NOTES

JUDICIAL INVALIDATION OF FEDERAL RESERVE POLICY AGAINST BANK HOLDING COMPANY EXPANSION*

Founder-Chairman of the Bank of America and Chairman of the Board of Transamerica Corporation, a bank holding company, Amadeo Peter Giannini today controls an empire embracing more than 40% of all banking offices and 38% of all commercial deposits in five western states.[1] The Bank of America, since 1946 the largest bank in the United States, maintains in California over 500 branch banking offices.[2] Transamerica, in addition to a substantial minority interest in the Bank of America,[3] holds a majority interest in forty separate banking systems [4] as well as a growing number of non-banking corporations.[5]

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* Peoples' Bank v. Eccles, 161 F.2d 636 (App. D.C. 1947), *cert. granted*, 68 Sup. Ct. 55 (Oct. 13, 1947).

1. *Hearings before Committee on Banking and Currency on S. 829*, 80th Cong., 1st Sess. 22, 171 (1947) (hereinafter cited as *Hearings on S. 829*). Since 1934, Transamerica Corporation and the Bank of America (National Trust and Savings Association), successors to the Bancitaly Corporation and the Bank of Italy, respectively, have acquired in Arizona, California, Nevada, Oregon and Washington, 126 banks and 74 additional branches, increasing the number of towns and cities served from 242 to 379. *Ibid.*

For a general history of the two corporations and the corresponding career of A.P. Giannini, see DANA, A.P. GIANNINI, GIANT IN THE WEST (1947); Saturday Evening Post, Sept. 13, Sept. 20, Sept. 27, Oct. 4, 1947. See also *Hearings before Committee on Banking and Currency under H. Res. 141*, pt. 11, 71st Cong., 2d Sess. (1930).

2. As of December 31, 1946, total resources of the Bank of America were $5,765,525,192; total deposits, $5,415,850,715. MOODY'S MANUAL OF INVESTMENTS, BANKS, INSURANCE, REAL ESTATE & INVESTMENT TRUSTS 258, 1515 (1947) (hereinafter cited as MOODY'S); STANDARD & POOR, CORPORATION RECORDS A-B 4048 (1947) (hereinafter cited as STANDARD & POOR'S). In addition to its 504 California branches, the bank maintains branches in London and Manila, and recently obtained permission from the Board of Governors of the Federal Reserve System to open a branch in Tokyo. MOODY'S 1801, 1821 (Supp. 1947); STANDARD & POOR'S A-B 4046.

3. Transamerica and its subsidiaries held 22.31% (1,904,037) of Bank of America's outstanding shares (8,531,710) as of Dec. 31, 1946. Prior to 1937, it held approximately 100%. STANDARD & POOR'S A-B 4047, T-Z 4726. Of further significance is Transamerica's interest in the National City Bank of New York, the second largest bank in the United States, represented by 7.23% (448,203) of outstanding shares (6,200,000) as of Dec. 31, 1946. *Id.* at T-Z 4726, 4728, L-O 2482.

4. As of Dec. 31, 1946, domestic subsidiaries operated 117 banking offices with combined deposits of $1,202,921,120. In addition, a foreign subsidiary, the Banca d' America e d'Italie, operates many branches in Italy, including Milan, Rome, and Naples. STANDARD & POOR'S T-Z 4726.

5. The most important of these include: Capital Company (real estate), Allied Building Credits Inc. (real estate financing), Pacific National Fire Insurance Co., Occi-

The continuing expansion of Giannini interests has encountered almost from the beginning the bitter, but ineffectual, opposition of nearly every institution, private or public, operating within the same sphere of influence. On the one hand, small unit bankers have struggled unsuccessfully against the branch-banking system developed by the Bank of America.[6] On the other hand, Wall Street itself has met defeat in a titanic battle waged to secure control of the Transamerica Corporation following an attempt to impose thereon its own banking standards.[7] But the most serious opposition to the "Giant of the West" has come from those public officials who fear a growing concentration of economic power in the traditionally competitive banking field.[8]

A recent offensive, launched by the Board of Governors of the Federal Reserve System and supported by the other supervisors of federally insured banks,[9]—the Comptroller of the Currency [10] and the Federal Deposit In-

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dental Life Insurance Co., General Metals Corp., Enterprise Engine and Foundry Co., Adel Precision Products Corp., Columbia River Packers Ass'n, Olympic Frozen Foods, Inc. STANDARD & POOR'S T–Z 4727–8; MOODY'S 869. The aggregate resources of all controlled non-banking business exceeds $275,000,000. *Hearings on S. 829* 22, 172.

6. *Hearings before Subcommittee of the Senate Committee on Banking and Currency on S. 1782 and H.R. 2,* 69th Cong., 1st Sess. 177–93, 227–36, 249–51, 256–8, 299–306, 307–29, 360 (1926) (hereinafter cited as *Hearings on S. 1782*); *cf.*, advertisement in Willows Journal (California), April 11, 1947, by the First National Bank of Willows, reprinted in *Hearings on S. 829* 36.

7. See DANA, *op. cit. supra* note 1, 173–7, 182–228; Saturday Evening Post, Sept. 27, 1947, pp. 79–82; *id.*, Oct. 4, 1947, pp. 28, 126. For Wall Street's attitude toward the Transamerica system, see Letter from the Board of Directors to Transamerica Stockholders, Dec. 9, 1931, in which the Board, then under Wall Street control, stated: "Your Board believes that it is unsound to link, through a holding company, the ownership and control of a bank with other unrelated activities, and that it is essential to the complete success of any bank that it should be operated and publicly regarded as an independent institution without responsibility for, or connection with, any other business."

8. Among banking authorities, California State Bank Superintendents were the first to offer resistance by refusing to permit the acquisition of additional branches by the Bank of America. But, since a rejection of branch applications was followed by the purchase and operation of independent banks through controlled holding companies, forebears of Transamerica, and since branch banking was finding increasing support among economists and politicians, state opposition to Giannini was short-lived. See generally DANA, *op. cit. supra* note 1, 72, 75–6, 88, 94–9, 102, 127–8; *Hearings on S. 1782* 323–6, 330; Fortune, July, 1947, pp. 69, 70; CHAPMAN AND WESTERFIELD, BRANCH BANKING 87–92 (1942). Proponents urged that through an extension of branch banking: 1) greater mobility of funds may be achieved, 2) otherwise bankless towns may be served, 3) more uniform banking standards and more expert supervision can be secured, and 4) greater capital can be accumulated for the needs of an expanding economy. *Id.* at 7–15. See also, *Hearings on S. 1782* 51, 111–22 (1947); *Hearings before Committee on Banking and Currency under H. Res. 141,* 71st Cong., 2d Sess. 1464 (1930). An explanation of the precipitate collapse of state opposition to Bank of America's branch policy has been attributed in part to the political pressure maintained by A.P. Giannini. See Los Angeles Times, Aug. 25, 1926, quoted in 68 CONG. REC. 2168 (1927); Saturday Evening Post, Sept. 20, 1947, p. 114.

9. Federal Deposit Insurance automatically covers all banks admitted to member-

surance Corporation,[11]—is aimed primarily at Transamerica.[12] Since the Board's power to act directly against bank holding companies is limited,[13] and since Congress has not yet acted on proposals for additional legislation,[14]

ship in the Federal Reserve System. 48 STAT. 169 (1933), as amended, 49 STAT. 687 (1935), 12 U.S.C. § 264(e) (1940). In addition, state non-member banks may secure coverage upon application to the Federal Deposit Insurance Corporation. 48 STAT. 179 (1933), as amended, 49 STAT. 687 (1935), 12 U.S.C. § 264(f)(2) (1940).

Although National Banks hold Reserve membership, 38 STAT. 251 (1913), 12 U.S.C. § 282 (1940), their supervision, where not inconsistent with the powers of the Board of Governors, is entrusted primarily to the Comptroller of the Currency. Supervision of state member banks is a primary function of the Board of Governors; of state non-member banks carrying deposit insurance, of the Federal Deposit Insurance Corporation. Compare, for example, REV. STAT. § 5168 (1875), 12 U.S.C. § 26 (1940), with 38 STAT. 259 (1913), as amended, 40 STAT. 232 (1917), 44 STAT. 1229 (1927), 48 STAT. 164 (1933), 48 STAT. 971 (1934), 49 STAT. 721 (1935), 12 U.S.C. § 321 (1940), and with 48 STAT. 170 (1933), as amended, 49 STAT. 687 (1935), 12 U.S.C. § 264(f) (1940).

10. See 78 REP. COMPTROLLER OF THE CURRENCY 5 (1940); *Hearings before Committee on Banking and Currency on H.R. 2634*, 78th Cong., 1st Sess. 15 (1943).

11. See REP. FDIC 10–11 (1944). See also the statements of Chairman Crowley in *Hearings before Committee on Banking and Currency on H.R. 1699*, 78th Cong., 1st Sess. 37–9, 49 (1943).

12. Entrance of the Bank of America into the Federal Reserve System provided only temporary opportunity for federal restrictions on the extension of branch banking, since the Banking Act of 1933 authorized National and other Federal Reserve member banks meeting certain capital requirements to maintain branches to the same extent permitted under state law to non-member banks. 48 STAT. 164 (1933), as amended, 49 STAT. 721 (1935), 12 U.S.C. § 321 (1940); 48 STAT. 189 (1933), as amended, 49 STAT. 708 (1935), 12 U.S.C. § 36(c) (1940). See CHAPMAN AND WESTERFIELD, *op. cit. supra* note 8, at 118–24. Federal banking authorities have, accordingly, directed increasing attention to the holding company or group banking aspect of the Giannini empire. See Cagle, *Branch, Chain and Group Banking* in BANKING STUDIES 131–8 (1941). Objections to group banking which mitigate the advantages which would be expected to be similar to branch banking are: 1) the difficulty of supervision and regulation, 2) greater expense of operation, and 3) the opportunity offered for speculation in bank stocks. CHAPMAN AND WESTERFIELD, *op. cit. supra* note 8, at 16.

13. The Board is authorized "as the public interest may require", to withhold from a "holding company affiliate" of a member bank permission to vote its stock therein. REV. STAT. 5144 (1875), as amended, 48 STAT. 86 (1933), 49 STAT. 710 (1935), 12 U.S.C. § 61 (1940); and 48 STAT. 166 (1933), 12 U.S.C. § 337 (1940). The definition of "holding company affiliate", however, includes only companies holding a majority of the outstanding shares of a bank, whereas control may be exercised with less than majority ownership. See note 32 *infra*. Moreover, 1) the Board's discretionary powers become operative only upon the need for and request by a holding company to vote its shares; 2) shares held in a non-member bank may be voted without permission; 3) the effective penalties operate more severely against the banks controlled than the holding company. For these reasons, the Board remains virtually powerless to act directly against the parent company. See *Hearings on S. 829* 9–12. The problem has become further complicated by the Investment Company Act of 1940, 54 STAT. 798 (1940), 15 U. S. C. § 80a-3(c)(4) (1940), which exempts from its provisions holding companies which have secured a single voting permit from the Board.

