLING WITHOUT A WARRANT IS AN ATTEMPT TO MAKE AN UNREASONABLE SEARCH IN VIOLATION OF THE FOURTH AMENDMENT.

A uniformed health inspector, accompanied by a policeman, appeared at a private residence and demanded admission to inspect for reported unsanitary conditions. No warrant had been obtained nor notice given. When the owner refused the proposed entry she was arrested and subsequently convicted of violating a municipal health regulation denoting it a misdemeanor for any person to interfere with inspection of any premises by an officer of the Health Department. The Municipal Court of Appeals reversed the conviction. The United States Court of Appeals for the District of Columbia Circuit affirmed
the judgment of the intermediate appellate court. *Held,* the proposed inspection of a private home by a health official without a warrant, in the absence of compelling emergency, was an attempt to make an unreasonable search in violation of the Fourth Amendment guarantee of the right of privacy, and the householder was entitled to resist it. *District of Columbia v. Little,* 18 U. S. L. Week 2076 (D. C. Cir. August 1, 1949), *cert. granted,* 338 U. S. 866 (1949).

This case adds a clarifying footnote to the much-debated chapter of law dealing with the meaning and scope of the Fourth Amendment interdict against unreasonable searches. The interest protected by the constitutional guarantee is the right of privacy from unlicensed intrusions by the government and its employees. *Wolf v. Colorado,* 338 U. S. 25 (1949). While reasonable searches are allowed, recent Supreme Court decisions on the subject, in particular the liberal trilogy of *Johnson v. United States,* 333 U. S. 10 (1948); *Trupiano v. United States,* 334 U. S. 699 (1948); and *McDonald v. United States,* 335 U. S. 451 (1948), demonstrate that for even the most justifiable intrusions judicial warrant is a prerequisite, to be excused only in "exceptional circumstances", and searches not passed on by a magistrate will be suspect. And where the object of search is a private residence there is considerable authority for the proposition that an even more exacting standard of reasonableness governs. *Agnello v. United States,* 269 U. S. 20, 32 (1925); *See Harris v. United States,* 331 U. S. 145, 151 (1947), note 15 and cases cited. In light of these precedents, the court in the instant case is correct in asserting that it has stated the rule no broader than existing law in saying, "... no matter who the officer is or what his mission, a government official cannot invade a private home, unless (1) a magistrate has authorized him to do so or (2) an immediate major crisis in the performance of duty affords neither time nor opportunity to apply to a magistrate."

The principal case offers a unique fact situation markedly different from prior search and seizure cases in the federal courts. The question presented, whether an "inspection" of a private home by an administrative officer performing an essentially civil function is a "search" as comprehended by the Fourth Amendment, has never reached the Supreme Court for decision. Uniformly, cases contributing to the law of search and seizure have had their inception in a criminal or quasi-criminal context, and have involved demand for, or seizure of, incriminating evidence in claimed violation of Fourth Amendment rights. See analysis chart of Supreme Court decisions in search and seizure cases from 1914 to 1938 appended to dissent of Mr. Justice Frankfurter in *Harris v. United States,* *supra,* at 175-181. Conversely, the situation in the reported case, at the moment the entry was attempted, was non-criminal in nature, no search for crime or seizure of evidence was contemplated, and no penal liability could have been visited on the householder as a result of the inspection since the ordinance involved provided for penalty only upon non-compliance with notice sent pursuant to the inspection. Section 2, Commis-
sioners' Regulations Concerning the Use and Occupancy of Buildings and Grounds, District of Columbia Health Department, 1897, as amended July 28, 1922. Except for the intrusion on privacy which would have occurred, the proposed entry was innocuous in every respect. Thus, in holding the situation within the purview of the Fourth Amendment the instant court was determining that the invasion of the privacy of a dwelling by government agents would in itself be a cognizable transgression of the Amendment in the absence of warrant or compelling emergency regardless of whether the motivation of the entry was penal or remedial. And further, the court was saying, that the characteristic elements of self-incrimination, summary deprivation of property, and criminal liability because of unfair police tactics are only incidental to the real grievance comprehended by the Amendment. To limit the scope of the Fourth Amendment to searches for evidence of crime would, in the outspoken view of this court, be tantamount to endorsement of the "fantastic absurdity" that "... a man suspected of crime has a right to protection against search of his home without a warrant, but that a man not suspected of crime has no such protection".

The dissenting justice took the contrary position that "... the Fourth Amendment relates only to searches and seizures in connection with criminal prosecutions or enforcement of penalties" and "... does not apply to inspections, if no seizure is intended". A number of federal decisions were adverted to as expressly or inferentially in accord. Camden County Beverage Co. v. Blair, 46 F. 2d 648 (D. N. J. 1930) and cases collected therein.

The majority opinion rejected the reasoning underlying this narrow construction of the constitutional guarantee and adopted as the true rule the view of Justice Vinson in Nueslein v. District of Columbia, 115 F. 2d 690, 692 (D. C. Cir. 1940), that the legislative history of the Fourth Amendment shows "... a principle was being developed instead of a particular abuse being remedied", and that in consequence the amendment "gives a protection wider than these abuses" which prompted its adoption. It should be noted also that the cases relied on in the dissent as authority for exempting the attempted inspection here from the constitutional prohibition arose without exception in a commercial environment and none dealt with the "private home" factor involved in the instant case.

A further argument in the dissent, more pragmatic than legal, alluded to the effect of the warrant requirement on administration of health regulations. Since there exists no statutory provision for issuing a search warrant to a health inspector, the dissenting justice expressed alarm at the "serious situation" which the conclusion of the court might produce in suspending the function of inspection. Also, belief was expressed that the "new type of process" proposed would not be sufficiently plastic to meet public health protection needs, and would work the mischief of putting the courts in the business of supervising an executive function. But, as the majority opinion stated, "That is a legislative
problem”, and “it is untenable to argue that because Congress has failed to provide procedure for obtaining a search warrant, searches otherwise unconstitutional can therefore be made”.

The majority holding gains added significance in light of the recent pronouncement by the Supreme Court that the Fourth Amendment is enforceable against the states through the “due process clause” of the Fourteenth Amendment. Wolf v. Colorado, supra. If the Supreme Court affirms the decision below, health inspectors and other administrative officials in every municipality in the country could be compelled to secure warrants to gain access to private dwellings, and statutes or ordinances affirmatively authorizing warrantless entries over objection could be stricken down.

The principal case does more than attain a salutary result in terms of maintaining the sanctity of the home. It also arrives at the more intelligent result in measuring the reach of the Fourth Amendment immunity. Some may quarrel with the court’s application of rules developed in “criminal” cases to a health inspection, but on consideration of the fact that it is the right of privacy which is “at the core of the Fourth Amendment”, it should be seen that differentiation of official intrusions according to whether they occur on the civil side or the criminal side is an illogical dichotomy.

JOSEPH C. MCMURRAY

CONSTITUTIONAL LAW—SECURITY OF PRIVACY AGAINST ARBITRARY INTRUSION, GUARANTEED BY THE FOURTH AMENDMENT TO THE CONSTITUTION, IS ENFORCEABLE AGAINST THE STATES THROUGH THE DUE PROCESS CLAUSE, BUT THIS RIGHT DOES NOT REQUIRE STATE COURTS TO SUPPRESS EVIDENCE UNLAWFULLY SEIZED.

Evidence obtained by an unreasonable search and seizure was admitted in the trial of defendant in a state court on a charge of conspiracy to commit abortions. The conviction was affirmed by the highest court of the state, whereupon the Supreme Court of the United States granted certiorari. Defendant contended that the admission of evidence so obtained was a violation of the Due Process Clause of the Fourteenth Amendment. Held, the security of one’s privacy against arbitrary intrusion by the police is basic to the concept of ordered liberty, and therefore enforceable against the states through the Fourteenth Amendment, but this right may be enforced in various ways and does not require the suppression of evidence in state courts. The conviction was affirmed. Wolf v. Colorado, 338 U. S. 25 (1949).

Under this line of reasoning, the decision of the Court that the Fourteenth Amendment prohibits unreasonable searches and seizures seems to make no change at all in the law, but the most interesting part of the case is the intima-
tion by Mr. Justice Frankfurter in the majority opinion that Congress by statute might be able to change the rule of the federal courts, originally declared in the case of *Weeks v. United States*, 232 U. S. 383 (1914), which bars the use of evidence unlawfully seized. Obviously Congress cannot change the federal rule if such rule, by interpretation of the Court, is a part of the Fourth Amendment. Mr. Justice Black, in a concurring opinion, bases his decision entirely on the ground that the Fourth Amendment itself does not require the exclusion of evidence unlawfully seized, and he agrees with what he claims to be the "plain implication" of the majority opinion that the rule is only a judicially created rule of evidence which Congress might abolish.

