

NOTES

EQUITY POWER OF BANKRUPTCY COURTS OVER CLASSIFICATION AND ASSIGNMENT OF CLAIMS*

THE expanding equitable powers of bankruptcy courts loom as an encouraging safeguard to creditors and investors in proceedings under the Bankruptcy Act. The difficulties of drafting legislation comprehensive enough to encompass the diverse problems encountered in distributing the assets of and the control over debtors' estates have become increasingly apparent. By emphasizing equity power, the Supreme Court has provided a means of filling in gaps in the Act and of supplementing the technical confines of statutory provisions.¹

A significant step in extending the equitable functions of bankruptcy courts was taken by the Court in a recent case² involving a municipal composition under Chapter IX of the Chandler Act.³ Unable to service or meet maturity dates on its indebtedness, the City of Avon Park, Florida, contracted for the services of R. E. Crummer & Co. as its fiscal agent in a proposed refunding plan.⁴ The contract provided for compensation to Crummer by a four per cent assessment against participating bondholders, subject to a reduction to two per cent if bondholders sold accrued interest coupons to the fiscal agent

* American United Mutual Life Ins. Co. v. Avon Park, 61 Sup. Ct. 157 (U. S. 1940).

1. See especially *Securities & Exch. Comm. v. United States Realty & Imp. Co.*, 310 U. S. 434 (1940); *Pepper v. Litton*, 308 U. S. 295 (1939); *Taylor v. Standard Gas & Elect. Co.*, 306 U. S. 307 (1939). For an example of judicial clarification of ambiguous statutory provision see *Case v. Los Angeles Lumber Prod. Co.*, 308 U. S. 106 (1939), (1940) 49 YALE L. J. 1099.

2. American United Mutual Life Ins. Co. v. Avon Park, 61 Sup. Ct. 157 (U. S. 1940).

3. 50 STAT. 653 (1937), as amended 52 STAT. 939 (1938), 11 U. S. C. §§ 401-404 (Supp. 1939). Legislation providing for municipal debt readjustments was first enacted in 1934 as a two-year emergency amendment to the National Bankruptcy Act. 48 STAT. 798 (1934). Prior to its expiration date, this portion of the Act was declared unconstitutional. *Ashton v. Cameron County Water Imp. Dist.*, 298 U. S. 513 (1936). The amendment was again enacted, with minor changes, in 1937. 50 STAT. 653 (1937). Its constitutionality has since been sustained. *United States v. Bekins*, 304 U. S. 27 (1938). The present expiration date of the amendment is June 30, 1942.

4. The fiscal agency device has achieved widespread use in dealing with the problems of defaulting local taxing units. This method has the advantage of effecting debt adjustments without the lengthy periods of negotiation formerly encountered. But uncontrolled use of the device has permitted fiscal agents to engage in speculative activities and may occasionally have resulted in adjusting debts of local taxing units where relief was not actually necessary. For an insight into both the advantages and dangers in the activities of fiscal agents, see *Hearings before Committee on the Judiciary on H. R. 8016*, 76th Cong., 3d Sess. (1940). The dangers have been aggravated by the tendency of the courts to place primary emphasis upon the presence of the required statutory assents as indicating the fairness of a proposed plan. *Vallette v. Vero Beach*, 104 F. (2d) 59 (C. C. A. 5th, 1939), *cert. denied*, 308 U. S. 586 (1939).

at one-third their face value.⁵ Crummer itself held approximately 34 per cent of the claims against the city, some having been acquired after the fiscal agency contract at half the face value. The proposed refunding plan was filed in a district court after 69 per cent of the bondholders, including the fiscal agent, had assented to the exchange.⁶ In securing assents, apparently neither the city nor Crummer disclosed the latter's true interest in the composition. Both the district court and the circuit court of appeals approved the plan as conforming to statutory requirements⁷ and the charge of four per cent as a reasonable one. No affirmative finding was made, however, as to Crummer's speculative interest either in the accrued interest coupons or in the bonds acquired at default prices.

The Supreme Court set aside the order of confirmation, holding unanimously that, in the absence of an affirmative finding that Crummer's interest in the composition had been fully disclosed to bondholders, the assents were not solicited and obtained in good faith within the meaning of the statute.⁸ Asserting that full disclosure is only a minimum requirement, the Court emphasized that the responsibility of bankruptcy courts entails scrutiny of motives inducing acceptances, the time when claims were acquired, and the amounts paid for them.⁹ Furthermore, where investigation discloses inequitable conduct or treatment, the Court indicated that equitable remedies—complete subordination of some claims,¹⁰ separate classification of claimants, and limitation of voting power to the amount paid for claims—may be utilized to effect a just distribution of assets or control.

Equitable classification of claimants for voting purposes is an important adjunct to the statutory powers of bankruptcy courts under Chapter IX. Designed to avoid difficulty and inequity resulting from the common law "race of diligence" after defaults of local taxing units,¹¹ proceedings under

5. The original contract made surrender of the accrued interest coupons to Crummer at one-third of face value a prerequisite to participation. See *American United Mutual Life Ins. Co. v. Avon Park*, 61 Sup. Ct. 157, 160, n. 3 (U. S. 1940).

6. The statute requires acceptance by holders of two-thirds of the aggregate amount of claims. BANKRUPTCY ACT § 83(d), 50 STAT. 657 (1937), 11 U. S. C. § 403(d) (Supp. 1939). The Act will hereafter be cited only by section number except where reference is made to entire chapters.

7. § 83(e).

8. § 83(e)(5).

9. Cf. *Case v. Los Angeles Lumber Prod. Co.*, 308 U. S. 106 (1939); *National Surety Co. v. Coriell*, 289 U. S. 426 (1933); see *Continental Ins. Co. v. Louisiana Oil Ref'g Co.*, 89 F. (2d) 333, 337 (C. C. A. 5th, 1937).

10. The equitable power of bankruptcy courts to subordinate claims in cases of fraud or mismanagement has previously been indicated by the Supreme Court. *Pepper v. Litton*, 308 U. S. 295 (1939); *Taylor v. Standard Gas & Elect. Co.*, 306 U. S. 307 (1939). See Comment (1940) 49 YALE L. J. 881.

11. Creditors of local taxing units experienced great difficulty in obtaining satisfactory settlement of claims prior to the enactment of the municipal debt-readjustment provisions of the Bankruptcy Act. See Dession, *Municipal Debt Adjustment and the Supreme Court* (1936) 46 YALE L. J. 199, 200-213; Comment (1934) 43 YALE L. J. 924, 962-78; SEC REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL, AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, Pt. IV

Chapter IX are essentially compositions in which the rule that "equality is equity" among creditors prevails. The statute provides for separate classification of claimants only where claims are payable from different sources.¹² All claims in the principal case were payable from the general taxing power of the municipality and thus would be grouped as a single class for voting purposes.¹³ The Supreme Court recognized, however, that voting in a single class may be inequitable where one creditor's vote is motivated by an inducement peculiar to him and not shared by other creditors in the class. Hence, an affirmative finding that profits under the plan would accrue to Crummer on the interest coupons but not to other creditors would constitute sufficient discrimination to authorize separate classification for voting purposes regardless of the limitation of the statute. Such a view accords with that reached under a somewhat comparable English statute. There the required statutory vote had been obtained but the English court refused confirmation of the proposed plan because an unsecured bank creditor whose large claim had been guaranteed in full by the directors of the debtor had not been separately classified for voting from other unsecured creditors who had received no guarantee.¹⁴ American commentators have frequently argued that such a view would not obtain under applicable bankruptcy statutes in this country because the only classification contemplated would be on a basis of economic status arising out of past dealing with the debtor.¹⁵ But in the principal case the Court appears to have rejected this narrow view of classification. By concluding that a judge must inquire into the motives of those obtaining

(1936) 46-60. [Hereinafter cited as SEC REPORT.] Doubt has been expressed as to whether Chapter IX provides sufficient controls to meet former difficulties. Dession, *supra* 46 YALE L. J., at 215-17; Comment (1934) 43 YALE L. J. 924, 974; Dimock and Frye, Book Review (1936) 46 YALE L. J. 186, 189-90. Need for additional legislation has been suggested providing for greater judicial control over the entire proceedings, as in Chapter X, or for submitting plans to the SEC. See Douglas, *The Legal Problems of Control over Protective Committees for Municipal and Quasi-Municipal Obligations* (1936) 2 LEGAL NOTES ON LOCAL GOVERNMENT 81, 87; *Hearings before Committee on the Judiciary on H. R. 8016*, 76th Cong., 3d Sess. (1940) 83, 140-8.

12. Section 83(b) provides that ". . . the judge shall classify the creditors according to the nature of their respective claims and interests: *Provided, however*, That the holders of all claims, regardless of the manner in which they are evidenced, which are payable without preference out of funds derived from the same source or sources shall be of one class."

13. The courts have construed the classification provision to mean that all claims to be satisfied from the taxing power of the state or municipality are payable from the same source and may properly be placed in one class. See *West Coast Life Ins. Co. v. Merced Irrig. Dist.*, 114 F. (2d) 654, 671 (C. C. A. 9th, 1940); *Luehrmann v. Drainage Dist.*, 104 F. (2d) 696, 703 (C. C. A. 8th, 1939).

14. *La Lainière de Roubaix v. Glen Glove & Hosiery Co.*, [1926] Sess. Cas. 91. The English court construed the general classification provision of the English Companies Act to include this type of classification. Cf. *Sovereign Life Assurance Co. v. Dodd*, [1892] 2 Q. B. 573. The Court in the *Avon Park* case indicated that equitable classification is an inherent power of bankruptcy courts existing independent of statutory provision.

15. See FINLETTER, *THE LAW OF BANKRUPTCY REORGANIZATION* (1939) 466; Friendly, *Some Comments on the Corporate Reorganizations Act* (1934) 48 HARV. L. REV. 39, 71.

assents and require separate classification if necessary in order to guarantee that the vote equitably represents the judgment of the creditors, the Court recognized that prior economic status is not necessarily a satisfactory measure of the interests of creditors in a proposed plan.

This view of the Court appears likely to provide an important supplement to the classification provision of Chapter X,¹⁶ which implies that in corporate reorganizations classification¹⁷ is according to the absolute priority rule of the *Boyd* case.¹⁸ As a general rule, claims having the same economic status are accorded equal treatment and vote as an independent class.¹⁹ But the exception noted in the principal case would seem to permit further classification, apart from the provisions of the statute.²⁰ Thus, when it appears that certain creditors within a class are voting under a special inducement, they may be separated for voting purposes. In accordance with this view, the Second Circuit Court of Appeals, by way of dictum, expressed doubt in a 77B proceeding²¹ as to the fairness of a plan which permitted two secured creditors, who were also stockholders of the debtor, to vote in the same class with other secured creditors when the plan contemplated permanent injunction of actions against stockholders for liability on their shares.²² It was indicated that the interest of the shareholder-creditors in obtaining release from liability was not shared by other members of the same class. The power to require separate classification for voting in such situations is important

16. 52 STAT. 883 (1938), 11 U. S. C. §§ 501-676 (Supp. 1939). The court granted certiorari in the *Avon Park* case because it involved important problems ". . . in the administration of the composition and reorganization provisions of the Act," thus indicating that the import of the decision is not confined to debt adjustments of local taxing units under Chapter IX. See *American United Mutual Life Ins. Co. v. Avon Park*, 61 Sup. Ct. 157, 159 (U. S. 1940).

17. Section 197 provides that "for the purposes of the plan and its acceptance, the judge shall fix the division of creditors and stockholders into classes according to the nature of their respective claims and stock."

18. *Northern Pacific Ry. v. Boyd*, 228 U. S. 482 (1913). Under the doctrine of the *Boyd* case, strict adherence to economic priority must be observed. Junior interests cannot participate in a reorganization, without contribution, unless senior claims are satisfied. See SEC REPORT, Pt. VIII (1940) 142-161. Application of the *Boyd* case rule to Chapter X proceedings was forecast in *Case v. Los Angeles Lumber Prod. Co.*, 303 U. S. 106 (1939). For a discussion of the case see Dodd, *The Los Angeles Lumber Products Company Case and its Implications* (1940) 53 HARV. L. REV. 713.

19. See MOORE, BANKRUPTCY MANUAL (1939) 584; 2 GERDES, CORPORATE REORGANIZATIONS (1936) § 1045. Cf. *J. P. Morgan & Co. v. Missouri P. R. R.*, 85 F. (2d) 351 (C. C. A. 8th, 1936), *cert. denied*, 299 U. S. 604 (1936). See Comment (1940) 49 YALE L. J. 881, 882.

20. The *Avon Park* case states that the equitable power to classify is inherent in bankruptcy courts, not dependent upon express statutory provision. See *American United Mutual Life Ins. Co. v. Avon Park*, 61 Sup. Ct. 157, 162 (U. S. 1940).

21. Classification under § 77B was substantially the same as that provided in Chapter X.

22. *First Nat. Bank of Herkimer v. Poland Union*, 109 F. (2d) 54, 55 (C. C. A. 2d, 1940) (cited with approval in the principal case); cf. *In re Radio-Keith-Orpheum*, 106 F. (2d) 22, 26 (C. C. A. 2d, 1939); *Continental Ins. Co. v. Louisiana Oil Refg Corp.*, 89 F. (2d) 333, 338 (C. C. A. 5th, 1937).

not only because the court may adjust bargaining power within each class and so prevent discriminatory treatment, but also because the knowledge of any particular group that it cannot by its voting power prevail over a discriminated minority will increase the latter's power in striving for position in the reorganized company.²³

It should be noted, furthermore, that the broad tenor of the opinion in the principal case appears to go further than separate classification for voting purposes. Equally as important in the reorganizing process is the power to prevent inequitable treatment arising from strict adherence to economic status. The Court's reliance in the *Avon Park* case on the broad equity power of bankruptcy courts forecasts the possible use of this power to require separate classification for treatment within a class having the same economic status if equal treatment would result in inequity.²⁴

The Supreme Court's emphasis on the courts' duty to scrutinize the motives lying behind the activities of participating claimants and their power to provide equitable classification have special importance as protective devices in proceedings under Chapter XI.²⁵ Contemplating a streamlined procedure for liquidating or extending the claims of unsecured creditors, XI lacks many of the protective features of X.²⁶ The debtor is left largely in control under XI,²⁷ and may obtain the required statutory assents to its proposed plan prior to the filing of a petition, and without judicial supervision of their solicitation.²⁸ The placing of claims in hands friendly to the debtor and the use of outside inducements and misrepresentations in obtaining assents are real dangers to creditors. Judicial scrutiny of motives and interests would therefore seem necessary before confirmation of a plan.²⁹ Moreover, the

23. If the severed minority adopts obstructionist tactics to gain further advantage and threatens to block a proposed plan, the judge would seem to have ample power under Chapter X to disfranchise the claims as not voted in good faith. § 203.

24. Different treatment within a class may result from compromise in the reorganization process. In a § 77B proceeding, two unsecured creditors holding a large proportion of the claims were accused by other unsecured creditors of dominating the debtor. A compromise was effected by which the two large creditors received less advantageous treatment, the other creditors withdrawing their accusations. The plan was confirmed. *In re Burns Bros.*, 14 F. Supp. 910 (S. D. N. Y. 1936). Cf. *St. Louis Union Trust Co. v. Champion Shoe Mach. Co.*, 109 F. (2d) 313 (C. C. A. 8th, 1940); *Continental Ins. Co. v. Louisiana Oil Ref'g Corp.*, 89 F. (2d) 333 (C. C. A. 5th, 1937). See Comment (1940) 49 YALE L. J. 881, 884.

25. 52 STAT. 905 (1938), 11 U. S. C. §§ 701-799 (Supp. 1939).

26. See Rostow and Cutler, *Competing Systems of Corporate Reorganization: Chapters X and XI of the Bankruptcy Act* (1939) 48 YALE L. J. 1334. For a comparison of the two Chapters in tabular form see (1940) A3 CORP. REORG. AND AM. BANK. REV. 329.

27. Under Chapter X the trustee prepares a plan before the debtor may propose a plan or amendments. § 169. Under Chapter XI, the debtor alone may propose a plan or amendments. §§ 323, 363.

28. § 336(4).

29. The same high standard of surveillance is required of a bankruptcy court whether the assents are solicited before or after the filing of a petition. See *American United Mutual Life Ins. Co. v. Avon Park*, 61 Sup. Ct. 157, 162 (U. S. 1940).

debtor apparently may divide creditors into classes under XI before the plan is presented to the Court.³⁰ Consequently, the possibility of discriminatory classification to control voting power constitutes an additional hazard to creditors which a court may be able to offset through its equitable power to alter classification.³¹

A problem intimately connected with classification in reorganizations and compositions involves the treatment to be accorded claims acquired immediately prior to or during the judicial proceedings. In addition to stressing the need for scrutinizing motives and interests, the *Avon Park* case emphasized the responsibility of a bankruptcy court to investigate the time when claims were acquired and the amounts paid for them.³² Where the need arises, the Court indicated, there is power to limit the vote of such claims to the amount of consideration paid. The practice of speculators in buying up claims at default prices and attempting to extort unreasonable profits or to prevent reorganization by adopting obstructionist tactics in the judicial proceedings hardly accords with the accepted principles of "fair and equitable" rehabilitation.³³ In addition, the danger that claims might be purchased by persons friendly to the debtor, thus facilitating the solicitation of the required statutory assents, formerly constituted a hazard to creditors. Both of these dangers have been obviated by statutory provision in Chapter X permitting the judge to disfranchise any claims not voted in good faith.³⁴ The problem of debtor-controlled votes has apparently been met in Chapters IX³⁵ and XI³⁶ by making acceptances in good faith a prerequisite to confirmation. But the absence of provision in IX and XI for handling dissenters who acquire claims at default prices makes the problem of obstruction and control of proceedings acute. Hence the weapon of limitation, filling this statutory gap, may be put to salutary use in facilitating acceptance of a fair plan despite the obstruc-

30. This would seem the logical interpretation inasmuch as the chapter contemplates classification and the debtor may both propose a plan and submit it to creditors for acceptance prior to the filing of a petition.

31. Presumably this result could be reached by a broad interpretation of the classification provision in XI as well as on equitable grounds. Section 351 provides: "For the purposes of the arrangement and its acceptance, the court may fix the division of creditors into classes. . . ." See note 14 *supra*.

32. See *Continental Ins. Co. v. Louisiana Oil Ref'g Co.*, 89 F. (2d) 333, 337 (C. C. A. 5th, 1937).

33. Courts have regarded such practices with disfavor. See *J. S. Farlee & Co. v. Springfield-So. Main Realty Co.*, 86 F. (2d) 931, 936 (C. C. A. 1st, 1936); *Guaranty Trust Co. v. Chicago, M. & St. P. Ry.*, 15 F. (2d) 434, 443 (N. D. Ill. 1926).

34. Under § 203 the judge may exercise his power of disfranchisement regardless of the time of acquisition of claims, thus meeting the additional problem of the large equity holder who refuses to accept a plan not retaining him in control.

35. § 83(e) (5). An additional safeguard in Chapter IX permits the judge to exclude from the vote claims owned or controlled by the petitioner. § 83(d). The Court indicated in the principal case that this might be a ground for excluding the vote of the Crummer interests. See *American United Mutual Life Ins. Co. v. Avon Park*, 61 Sup. Ct. 157, 163 (U. S. 1940).

36. § 366(5).

tionist tactics of opportunistic dissenters.³⁷ Furthermore, insistence upon investigation of the time of acquisition of claims and their use in proceedings under Chapters IX and XI seems highly necessary because assents may be obtained before the filing of a petition. A disproportionate number of newly acquired claims among the acceptances may influence judgment against the fairness of a proposed plan.

In addition to the limitation which the *Avon Park* case declares may be placed upon the voting power of assigned claims, Chapter X expressly provides that in certain circumstances the court shall examine and may limit claims in amount of participation to the actual consideration paid. One such situation is where rent claims have been assigned³⁸ and the other is where protective committees or their members have acquired claims during or in contemplation of proceedings.³⁹ The courts have construed the clause relating to landlords' rent claims as being declaratory of existing law, with the result that claims will not be limited if investigation fails to disclose a breach of duty in connection with the assignment.⁴⁰ In regard to claims acquired by protective committees or their members, it has been suggested that a like showing of breach of fiduciary duty is essential to limitation.⁴¹

Since insiders have frequently purchased claims at a fraction of their true value in order to gain voting control or for personal profit, the provision relating to committee claims is particularly salutary. Rigid enforcement of the statute is desirable where committee members, by misrepresentation or failure to disclose inside information, have purchased claims at default prices even though the claims were acquired from holders other than those depositing

37. In *In re McEwen's Laundry*, 90 F. (2d) 872 (C. C. A. 6th, 1937), the court, on equity grounds, approved limiting the voting privileges of two unsecured creditors in a § 77B proceeding to the amount of consideration they had paid for claims. It appeared that the two creditors were also stockholders of the debtor, had each submitted plans of reorganization, and had each acquired unsecured claims at 15% of face. To permit them to vote in full on the assigned claims might thus have placed them in a position to block all plans unless they were retained in control or accorded preferred treatment. Or presumably they might force liquidation to the detriment of other creditors. But see *Texas Hotel Securities Corp. v. Waco Development Co.*, 87 F. (2d) 395, 399 (C. C. A. 5th, 1937), *cert. denied*, 300 U. S. 679 (1937). For a discussion of the problem see SEC REPORT, Pt. VIII (1940) 113-25.

38. § 202. The same provision is contained in Chapter XI. § 353.

39. § 212.

40. Where a corporation had been reorganized under § 77B, which contained a similar scrutiny clause, a district court refused to limit the amount of a claim where it found that the assignee had not obtained confidential information from the bankruptcy trustee or breached any fiduciary duty. *Cumberland Corp. v. McLellan Stores Co.*, 32 F. Supp. 840 (S. D. N. Y. 1940). Where assigned rent claims have been limited, the courts have rested on grounds other than the scrutiny clause. *In re McCrory Stores*, 12 F. Supp. 267 (S. D. N. Y. 1935). See FINLETTER, *THE LAW OF BANKRUPTCY REORGANIZATION* (1939) 293.

41. SEC REPORT, Pt. VIII (1940) 119, n. 139; FINLETTER, *THE LAW OF BANKRUPTCY REORGANIZATION* (1939) 296-7. The author, however, notes the likelihood that equity principles may be utilized to reduce provable amounts.

claims with the particular committee.⁴² Moreover, a policy permitting the former holder to intervene as equitable owner of the claims might be developed under Chapter X, measure of participation being the difference between the value of the claim in the reorganization and the amount actually received by the former holder from the assignee. This would permit an equitable distribution of the estate in one proceeding without relegating defrauded creditors to an independent action against committee members.⁴³ Furthermore, if defrauded creditors could participate, there would be no windfall to other participating interests in the event the judge exercised his power to limit the committee's claims.

While the limitation on extent of participation may presumably be invoked under Chapter X only in the two specified situations, extension of the limitation on equitable grounds to other types of assigned claims may prove desirable in achieving a just result. The powers of bankruptcy courts might well include limitation in amount as well as on voting privilege where third parties have dominated committees and prevented other bidders from acquiring deposited claims,⁴⁴ where parent corporations have acquired claims against debtor subsidiaries by misrepresentations,⁴⁵ or where persons connected with the debtor have acquired claims under questionable circumstances in a reorganization.⁴⁶ Such a power of limitation upon extent of participation, by threatening to jeopardize the financial gain to be derived from such dealing, would have the advantage of serving as a deterrent to inequitable speculative activities.⁴⁷

42. Argument can be made that such a restriction would tend to interfere with ordinary bargaining processes in a reorganization. Committees often buy claims from outside holders in order to promote the interests of depositing creditors. See 1 GERDES, CORPORATE REORGANIZATIONS (1936) 133. But it would seem that distinction might be drawn between cases where the purchase of claims is made upon full disclosure and accurate representation and those where inequitable conduct is disclosed. Rigid adherence to a strict fiduciary concept in interpreting the limitation provision may prove too narrow. The *Avon Park* case indicates that the requirement of full disclosure can be broadened on equitable grounds. An overemphasized certainty of prediction may well be sacrificed to the paramount consideration of protecting creditors and investors by flexible adjustment of the remedy.

43. Problems of proof would presumably be greater in an independent action. The tendency of the courts to adhere to a strict fiduciary rationale could not be obviated.