14. The Board secured the introduction of H.R. 2776 and S. 792 (anti-bank holding

the Board seeks to curb Transamerica indirectly by so conditioning the admission of individual banks into the Federal Reserve System as to prevent such banks from coming under Giannini control.

In *Peoples' Bank v. Eccles* [15] the Board's authority to exercise such indirect restraint on Transamerica expansion has been denied by the Court of Appeals for the District of Columbia upon the questionable ground that authority to restrain directly is inadequate. The facts are these. Incorporated in 1941 upon a finding by the California State Superintendent of Banks that the "public convenience and advantage" would be thereby promoted, the Peoples' Bank of Lakewood Village forthwith applied for membership in the Federal Reserve System. The bank was admitted by the Board of Governors subject, not only to conditions customarily imposed upon Reserve membership,[16] but also to a special condition—that membership would be withdrawn upon sixty days' notice if "without prior written approval of the Board of Governors" Transamerica Corporation or any unit, affiliate, or subsidiary of the Transamerica group, including the Bank of America, should acquire directly or indirectly "any interest in such bank other than such as may arise out of usual correspondent bank relationships. . . ." [17] Less than two years after acceptance by the bank of conditioned membership, without its knowledge, and consequently without prior approval of the Board, Transamerica acquired more than 10% of its outstanding shares of capital stock.[18] Informed that enforcement of the condition would result in deprivation of deposit insurance,[19] as well as Reserve membership, the bank requested its cancellation. On the Board's refusal, the bank instituted the present suit to have the condition declared void and its enforcement enjoined.

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company bill) in March 1945, 91 CONG. REC. 2747, 2795, A1476 (1945), which was withdrawn after extensive opposition developed. 92 CONG. REC. A2389 (1946). Substituted therefor was H.R. 6225 which died in Committee. 92 CONG. REC. 4264 (1946). On March 6, 1947, S. 829 was introduced by Senator Tobey and is still awaiting Congressional action.

15. 161 F.2d 636 (App. D.C. 1947), *cert. granted,* 68 Sup. Ct. 55 (Oct. 13, 1947).

16. *Id.* at 638. By these conditions, the bank is required to conduct its business "with due regard to the safety of its depositors", to seek Board approval of any change in the character of its business or in the scope of its corporate powers, to maintain adequate capital and surplus funds in relation to its assets and deposit liabilities, and to accede to restrictions on real estate loans.

17. *Ibid.*

18. As of December 31, 1946, Transamerica still held 540 shares in the Peoples' Bank of 5000 outstanding. MOODY'S 870; STANDARD & POOR'S T-Z 4728. On June 30, 1947, it was announced that Samuel B. Stewart, Jr., on the brief for the Peoples' Bank, had been appointed vice-president and general counsel of the Bank of America. STANDARD & POOR'S A-B 65-6 (Guide and Index Section, Oct.-Nov., 1947).

19. The Federal Deposit Insurance Corporation appears to have indicated "its unwillingness under existing circumstances to insure any newly organized State non-member bank in which Transamerica Corporation has a substantial interest or any bank in the group which may withdraw from the Federal Reserve System." Brief for Appellees, p. 26, Peoples' Bank v. Eccles, 161 F.2d 636 (App. D.C. 1947).

Reversing the lower court which had sustained a defense that the bank, having accepted Reserve membership, was estopped to question the validity of the condition,[20] the Court of Appeals, one judge dissenting, held that the condition as imposed "to prevent the enlargement of Transamerica" [21] was beyond the statutory power of the Board. In place of the original condition, the court substituted a judicial version requiring, before forfeiture could become effective, a finding that "a change for the worse" has occurred in the "character of the bank's personnel [or] in its banking policies" [22] jeopardizing the safety of its depositors.

Confronted with this decision and still desirous of curbing Transamerica, the Board had two alternatives. On the one hand, to enforce the condition as modified by the court's mandate would require a finding of jeopardy to depositors which the Board was presumably unprepared to make. Although charges have been levelled at Giannini-dominated banking associations that, for example, the ratio maintained between capital and deposits is inadequate [23] or that certain bank accounting practices are irregular,[24] there is no suggestion in its brief that the Board regards Transamerica's banking policy as unsound in the restricted sense adopted by the court. On the other hand, to secure review by the Supreme Court might enlarge the limited scope of the condition. Adopting the latter course, therefore, the Board has filed a successful petition for certiorari.[25]

Whether the Board's position will be vindicated on review will depend upon how the Supreme Court construes Section 9 of the Federal Reserve Act which authorizes the Board "subject to the provisions of this Act and to such

20. The decision of the lower court on this question is unreported. It had previously held that a sufficiently justiciable controversy existed to permit the invocation of a declaratory judgment. Peoples' Bank v. Eccles, 64 F. Supp. 811 (D.D.C. 1946).

21. 161 F.2d 636, 643–4 (App. D.C. 1947).

22. *Ibid.*

23. In a letter to A.P. Giannini by Board Chairman Eccles, March 3, 1943, the latter suggested that the low ratio between capital funds and deposits maintained by the Bank of America "might be considered an example of the kind of 'financial policy' referred to in recent correspondence and discussions" as unsound. Joint Appendix, pp. 90, 91, Peoples' Bank v. Eccles, 161 F.2d 636 (App. D.C. 1947). Compare the capital-deposit ratio of 7.1% maintained by Chase National Bank with the 4.3% ratio maintained by Bank of America. Fortune, July, 1947, p. 172. For the similar problem facing all banks, however, see the alarm broadcast by Chairman Harl of the Federal Deposit Insurance Corporation: "The ratio of capital to deposits [in all federally insured banks] had shrunk from 25% in 1914 to 11% in 1940, and is only about 6% today" despite the fact that in 1945 insured banks retained 70% of their profits in the capital account. Commercial & Finance Chronicle, May 16, 1946, p. 2690, cols. 4–5.

24. This charge formed a partial basis of the proceedings instituted against Transamerica in 1938 by the Securities and Exchange Commission and dismissed in 1947 after extensive hearings. See Bank of America, N.T. & S. Ass'n v. Douglas, 105 F.2d 100, 102–3 (App. D. C. 1939); Saturday Evening Post, Oct. 4, 1947, p. 128; DANA, *op. cit. supra* note 1, at 291–310; *cf.* Transamerica Corporation, 10 S.E.C. 454 (1941).

25. 68 Sup. Ct. 55 (Oct. 13, 1947).

conditions as it may prescribe *pursuant thereto*" to admit an applying bank to Reserve membership.[26] The Court of Appeals, consulting the legislative history of Section 9, found that Congress, "quite deliberately and because of what it considered an abuse of power," [27] inserted the words "pursuant thereto" as a substantial restriction on the power of the Board.[28] Turning then to repeated assertions by the Board in its pending appeal for Congressional action that it lacks the direct authority needed to control bank holding company expansion,[29] the court concluded that the condition in its original form is not "pursuant to the legislative intent in adopting the Act." [30]

But from the mere circumstance that the Board is unable to vindicate its banking policy by direct action against Transamerica, it does not follow that the Board is precluded from prescribing otherwise valid conditions of Reserve membership. Since in passing initially upon membership applications and deposit insurance eligibility, the Board is required by the Act itself to consider, *inter alia*, not only "the financial condition of the applying bank," but also "the general character of its management," [31] it should be

26. 40 STAT. 233 (1917), as amended, 44 STAT. 1229 (1927), 12 U.S.C. § 321 (1940) (italics added).

27. 161 F.2d 636, 641 (App. D.C. 1947).

28. Before amendment in 1927, § 9 read: "The Federal Reserve Board *subject to such condtions as it may prescribe* may permit the applying bank to become" a Reserver member. 40 STAT. 233 (1917) (italics added). There can be no doubt that, by the 1927 amendment, Congress did intend to restrict the power of the Reserve Board. But there is no evidence that Congress was concerned with the Board's power over bank holding companies, and the court did not purport to place its decision on this ground. The purpose of the amendment appears to have been twofold: 1) to remedy an obvious and inadvertent defect in the original act which had omitted to provide any limitation on the Board's discretion, *Hearings on S. 1782* 125; 66 CONG. REC. 4413 (1925); 68 CONG. REC. 3953 (1927); and 2) to prevent the Board from continuing in effect certain of its branch banking regulations which were inconsistent with provisions of the McFadden Act, 44 STAT. 1228–9 (1927), of which the amendment was a part. See *Hearings on S. 1782* 297; 66 CONG. REC. 1463–74 (1925). Compare the more restrictive amendments considered and rejected. *Id.* at 1779, 1819; 67 CONG. REC. 3241, 3249 (1926); *Hearings on S. 1782* 20.

29. Testimony of Marriner S. Eccles, Chairman of the Board of Governors in *Hearings before the Committee on Banking and Currency on H.R. 1699*, 78th Cong., 1st Sess. 132–3 (1943); *Hearings before Committee on Banking and Currency on H.R. 2634*, 78th Cong., 1st Sess. 13–5, 20–1 (1943); 30 REP. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM 34–7 (1943). Compare the testimony of Board Vice Chairman Ronald Ransom and Board Counsel J. Leonard Townsend in *Hearings before Subcommittee of House Committee on the Judiciary on H.R. 2357* (to amend the Clayton Act) 79th Cong., 1st Sess. 336–40 (1945).

30. 161 F.2d 636, 641 (App. D.C. 1947).

31. 40 STAT. 233 (1917), 12 U.S.C. § 322 (1940) (membership applications); 48 STAT. 169 (1933), as amended, 49 STAT. 688 (1935), 12 U.S.C. § 264(g) (1940) (deposit insurance eligibility). The Board is required to consider, in addition, "the adequacy of its capital structure, its future earnings prospects, . . . the convenience and needs of the community to be served by the bank, and whether or not its corporate powers are consistent with the purposes of this section." *Ibid.*

clearly empowered so to condition membership as to prevent the subsequent impairment of either. And the court recognized that a restriction of the type imposed by the Board is "pursuant" to the provisions of the Act [32] by itself substituting an emasculated version of the membership condition.

The real difficulty is that the Act fails to lay down any precise standards for determining when the "management" or "financial condition" of an applying bank is unsatisfactory.