If the majority opinion does make this "plain implication", it is dictum in the opinion. The reasoning by Mr. Justice Frankfurter commences with a reaffirmance of the stand that the Due Process Clause does not incorporate the original Bill of Rights, but does include those rights which are fundamental to the concept of ordered liberty. *Palko v. Connecticut*, 302 U. S. 319 (1937). Thus the Court makes clear that the Fourth Amendment, as such, is not applicable to the States. Justices Black, Douglas, and the recently deceased Justices Murphy and Rutledge continued to insist that all of the first eight amendments to the Constitution are incorporated in the Fourteenth. The latter three therefore dissented. Mr. Justice Black concurred in result with the majority for the reasons previously stated. All nine justices thus agreed that the Fourteenth Amendment prohibited unreasonable searches and seizures.

There the agreement ends, and the question for the majority becomes, Is the exclusion of evidence unlawfully seized implicit in the concept of ordered liberty? This question is answered in the negative, the Court relying heavily on the fact that as of today, of the 47 states, plus ten jurisdictions of the United Kingdom and the British Commonwealth, which have considered this question, 30 of the states and all of the British jurisdictions have rejected the *Weeks* doctrine. The opinion contains a valuable and detailed survey of the holdings of the various jurisdictions. The Court also emphasizes, as a justification of this decision, that public opinion can be exerted far more effectively against local police than against federal agents.

This interpretation of the Due Process Clause seems to be correct under the approach of the *Palko* case, *supra*, to the question whether any particular right is included within that nebulous clause. The dissenting opinions are based on the reasoning that the only effective remedy to enforce the right is to bar the use of the evidence obtained. But the problem here is not to determine the best way to enforce the right, but whether the exclusion of evidence is the fundamental corollary of the basic right; whether 30 states must be told that their own decisions, most of them either decided since the *Weeks* case or reconsidered since it was handed down, have been violating fundamental human rights. The very statement of these facts seems enough to justify the negative answer to the question whether the exclusion of evidence unlawfully seized is a fundamental concept.
The other question, whether the Fourth Amendment prohibits the introduction of evidence unlawfully seized or whether the rule is merely a judicially created rule of evidence, arises from dictum to the effect that a different question would be presented if Congress under its legislative powers passed a statute purporting to negate the Weeks doctrine in the federal courts or to enforce that doctrine on the state courts. Mr. Justice Frankfurter's opinion clearly states that the Fourth Amendment has been interpreted to bar evidence unlawfully seized. Congress has no power to change this interpretation inasmuch as the final decision as to the meaning of the Constitution has belonged to the Court ever since Marbury v. Madison, 1 Cranch 137 (U. S. 1803). Therefore the only meaning of the dictum must be an intimation that the Court might reconsider its interpretation of the Fourth Amendment. Whether such a change of interpretation is correct or desirable is beyond the scope of this discussion. Likewise, it would appear that Congress could not enforce the Weeks doctrine on the states under § 5 of the Fourteenth Amendment unless the Court overrules the present case. Obviously both questions will remain moot unless Congress sees fit to act.

One possible effect of the present case remains to be considered. Federal courts have held that evidence obtained unlawfully by state officers, not acting under or in conjunction with federal authorities, may be used in a federal court. Youngblood v. United States, 266 Fed. 795 (8th Cir. 1920). The gist of the reasoning was that the Fourth Amendment applied only to federal governmental action. Since the Wolf case now places the same prohibition of unreasonable searches on state officers, a logical conclusion might be made that evidence seized by state officers would be barred in federal courts. That such a conclusion probably is wrong is demonstrated by the case of Lustig v. United States, 69 S. Ct. 1372 (1949), decided on the same day as the Wolf case. The majority in the Lustig case held that federal participation in the search in question made the evidence inadmissible, and therefore did not reach the question of the admissibility of evidence seized by state officers. But four justices dissenting, all of whom were in the majority deciding the Wolf case, held that there was no federal participation and that the evidence seized unlawfully by the state officers was properly admitted in the federal court. Therefore, as previously stated, the decision of the court in the Wolf case seems to make no direct change in the law.

Those searching for some hidden meaning of the decision may arrive at the idea that the Court is intimating that it does not intend to give any broader interpretation to the Constitution than has already been given to bar otherwise admissible evidence.

EUGENE B. SISK, JR.

Defendant was convicted for perjury as a result of his testimony before the House Committee on Education and Labor concerning his affiliation with the Communist Party. He defended on the ground that a quorum of the committee was not physically present at the time the statements in question were made, although a quorum had been determined present when the committee convened and the point of no quorum was not raised throughout the proceedings. He contended that the committee was not, therefore, a "competent tribunal" within the meaning of the statute under which he was tried. The statute states, in part: "Every person who, having taken an oath . . . before a competent tribunal, . . . in any case in which the law authorizes such oath . . . wilfully and contrary to such oath . . . states or subscribes to any material matter which he does not believe to be true, shall be guilty of perjury . . . .", D. C. Code § 22-2501 (1946). The court instructed the jury in effect that if a quorum of the committee was present at the beginning of the session and the question of a quorum was not raised subsequently during the session, the fact that a majority of the committee was not physically present at the time of the perjury would not affect the existence of the committee as a "competent tribunal." After conviction was affirmed by the Court of Appeals, certiorari was granted by the Supreme Court. Held, since an essential element of the crime of perjury under the statute is the presence of a "competent tribunal," and all such elements must be proved beyond a reasonable doubt, it was for the jury to decide, when evidence was offered by the defendant to the contrary, that a quorum was physically present at the time of the perjury. The conviction was reversed. Christoffel v. United States, 69 Sup. Ct. 1447 (1949).

The instant case establishes the criterion that for a House Committee to be a "competent tribunal" within the meaning of the statute, a quorum must be physically present in the committee room. In arriving at this decision, Mr. Justice Murphy relied on a literal interpretation of the Legislative Reorganization Act of 1946, 60 Stat. 812, § 133 (d), which specifies in regard to congressional committees: "No measure or recommendation shall be reported from any such committee unless a majority of the committee were actually present." He further justified the decision by reference to VIII Cannon's Precedents 2212, p. 28, 29, wherein it appears that a report of a House Committee was not allowed introduction on the floor of the House when it was shown that in considering the bill to be reported, a quorum of the committee did not meet, although the point of no quorum was not raised in committee. From this, Mr. Justice Murphy concluded that in order to take any action, except to determine a quorum or to adjourn, a quorum of the committee must be physically present. Meyers v. United States, 171 F. 2d 800 (D. C. Cir. 1948), is referred to in a footnote as sustaining this view. However, it should be noted that in the
Meyers case, supra, Transcript of Record, p. 1933, the trial court denied defendant’s motions to instruct the jury that a quorum of the sub-committee must have been physically present at the time of the perjury for which Meyers was convicted for having suborned. The trial court ruled that if at the time the hearing of the sub-committee was opened there was a quorum present, the fact that later on, in the course of the hearing, one or more members absented themselves so that there was no quorum, such fact did not vitiate the proceedings. The appellate court affirmed the decision, finding no error in the trial court’s ruling on the defendant’s motions, 171 F. 2d 800 (D. C. Cir. 1948), cert. denied, 336 U. S. 912 (1948).

The appellate court also ruled, in the Meyers case, supra at 811, that the presence of a quorum never having been determined on October 6, the testimony given on that day could not be considered as perjury, since the sub-committee could not function except to adjourn. This rule, however, applies only in a case where it has not been determined at the beginning of the hearing that there was no quorum present. It does not apply to the instant case where the presence of a quorum at a particular time during the hearing is the major issue, the point never having been raised at the hearing.

In United States v. Stewart, Criminal No. 47138, D. C. Sup. Ct., Nov. 20, 1928, an unreported case decided by the Supreme Court of the District of Columbia, defendant was tried for perjury under the instant statute after having given contradictory statements in a hearing before the Senate Committee on Public Lands and Surveys. Justice Bailey instructed the jury, in part, as follows: “If such a committee so met; that is if eight men did meet, and thereafter during the progress of the hearing some of them left temporarily or otherwise and no question was raised as to the lack of a quorum, then the fact that a majority did not remain there would not affect, for the purposes of this case, the existence of that committee as a competent tribunal . . . ”, VI Cannon’s Precedents 345, p. 491-92. The case is cited by Cannon as establishing the same procedure for a quorum in Senate Committee meetings as those of the House; i.e., that once a quorum has been determined, it is conclusively presumed to continue until the question of no quorum is raised at the meeting.