44. But *cf.* *Security-First Nat. Bank v. Rindge Land & Navig. Co.*, 85 F. (2d) 557 (C. C. A. 9th, 1936), *cert. denied*, 299 U. S. 613 (1937). "Section 77B . . . does not purport to alter long established incidents of property by introducing a vague and indefinable 'equity' into the proceedings." *Supra* at 561-2.

45. But *cf.* *In re Lubliner & Trinz Theatres*, 100 F. (2d) 646 (C. C. A. 7th, 1938). See the relationship of the parties in *In re Indiana Central Tel. Co.*, 24 F. Supp. 342 (D. Del. 1938), although there was no evidence of fraud or overreaching.

46. The situation involved in *In re McEwen's Laundry*, 90 F. (2d) 872 (C. C. A. 6th, 1937), discussed *supra* note 37, might well call for limitation upon amount of participation, if claims had been acquired by unfair dealing.

47. Speculation alone is not a danger. See *In re Consolidated Rock Prod. Co.*, 114 F. (2d) 102, 104 (C. C. A. 9th, 1940) *aff'd sub nom.* *Consolidated Rock Prod. Co. v. DuBois*, 9 U. S. L. WEEK 4216 (U. S. 1941). Too rigid restriction upon specula-

Chapter IX contained no provision permitting the court to limit in amount claims acquired by protective committees or their members in contemplation of or during proceedings. The Court in the principal case indicated, however, that the scope of the bankruptcy court's power at least includes the power to deny compensation to committee members in such situations.⁴⁸ Furthermore, remedial legislation aimed at dangers in the uncontrolled use of the fiscal agency device has recently been enacted⁴⁹ directing courts to scrutinize contracts, acceptances, deposit agreements and other papers relating to a proposed plan in order to determine compensation received by representatives of creditors or the petitioner. Where speculative activity is possible, the judge may refuse confirmation and assess costs against the offender. A vigorous policy in enforcing the scrutiny clause, coupled with the broadened equitable powers of bankruptcy courts, should go far in eliminating subtle machinations from compositions under Chapter IX.

The Court's opinion in the *Avon Park* case serves well as a reminder that the equity power possessed by a bankruptcy court is a potent weapon in the every day conduct of debtor proceedings. Seemingly rigid doctrines such as the priority rule of the *Boyd* case, apparent omissions in the various statutory provisions for rehabilitations, unnecessarily narrow scope of some statutory grants of power—all of these seem destined to be softened in their impact. So long as reorganizations, which are essentially problems of readjustment of economic status and redistribution of entrepreneurial power, must take place within the confines of statutory and judicial rules-of-thumb, it is vitally necessary to provide a compensatory power by which courts can cope with the occasional inequities which arise.

WITHDRAWAL OF DUE PROCESS LIMITATIONS ON STATE TAX JURISDICTION*

JURISDICTIONAL limitations upon state taxing power have, until recently, been found in an elaborately complex system of doctrine, erected by judicial logic upon slim Constitutional foundations. When a state tax was laid upon

tive activity would depress the market prices of claims and prevent financially pressed creditors from unloading prior to lengthy reorganization proceedings. But speculation accompanied by inequitable conduct should be curbed.

48. See *American United Mutual Life Ins. Co. v. Avon Park*, 61 Sup. Ct. 157, 162 (U. S. 1940). Cf. *Woods v. City Nat. Bank & Trust Co.*, 61 Sup. Ct. 493 (U. S. 1941) (compensation denied in a Chapter X proceeding where members were serving conflicting interests); *In re Paramount Publix Corp.*, 12 F. Supp. 823 (S. D. N. Y. 1935) (77B proceeding).

49. Pub. L. No. 669, 76th Cong., 3d Sess. (June 28, 1940). See (1940) A3 CORP. REORG. AND AM. BANK. REV. 335-9. Cf. § 249.

**Wisconsin v. J. C. Penney Co.*, 61 Sup. Ct. 246 (U. S. 1940).

material property or upon a person, the relatively simple issues of geographical location¹ or domicile² obviated jurisdictional controversy. But in the case of taxes upon intangibles—upon a transaction, a chose-in-action, a transfer at death, or receipt of income—jurisdictional status became a highly fictional concept.³ While it is axiomatic that a state may not tax beyond the limits of its sovereignty,⁴ recourse to the due process clause of the Fourteenth Amendment proved necessary in order to provide a convenient rationalization for most of the jurisdiction-to-tax decisions.⁵ Taxation without jurisdiction was treated as bare extortion. But jurisdiction, to the Supreme Court, was very largely a matter of legal doctrine rather than economic fact.⁶

Underlying the polished conceptualism of the cases, however, lay a very real and practical problem of protecting interstate economic activity from multiple and thus unconscionable local exactions. It is a problem of the same order, though wider in scope, as that presented by the commerce clause and the decisions construing it as a limitation upon state power to tax. Thus many cases involving taxes upon corporate business have been decided upon the dual grounds of interstate commerce and due process from the same factual basis.⁷ Since, however, the commerce clause has been interpreted to permit non-discriminatory state taxes upon interstate enterprise,⁸ protesting corporate taxpayers have of necessity come to rely more upon the jurisdictional objection.

1. *Union Refrig. Transit Co. v. Kentucky*, 199 U. S. 194 (1905); see *Frick v. Pennsylvania*, 268 U. S. 473, 488-489 (1925).

2. See *Lawrence v. State Tax Comm.*, 286 U. S. 276 (1932) and cases there collected at 279-280.

3. *Rhode I. Hosp. Tr. Co. v. Doughton*, 270 U. S. 69 (1926); *Travis v. Yale & Towne Mfg. Co.*, 252 U. S. 60 (1920); *Corry v. Baltimore*, 196 U. S. 466 (1905).

4. *McCulloch v. Maryland*, 4 Wheat. 316, 429 (U. S. 1819); *Curry v. McCanless*, 307 U. S. 357, 366 (1939).

5. The first was *Union Refrig. Transit Co. v. Kentucky*, 199 U. S. 194 (1905). Previously, jurisdiction to tax decisions had had no specific constitutional basis, but had been written in terms of the attributes of sovereignty, *McCulloch v. Maryland*, 4 Wheat. 316 (U. S. 1819); or in terms of ultra vires acts of state legislatures, *Railroad Co. v. Jackson*, 7 Wall. 262 (U. S. 1868). The early "due-process" cases are summarized, and their application to the privilege tax situation analysed by Hughes, J. in *Provident Savings Life Assur. Soc. v. Kentucky*, 239 U. S. 103, 112 (1915).

6. See, for instance, the opinions in *Provident Savings Life Assur. Soc. v. Kentucky*, 239 U. S. 103 (1915); *Equitable Life Assur. Soc. v. Penn.*, 238 U. S. 143 (1915); *Maxwell v. Bugbee*, 250 U. S. 525 (1919); *Shaffer v. Carter*, 252 U. S. 37 (1920); *Rhode I. Hosp. Tr. Co. v. Doughton*, 270 U. S. 69 (1926). Compare the less doctrinaire approach of Holmes, J. in *St. Louis Cotton Compress Co. v. Arkansas*, 260 U. S. 346 (1922).

7. *Felt & Tarrant Co. v. Gallagher*, 306 U. S. 62 (1939); *Looney v. Crane Co.*, 245 U. S. 178 (1917); *Kansas City Co. v. Botkin*, 240 U. S. 227 (1916); *International Paper Co. v. Massachusetts*, 246 U. S. 135 (1918); *Southern Pac. Co. v. Gallagher*, 306 U. S. 167 (1939); *Pacific Tel. Co. v. Gallagher*, 306 U. S. 182 (1939).

8. For collection of cases and historical summary of liberalized treatment of state taxes upon interstate commerce see Justice Stone's opinion in *McGoldrick v. Berwind-White*, 309 U. S. 33, 45-50 (1940).

Most of the standard arguments upon the jurisdictional issue — the distinction between the "subject" and the "measure" of a tax,⁹ the benefit-burden theory,¹⁰ the doctrine of unconstitutional conditions,¹¹ the concepts of commercial domicile of corporations¹² and business situs of intangible wealth¹³ — had been worked out by the Supreme Court prior to 1930. All of these were engrafted upon the two original propositions, that the domiciliary state taxed a person and his intangible personalty¹⁴ and that realty and tangible personalty were subject to *in rem* taxation wherever they were found.¹⁵ The system lacked internal consistency at many points,¹⁶ resulting in limited predictability and abundant litigation.

9. *Maxwell v. Bugbee*, 250 U. S. 525 (1919); see *Rhode I. v. Doughton*, 270 U. S. 69, 81 (1926); *accord*, *Educational Films Corp. v. Ward*, 282 U. S. 379 (1931). For an implicit recognition of the distinction in an early case see *The Delaware R. R. Tax*, 18 Wall. 206 (U. S. 1873). See Isaacs, *The Subject and Measure of Taxation* (1926) 26 Col. L. Rev. 939.

10. Mr. Justice Holmes was an early exponent of this theory. See his opinion in *Blackstone v. Miller*, 188 U. S. 189, 205 (1903) and his dissent in *Baldwin v. Missouri*, 281 U. S. 586, 595 (1930). See Carpenter, *Jurisdiction Over Debts* (1918) 31 HARV. L. REV. 905.

11. While a state was allowed reasonable liberty in attaching conditions to its grant of business privileges to foreign corporations, certain conditions were deemed fundamentally contradictory to basic constitutional doctrine and therefore unenforceable. *Fidelity & Dep. v. Tafoya*, 270 U. S. 426 (1926); *Looney v. Crane Co.*, 245 U. S. 178 (1917). Nor could foreign corporations be required to purchase relief from ouster by paying taxes on property which was immune through foreign situs. *People ex rel Alpha Portland Cement Co. v. Knapp*, 230 N. Y. 48, 129 N. E. 202 (1920).

12. Under this theory a state in which the management and control of a corporation are localized may tax to the full extent of its intangibles, even though the corporation is legally domiciled elsewhere. The concept was not openly adopted by the Supreme Court until *Wheeling Steel Corp. v. Fox*, 298 U. S. 193 (1936) and *Southern Nat. Gas. Corp. v. Alabama*, 301 U. S. 148 (1937). But state courts had conceived it much earlier. *State v. Tenn. Coal, Iron & R. Co.*, 188 Ala. 514, 66 So. 178 (1914); *Commonwealth v. United Cig. Mach. Co.*, 119 Va. 447, 89 S. E. 935 (1916).

13. *DeGanay v. Lederer*, 250 U. S. 376 (1919); *Liverpool & London & Globe Ins. Co. v. Board of Assessors*, 221 U. S. 346 (1911); *Board of Assessors of Orleans v. New York Life Ins. Co.*, 216 U. S. 517 (1910); *Metropolitan Life Ins. Co. v. New Orleans*, 205 U. S. 395 (1907); *Bristol v. Washington County*, 177 U. S. 133 (1900).

14. At common law the maxim "*mobilia sequuntur personam*" was applied to taxation of intangibles. Except where the "business situs" exception is appropriate [note 13 *supra*] the domiciliary state of the owner still has this broad tax power. *Newark Fire Ins. Co. v. State Bd. of Tax Appeals*, 307 U. S. 313 (1939); *Blodgett v. Silberman*, 277 U. S. 1 (1928); *Cream of Wheat Co. v. Grand Forks County*, 253 U. S. 325 (1920). See Lowndes, *State Jurisdiction to Tax Income* (1932) 6 TEMP. L. Q. 486.

15. *Great Northern Ry. Co. v. Minnesota*, 278 U. S. 503 (1929); see *Shaffer v. Carter*, 252 U. S. 37 (1920).

16. See Rodell, *A Primer on Interstate Taxation* (1935) 44 YALE L. J. 1166; Carpenter, *Jurisdiction Over Debts* (1918) 31 HARV. L. REV. 905; Lowndes, *Spurious Concepts of the Constitutional Law of Taxation* (1934) 47 HARV. L. REV. 628; *Rate and Measure in Jurisdiction to Tax* (1936) 49 HARV. L. REV. 756. A fairly complete collection of periodical literature on the subject is made in notes to Merrill, *Jurisdiction to Tax—Another Word* (1935) 44 YALE L. J. 582.

The *Farmer's Loan*¹⁷ and *Baldwin*¹⁸ cases in 1930 inaugurated a period of about seven years in which one group of Justices struggled valiantly, especially in the death-tax field but also in the field of business taxes, to do away entirely with multi-state taxation by assigning each taxable object or activity to a single jurisdiction, and so to establish a new ideal of "one person, one subject, one tax."¹⁹ Mr. Justice Stone's minority, never accepting the theory that the Fourteenth Amendment flatly outlawed multi-state taxation, induced a gradual inroad of exceptions to the new majority rule until the rule itself collapsed from want of substance and was specifically rejected in 1937 and 1938.²⁰ For a short time thereafter and to a limited extent, the Court appeared to concern itself with the underlying practicalities of tax-jurisdiction cases—with an economic analysis of the ultimate incidence of the tax, and with a comparison of the taxpayer's burden to the privileges offered by the state in return. "Reasonableness" seemed to be the test of constitutionality.²¹ With the *Newark Fire Insurance* case, however, it became evident that some Justices were no more inclined to apply a test of economic reasonableness than they were to retain the earlier doctrinaire approach. Taxation, they said, is a "phase of empirical legislation" and "belongs to the range of experimental activities of government." Where there is no claim of state encroachment upon national powers, the Court should not intervene in the "autonomous area of the legislative taxing power."²² Under this theory,

17. *Farmer's Loan & Trust Co. v. Minnesota*, 280 U. S. 204 (1930). Six Justices disapproved the tax on the ground that New York's right to tax was superior to that of Minnesota and that the Fourteenth Amendment forbade double taxation. Stone, J. concurred in the result because Minnesota neither "potentially nor actually played any beneficial part in the transfer." Holmes and Brandeis, JJ. dissented.

18. *Baldwin v. Missouri*, 281 U. S. 586 (1930). Stone, J., who opposed the *Farmer's Loan* tax (*supra* note 17), voted with the dissent (Holmes and Brandeis, JJ.) here because Missouri had "benefited" the transfer through the assistance of her legal machinery. This was the first case to draw a sharp distinction between the no-double-tax theory based on the Fourteenth Amendment and the theory that for every benefit conferred a tax could be exacted in recompense.

19. *Farmer's Loan & Trust Co. v. Minn.*, *supra* note 17, at 212; *Beidler v. South Carolina Tax Comm.*, 282 U. S. 1 (1930); *First Nat. Bank v. Maine*, 284 U. S. 312 (1932). The last of these opinions predicted a further tightening of jurisdictional limitations.

20. Such an outcome seemed inevitable from the time of the unanimous adoption of a benefit-burden theory in *Lawrence v. State Tax Comm.*, 286 U. S. 276 (1932). Further momentum was given by *Wheeling Steel Corp. v. Fox*, 298 U. S. 193 (1936); *New York ex rel. Cohn v. Graves*, 300 U. S. 308 (1937); *First Bank Stock Corp. v. Minnesota*, 301 U. S. 234 (1937). The *coup de grace* was administered in *Guaranty Trust Co. v. Virginia*, 305 U. S. 19 (1938).

21. See *Great A. & P. Co. v. Grossjean*, 301 U. S. 412 (1937); *Ford Motor Co. v. Beauchamp*, 308 U. S. 331 (1939); *New York ex rel. Cohn v. Graves*, 300 U. S. 303 (1937); *Curry v. McCannless*, 307 U. S. 357 (1939); *Graves v. Elliott*, 307 U. S. 383 (1939).

22. *Frankfurter, Stone, Black, and Douglas, JJ. concurring in Newark Fire Ins. Co. v. State Bd. of Tax App.*, 307 U. S. 313, 323 (1939).

except in cases of grossest injustice, the aggrieved taxpayer must seek his remedy by legislative reformation rather than by invocation of constitutional stricture in the courts. This tendency toward judicial abdication in the tax-jurisdiction field continues, although the extent to which it may ultimately go is still uncertain.

The most recent case on the subject, *Wisconsin v. J. C. Penney Co.*,²³ illustrates some of the difficulties caused by the unsettled attitude of the Court. Wisconsin imposed a "Privilege Dividend Tax" upon the declaration and receipt of dividends out of corporate income earned in Wisconsin, and directed the paying corporations to deduct the amount of this tax from their distributions to stockholders, regardless of the domicile of either corporation or stockholder.²⁴ Penney Co., a Delaware corporation authorized to do business in Wisconsin and commercially domiciled in New York,²⁵ successfully attacked the constitutionality of the tax in the Wisconsin courts²⁶ on the theory of *Connecticut General Life Insurance Co. v. Johnson*,²⁷ that a state was powerless to tax a transaction performed wholly out of the state. The Supreme Court reversed this judgment and upheld the tax.

Mr. Justice Frankfurter's majority opinion rests in part upon the assumed equivalence of this tax to a supplementary corporate income tax, with deferred liability, on Penney Co.'s Wisconsin earnings. While a careful analysis of the incidence of the tax casts grave doubt upon the validity of this assumption,²⁸ it is probably not wise in any event to attach much importance to the

23. 61 Sup. Ct. 246 (U. S. 1940). Two companion cases were decided on the authority of this decision: *Wisconsin v. Minnesota Mining & Mfg. Co.*, 61 Sup. Ct. 253 (U. S. 1940); *Wisconsin v. F. W. Woolworth Co.*, 61 Sup. Ct. 395 (U. S. 1940). The state court opinion is noted in 88 U. OF PENN. L. REV. 1025; 24 MINN. L. R. 711, 24 MARQ. L. REV. 167 (1940).

24. Wisc. Laws 1935, c. 505, § 3 as amended by c. 552: "(1) For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is hereby imposed a tax equal to two and one half percentum of the amount of such dividends declared and paid by all corporations (foreign and local) after the passage of this act . . . Such tax shall be deducted and withheld from such dividends payable to residents and non-residents by the payor corporation . . . (3) Every such corporation hereby made liable for such tax shall deduct the amount of such tax from the dividends so declared."

25. The company maintained its principal office in New York, held its directors' meetings there, and paid its dividends with checks drawn upon New York city banks. Something less than 4% of the company's total income for the taxable year here in question was derived from Wisconsin. Over 96% of its stockholders owning 98% of its stock reside outside Wisconsin. The company does business in and distributes dividends to all of the 48 states.

26. *Penney Co. v. Tax Comm'r*, 233 Wis. 286, 289 N.W. 677 (1940). The Wisconsin Court felt constrained, on the authority of the *Connecticut General* case [*infra* note 29], to overrule its prior judgment of constitutional validity given in *State ex rel. Froedtert G. & M. Co. v. Tax Comm'r*, 221 Wis. 225, 265 N.W. 672 (1936).

27. 303 U. S. 77 (1938).

28. The United States Treasury Department has decided that the tax is upon the stockholder rather than the corporation, and has allowed income tax deductions accord-

doctrinal rationale. Insofar as it advances the purely nominal argument that the same exaction is good as an income tax and bad as an excise, this part of the opinion must be regarded as no more than a conventional gesture to outmoded formula.

The opinion says as much when it dismisses these considerations as "merely a reformulation of the classic approach of this Court to the taxing power of the states." The real basis for the holding is stated thus:

"At best, the responsibility for devising just and productive sources of revenue challenges the wits of legislators. Nothing can be less helpful than for courts to go beyond the extremely limited restrictions that the Constitution places upon the states and to inject themselves in a merely negative way into the delicate processes of fiscal policy-making."²⁹

While the minority opinion does not disapprove, because it does not recognize, the abdication argument of the majority, it does indicate the incompatibility of the decision with doctrinal precedent, particularly with the recent *Connecticut General* case.³⁰ There the Court had explicitly declined to look beyond the immediate object of the tax to the "ultimate thrust of economic benefits and burdens." It had recognized that accurate allocation among forty-eight states of ultimate source and destination of values arising from an integrated national economy was a practical impossibility, and that juris-

ingly. XV. INT. REV. BULL. No. 2, at 142 (1936). The Wisconsin State Tax Commission has unofficially taken a similar position in a letter to the Corporation Trust Co., C. C. H. Corporation Tax Serv. for Wisc., ¶10-640.19. This interpretation is plainly in accord with the intent of the statute. See note 24 *supra*.

29. 61 Sup. Ct. 246 at 250 (U. S. 1940).

30. *Connecticut General Life Ins. Co. v. Johnson*, 303 U. S. 77, 80 (1938). There California had taxed premiums on reinsurance contracts made in Connecticut to cover California policies, calling the tax an excise upon the insurer for the privilege of doing California business. The tax was struck down by the Supreme Court because no act in the performance or discharge of the contracts was done within the taxing state. Mr. Justice Stone is the only individual who voted with the majority both in the *Connecticut General* and *Penney* cases. The other four majority votes in the *Penney* case came from Black, J., who dissented from the *Connecticut General* opinion, and from Frankfurter, Douglas, and Murphy, JJ., who joined the Court after that decision. While one can only speculate upon the distinction which underlay Justice Stone's shift, it seems possible that he was impressed by Justice Frankfurter's assumption that the Privilege Dividend Tax was equivalent to a supplementary income tax. If this were true, there would be a much closer connection between the Wisconsin tax and Wisconsin earnings than there was between the California tax and the underlying California life insurance which formed the subject of the *Connecticut General* reinsurance contracts. If, however, the Privilege Dividend Tax be considered an excise (Wisconsin court's view) and not an income tax (Justice Frankfurter's view) there is a much weaker case for state power than in the California case. See exhaustive analysis along these lines in *Penney Co. v. Tax Comm.*, 233 Wis. 286, 296, 289 N.W. 677, 680-682 (1940). The importance of determining Justice Stone's rationale lies in the pivotal position which he seems to occupy on this question at the moment.

dictional limitations must be stated in terms of immediate rather than ultimate objects of taxation.³¹

If the *Penney* decision were taken seriously upon the doctrinal level, it would be difficult to estimate the magnitude of its effect upon future tax development. Hitherto the Court has been willing to allow extra-territorial factors to enter into the measure of a tax providing always that the *subject* was within the taxing jurisdiction.³² A chain store privilege tax could be measured by the national size of the chain.³³ But an excise measured by intrastate insurance business could not be validly imposed upon a subject, a reinsurance contract, which was wholly extra-state.³⁴ While the Wisconsin tax in the instant case was measured by intrastate income, it was expressly, beyond shadow of doubt of legislative intention, imposed upon an out-of-state transaction — "on the privilege of declaring and receiving dividends."³⁵ The logical extensions of this decision are at least startling from an historical perspective, however acceptable they may seem *a priori*. One is led to believe, for instance, that a state could impose a property tax upon extra-territorial tangible property which could be shown to have grown out of earnings from within that state,³⁶ or that it could impose an inheritance tax upon the succession to shares of corporate stock merely because some of the capital assets of the corporation were located within the state.³⁷ If the Court in the *Penney* case meant to say that the only nexus between a state and a taxable object necessary to perfect jurisdiction is the fact that the object is the economic

31. See Merrill, *supra* note 16, at 594, n. 76, 77; Harding, *State Jurisdiction to Tax Dividends and Stock Profits to Natural Persons* (1937) 25 CALIF. L. REV. 139, 152-154; Graniteville Mfg. Co. v. Guery, 283 U. S. 376 (1931); *accord*, Domeneck v. United Porto Rican Sugar Co., 62 F. (2d) 552 (C. C. A. 1st, 1932), *cert. denied*, 289 U. S. 739 (1933).

32. Educational Films Corp. v. Ward, 282 U. S. 379 (1931); James v. Dravo Contracting Co., 302 U. S. 134, 138 (1937); *accord*, Keeney v. New York, 222 U. S. 525 (1912); New York *ex rel.* Hatch v. Reardon, 204 U. S. 152 (1907). For a criticism of this slippery distinction, see Lowndes, *Spurious Concepts of the Constitutional Law of Taxation* (1934) 47 HARV. L. REV. 628.

33. Great A. & P. Tea Co. v. Grossjean, 301 U. S. 412 (1937).

34. Connecticut General Life Ins. Co. v. Johnson, 303 U. S. 77 (1938).

35. See part of taxing statute set out *supra* note 24. Completely inconsistent with the Court's attempt to metamorphose this tax into a corporate income tax is a very recent decision in which a unanimous opinion read, partly: "The determination of the state court as to the incidence of the tax has great weight with us, and, when it follows logically the language of the act, as here, is controlling." Colorado Bank v. Bedford, 310 U. S. 41, 52 (1940).