The court chose the narrow criterion of the safety of the bank's own depositors; but there is a broader policy which the Federal Reserve Act was designed to effectuate. A reading of the Act and its history indicates that its primary purpose is to strengthen the national economy as a whole by the maintenance of a sound banking system.[33] The Board could reasonably

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32. If the premise is accepted that ownership of a majority of its shares is not necessary to obtain effective control of a company, (see Northern American Co. v. SEC, 327 U.S. 686, 693 (1946)), the restriction placed on the admission of the Peoples' Bank is directly related to its management and indirectly to its financial condition.

33. Except in its preamble ("An Act to provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes"), the objectives of the Federal Reserve Act are not articulated. Congress was, in fact, requested by Board Chairman Eccles to incorporate a more general statement of policy, but the request has been unanswered to date. See *Hearings before Committee on Banking and Currency on H.R. 5357*, 74th Cong., 1st Sess. 251 (1935).

Even as originally conceived, however, the Act, designed to remedy serious defects in the banking system responsible for a series of national financial panics, was directly concerned with the stabilization of the economy and only indirectly with the protection of individual bank depositors; see REP. NATIONAL MONETARY COMMISSION 6-9 (1912) (enumerating deficiencies in the banking system prior to the establishment of the Federal Reserve Board); H.R. REP. No. 69, 63d Cong., 1st Sess. 3-30 (1913); BURGESS, THE RESERVE BANKS AND THE MONEY MARKET c. 18 (Rev. ed. 1946); Willis, *Federal Reserve System* in 6 ENCYC. SOC. SCI. 154 (1931); while the Reserve Board the Act established was intended to insure "a banking policy which shall be uniform and harmonious for the country as a whole." H.R. REP. No. 69, 63d Cong., 1st Sess. 16 (1913). And an examination of its provisions, as amended, makes even more clear the responsibilities entrusted to the Board of Governors in the effectuation of broad economic policy. Thus, for example: Regulations governing open-market operations are to be adopted by the Board and representatives of the Reserve Banks "with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country." 48 STAT. 168 (1933), as amended, 49 STAT. 705 (1935), 12 U.S.C. § 263 (1940), 56 STAT. 647 (1942), 12 U.S.C. § 263 (Supp. 1946). Federal Reserve Banks, subject "to the orders of the Board of Governors . . ." may extend to member banks "such discounts, advancements, and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks, the maintenance of sound credit conditions, and the accommodation of commerce, industry and agriculture," 38 STAT. 254 (1913), as amended, 48 STAT. 163 (1933), 49 STAT. 704 (1935), 12 U.S.C. § 301 (1940), and may engage in purchase and sale of acceptances on the open market "whenever the Board of Governors of the Federal Reserve System shall declare that the public interest so requires." 38 STAT. 264 (1913), as amended, 42 STAT. 1480 (1923), 12 U.S.C. § 359 (1940). See also 38 STAT. 261 (1913), as amended, 49

conclude that the achievement of this objective [34] requires: 1) the preservation of independent member banks to minimize the possibilities of fiscal paralysis from the economic misfortunes of a single organization,[35] and 2) the separation of private banking control from the management of other corporate enterprises to insure that credit will be extended on an impartial basis to all members of the borrowing public.[36] It follows that the anticipated attempt of Transamerica to secure an interest in the Peoples'

STAT. 704 (1935), 12 U.S.C. § 248(m) (1940); 38 STAT. 264 (1913), as amended, 49 STAT. 706 (1935), 12 U.S.C. § 357 (1940); 48 STAT. 54 (1933), as amended, 56 STAT. S9(9. 706 (1935), 12 U.S.C. § 357 (1940); 48 STAT. 54 (1933), as amended, 56 STAT. 704 (1935), 12 U.S.C. § 241 (1940). For a judicial summary of the Board's responsibilities *see* Raichle v. Federal Reserve Bank, 34 F.2d 910, 912 (C.C.A. 2d 1931). For discussion by a member of the staff of the Board of Governors, see Goldenweiser, *Instruments of Federal Reserve Policy* in BANKING STUDIES 389 (1941).

34. It is quite possible that measures taken by the Board, conducive to the maintenance of a sound banking system as a whole, will be inconsistent with the best interests of an individual bank's depositors. "For example, an individual bank is generally regarded as having strengthened its position if, at the first sign of weakness or impending weakness in prices or values, it sells bonds and calls loans. If such a policy, however, is followed by many banks at the same time, either on their own volition or because of supervisory action, it may cause such a decline in values as to weaken the system as a whole. . . ." Leonard, *Supervision of the Commercial Banking System* in BANKING STUDIES 189, 192 (1941).

35. See *Hearings on S. 829 27*; SEN. REP. No. 1455, 73d Cong., 2d Sess. 294 (1934); 66 CONG. REC. 4437 (1925); *cf.* Brief for Appellees, pp. 36-7, Peoples' Bank v. Eccles, 161 F.2d 636 (App. D.C. 1947). "[I]f the Federal Deposit Insurance Corporation . . . itself had determined that Transamerica's bank expansion program was unsound from the standpoint of further extending the insurance liability of the United States to that group of affiliated banks, then it seems clear that such determination was entitled to the highest respect by the Board." *Ibid.* See also the remarks of Chairman Crowley of the Federal Deposit Insurance Corporation to Secretary of the Treasury Morgenthau: "Here I am guaranteeing 800 million in deposits all over the country, and 400 million of that is in one bank, the Bank of America." Saturday Evening Post, Oct. 4, 1947, p. 128.

36. See *Hearings on S. 829* 15, 20, 24. Such a separation of control would have the additional advantage of protecting bank depositors by insuring that loans would be extended only in the best interests of the bank. The court's mandate that a finding of jeopardy to depositors precede enforcement of the membership condition might conceivably sanction a mere finding that depositors in the Peoples' Bank are endangered by Transamerica's dual interest in both the bank and non-banking enterprises. From a reading of the opinion, however, it appears unlikely that the court had this problem in mind in framing the decree. Moreover, the additional requirement imposed by its mandate that the condition's enforcement be specifically predicated upon "a change for the worse" in the "character of the bank's personnel" "or in its banking policies" would seem to necessitate a finding of particular instances where the extension of credit to non-banking enterprises under Transamerica control was not in the best interests of the Peoples' Bank. In view of the practical difficulty involved in making such a determination, the Board is forced, therefore, to seek Supreme Court restoration of the original condition if its attempt to curb Transamerica is to be successful.

Bank forms a relevant consideration in evaluating the "general character of [the bank's] management" and thus, in conditioning its Reserve membership.

By the Banking Act of 1933 a further guidepost to Congressional policy was incorporated in the Reserve Act. Through an amendment requiring approval of the Board before a "holding company affiliate" of a member bank may vote its stock therein,[37] Congress sought for the first time to apply direct sanctions to bank holding companies. Although the inadequacy of the statute since its adoption to accomplish the purpose for which it was designed [38] has led the Board to seek its amendment,[39] it remains, nevertheless, a positive expression of Congressional policy diametrically opposed to the unfettered expansion of holding company control over "the affairs" of individual banking institutions. Here, then, is another standard against which the "character of management" of the Peoples' Bank should be judged.

Furthermore, it is arguable that the Board should be permitted to look beyond the broad policy of the Federal Reserve Act to the policy of the Clayton Act whose banking provisions it is expressly required to enforce.[40] Since the Clayton Act is intended to supplement the Sherman Act by reaching "in their incipiency" [41] combinations which "*may* substantially lessen competi-

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37. REV. STAT. 5144 (1875), as amended, 48 STAT. 186 (1933), 49 STAT. 710 (1935), 12 U.S.C. § 61 (1940) (amendment to National Banking Act applicable to National Banks); 48 STAT. 166 (1933), 12 U.S.C. § 337 (1940) (amendment to Federal Reserve Act applicable to State member banks). The amendment was adopted after an extensive study and investigation of "group, chain, and branch banking", *Hearings before House Committee on Banking and Currency under H. Res. 141*, 71st Cong., 2d Sess. (1930), followed by a favorable report from the Senate Committee on Banking and Currency, SEN. REP. No. 584, pt. 1, 72d Cong., 1st Sess. 9–11 (1932). Holding company control of member banks was strongly condemned as "a perversion of national banking and state banking laws . . . which tends toward danger in several directions." *Id.* at 9. Since, in the opinion of the Senate Committee, bank holding companies had "in some parts of the United States become well rooted . . ." with resulting difficulty in "eliminating or abolishing them in any effective way", it was "thought best to attempt the control and oversight of these companies" through controlling the conditions under which their stocks could be voted. *Id.* at 10.

38. See note 13 *supra*.

39. See note 14 *supra*.

40. 38 STAT. 734 (1914), 15 U.S.C. § 21 (1940). Thus, the Board, after hearing, may issue "cease and desist" orders against persons or banking associations violating the provisions of Clayton Act §§ 2, 3, 7, 8 (15 U.S.C. §§ 12, 13, 18, 19). Of particular importance are § 7 (prohibiting the acquisition by one corporation of the stock of a competing corporation or of corporations competing with each other whose effect may be substantially to lessen competition, to restrain commerce, or to create monopoly) and § 8 (prohibiting certain interlocking directorates between competing banks).

Another policy which might appropriately guide the Board in its duties under the Reserve Act is expressed in the Securities and Exchange Act of 1934 directing the Board to establish margin requirements for trading in securities registered on national securities exchanges. 48 STAT. 886 (1934), 15 U.S.C. § 78(g) (1940).

41. Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346, 356 (1922); *cf.* Fashion Originators Guild of America v. FTC, 312 U.S. 457 (1941).

tion or *tend* to create monopoly," [42] the Board, in evaluating the "character of management" of the Peoples' Bank, should not be precluded from weighing the possibility that Transamerica's influence upon that management may contribute to monopolistic tendencies in banking.[43] The Board has indicated fairly clearly its opinion that such a possibility is real,[44] and the factual foundations for its opinion do not appear wholly without merit.[45] On the one

42. 38 STAT. 731 (1914), 15 U.S.C. § 18 (1940) (italics added). Moreover, the Federal Reserve Act itself, passed by the same Congress which enacted the Clayton Act, implicitly contemplates a competitive banking system. See H.R. REP. No. 69, 63d Cong., 1st Sess. 18 (1913). In drafting the bill, the Committee on Banking and Currency abandoned "all thought of attempting a plan of banking reform based upon the conception of large privately managed institutions operating unrestrictedly and with great numbers of branches." *Id.* at 13. Compare the description of the Federal Reserve System by President Woodrow Wilson shortly after it had received executive approval, quoted in *Hearings before Committee on Banking and Currency on S. 1715 and H.R. 7617*, 72d Cong., 2d Sess. 262, 291 (1934). It does not follow, of course, that the location of competing banks within the same community is always possible or desirable. *Cf.* amendment to the Reserve Act, 49 STAT. 688 (1935), 12 U.S.C. § 264(g) (1940), whose limited effect on the competitive banking system is discussed in *Hearings on S. 1715 and H.R. 7617, supra*, at 143–5, 181–5, and Wyatt, *Federal Banking Legislation* in BANKING STUDIES 39, 60 (1941). Nor does it follow that even where independent banks coexist within the same community that the competition between them should be entirely unrestrained. *Cf.* Chandler, *Monopolistic Elements in Commercial Banking*, 46 J. POL. ECON. 1 (1938). To the extent that monopoly is permitted to grow, however, one of the premises upon which are predicated the credit policies entrusted to the Board is undermined. *Id.* at 21.