Neither of the previous cases support the holding of the majority. If it is to be supported, it must be done by reference to House Committee procedure, or parliamentary law. As stated above, Mr. Justice Murphy attempted to establish such procedure by reference to VIII Cannon’s Precedents 2212. The ruling of the chair in that instance applied to action of a committee taken at a meeting where a roll call to determine a quorum was never taken, and the committee chairman admitted that at no time was a quorum actually present, (p. 29). Furthermore, in a subsequent ruling, VIII Cannon’s Precedents 2222, (p. 37-38), when a point of order was raised that a report of a House Committee was invalid because it was authorized by a committee meeting at which a quorum was not present, the chair ruled, narrowly, that while the House needs
no roll call for the purpose of determining a quorum before beginning to act, a House Committee does. The chair then went on to say, in part: "It is the recollection of the chair that that committee was scrupulous that there should always be a quorum present. That, of course, does not mean . . . that a quorum was present every minute. Men would go in, and would go out. . . . But a roll call must disclose a quorum was present." p. 37.

In the dissent, Mr. Justice Jackson states that under House rules of procedure, once it has been determined that a quorum is present at a particular committee meeting, a quorum is conclusively presumed unless the point of no quorum is raised at the meeting. If this is not the case, says Mr. Justice Jackson, it would be possible, by an attack at any time subsequent to passage by a House Committee, to prove a large amount of legislation invalid by alleging and proving to a jury's satisfaction that a quorum was not physically present at the committee meeting at which the measure was passed. He further points out that neither Christoffel, nor any member present throughout the meeting in question, raised the point of no quorum. He feels that it is necessarily too late to raise the point at trial.

Mr. Justice Jackson notes that the majority cites no cases and supports the dissent by stating that the charge to the jury in the Meyers case supra, was essentially the same as the charge in the instant case held to be erroneous. His statement is not precisely in accord with the facts. As shown above, the court, in denying Meyers' motions for instructions to the contrary, ruled as a matter of law that once a quorum was determined, it was conclusively presumed until the point of no quorum was raised at the meeting. The ruling was upheld in the court of appeals.

The decision in the instant case, in that it establishes that a House Committee is not a "competent tribunal" unless a quorum was physically present at the time of the perjury, even though a quorum was present when the committee met and the point of no quorum was not raised subsequently at the hearing, cannot be supported by decided cases, nor by reference to the parliamentary law of the House itself. It seems to establish a rather poor precedent; although the dire results predicted by Mr. Justice Jackson probably will not actually occur. This is readily demonstrated by the fact that there is pending before the Congress at the present time H.R. 6166, 81st Cong., 1st Sess. (1949), a bill to amend § 133(d) of the Legislative Reorganization Act of 1946, supra, and H.R. Res. 355, 81st Cong., 1st Sess. (1949), proposing amendment of par. 2 of rule XI of the House. Both the bill and the resolution are to the effect that once a quorum has been determined at a meeting of a House Committee, it is conclusively presumed until the point of no quorum is raised at the meeting.

WILLIAM C. PLOTT
EVIDENCE—Selection of Evidence by Federal Agent at Scene of Illegal Search and Seizure Conducted by Local Police Renders Evidence Inadmissible in Federal Prosecution.

A federal secret service agent in Camden, New Jersey, was informed by the local police that petitioner and others were suspected of violating the federal counterfeiting statutes. The federal agent proceeded to petitioner's hotel room and peeped through the keyhole but failed to discover anything that would indicate a violation of the law. After reporting to the local police that he had seen no evidence of counterfeiting, but that he was confident that "something was going on", the federal agent returned to police headquarters. Later in the day the local police, armed with a search warrant, which by federal standards was illegal, entered the hotel room during the absence of the occupants and searched it. Upon discovery of certain evidence that indicated a violation of the federal counterfeiting statutes, the local police sent word to the federal agent who came to the hotel and examined and selected certain items. Some of these items were given to the federal agent before he left the hotel; all were eventually turned over to him.

Before trial in the District Court of the United States for the District of New Jersey, the defendant moved to suppress the evidence seized in contravention of the 4th Amendment; the motion was denied and the defendant convicted; conviction was affirmed by the Circuit Court of Appeals for the Third Circuit, subsequently reversed by the Supreme Court. Held, selection of evidence by a federal agent at the scene of an illegal search and seizure made by local police was such a part of the entire transaction that it was not severable and therefore was a part of the illegal search and renders the evidence inadmissible. Lustig v. United States, 69 Sup. Ct. 1372 (1949).

The federal exclusionary rule that evidence seized by virtue of a search and seizure in violation of the 4th Amendment to the Federal Constitution cannot be used in a federal prosecution was first clearly established in Weeks v. United States, 232 U.S. 383 (1914). The rule has been frequently applied. Silverthorne Lumber Co. v. United States, 251 U.S. 385 (1920); Gouled v. United States, 255 U.S. 298 (1921); Agnello v. United States, 269 U.S. 20 (1925).

Two major exceptions to the rule have developed. First, the right to demand the exclusion of evidence wrongfully seized is personal and cannot be claimed by a third party. Kelly v. United States, 61 F. 2d 843 (8th Cir. 1932); United States v. De Vasto, 52 F. 2d 26 (2nd Cir. 1931). Second, evidence obtained by virtue of an illegal search made by a private citizen as in Burdeau v. McDowell, 256 U.S. 465 (1921) or by a state officer as in Lerskov v. United States, 4 F. 2d 540 (8th Cir. 1925) is admissible in prosecution by the federal government.

The reported case is concerned with the application of the second exception to the exclusionary rule of evidence set out above. Byars v. United States, 273 U.S. 28 (1926) is probably the closest that the Supreme Court has come to
treatment the precise issue involved in the instant case. It was held there that although the right of the federal government to avail itself of evidence improperly seized by state officers operating entirely upon their own account is not questioned, the rule is otherwise when the federal government itself, through its agents, acting as such, participates in the wrongful search and seizure. Such participation is present where the federal government had requested active state cooperation. Gambino v. United States, 275 U.S. 310 (1927). The Supreme Court's aversion to drawing "nice distinctions as to when wrongful acquisition of evidence by state agencies was also a federal enterprise," indicated in Feldman v. United States, 322 U.S. 487 (1944), has obviously not been shared by the lower federal courts.

In United States v. Falloco, 277 F. 75 (W. D. Mo. 1922), state and federal officers were cooperating generally in enforcement of the federal prohibition law. The court there held that it was unnecessary to show that the federal officers had knowledge of or gave specific directions for the particular search in controversy, which was made by state authorities without a warrant, in order to render the evidence procured by that search incompetent in a prosecution in the federal court. Accord, Lowry v. United States, 128 F. 2d 477 (8th Cir. 1942); Ward v. United States, 96 F. 2d 189 (5th Cir. 1938); Fowler v. United States, 62 F. 2d 656 (7th Cir. 1932).

But in Kitt v. United States, 132 F. 2d 920 (4th Cir. 1942), despite the fact that state authorities were in the general habit of turning over illegally seized evidence to federal agents, the court noted that there was no agreement whereby the federal authorities were obligated to take over prosecutions based on that evidence and hence, that the evidence so seized and delivered could be used in a federal prosecution. Some earlier federal cases have also permitted a broad degree of cooperation between state and federal authorities without the effect of excluding the evidence so obtained. Walker v. United States, 41 F. 2d 538 (W. D. Tenn. 1930); McGrew v. United States, 281 F. 809 (9th Cir. 1922).

Where there has been actual instigation by federal agents to induce state authorities to conduct an illegal search, there is no dispute that evidence seized thereby cannot be used in a federal prosecution. United States v. De Bousi, 32 F. 2d 902 (D. Mass. 1929); Crank v. United States, 61 F. 2d 981 (8th Cir. 1932).

In the instant case the court precluded the application of those cases which turn on either cooperation or instigation by accepting as a fact that the federal agent "did not request the search, that, beyond indicating to the local police that there was something wrong, he was not the moving force in the search, and that the search was not undertaken by the police to help enforcement of a federal law." The federal agent's actual participation in the search was limited to a selection of the evidence, at the scene of the search, which had already been discovered by the local police. Participation in the search limited to that degree has not heretofore served to link the federal authorities using
the evidence with the illegal state search. *United States v. Dinguid*, 146 F. 2d 848 (2nd Cir. 1945); *United States v. Brown*, 8 F. 2d 630 (D. Ore. 1925).

In this inferential overruling of the *Brown* case and the *Dinguid* case, the Supreme Court, in the reported case, appears to have heeded the powerful admonition of *Byars v. United States*, *supra*, that "while mere participation in a state search of one who is a federal officer does not render it a federal undertaking, the court must be vigilant to scrutinize the attendant facts with an eye to detect and a hand to prevent violations of the Constitution."

Although the Court is opposed to any extension of the rule in *Weeks v. United States*, *supra*, as seen by the refusal to apply it to the states in *Wolf v. Colorado*, 69 Sup. Ct. 1359 (1949), the instant case serves as sound assurance that the Court will not permit the slightest encroachment upon the federal application of the rule. The Court thus indicates an adoption of the proposition that as long as the exception to the federal exclusionary rule is recognized, absorption of the rule by the exception can only be prevented by denying the use in a federal prosecution of any evidence that bears the slightest taint of federal cooperation, instigation or participation in its procurement.