36. The dissent in the instant case took this view: "An ad valorem property tax by Wisconsin [on property purchased out of past earnings] could be quite as easily justified under the label of an income tax because the property represented income once received, as the present tax, on the declaration and receipt of dividends out of earned surplus." 61 Sup. Ct. 246, 252. Similar arguments were made by counsel in this and companion cases. Such a tax would be irreconcilable with the leading case on due process as a basic requirement of taxing jurisdiction. Union Refrig. Transit Co. v. Kentucky, 199 U. S. 194 (1905).

37. An unconstitutional tax under Rhode I. Hosp. Tr. Co. v. Doughton, 270 U. S. 69 (1926).

embodiment of income formerly earned within state borders, it will become possible for a state to pursue and tax its capital exports to a degree never before thought possible, and the area of potential multi-state taxation will be considerably increased. Although a development of the implications of this case to their logical extreme is unlikely, the fact that they are so far out of line with doctrinal precedent³⁸ suggests that the Court is clinging merely to the theory, but not to the substance, of judicial regulation of state tax jurisdiction.

Nor can the decision be explained any more satisfactorily upon a theory of reasonableness of practical effect than upon a conceptual theory. No detailed practical analysis of the tax was briefed or argued before the Court.³⁹ Mr. Justice Frankfurter's generalizations about the relation between the exercise of Wisconsin's taxing power to the benefits which it has conferred, and his statement that the tax "gains nourishing significance when placed in the context of the Wisconsin taxing system"⁴⁰ fail to account for numerous economic facts which an empirical investigation of the tax incidence would certainly have disclosed. By the terms of the statute the tax must be deducted from the dividend checks of individual stockholders. The stockholders, and not the corporation, are the tax-payers.⁴¹ Counsel for the taxpayer estimate that these deductions are so small as to be less than the cost of hiring accountants to compute them on blocks of stock of less than sixty shares.⁴² In its practical operation the tax is excessively burdensome and raises difficulties which would never arise if the tax were, as the Court seemed to think it was, merely a corporate income tax. In the case of a corporation having preferred stock, for instance, if the tax is deducted from the preferred holder's contractual six per cent, he may protest that corporate taxes must first be paid out of the common stock equity, and that no foreign state can alter his contract. If the tax is *not* deducted from preferred dividends, the common stockholder will protest that the terms of the taxing statute are not being followed. And finally, in its context in the Wisconsin tax-structure, this tax looks much more like a devious way of preserving an existing discrimination in favor of stockholders in local enterprises over stockholders in foreign corporations, than like a device to "equalize burdens."⁴³

38. See Rottschaefer, *State Jurisdiction of Income for Tax Purposes* (1931) 44 HARV. L. REV. 1075, 1097, erroneously predicting that a tax such as the one in the instant case would be invalidated.

39. Upon petition for rehearing in the Supreme Court, Penney Co. set forth in detail for the first time an economic analysis of the "ultimate thrust" of the tax which demonstrates the material, practical difference between this and a corporate income tax. *Petition of Respondent for Rehearing and Brief in Support Thereof*, Wisconsin v. Penney Co., Supreme Court (Oct. term, 1940) No. 46. The petition was denied. 9 U. S. L. WEEK 3185 (U. S. 1940).

40. Wisconsin v. Penney Co., 61 Sup. Ct. 246, 249 (U. S. 1940).

41. See note 24 *supra*.

42. Petition for Rehearing, *supra* note 39, at 26.

43. Cf. note 24 *supra*. The Court evidently considered the tax as an elaborate attempt on Wisconsin's part to achieve a just taxation of corporate dividends, which are exempt under the personal income tax. Actually the tax seems designed to per-

The unwillingness of the Court to act as moderator of state taxing jurisdiction either on a theory of legal doctrine or economic reasonableness finds its parallel in the current treatment of state taxes upon interstate commerce. Justices Black, Douglas, and Frankfurter are somewhat in advance of any practical majority combination on the Supreme Court in their view that state taxing power should remain unhampered unless and until Congress exercises its plenary power under the commerce clause for taxation as well as regulation.⁴⁴ But even here the recent *Best*⁴⁵ decision, which is a seeming qualification of the *Berwind-White*⁴⁶ case, serves notice that the Court has not forgotten the use of its ancient arsenal of doctrinal weapons to strike down a particularly outrageous extortion.

In the commerce clause cases there is a very clear and definite alternative to judicial control of state taxing power—the superior power of Congress itself.⁴⁷ In the jurisdictional field the alternative to judicial control is not as apparent. Obviously some authority must control our forty-eight independent taxing administrations, or else business must confine itself within Balkanized state boundaries—escaping multi-state taxation by the primitive method of keeping out of reach of foreign tax-collectors. That temporary, local self-interest is likely to prevail over long term national considerations in the absence of exertion of national authority is abundantly demonstrated by the recent growth of interstate economic barriers of all sorts.⁴⁸

Chief Justice Hughes, dissenting in the *Berwind-White* case, admitted the desirability of a comprehensive system of national taxation through state and federal cooperation.⁴⁹ While it is conceivable that such a scheme could be worked out among the several states by way of enactment of uniform laws or by interstate compact, as a practical matter, Congressional leadership is necessary, particularly if the solution is to be achieved in time to prevent an interregnum outbreak of crippling local taxes.

petuate the system by which large resident holdings of local corporate stock are taxed uniformly at the corporate level instead of progressively at the stockholder level. Dividend receipts are not taxable to Wisconsin residents if 50% of the corporation's net income was earned in Wisconsin. Obviously this exemption benefits only stockholders of local companies.

44. See Justice Black's dissenting opinions in *Adams Mfg. Co. v. Storen*, 304 U. S. 307, 316 (1938), and in *Gwin, White & Prince, Inc. v. Henneford*, 305 U. S. 434, 442 (1939); also the dissent of Black, Frankfurter, and Douglas, JJ., in *McCarroll v. Dixie Greyhound Lines*, 309 U. S. 176, 183 (1940).

45. *Best & Co. v. Maxwell*, 61 Sup. Ct. 334 (U. S. 1940). A tax which, *in form*, could have been sustained under the *Berwind-White* ruling was struck down as unduly discriminatory against interstate commerce in amount and practical effect.

46. *McGoldrick v. Berwind-White Coal Min. Co.*, 309 U. S. 33 (1940).

47. The commerce clause is, of course, essentially a grant of power to Congress and only incidentally, by judicial construction, a limitation on the states. U. S. CONST. Art. I, § 8(3).

48. Lockhart, *State Tax Barriers to Interstate Trade* (1940) 53 HARV. L. REV. 1253; Meyer, *State Barriers to Highway Transportation* (1940) 8 GEO. WASH. L. REV. 1070; Note (1938) 38 COL. L. REV. 1084.

49. *McGoldrick v. Berwind-White Co.*, 309 U. S. 33, 69 (1940).

Congress might find its Constitutional authorization in the almost forgotten last section of the Fourteenth Amendment,⁵⁰ which empowers Congress "to enforce, by appropriate legislation, the provisions of this article." On a practical level the same sanction to secure state cooperation might be employed as in the social security legislation⁵¹ — the imposition of heavy federal taxes upon corporate and personal incomes, with provision for refund of the proceeds to those states which bring their own tax systems into line with the federal plan.⁵²

In the wake of the Court's abdication from policing the jurisdiction-to-tax field temporary confusion is bound to result. The instant case confirms the trend toward abdication and increases the confusion. But judicial regulation has never been wholly satisfactory here and, in a backhanded way, this decision may be welcome because it makes the need for Congressional action more urgent and more obvious.

INDISPENSABILITY OF SUPERIOR OFFICERS IN SUITS AGAINST ADMINISTRATIVE OFFICIALS*

AMONG the various rules advanced by courts for refusing to interfere with administrative action, one of the most troublesome and difficult of application prescribes that a subordinate administrative officer will not be enjoined in the absence of a superior deemed to be an indispensable party to the suit. Adherence to the rule results in dismissal where the indispensable party is a non-resident who does not consent to be sued.¹ It is therefore of especial

50. U. S. CONST. AMEND. XIV, § 5. See restricted interpretation of this clause in Civil Rights Cases, 109 U. S. 3, 10-14 (1883); *In re Rahrer*, 140 U. S. 545, 555. But query whether these nineteenth century views on federal power would prevail today.

51. See *Carmichael v. Southern Coal Co.*, 301 U. S. 495 (1937); *cf. Massachusetts v. Mellon*, 262 U. S. 447 (1923).

52. Rodell, *supra* note 16, at 1181-1185.

* *Connecticut Importing Co. v. Perkins*, 35 F. Supp. 414 (D. Conn. 1940); *A. H. Belo Corp. v. Street*, 35 F. Supp. 430 (N. D. Tex. 1940).

1. If the superior is a non-resident, the court cannot acquire jurisdiction over his person unless he consents to suit or is served within the district. A second difficulty is presented by the general venue statute, 49 STAT. 1213 (1936), 28 U. S. C. § 112 (Supp. 1939), which provides that, except in diversity cases, the defendant may be sued only in his own district. While the defendant willing to be sued would ordinarily confer jurisdiction over his person by consent and waive his objection to venue, the requirements are distinct. Thus a defendant served within the district would still be able to object to venue.

The pragmatic distinction between necessary and indispensable parties is that the court cannot proceed without indispensable parties even if joining them divests it of jurisdiction. For a general exposition see 2 MOORE, *FEDERAL PRACTICE* (1938) 2133-2163. See also dissent of Mr. Justice Brandeis in *Pennsylvania v. West Virginia*, 262 U. S. 553, 616-618 (1923); Address of Charles E. Clark, *Proceedings of the American Bar Ass'n Institute at Washington, D. C., Oct. 6, 7, 8, 1938* (1939) 65.

importance in federal administrative law,² where a finding of indispensability may be used to limit suits against federal agencies to the District of Columbia, in which superior federal officers normally reside.³

The unwillingness of many federal courts to reach this severe result in practice has produced a penumbra of uncertainty about the indispensability rule, to which the Supreme Court has contributed in its two leading decisions on the doctrine. In 1924 in *Gnerich v. Rutter*⁴ the Court, after a long interval during which the rule had fallen into desuetude,⁵ revived it in holding that a suit to enjoin a local prohibition director from enforcing a withdrawal order authorized by regulations issued by the Commissioner of Internal Revenue should have been dismissed in the absence of the Commissioner, whose power to issue the regulations had been attacked.⁶ A year later, when the State of Colorado sued to enjoin the superintendent of the Rocky Mountain National Park from enforcing regulations issued by the Secretary of the Interior on the ground that their subject matter exceeded the authority ceded by the State, the Court held in *Colorado v. Toll*⁷ that the Secretary

2. For discussions of superior federal administrative officers as indispensable parties, see Alpert, *Suits Against Administrative Agencies Under N.I.R.A. and A.A.A.* (1935) 12 N. Y. U. L. Q. REV. 393, 405-411; (1937) 32 ILL. L. REV. 99; (1937) 37 COL. L. REV. 140; (1937) 4 U. OF CHI. L. REV. 342; (1937) 50 HARV. L. REV. 796. Perhaps because of the relatively greater convenience of suing state administrative superiors in their own districts, state litigation is infrequent. *McCarter v. Dungan*, 74 N. J. Eq. 251, 68 Atl. 1096 (Ch. 1908); *Castleman v. Rainey*, 211 S. W. 630 (Tex. Civ. App. 1919). One federal court decision on state officials found the superior indispensable. *Strutwear Knitting Co. v. Olson*, 13 F. Supp. 384 (D. Minn. 1936).

3. The official residence of the superior controls for the purposes of the venue statute. A suit attempted against the Secretary of Agriculture in his home district in Iowa was dismissed on this ground, on his objection to the venue. *Nesbitt Fruit Products v. Wallace*, 17 F. Supp. 141 (S. D. Iowa 1936). Of course, if suit were brought against the superior in the District of Columbia, and the subordinate were found indispensable, the latter could raise the same objections, lack of jurisdiction over his person and improper venue, thus rendering any judicial review impossible. But this argument does not seem to have been made.

4. 265 U. S. 388 (1924).

5. The Supreme Court applied the indispensability rule narrowly in *Warner Valley Stock Co. v. Smith*, 165 U. S. 28 (1897), refusing to order the issuance of a land patent or to enjoin trespasses by Government officials in the absence of the Secretary of the Interior. But between 1897 and *Gnerich v. Rutter* in 1924, injunctive relief was regularly granted against subordinates in the absence of superiors, without the point being raised either by courts or litigants. *American School of Magnetic Healing v. McAnnulty*, 187 U. S. 94 (1902); *Swigart v. Baker*, 229 U. S. 187 (1913); *Magruder v. Belle Fourche Valley Water Users Ass'n*, 219 Fed. 72 (C. C. A. 8th, 1914). A list of such cases is cited in the argument of appellant in *Webster v. Fall*, 266 U. S. 507, 508 (1925). In that case the Court, explaining that these earlier cases were not inconsistent with *Gnerich v. Rutter*, stated that "the point was in the cases if anyone had seen fit to raise it." It has been said that a court may raise the point *sua sponte*. *Alcohol Warehouse Corp. v. Canfield*, 11 F. (2d) 214, 216 (C. C. A. 2d, 1926). In *Gnerich v. Rutter* the issue was first raised in the circuit court of appeals.

6. 265 U. S. 388, 391 (1924).

7. 268 U. S. 228 (1925).

was not an indispensable party. Since the Court supplied no basis for distinguishing indispensability in the two cases and none of the distinctions attempted by lower courts has won general acceptance,⁸ the two holdings have acquired in some measure the status of alternative authorities. In a field where uniformity is important and *ad hoc* rulings least to be desired, the indispensability doctrine has become an obstacle, instead of a guide, to orderly litigation.

Much of the difficulty which judges have experienced with the rule may be traced to a lack of agreement over its origin and content. One learned federal judge confessed that he could "conjure up" no explanation for the rule better than the possibility that enjoining a subordinate without binding his superior might expose the subordinate to a crossfire between court and superior.⁹ Another supposed danger is that the superior might render the decree nugatory by appointing a different subordinate to perform the act enjoined.¹⁰ Both arguments appeal to unreality in view of the structure and habits of administrative agencies, which are hardly likely either to instruct subordinates to disregard court orders on pain of contempt, or to make changes in personnel merely to frustrate an injunction. Similarly, any fear that, absent the rule, federal agencies might be hamstrung by decrees entered without actual notice to superior officers seems imaginary. In practice, plaintiffs often join and serve the non-resident superior, who sometimes makes a special appearance to secure dismissal,¹¹ leaving the subordinate to argue the indispensability issue before the tribunal.¹²

8. The opinion in *Colorado v. Toll* does not mention *Gnerich v. Rutter*. The Ninth Circuit Court of Appeals, after purporting to limit *Colorado v. Toll* to cases where state power is at issue (*Moore v. Anderson*, 68 F. (2d) 191, 195 (C. C. A. 9th, 1933)), later extended it to cases where superior and subordinate were acting beyond the authority conferred on them by statute. *Berdie v. Kurtz*, 75 F. (2d) 898 (C. C. A. 9th, 1935); *Hill v. Darger*, 76 F. (2d) 198 (C. C. A. 9th, 1935), *aff'g*, 8 F. Supp. 189 (S. D. Cal. 1934). The Fourth Circuit Court of Appeals has similarly intimated that *Colorado v. Toll* would govern in an attack on an unconstitutional statute or unauthorized act. *Ferris v. Wilbur*, 27 F. (2d) 262 (C. C. A. 4th, 1928). The act complained of in *Gnerich v. Rutter* was, however, alleged to be unauthorized. The Fifth Circuit Court of Appeals appears to have followed both rules. *Cf. Rood v. Goodman*, 83 F. (2d) 28 (C. C. A. 5th, 1936); *Ryan v. Amazon Petroleum Corp.*, 71 F. (2d) 1 (C. C. A. 5th, 1934), *rev'd on other grounds sub nom. Panama Refining Co. v. Ryan*, 293 U. S. 388 (1935); *Yarnell v. Hillsborough Packing Co.*, 70 F. (2d) 435 (C. C. A. 5th, 1934). See also *Carr v. Desjardines*, 16 F. Supp. 346 (W. D. Okla. 1936); *Consolidated Gas Co. v. Hardy*, 14 F. Supp. 223 (S. D. N. Y. 1936); *Wheeler v. Farley*, 7 F. Supp. 433 (S. D. Cal. 1934).

9. Learned Hand, J., in *National Conference on Legalizing Lotteries v. Goldman*, 85 F. (2d) 66 (C. C. A. 2d, 1936), (1937) 4 U. OF CHI. L. REV. 342.

10. *Alcohol Warehouse Corp. v. Canfield*, 11 F. (2d) 214, 215 (C. C. A. 2d, 1926).

11. This common procedure was adopted in one of the principal cases. *Connecticut Importing Co. v. Perkins*, 35 F. Supp. 414, 416 (D. Conn. 1940).

12. Objection to the non-joinder of an indispensable party may, under the Federal Rules of Civil Procedure, be made before trial under Rule 12(b) and 12(d), either by motion to dismiss or by answer and preliminary hearing. Or a motion may be made under Rule 21 for an order requiring the indispensable person to be made a party, dismissal to be granted if the party cannot be brought into court. Notes, 2 FED. RULES

The real vitality of the rule is to be found, not in its jurisdictional aspect, but in the fact that it may enable courts to repel plaintiffs who are seeking to obtain untimely or otherwise improper relief from administrative action. Thus it may be used to implement policies sanctioned by other rules. A finding of indispensability may serve as a substitute for the final order rule,¹³ by inhibiting interference with a subordinate who is performing an investigatory function preliminary to the administrative action which the plaintiff seeks to prevent.¹⁴ Or the superior may be said to be indispensable in the sense that the plaintiff has not exhausted his administrative remedies within the agency. Thus, the rule has been invoked to avoid restraining a regional director for the National Labor Relations Board from taking testimony or proceeding with a hearing before a trial examiner.¹⁵ Or it may be held that the Attorney General is indispensable to a suit to enjoin actions under a statute which he is directed to enforce,¹⁶ although the suit might properly be dismissed on other grounds.¹⁷

But, despite the fact that application of the indispensability rule may incidentally lead to a desirable result in certain situations, the rule itself is both confusing and unnecessary when applied in conjunction with, or in

SERV. (1940) 658; *Massachusetts Farmers' Defense Com. v. United States*, 26 F. Supp. 941 (D. Mass. 1939). For procedure under the old practice, see *Krouse v. Brevard Tannin Co.*, 249 Fed. 538, 544 (C. C. A. 4th, 1918).

13. The final order rule, which is the administrative analogue of the final judgment rule in appeals from courts, prescribes that judicial review of administrative action may be had only when the administrative process has been completed with regard to the individual complainant, thus excluding review of interlocutory orders and mere declarations of status. The authoritative statement of finality for the purposes of judicial review, supplanting the old dichotomy of "negative" and "affirmative" orders, is contained in *Rochester Tel. Corp. v. United States*, 307 U. S. 125 (1939).

14. For a consideration of the relation between the final order rule and the indispensability rule, see *Bradley Lumber Co. v. NLRB*, 84 F. (2d) 97 (C. C. A. 5th, 1936); cf. *Bethlehem Shipbldg. Corp. v. Nylander*, 14 F. Supp. 201 (S. D. Cal. 1936).

15. *Bradley Lumber Co. v. NLRB*, 84 F. (2d) 97 (C. C. A. 5th, 1936). The administrative remedies to which plaintiff is limited include raising his objection at a hearing before the trial examiner, objecting to the intermediate report rendered before the final decision by the Board, and objecting in the circuit court of appeals when the Board applies for enforcement of its order. *Myers v. Bethlehem Shipbldg. Corp.*, 303 U. S. 41 (1938); *Sanco Piece Dye Works v. Herrick*, 33 F. Supp. 80 (S. D. N. Y. 1940); cf. *Chester C. Fosgate Co. v. Kirkland*, 19 F. Supp. 152 (S. D. Fla. 1937). See Berger, *Exhaustion of Administrative Remedies* (1939) 48 YALE L. J. 981.

16. *Appalachian Elec. Power Co. v. Smith*, 67 F. (2d) 451 (C. C. A. 4th, 1933); cf. *Consolidated Gas Co. v. Hardy*, 14 F. Supp. 223 (S. D. N. Y. 1936).

17. One ground might be that contesting the proceedings when brought would provide an adequate remedy at law, a result related to the exhaustion rule. *Federal Trade Comm. v. Claire Furnace Co.*, 274 U. S. 160 (1927); *John Blood & Co., Inc. v. Madden*, 15 F. Supp. 779 (E. D. Pa. 1936); see note 15 *supra*; cf. *Chicago Bd. of Trade v. Olsen*, 262 U. S. 1 (1923). A declaratory judgment on the constitutionality of a statute may be refused against the Attorney General on the theory that it will not be presumed that he will attempt the enforcement of an unconstitutional statute, and that therefore no case or controversy exists. *Southern Pacific Co. v. Conway*, 115 F. (2d) 746 (C. C. A. 9th, 1940).

lieu of, these independent requirements for judicial relief. That its application may lead to equivocal results is illustrated in two recent cases¹⁸ involving petitions for declaratory judgments under the Fair Labor Standards Act.¹⁹ In *Connecticut Importing Co. v. Perkins*,²⁰ a wholesale liquor dealer sought a declaratory judgment that he was not engaged in interstate commerce and hence not subject to the Act. His complaint alleged that the Administrator of the Wage & Hour Division of the Department of Labor had issued an "interpretive bulletin"²¹ stating that wholesalers purchasing goods from other states for intrastate sale fell within the purview of the Act, and that agents of the Division had investigated his business and had advised him to comply with the Act. Named as defendants were the Administrator, the Secretary of Labor, the Connecticut Commissioner of Labor and his deputy, and the federal attorney in the district. The Secretary of Labor and the Administrator were granted dismissals as non-residents, the Connecticut state officials because they had no authority to enforce the Act.²² The issue then posed was whether any relief should be granted against the district attorney, in the absence of the officials dismissed and of the Attorney General. The court held that the superiors were not indispensable to relief, and that if the plaintiff on amendment could show that the district attorney had made any threats to prosecute, it would grant a declaration on the merits.

In the case of *A. H. Belo Corp. v. Street*,²³ a newspaper publisher sought a similar declaration that he was not in interstate commerce and hence not subject to the Act, naming the regional director as a defendant. It was alleged that the director had threatened to proceed against the plaintiff through a class suit as representative of the plaintiff's employees,²⁴ and also to take steps to enforce the Act in his official capacity.²⁵ On the former ground the court held that relief could be granted against the director personally in the absence of his superiors. But it was held that no attack could be made on him in his official capacity in the absence of the Administrator and the Attorney General as indispensable parties.

18. *Connecticut Importing Co. v. Perkins*, 35 F. Supp. 414 (D. Conn. 1940); *A. H. Belo Corp. v. Street*, 35 F. Supp. 430 (N. D. Tex. 1940).

19. 52 STAT. 1060 (1938), 29 U. S. C. § 201 *et seq.* (Supp. 1939).

20. 35 F. Supp. 414 (D. Conn. 1940).

21. Wage & Hour Admin'r of the Dep't of Labor, Interpretative Bulletin No. 5, Dec. 12, 1938.

22. "The Administrator may establish and utilize such regional, local, or other agencies, and utilize such voluntary and uncompensated services, as may from time to time be needed." 52 STAT. 1061 (1938), 29 U. S. C. § 204 (Supp. 1939).

23. 35 F. Supp. 430 (N. D. Tex. 1940).

24. Employees may sue on their own behalf or through a designated agent for their unpaid minimum wages, plus an equal sum in liquidated damages. 52 STAT. 1069 (1938), 29 U. S. C. § 216(b) (Supp. 1939).

25. By recommending enforcement action to the Administrator. An action by the Administrator to restrain plaintiffs was pending in the same court. The technical disposition of the principal case was to overrule the director's motion to dismiss, and transfer the case for trial with the administrator's action. *Aetna Casualty & Surety Co. v. Quarles*, 92 F. (2d) 321 (C. C. A. 4th, 1937). This fortuitous result did not affect the court's position on indispensability.