43. *Cf.* National Broadcasting Co. v. United States, 319 U.S. 190 (1944), where the Supreme Court sustained FCC regulations, designed to insure competitive conditions in the broadcasting industry, imposed upon radio networks applying for a license. The regulations were held to be within the broad authority of the Commission to act "in the public interest" although "the Act does not explicitly say that the Commission shall have power to deal with network practices found inimical to the public interest." *Id.* at 219. The Court indicated, moreover, that "the public interest" comprehends the purposes the anti-trust acts are designed to achieve despite the absence of Congressional authorization to the Commission to enforce either the Sherman or Clayton Acts and regardless of whether the monopolistic practices sought to be regulated were contrary to their express provisions. Compare the dissenting opinion by Mr. Justice Douglas in McLean Trucking Co. v. United States, 321 U.S. 67, 86 (1944), where he urges that despite the express exemption from the requirements of the anti-trust laws conferred upon participants in consolidations approved by the Interstate Commerce Commission, "administrative authority to replace the competitive system with a cartel should be strictly construed. . . . Since the 'public interest' includes the principles of free enterprise, which have long distinguished our economy, I can hardly believe that Congress intended them [the anti-trust laws] to be swept aside." *Id.* at 93–4.

44. Brief for Appellees, pp. 5–6, 26–8, 41–3, Peoples' Bank v. Eccles, 161 F.2d 636 (App. D.C. 1947). The Board, of course, does not propose to exact forfeiture of Reserve membership without the advance notice, hearing, and findings prescribed in 46 STAT. 250, 251 (1913), 12 U.S.C. § 327 (1940). *Id.* at 6.

45. Whether the instant acquisition by Transamerica of shares in the Peoples' Bank may be construed to violate § 7 of the Clayton Act, 38 STAT. 732 (1914), 15 U.S.C. § 18 (1940), is not capable of satisfactory determination upon the available facts. Moreover,

hand, banking associations competing with those in the Transamerica group are being progressively absorbed or eliminated.[46] On the other hand, non-banking enterprises under Transamerica control occupy a preferred position over their competitors in obtaining access to its credit facilities.[47]

It is questionable, therefore, whether the instant decision substantially limiting the power of the Board to condition Reserve membership can be justified by the Federal Reserve Act. There would seem to be no Congressional intention manifest in the express language of Section 9 to confine the Board's discretion in passing upon Reserve applicants to considerations affecting only the depositors of an individual bank or even depositors as a class. On the contrary, wherever Congress has affirmatively indicated the objectives of the Reserve System, it has emphasized that the Board must consider the needs of the borrowing and investing public as well as those of the individual lending institution. Reversal of the Court of Appeals' restrictive decision seems in order.

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no reported cases have been found to indicate the applicable extent of § 7 to banks, banking associations, or trust companies, for the excellent reason that the Board has not pursued its enforcement. J. Leonard Townsend, General Counsel for the Board, explains the hesitation of the Board to invoke Clayton Act proceedings by its conclusion that "it is more against than in the public interest to commence such a proceeding and let the onus fall upon the bank involved, as it would, rather than upon an acquiring corporation." *Hearings before Subcommittee of Committee on the Judiciary on H.R. 2357*, 79th Cong., 1st Sess. 340 (1945). The Board nevertheless wholeheartedly endorsed a proposed amendment to § 7 which would have extended the prohibition of stock acquisitions to include the acquisition of physical assets of competing corporations. *Id.* at 336.

The Board's hesitation in seeking enforcement of the Clayton Act provides a partial explanation for the imposition of Reserve membership conditions, voluntarily assumed by an individual applying bank, in an unsuccessful attempt to achieve a similar result without the undesirable consequences conceived by the Board to follow from Clayton Act enforcement. *But cf.* Brief for Appellees, pp. 45–6, Peoples' Bank v. Eccles, 161 F.2d 636 (App. D.C. 1947). It is not clear, however, in what way the onus of Clayton Act enforcement would fall upon an individual bank, since under 38 STAT. 734 (1914), 15 U.S.C. § 21 (1940), the Board could simply require Transamerica to divest itself of the shares held in the Peoples' Bank.

46. See pp. 297–8 *supra*. See also *Hearings on S. 829* 22, 24, 26, 39; *Hearings before Committee on Banking and Currency on H.R. 2634*, 78th Cong., 1st Sess. 14–5, 20–1 (1943); *cf. Hearings before Subcommittee of Committee on the Judiciary on H.R. 2357*, 79th Cong., 1st Sess. 336–40 (1945).

47. See *Hearings on S. 829* 22–4, 32–3, 41–2.

INTRA-FAMILY ASSIGNMENTS AND INCOME TAXATION: USE OF THE CORPORATE FORM AS A MEANS OF AVOIDANCE*

In the last twenty years increasing judicial realism has frustrated a number of tax-reducing, income-splitting schemes.[1] One such device, the intra-family assignment, seemed consigned to relative obscurity under the holdings of the *Horst, Eubank* and *Schaffner* cases.[2] But a recent circuit court of appeals decision, by exclusive concern with the superficial, appears to revitalize this contrivance and also to invite further personal income tax evasion through use of the corporate form.

In *Sunnen v. Commissioner* [3] the taxpayer, an inventor-patentee, assigned to his wife his "right, title and interest" in several licensing contracts. The contracts granted ten-year, non-exclusive licenses to a corporation for the manufacture and sale of items covered by his patents, in exchange for a percentage of the sales, and were terminable by either party—some on six months', others on a year's notice.[4] Eighty-nine percent of the licensee corporation's stock was owned by the taxpayer, who was one of the company's five directors. The remaining shares were split among the other directors, one of whom was the wife-assignee.[5] In reviewing the Tax Court's finding

* Sunnen v. Commissioner, 161 F.2d 171 (C.C.A. 8th 1947).

1. Lusthaus v. Commissioner, 327 U.S. 293 (1946), Commissioner v. Tower, 327 U.S. 280 (1946) and Burnet v. Leininger, 285 U.S. 136 (1932) (family partnerships); Helvering v. Clifford, 309 U.S. 331 (1940) (short-term family trusts with settlor retaining managerial control over corpus); Lucas v. Earl, 281 U.S. 111 (1930); Brown v. Commissioner, 115 F.2d 337 (C.C.A. 2d 1940) (assignment of fees to wholly-owned corporation); Jones v. Page, 102 F.2d 144 (C.C.A. 5th 1939), *cert. denied*, 308 U.S. 562 (1939).

See generally Lowndes, *The Tax Decisions of the Supreme Court, 1940 Term*, 90 U. OF PA. L. REV. 1 (1941); Polisher, *Assignment of Income---An Ineffective Attempt to Reduce Income Taxes*, 78 J. ACCOUNTANCY 224 (1944).

2. Helvering v. Horst, 311 U.S. 112 (1940) (assignment of bond coupons before maturity); Helvering v. Eubank, 311 U.S. 122 (1940) (assignment of agent's commissions on renewals of insurance policies); Harrison v. Schaffner, 312 U.S. 579 (1941) (assignment of trust income for one year). In each case the income was held taxable to the assignor. See Notes 41 COL. L. REV. 340, 26 CORN. L. Q. 510, 39 MICH. L. REV. 495 (1941).

3. 161 F.2d 171 (C.C.A. 8th 1947).

4. For the licenses the corporation (the Sunnen Products Company) agreed to pay 10% of the gross sales price of the devices, which were used in the repair of automobiles. 161 F.2d 171, 173 (C.C.A. 8th 1947). The termination provision read: "either party shall have the right without liability for damages or breach, to cancel this license. . . ." *Id.* at 174.

5. Of the corporation's 2,000 outstanding shares of capital stock, the husband held 1,780. He also served as President. His wife owned 200. The vice-president held eighteen shares, and the remaining two directors owned a single share each. 161 F.2d 171, 172 (C.C.A. 8th 1947).

of tax liability, the circuit court conceded that if the taxpayer could abrogate the contracts which he had assigned, the royalties were taxable to him, but reversed on the theory that he had no such power.[6] The basis for this conclusion was that since three of the corporation's five directors must approve any corporate action, the taxpayer-assignor as a single director was unable to terminate the contracts.

The power of an assignor to defeat the assignee's receipt of income is generally well established as justification for taxing the assignor.[7] This concept of "negative control" saw principal service in the post-*Lucas* era.[8] The disallowance in that case of anticipatory assignments on income as legitimate means of reducing taxes had prompted taxpayers subsequently to characterize all intra-family assignments as transfers not of future income but of income-producing property. Thus the application of the practical concept of negative control, rationalized in terms of equivalency to income, was useful in despatching arguments that the location of "title" to the source of income foreclosed taxation of the transferor.[9]

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6. In its unanimous opinion, 6 T.C. 431 (1945), the Tax Court had relied heavily on its decision in Estate of J.G. Dodson, 1 T.C. 416 (1943). Dodson licensed a corporation in which he owned 51% of the stock for the exclusive use of a trade mark owned by him. His wife owned 49% of the stock, and he assigned to her one-half interest in the contract. There was one other director. The Tax Court ruled that his dominant stock position permitted him to cancel the licenses and thus rendered him taxable on the income flowing from his wife's "interest." The circuit court plainly considers the Dodson decision erroneous. 161 F.2d 171, 174, 176 (C.C.A. 8th 1947).

Both the Tax Court and the circuit court are interpreting a Congressional statute which sheds no light on the specific problem at hand. It reads: "'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities or the transaction of any business carried on for gain or profit or for gains or profits and income derived from any source whatever. . . ." INT. REV. CODE § 22(a). The taxable years involved were covered by a statute employing identical language. Revenue Act of 1936, § 22, 49 STAT. 1648 (1936). The applicable Treasury Regulation is no more helpful. U.S. Treas. Reg. 101, § 22(a) (1938).