While the holding of the reported case is of course limited to the precise factual situation involved, it would seem to indicate a trend toward a strict application of the exception to the *Weeks* rule.

EVERETT J. OLINDER

EVIDENCE—EVIDENCE SEIZED IN SEARCH OF PREMISES, INCIDENT TO ARREST BY FEDERAL OFFICERS, ACTING UNDER VALID ARREST WARRANT, HELD INADMISSIBLE AS VIOLATIVE OF THE FOURTH AMENDMENT WHERE SEARCH WARRANT COULD HAVE BEEN OBTAINED.

The accused was arrested, pursuant to a valid arrest warrant, on a charge of selling altered postage stamps. The arrest was made by federal officers in a one room office of the accused. The officers then proceeded to make a general search of the office and seized some of the altered stamps. *Held*, since the officers had information on which they could have obtained a search warrant, the search violated the Fourth Amendment and the evidence should have been excluded. The conviction was reversed. *United States v. Rabinowitz*, 176 F. 2d 732 (2d Cir. 1949), *cert. granted*, 338 U. S. 884 (1949).

This case, a two to one decision in which the majority opinion was written by Chief Judge Learned Hand, spotlights the confusion regarding the validity of searches incident to a lawful arrest which resulted from the decision of the Supreme Court in the case of *Trupiano v. United States*, 334 U. S. 699 (1948). Judge Hand points out that the real question is how far the *Trupiano* case modified the decision in *Harris v. United States*, 331 U. S. 145 (1947). He contends that complete reconciliation of these two cases is impossible.
In the *Harris* case the accused was arrested in the living room of his four room apartment. During a search for certain checks pertaining to the charge for which the arrest warrant was issued, the officers found and seized some fake draft registration cards, in no way connected with the charge for which the arrest was made. The Supreme Court in a five to four decision upheld the use of this evidence on the ground that *during the course of a valid search* the officers found this evidence, possession of which amounted to the commission of a crime in the presence of the officers. The importance here is that the search was held, necessarily, to be valid in its inception.

The *Trupiano* case was decided a few months later by the identical court. The defendants had been arrested on a charge of illegal operation of a still, and certain evidence was seized on the premises under the control of the person arrested. Both the arrest and the search were made without warrant, but the arrest was admittedly valid on the basis that the defendants were committing a felony in the presence of the officers. Certainly an arrest based on an arrest warrant cannot create a greater right to search incident to arrest than an arrest for a felony committed in the presence of the officers. The most important fact in the case was that the federal agents had maintained surveillance of the operations of the defendants for several months, even to the extent of having a government agent working with the defendants as an informer. Clearly the agents had exact information on which they could have obtained search warrants. In another five to four decision, the majority opinion being written by Mr. Justice Murphy, the Court reversed the conviction, holding that search warrants must be obtained whenever "reasonably practicable" and that the validity of the search, under the facts in this case, should not depend on the mere fortuitous factor of the location of the defendant at the time of the arrest.

Considering the principal case Judge Hand stated that the *Harris* case presented the same, or if anything more aggravated, circumstances. In both the officers had information on which a search warrant could have been obtained. If this is a correct statement of the facts in the *Harris* case, then the *Trupiano* case does overrule that decision and prohibits the admission of the evidence in the present case unless a factual distinction arises by definition of the words "reasonably practicable" in the *Trupiano* holding.

In any consideration of the *Harris* and *Trupiano* cases it must be realized that eight of the justices maintained a constant position, either for or against the admission of the evidence, in both decisions. Only Mr. Justice Douglas changed sides. The probable reason for this change appears in the *Trupiano* opinion, supra, at 708, where after discussing the facts of the case the Court said:

"These factual differences may or may not be of significance so far as general principles are concerned. But the differences are enough to justify confining ourselves to the precise facts of this case, leaving it to another day to test the Harris situation by the rule that search warrants are to be obtained and used whenever reasonably practicable." (Emphasis supplied.)
From this it appears highly probable that Mr. Justice Douglas joined in declaring the evidence inadmissible only because of the clear lack of justification for not obtaining a warrant of any kind. Of the nine justices who decided the Harris and Trupiano cases, only seven remain on the present Court. Five of those seven, Chief Justice Vinson and Justices Black, Burton, Reed, and Douglas, constituted the majority which upheld the admission of the evidence in the Harris case. Four of the seven would have admitted the evidence even in the Trupiano case. Thus from these simple mathematics, and without conjecture as to the probable decisions of the new Justices Clark and Minton, it appears probable that the present case will be reversed and that the Trupiano case may be overruled.

Searches of premises under the control of an accused at the time of arrest seem to be unquestioned under common law. Prior to the decision in the Harris case, the Supreme Court had accepted the validity of such searches, which “naturally and usually appertain to and attend such arrests.” Agnello v. United States, 269 U.S. 20, 30 (1925). The Court at least impliedly recognized such right in Weeks v. United States, 232 U.S. 383 (1914), the case in which the doctrine of exclusion of unlawfully seized evidence was first announced. Indeed it seems that the Trupiano case stands alone in questioning the validity of such searches incident to a valid arrest, and though that decision may be only a zealous effort to guard constitutional guarantees, in reality it appears to represent judicial legislation.

The security of privacy guaranteed by the Fourth Amendment is well protected by the strict requirements of the Supreme Court as to what constitutes a valid arrest. When considering extensions of individual rights under the guise of constitutional interpretation, the Court must also guard the interests of society which demand that criminals be brought to justice. To affirm the Rabinowitz case and thus overrule common law principles as well as the previous Supreme Court decisions would seem to be a protection only to the criminal, who undoubtedly will jump through every possible loophole for his own advantage.

EUGENE B. SISK, JR.

NEGLIGENCE—VENDOR OF LAND WHO PROMISES TO LOOK AFTER PURCHASER’S INTEREST AND GIVE GOOD TITLE IS LIABLE IN NEGLIGENCE WHEN PURCHASER RELIES ON SUCH PROMISE AND GOOD TITLE IN FACT IS NOT GIVEN.

Defendant conveyed certain real property to plaintiffs by quitclaim deed pursuant to a written contract to convey by “good and sufficient deed”. The plaintiffs brought an action on the case to recover damages for breach of contract when a portion of the property was sold for taxes as a result of an
encumbrance unknown to them. The defendant’s secretary, whose authority was unquestioned, had orally volunteered to give good title, to take all steps to protect the plaintiffs’ interest and to properly complete the transaction. The Superior Court, Hillsborough County, New Hampshire, indicated that the defendant’s motion for nonsuit on the original declaration would be granted, but permitted the plaintiffs to amend by adding a count to the effect that, reasonably relying on the oral promises to protect their interest, the plaintiffs had taken no steps to protect themselves, and as a result of defendant’s negligent performance of the undertaking they had been damaged. The case was submitted to the jury on a charge stating that, if they found the defendant undertook to act for the plaintiffs and performed so negligently as to result in damage to them, without fault of their own, they could recover. A verdict was returned in favor of the plaintiffs to which the defendant excepted. The case was transferred to the Supreme Court of New Hampshire. Held, judgment on the verdict; the plaintiffs could sue in tort for the damages caused by the negligent performance of an oral promise. Brunelle et al. v. Nashua Building and Loan Ass’n, 64 A. 2d 315 (N. H. 1949).

It is generally said that if a relation exists which would give rise to a legal duty without enforcing the contract promise itself, a tort action will lie, otherwise it will not. American Express Co. v. Lankford, 1 Ind. T. 233, 39 S. W. 817 (1897), Flint and Walling Mfg. Co. v. Beckett, 167 Ind. 491, 79 N. E. 503 (1906), Meihigan v. Sheehan, 94 N. H. 274, 51 A. 2d 632 (1947), Prosser on Torts 205 (1st ed. 1941).


The case of Buskey v. New England Telephone and Telegraph, 91 N. H. 522, 23 A. 2d 367 (1941) held that the duty to use due care was an implied term of the contract, but this does not seem consistent with the rule that uses relationship apart from the contract to create the legal duty.

Many relations originally contractual are recognized as creating a legal duty apart from the contract. Such a relation has been found to exist between principal and agent, physician and patient, bailor and bailee, bank and customer, carrier and shipper, innkeeper and guest, attorney and client, telegraph company and sender of message, and in many other instances. Prosser on Torts 204 (1st ed. 1941).