Viewed as attempts to define the concept of indispensability, the decisions are irreconcilable. In the *Connecticut Importing Co.* case, even though the plaintiff was seeking to test the validity of a regulation issued by the superior, the latter was held not to be an indispensable party. In the *Belo* case, on the other hand, where the only action alleged had been taken by the subordinate and it did not appear that his superiors had either taken any action or were threatening any, the superiors were held to be indispensable parties. The Connecticut court proceeded on the theory that relief against a subordinate should not be denied merely because it was incomplete in not binding the superior.²⁶ This proposition, that the plaintiff should be given what he asks from any official party defendant he chooses, is logically a denial of any effect whatever to the indispensability rule.²⁷ The Texas court at the other extreme supposed that the superior was indispensable to any action against the subordinate in his official capacity.²⁸

The actual problem in both cases was not whether all the interested parties were before the court, but whether at a given stage in the administrative process the plaintiffs could secure a judicial interpretation of their status under the Act. The problem would have remained if all the superiors named were within the jurisdiction of the court and had been made parties to the suit. It would seem that review was untimely in the *Connecticut Importing Co.* case unless the plaintiff could show, not merely that the district attorney had threatened to prosecute him, but that there was some reason why he should not be compelled to present his defenses in that prosecution, either for an injunction against violation of the Act²⁹ or for criminal penalties.³⁰ In the *Belo* case, although the effect of the decision was to deny the plaintiff a declaratory judgment, the reasoning of the court depended entirely on the absence of the superiors of the regional director, implying that relief would have been proper in their presence. Yet this inference seems unjustified. The Fifth Circuit Court of Appeals, in which the *Belo* case arose, has denied review of an administrative regulation under the same Act in a similar case on the ground that a test prosecution afforded the plaintiff an adequate remedy, after explicitly rejecting the argument that the Administrator was indispensable.³¹ This result would seem to follow *a fortiori* when the plaintiff was not attacking a specific regulation. In both the *Connecticut Importing Co.* and the *Belo* cases, then, it would seem that there were adequate grounds for denying relief regardless of the parties the plaintiff brought before the

26. *Connecticut Importing Co. v. Perkins*, 35 F. Supp. 414, 417 (D. Conn. 1940).

27. Any decree entered will, of course, bind the individual defendant, and so provide some measure of relief. But the incompleteness of the relief is one of the elements of the indispensability rule. *Alcohol Warehouse Corp. v. Canfield*, 11 F. (2d) 214, 215 (C. C. A. 2d, 1926).

28. *A. H. Belo Corp. v. Street*, 35 F. Supp. 430, 432 (N. D. Tex. 1940).

29. 52 STAT. 1069 (1938), 29 U. S. C. § 217 (Supp. 1939).

30. 52 STAT. 1069 (1938), 29 U. S. C. § 216 (Supp. 1939).

31. *Janes v. Lake Wales Citrus Growers Ass'n*, 110 F. (2d) 653 (C. C. A. 5th, 1940). This case was cited in the *Belo* opinion to support indispensability. Compare *Redlands Foothill Groves v. Jacobs*, 30 F. Supp. 995 (S. D. Cal. 1940) with the holding in the *Belo* case.

court, and that statement of the results in terms of the indispensability rule was misleading and unnecessary.

If, on the other hand, the plaintiff can show all the requisites for review of an administrative action, the practical problem posed by the indispensability rule is whether or not he shall be required to seek relief in the District of Columbia. Efforts to relax the rule to accommodate particular plaintiffs have produced no coherent limitations. One criterion which might be simple of administration, but which rests on little support in the cases, is that the superior should be indispensable only when the relief requires affirmative action on his part, such as the granting of a license or the disbursement of funds.³² A more familiar judicial pronouncement is that if the subordinate is acting beyond his statutory or constitutional authority, he may be attacked in the absence of his superior.³³ This doctrine may be used in any of three instances, often indistinct in practice. If the subordinate is acting without warrant of law, he may of course be in the position of a private tortfeasor.³⁴ Or the plaintiff may complain that the subordinate is acting on the basis of a regulation which was beyond the superior's authority under the statute.³⁵ Finally, the plaintiff may attack the constitutionality of the statute under which superior and subordinate alike are operating.³⁶ The rationale of this limitation is derived from the independent rule that, unless the plaintiff alleges that the official sued is acting beyond his statutory or constitutional authority, the suit is one against the sovereign and hence not maintainable without his consent.³⁷ But there is no reasonable connection between the dispensability of the sovereign and of the superior. The former is a dogmatic prerequisite to any judicial relief.³⁸ The latter is a question of judicial policy resting on

32. This criterion is suggested and criticized in (1937) 50 HARV. L. REV. 796. Historically, it is interesting in view of the opinion in *Guerich v. Rutter*, where the principal authority relied on was the case of *Vernon v. Blackerby*, 2 Atk. 151 (Ch. 1740). In this suit to compel the treasurer of a church building commission to pay a clergyman his benefice, relief was denied by Lord Hardwicke in the absence of the commissioners, without whose warrant the money could not be paid. It appeared that the fund had been invested in lands, so that the subordinate would have been physically as well as legally unable to obey a decree.

33. Since this is the point to be decided, the circularity of this test is apparent. "This is not a bill to cancel the Secretary's regulations, but only to test their efficacy to protect defendants in their alleged trespasses against complainants' rights." Hence, the Secretary is not indispensable. *Ryan v. Amazon Petroleum Corp.*, 71 F. (2d) 1, 4 (C. C. A. 5th, 1934), *rev'd on other grounds sub nom. Panama Refining Co. v. Ryan*, 293 U. S. 388 (1935); *cf. Carr v. Desjardines*, 16 F. Supp. 346 (W. D. Okla. 1936).

34. See *Moore v. Anderson*, 68 F. (2d) 191, 195 (C. C. A. 9th, 1933); *Castleman v. Rainey*, 211 S. W. 630 (Tex. Civ. App. 1919).

35. *Berdie v. Kurtz*, 75 F. (2d) 898 (C. C. A. 9th, 1935); *Yarnell v. Hillsborough Packing Co.*, 70 F. (2d) 435 (C. C. A. 5th, 1934).

36. *Ryan v. Amazon Petroleum Corp.*, 71 F. (2d) 1 (C. C. A. 5th, 1934), *rev'd on other grounds sub nom. Panama Refining Co. v. Ryan*, 293 U. S. 388 (1935); *cf. Webster v. Fall*, 266 U. S. 507 (1925).

37. *Philadelphia Co. v. Stimson*, 223 U. S. 605 (1912); *Whitehead v. Cheves*, 67 F. (2d) 316 (C. C. A. 5th, 1933).

38. See the discussion of sovereign immunity in *United States v. Lee*, 106 U. S. 196 (1882); *Carr v. United States*, 98 U. S. 433 (1878).

practical and equitable considerations. A limitation which says, in effect, that the more fundamental the attack on the agency, the less necessity there is to make it on a superior official, seems from the viewpoint of policy both meaningless and undesirable.

A more direct solution to the problems created by the indispensability rule has been suggested in connection with the review of postal fraud orders. These orders, issued by the Postmaster General to deny the facilities of the postoffice to persons using the mail for fraudulent purposes, are often attacked by injunction suits against local postmasters, to restrain them from carrying out the order by returning plaintiffs' mail, stamped fraudulent, to the senders.³⁹ The propriety of this form of review is doubtful under *Gnerich v. Rutter*, the Second Circuit Court holding the Postmaster General indispensable⁴⁰ and the Fifth Circuit Court the contrary.⁴¹ District courts have split on differing theories of indispensability.⁴² A critic of these holdings has suggested that a practical escape from the dilemma would be a statutory provision placing the venue of fraud order reviews in the plaintiff's district.⁴³

The simplicity of this solution suggests its extension to all reviews of federal administrative action. A general provision, designed to remove objections both to venue and to personal jurisdiction,⁴⁴ would enable the plaintiff to join all the officials involved. This would be in harmony with the policy of Congress, expressed in provisions for statutory review of administrative bodies, to regulate the venue of review with regard to the convenience of the individuals affected.⁴⁵ For the inconvenience to a plaintiff maneuvered

39. An injunction against a local postmaster was sustained on the merits in *American School of Magnetic Healing v. McAnnulty*, 187 U. S. 94 (1902). See (1937) 4 U. OF CHI. L. REV. 342.

40. *National Conference on Legalizing Lotteries v. Goldman*, 85 F. (2d) 66 (C. C. A. 2d, 1936).

41. *Rood v. Goodman*, 83 F. (2d) 28 (C. C. A. 5th, 1936).

42. *Bailey Gaunce Oil & Refining Co. v. Duncan*, 10 F. Supp. 280 (W. D. La. 1934) (Postmaster General not indispensable; local postmaster analogized to sheriff attempting to execute a null judgment); *Wheeler v. Farley*, 7 F. Supp. 433 (S. D. Cal. 1934), *appeal dismissed for want of jurisdiction*, 293 U. S. 526 (1934) (Postmaster General indispensable); *Consolidated Gas Co. v. Hardy*, 14 F. Supp. 223 (S. D. N. Y. 1936) (Postmaster General not indispensable to suit to enjoin local postmaster from excluding letters declared unavailable by Public Utility Holding Company Act).

43. (1937) 4 U. OF CHI. L. REV. 342, 344.

44. See note 1 *supra*. While venue is distinct from jurisdiction of the person, a statute fixing the venue of suit in a district other than that of the defendant's residence is held to imply power to serve extraterritorial process, for otherwise the provision would be nugatory. Power to issue extraterritorial process was inferred from statutes providing that a national bank could sue the Comptroller of the Currency in its own district, and restricting the place of suit by the United States on a contract bond to the place of performance of the contract. *First Nat. Bank v. Williams*, 252 U. S. 504, 510 (1920); *United States v. Congress Const. Co.*, 222 U. S. 199 (1911); *cf. Robertson v. Railway Labor Bd.*, 268 U. S. 613 (1925); *Farmers Union Supply Co. v. Colorado & S. Ry.*, 25 F. Supp. 923 (N. D. Tex. 1939).

45. The Fair Labor Standards Act, for example, provides for review of wage orders in the circuit court of appeals of the circuit in which the petitioner lives or does business.

by indispensability into litigating in Washington is obviously great. With the present numbers and availability of Government counsel, on the other hand, there would be no corresponding disadvantage to the administrative body if its superior official were joined as a party defendant in the plaintiff's district. An alternative method of reaching the same result might be statutory elimination of the indispensability rule by prescribing that review could be had against subordinates above a specified rank. Besides the difficulty of drafting a statute applicable to the varied administrative hierarchies, this method would be undesirable unless it provided superiors with adequate notice and opportunity to intervene when their actions were challenged through their subordinates.⁴⁶

Whether the indispensability rule is eliminated altogether, or its practical hardships are removed by a simple procedural reform, the effect would be freedom from a puzzling and useless hindrance to litigation. While indispensability may at present serve as a convenient means of denying improper review of administrative action, whatever accidental results it achieves in this direction can be safeguarded by the application of other, well-understood rules. As the principal cases show, indispensability is in itself either an unnecessary or insufficient protection. Its elimination, by compelling courts to rely on well-defined reasons for denying review, should help in the important task of clarifying the relations between administrative agencies and courts.

CATHOLIC SCHOOLS AND PUBLIC MONEY*

THE constitutions of forty-six of the United States, thirty-seven of them by explicit reference to sectarian institutions, prohibit the appropriation of public money to schools controlled by religious organizations. Coincidentally, scattered across most of these states by 1937 were at least 340 Catholic schools supported substantially by direct appropriation of public funds. The legal and political synthesis of these disparate elements is the work of a determined minority, frankly bent on securing from government as much support as possible of some 7,500 Catholic elementary and secondary schools.

The techniques which are making the Catholic cause a successful one are exemplified in a recent Indiana supreme court decision which opens the way in that state to a wide measure of public finance for Catholic education.¹ Served with notice that parochial schools enrolling some 800 students would be unable to continue in operation, the public school authorities of Vincennes, Indiana, entered into an arrangement with Catholic authorities involving the

52 STAT. 1065 (1938), 29 U. S. C. §210 (Supp. 1939). Orders of the NLRB may be reviewed where the petitioner lives or does business, or where the subject matter arose. 49 STAT. 453 (1935), 29 U. S. C. §160(f) (Supp. 1939). For a collection of similar statutory provisions see (1937) 32 ILL. L. REV. 99, nn. 10, 11.

46. The Attorney General must in any event be notified of attacks on the constitutionality of a federal statute. 50 STAT. 752 (1937), 28 U. S. C. §380a (Supp. 1939).

* State *ex rel.* Johnson v. Boyd, 28 N. E. (2d) 256 (Ind. Sup. Ct. 1940).

1. State *ex rel.* Johnson v. Boyd, 28 N. E. (2d) 256 (Ind. Sup. Ct. 1940).

payment by the municipality of the salaries of Catholic instructors in return for continued operation of the schools by the church.² The arrangement was challenged by a taxpayers' suit to recover on school treasurers' bonds the salaries paid under the agreement. The Indiana constitution provides: "No money shall be drawn from the treasury, for the benefit of any religious or theological institution."³

Without a dissent the court analyzed the elements involved, approved a conclusion of law that the schools are "public" and not "parochial," and sustained the lower court in favor of defendants.⁴ In constructing its conclusion that the schools are not "religious or theological institutions" the court minimized the following facts: (1) only Catholic children attend; (2) all teachers are members of Catholic religious orders and wear the characteristic habit of their orders; (3) the crucifix, holy water, and a picture of the Holy Family are furnished each room; (4) religious instruction, upon which all children voluntarily attend, is given each morning for a half hour before the official opening of school.⁵ On the critical issue of control, alleged to be in the Catholic Bishop through the clerical government of the church, the lower court made no finding of fact. The payment of salaries by the public school board, the certification of the Catholic teachers by state authorities, and the employment of a curriculum parallel to that of the public schools were found sufficient to sustain the arrangement.⁶

2. Four schools were involved in the original agreement of 1933, one of them a high school which was subsequently closed. The course of study pursued and textbooks used were to conform to the public school curriculum. No sectarian instruction was to be given in school hours. The buildings were furnished and maintained by the Church. Only Catholic instructors were selected to teach in the three schools covered by the agreement. All, however, were licensed by the state education authority.

3. IND. CONST., Art. I, § 6.

4. No analysis was made of quite probable benefit to an admittedly religious institution, the local Church, through continued operation of the schools without interruption of their religious program.

5. No consideration was given to the total effect of these religious influences on the minds of children. Each element was analyzed separately and found insufficient, by itself, to constitute the school a Catholic school. In its discussion of judicial opinion regarding the effect of sectarian costume on the denominational character of the school, the court relied on *Hysong v. Gallitzin School Dist.*, 164 Pa. 629, 30 Atl. 482 (1894). The year after this decision minimized the effect of sectarian costume, Pennsylvania by statute forbade the wearing of religious costume in the schools. PURDON'S PA. STAT. (1930) tit. 24, §§ 1129, 1130, upheld in *Commonwealth v. Herr*, 229 Pa. 132, 78 Atl. 68 (1910). Similar statutes are in force in Oregon and Nebraska. NEBR. SCHOOL LAWS (1929) § 79-1417; ORE. CODE (1930) § 35-2406. See *O'Connor v. Hendrick*, 184 N. Y. 421, 77 N. E. 612 (1906) (prohibiting religious costume in the schools). See also JOHNSON, CHURCH-STATE RELATIONSHIPS IN THE UNITED STATES (1934) 205-212; LISCHKA, PRIVATE SCHOOLS AND STATE LAWS (1926) 31.

6. Since the payment of salaries by public officials is the act at issue it is difficult to see the logic of its use as a justification for the decision: if payment is legal because payment has been made, no question may ever be raised. A teacher's certificate, moreover, goes only to the question of ability to teach. IND. STAT. ANN. (Burns, 1933) tit. 28, § 4207. It is irrelevant to the issue of the religious or sectarian content of the matters

Although the Indiana decision is more sweeping in its approval of Catholic education at public expense than that of any other court to date, the problem with which it deals is not new to American education.⁷ The heterogeneous character of American religious belief has exercised a determinative influence on the policy of free public instruction since the origin of truly public schools in the second quarter of the nineteenth century.⁸ Since education implies philosophical orientation, control of that orientation is a consummation devoutly to be wished by every religious sect. The advent of education by the state precipitated, therefore, a contest for sectarian control which attained equilibrium only through compromise: public education would be secular.⁹ Protestant religious education retired to the church, a sprinkling of private schools supported by church groups, and the sectarian colleges.¹⁰ But for a Catholic the compromise was unacceptable; non-religious education is a contradiction in Catholic terms.¹¹ As a politically negligible minority in most states the Catholic group was forced to continue its own schools, as did many Protestant sects.¹² Between 1830 and 1890, however, heavy Catholic immigration redressed the balance sharply, and as early as 1840 in New York efforts were made to obtain public funds for Catholic education.¹³ The continuance of such efforts, coinciding often with periodic waves of anti-Catholic sentiment

taught. Nor does the fact of curriculum parallel to that employed in public schools relieve the Catholic teacher of an obligation to interpret that curriculum according to the tenets of his faith.

7. GABEL, *PUBLIC FUNDS FOR CHURCH AND PRIVATE SCHOOLS* (1937); CONFREY, *SECULARISM IN AMERICAN EDUCATION* (1931); JOHNSON, *CHURCH-STATE RELATIONSHIPS IN THE UNITED STATES* (1934); EDWARDS, *THE COURTS AND THE PUBLIC SCHOOLS* (1933); LISCHKA, *PRIVATE SCHOOLS AND STATE LAWS* (1926); BILLINGTON, *THE PROTESTANT CRUSADE, 1800-1860* (1938); WILLIAMS, *THE SHADOW OF THE POPE* (1932).

8. The best brief summary of the development and extent of sectarian education in the United States is Niebuhr, *Sectarian Education*, 5 *ENCYC. SOC. SCI.* 421 *et seq.* (1931). See also GABEL, CONFREY, and JOHNSON, *op. cit. supra* note 7.

9. Niebuhr, *loc. cit. supra* note 8.

10. Forty-two religious denominations other than the Roman Catholic today support private elementary schools in the United States, but 90% of such schools are Catholic. The only substantial group aside from the Catholic is the Lutheran, which enrolls 67,124 pupils. Catholic elementary school enrollment is set at 1,630,120 by the latest government statistics. In the non-Catholic high school field only the Episcopalians today support an appreciable number of institutions—90—although most of the other Protestant denominations conduct a few high schools. There are 1,715 Roman Catholic secondary schools, enrolling 197,712 students. 2 *BIENNIAL SURVEY OF EDUCATION, 1934-6* (U. S. Office of Educ. 1939) *passim*. In the field of higher education, Protestant denominations maintain 259 colleges or universities, 5 normal schools, 1 teachers' college, and 109 junior colleges. There are 134 Roman Catholic colleges, 4 teachers' colleges, 5 normal schools, and 39 junior colleges. *EDUC. DIRECT.* (U. S. Dep't of Int. 1939) 6.

11. POPE PIUS XI, *CHRISTIAN EDUCATION OF YOUTH* (Encyclical, 1930) 24, 25, 30-1, 35-6. See LIPPMANN, *A PREFACE TO MORALS* (1929) 77.

12. There were at least 200 parish schools in the United States by 1840. Hagan, *Catholic Education and the Elementary School* in *VITAL PROBLEMS OF CATHOLIC EDUCATION* (1939) 61.

13. *Id.* at 62. See also GABEL, *PUBLIC FUNDS FOR CHURCH AND PRIVATE SCHOOLS* (1937) 348-470.

which swept over America between 1830 and 1928, persuaded citizens in almost every state that the intersectorian compromise was safe only if embodied in explicit constitutional provision.¹⁴ Amendment of those state constitutions which lacked the necessary limitation closely followed the rise to power of the first important anti-Catholic political party in 1835.¹⁵

By 1938 only Vermont lacked at least one constitutional provision capable of limiting the grant of public funds for Catholic, or other sectarian, education.¹⁶ The phraseology of the provisions varies, but seven generic types are distinguishable:¹⁷ prohibition (1) against the use of public school funds for any purpose other than the support of common schools;¹⁸ (2) against any grant or appropriation of money, property, or credit of the state to educational institutions not under the exclusive control of the state;¹⁹ (3) upon the appropriation of public funds for any sectarian purpose, society, or institution;²⁰ (4) denying state aid to educational institutions controlled by

14. See WILLIAMS, *THE SHADOW OF THE POPE* (1932) *passim*.

15. Five states had constitutional provisions capable of limiting the appropriations of public funds to Catholic—or other non-public—schools before 1840. Three more states enacted them in the 1840's, eight between 1850-1860, six in 1860-1870, ten between 1870-1880, seven in the decade 1880-1890, three more between 1890-1900, four more by 1911. The other states, except Maryland and Vermont, have restrictions which indirectly limit public funds. Maryland courts, in the absence of express constitutional restriction, decided in 1876 that private charitable institutions, by implication of the definition of funds as "public," are unable to share therein. *St. Mary's Industrial School v. Brown*, 45 Md. 310 (1876). Vermont, alone, lacks a constitutional provision or a judicial limitation. Provisions are cited and classified at notes 18-25 *infra*.

16. In no provision is the Catholic church specifically named, and in no case has it been questioned that non-Catholic denominations are equally excluded from public support. The present survey is concerned, however, only with the impact of these provisions upon Catholic education since, as has already been suggested, sectarian schools of other denominations are so few as to be of negligible importance, and pressure on public funds is largely Catholic.

17. The most workable classification which has been made is that of Kindred, *Public Funds for Private and Parochial Schools* (unpublished thesis in University of Michigan Library, 1938). It has been followed below in preference to those of GABEL, CONFREY, and LISCHKA, *op. cit. supra* note 7. An adequate compilation of state constitutions is *New York Const. Conv. Committee, CONSTITUTIONS OF THE STATES AND UNITED STATES* (1938).

18. Constitution of: Arkansas, Art. XIV, § 2; Connecticut, Art. VIII, § 2; Delaware, Art. X, § 4; Florida, Art. XII, § 13; Indiana, Art. VIII, § 3; Iowa, Art. IX, par. 2, § 3; Kansas, Art. VI, § 3; Massachusetts, Amend. XLVI, § 2; Nebraska, Art. VII, § 9; New Jersey, Art. IV, § 7, par. 6; North Carolina, Art. IX, § 4; Rhode Island, Art. XII, § 4; South Dakota, Art. VIII, § 3; Tennessee, Art. XI, § 12; Texas, Art. VII, § 5; West Virginia, Art. XII, § 4.

19. Constitution of: Alabama, Art. IV, § 73; California, Art. IX, § 8, Art. IV, § 22; Colorado, Art. V, § 34; Massachusetts, Amend. XLVI, § 2; Montana, Art. V, § 35; North Dakota, Art. VIII, § 152; Pennsylvania, Art. III, § 17; Virginia, Art. IX, § 141.

20. Constitution of: Arizona, Art. II, § 12; California, Art. IV, § 30; Colorado, Art. V, § 34 and Art. IX, § 7; Florida, Dec. of Rights, § 6; Georgia, Art. I, § 1, par. 14; Idaho, Art. IX, § 5; Illinois, Art. VIII, § 3; Indiana, Art. I, § 6; Louisiana, Art. IV, § 8; Michigan, Art. II, § 3; Minnesota, Art. I, § 16; Missouri, Art. II, § 7; Montana, Art. V, § 35; Nevada, Art. XI, § 10; Oklahoma, Art. II, § 5; Oregon, Art. I, § 5; South

a sectarian denomination;²¹ (5) denying state aid to sectarian schools;²² (6) denying state aid to private schools;²³ (7) upon appropriations of public money for any school in which a sectarian doctrine is taught.²⁴ There are, in addition, miscellaneous groups of provisions,²⁵ as well as statutes in some of the forms suggested.²⁶

As a statement of public policy the abundance of these limitations is impressive. As an obstacle to the support of Catholic schools by the state it is less so. Many arteries are left unsutured. Attempts to amend the Federal Constitution to prevent use of public funds for schools which teach sectarian doctrine have been successfully resisted.²⁷ Appropriations for the National Youth Administration,²⁸ as well as certain Indian tribal and treaty funds,²⁹

Dakota, Art. VI, § 3; Texas, Art. I, § 7; Utah, Art. I, § 4; Washington, Art. I, § 11; Wisconsin, Art. I, § 18; Wyoming, Art. I, § 19.