7. 2 MERTENS, LAW OF FEDERAL INCOME TAXATION § 18.02. (1942); Note, 31 ILL. L. REV. 271 (1936).

This power is seldom a major factor in the ordinary income tax case involving the assignment of licensing contracts because the licensor rarely has any interest in the manufacturing licensee. Nelson v. Ferguson, 56 F.2d 121 (C.C.A. 3d 1932), *cert. denied*, 286 U.S. 565 (1932); J.E. Lilienfeld, 35 B.T.A. 391 (1937); Ralph M. Lovejoy, B.T.A. MEM. OP. DKT. No. 93197 (April 28, 1939). Estate of J.G. Dodson, 1 T.C. 416 (1943) is the lone exception. See note 6 *supra*.

8. Lucas v. Earl, 281 U.S. 111 (1930), 43 HARV. L. REV. 1282, 8 TEX. L. REV. 610.

9. Rossmoore v. Commissioner, 76 F.2d 520 (C.C.A. 2d 1935) (wife's interest in partnership ignored as the tax determinant); Ward v. Commissioner, 58 F.2d 757, 760 (C.C.A. 9th 1932) (". . . decedent was free to transfer the lease itself, thereby depriving himself of the right to receive future rentals and rendering the assignments to

While professing full adherence to this concept, the court in the instant case sapped it of considerable vitality by failing to recognize basic powers of the assignor. It overlooked the significance of the assignor's continuing status as patent owner and the non-exclusive nature of the licenses.[10] These two facts enable the assignor to license other firms and thereby possibly to cut off some of his wife's royalties.[11] Reduction of the royalties might also be accomplished by his refusal to prosecute patent infringements.[12]

More unfortunate is the court's reasoning that the assignor cannot effect

petitioners valueless . . ."); Chicago Title and Trust Co., 33 B.T.A. 65 (1935) (right to attorney's fees); T.J. Primm, 28 B.T.A. 13 (1933).

Instead of branding the barren "title" argument as irrelevant, the court in the principal case devoted considerable space to this sophistic type of reasoning. See L. Hand, J., dissenting in *In re* Lake's Laundry, 79 F.2d 326, 328 (C.C.A. 2d 1935). Its participation in the chicken-and-egg argument as to whether the patents, retained by the taxpayer, or the contracts, held by his wife were the source of royalties is unfortunate since the precedent which the court summons is very weak. Of the seven cases cited as establishing that the contracts were the source, six do not pertain to royalties and patents. Commissioner v. O'Donnell, 90 F.2d 907 (C.C.A. 9th 1937), *rev'd on other grounds,* 303 U.S. 370 (1938); Shanly v. Bowers, 81 F.2d 13 (C.C.A. 2d 1936) (legatee conveyed legacy to a trust company as trustee for wife); Helvering v. Seatree, 72 F.2d 67 (App. D.C. 1934) (interest in profits of a partnership); Lowery v. Helvering, 70 F.2d 713 (C.C.A. 2d 1934) (income from legacy under a will); Hall v. Burnet, 54 F.2d 443 (App. D.C. 1931), *cert. denied,* 285 U.S. 552 (1932) (right to commissions on insurance premiums); Commissioner v. Field, 42 F.2d 820 (C.C.A. 2d 1930) (assignment of part of amount due under will).

The lone cited case which does involve patents and royalties is not in point because there the contract assignor had previously assigned the patents to the manufacturer; whereas here he retained ownership of them. Nelson v. Ferguson, 56 F.2d 121 (C.C.A. 3d 1932), *cert. denied,* 286 U.S. 565 (1933).

In Lilienfeld v. Commissioner, 35 B.T.A. 391 (1937), which the *Sunnen* court does not cite, it was held that the assigned licensing contract was the sole source of the royalties, but there the Board had treated the exclusive licensing arrangement as an assignment of the patents to the manufacturing licensee.

Two other decisions assume the circuit court's contention expressly for the sake of argument and then proceed to an opposite conclusion—*i.e.,* taxation of the assignor. Washington v. Commissioner, 80 F.2d 829 (C.C.A. 2d 1936), *cert. denied,* 298 U.S. 689 (1936) (power to defeat the assignees' income by express reservation); Estate of J.G. Dodson, 1 T.C. 416 (1943). See note 6 *supra.*

10. The court does not even mention the fact that these are non-exclusive licenses. For a description of the various types of licenses see 2 WALKER ON PATENTS §§ 366–80 (Deller's ed. 1937).

11. The likelihood that a reduction of his wife's royalties would result from additional licenses destroys the court's analogy to land rentals. The court argues that the royalties were no more under the assignor's control after assignment of the contract than would be the rentals after an assignment of a realty lease. 161 F.2d 171, 175 (C.C.A. 8th 1947). But the difference between a lease of realty and a non-exclusive license is considerable since ordinarily the assignor of the former could not diminish its value.

12. Nor could the Sunnen corporation, itself, successfully institute an infringement suit, for a non-exclusive licensee cannot maintain such a suit. Contracting Division, A.C. Horn Corp. v. N.Y. Life Ins. Co., 113 F.2d 864 (C.C.A. 2d 1940).

termination of the contracts by the corporation because he has but one of the three directors' votes necessary to sanction such action.[13] It is unlikely that directors with token stock holdings would defy a director with holdings of eighty-nine per cent.[14] And even if such defiance did occur, the assignor's frustration would last only until the next annual shareholders' meeting when he could replace the recalcitrants with more pliable directors.[15] Because of this control the assignor could also determine the corporation's production and sales policies. Since no minimum royalties are specified and since the corporation produces mechanical devices other than those covered by the contracts,[16] petitioner might even stop all his wife's income, without canceling the contracts, by simply ceasing to manufacture the particular patented objects.

Nor does the wife appear able to forestall termination of the contracts as long as the required notice is given her. As assignee she is a party to agreements expressly terminable by the other party without liability. As a minority stockholder, she could seek enforced continuation of the contracts on the ground that cancellation would be a wrong to the corporation.[17] Such a claim, however, would fall apart upon the inevitable showing that the assignor and the corporation were prepared to enter into a new arrangement on terms more favorable to the corporation—on an exclusive licensing basis.[18] In fact, the only untrammelled right which the wife appears to have is the dubious one of terminating the contracts.[19]

13. "A majority stockholder in a corporation neither owns nor directly controls the contracts or assets of the corporation. The only legitimate thing the corporation could do in this case to destroy the income from royalties would be to exercise its reserved right to cancel the contracts upon notice, as provided in each contract. On that proposition Sunnen could vote as one member of the board of five directors only." 161 F.2d 171, 176 (C.C.A. 8th 1947).

14. Federal statutes embody just such skepticism. Investment Company Act, 54 STAT. 789, 15 U.S.C. § 80a-1 (1940) (presumption that company having twenty-five percent of the voting stock of another company has controlling influence in the latter); Public Utility Act, 49 STAT. 803 § 2(a) 7 (1935), 15 U.S.C. § 79b (1940) ("holding company" defined as one which directly or indirectly controls ten percent of the voting shares of a public utility company).

For description of British law on the subject see Comment, 56 YALE L. J. 1383 (1947).

15. Transcript of Record, pp. 31–2, Sunnen v. Commissioner, 161 F.2d 171 (C.C.A. 8th 1947).

16. *Id.* at 33–4, 36–7, 39–41.

17. Of course there is some doubt that equity would take jurisdiction in a family situation such as this. *See* Sockstrom v. Commissioner, 148 F.2d 491, 495–6 (C.C.A. 8th 1945); White v. Higgins, 116 F.2d 312, 320 (C.C.A. 1st 1940).

18. Or the assignor might agree to royalties of only 5% as compared with the present figure of 10%. The arrangement would mean only that the "lost" royalties would appear as dividends, and the assignor with 89% of the stock would receive only 5.5% less total income than he would receive if he were being paid royalties of 10%.

19. In the light of all these facts, the *Sunnen* opinion seems in error when it distinguishes the case of Dickey v. Burnet, 56 F.2d 917 (C.C.A. 8th 1932), *cert. denied*, 287

The decision also is unorthodox in the light of doctrines developed in related tax fields. Thus the entire earnings of a family partnership are attributable to the husband if cessation of his efforts would eliminate those earnings.[20] Various trust concepts, furthermore, are equally applicable. The settlor who can change the trust beneficiaries has been held taxable on the trust income even if he himself cannot become a beneficiary.[21] More striking is the analogy to a revocable trust, for in the present case the transferor could not only cut off his wife's royalties but could also channel them to himself by termination of the contracts.[22] And if the assignor were prevented

U.S. 606 (1932) on the theory that in that case the assignor could veto the assignee's right to income, whereas in the instant case he could not. In the *Dickey* case the taxpayer sold to a corporation, controlled by himself, a tract of clay-producing land. In return the corporation agreed to pay two-thirds of the gross income from the land to the taxpayer's wife and children. The income from the land was derived from a contract between Dickey and the corporation specifying a set price per ton of clay; this contract was subject to alteration or termination at the will of the parties. The only significant difference between the two cases is that notice was required in the *Sunnen* case. The fact that Dickey's wife and children were beneficiaries and not assignees of the contract is of no consequence. They as well as Mrs. Sunnen could sue if the corporations failed to pay the royalties as agreed. But obviously such failure would occur only at the instigation of the husbands, who had the legal weapons at hand to effect the same result.

The court's finding of "no control" may run into another difficulty—the "rule" in Dobson v. Commissioner, 320 U.S. 489 (1943), that the Tax Court's findings are to be accorded the status of those of administrative agencies. As the circuit court rendering the *Sunnen* opinion expressed it in an earlier case: ". . . [Where] fair-minded men may honestly draw different conclusions . . . the conclusion reached by the Tax Court is binding." Doll v. Commissioner, 149 F.2d 239, 247 (C.C.A. 8th 1945). In other words, this court's contention appears to be that no fair-minded person could conclude that Sunnen had control of the policies of the Sunnen Products Company.

For evaluation of the "rule" in Dobson v. Commissioner, *supra*, see Paul, *Dobson v. Commissioner: The Strange Ways Of Law And Fact*, 57 HARV. L. REV. 753 (1944); Note, 29 CORN. L. Q. 515 (1944).

20. Burnet v. Leininger, 285 U.S. 136 (1932); Rossmoore v. Commissioner, 76 F.2d 520 (C.C.A. 2d 1935). In the latter case, L. Hand, J. held the *Burnet* case to be controlling: "Nothing turned upon the form of the transfer, and everything upon the fact that the assignor remained in control of the income since it was only through his continued efforts that it could be earned . . . any future earnings which he can assign are conditional upon his continued efforts and remain in that sense at his disposition. That is the critical factor; the legal scaffolding is of no consequence. . ." *Id.* at 521.