It is said that the distinction between misfeasance and nonfeasance is without significance as a test of liability, Buskey v. New England Telephone and Telegraph, supra, but it is generally held that the mere omission to perform a contract may not be treated as negligence. Willey v. Alaska Packers’ Ass’n, 9 F. 2d 937 (1926), aff’d 18 F. 2d 8 (1927), Attleboro Mfg. Co. v. Frankfort

In the subject case the court stated that it was not necessary to find the relationship of principal and agent to hold the defendant responsible; instead it stressed the facts that the defendant had assumed to act, the plaintiff had relied and the defendant had breached its common law duty to use due care. Such statements are not in conflict with the majority views previously discussed; however, the application of these views to the particular fact situation is of some interest.

Upon first consideration it would seem that a failure to give good title, to take all steps to protect the plaintiffs' interest and to properly complete the transaction, all might amount to nothing more than a negligent failure to perform a contract for which there is no remedy in tort. It is clearly indicated, however, that the court considered that performance had begun, but how it was begun is not so clear. In this connection it should be noted that the courts will generally attempt to find a bailment or will seize upon any trivial act to show the commencement of an undertaking with the attendant duty to use due care. Carr v. Maine Central R.R., supra (where papers were accepted for forwarding), Herzig v. Herzig, 67 Misc. 250, 122 N.Y. Supp. 440 (Sup. Ct. 1910) (note accepted). It has been held that a gratuitous promise relied upon by the plaintiff, where the defendant has reason to expect such reliance, is sufficient to create the duty to use due care. Lusk-Harbison-Jones, Inc. v. Universal Credit Co., 164 Miss. 693, 145 So. 623 (1933), Kirby v. Brown, Wheelock, Harris, Vought & Co., 229 App. Div. 155, 241 N.Y. Supp. 255 (1930). Contra: Brown v. Lyford, 103 Me. 362, 69 A. 544 (1907), Comfort v. McCorkle, 149 Misc. 826, 268 N.Y. Supp. 192 (Sup. Ct. 1933), Thorne v. Deas, 4 Johns. 84 (N.Y. 1809).

Two obstacles to recovery in contract in the principal case were the parol evidence rule and the fact that conveyance was made by quitclaim deed which necessarily contains no covenants for title and is regarded in some states as notice to the purchaser of possible defects in title. Tiffany, Real Property, § 659 (New Abridged Ed. 1940). The minority viewed the oral undertaking as within the parol evidence rule because they regarded the action as one of breach of contract. The majority avoided mention of both objections to recovery in contract by treating the oral undertaking as entirely separate for which there was liability in tort. It is questionable whether the foregoing reasoning should be used as a means of circumventing the parol evidence rule and setting up verbal warranties that accompany written contracts.

If it were clear that no performance had actually begun in the present case, it would indicate that New Hampshire has accepted the doctrine that a mere promise by the defendant where he has reason to believe that the plaintiff will rely to his detriment is sufficient to create a duty, for the breach of which a
tort action will lie. It is believed, however, that this case falls within that class of cases exemplified by *Carr v. Maine Central R.R.*, supra, and is nothing more than another instance where the court has found that performance was begun, as manifested by some slight act.

R. B. HERRINGTON

SALES—Selection By a Customer of an Article From the Retailer's Shelves in a Self-Service Store Is Insufficient To Pass Title to the Article and at That Point in the Transaction There Is Neither an Executed Sale Nor an Executory Contract of Sale.

The plaintiffs, husband and wife, selected two bottles of ginger ale from the shelves of a self-service store of the Great Atlantic and Pacific Tea Company. As the husband was about to place the bottles in a merchandise cart one of them exploded, injuring his wife. The defendants, doing business as Confair's Beverage Company, bottled, sold, and delivered the ginger ale to the Great Atlantic and Pacific Tea Company for resale in its stores. The plaintiffs based their action in assumpsit on a breach of implied warranty of fitness. Preliminary objections were sustained by the Court of Common Pleas, Luzerne County, Pa. The judgment entered in favor of the defendants was affirmed by the Supreme Court of Pennsylvania. *Held*, there was neither an executed sale nor an executory contract of sale and hence no warranty, express or implied. *Loch et ux. v. Confair et ux.*, 63 A. 2d 24 (Pa. 1949).

Notwithstanding the rapid increase in the volume of business being done by the self-service stores, a search has revealed but one other case, *Lasky v. Economy Grocery Stores*, 319 Mass. 224, 65 N. E. 2d 305 (1946), which has considered in detail the transaction between the customer and the self-service retailer. There the court, given a similar fact situation to that of the instant case, decided that possession of the article alone was not sufficient to pass title, but that a cash sale is made at the time the price is paid to the cashier, at which time the delivery becomes absolute and title passes, and further, that the transaction involves no executory contract. The customer’s option of returning an item to the shelf at any time prior to payment led to the conclusion that no executory contract of sale is involved by reason of a lack of mutuality. The retailer was regarded as making “an offer to the plaintiff to sell for cash at the prices marked on the goods, such articles as the plaintiff might wish to purchase and might take to the cashier. Until there was acceptance . . . of this offer in accordance with its terms no contractual relation arose between the parties . . .”. *Lasky v. Economy Grocery Stores*, supra, at 306. See *Gargaro v. Kroger Grocery and Baking Co.*, 22 Tenn. App. 70; 118 S. W. 2d 561, 562 (1938).

Williston states, “. . . it is clear that a cash sale is the true construction
of the transaction; that is, sales made by shopkeepers over the counter. So in self-service shops where the buyer selects and picks up goods, and pays for them when he passes the cashier's desk, it is a cash sale; the buyer may replace the goods that he has chosen until he comes to the desk and pays the price”.

2 Williston, Sales § 343 (Rev. Ed. 1948). To support this statement Lasky v. Economy Grocery Stores, supra, is cited.

The decision in the subject case quotes copiously from the discussion in Lasky v. Economy Grocery Stores, supra, and appears to fall squarely within the rule of the latter, though it is not decided exactly when title passes. In addition the court rejects the possibility of interpreting the transaction as “on sale or return”, stating that Rule 3, First, of § 19 of the Sales Act of 1915, 69 P. S. 143, must be read in conjunction with § 42 of the Sales Act of 1915, 69 P. S. § 252. (These sections are identical to Rule 3, First, of § 19 of the Uniform Sales Act and § 42 of the Uniform Sales Act respectively).

The defendant in the subject case brought the action against the manufacturer instead of the retailer, Pennsylvania being one of those jurisdictions which have imposed the liability of a warrantor on the manufacturer of food products in favor of the ultimate purchaser. Nock v. Coca Cola Bottling Works of Pittsburgh, 102 Pa. Super. 515, 156 A. 537 (1931). Although the court subscribed to this relaxation of the rule that warranties are enforceable only by an immediate purchaser, 1 Williston, Sales § 244 (Rev. Ed. 1948), it preferred not to depart from the general rule that there must be some contractual relation to support an implied warranty. Welshausen v. Charles Parker Co., 83 Conn. 231, 76 A. 271 (1910), Grapico Bottling Co. v. Ennis, 140 Miss. 502, 106 So. 97 (1925), General Home Improvement Co. v. American Ladder Co., 26 N. J. Misc. 24, 56 A. 2d 116 (1947), Swank v. Moisan, 85 Or. 662, 166 P. 962 (1917).

Notwithstanding the fact that the ordinary sale by the shopkeeper over the counter is regarded as a cash sale, it is believed that the problem presented by the instant case should be treated as one of contract. Even though the sale in the “supermarket” and the sale over the counter serve the same purpose, they differ in several respects, so that, if it were desired to allow recovery in a warranty action, it could be logically concluded that the retailer and buyer enter into a contract at the time the buyer selects the article from the shelf.

As noted previously, the opinion in the Lasky case considered the retailer as making “an offer to sell for cash at the prices marked on the goods. . . .” Such an offer could be easily construed as an offer to enter into a contract for the sale of specific goods at the prices listed. The argument might be advanced that the listing of prices on the shelves is merely an advertisement or an invitation to make an offer. Although this may be true insofar as many business dealings are concerned, it is doubtful that the retailer considers that he is advertising or inviting an offer when he places the price under the article for sale. It is more than likely that he considers his window displays, newspaper and circular advertisement as inducements to get the customer into the store, at
which time he offers his merchandise at the prices listed, acceptance to be sign-
nified by the customer's selection of the item from the shelf. That actual
communication of acceptance is unnecessary, and that the assent of the offer
may be inferred from the circumstances and acts is well settled. *Mactier v.
v. Swindle*, 15 S. W. 2d 922 (Mo. 1929), *Adams v. Lindsell*, 1 B. and Ald. 681,

Whether or not the parties intend to be bound at the time the article is
taken from the shelf and placed in the basket can best be considered by asking
two moot questions: (1) What would the average customer's reaction be to
an attempt by the retailer to remove an article from the basket on the ground
that he was not bound to sell? (2) Does the retailer believe that the customer
may be forced to keep the article once it is selected? The answer to the first
question is, of course, that the customer would manifest displeasure, for the
reason that at this point he regards the item as his own. As to the second
question, the retailer may believe that the customer could be forced to keep
the article, but that it isn't, as a matter of sales policy, advisable to enforce
such an obligation unless the return would involve a substantial loss to the
retailer. Whether the retailer actually believes this or not the matter of the
customer's option to return should not be considered evidence of a lack of
mutuality for even in the ordinary sale over the counter the customer is gener-
ally allowed to return the item purchased although the vendor is not necessarily
bound to accept it.