21. Constitution of: California, Art. IV, § 30; Colorado, Art. IX, § 7; Idaho, Art. IX, § 5; Illinois, Art. VIII, § 3; Missouri, Art. XI, § 11; Montana, Art. XI, § 8; New York, Art. IX, § 4; South Carolina, Art. XI, § 9; Utah, Art. X, § 13; Washington, Art. IX, § 4; Wyoming, Art. VII, § 8.

22. Constitution of: Alabama, Art. XIV, § 263; Arizona, Art. IX, § 10; California, Art. IX, § 8; Delaware, Art. X, § 3; Florida, Art. XII, § 13; Kentucky, § 189; Louisiana, Art. XII, § 13; Mississippi, Art. VIII, § 208; New Hampshire, Part II, Art. 83; New Mexico, Art. XII, § 3; North Dakota, Art. VIII, § 152; Pennsylvania, Art. X, § 2; South Dakota, Art. VIII, § 16; Texas, Art. VII, § 5.

23. These, like groups (1) and (2), do not affect sectarian schools alone and would operate restrictively also against schools set up to foster any non-religious political or social belief or program. See constitutions of: California, Art. IX, § 8; Louisiana, Art. XII, § 13; Arizona, Art. IX, § 10; New Mexico, Art. XII, § 3.

24. Constitutions of: Massachusetts, Amend. XLVI, § 2; Minnesota, Art. VIII, § 3; New York, Art. IX, § 4; Nebraska, Art. VII, § 11; South Dakota, Art. VIII, § 16; Idaho, Art. IX, § 6.

25. The constitution of South Dakota, Art. VIII, § 16, forbids acceptance by the state of bequests for sectarian purposes. Those of Ohio, Art. VI, § 2, Kansas, Art. VI, § 8, and Mississippi, Art. VIII, § 208, prohibit control of educational funds by a religious sect. See ME. CONST., Art. VIII. Clauses regulating finances of state institutions in which schools may be taught as a part of a corrective or charitable program are also to be found. See Kindred, *Public Funds for Private and Parochial Schools* (unpublished thesis in Univ. of Michigan Library, 1938) 15-18; GABEL, *PUBLIC FUNDS FOR CHURCH AND PRIVATE SCHOOLS* (1937) 537-549.

26. GABEL, *loc. cit. supra* note 25, found 16 states with such statutes in 1937.

27. President Grant in his message to Congress in 1875 recommended an amendment forbidding the teaching of sectarian doctrines in any school supported wholly or in part by public money. 4 CONG. REC. (part 1) 175, 181 (1875). James G. Blaine introduced a bill to this effect and the issue became one in the campaign of 1876. The bill failed to pass Congress. 4 CONG. REC. (part 6) 5190, 5580, 5595 (1876).

28. WPA appropriations are also available to sectarian institutions. It may, of course, be argued that NYA funds are an aid to the pupil, not the school; but by affording such schools clerical and even manual labor and by placing them in a better position to compete with public schools insofar as student-aid funds are concerned these grants directly aid Catholic schools. Students in all tax-exempt private institutions are eligible for NYA assistance. See JOHNSON AND HARVEY, *THE NATIONAL YOUTH ADMINISTRATION* (1933) *passim*.

29. In 1933 the office of Indian Affairs listed 35 private Indian Schools receiving Federal funds, some 90% of which are operated by the Catholic Church. JOHNSON,

are as a consequence available to Catholic students in Catholic schools. The 1938 *Report of the President's Advisory Committee on Education* recommended federal aid for private institutions.³⁰ In many state schools conducted in orphanages, asylums, or corrective institutions are permitted public support regardless of sectarian character.³¹ Recent legislation and judicial opinion on the related matters of transportation and free textbooks for parochial pupils have materially strengthened the Catholic position.³² The most extensive subsidy allotted to the Catholic school, however, is tax exemption, available in varying degrees in all states but California.³³ Upon none of these items, except transportation and textbooks, do the limitations in state constitutions impinge.

Concessions in these peripheral areas, however, are insufficient, both in philosophy and economics, to meet the Catholic demand. To only half of some four million American Catholic children is parochial elementary school education available.³⁴ Only one out of fourteen may expect Catholic secondary schooling.³⁵ Meanwhile increased public expenditure for the public school, the extension of its curriculum to vocational and custodial fields, provide a competition for enrollment which the Catholic school, caught between expanding need and declining means, finds hard to meet.³⁶ Nor can the Church

CHURCH-STATE RELATIONSHIPS (1934) 205. The legality of these appropriations was upheld by the Supreme Court in *Reuben Quick Bear v. Leupp*, 210 U. S. 50 (1908).

30. P. 54. The report was widely criticized by non-Catholics for its recommendations in this sphere. See, e.g., Kirkpatrick, *Proposed Public Support for Non-Public Schools: A Serious Threat* (1938) 4 SOCIAL FRONTIER 210.

31. This is true in New Haven, Conn., and in some localities in New York, Pennsylvania, Delaware, Maryland, Georgia, Texas, Ohio, Illinois, California, and New Mexico. GABEL, *PUBLIC FUNDS FOR CHURCH AND PRIVATE SCHOOLS* (1937) 570-690.

32. Some form of free transportation was available in 1938 to Catholic school pupils in Connecticut, Illinois, Indiana, Kansas, Louisiana, Maryland, Massachusetts, New York, New Hampshire, Oklahoma, Vermont, West Virginia, and Wisconsin. Kindred, *Public Funds for Private and Parochial Schools* (unpublished thesis in Univ. of Michigan Library, 1938) 66-67. Textbooks are furnished to parochial pupils in Indiana, Louisiana, and New Mexico. *Id.* at 81-82. Public health service for teachers and pupils of Catholic schools was also available in 1938 in six states—Arkansas, Florida, Indiana, New Hampshire, Rhode Island, Vermont. *Id.* at 184. Judicial opinion on these matters is collected *infra* notes 53 to 55.

33. GABEL, *PUBLIC FUNDS FOR CHURCH AND PRIVATE SCHOOLS* (1937) 760-1. In California only sectarian colleges are tax-exempt. CALIF. REV. AND TAX. CODE (Deering, 1939) §§ 202, 203; CALIF. CONST. Art. XIII, §§ 1, 1a.

34. Hagan, *Catholic Education and the Elementary School* in VITAL PROBLEMS OF CATHOLIC EDUCATION (1939) 67.

35. The latest Catholic survey of the high school area lists a total enrollment in 1936 of 288,864 students in 1,984 schools. NATIONAL CATHOLIC WELFARE CONFERENCE, *CATHOLIC COLLEGES AND SCHOOLS IN THE UNITED STATES* (1938) 55.

36. The cost of educating 21 million public schools pupils in 1930 was estimated at about \$100 per pupil. The estimated cost of Catholic education is said to be about \$30 per pupil. Disregarding savings available through volunteer teaching by members of Catholic orders the disproportion suggests a serious divergence in the quality of the curriculum. See Newton, *Educational Administration as Social Policy* in REPORT OF THE COMMISSION ON SOCIAL STUDIES, PART VIII (1934) 14; Peterson, *Sursum Corda*, PRO-

conscientiously expose its members to an education increasingly oriented toward the horizons of empirical science or social pragmatism.³⁷ While publicly seeking repeal of constitutional restrictions,³⁸ Catholics have pressed local school boards, where possible, to compass their evasion. As the Vincennes case suggests, such arrangements are not always destroyed when challenged in the courts.

In 1937 at least 340 arrangements like that in Vincennes, involving public support of Catholic schools, were in effect in spite of constitutional inhibition.³⁹ Absence of adversary parties in many predominantly Catholic districts suspends enforcement of restrictions, and even when suit is brought some courts display a tendency, as in the Vincennes decision, to escape an unwanted conclusion by refusing to view the situation realistically. The effectiveness of legal challenge, moreover, is limited by as adroit a manipulation of fictions as judicial literature in any field has produced. The Illinois courts have

CEEDINGS, CATH. EDUC. ASS'N CONV. (1933) 48-57. Catholics, however, criticize public education as wasteful. See GABEL, PUBLIC FUNDS FOR CHURCH AND PRIVATE SCHOOLS (1937) 772. Catholics feel particularly keenly competition from recent development of vocational education in public high schools. See Johnson, *The Catholic School and Secondary Education* in VITAL PROBLEMS OF CATHOLIC EDUCATION (1939) 83.

37. The Catholic problem, and the Catholic solution therefor, are succinctly stated by the Rev. George Johnson: "The Catholic argument is that, since the state passes laws compelling all children to go to school, it is the duty of the state to provide schools that accord with the dictates of the parents' conscience. The public school maintains neutrality with regard to religion and creed. This in itself amounts to government taking a theological position, because it implies that religion and the creed one professes have no real or vital connection with everyday life, and that religion does not matter in the same degree as does arithmetic, geography, or natural science. The philosophy of secular education is not merely negatively but positively religious. Consequently, it stands in contradiction to Catholic principles of education." *The Catholic Schools in America* (1940) 165 ATLANTIC MONTHLY 504. See CONWAY, THE QUESTION BOX (2d ed. 1929) 215.

38. Efforts were made in Ohio from 1933 to 1937 to obtain state aid for Catholic schools. The issue became an important one in state elections in 1934, but all attempts were unsuccessful. See JOHNSON, CHURCH-STATE RELATIONSHIPS IN THE UNITED STATES (1934) 151-2; GABEL, PUBLIC FUNDS FOR CHURCH AND PRIVATE SCHOOLS (1937) 662-673. The New York constitution was amended in 1938 to permit free transportation of parochial pupils. NEW YORK CONST. ART. IX, § 4; BALDWIN'S NEW YORK LAWS SERVICE (June, 1940) 43. This amendment superseded the decision of *Judd v. Board of Educ. of Union Dist. No. 2*, 278 N. Y. 200, 15 N. E. (2d) 576 (1938). The administration of transportation in New York has since been severely criticized in the Protestant press. See *Roman Catholic Aggression on Public School Funds*, (1939) 56 CHRISTIAN CENTURY 1364. For a similar campaign in the territory of Arizona, see GABEL, *op. cit. supra*, 489-90, 688-9. Public efforts in Connecticut are detailed in HEFFERNAN, A HISTORY OF CATHOLIC EDUCATION IN CONNECTICUT (1937) 55-74, 99-106, 132-136. These were not entirely unsuccessful, and in New Haven, at least, certain Catholic schools receive public support. *Id.* at 55-73.

39. CRONIN AND DONAHUE, CATHOLIC PUBLIC SCHOOLS IN THE UNITED STATES (1937), summarized in 45 SCHOOL AND SOCIETY (1937) 756-8. Historically the system is called "the compromise plan" by Catholic writers and was in operation as early as 1873 in Poughkeepsie, N. Y., and in communities throughout New York and some nineteen other states. LISCHKA, PRIVATE SCHOOLS AND STATE LAWS (1925) 207-9.

evaded a restriction on public expenditures "in aid of any church or sectarian purpose" by absolving of illegality all appropriations to Catholic institutions so long as the cost of the institution's service is less than that of comparable secular costs: "It is contrary to fact and reason to say that paying less than the actual cost of clothing, medical care and attention, education and training in useful arts and domestic sciences is aiding the institution where such things are furnished."⁴⁰ A few years earlier the Illinois court had found it possible to permit erection of a Catholic chapel on the grounds of a state institution by viewing the transaction as a gift by the Church to the state rather than a license of the use of land to the Church by the state.⁴¹ Difficulty is experienced in selecting an appropriate legal remedy to raise the constitutional issue in a number of cases. Mandamus to school officials suffers from its limitation to non-discretionary acts,⁴² while injunction implies prior exhaustion of less summary remedies.⁴³ Laches may bar equitable relief where the community has tolerated a Catholic arrangement with the school board.⁴⁴ The United States Supreme Court has twice avoided a square holding on the religious issue. It found a Catholic-owned and operated hospital in the District of Columbia non-sectarian on the ground that a corporation cannot belong to a religious sect,⁴⁵ and in the Louisiana textbook case approved the disputed fiction that free books for parochial pupils represent a gift to the pupil, not an aid to the school.⁴⁶ New York opened a breach in its constitutional barrier by finding that a Catholic school taught within a Catholic orphanage was not included in the prohibition of funds to a religious "school or institution of learning."⁴⁷ Occasionally a case is disposed of favorably to the Catholic position by omission to cite the constitutional limitation at all.⁴⁸

Of the nine judicial holdings dealing with the merits of arrangements closely analogous to that in Vincennes, however, eight have found a violation of the state constitution: those in Nebraska, Pennsylvania, Iowa, Kentucky, Massachusetts, Kansas, South Dakota, and Nevada.⁴⁹ Only in North Dakota

40. *Dunn v. Chicago Indust. School*, 280 Ill. 613, 618, 117 N. E. 735, 737 (1917); cf. *County of Cook v. Chicago Indust. School for Girls*, 125 Ill. 540, 18 N. E. 183 (1888).

41. *Reichwald v. Catholic Bishop*, 258 Ill. 44, 101 N. E. 266 (1913).

42. *Scripture v. Burns*, 59 Iowa 70, 12 N. W. 760 (1882); see *Dorner v. School Dist. No. 5*, 137 Wis. 147, 118 N. W. 353 (1908).

43. *Nance v. Johnson*, 84 Tex. 401, 19 S. W. 559 (1892).

44. *Dorner v. School Dist. No. 5*, 137 Wis. 147, 118 N. W. 353 (1908).

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

46. *Cochran v. Louisiana State Bd. of Educ.*, 281 U. S. 370 (1930).

47. *Sargent v. Board of Educ.*, 177 N. Y. 317, 69 N. E. 722 (1904).

48. *Millard v. Board of Educ.*, 121 Ill. 297, 10 N. E. 669 (1887). The tendency to sidestep sometimes, however, favors the anti-Catholic position. See *Pronovost v. Brunette*, 36 N. Dak. 288, 162 N. W. 300 (1917).

49. *State ex rel. Public School Dist. No. 6 v. Taylor*, 122 Nebr. 454, 240 N. W. 573 (1932); *Collins v. Kephart*, 271 Pa. 428, 117 Atl. 440 (1921); *Knowlton v. Baumhover*, 182 Iowa 691, 166 N. W. 202 (1918); *Williams v. Stanton Dist.*, 173 Ky. 708, 191 S. W. 507 (1917); *Atchison, T. & S. F. Ry. v. Atchison*, 47 Kans. 712, 28 Pac. 1000 (1892); *Dakota Synod v. State*, 2 S. Dak. 366, 50 N. W. 632 (1891); *State ex rel. Nevada Orphan Asylum v. Hallock*, 16 Nev. 373 (1882); *Jenkins v. Inhabitants of Andover*, 103 Mass. 94 (1869); accord, *Hlebanja v. Brewes*, 58 S. Dak. 351, 236 N. W. 296

have the courts sustained an arrangement resembling the Vincennes type in the face of legal restriction, but there the only issue before the court was the employment of nuns in religious garb by the public school board.⁵⁰ In addition to cases forbidding free textbooks and transportation, New York and Oklahoma courts have handed down opinions on collateral issues which probably preclude direct financial aid to Catholic schools.⁵¹

In some states constitutional restrictions have been lowered to the extent that free textbooks and free transportation in school buses are available to Catholic students.⁵² The Supreme Court sustained a Louisiana interpretation of such aid as support to the pupil and not to the school,⁵³ and Maryland has adopted that rationale.⁵⁴ All other state courts which have examined the issue have refused to regard it in such a light.⁵⁵ The New York constitution has been amended to permit transportation of parochial pupils.⁵⁶ A final constitutional barrier, as yet scarcely explored by the courts with reference to the religious issue, has arisen in Maryland to complicate the campaign which seeks to reduce restrictions. A familiar constitutional principle forbids appropriations of public funds to a private purpose, and though Maryland courts have not invoked that formula to restrain expenditures for transportation of Catholic children, it has been employed to defeat appropriation to Catholic charitable institutions.⁵⁷

Should present constitutional provisions barring public funds to Catholic schools be generally repealed, the courts would still be in a position to invalidate appropriations for them on this ground. A judicial disinclination to do so, however, is likely to be present when public opinion has been sufficiently strong to remove express restrictions. Nor does the usual state constitutional provision forbidding laws respecting the establishment of

(1931); Opinion of the Justices, 214 Mass. 599, 102 N. E. 464 (1913). See generally Notes (1920) 5 A. L. R. 866, (1922) 20 A. L. R. 1351, (1924) 31 A. L. R. 1125, (1928) 57 A. L. R. 195.

50. *Gerhardt v. Heid*, 66 N. Dak. 444, 267 N. W. 127 (1936).

51. See *Stein v. Brown*, 125 Misc. 692, 211 N. Y. Supp. 822 (Sup. Ct. 1925); *Connell v. Gray*, 33 Okla. 591, 127 Pac. 417 (1912).

52. See note 32 *supra*.

53. *Cochran v. Louisiana State Board of Educ.*, 281 U. S. 370 (1930), *aff'g* 168 La. 1030, 123 So. 664 (1929). On judicial treatment of books for parochial schools, see generally Notes (1922) 17 A. L. R. 299, (1930) 67 A. L. R. 1196.

54. *Board of Educ. of Baltimore Co. v. Wheat*, 174 Md. 314, 199 Atl. 628 (1938); *accord*, *State v. Johnson*, 170 Wis. 251, 176 N. W. 224 (1919) (gift to war veterans for educational use).

55. *Judd v. Board of Educ. of Union Dist. No. 2*, 278 N. Y. 200, 15 N. E. (2d) 576 (1938); *State ex rel. Traub v. Brown*, 36 Del. 181, 172 Atl. 835 (1934); *State ex rel. Van Straten v. Milquet*, 180 Wis. 109, 192 N. W. 392 (1923); *Smith v. Donahue*, 202 App. Div. 656, 195 N. Y. Supp. 715 (3d Dep't, 1922). See Notes (1938) 51 HARV. L. REV. 935, 37 MICH. L. REV. 335, 16 N. Y. U. L. Q. REV. 141, 7 FORDHAM L. REV. 436, 8 BROOKLYN L. REV. 90, (1939) 7 GEO. WASH. L. REV. 542.

56. See note 38 *supra*.

57. *St. Mary's School v. Brown*, 45 Md. 310 (1876). See (1938) 16 N. Y. U. L. Q. REV. 141, 143.

religion present more than a casual inhibition. The effective constitutional restraints are the explicit ones.

The chaotic condition of legal theory on the Catholic school question reflects the confused social and political issues which underlie it. The picture is one of concrete and explicit expression of public policy in a relatively comprehensive area—the state constitution—subjected to an unremitting legal and political opposition at the hands of a well-organized and powerful minority group. The natural judicial tendency to abjure controversial political issues favors the *status quo* when challenge is offered to an allegedly illegal arrangement. When the issue is squarely joined the law is clear that public support of Catholic education in most of its forms is illegal, but the direction indicated by the Indiana and North Dakota decisions may be significant for the future. The possibility of change appears even less contingent when the textbook and transportation cases are compassed.

The advent of actual religious tolerance in wide areas of the United States has, moreover, created a receptive audience for Catholic petitions to share the public fund to which Catholics as taxpayers must contribute. Catholic expenditures for education save millions of dollars annually for the public purse. The Federal Constitution may guarantee freedom of religion from government control, but the Catholic must pay an enormous bounty to protect his children from the secular influence of the public school. The Catholic case is not an unsubstantial one. Far short of bigotry, however, it is possible to formulate a concrete program of objection to any extensive reduction of the century-old intersectarian compromise. Non-Catholics are grateful for the savings volunteered to the state through Catholic finance of Catholic schools, but the favor is one unasked, indeed unwanted. Nor can the state conscientiously release its funds to agencies over whose fundamental policy it may not exercise control.⁵⁸ Acceptance of the principle implied in the Catholic demand, moreover, entails a willingness to support with public funds the separate schools of any legitimate religious, social, or even political group. In a society already harassed by growing religious segregation and social and ideological stratification, that prospect is not an inviting one.⁵⁹ The tendency of minority cultures is exemplified in recent fondness for anti-democratic notions among some groups of the Catholic clergy, as Catholics themselves point out;⁶⁰ the state can ill afford to level-off barriers which hold such dangers in check. *Laissez-faire* in the realm of religion has been the key to a successful American solution of the church-state problem. Entrance of the state upon a program of religious subsidy, however benign,

58. Acceptance of public funds by Catholic schools would result in state control over the manner in which the funds were used, and the schools would lose much of their present independence. Consistent with Catholic opposition to the child labor amendment on the ground that it would result in federal control of education, some Catholic leaders have opposed acceptance of state aid by parochial schools. See 3 CATHOLIC ENCYCLOPEDIA 560 (1907); NATIONAL CATHOLIC ALMANAC (1941) 287-8.

59. For amplification of this view, see Kilpatrick, *Proposed Public Support for Non-Public Schools: A Serious Threat* (1938) 4 SOCIAL FRONTIER 210; Johnson, *Relation of the Political State to Religion* (1939) 34 RELIG. EDUC. 82; Niebuhr, *Sectarian Education*, 5 ENCYC. SOC. SCI. (1931) 425.

60. Shuster, *The Conflict Among Catholics* (1940) 10 AMER. SCHOLAR 5.

reawakens the slumbering forces of intolerance and hate and invites them to a contest for public support.⁶¹ The neighborhood common school, cutting across the lines of class, sect, race, and ability is a fundamental ideal of democratic society not lightly to be abandoned. A regard for the American constitutional principle of religious liberty has for a hundred years exacted of that ideal a sacrifice, and four million Catholic children are free to forsake the public school for the classrooms of their church. Non-Catholic citizens are apparently willing to make further concessions in the direction of week-day religious education.⁶² Beyond that area, however, lie issues to which a democratic society dare not be indifferent.⁶³

FEDERAL DECLARATORY JUDGMENTS ON THE VALIDITY OF STATE TAXES*

A FACTOR long disturbing the delicate relationship between national and state authority was the jurisdiction of the federal courts to enjoin the assessment and collection of state taxes.¹ Even after many state legislatures, as well

61. A state subsidy for schools frankly bent on religious instruction creates, for example, the problem of Protestant children in predominantly Catholic areas. If the only public school is actively Catholic the child's right to an education is conditioned on acquiescence in sectarian instruction. For Catholic children in predominantly Protestant areas a similar problem is raised. The essence of current compromise which excludes active sectarianism from the schools arises from a desire to avoid this conflict, as well as that of Protestant sects among themselves. There is, moreover, a potential Federal constitutional objection. See *Cantwell v. Connecticut*, 310 U. S. 296 (1940).

62. Children were being excused from school for religious instruction in 35 states at the time of a survey made by the Federal Office of Education in 1933, and plans of this character date back to 1913. DAVIS, *WEEKDAY RELIGIOUS INSTRUCTION* (1933) *passim*. Constitutionality of the practice was upheld in New York in *People ex rel. Lewis v. Graves*, 219 App. Div. 233, 219 N. Y. Supp. 189 (3d Dep't 1927), *aff'd*, 245 N. Y. 195, 156 N. E. 663 (1927). New York in 1940 enacted a law empowering the superintendent of education to establish regulations for a state-wide practice involving the excuse of children from school to receive religious instruction. New York Laws (1940), c. 305, amending N. Y. EDUC. LAW, Art. 23, § 625. The program has been initiated in 18 New York City schools. *TIME* (Feb. 17, 1941) 39.

63. On religious liberty in the United States, see generally Hartogensis, *Religious Minorities and Non-Believers* (1930) 39 YALE L. J. 659; Deutsch, *Concept of Freedom of Religion in American Constitutional Philosophy* (1940) 28 GEO. L. J. 487; Warm, *Applied Democracy—The Bill of Rights in Action* (1940) 14 U. OF CIN. L. REV. 53, 54-83; Wright, *Religious Liberty under the Constitution* (1940) 27 VA. L. REV. 75; McCullough, *Religious Liberty Judicially Defined* (1938) 13 NOTRE DAME LAWYER 260; Stephens, *School, Church & State* (1928) 12 MARQ. L. J. 206; Comments (1938) 14 NOTRE DAME LAWYER 115, 18 ORE. L. REV. 122, 36 MICH. L. REV. 485, (1915) 15 COL. L. REV. 704.

* *Morrison-Knudsen Co., Inc. v. State Board of Equalization of Wyoming*, 35 F. Supp. 553 (D. Wyo. 1940).