21. Commissioner v. Buck, 120 F.2d 775, 777 (C.C.A. 2d 1941) ("when there is . . . the power freely to sprinkle the income about among any beneficiaries he may select (as if he were playing a hose) . . . ," the settlor may be taxed on the trust income).

The newest Treasury rulings likewise would attribute to the settlor trust income which he can shunt to others at will by switching beneficiaries. This holds true regardless of the duration of the trust or of the absence of other controls. T.D. 5488, 1 CUM. BULL. 19 (1946), as amended by T.D. 5567, 1947 INT. REV. BULL. No. 14 at 2 (1947).

22. Such a situation apparently would have overcome the qualms felt by some judges in the 1930's when they were invoking the principle of negative control. In Har-

from cancelling a contract for the two years requisite for displacement of recalcitrant directors and notice of termination,[23] that figure would still be well within the six-year limit set out in the *Clifford* case.[24] Furthermore, irrespective of any powers of the assignor, the ten-year life of the licenses is but a single day beyond the duration of the "short-term" trust, the income of which is automatically taxable to the settlor under current Treasury Regulations.[25]

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wood v. Eaton, 68 F.2d 12, 14 (C.C.A. 2d 1933) L. Hand, J. confessed, ". . . I have some difficulty in thinking of the income as remaining within the assignor's control, merely because he can defeat payment by defaulting; but I accept that explanation. . . ." In the *Lucas*-type situation, rationalization is difficult since in defeating his wife's income he must cut off his own. But here elimination of his wife's income may mean appropriation of the same to himself.

The two-year maximum results from the year's duration between meetings of the Board of Directors and the requirement of a year's notice for termination of the contracts. Income from a revocable trust is always taxed to the settlor under specific statutory mandate. The constitutionality of the original act (Revenue Act of 1924, 43 STAT. 253, 277 (1924)) was upheld in Corliss v. Bowers, 281 U.S. 376 (1930), the rationale of which appears equally appropriate to the instant case. "The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income whether he sees fit to enjoy it or not. . . ." *Id.* at 378. See 42 HARV. L. REV. 958 (1929), 15 MINN. L. REV. 129 (1930), 78 U. OF PA. L. REV. 440 (1929).

The statute involved in the *Corliss* case embraced trusts revocable within the "taxable year", and in Langley v. Commissioner, 61 F.2d 796 (C.C.A. 2d 1932), a circuit court upheld a taxpayer claiming immunity because he reserved the right to revoke one year and one day after the notice is given. A statutory amendment ruled out this dodge. The applicable part of the present provision reads: "Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—(1) in the grantor alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or interest therefrom . . ." 53 STAT. 68 (1939), 26 U.S.C. § 166 (1940).

23. This period of temporary frustration for the assignor would be only one year and a half in some instances, since some of the contracts were terminable on six months' notice.

24. Helvering v. Clifford, 309 U.S. 331 (1940), 38 MICH. L. REV. 885, 49 YALE L.J. 1305. It is true that the short duration of the trusts was not the only reason for taxing the settlor on the trust income. Additional factors were the intra-family nature of the arrangement and the managerial powers which the settlor retained over the corpus. This latter element has its counterpart in the instant case—Sunnen's control over the manufacturing and sales policies of the licensee. See p. 311 *supra*. For the complementary nature of the three criteria in the *Clifford* case, see L. Hand, J. in Helvering v. Elias, 122 F.2d 171, 173 (C.C.A. 2d 1941), *cert. denied*, 314 U.S. 692 (1941).

25. Under T.D. 5488, 1 CUM. BULL. 19 (1946), as amended by T.D. 5567, 1947 INT. REV. BULL. No. 14 at 2 (1947), the income from any trust established for less than ten years is taxable to the settlor. Trusts with lives ranging from ten to fifteen years find the settlor taxed if he retains certain administrative powers. If a trust is for longer than fifteen years, the settlor is immune unless he is able to determine the beneficiaries, which power always warrants imposition of tax liability. For strong disapproval of this Treasury Department "legislation" see Pavenstedt, *The Treasury Legislates: The*

Not only is the holding at odds with these standards of taxability—*i.e.*, negative control and revocable trust,[26]—but it suggests a new method of income deflection not confined to the field of royalty contracts. A husband who controlled a corporation could secure a contract between the corporation and his wife for the use of some of the wife's property on terms unfavorable to the corporation.[27] In the *Sunnen* case the specified percentage of sales appears normal, but if the royalties had been excessively high, some of the husband's dividend income would have been diverted to his wife. This device would find favor only with prosperous corporations, but it could be employed wherever the wife held property used by the corporation under a terminable arrangement. The mere existence of dummy directors would legitimize the arrangement.[28]

Perhaps the logical answer to this, as to most problems of family income, lies in Congressional enactment of statutes requiring compulsory joint returns or per capita allocation of total family earnings.[29] Meanwhile the only

Distortion of the Clifford Rule, 2 TAX L. REV. 7 (1946); but see PAUL, TAXATION FOR PROSPERITY 299 (1947).

26. Another possible rationale for taxing the assignor would be grounded on the "earner" theory. Lucas v. Earl, 281 U.S. 111, 114 (1930) ("there is no doubt that the statute could tax salaries to those who earned them . . ."); Lusthaus v. Commissioner, 327 U.S. 293 (1946); Saenger v. Commissioner, 69 F.2d 631, 632 (C.C.A. 5th 1934) ("it is an expression of the simple truth that earned incomes are taxed to and must be paid by those who earn them. . . ."); Robert E. Werner, 7 T.C. 39 (1946).

Ordinarily this theory would be inapplicable since royalties on a percentage basis stem from both the prior efforts of an inventor-patentee and the manufacturing and sales activities of the licensee. But here it is possible to claim that the assignor's power to set corporate policy makes the licensee's efforts synonymous with those of the assignor. Of course invocation of this rationale would entail far more frequent taxation of assignors than is the case today.

27. This seems to have been the essence of the scheme in Dickey v. Burnet, 56 F.2d 917 (C.C.A. 8th 1932), *cert. denied*, 287 U.S. 606 (1932). See note 14 *supra*.

28. It must be remembered that the *Sunnen* decision's respect for formal corporate authority diverges from recent judicial policy. Griffiths v. Commissioner, 308 U.S. 355 (1939) (corporation ignored in taxing individual who controlled it and dealt with it); Higgins v. Smith, 308 U.S. 473 (1940); Brown v. Commissioner, 115 F.2d 337 (C.C.A. 2d 1940) (attorney fees assigned to wholly owned corporation regarded as assignor's).

29. Attempts to secure Congressional passage of a statute requiring compulsory joint returns failed in 1941. A Wisconsin statute of similar purpose was held unconstitutional in Hoeper v. Tax Commission, 284 U.S. 206 (1931), but the presumption of constitutionality now accorded federal economic legislation suggests that the present tribunal would uphold such a Congressional Act against due process arguments.

For discussion of the per capita allocation scheme, by which all members of the family would be taxed an equal fraction of the family's total income, see Surrey, *Family Income and Federal Taxation*, 24 TAXES 980, 984 (1946).

Extension of the state community property laws, which the Treasury recognizes as sanctioning income-splitting between husband and wife under Poe v. Seaborn, 282 U.S. 101 (1930), continues in the face of Congressional inaction. Three state legislatures enacted such laws this year—Nebraska, Michigan and Pennsylvania—making a total of twelve in all. N.Y. Times, August 23, 1947, p. 17.

remedy for weakening of the surtax structure lies in the courts' realistic application of available criteria. The *Sunnen* decision's distortion of the control standard by resort to a naive conception of corporate life is clearly incompatible with such an objective.

SECTION 18 OF THE JUDICIAL CODE: THE POWER OF A SENIOR CIRCUIT JUDGE TO REMOVE A SITTING DISTRICT JUDGE*

SECTION 18 of the Judicial Code [1] empowers a senior circuit judge to assign, if the public interest requires, any circuit judge to hold a district court.[2] Whether the section authorizes no more than administrative assignment where district judges are unavailable, or whether public interest in the dispatch of particular litigation may call for examination of conduct of the trial, and, where necessary, subsequent reassignment of the case, is a question which has heretofore remained unanswered. Senior Circuit Judge Evans of the Seventh Circuit, however, has recently indicated, in holding that Section 18 did not vest him with authority to designate a circuit judge to displace a sitting district judge, that construction of the section is limited to the former alternative.[3]

Arising out of the fourteen year old reorganization of the Chicago, Rock Island & Pacific Railroad,[4] a petition was presented by secured creditor

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Thus there is considerable pressure from those states not having community property laws to secure revision of existing federal laws so as either to remove the effect of such laws on the federal income tax or to permit all couples everywhere to split their income for tax purposes. For comprehensive study of the entire family tax problem and possible modes of treatment see TREASURY DEPARTMENT, TAX TREATMENT OF FAMILY INCOME (1947).

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* *In re* Chicago, Rock Island and Pacific Ry., 162 F.2d 606 (C.C.A. 7th 1947).

1. 36 STAT. 1087–1169 (1911), as amended, 28 U.S.C. §§ 1–450 (1940).

2. 36 STAT. 1089 (1911), 28 U.S.C. § 22 (1940), as amended, 56 STAT. 1095 (1942), 28 U.S.C. § 22 (Supp. 1942). The pertinent part of the section reads as follows: ". . . (a) The Chief Justice of the United States, . . . or the circuit justice of any judicial circuit, or the senior circuit judge thereof, may, if the public interest requires, designate and assign any circuit judge . . . to hold a district court within such circuit."

3. 162 F.2d 606 (C.C.A. 7th 1947).

4. The railroad petitioned on June 7, 1933, in the District Court for the Northern District of Illinois, for reorganization under § 77 of the National Bankruptcy Act, 47 STAT. 1474 (1933), as amended, 11 U.S.C. § 205 (1940). For a history of the voluminous litigation that ensued, *see* Continental Illinois Nat. Bank and Trust Co. v. Chicago, R.I. & Pac. Ry., 72 F.2d 443 (C.C.A. 7th 1934), *aff'd*, 294 U.S. 648 (1935); *In re* Chicago, R.I. & Pac. Ry., 90 F.2d 312 (C.C.A. 7th 1937), *cert. denied sub. nom.* Bankers' Trust Co. v. Wise, 302 U.S. 717 (1937); *In re* Chicago, R.I. & Pac. Ry., 90 F.2d 795

groups, who alleged that obstructionist tactics and deliberate delay by the district judge were preventing effectuation of the plan of reorganization.[5] Requesting assignment of a circuit judge to succeed the sitting district judge, petitioners argued that the public interest called for exercise by the senior circuit judge of the authority vested in him by Section 18 to appoint a circuit judge to conclude the proceedings, because litigation of great public importance was proceeding neither expeditiously nor judicially.[6] In denying the petition, Judge Evans held that neither the legislative history nor previous construction of the section seemed to warrant assumption of power to displace a sitting district judge [7]—a conclusion he felt to be substantiated by the adequate remedies otherwise available to litigants.