From the foregoing it should be clear that it is possible to place more than
one construction on the transaction. By requiring more of the customer to con-
summate the sale, the self-service retailer operates with fewer employees and
reduces his operating expenses, which in turn increases his profits. In view of
these facts it would seem reasonable if the courts increased the protection given
the customer by finding that he enters into a contract of sale with the retailer
at the moment he selects an item from the shelf.

R. B. Herrington

TAXATION—Income Payable to Parent Corporation Under “Agency”
Contract with Wholly-Owned Subsidiaries Held Taxable to Sub-
sidiaries Where They Manufacture and Sell Products for Their
Own Account and Where the Usual Incidents of an Agency
Relationship Are Not Present.

Petitioners are wholly-owned subsidiaries of Air Reduction Co. They oper-
ated under “agency” contracts with the parent, Airco, which provided that
Airco would turn over various plants to the subsidiaries, furnish working capital,
and provide executive management, and that the subsidiaries would manu-
facture and sell the various products in their own name. Each subsidiary agreed to pay to Airco all net profits in excess of 6% of its capital stock, which was only nominal in amount. Airco reported such profits as income and the subsidiaries excluded them from their incomes. Large deficiencies in income and declared value excess profits taxes, the subject of this litigation, were asserted against the subsidiaries with respect to the year 1938. The Tax Court found for petitioners. Judgment was reversed by the United States Court of Appeals for the Second Circuit and the Supreme Court granted certiorari. Held, the profits are income taxable against the subsidiaries and they cannot escape liability either on the theory that they handle the income as mere agents of the parent or on the theory that the corporate entity may be disregarded for tax purposes under these facts. National Carbide Corporation v. Commissioner of Internal Revenue, 336 U.S. 422 (1949).

“A taxpayer may adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the tax disadvantages.” Higgins v. Smith, 308 U.S. 473, 477 (1940); Esmond Mills v. Commissioner, 132 F.2d 753 (1st Cir. 1943). This is equally true in the case of a double corporate organization, Raritan Co. of Del. v. Commissioner, 136 F.2d 364 (3rd Cir. 1943), cert. denied, 320 U.S. 753 (1943).

Another line of cases has established the rule that income must be taxed to those who earn it, and that anticipatory arrangements and contracts cannot succeed in preventing the income from vesting in the earner. Lucas v. Earl, 281 U.S. 111 (1930); Helvering v. Clifford, 309 U.S. 331 (1940). The dominant purpose of the revenue laws is the taxation of income to those who earn or otherwise create the right to receive and enjoy the benefit of it when paid. Commissioner v. Tower, 327 U.S. 280 (1946); Commissioner v. Sunnen, 333 U.S. 591 (1948). But on the facts here involved, no case had ever been decided.

Petitioners relied principally on Southern Pacific Co. v. Lowe, 247 U.S. 330 (1918) which involved dividends constructively paid in 1914 to the parent company by a subsidiary under an agreement similar to the one in dispute in the instant case. The Court held that the dividends were not taxable income since they were transferred only by a bookkeeping entry out of profits which had accrued to the parent before the effective date of the 1913 Act. But at p. 337 in its opinion the Court used the language upon which petitioners in the instant case put much reliance: “While the two companies were separate legal entities yet, in fact, and for all practical purposes they were merged, the former being but a part of the latter, acting merely as its agent and subject in all things to its proper direction and control.” The Court made it clear, however, that the case turned “upon its very peculiar facts.”

In the case of Burnet v. Commonwealth Improvement Co., 287 U. S. 415 (1932) a corporation wholly owned by a decedent’s estate realized a gain in an exchange of securities with the estate. The corporation contended there could be
no true loss or gain between it and the estate because they were the same entity, citing Southern Pacific Co. v. Lowe, supra. The Court held that case distinguishable, and specifically limited its application in these words: "Southern Pacific Co. v. Lowe . . . cannot be regarded as laying down any general rule authorizing disregard of corporate entity in respect of taxation."

The notion that in the Southern Pacific case the Court had formulated the doctrine that in some cases a wholly-owned corporation may be regarded as a mere agent for tax purposes was not so easily laid to rest. In Moline Properties, Inc. v. Commissioner, 319 U. S. 436 (1943), a corporation organized as a real estate holding device sought to have the gain from sale of real property treated as the income of its sole stockholder. It kept no books and maintained no bank account. The corporation, relying in part on the Southern Pacific case, argued that it was a mere agent of its stockholder and "therefore the same tax consequences follow as in the case of any corporate agent or fiduciary." The Court held that the corporation was a separate taxable entity, pointing out that there was no actual contract of agency nor the usual incidents of an agency relationship.

The foregoing decisions should not be interpreted to mean that the courts will never look beyond the corporate form in determining tax liability. In certain very exceptional situations they have done so. In Munson S.S. Line et al. v. Commissioner, 77 F. 2d 849 (2nd Cir. 1935), the court disregarded a corporate entity in order better to carry out the purpose of a statute designed to encourage the development of an American merchant marine. The courts will also "pierce the corporate veil" where that is necessary in order to carry out the plain intent of the taxing statutes. The landmark case on this point is Gregory v. Helvering, 293 U. S. 465 (1935), in which it was held that while a certain reorganization plan conformed to the terms of the statute, there was no reorganization within the intent of the statute. See also Higgins v. Smith, supra; Continental Oil Co. v. Jones, 113 F. 2d 557 (10th Cir. 1940).

The decision in the instant case should relegate the Southern Pacific case to a peaceful grave and erase it as a precedent relied upon by taxpayers seeking to disregard the existence of a wholly-owned and dominated corporation. The Court disposes of that case on the point of agency, pointing out that the term "agency" as used in that opinion meant "practical identity". It then held that the contracts in the instant case were not agency contracts, but that the parent had carefully avoided assuming the burdens of a principal. This led naturally to the conclusion that the contracts were mere anticipatory arrangements for the disposition of the income of the subsidiaries and did not relieve the subsidiaries of taxation upon that income under the decisions in Lucas v. Earl, Helvering v. Clifford, and Commissioner v. Sunnen, all supra. The Court in the National Carboide case does indicate that it will honor true agency contracts but at p. 437 lists some of the tests: "Whether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money
received to the principal, and whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal . . . .”.

The conclusions to be drawn from the instant decision, in the setting of the Court’s other decisions, are: (1) A taxpayer will not be permitted, on its own motion, to escape the tax effects of using the corporate form, though under similar facts the commissioner might succeed in having the corporate form disregarded; and (2) In order to escape the effect of the assignment-of-income cases, a true agency relation must exist.

RICHARD B. BUHRMAN

TORTS: A MINOR CHILD HAS A CAUSE OF ACTION AGAINST ONE ENTICING ITS PARENT FROM THE FAMILY HOME TO RECOVER DAMAGES SUSTAINED AS A RESULT OF THE ENTICEMENT.

Plaintiff, a minor six years old, sues, by her guardian, to recover damages alleged to have been sustained as a result of defendant’s enticing her mother from the family home. Held, a child has a cause of action against one enticing parent from the family home to recover damages sustained as a result of the enticement. Miller v. Monsen, 37 N. W. 2d 543 (Minn. 1949).

The majority of the courts and most authoritative writers, though they generally admit the existence of a child’s interest in the maintenance of the parent-child relation, agree that such interest is unsecured by law and hence, does not give a right of action. Thus in 1934, in the case of Morrow v. Yannantuono, 152 Misc. 134, 273 N. Y. S. 912, the facts were essentially the same as herein and the action was denied for fear that recognition would open the courts to a flood of litigation. McMillan v. Taylor, 160 F. 2d 221 (D.C. Cir. 1946); Garza v. Garza, 209 S. W. 2d 1012 (Tex. Civ. App. 1948). It has also been denied on the basis of the numerous practical obstructions to the administration of such an action, Taylor v. Keeje, 134 Conn. 156, 56 A. 2d 768 (1947); 83 U. OF PA. L. REV. 276 (1934), and that it is barred by a state statute abolishing alienation of affection suits, Rudley v. Taylor, 84 Cal. App. 2d 454, 190 P. 2d 984 (1947).