1. Lockwood, Maw and Rosenberry, *The Use of the Federal Injunction in Constitutional Litigation* (1930) 43 HARV. L. REV. 426, 428, 450. See also Hughes, C. J., dissenting in *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U. S. 33, 61 (1940).

as Congress, attempted to insulate their respective revenues from intrusions by their own judicial bodies,² the federal injunction remained as the classic method for determining the validity of state taxes.³ Consequently, taxpayers who could establish federal jurisdiction⁴ were able to halt the collection of these taxes despite state statutory requirements that payment be made prior to litigation. But when the states adopted sales and use taxes to meet the added expenditures necessitated by the depression,⁵ such interference with their fiscal operations became intolerable and Congress passed the Act of August 21, 1937⁶ limiting federal jurisdiction in the following respect:

" . . . no district court shall have jurisdiction of any suit to enjoin, suspend, or restrain the assessment, levy, or collection of any tax imposed by or pursuant to the laws of any State where a plain, speedy, and efficient remedy may be had at law or in equity in the courts of such State."

The language of this Act is derived from its sister statute, the Johnson Act of 1934,⁷ in which Congress, by a parallel limitation on federal jurisdiction, endeavored to promote effective state regulation of public utilities. The scope of the Johnson Act was at least temporarily limited by the Supreme Court's interpretation of the clause requiring a "plain, speedy, and efficient remedy" in the state courts.⁸ But although comparable devitalization of the

2. "No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court," REV. STAT. § 3224 (1875), 26 U. S. C. § 1543 (1934). Since it was enacted as an amendment to the Revenue Act in 1867, this statute has been applied only to suits to enjoin federal taxes. Despite the all-inclusive language, the courts have riddled it with exceptions. See MOORE'S FEDERAL PRACTICE (1938) 204-206. See also MICH. COMP. LAWS (1929) § 3507: "No injunction shall issue to stay proceedings for the assessment or collection of taxes under this act."

3. Prior to 1937, the constitutionality of state taxes was generally tested by suits to enjoin them in the federal courts. *Southern Pac. Co. v. Gallagher*, 306 U. S. 167 (1939) (filed before 1937); *Sonneborn v. Cureton*, 262 U. S. 506 (1923); *Texas Co. v. Brown*, 258 U. S. 466 (1922); *Bowman v. Continental Oil Co.*, 256 U. S. 642 (1921); *Ex parte Young*, 209 U. S. 123 (1908).

4. Large corporations easily obtained federal equity jurisdiction. As non-residents, they invariably could establish diversity of citizenship, and their tax bills were generally far in excess of \$3000. The remedy at law in the federal courts consisted of a suit against the state for refund and was consequently inadequate because it was barred by the Eleventh Amendment. See MOORE'S FEDERAL PRACTICE (1938) 206-208.

5. Sales and use taxes had been adopted previously in some states, but their popularity increased enormously during the thirties. Powell, *New Light on Gross Receipts Taxes* (1940) 53 HARV. L. REV. 909, 911.

6. 50 STAT. 738 (1937), 28 U. S. C. § 41 (1) (Supp. 1939).

7. 48 STAT. 775 (1934), 28 U. S. C. § 41 (1) (1934).

8. *Mountain States Power Co. v. Public Service Comm. of Montana*, 299 U. S. 167 (1936); *Corporation Comm. of Oklahoma v. Cary*, 296 U. S. 452 (1935). But see *New Jersey Suburban Water Co. v. Board of Public Utility Comm'rs*, 23 F. Supp. 752 (D. N. J. 1938); *East Ohio Gas Co. v. Cleveland*, 23 F. Supp. 965 (N. D. Ohio 1937). For the view that the court's decisions have substantially nullified the Act, see Legis. (1937) 50 HARV. L. REV. 813.

Act of August 21, 1937 might have been expected, no such result has been forthcoming. All but one of the numerous attempts to enjoin state taxes after the Act became effective have failed⁹ because the state remedy was found to comply with the statutory requirement.¹⁰ Under these decisions actual exhaustion of state remedies is virtually required in order to determine their adequacy. The mere possibility of a "plain, speedy, and efficient remedy" in the state courts is thus enough to forestall federal jurisdiction to enjoin state taxes.¹¹

Finding the courts unreceptive to their pleas to enjoin state taxes, some taxpayers resorted to declaratory judgments in an effort to obtain federal relief from those taxes despite the Act of August 21, 1937.¹² Although federal declarations on the validity of state taxes were freely obtainable prior to 1937,¹³ few of them were requested because the more familiar injunctive

9. The lone exception was the decision of a single district judge in the case of *Printers & Publishers Corp., Ltd. v. Corbett*, 25 F. Supp. 369 (S. D. Cal. 1938). An opposite result was reached by a three judge district court for the Northern District of California a week earlier. *Nevada-California Electric Co. v. Corbett*, 22 F. Supp. 951 (N. D. Cal. 1938). See discussion of these cases in Note (1939) 87 U. of PA. L. REV. 615. A saving clause in the Act excluded suits commenced before August 21, 1937. 50 STAT. 738 (1937), 28 U. S. C. § 41 (1a) (b) (Supp. 1939). The case of *Consolidation Coal Co. v. Martin*, 113 F. (2d) 813 (C. C. A. 6th, 1940) does not seem to have arisen prior to 1937, yet the court determined the validity of the state tax without even considering the question of its jurisdiction.

10. *Baker v. Atchison, T. & S. F. Ry.*, 106 F. (2d) 525 (C. C. A. 10th, 1939), *cert. denied*, 308 U. S. 620 (1939); *Brown Motor Freight Lines, Inc. v. O'Hara*, 32 F. Supp. 173 (W. D. Mich. 1939); *Guerra v. Philadelphia*, 30 F. Supp. 791 (E. D. Pa. 1940); *Sears, Roebuck & Co. v. Roddewig*, 24 F. Supp. 321 (S. D. Iowa 1938). The case of *Phipps v. School District of Pittsburgh*, 111 F. (2d) 393 (C. C. A. 3d, 1940) indicates the liberal standards set for a "plain, speedy and efficient remedy." The local taxing statute involved in that case had been held unconstitutional by the Pennsylvania Supreme Court. Litigants in plaintiff's position had previously been denied relief in the state courts. Yet the Third Circuit Court of Appeals decided that the state courts furnished a remedy adequate enough to prevent federal jurisdiction.

11. Under the ruling of the Supreme Court in *Kohn v. Central Distributing Co.*, 306 U. S. 531 (1939) the fact that plaintiff once had a state remedy bars federal jurisdiction even though it may be unavailable when he brings the federal suit. Under the rule evolved in the Johnson Act cases, the possibility that the state remedy might be inadequate justified federal jurisdiction. *Mountain States Power Co. v. Public Service Comm. of Montana*, 299 U. S. 167 (1936) (utility not required to exhaust "doubtful" state procedures). Under present interpretation of the Act of August 21, 1937, the fact that the state remedy may be adequate prevents taxpayers from resorting to the federal courts.

12. Since the utility companies got federal relief despite the Johnson Act of 1934 (see note 8 *supra*), there was no incentive for them to use the declaratory judgment in this situation. But *cf. Mississippi Power and Light Co. v. Jackson*, 116 F. (2d) 924 (C. C. A. 5th, 1941) (declaratory judgment granted in controversy over contract affecting utility rates).

13. It has been forcibly argued that the declaratory judgment meets the litigants' needs in this situation more adequately than the injunction does. BORCHARD, *DECLARATORY JUDGMENTS* (1934) 558-9.

remedy was also available.¹⁴ In the recent case of *Morrison-Knudsen Corporation v. State Board of Equalization of Wyoming*,¹⁵ a lower federal court held that the Act forbidding it to "enjoin, suspend, or restrain" such taxes did not deprive it of jurisdiction to grant declaratory judgments on the validity of such taxes. The Wyoming Sales and Use Taxes involved in that case required immediate payment of the tax and provided subsequent procedure in the state courts for recovery of taxes collected illegally.¹⁶ Ignoring the statutory procedure, plaintiff corporation sued in the federal district court for a declaration that it was legally immune from tax. The court held that the statutes were unconstitutional insofar as they made no provision for mandatory refund of taxes improperly collected and it was thus conceivable that some taxpayers would not be repaid even though they won judgments for refunds in the state courts. The decision, however, was not based on a finding that the state remedy was inadequate; the court took the position that the Act of August 21, 1937 was inapplicable to declaratory judgments.

In support of its interpretation of the Act, the court in the *Morrison* case said that Congressional failure to mention declaratory judgments in the Act of August 21, 1937 indicated an intention to exclude them from its operation. Since Congress spoke only of federal taxes in the 1935 amendment to the Federal Declaratory Judgments Act¹⁷ the court inferred an intention to treat state taxes differently. It also noted that, prior to 1935, federal courts had given declaratory relief from federal taxes¹⁸ despite the venerable prohibition against enjoining those taxes.¹⁹ The court's arguments must be qualified, however, by the fact that declaratory judgments are unfamiliar to many legal practitioners even today, and it is quite likely that Congress never thought about them when considering the limitation on federal jurisdiction over state taxes. Moreover, the 1935 amendment to the Declaratory Judgments Act was enacted at the insistence of the United States Treasury Department, which was naturally interested only in facilitating the collection of federal taxes.

14. The only reported case is *Gully v. Interstate Natural Gas Co., Inc.*, 82 F. (2d) 145 (C. C. A. 5th, 1936) (plaintiff declared within exceptions allowed by Mississippi tax statute).

15. 35 F. Supp. 553 (D. Wyo. 1940).

16. C. 102, § 1, Wyo. Laws 1937; c. 118, § 1, Wyo. Laws 1937.

17. 49 STAT. 1027 (1935), 28 U. S. C. § 400 (1) (Supp. 1939). The amendment applied to proceedings pending at the time it was passed.

18. The Federal Declaratory Judgments Act was not adopted until June, 1934. 48 STAT. 955 (1934), 28 U. S. C. § 400 (1934). Between the adoption of the Act and the exclusion of federal taxes in 1935, numerous declaratory judgments on federal taxes were granted. *Penn v. Glenn*, 10 F. Supp. 483 (W. D. Ky. 1935), *appeal dismissed*, 84 F. (2d) 1001 (C. C. A. 6th, 1936); *Black v. Little*, 8 F. Supp. 867 (E. D. Mich. 1934); *F. G. Vogt & Sons, Inc. v. Rothensies*, 11 F. Supp. 225 (E. D. Pa. 1935). Since the amendment to the Declaratory Judgments Act, such relief has, of course, been refused. *Beeland Wholesale Co. v. Davis*, 88 F. (2d) 447 (C. C. A. 5th, 1937); *W. B. Scaife & Sons Co. v. Driscoll*, 18 F. Supp. 748 (W. D. Pa. 1937); *Union Packing Co. v. Rogan*, 17 F. Supp. 934 (S. D. Cal. 1937). *Cf. Chester C. Fosgate Co. v. Kirkland*, 19 F. Supp. 152 (S. D. Fla. 1937).

19. § 3224 REV. STAT. (1875), 26 U. S. C. § 1543 (1934). See note 2 *supra*.

Diametrically opposed to the decision in the *Morrison* case is the opinion rendered several months earlier by the District Court for the Southern District of New York in *Collier Advertising Service, Inc. v. City of New York*.²⁰ Plaintiff corporation in that case sold candy bars through vending machines located in the New York subways and questioned the application of the New York City Sales Tax²¹ to retail sales of such small value. In addition to a declaration that plaintiff vendor was under no duty to collect the tax from the vendees, an injunction was sought to prohibit the City from collecting the tax from plaintiff. The court dismissed the bill for the injunction on the authority of the literal provisions of the Act of August 21, 1937.²² Although the Act does not specifically forbid a declaratory judgment on state taxes, the Court reasoned that granting a declaration would accomplish the same result as an injunction and it accordingly dismissed plaintiff's entire bill as a matter of law.

The decision in the *Collier* case appears to be a sensible application of the Act of August 21, 1937. Even though Congressional attention was focused on federal injunctions against the collection of state taxes when the Act was passed,²³ it seems reasonable to include declaratory judgments within the jurisdictional prohibition. Decisions in the injunction cases were frequently deferred until long after the taxable year in question and revenue collection was of course suspended by temporary injunctions pending adjudication. Such interference resulted in extreme disorganization of state fiscal affairs.²⁴ State budgets are based upon a definite revenue expectation for each fiscal year, and the anticipated taxes must be secured if government is to function effectively. Although the statute was designed to eliminate specific evils associated with the injunction, its basic objective was to protect state revenue systems from unwarranted obstructions imposed by the federal courts.²⁵

Congress answered this problem by gearing federal jurisdiction to state procedures. The decision as to whether taxpayers should be privileged to litigate liability prior to payment of the tax was placed exclusively in the hands of the states. States have thus been enabled to harmonize budgetary policy with the procedural mechanism for refunding illegal taxes. If they choose to collect all taxes and repay the illegal portion as one of the expenses of government in the ensuing year,²⁶ they may do so. If, on the other hand,

20. 32 F. Supp. 870 (S. D. N. Y. 1940).

21. New York City Local Law No. 24 (1934) 164 (published as No. 25). See also c. 873 New York Laws 1934.

22. Plaintiff argued that the Act applied only to state taxes and not to those levied by municipalities. Since the New York City Sales Tax was expressly authorized by the state legislature (see note 21 *supra*) there would seem to be but little question that it was levied "pursuant to the laws" of that state.

23. See Legal Brief on S. 1551, SEN. REP. No. 1035, 75th Cong., 1st Sess. (1937).

24. See speech by Senator Bone. 81 CONG. REC. 1415 (1937).

25. See H. R. REP. No. 1503, 75th Cong., 1st Sess. (1937). See also Note (1940) 26 VA. L. REV. 374.

26. State budgets are, by nature, less flexible than those of private corporations. It may well be that their only successful mode of operation is to collect the anticipated

they are convinced that better policy dictates adjudication of the legality of the tax prior to its collection,²⁷ they may so provide. In either event, all taxpayers will have the same remedies and there will be no discrimination in favor of those who could establish federal jurisdiction.²⁸

Both the situation evoking the legislation and the solution which Congress has given would seem to compel inclusion of federal declaratory judgments within the jurisdictional prohibition of the Act of August 21, 1937. The Act itself indicates that, other things being equal, the state courts rather than the federal courts should decide the validity of state taxes. The disruption of state revenue policies follows from the federal district court's declaration as inevitably as from its injunction. If the former relief is granted, this result is achieved by the voluntary submission of state officials to such an authoritative declaration.²⁹ In the latter case they obey the court's coercive decree, but such a difference would not seem to be material.³⁰ Congress certainly intended to eliminate a practical evil rather than to abolish a form of judicial procedure. Interpretation of the words of Congress in relation to the evil at which they were aimed thus compels the conclusion that the district courts have been deprived of jurisdiction to grant declaratory judgments on the validity of state taxes where there is a "plain, speedy, and efficient remedy" in the state courts.³¹

Even though the Act of August 21, 1937, were not interpreted to withdraw jurisdiction from the court and thus require the declaratory judgment to be denied as a matter of law, it would still be improper to grant declarations on the validity of state taxes. Declaratory judgments do not issue as

amount of revenue each year regardless of how much of it will have to be subsequently refunded.

27. Where finances are sufficiently sound to permit determination of legality prior to collection, the expense of collecting and refunding might be saved. This saving would not be large, however, since setoffs would be taken against taxes due in the ensuing year instead of completing a cash refund process.

28. One of the factors causing the state resentment against federal injunctions was the discrimination which they caused. Local citizens were forced to abide by state remedies although large corporations could override them. The right to litigate tax liability prior to payment thus depended on the fortuitous circumstance of whether federal jurisdiction existed or not, rather than upon state fiscal policy. See note 25 *supra*.

29. There is a natural presumption that public officials will follow the court's declaration and respect its interpretation of the law. *Socony-Vacuum Oil Co., Inc. v. City of New York*, 247 App. Div. 163, 287 N. Y. S. 288 (1936). It has seldom been necessary to take ancillary proceedings to enforce declaratory judgments. See BORCHARD, *DECLARATORY JUDGMENTS* (1934) 559.

30. In his opinion in the *Collier* case, Judge Clancy said that the result of the declaratory judgment would be "precisely the same" as the injunction. He concluded therefore that issuance of the declaratory judgment would mean "substantial nullification" of the Act of August 21, 1937. *Collier Advertising Service, Inc. v. City of New York*, 32 F. Supp. 870, 871 (S. D. N. Y. 1940). See MOORE'S *FEDERAL PRACTICE* (1938) 3216.

31. It is assumed, of course, that the liberal interpretation of the "plain, speedy, and efficient remedy" clause in the injunction cases (see note 10 *supra*) would be carried over to the declaratory judgment cases.

matters of right, but only in the sound discretion of the court.³² This does not mean that trial courts may grant declaratory judgments whenever they please, for their discretion has been "hardened by experience into rule" and is reviewable on appeal.³³

The rules governing judicial discretion dictate that it be exercised unfavorably toward federal interference with state taxes. Before the court may issue the declaration, it must be sure that it will not contravene public policy or embarrass the operations of government.³⁴ While the 1937 Act is admittedly ambiguous with respect to declaratory judgments, it reflects unmistakable Congressional disapproval of federal interference in state finances. The summary procedures traditionally used in tax collection³⁵ evidence a deep-rooted policy of expediting that process as much as possible. Prior to 1937, national courts were justified in violating this basic principle because they were required to do so in order to carry out an equally important public policy—*i.e.*, adjudication of certain controversies that Congress felt should be decided in the federal courts.³⁶ Since Congress has now abandoned this latter policy by contracting federal jurisdiction in this sphere in order to strengthen the former policy of protecting revenues, federal declarations on state taxes would be unjustifiable contraventions of a well-defined policy trend.

In addition to these legislative manifestations of public policy, the lower federal courts should also consider expressions by the Supreme Court when exercising their discretion relative to declaratory judgments. A unifying thread in the recent decisions of that Court has been the abnegation of federal jurisdiction in favor of state adjudication on matters better suited to local decision.³⁷ There has been a pronounced insistence, for example, that federal courts defer decisions on questions of local law and permit state bodies to decide them wherever feasible.³⁸ The sales and use tax cases in which federal declaratory judgments are now being sought involve the construction of complex state statutes. Even where constitutional issues are presented, the statutes must first be construed. Since the state courts have

32. *Aetna Life Ins. Co. v. Haworth*, 300 U. S. 227 (1937); *Aetna Casualty & Surety Co. v. Quarles*, 92 F. (2d) 321 (C. C. A. 4th, 1937); *Wilder v. Doe*, 30 F. Supp. 859 (E. D. Pa. 1939).

33. BORCHARD, *DECLARATORY JUDGMENTS* (1934) 100.

34. *Id.* at 111.

35. Distraint proceedings are a common example. INT. REV. CODE §§ 3690-3717 (1939).

36. Lower federal courts are, of course, obliged to take jurisdiction in cases and controversies where Congress directs them to do so. The *Morrison* opinion clearly reflects the feeling that the court was duty-bound to exercise the "novel field of jurisdiction" conferred upon it by the Declaratory Judgments Act. *Morrison-Knudsen Co., Inc. v. State Board of Equalization of Wyoming*, 35 F. Supp. 553, 554 (D. Wyo. 1940).

37. *Pennsylvania v. Williams*, 294 U. S. 176 (1935); *Gilchrist v. I. R. T. Co.*, 279 U. S. 159 (1929).

38. *Thompson v. Magnolia Petroleum Co.*, 309 U. S. 478 (1940); *Palmer v. Massachusetts*, 308 U. S. 79 (1939); *R. R. Comm. of Texas v. Rowan & Nichols Oil Co.*, 310 U. S. 573 (1940). See also (1940) 50 YALE L. J. 165.

the final word on the interpretation of these statutes,³⁹ and the national courts ultimately decide the constitutional issues,⁴⁰ a well-ordered judicial procedure demands prior determination of the underlying questions of interpretation.⁴¹

Declaratory judgments on the validity of state taxes should consequently be dismissed by the federal courts as a matter of discretion if not as a matter of law. The issue is whether the inherent Congressional objective shall be subordinated to the imperfectly expressed formula which was written into law. The courts are justified in reading interlacing statutory and judicial expressions of general policy as a "harmonizing text" in order to accord "hospitable scope to Congressional purpose."⁴² Moreover, constitutional issues are absent, and the decision must proceed solely on the level of ascertaining the policy intended to be prescribed.⁴³ Although some canons of abstract statutory construction may point the other way,⁴⁴ the more convincing evidence of legislative intention compels national courts to refuse declaratory judgments in the vital realm of state taxation.

ALTERNATIVE MOTIONS UNDER FEDERAL RULE 50 (b)*

RULE 50(b) of the Federal Rules of Civil Procedure sets forth the method by which a party may move to have an adverse jury verdict set aside and judgment entered in accordance with his prior motion for a directed verdict. This motion, according to the Rule, may be made separately or in conjunction

39. *Douglas v. Noble*, 261 U. S. 165, 168 (1923); *cf.* *R. R. Comm. of Texas v. Pullman Co.*, 9 U. S. L. WEEK 4220 (U. S. 1941).

40. *Martin v. Hunter's Lessee*, 1 Wheat. 304 (U. S. 1816). Ultimate review of federal questions by the United States Supreme Court is not impaired by statutes limiting the jurisdiction of the lower federal courts.

41. Frankfurter, *Distribution of Judicial Power Between United States and States Courts* (1928) 13 CORN. L. Q. 499, 519. "All these difficulties would be avoided if the road to the protection of constitutional rights lay to the Supreme Court from the state courts. Coming thus, all state matters would be concluded, and the special local facts upon which constitutional issues now so frequently turn would, in the first instance, be canvassed by judges presumably most familiar with them." See also Pogue, *State Determination of State Law under the Judicial Code* (1928) 41 HARV. L. REV. 623.

42. *United States v. Hutcheson*, 61 Sup. Ct. 463 (U. S. 1941).

43. The constitutionality of the Johnson Act of 1934 was sustained in the case of *Mississippi Power and Light Co. v. Jackson*, 9 F. Supp. 564 (S. D. Miss. 1935). Although Article III of the Constitution authorizes Congress to create inferior federal courts, it does not compel their establishment. By the same token, Congress may withdraw jurisdiction previously conferred on the district courts. *Kline v. Burke Constr. Co.*, 260 U. S. 226 (1922). Constitutional objections were raised by Congressman Beck, however, during the course of the debates on the Johnson Act. See 78 CONG. REC. 8332 (1934).

44. Those relied on by the court in the *Morrison* case. See note 17 *supra*.

* *Montgomery Ward & Co. v. Duncan*, 61 Sup. Ct. 189 (U. S. 1940).

with an alternative prayer for new trial.¹ While comparable devices for challenging the legal sufficiency of evidence were not unknown at common law² or in early federal practice,³ the federal courts, prior to this Rule, had in most states only restricted powers to delay decision upon the sufficiency of evidence until a verdict had been returned by the jury. In states which had by statute expressly extended the common law motion for judgment *non obstante veredicto*, however, federal courts had by virtue of the Conformity Act⁴ utilized this convenient method of correcting an earlier hasty denial of a motion for directed verdict.⁵ But recourse to this device was curbed by the Supreme Court's 5-4 decision in *Slocum v. New York Life Insurance Co.*, holding the statutory judgment *non obstante veredicto* unconstitutional as a deprivation of the litigant's right to trial by jury under the Seventh Amendment.⁶ Only after a period during which wholesale resort to new

1. Rule 50(b), FED. RULES CIV. PROC., provides: "Whenever a motion for a directed verdict made at the close of all the evidence is denied or for any reason is not granted, the court is deemed to have submitted the action to the jury subject to a later determination of the legal questions raised by the motion . . . A motion for a new trial may be joined with this motion, or a new trial may be prayed for in the alternative. If a verdict was returned the court may allow the judgment to stand or may reopen the judgment and either order a new trial or direct the entry of judgment as if the requested verdict had been directed."