(C.C.A. 7th 1937); *id.* 108 F.2d 410 (C.C.A. 7th 1939); *id.* 110 F.2d 395 (C.C.A. 7th 1940); *id.* 50 F. Supp. 835 (N.D. Ill. 1943); *id.* 149 F.2d 529 (C.C.A. 7th 1945), *rev'd sub nom.* Meyer v. Fleming, 327 U.S. 161 (1946); *In re* Chicago, R.I. & Pac. Ry., 67 F. Supp. 547 (N.D. Ill. 1945), *aff'd sub nom.* Chicago, R.I. & Pac. Ry. v. Fleming 157 F.2d 241 (C.C.A. 7th 1946), *cert. denied,* 329 U.S. 780 (1946); *In re* Chicago, R.I. & Pac. Ry., 155 F.2d 889 (C.C.A. 7th 1946), *rev'd per curiam sub nom.* Fleming v. Traphagen, 67 Sup. Ct. 365 (1946), *rehearing denied,* 67 Sup. Ct. 500 (1947); *In re* Chicago, R.I. & Pac. Ry., 160 F.2d 942 (C.C.A. 7th 1947); *id.* 160 F.2d 949 (C.C.A. 7th 1947); Cheston v. Igoe, 162 F.2d 257 (C.C.A. 7th 1947).

See Chicago, R.I. & Pac. Ry., 242 I.C.C. 298 (1940) (original plan of reorganization); *id.* 257 I.C.C. 307 (1944) (modified plan of reorganization).

5. Petitioners alleged that District Judge Igoe and his appointee, Trustee Colnon, had "virtually announced that they consider their province to be to work for unsecured creditors and stockholders" who were eliminated by the plan of reorganization. Petition, p. 3. *See* Chicago, R.I. & Pac. Ry., 257 I.C.C. 307 (1944) (modified plan of reorganization). Judge Igoe delayed more than ten months before approving the plan and three months before refusing to confirm it. After the circuit court ultimately affirmed it, *In re* Chicago, R.I. & Pac. Ry., 160 F.2d 942 (C.C.A. 7th 1947), the district judge then refused to accept two nominees of the secured creditors for reorganization managers, thereby substantially altering the plan. *See* Cheston v. Igoe, 162 F.2d 257, 258 (C.C.A. 7th 1947). Meanwhile, Trustee Colnon was allegedly attempting to organize stockholders to oppose the plan, although under § 77(f) the court was obligated to carry it into effect. Petition, p. 8. *See In re* Chicago, R.I. & Pac. Ry., 162 F.2d 606, 614 (C.C.A. 7th 1947) (remarks of Judge Evans concerning impropriety of Trustee Colnon's actions). Two weeks prior to Judge Evans' opinion in the instant case, the circuit court issued a writ of mandamus directing the District Judge to expunge his alteration from the plan. Cheston v. Igoe, *supra.* Petitioners claimed that the net result of Judge Igoe's actions was an unnecessary delay of two years. Brief for Petitioners, p. 10.

6. The principal business of a court in a railroad reorganization is to effect a reorganization diligently. Continental Illinois Nat. Bank & Trust Co. v. Chicago, R.I. & Pac. Ry., 294 U.S. 648, 685 (1935); *In re* Chicago, R.I. & Pac. Ry., 72 F.2d 443, 452 (C.C.A. 7th 1934). On the basis of the district judge's statement that the court could have no confidence in any nominees proposed by the secured creditors, petitioners claimed that he could not henceforth pass judicially on the suitability of such nominees. Brief for Petitioners, p. 11. Allegations that Judge Igoe had stimulated hostility between Colnon and his co-trustee were also pointed to as indicative of unjudicial administration of the case. Brief for Petitioners, p. 12.

7. Judge Evans conceded, however, that "There are some judicial precedents which

Although it is not clear from an analysis of the legislative history of Section 18 how much latitude Congress intended to give a senior circuit judge to act in the public interest,[8] it would seem that Congressional acquiescence

seem to uphold the construction which petitioners place upon this statute. . . ." 162 F.2d 606, 612. He distinguished M. L. Sylvia, 34 F. Supp. 404 (D.C. Mass. 1940) and Johnson v. Manhattan Ry., 289 U.S. 479 (1933). See note 10 *infra*. But he conceded that the action of Judge Lewis of the Tenth Circuit in substituting a judge to sit in the place of Judge Hopkins was a holding "in favor of the petitioners." 162 F.2d 605, 613. See note 11 *infra*.

8. The section was originally reported as merely a measure to remedy congestion in district courts by permitting circuit judges to try cases therein. *Report of Special Joint Committee on Revision of the Laws*, H.R. Doc. No. 783, 61st Cong., 2d Sess., p. 1, pp. 5, 13 (1910). It also appears that a collateral purpose of the section was to permit circuit judges to conclude unfinished equity cases over which they had formerly exercised original jurisdiction. *See* Penna. Steel Co. v. New York City Ry., 221 Fed. 440, 442 (S.D. N.Y. 1915) and Note, 42 YALE L. J. 279, 282 (1932).

On the other hand, committee members explained to their respective houses that § 18 was intended to establish a flexible plan whereby any circuit judge might be assigned to hold a district court whenever occasion therefor might arise, whether from pressure of business, 46 CONG. REC. 302, 304 (1910), because of the public importance of the case below, *id.* at 302, 303, *id.* at 2138, 4006 (1911), to further the "promotion of justice," 45 CONG. REC. 3999 (1910), or to effect any other purpose deemed to be in the public interest, *ibid.*, 46 CONG. REC. 2138 (1911). See, in particular, colloquy between Chairman Moon and Representative Parker of New Jersey, *id.* at 4006. *See* Johnson v. Manhattan Ry., 289 U.S. 479, 498 (1933).

Judge Evans suggests that failure of proposals to make circuit judges *ex officio* members of district courts indicates that no broad grant of authority was intended by Congress. *See* 162 F.2d at 613 and 46 CONG. REC. 303, 304 (1910), *id.* at 809, 1452–4, 2144–54 (1911). Though the Chairman of the Committee argued that only humiliation of district judges would result, a provision that a circuit judge should have "throughout his circuit the powers and jurisdiction of a district judge" passed the House. *Id.* at 2155. But it does not follow that these proposals were rejected as a denial of power; rather it seems to have been felt that § 18 made such a grant unnecessary. "This amendment . . . is already in the bill and comes in as § 18." Chairman Moon of the Committee on Revision of Laws, *id.* at 303. See *id.* at 304, 809. The clause was eventually dropped out in conference for this reason, *id.* at 3998–4002. See *id.* at 4003–4. But see Note, 46 HARV. L. REV. 503, n.4 (1933).

Strong support for the proposition that section 18's "public interest" criterion encompasses more than docket-clearing authority is found in the fact that all the so-called "designation powers" in other sections of the Judicial Code but one provide for reassignment of district judges with particular reference to judicial disability or crowded dockets, but without references to the "public interest." These designation powers comprise the following sections of the Judicial Code in addition to Section 18: Judicial Code § 13, 36 STAT. 1089 (1911), 28 U.S.C. § 17 (1940) (authority for district judge to sit outside his district); Judicial Code § 14, 36 STAT. 1089 (1911), 28 U.S.C. § 18 (1940) (power of judge designated under § 13); Judicial Code § 15, 36 STAT. 1089 (1911), 28 U.S.C. § 19 (1940) (designation by Chief Justice of district judge to any district); Judicial Code § 16, 36 STAT. 1089 (1911), 28 U.S.C. § 20 (1940) (new appointments of district judges under §§ 13, 14, 15); Judicial Code § 17, 36 STAT. 1089 (1911), 28 U.S.C. § 21 (1940) (designation of district judge in place of or in aid of another in his circuit); Judicial Code § 19, 36 STAT. 1090 (1911), 28 U.S.C. § 23 (1940) (duties of assigned judges). See

in subsequent judicial interpretation at least establishes that the scope of the section encompasses more than docket-clearing authority. The assignment of a circuit judge to hear a particular case, irrespective of the condition of dockets below, rapidly became an established judicial practice after the enactment of Section 18 in 1911.[9] In several instances, moreover, courts have had occasion to remark that the determining factor in the exercise of Section 18 is the presence of any condition sufficiently affecting the public interest rather than the status of district court dockets.[10] In at least one case where a senior circuit judge did not consider conduct of a receivership proceeding compatible with the public interest—because the sitting district judge was not "qualified" to handle the case—a circuit judge was

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also Judicial Code § 120, 36 STAT. 1132 (1911), 28 U.S.C. § 216 (1940) (authority for district judge to sit in the circuit court). The lone other section employing the broad criterion of the "public interest" is section 17. It is not clear whether this section could be employed in the same manner as petitioners seek in the instant case. *Cf.* McDowell v. United States, 159 U.S. 596 (1895); Ball v. United States, 140 U.S. 118 (1891).

9. "Since the Judicial Code went into effect it has been the practice of most of the senior circuit judges to assign themselves, as well as other circuit judges, to sit in district courts within their circuits whenever they deemed the public interest required it. The practice was initiated early in 1912 by the then senior circuit judge for the Second Circuit. . . . In the other circuits the senior circuit judges, with a notable exception, adopted that course of action." Van Devanter, J., in Johnson v. Manhattan Ry., 289 U.S. 479, 498 (1933). The notable exception was Judge Sanborn of the Eighth Circuit, whose successors conformed to the general practice. See *id.* at 498, n.10. See also Transcript of Record, pp. 553–555, 662, Johnson v. Manhattan Ry., *supra*, for listings of individual examples. It was early established that an assignment to a specified receivership suit is valid. Penna. Steel Co. v. New York City Ry., 221 Fed. 440, 443 (S.D. N.Y. 1915).