In 1945, this type action was first allowed, the court recognizing that the basic family unit has changed and the child has a right in the preservation of the family unit. Dailey v. Parker, 152 F. 2d 174 (7th Cir. 1945). It was approved by Johnson v. Luhman, 330 Ill. App. 598, 71 N. E. 2d 810 (1946), which also relied for support upon Heck v. Schupp, 394 Ill. 296, 68 N. E. 2d 464 (1945) where the court, in declaring the statute abolishing alienation of affection suits unconstitutional, stated that criminal conversation and alienation of affections involve rights which all members of a family have the right to protect. See Fisher, Pater Familias, 41 ILL. L. REV. 27 (1946); 34 GEO. L. J. 539 (1946).
The Supreme Court of Minnesota, in granting relief herein, denies the arguments advanced by the majority, stating that there has not been a flood of litigation since Dailey v. Parker, supra; it is possible to administer the tort action as shown by the above cases; and the mere fact that no such right of action existed at common law is no reason for denying the tort today. Actually the split of opinion on this action is based upon two conflicting tendencies in our courts today. One, the minority, presents the modern trend to substitute for the old common law concept of absolute rule of the father, the full grown belief in the family unit as an essential factor in the education of children and the curbing of juvenile delinquency. The other, the majority, reflects the trend of courts and legislatures cognizant of the abuses therein to limit, if not to abolish, suits for alienation of affections as shown by the Heart Balm Acts. The future of the child's right to sue will depend on which of these tendencies prevails.

It is significant that the United States District Court for Western Michigan on 31 August 1949, in Russick v. Hicks supported this cause of action for the same reasons as advanced by Miller v. Monsen, supra, even though Michigan has a statute abolishing alienation of affection suits.

GEORGE B. BRONFEN

TORTS—CONTRIBUTION ALLOWED BETWEEN CONCURRENT TORTFEASORS WHO ARE NOT INTENTIONAL WRONGDOERS, ALTHOUGH ONE OR BOTH MAY HAVE BEEN PERSONALLY NEGLECTFUL.

Plaintiff Evelyn Langland and her husband brought suit against Feltman for damages for injuries suffered in a collision between a cab owned by Feltman and driven by one of his employees, and a car owned and operated by Knell, in which the Langlands were riding. Feltman filed a third-party complaint against Knell. After the jury found that both drivers were negligent and that the negligence of each had contributed to the collision, judgment was entered against Feltman for the full amount of damages in favor of the plaintiffs, and against Knell, in favor of Feltman, for one half the amount paid by the latter. At no time did the Langlands amend their complaint to include Knell as a defendant. Held, contribution will be allowed between concurrent tortfeasors who are not intentional wrongdoers, although one or both may have been personally negligent, and a joint judgment against both tortfeasors is not necessary. Knell v. Feltman, 174 F. 2d 662 (D. C. Cir. 1949).

Merryweather v. Nixan, 8 T. R. 186, 101 Eng. Rep. 1337 (K. B. 1799), in which the common law rule denying contribution between concurrent tortfeasors was supposedly established, was a case involving wilful and intentional tortfeasors, the plaintiff's claim for contribution resting on his own deliberate wrong. Later English cases held that the rule applied only to wilful and conscious wrongdoers. Burrows v. Rhodes, 1 Q. B. 816 (1899); Hillen v. I. C. I.,
1 K. B. 455 (1934). Early American decisions followed this line of reasoning. Miller v. Fenton, 11 Paige 18 (N. Y. 1844); Hunt v. Lane, 9 Ind. 248 (1857); Nickerson v. Wheeler, 118 Mass. 295 (1875). But American courts generally came to deny contribution without regard as to whether the conduct was wilful and intentional or merely negligent. Illinois Cent. R. Co. v. Louisville Bridge Co., 171 Ky. 445, 188 S. W. 476 (1916); Adams v. White Bus Line, 184 Cal. 710, 195 P. 389 (1921); Royal Indemnity Co. v. Becker, 122 Ohio St. 582, 173 N. E. 194 (1930). The logic of these courts in their refusal to allow contribution between tortfeasors, whether wilful and intentional or merely negligent, is based upon the idea that the law will not imply contribution between wrongdoers, and such a denial of recovery inter se will act as a deterrent. However, an inadvertent tortfeasor is not guilty of wrong in the same sense as the conscious tortfeasor and the denial of contribution between concurrent tortfeasors who are not conscious wrongdoers cannot be supported on any idea of deterrence. In its opinion the court noted that in a number of states the illogical rule of the majority of American courts has been repudiated by statute.

The court, in the instant case, adopted without reservation the rule "that when the parties are not intentional and wilful wrongdoers, but are made such by legal inference or intention, contribution may be enforced." George's Radio, Inc. v. Capital Transit Co., 126 F. 2d 219, 221 (D. C. Cir. 1942). That case expressly overruled Curtis v. Welker, 296 Fed. 1019 (D. C. Cir. 1924), where contribution was denied between corporate directors liable to stockholders on account of their neglect of official duties. Previous to Curtis v. Welker, supra, the Supreme Court of the District of Columbia, although denying contribution in a trust case, had stated by dictum that the more modern view was to deny contribution only in cases where there was moral turpitude. Herr v. Barber, 2 Mackey 545 (1883).

In the George's Radio case, an action for personal injury, the defendants were both vicariously liable. A broader application of the rule, which would cover personal participation in a negligent tort, was given some support by implication in McKenna v. Austin, 134 F. 2d 659 (D. C. Cir. 1943). The question there was as to the effect between concurrent tortfeasors of a settlement with and release of one of them, but there also the parties were vicariously liable. Subsequently, the Municipal Court of Appeals for the District of Columbia made an interpretation of the rule as to when contribution would be allowed and stated that it excluded cases in which liability was based upon actual personal wrongdoing by the liable parties whether negligent or wilful. Peake v. Ramsey, 43 A. 2d 763 (D. C. Mun. App. 1945); 35 Geo. L. J. 382 (1946).

The decision in the present case places the District of Columbia with the growing minority of jurisdictions, which, in the absence of statute, have allowed contribution between negligent tortfeasors despite personal participation in the tort. It should be noted, however, that the third-party plaintiff, Feltman, did
not personally participate in the tort and on the basis of vicarious liability alone, contribution could have been allowed.

The court pointed out that a joint judgment against Knell was not necessary and that he was bound by the jury’s findings, since, under Rule 14(a), Federal Rules of Civil Procedure, Knell had the right not only to assert against Feltman his defenses against him but also to assert against the plaintiffs any defenses which Feltman had against them. As the court stated, Knell v. Feltman, 174 F.2d (D. C. Cir. 1949), at 665: "... he was in the thick of the fray, and entitled to participate to the fullest extent as though he had been originally a defendant.” New York decisions, based on a particular state statute, have held that such a judgment was a prerequisite. Price v. Ryan, 255 N.Y. 16, 173 N.E. 907 (1930); Fox v. Western New York Motor Lines Inc., 257 N.Y. 305, 178 N.E. 289 (1931).

The danger in requiring a joint judgment in order to allow contribution is that often the plaintiff’s whim rather than equitable considerations will control. Gale Lumber Co. v. Bush, 227 Mass. 203, 116 N.E. 480 (1917); Gulf & S.I.R. Co. v. Gulf Refining Co., 260 Fed. 262 (1919); Pennsylvania Co. v. West Penn Rys. Co., 110 Ohio St. 516, 144 N.E. 51 (1924). Although the injured party cannot be compelled to take judgment against the concurrent tortfeasor brought in as a third-party defendant, the concurrent tortfeasor, named as an original defendant, nevertheless may obtain contribution by means of the Federal Rules as to third-party practice.

JAMES P. NASH
BOOK REVIEWS


The preface of this book states that the book grew out of a series of lectures in patent law given by the author at the University of Delaware and the book should be appraised in the light of the audience to which it is addressed. In the space of two hundred and thirty-six textual pages, the author covers not only the whole field of patent law but also covers related matter such as trade secrets and their protection. The treatment of such a broad subject in such a brief work would necessarily be inadequate unless the reader supplements the text by study of the additional decisions cited by the author.

Considered as a text for a course in patent law for law students the book is useful and practical. The book is directed to the educating of practical, working patent lawyers and is not concerned merely with patent theory. It is the work of an active practitioner as well as a legal scholar.

Generally speaking, the book treats most points in the conventional manner and, after quoting from leading cases, the author states his own views and cites additional authorities for the student to examine on each question treated. There are, however, features which are unexpected in a book of this coverage and brevity. The chapter on permissible breadth of chemical claims is an excellent treatment of a difficult subject and the chapter on trade secrets contains some interesting analogies between patents and trade secrets.

In general, the book brings the various topics up to date but the more recent decisions have been omitted from the section on price fixing. Although the book has a 1949 copyright notice, no mention is made of United States v. Line Material Company, 333 U. S. 287 and United States v. U. S. Gypsum Company, 333 U. S. 364, both decided March 8, 1948. These omissions are difficult to understand.