2. At common law, the legal sufficiency of the evidence was challenged by a motion for directed verdict or by a demurrer to the evidence. There was, however, this important distinction between the two devices: a party demurring to the evidence lost his opportunity to go to the jury in case his demurrer was overruled [*Gibson v. Hunter*, 2 Bl. H. 187, 126 Eng. Rep. 499 (H. of L. 1793); *Wright v. Pindar*, Aleyn 18, 82 Eng. Rep. 892 (K. B. 1647)], while a party moving for a directed verdict and losing was, nevertheless, entitled to have the case submitted to the jury. *Mead v. Robinson*, Barnes 451, 94 Eng. Rep. 999 (C. P. 1744). With the consent of the jury and of the parties litigant, courts frequently reserved rulings on motions for directed verdict until a verdict had been returned by the jury. *Bird v. Randall*, 3 Burr. 1345, 97 Eng. Rep. 866 (K. B. 1762); *Coppendale v. Bridgen*, 2 Burr. 814, 97 Eng. Rep. 576 (K. B. 1759). See also THAYER, PRELIMINARY TREATISE ON EVIDENCE (1898) 241.

3. The practice of demurring to the evidence was recognized in federal courts during their early history. *Chinoweth v. Lessee of Haskell*, 3 Pet. 92 (U. S. 1830); *United States Bank v. Smith*, 11 Wheat. 171 (U. S. 1826); *Pawling v. United States*, 4 Cranch 219 (U. S. 1808). Demurring to the evidence, however, proved a cumbersome device for challenging the legal sufficiency of the evidence, and was soon replaced by the motion for directed verdict. *Parks v. Ross*, 11 How. 362 (U. S. 1850).

4. The Conformity Act required federal courts to conform "as near as may be" to the practice, pleadings, and forms and modes of proceeding existing in the courts of the state within which the trial was held. 17 STAT. 197 (1872), 28 U. S. C. § 724 (1934).

5. At common law, the motion for judgment *non obstante veredicto* could be made only by the plaintiff; it challenged only the sufficiency of the record, not the evidence. Minnesota was the first state to broaden the scope of the common law motion to include the evidence at the trial. MINN. GEN. LAWS (1895) c. 320, 2 MINN. STAT. (Mason, 1927) § 9495. All but eleven states now have similar statutes. See Comment (1935) 34 MICH. L. REV. 93, 94 n. 4, 6.

6. 228 U. S. 364 (1913). The decision of the majority was severely criticized both by the dissenting justices and by legal writers. Thorndike, *Trial by Jury in United States Courts* (1913) 26 HARV. L. REV. 732; Scott, *Trial by Jury and the Reform of Civil Pro-*

trials proved an eminently unsatisfactory substitute⁷ did the Supreme Court relax this holding and permit the effect of a judgment *non obstante veredicto* to be achieved by the trial judge expressly reserving action on the motion for directed verdict until an adverse jury verdict had been returned.⁸

By prescribing an automatic reservation of the ruling upon a motion for directed verdict, Rule 50(b) follows the pattern sanctioned by the Court in *Baltimore & Carolina Line v. Redman*⁹ and thus circumvents the constitutional hurdle which the Court unnecessarily erected barring judgments *non obstante veredicto*.¹⁰ But while the Rule is explicit in enabling the trial judge to render more carefully deliberated rulings and thus avoid needless retrials, it fails to specify how the trial judge should dispose of alternative motions and how the appellate court should proceed in reviewing this action.

Several cases have arisen under Rule 50(b) wherein, after denial of a motion for directed verdict made at the close of the testimony, alternative motions for a directed verdict and for a new trial were duly made within the prescribed ten days after return of an adverse verdict, and the reserved motion for directed verdict was sustained.¹¹ The trial judges in these cases uniformly followed the general state practice of refusing to pass upon the motion for new trial until final appellate action, if any, was taken upon the

cedure (1918) 31 HARV. L. REV. 669, 685; Thayer, *Judicial Administration* (1915) 63 U. OF PA. L. REV. 585, 600.

7. The practice of remedying a previous incorrect ruling by a new trial "submits the aggrieved party to the delay, annoyance, and cost of relitigation which will undoubtedly end in his favor anyhow if the memories of witnesses have not become dulled by the passage of time." Comment (1935) 34 MICH. L. REV. 93. For this reason, federal courts followed the rule of the *Slocum* case reluctantly. See SIMKINS, *FEDERAL PRACTICE* (rev. ed. 1934) § 198.

8. The Court first departed from the *Slocum* doctrine without comment in *Northern Ry. v. Page*, 274 U. S. 65 (1927). The doctrine was substantially altered in *Baltimore & Carolina Line v. Redman*, 295 U. S. 654 (1935), and was, in effect, overruled when the Supreme Court construed the statute involved in the *Slocum* case to be valid where action upon the motion was properly reserved. *Aetna Ins. Co. v. Kennedy*, 301 U. S. 389 (1937).

9. 295 U. S. 654 (1935).

10. Mr. Justice Van Devanter, who had earlier enunciated the *Slocum* doctrine, also wrote the decision in the *Redman* case. His attempt to distinguish the two decisions on grounds that only a question of law was presented in the latter case and that the parties might be deemed to have consented to the reservation, is hardly convincing in view of the fact that precisely the same question—the legal sufficiency of the evidence—was involved in both cases. Furthermore, the inferable consent argument was equally applicable to the former case, had the court then been willing to accept it. The automatic reservation provided by Rule 50(b), however, precludes further entanglement with these problems. See 3 MOORE, *FEDERAL PRACTICE* (1938) 3102 *et seq.*

11. *Churchill v. Baltimore & O. Ry.*, 2 FED. RULES SERV. 50b. 31, Case 1 (W. D. Pa. 1939); *Bachner v. Eickhoff & Co.*, 27 F. Supp. 105 (S. D. N. Y. 1939); *Duncan v. Montgomery Ward & Co.*, 27 F. Supp. 4 (E. D. Ark. 1939); *Blue Bird Taxi Corp. v. American Fid. & Cas. Co.*, 26 F. Supp. 808 (E. D. S. C. 1939); *Pessagno v. Euclid Inv. Co.*, 25 F. Supp. 896 (D. D. C. 1939). For other cases in which the district courts have granted the reserved motion for directed verdict in unreported opinions, see note 13 *infra*.

judgment entered for the moving party.¹² This course was justified on the theory that if the judgment is not appealed or is affirmed upon appeal, any ruling upon the new trial motion would prove superfluous as well as inconsistent with the previous determination. Furthermore, a trial judge, if reversed upon appeal, is better qualified to rule correctly on the new trial motion after he has been apprised by the appellate court as to the proper weight to be accorded the particular evidence.

Appellate courts, however, in reversing the judgments in four of these cases, have rendered conflicting interpretations of the practice contemplated under Rule 50(b). While three circuit courts of appeal have reinstated the verdict and remanded the case to the district court for consideration of the motion for new trial,¹³ the Eighth Circuit Court¹⁴ construed the trial judge's granting of the alternative motion for directed verdict as "equivalent to a denial of the motion for new trial," causing the latter motion to "pass out of the case upon entry of the [former] order."¹⁵ On the basis of this determination,¹⁶ the circuit court entered final judgment on the verdict. The palpable injustice of depriving a litigant who follows the procedure prescribed by Rule 50(b) of a determination of his new trial motion induced the Supreme Court to grant certiorari in this case¹⁷ and to promulgate a uniform practice for dealing with alternative motions. Although remanding this case to the district court for a hearing upon the new trial motion, the Court determined that in the future trial judges are to pass upon both motions at the same time, irrespective of their rulings on the reserved motion for directed verdict.¹⁸

12. *Estate of Caldwell*, 216 Cal. 694, 16 P. (2d) 139 (1932); *Daniels v. Butler*, 175 Iowa 439, 155 N. W. 1013 (1916); *In re Cummins' Estate*, 271 Mich. 215, 259 N. W. 894 (1935); *Jones v. Chicago St. P. M. & O. Ry.*, 80 Minn. 488, 83 N. W. 446 (1900); *Fisk v. Henarie*, 15 Ore. 89, 13 Pac. 760 (1887); *Osche v. New York Life Ins. Co.*, 324 Pa. 1, 187 Atl. 396 (1936); *Fagerdahl v. North Coast Transp. Co.*, 178 Wash. 482, 35 P. (2d) 46 (1934); *cf. Sulzbacher v. Continental Casualty Co.*, 88 F. (2d) 122 (C. C. A. 8th, 1937).

13. *Vearn v. Crane*, 114 F. (2d) 896 (C. C. A. 7th, 1940); *Pessagno v. Euclid Inv. Co.*, 112 F. (2d) 577 (App. D. C. 1940); *Pruitt v. Hardware Dealers Mut. Fire Ins. Co.*, 112 F. (2d) 140 (C. C. A. 5th, 1940).

14. *Duncan v. Montgomery Ward & Co.*, 108 F. (2d) 848 (C. C. A. 8th, 1940).

15. While the Eighth Circuit Court failed to cite supporting cases for its position, it was not completely without authority. See *Spruce v. Chicago, R. I. & P. Ry.*, 139 Okla. 123, 281 Pac. 586 (1929); *cf. Kauders v. Equitable Life Ass. Soc.*, 299 Ill. App. 152 (1939); *Jenkins v. Pilot Life Ins. Co.*, 186 S. C. 518, 197 S. E. 28 (1938). But the case of *Luse v. Union Pac. Ry.*, 57 Kan. 361, 46 Pac. 768 (1896), upon which plaintiff in the principal case relied, though containing dictum that the appellate court should grant final judgment for appellant, actually was ordered back to the lower court for a new trial.

16. The circuit court of appeals placed considerable emphasis on the unfortunate phraseology of the defendant's alternative motion. Its holding, however, was couched in general language equally applicable to any alternative motion. See 3 *MOORE, FEDERAL PRACTICE* (Supp. 1940) 3111.

17. *Montgomery Ward & Co. v. Duncan*, 309 U. S. 650 (1940).

18. *Montgomery Ward & Co. v. Duncan*, 61 Sup. Ct. 189 (1940), (1941) 29 CALIF. L. REV. 247, 54 HARV. L. REV. 694. This practice was suggested in *SIMKINS, FEDERAL*

The Supreme Court has thus adopted what would seem the obvious solution for expediting litigation. The approved practice not only assures a decision on the second motion while the evidence is fresh in the trial judge's mind, but enables the appellate court to review on the same appeal both the alleged grounds for judgment notwithstanding the verdict and the alleged errors of law committed during trial. The ramifications of this practice, however, became apparent only upon a consideration of the various combinations of rulings that may be rendered upon the alternative motions.

Existing procedure is unmodified where the trial court denies both the reserved motion for directed verdict and the motion for new trial.¹⁹ Judgment will be entered on the verdict, and the losing party may of course appeal, assigning as errors both the denial of judgment notwithstanding the verdict and errors of law in the trial.²⁰ The appellate court may then either affirm the judgment or reverse it and enter judgment for appellant notwithstanding the verdict, or remand the case for a new trial.²¹ The sole effect that Rule 50(b) has upon previous federal practice in this situation is to endow the appellate court with power to enter final judgment for the appellant.²²

Where the trial court grants both the reserved motion for directed verdict and the motion for new trial, an appeal may be taken from the judgment entered. While the appellate court may reverse this judgment, the case, instead of being remanded for consideration of the new trial motion, will be governed under the new practice by the order of the lower court granting new trial, since such orders are ordinarily not reviewable.²³ For the same reason, if the trial court denies the reserved motion for directed verdict and grants the motion for new trial, the party favored by the jury verdict will be precluded from an appeal. The movant, likewise, will probably be refused

PRACTICE (3d ed. 1938) § 702. Michigan and Wisconsin apparently follow a similar procedure. *Peters v. Aetna Life Ins. Co.*, 282 Mich. 426, 276 N. W. 504 (1937); *Tomberlin v. Chicago, St. P. M. & O. Ry.*, 211 Wis. 144, 246 N. W. 571 (1933).

19. *Sampson v. Channell*, 27 F. Supp. 213, 215 (D. Mass. 1939).

20. The question is still unsettled whether an appellate court may, under Rule 50 (b), order judgment for the appellant where the appellant has failed to renew its motion for directed verdict after the jury has returned an adverse verdict. In two recent cases, the Second Circuit Court held the renewal of the motions unnecessary, but the Supreme Court in reviewing this action reversed the cases on the merits without considering the procedural problem under Rule 50 (b). *Berry v. United States*, 111 F. (2d) 615 (C. C. A. 2d, 1940), *rev'd*, 9 U. S. L. WEEK 4227 (U. S. 1941); *Conway v. O'Brien*, 111 F. (2d) 611 (C. C. A. 2d, 1940), *rev'd*, 9 U. S. L. WEEK 4227 (U. S. 1941). See also *United States v. Halliday*, 116 F. (2d) 812 (C. C. A. 4th, 1941).

21. *Southern Ry. v. Bell*, 114 F. (2d) 341 (C. C. A. 4th, 1940); *Williams v. New Jersey-New York Transit Co.*, 113 F. (2d) 649 (C. C. A. 2d, 1940); *Ferro Concrete Constr. Co. v. United States*, 112 F. (2d) 488 (C. C. A. 1st, 1940); *Reliance Life Ins. Co. v. Burgess*, 112 F. (2d) 234 (C. C. A. 8th, 1940); *Lowden v. Denton*, 110 F. (2d) 274 (C. C. A. 8th, 1940); *Massachusetts Prot. Ass'n v. Moubler*, 110 F. (2d) 203 (C. C. A. 8th, 1940).

22. See SIMKINS, FEDERAL PRACTICE (3d ed. 1938) § 637.

23. *Pittsburgh, C. & St. L. R. Co. v. Heck*, 102 U. S. 120 (1880); *Paine v. St. Paul Union Stockyards Co.*, 28 F. (2d) 463 (C. C. A. 8th, 1928); *cf. Fairmount Glass Works v. Cub Fork Coal Co.*, 287 U. S. 474 (1933); *Hayden v. Johnson*, 59 Ga. 104 (1877).

an appeal from the order denying his reserved motion for directed verdict on grounds that this order does not represent a final adjudication of the cause, that he has gained the relief sought, and that he may move for a directed verdict in the new trial.²⁴ Granting an appeal to the movant at this point might conceivably render retrial unnecessary, at least in cases where the new trial was granted because the verdict was against the weight of the evidence.²⁵ In most cases, however, — and particularly where the new trial was predicated upon other grounds²⁶ — the appellate court would probably be reluctant to enter judgment notwithstanding the verdict, and the right to appeal would prove illusory.

The new practice enunciated by the Supreme Court is primarily significant where the trial court grants the reserved motion for directed verdict and denies the new trial motion.²⁷ If the party winning the jury verdict appeals from this judgment on the motion, the opposing party should cross-appeal and assign error to any rulings of law at the trial; upon possible reversal of the trial court's judgment on the motion, the appellate court may then pass upon the alleged errors of law which might require a new trial.²⁸

In practice, however, this combination of rulings is likely to prove hypothetical. A trial judge, convinced that the evidence is of such conclusive character that a verdict must be directed as a matter of law, would not seem likely to reverse his position and make the findings requisite for a denial of the new trial motion — namely, that the weight of the evidence supports the verdict.²⁹ The theory that the trial judge will enter a mental vacuum

24. Minnesota courts deny the moving party an appeal at this point under a statute which closely resembles Rule 50(b). *Drcha v. Great N. Ry.*, 178 Minn. 286, 226 N. W. 846 (1929); *St. Anthony Falls Bank v. Graham*, 67 Minn. 318, 69 N. W. 1077 (1897). But see *Michigan-Ohio-Indiana Coal Ass'n v. Nigh*, 131 Ohio St. 405, 3 N. E. (2d) 355 (1936), 4 U. OF CHI. L. REV. 153.

25. Where a new trial is sought on grounds that the verdict is against the preponderance of the evidence, the question presented to the court differs only in degree from that posed by a reserved motion for directed verdict. In the former instance, the trial judge has discretion to set aside the verdict if he believes the verdict opposes the weight of the evidence. In the latter case, he may only grant the motion for directed verdict if he finds no substantial evidence in support of the verdict returned. Federal courts, however, require more than a scintilla of evidence to preclude the direction of a verdict. *Small Co. v. Lamborn & Co.*, 267 U. S. 248 (1925); *Jones v. Travelers' Prot. Ass'n*, 70 F. (2d) 74 (C. C. A. 4th, 1934).

26. Other grounds upon which new trials have been granted include prejudicial misconduct of counsel [*Chadwick v. United States*, 141 Fed. 225 (C. C. A. 6th, 1905)], bias of a juror [*Union Electric Light & Power Co. v. Snyder Estate Co.*, 15 F. Supp. 379 (W. D. Mo. 1936)], improper and prejudicial rulings upon the admissibility of evidence [*Keliher v. United States*, 193 Fed. 8 (C. C. A. 1st, 1912)], erroneous instructions to the jury [*United States v. Bergdoll*, 272 Fed. 498 (E. D. Pa. 1921)], excessive damages [*Jacoby v. Johnson*, 120 Fed. 487 (C. C. A. 3d, 1903)], newly-discovered evidence [*Knowlton v. Seneca Eng. Co.*, 36 F. (2d) 394 (W. D. N. Y. 1929)].

27. See 3 FED. RULES SERV., Commentary 50b. 211.

28. *Montgomery Ward & Co. v. Duncan*, 61 Sup. Ct. 189, 195 (1940); cf. *Peters v. Aetna Life Ins. Co.*, 282 Mich. 426, 276 N. W. 504 (1937).

29. In order to grant judgment notwithstanding the verdict, a trial judge must find that there are no controverted issues upon which reasonable men could differ. This re-

and render a decision of the motion for new trial entirely unaffected by his previous determination seems highly unrealistic. The necessity of ruling upon the two motions at once would seem more likely to induce the trial judge to adopt one of two courses. He might grant both the motions for directed verdict and for new trial automatically whenever he deems a directed verdict appropriate.³⁰ Or he might grant a new trial and deny the motion for directed verdict, thus giving another jury an opportunity to arrive at the proper verdict, and at the same time avoiding the risk of an appellate reversal. Either of these courses would increase the number of new trials over that which might have resulted had the Court adopted the general state practice under which the trial judge reserves action on the motion for new trial until final appellate action has been taken on the judgment notwithstanding the verdict.³¹ After the trial judge has been reversed upon appeal, the determination of the motion for new trial loses its previous hypothetical character, and presents a concrete problem.

The experience in state practice indicates a stronger reluctance on the part of trial judges to grant new trials after reversal of their previous order than is likely to obtain under the procedure recently sanctioned by the Supreme Court. Under state practice, appellate courts in reversing judgments notwithstanding the verdict, generally indicate the weight properly attributable to the specific evidence in the case. Trial judges are thus enabled to render an order on the new trial motion in conformity with the appellate court's view of the evidence, and fewer new trials are likely to result than if the motion for new trial were ruled on prior to reversal. In fact, trial judges have occasionally been unduly reluctant to grant new trials after reversal, and their denials of the new trial motion have subsequently been reversed upon appeal.³² Federal procedure, however, does not afford the safeguard of an appellate review of the trial court's action upon the motion for new trial, except in the rare case where the trial judge has clearly abused his discretion.³³ Consequently the practice under Rule 50(b) present a dilemma.

quires a far greater degree of conviction than is requisite to justify ordering a new trial. Upon granting judgment notwithstanding the verdict, a finding that the verdict is against the preponderance of the evidence would seem to follow as a matter of course. If the trial court, however, predicates its judgment notwithstanding the verdict upon a conclusion of law and not upon the insufficiency of the evidence, an occasion arises in which the trial judge would deny the motion for new trial. See *Pease v. Sinclair Refining Co.*, 104 F. (2d) 183 (C. C. A. 2d, 1939).

30. In the one case reported since the Supreme Court's decision in the *Duncan* case the trial judge adopted this course. *Bopst v. Columbia Cas. Co.*, 4 FED. RULES SERV. 50b. 211, Case 2 (D. Md. 1940). The trial judge stated, "In this case I find it proper to grant the motion for new trial as well as the motion for judgment notwithstanding the verdict in accordance with the practice outlined in the *Montgomery Ward* case. My principal reason for granting a new trial is that the verdict of the jury, I think, is definitely contrary to the very considerable weight of the evidence."

31. See cases cited *supra* note 12.

32. See *Linker v. Union Pac. Ry.*, 87 Kans. 186, 123 Pac. 745 (1912); *Fohl v. Chicago & N. W. Ry.*, 84 Minn. 314, 87 N. W. 919 (1901); *cf. Chicago & N. W. Ry. v. Dimick*, 96 Ill. 42 (1880).

33. *Sultzbacher v. Continental Casualty Co.*, 88 F. (2d) 122 (C. C. A. 8th, 1937); *cf. Fairmount Glass Works v. Cub Fork Coal Co.*, 287 U. S. 474 (1933).

If the Supreme Court had adopted the state practice, no adequate protection would have been afforded litigants against unjustified denials of the motion for new trial.³⁴ Yet the procedure approved by the Supreme Court seems likely to increase the granting of new trials in contravention of the purpose explicit in Rule 50(b)—namely, to curb needless relitigation.

Possibly the most expedient practice in the case of alternative motions would be for the trial court to abdicate its power to make primary determinations of the propriety of a new trial, by rendering an arbitrary denial of the motion for new trial. The party favored by the jury could then appeal from the order granting judgment notwithstanding the verdict, and the movant could cross-appeal the alleged errors at the trial. This course would enable the appellate court, in the event of reversal of the judgment notwithstanding the verdict, to rule on the alleged errors at the trial, and would avoid retrials which the appellate court deemed unnecessary.³⁵ Adoption of this practice would be consistent with the existing scope of appellate review in federal courts.

BANK NIGHT AND SIMILAR DEVICES AS ILLEGAL LOTTERIES*

A FAVORITE merchandising device, especially during depression periods, has been the lottery, dressed in the guise of Bank Night¹ or some scheme of similar nature.² Appealing to the gambling and sporting instincts of the consumer, rather than to his sense of merchandise quality, these schemes are likely to run afoul of universal state legislation outlawing the lottery.³

34. The federal trial judge reversed in *Pessagno v. Euclid Ins. Co.*, 112 F. (2d) 577 (App. D. C. 1940), is reported by the clerk to have denied the motion for new trial on Nov. 4, 1940. The case of *Pruitt v. Hardware Dealers Mutual Fire Ins. Co.*, 112 F. (2d) 140 (C. C. A. 5th, 1940), however, was settled on August 23, 1940, prior to action on the motion for new trial.

35. The circuit court of appeals in the *Duncan* case, after construing the trial judge's action as a denial of the motion for new trial, might readily have achieved this result, had it reviewed appellee's contentions for a new trial, instead of holding that the motion had "passed out of the case."

1. This scheme, designed to increase the attendance at motion picture theaters, has been promoted by Affiliated Enterprises, Inc., a Colorado corporation chartered in 1933. See *Affiliated Enterprises, Inc. v. Gantz*, 86 F. (2d) 597 (C. C. A. 10th, 1936); *Affiliated Enterprises, Inc. v. Rock-Ola Mfg. Corp.*, 23 F. Supp. 3 (N. D. Ill. 1937).

2. Merchandising schemes found at one time or another to be lotteries include the "break and take" candy package, *Minter v. Federal Trade Comm.*, 102 F. (2d) 69 (C. C. A. 3d, 1939); the punchboard scheme for selling candy, *Helen Ardelle, Inc. v. Federal Trade Comm.*, 101 F. (2d) 718 (C. C. A. 9th, 1939); and the suit club, *People v. Hecht*, 119 Cal. App. (Supp.) 778, 3 P. (2d) 399 (1931). The early success of Bank Night encouraged the promotion of several schemes connected with theaters, not the least of which is "Screeno." *United-Detroit Theatres Corp. v. Colonial Theatrical Enterprise*, 280 Mich. 425, 273 N.W. 756 (1937).

3. All forty-eight states have statutes dealing with lotteries, three-quarters of them having constitutional provisions as well. Federal legislation renders matters concerning lotteries unmailable and forbids the radio broadcasting of information concern-

Few of these statutes describe the device which is outlawed.⁴ That task has been left to the courts, which have generally defined the lottery as a scheme in which a chance for a prize has been given in return for a consideration. Unless all three elements — prize, chance, and consideration — are found to be present, the device is not a lottery.⁵ Because evaders can easily eliminate from their schemes any particular type of consideration seized upon by the courts in earlier devices, the consideration requirement, included in the definition when the word "lottery" connoted only a scheme in which lottery tickets were sold for a definite price, has in recent years plagued courts applying the statutes.