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164
The importance of language in the law is well known. Lawyers generally know, too, that any definition to be found in the derivation of a word, or in a dictionary, is supplemented by the context in which the word is used, and by the connotations which it awakens in the mind of reader or hearer. This book discusses entertainingly certain devices available for the effective use of language in the courts. There are chapters on "persuasion", "interpretation", "the two forensic styles—factual and emotive", "bias", "metaphor", and "evaluation". Half the book is devoted to excerpts from, and comments upon, four celebrated cases. Consideration of the language both of statutes and of contracts is intentionally omitted. Indeed the book might well have been entitled: The Art of the Advocate. For example: "The meaning of a word may be completely altered by differences in tone and emphasis, and these differences, if made clear by an able lawyer, can sometimes change the whole complexion of a case." Respecting the use of language to evoke a desired result—especially for one who is only pretending to believe in his client's case—the book is interesting and suggestive.

Discussion of words and of their use leads the author, however, to exhibit throughout the book his belief in science and semantics, and seemingly in little else save what he can touch or measure. Words are symbols and they may stand, by the author's analysis, for thoughts of three kinds: "First come thoughts of picturable things . . . defined by pointing. . . . Second come thoughts of actions. Words referring to those actions are defined by pantomime. . . . Words that can be defined by pointing or by pantomime may be called concrete words. Words of the third type, called abstract words, stand for thoughts of relations, whether these relations are between picturable things or between actions or between thoughts. . . . Controversies about the 'correct' definitions of words are usually about abstract words. Democracy and beauty are examples, and of special interest to lawyers are freedom, justice, law and rights." "The theory, for example, that there is such a thing as justice that exists independently of human minds, and that the business of the law is to find out what it is, will not stand examination."

Beyond that attitude even, there are derogatory innuendos regarding

1 Philbrick, Language and the Law 37 (1949).
2 Id. at 29.
3 Id. at 33.
religion and moralists which seem to be entirely gratuitous and not, under any pretext, a necessary part of the spinning of the author's theories on language as applied in the field of the law.

Thus on his first page the author says: "Confusion about the different functions of language is not, however, confined to the courtroom. It is the root of many controversies that for centuries have afflicted (or enlivened) the churches. Should the liturgy be in Latin or in the vernacular? Those who think the service (sic) should be conducted in English point to the first function of language, to convey information; those who favor Latin want a ceremonial language that can induce mood." For a volume which pontificates on the meanings of law and of justice and of morals, that is very unreliable analogy. The Catholic Church is certainly the leading denomination using Latin; and the implication that it is interested in creating mood in lieu of giving information is uninformed. The author might have learned from any child of the Catholic Church that information is conveyed in the gospel read, and in the sermon preached, at the required Sunday Masses, and that both are in English or the vernacular. The Church does not disdain mood: the sacramentals, namely, candles, statues, stained-glass windows, and holy water—these are to induce mood; but not one of them is concerned with words or language. The liturgy is not to inform the laity but, on their behalf, to thank, to praise and to supplicate the God whom they adore. Latin, a dead language, is used in the liturgy to preserve its historic verity and catholicity, everywhere and for all time. The author's suggestion about "those who favor Latin" seems to have been made carelessly or even flippantly.

Again under the subject of interpretation, the author says that one complication is "the existence of distinct but not separate meanings for the same word". Taking "law" as an example, he gives its three chief meanings as "the law of the courts, natural law and moral law". The last he defines as "a set of rules drawn up by moralists". Then the further comment: "Every moralist believes that the moral law as understood by himself is the moral law." Hence the author lets himself write plainly and positively: "It is enough to state, what cannot be contradicted, that the moral law, as defined in different circumstances, shows pretty wide variations, whereas scientific laws do not; that the use of the same word law to denote both (sic) of them is a possible source of confusion; and that this confusion can be taken advantage of by care-

4 Id. at 1.
less or dishonest speakers and writers."\textsuperscript{5} By whom? Note that the law of the courts had been passed, and the antithesis presented is between the invariable scientific law and the moral law. If sentence structure and use of words can be relied upon here as expressing the thought intended, it is apparently among the moralists that the author wishes us to beware of "careless or dishonest speakers and writers". If that be not his intent, then so grave a charge should have been stated, in a book such as this, in more carefully explicit language.

A cognate idea is presented by similar indirection in the chapter on evaluation. The intelligent man, says the author, "... knows that nothing is either wholly good or wholly bad; that nothing can ever be described with perfect accuracy; and that the distinctions we are bound to draw are sharp lines in regions where nature (sic) has only insensible gradations." The intelligent man's "thoughts and feelings" about "the Catholic Church for example—far from consisting of uncritical devotion or ignorant hostility, are made up of a complete group of intellectual and emotional responses of a largely impersonal character. ... His friendship with a Catholic priest whom he greatly admires carries comparatively little weight with him, for he knows that his friend is but one of many.\textsuperscript{6}

Warnings against hasty generalizations are familiar: the family is not to be judged by its black sheep; nor a nation by its traitors; nor a profession by its scoundrels; nor a religion by its apostates. The author's illustration, that an institution is not to be judged solely upon an acquaintance with one of its admired leaders is equally valid; but it has a strikingly novel twist. It suggests the inference that the good priest is possibly, even probably, the exception. The author concludes his paragraph with the quotation: "Tout comprendre, c'est tout pardonner." Perhaps if we understood why he has indulged in these sly small shafts at the Church, we might also more quickly pardon, and overlook them. They blemish rather than adorn the author's book.

Respecting generalizations, it might be observed that the author lists the lawyers and the judges from whose writings his examples of legal lore have been taken. They include Justice Holmes and Clarence Darrow and perhaps a half dozen others. According to his own preface, these few appear to be the sources from which the author arrives at his conclusions concerning law.

\textsuperscript{5} Id. at 48.
\textsuperscript{6} Id. at 109.
The text of *Language and the Law* closes thus: "Amid the confused standards of the present time, when moral choices are so likely to be mistaken, and single-valued judgments certain to be, the development of many-valued opinions is more than ever a duty. The cultivation of such many-valued attitudes in the courts, and their expression in the most flexible and sensitive language that he has at his command, is a task to which the student of forensic English need not be ashamed to devote his talents and his time."  

The final sentence there must be read with attention for one to understand accurately whether it is "the student" who is to do the cultivating of attitudes in the courts, or whether it is the student or the courts who will use "flexible and sensitive language" in the expression of those attitudes, and whether their expression in such language is to be the means toward, or the result following, this "cultivation".

That final culminating sentence of the author's thesis recalls, by connotation, a sentence used by Ben Palmer, Esq., in his erudite two-page review in the *American Bar Association Journal* for July: "This little book has some practical suggestions for calculated obfuscation." Those ten words come close to describing this book completely. To counsel having need for such suggestions the book should prove valuable. To others—whether or not they share the author's beliefs in matters of more importance than words—the volume will be both interesting and amusing.

VICTOR S. MERSCH*


The first volume in this series was reviewed in this Journal for January, 1949, p. 293. The present volume deals with the trial of Josef Kramer and forty-four others for crimes and atrocities committed in the poison gas chambers at Auschwitz and the Belsen concentration camp where victims perished by the thousands. After perusing the evidence reproduced *in extenso* in this volume, the reader may well agree with the description of one of the witnesses, the only British subject in the Belsen camp, that it was "probably the foulest and vilest spot that ever soiled the surface of the earth".1

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1 HODGE, WAR CRIME TRIALS, VOL. II—THE BELSEN TRIAL, 65 (1949).
The law under which the offenders were tried and convicted was not related in terms to the law applied by the Nuremberg Tribunal under the London agreement of August 8, 1945, although some of the crimes charged fell within the definitions of the Charter annexed to the London Agreement. The introduction to The Belson Trial is careful to point to this contrast. Widespread criticism has been levelled at the Nuremberg Tribunal on the ground that it applied ex post facto law. At the Belsen trial "the substantive law under which the charges were laid was International Law as it existed at the time when the alleged offenses were committed." Authority for the tribunal was a Royal Warrant of June 14, 1945, and Regulations for the Trial of War Criminals issued thereunder. No international declaration or agreement was relied upon.

British Army officers were assigned to the defense, and a former professor of international law at London University was engaged to assist them on legal questions in that field. He and his colleagues made a gallant effort to argue that the crimes charged did not constitute offenses at international law, but they were unsuccessful. The indictment and results of this trial establish that there was no necessity for the extraordinary course adopted at Nuremberg of defining by international agreement a few months before the trial special offenses to be charged against the German defendants. The Belsen trial proves that the same legal results might have been accomplished at Nuremberg by confining the charges to violations of international law already agreed to by all nations, including Germany. Such a course would have saved the Nuremberg experiment from well-grounded suspicion that in the main it was a trial of defeated enemies by their conquerors, a charge which bodes nothing but ill for the future peace of the world.

GEORGE A. FINCH*

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2 Id. at xxxi.

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BOOKS RECEIVED


170