There are three types of schemes in which prize and chance concur: the closed-participation device, in which every participant must give up some valuable consideration in connection with the scheme, though in actuality, perhaps not directly for the chance;⁶ the flexible-participation device, of which Bank Night is an example, in which some give up a consideration, but others do not;⁷ and the open-participation, in which none of the participants parts with a consideration. The last is always legal,⁸ the first, almost never. The flexible-participation scheme, on the other hand, partaking of the qualities of both of the others, has for a half-century been the subject of a formidable judicial schism.⁹ In some jurisdictions it has been held legal, for lack of consideration,¹⁰ but in the majority of states it has been thrown out of court

ing them. See WILLIAMS, *FLEXIBLE-PARTICIPATION LOTTERIES* (1st ed. 1938) 31-77; Pickett, *Contests and the Lottery Laws* (1932) 45 HARV. L. REV. 1196.

4. There are three general types of anti-lottery statutes: (a) those prohibiting a "lottery," and defining it as a scheme in which a valuable consideration is given for a chance, CAL. PEN. CODE (Deering, 1937) § 319; (b) those prohibiting a "lottery," but not defining it, 18 PA. STAT. (Purdon, Supp. 1940) tit. 18, § 4601; and (c) those prohibiting "gift enterprises" or "schemes of chance" as well as "lotteries," ALA. CODE ANN. (Michie, 1928) § 4247. In some states, some lotteries are exempted if the proceeds go to charity. See *Commonwealth v. O'Connell*, 293 Mass. 459, 200 N. E. 269 (1936).

5. WILLIAMS, *op. cit. supra* note 3, at 101-107, and cases cited there; *Horner v. United States*, 147 U. S. 449, 458 (1893).

6. Pickett, *supra* note 3, at 1206-7. See cases cited in *Commonwealth v. Lund*, 15 A. (2d) 839, 843 (Pa. 1940). It was the intransigent objection to the existence of payment as a condition precedent to participation that led to the formulation of flexible-participation schemes.

7. Under the flexible-participation scheme any person is given a free chance if he complies with certain conditions, none of which involves the payment of money. But those who purchase the merchandise or attend the theater are also given a chance, without having to comply with the conditions. And the conditions hedging the free chance are generally made so onerous as to exert a pressure on the public to buy in order to avoid the necessity for compliance. See *Affiliated Enterprises, Inc. v. Waller*, 5 A. (2d) 257 (Super. Ct. Dela. 1939).

8. See *Willis v. Young* [1907] 1 K. B. 448; *Commonwealth v. Wall*, 295 Mass. 70, 3 N. E. (2d) 28 (1936).

9. The two leading cases are *Yellow-Stone Kit v. State*, 88 Ala. 196, 7 So. 338 (1890) (legal) and *Willis v. Young* [1907] 1 K. B. 448 (illegal).

10. At present, Iowa, New Hampshire, New Jersey, New York, Rhode Island and Tennessee legalize Bank Night, and California, Colorado and South Carolina, which have not passed on the scheme itself, have approved other flexible-participation devices.

on one or another of five grounds,¹¹ four of which involve the finding of the "consideration" necessary to make it a "lottery."

Perhaps the best-known example of the flexible-participation lottery is theater-sponsored Bank Night; in the past half-decade the development of lottery law has been furthered almost exclusively by cases involving this particular device. Under the ordinary rules of its operation,¹² the public registers free of charge, the winning number being chosen by lot from among the registrants, but those who do not pay to enter the theater are required to claim the prize within two or three minutes after the name of the winner is announced outside. Participants are thus forced to purchase a ticket of admission, or else stand outside of the theater, if they are not to forfeit their chances.

The crudest of the rationales directed toward judicial control of Bank Night held the so-called "free participation," made possible by the registration system, to be illusory.¹³ As a practical matter, said the courts, everyone bought a theater ticket, although free chances were theoretically available, and in its practical operation the scheme appeared to be the illegal closed lottery in disguise. This particular view had, however, been worked out in the pre-Bank Night era for the control of less artfully constructed flexible-participation schemes,¹⁴ and the Bank Night device was carefully designed to make its application unrealistic.¹⁵ The large measure of free participation in Bank Night was too apparent to be ignored, and treatment of the free chance as a subterfuge gave way to a more sophisticated reasoning which recognized the undeniably novel problems introduced by free registration.

Thus a second general rationale evolved as an adaptation of the closed-participation rule. The scheme was deemed a lottery if a *great majority* of those buying the merchandise or attending the theater paid in part for a chance to win the prize,¹⁶ thus giving a *valuable consideration* for it.¹⁷ Of

11. Alabama, Connecticut, Delaware, Florida, Georgia, Illinois, Kansas, Massachusetts, Minnesota, Missouri, Montana, Nebraska, New Mexico, Ohio, Oregon, Pennsylvania, Texas, Vermont, and Wisconsin have ruled against Bank Night. Michigan, Virginia, and Washington have outlawed other flexible-participation lotteries.

12. See WILLIAMS, *op. cit. supra* note 3, at 109.

13. *Affiliated Enterprises, Inc. v. Gantz*, 56 F. (2d) 597 (C. C. A. 10th, 1936); see *City of Wink v. Griffith Amusement Co.*, 129 Tex. 40, 100 S. W. (2d) 695 (1936).

14. *State v. Danz*, 140 Wash. 546, 250 Pac. 37 (1926); *Glover v. Malloska*, 238 Mich. 216, 213 N. W. 107 (1927); *Featherstone v. Independent Service Station Ass'n*, 10 S. W. (2d) 124 (Tex. Civ. App. 1928).

15. In *State v. Danz*, a pre-Bank Night case, *supra* note 14, no one had actually taken a free chance, although they were available. This was not the case in the Bank Night schemes. See, for instance, *General Theatres, Inc. v. Metro-Goldwyn-Mayer Distributing Corp.*, 9 F. Supp. 546 (D. Colo. 1935).

16. This doctrine seems to have been laid down first in *Central States Theatre Corp. v. Patz*, 11 F. Supp. 566 (S. D. Iowa 1935), where the plan required that only a few pay for the chance. It was then adopted in the early cases legalizing Bank Night, which stated that a *great majority* must pay. *State v. Eames*, 87 N. H. 477, 183 Atl. 590 (1936); *State v. Hundling*, 220 Iowa 1369, 264 N. W. 608 (1936). Recently, the rule has been phrased according to its original requirement. *McFadden v. Bain*, 162

course, since the chances were given away to customers and non-customers alike, it could not very well be argued that the customers were paying partly for a chance they could have obtained for nothing. To meet this objection, several of the courts pointed out that the customer received a *better chance*¹⁸ — he was comfortably seated out of the weather and jostling crowd, he was nearer to the stage and thus did not have to fear the brief time-limit for self-identification, and he was not, in claiming the prize, subject to the psychological inhibitions and embarrassments besetting one who had waited outside.

The portion of the admission price paid by theater patrons for this "better chance" constituted a valuable consideration moving from the participants. Though paid by only a part of the participants, it was sufficient to make the scheme a lottery.¹⁹ Because of the emphasis laid by different courts on different steps of this rationale, it has variously been termed as the "mass consideration," "valuable consideration," or "better chance" theory. It is particularly vulnerable at the point of "better chance," a fact soon recognized by theater-owners operating Bank Night, for if the restrictions on outside participation are substantially removed, it cannot be argued that the customers are paying partly for a chance.²⁰ Thus the facts of each individual case are often very important. The absence of the irksome requirement that free participants be present at the time of the drawing, has proved conclusive in absolving the operator,²¹ as has a marked lengthening of the time-limit

Ore. 250, 91 P. (2d) 292 (1939); see *Commonwealth v. Wall*, 295 Mass. 70, 73, 3 N. E. (2d) 28, 30 (1936).

17. The valuable consideration rule originated before the invention of Bank Night [*People v. Cardas*, 137 Cal. App. (Supp.) 788, 28 P. (2d) 99 (1933)], but its greatest development came in the early cases favorable to the scheme. *People v. Shafer*, 160 Misc. 174, 289 N. Y. Supp. 649 (1936), *aff'd*, 273 N. Y. 475, 6 N. E. (2d) 410 (1936), 16 ORE. L. REV. 97, 3 U. OF PITT. L. REV. 67.

18. Foreshadowed in *Commonwealth v. Wall*, 295 Mass. 70, 3 N. E. (2d) 28 (1936), the "better chance" rule was first advanced as an independent ground for decision in *City of Wink v. Griffith Amusement Co.*, 129 Tex. 40, 100 S. W. (2d) 695 (1936) and *Iris Amusement Corp. v. Kelly*, 366 Ill. 256, 8 N. E. (2d) 648 (1937).

19. This phase of the rationale, invented in England [*Willis v. Young* (1907) 1 K. B. 448], has been called the "mass consideration" rule. *Central States Theatre Corp. v. Patz*, 11 F. Supp. 566 (S. D. Iowa 1935); *Iris Amusement Corp. v. Kelly*, 366 Ill. 256, 8 N. E. (2d) 648 (1937); *Barker v. State*, 56 Ga. App. 705, 193 S. E. 605 (1937). A further development of the mass consideration rule points out that the admission prices must be the consideration for all participants because they are the only source from which the prize can be created. *Jones v. Smith Oil & Refining Co.*, 295 Ill. App. 519, 15 N. E. (2d) 42 (1938); *State ex rel. Dussault v. Fox Missoula Theatre Corp.*, 101 P. (2d) 1065 (Mont. 1940). But *cf.* *State v. Danz*, 140 Wash. 546, 250 Pac. 37 (1926) (prizes donated to operators by third parties).

20. See *People v. Cardas*, 137 Cal. App. (Supp.) 788, 28 P. (2d) 99 (1933); *People v. Psallis*, 12 N. Y. S. (2d) 796 (City Mag. Ct. N. Y. 1939).

21. *Yellow-Stone Kit v. State*, 88 Ala. 196, 7 So. 338 (1890); *Cross v. People*, 18 Colo. 321, 32 Pac. 821 (1893); *Darlington Theatres, Inc. v. Coker*, 190 S. C. 282, 2 S. E. (2d) 782 (1939). But *cf.* *State ex rel. Dussault v. Fox Missoula Theatre Corp.*, 101 P. (2d) 1065 (Mont. 1940); *State ex rel. Regez v. Blumer*, 236 Wis. 129, 294 N. W. 491 (1940).

within which the prize may be claimed,²² since there is in such cases no real disadvantage connected with the "outsider's" chance.

On the other hand, so-called "matinee registration" schemes, by which those attending in the afternoon may sign proxy slips obviating the necessity for their presence at the Bank Night drawing in the evening, are sometimes seized upon as clear indications that part of the *matinee* admission price, at least, is paid for a "better chance."²³ And the absence of a fixed time for the drawing, forcing the outsider to wait for a long while in the street, may constitute important evidence of the undesirability of the "free" chance.²⁴ Similarly adverse to legality may be a marked increase in attendance on Bank Night,²⁵ or a large percentage of paying participants as opposed to non-paying.²⁶

In many cases, where "free" participation is made relatively attractive, it has been clear that the scheme benefited the merchant or theater-owner, and excited the gambling instincts of the public, but not at all clear, especially in criminal prosecutions,²⁷ that the customers were necessarily paying for a chance. And it was to meet such situations that the third and fourth rationales were devised. In both of them, the concept of a valuable consideration, bargained for by the operator and paid by the participant at least in part for the chance, was abandoned. They might be called the "contract consideration" and the "increased revenue" rules.

22. The ordinary time allowed for claiming the prize is two or three minutes. See *Darlington Theatres, Inc. v. Coker*, 190 S. C. 282, 2 S. E. (2d) 782 (1939) (10 minutes allowed; legal); *People v. Shafer*, 160 Misc. 174, 289 N. Y. Supp. 649 (1936) (5 minutes; legal); *State v. Wilson*, 109 Vt. 349, 196 Atl. 757 (1938) (one minute; illegal); *Griffith Amusement Co. v. Morgan*, 98 S. W. (2d) 844 (Tex. Civ. App. 1936) (winner notified by telephone; legal).

23. See *State ex rel. Cowie v. LaCrosse Theatres Co.*, 232 Wis. 153, 286 N. W. 707 (1939); *Grimes v. State*, 178 So. 69 (Ala. Ct. App. 1937) [compare, however, the decision on appeal, 178 So. 73 (Ala. Sup. Ct. 1937)]; *Commonwealth v. Lund*, 15 A. (2d) 839 (Pa. 1940) (no free registration, but free proxy cards of the type given to matinee patrons).

24. *Gulf Theatres, Inc. v. State ex rel. Ferguson*, 185 So. 862 (Fla. Sup. Ct., Div. B., 1939) (drawing at some time between 7 P.M. and 10 P.M.); *Cole v. State*, 133 Tex. Crim. App. 548, 112 S. W. (2d) 725 (1937) (drawing at end of first show).

25. *Little River Theatre Corp. v. State ex rel. Hodge*, 185 So. 855 (Fla. Sup. Ct. 1939) (attendance on Bank Night from two to seven times normal). See also *Commonwealth v. Lund*, 15 A. (2d) 839 (Pa. 1940).

26. *General Theatres, Inc. v. Metro-Goldwyn-Mayer Distributing Corp.*, 9 F. Supp. 546 (D. Colo. 1935) (354,000 chances given to patrons, 180,000 to non-patrons); *State v. Jones*, 107 P. (2d) 324 (N. M. 1940) (great majority of registrants bought tickets). Still another factor indicating purchases for the sake of participation, is a decline in the quality of the film shown on Bank Night. *Central States Theatre Corp. v. Patz*, 11 F. Supp. 566 (S. D. Iowa 1935).

27. Flexible-participation lotteries are most likely to be declared legal in criminal cases. *State v. Big Chief Corp.*, 13 A. (2d) 236 (R. I. 1940); *State v. Horn*, 16 N. J. Misc. 319, 1 A. (2d) 51 (1938); see *Darlington Theatres, Inc. v. Coker*, 190 S. C. 282, 2 S. E. (2d) 782 (1939). The next most lenient type of case, for obvious reasons, is that in which the prizewinner sues a reneging proprietor for his prize. *St. Peter v. Pioneer Theatre Corp.*, 227 Iowa 1391, 291 N. W. 164 (1940).

Maughs v. Porter,²⁸ decided in 1931, is the leading case propounding the contract consideration theory. Under that doctrine the consideration proceeding from the participant need not be valuable, but merely sufficient to support a contract. In the Bank Night scheme the acts of registration and attendance outside of the theater at the time of the drawing would be bargained-for detriments to the promisee. Since the operator bargains for them with a reasonable expectation that they will increase his profits (because many of the outside participants are eventually induced to come in and sit down), they are not conditions to a gift, but consideration to support the promise to give a prize to the participant if his number wins.²⁹ And under the doctrine of the *Maughs* case, this consideration is sufficient to make the scheme a lottery.

This rationale raises the whole question of the public policy behind the lottery statutes, for if they are designed only to prevent the public from hazarding its money on the chance of a large return, there would seem to be no reason for calling anything but pecuniary consideration such consideration as makes the scheme of chance a lottery.³⁰ If, on the other hand, as many judges seem to think, the statutes are designed to prevent other evils incident to the operation of schemes of chance, such as the general excitement of the gambling instinct, and the purchase of luxuries that might not otherwise be bought, the concept of "lottery consideration" will have to be broadened to include more than the mere passage of money from the participants to the operator.³¹ The consideration requirement, because it is one tool by which the court declares a scheme illegal as a "lottery," is, depending upon what it is made to include in each case, a doctrinal expression of each court's philosophy concerning lotteries in general.

The *Maughs* case, involving an expansion of the consideration concept, was at first violently criticized when applied to Bank Night.³² Then, as the

28. 157 Va. 415, 161 S. E. 242 (1931); (1932) 18 VA. L. REV. 465; (1932) 80 U. OF PA. L. REV. 744.

29. This is orthodox contract law. 1 WILLISTON, CONTRACTS (rev. ed. 1936) 379 *et seq.*; *State v. Wilson*, 109 Vt. 349, 196 Atl. 757 (1938).

30. *City of Roswell v. Jones*, 41 N. M. 258, 67 P. (2d) 286 (1937), *overruled in State v. Jones*, 107 P. (2d) 324 (N. M. 1940); *Griffith Amusement Co. v. Morgan*, 98 S. W. (2d) 844 (Tex. Civ. App. 1936); *St. Peter v. Pioneer Theatre Corp.*, 227 Iowa 1391, 291 N. W. 164 (1940); *State v. Hundling*, 220 Iowa 1369, 264 N. W. 608 (1936); *Affiliated Enterprises, Inc. v. Rock-Ola Mfg. Co.*, 23 F. Supp. 3 (N. D. Ill. 1937). See Pickett, *supra* note 3, at 1205, 1210; INSTITUTE OF MUN. LAW OFF., REP. No. 22 (Sept. 1937); Comment (1937) 9 Miss. L. J. 495.

31. The courts have complained that the scheme fosters "cupidity, envy, jealousy, and temptation" [*Iris Amusement Corp. v. Kelly*, 366 Ill. 256, 8 N. E. (2d) 648 (1937)], and that it stimulates the desire to gain profits "by the lucky turn of chance," at the expense of the "industry and earnings of others," rather than by one's own efforts, as a reward for skill, accomplishment, or hard work. *State v. Dorau*, 124 Conn. 160, 198 Atl. 573 (1938); *State ex rel. Hunter v. Fox Beatrice Theatre Corp.*, 133 Neb. 392, 275 N. W. 605 (1937). See Haley, *The Broadcasting and Postal Lottery Statutes* (1936) 4 GEO. WASH. L. REV. 475, 485; (1938) 17 NEB. L. BULL. 94.

32. *People v. Shafer*, 160 Misc. 174, 289 N. Y. Supp. 649 (1936); *State ex rel. Dist. Att'y Gen. v. Crescent Amusement Co.*, 170 Tenn. 351, 95 S. W. (2d) 310 (1936).

minor popular hysteria evoked by the scheme, or the annoying interruption it wrought in the middle of the regular entertainment, or perhaps the decline in quality of the accompanying film, impressed themselves unfavorably upon the judicial mind, the criticism became largely confined to cases in which a winner sued for his prize.³³ These are notoriously hard cases, since an application of the *Maughs* rule must result in the winner's having either an illegal contract, or no contract at all. But recent renewal of emphasis upon the doctrine of contract consideration may herald a general broadening, by its use, of the lottery consideration requirement.³⁴

Under the fourth rationale the increased revenues received by a merchant or theater-owner after operation of a scheme of chance is begun are in themselves such consideration as to constitute it a lottery. The idea that the consideration must be viewed only from the standpoint of the participants is abandoned in favor of a new theory looking to benefits received by the operator. Logically, the theory can be attacked on the ground that the desire for increased revenues is merely a motive which induces the operator to bargain for registration and attendance at the drawing. On the other hand, the scheme must be viewed as a whole, and not as a series of separate contracts, if its true effect is to be discovered.³⁵ The doctrine of increased revenue, although perhaps the most recent rationale to appear as a principal ground of decision, has proved to be the most popular.³⁶ Because no scheme would be operated unless it were profitable, this theory of indirect benefits seems to embody the doctrinal answer to almost any scheme offensive to the spirit of the statutes. The possibilities of expansion of the lottery consideration concept along these lines, to include even such remote benefits as advertising, would seem to be almost unlimited.

Two cases, decided last year, mark a further step in the judicial campaign against flexible-participation lotteries, and indicate the usefulness of the new concepts forged largely during the Bank Night period. In both *State ex rel.*

33. *Simmons v. Randforce Amusement Corporation*, 162 Misc. 491, 293 N. Y. Supp. 745 (1937); *Dorman v. Publix-Saenger-Sparks Theatres*, 184 So. 836 (Fla. Sup. Ct., Div. A., 1938); *St. Peter v. Pioneer Theatre Corp.*, 227 Iowa 1391, 291 N. W. 164 (1940); *Corio v. Laurelton Amusement Co.*, N. Y. L. J., Feb. 13, 1937, p. 764, col. 2 (Sup. Ct., App. Term), (1937) 37 COL. L. REV. 877.

34. See *State ex rel. Regez v. Blumer*, 236 Wis. 129, 294 N. W. 491 (1940); *Affiliated Enterprises, Inc. v. Waller*, 5 A. (2d) 257 (Super. Ct. Dela. 1939); *State v. Wilson*, 109 Vt. 349, 196 Atl. 757 (1938); *State v. Jones*, 107 P. (2d) 324 (N. M. 1940) *semble*.

35. *Commonwealth v. Lund*, 15 A. (2d) 839 (Pa. 1940).

36. The theory was rejected in the earlier flexible-participation cases. *Yellow-Stone Kit v. State*, 88 Ala. 196, 7 So. 338 (1890). It seems to have originated in *State v. Bader*, 21 O. L. Rep. 293 (Ohio 1922), or *State v. Danz*, 140 Wash. 546, 250 Pac. 37 (1926), as an alternative holding to the "subterfuge" theory, and was rejected in the earlier Bank Night cases. *State v. Hundling*, 220 Iowa 1369, 264 N. W. 603 (1936). In the Bank Night cases, it appears first as an alternative holding in *State ex rel. Beck v. Fox Kansas Theatre Co.*, 144 Kan. 687, 62 P. (2d) 929 (1936), and as a principal holding in *United-Detroit Theatres Corp. v. Colonial Theatrical Enterprise, Inc.*, 280 Mich. 425, 273 N. W. 756 (1937).

*Dussault v. Fox Missoula Theatre Corp.*³⁷ and *State ex rel. Reges v. Blumcr.*³⁸ the lotteries were operated so that the non-paying participants did not have to be present at the drawing, a fact obliterating any difference between "paid" and "free" chances. Neither customers nor theater-goers could be said to have paid for their chances, yet both schemes, probably legal a few years ago, were declared lotteries through the use of the third and fourth rationales here described.

A fifth method of disposing of schemes of chance, appearing relatively recently, involves the judicial construction of statutes which prohibit "schemes of chance"³⁹ or "gift enterprises"⁴⁰ as well as "lotteries." These terms, and others,⁴¹ have not yet been given the legal content of the word "lottery," and there are indications that in such instances the consideration requirement may be much weakened or abolished. As yet the decisions are sparse, but they may point the way toward the complete disappearance of consideration as a requirement for illegal schemes of chance in more than one jurisdiction.

In the last analysis, the use of any lottery law to regulate Bank Night is an anachronism. All of these statutes were enacted to prohibit an immoral kind of activity; as employed in the Bank Night cases, they are often simply an instrument for the regulation of business competition among theater operators.⁴² There seems no need, however, for clarifying legislation in this field; the liberal constructions developed by the judiciary have to date effected a satisfactory administration of the present dual function of the lottery statute.

37. 101 P. (2d) 1065 (Mont. 1940). It was possible for persons to avoid attendance outside of the theatre merely by writing their names and addresses on cards available at the theatres.

38. 236 Wis. 129, 294 N. W. 491 (1940). A druggist gave out coupons daily to all who entered his store, whether or not they bought merchandise. Each day, a drawing was held from a list of free registrants, and the winner sought out at his address, or wherever he could be found. If he could not produce a coupon given out on the previous day the prize went back into the pool. Cf. *State ex rel. Cowie v. LaCrosse Theatres Co.*, 232 Wis. 153, 286 N. W. 707 (1939).

39. *Troy Amusement Co. v. Attenweiler*, 64 Ohio App. 105, 28 N. E. (2d) 207 (1940).

40. See *State ex rel. Dussault v. Fox Missoula Theatre Corp.*, 101 P. (2d) 1065, 1070-71 (Mont. 1940); *City of Wink v. Griffith Amusement Co.*, 129 Tex. 40, 100 S. W. (2d) 695 (1936).

41. *State v. Dorau*, 124 Conn. 160, 198 Atl. 573 (1938) ("hazard"). But see *State v. Big Chief Corp.*, 13 A. (2d) 236 (R. I. 1940) (liberal statute more or less ignored).

42. It is quite probable that a majority of the criminal cases involving Bank Night were the result of pressure applied by disgruntled competitors. And many of the civil actions were actually instituted by exhibitors seeking an injunction on grounds of unfair competition. *United-Detroit Theatres Corp. v. Colonial Theatrical Enterprise*, 280 Mich. 425, 273 N. W. 756 (1937); *Sproat-Temple Theatre Corp. v. Colonial Theatrical Enterprise*, 276 Mich. 127, 267 N. W. 602 (1936). See *General Theatres, Inc., v. Metro-Goldwyn-Mayer Distributing Corp.*, 9 F. Supp. 546 (D. Colo. 1935) (violation of NRA Code).