10. In particular, Johnson v. Manhattan Ry., 289 U.S. 479 (1933), seems to visualize assignment of a circuit judge to a case already before a district judge. See *id.* at 498. This case grew out of a collateral attack upon an order made by Senior Circuit Judge Manton of the Second Circuit sitting as a district judge pursuant to § 18. Justice Van Devanter reviewed at length the section's history in upholding Judge Manton's assignment of himself to a case about to be instituted but not yet docketed. The Court affirmed in part Johnson v. Manhattan Ry., 61 F.2d 934 (C.C.A. 2d 1932) which had reversed the voiding of Judge Manton's order by Judge Woolsey in 1 F. Supp. 809 (S.D. N.Y. 1932). *See* American Brake Shoe & Foundry Co. v. Interborough Rapid Transit Co., 1 F. Supp. 820 (S.D. N.Y. 1932) (opinion of Judge Manton sustaining validity of his order).

Justice Frankfurter, as circuit justice, appeared to assume that he possessed the power to displace a sitting district judge, although justified only by the most extraordinary circumstances. The M.L. Sylvia, 34 F. Supp. 404, 405 (D.C. Mass. 1940). The senior circuit judge may make an assignment under § 18 when any conditions arise which so involve the public interest as to require designation. United States v. Gill, 292 Fed. 136 (C.C.A. 4th 1923). *But cf.* Benitez v. Bank of Nova Scotia, 141 F.2d 939 (C.C.A. 1st 1944) (when a district judge is available, it is proper for a senior circuit judge to refuse to assign a circuit judge to hold the district court) and *In re* Wingert, 22 F. Supp. 483 (D.C. Md. 1938) (error by district judge in denying affidavit of prejudice may not be corrected by designation power of § 18).

appointed to replace him.[11] Hearings on this action were held before a sub-committee of the House in 1937.[12] Since no legislative action was taken as a result of these hearings, it seems reasonable to conclude that Congress conceded that Section 18 contained the power which the senior circuit judge found there.[13] Moreover, Congressional re-enactment of the section without substantial change in 1942 suggests legislative approval of these judicial interpretations and practices,[14] just as the section's first reenactment in 1922 suggested approval of practices that had grown up prior thereto.[15] It is

11. In 1937, the case of *Holloway v. Federal Reserve Life Insurance Co.* was being tried before District Judge Hopkins of the district of Kansas, who had taken over the case after the death of District Judge Pollock. Judge Hopkins' administration brought severe criticism, and George E. Brammer, counsel for a party to the action, orally presented grounds of complaint to the senior circuit judge. Communication from T. M. Lillard, Kansas City, Mo., attorney for the receiver of the Federal Reserve Life Insurance Company, to attorneys for petitioners in the instant case (copy on file in Yale Law Library). Both dilatory and unjudicial conduct prejudicial to the public interest was alleged. See Affidavit dated April 14, 1937, reprinted Kansas City Journal-Post, July 28, 1937, p. 6, col. 1. As a result, Senior Circuit Judge Lewis of the Tenth Circuit, by order of April 14, 1937 assigned administration of the Federal Reserve Insurance Co. receivership to Circuit Judge Phillips. Order of Assignment reprinted Kansas City Journal-Post, July 28, 1937, p. 6, col. 2. By order of June 18, Judge Phillips was reassigned to the case until final adjudication.

In the same year, Senior Circuit Judge Lewis forestalled normal assumption of jurisdiction by a district judge of four receivership cases when he designated Circuit Judge Phillips, on the death of District Judge McDermott, to handle four receiverships which would have fallen to Judge Hopkins, the only remaining district judge for Kansas.

12. At the request of Judge Hopkins, a sub-committee of the House Judiciary Committee investigated the Federal Reserve assignment. See note 11 *supra*. No action was taken nor were the hearings reported. For reference to these hearings, see Kansas City Journal-Post, July 28, 1937, p. 6, col. 1, and *Hearings before House Judiciary Committee on Additional United States Judges*, 75th Cong., 3d Sess. 24–5 (1938).

13. Apparently as a result of the Kansas disclosures, two bills limiting the exercise of authority of § 18 were introduced during the 76th Congress, 1st Session: H.R. 2566 in January 1939 to amend § 18 to read "when requested to do so, or with the consent of, the senior district judge . . . ," 84 CONG. REC. 346 (1939), which passed the House, *id.* at 6610, but died in the Senate Judiciary Committee; and H.R. 1984 to permit designation only on the disability of the district court, 84 CONG. REC. 156, which died in the House Judiciary Committee. H.R. 2566 was reintroduced as H.R. 138, 77th Cong., 1st Sess., and passed the House, 87 CONG. REC. 1068 (1941), again to die in Senate Committee. The accompanying House Report indicates that Judge Lewis was correctly interpreting his authority under § 18: "Circuit judges . . . should not, the committee feel, take cases away from a district judge . . . *the reported bill undertakes to put some limitations on existing law . . .*" (emphasis supplied) H.R. REP. No. 46, 77th Cong., 1st Sess., 1 (1941).

14. 56 STAT. 1095 (1942), 28 U.S.C. § 22 (Supp. 1943). The amendments of this year did not concern the provisions here discussed. For the proposition that reenactment acts as implied legislative approval *see* Johnson v. Manhattan Ry. 289 U.S. 479, 500 (1933); Old Colony R.R. v. Commissioner, 284 U.S. 552, 557 (1932); McCaughn v. Hershey Chocolate Co., 283 U.S. 488, 492 (1931).

15. After the judicial practices described in note 9, *supra*, had been followed for ten years, Section 18, originally enacted in 1911, was re-enacted, without pertinent change, in

arguable therefore that Judge Evans was not compelled by prior statutory construction to limit the authority of Section 18 to depend upon the present relationship of district judges to cases.

Judge Evans' opinion indicates that, where a judge is presently sitting, the sufficiency of other remedies substantiates the conclusion that Section 18 is limited in scope to purely administrative assignments where district judges are unavailable. Misconduct on the part of a district judge may be corrected by removal from office through impeachment.[16] Congress has provided statutory means for change of venue in a particular case, either by the judge's own action,[17] or by the petition of the parties through an affidavit of prejudice.[18] Error, including abuse of discretion, may be remedied on appeal.[19] Furthermore, circuit courts have authority to issue extraordinary

1922. 42 STAT 839 (1922), 28 U.S.C. § 22 (1940). During debates on the 1922 amendments to the Judicial Code, designation under this section was reported by the Chairman of the Senate Judiciary Committee as permissible "whenever [the senior circuit judge] is satisfied that the occasion therefor exists and that the public interests so require." 62 CONG. REC. 4852 (1922). Some senators considered this power subject to abuse, but all proposed amendments were rejected. *Id.* at 5166–74.

16. U.S. CONST. Art. II, § 4. The only Constitutional provision for removing unfit judges, impeachment has been widely criticized as an ineffective technique. See Moore, *Judicial Trial and Removal of Federal Judges,* 20 TEX. L. REV. 352 (1942); Shartel, *Federal Judges—Appointment, Supervision, and Removal,* 28 MICH. L. REV. 870, 871 (1930); WILLOUGHBY, PRINCIPLES OF JUDICIAL ADMINISTRATION 392 (1929); Potts, *Impeachment as a Remedy,* 12 ST. LOUIS L. REV. 15 (1927); 1 BRYCE, AMERICAN COMMONWEALTH 212 (1913). For recent attempts to provide an alternative to impeachment, see S. 4527, 74th Cong., 2d Sess. (1936), H.R. 2271, 75th Cong., 1st Sess. (1937) and H.R. 146, 77th Cong., 1st Sess. (1941). Impeachment is, of course, not essentially a remedy provided for the benefit of litigants, although Judge Evans suggests it may be used as such. 162 F.2d 606, 613.

17. § 20 of the Judicial Code, 36 STAT. 1090 (1911), 28 U.S.C. § 24 (1940) provides for disqualification of a district judge where, in his opinion, he is "concerned in interest" in the suit. The extreme discretion left in the trial judge has lessened its effectiveness as a remedy. See Frank, *Disqualification of Judges,* 56 YALE L. J. 605, 628 (1947).

18. § 21 of the Judicial Code, 36 STAT. 1090 (1911), 28 U.S.C. § 25 (1940). Filing an affidavit of prejudice may also prove an ineffectual remedy. Personal hostility and bias towards a particular party must be shown. Henry v. Speer, 201 Fed. 869 (C.C.A. 5th 1913). Narrow interpretation of the petition's "legal sufficiency" has sharply restricted its usefulness as a change of venue remedy. *Cf. In re* Lisman, 89 F.2d 898 (C.C.A. 2d 1937), Johnson v. U.S., 35 F.2d 355 (W.D. Wash. 1929), Benedict v. Seiberling, 17 F.2d 831 (N.D. Ohio 1926); See Frank, *supra* note 17 at 629. *But cf.* Whitaker v. McLean, 118 F.2d 596 (App. D.C. 1941). For a discussion of federal disqualification practice, see Notes, 13 CORN. L. Q. 454 (1928), 65 U.S.L. REV. 68 (1931). In an ordinary civil action, appeal from denial of an affidavit of prejudice must await final judgment, and it is by no means clear that such an appeal in bankruptcy must not also await final judgment. *See In re* Lisman, *supra* at 899; *In re* Wingert, 22 F. Supp. 483, 484 (D.C. Md. 1938).

19. Circuit courts have jurisdiction to review final decisions of district courts on appeal. Judicial Code § 128, 36 STAT. 1133 (1911), as amended, 28 U.S.C. § 225 (Supp. 1946). Interlocutory review may be had only under certain circumstances. Judicial

writs in exercise of their appellate jurisdiction,[20] thereby compelling a dilatory judge to take action [21] or requiring particular performance where abuse of discretion has manifested a disregard of duty.[22] For example, eleven days prior to the decision in the instant case, a mandamus was directed to Judge Igoe by the Seventh Circuit to comply with the provisions of the approved reorganization plan.[23] Since adequate procedural devices are thus available to litigants for protecting their substantive rights, it would seem that Section 18 was not intended as an additional weapon in the individual litigant's already replete procedural arsenal. It would appear that application of the section rests on criteria apart from the special interests of litigants, even though it would normally be invoked by them.[24]

It does not follow from such a conclusion, however, that the scope of the Section is limited to docket-clearing assignments. The public interest—the

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Code § 129, 36 STAT. 1134, as amended, 28 U.S.C. § 227 (1940). Appeals in bankruptcy are governed by NATIONAL BANKRUPTCY ACT §§ 24-5, 30 STAT. 553 (1898), as amended, 11 U.S.C. §§ 47-8 (1940). In bankruptcy proceedings, however, interlocutory review may generally be had, except in the case of "controversies in bankruptcy." See 2 COLLIER, BANKRUPTCY 715 (14th ed., 1940). But the trial court's discretion will, as a general rule, not be reviewed unless abuse of discretion is shown. Luhrig Collieries v. Interstate Coal and Dock Co., 287 Fed. 711 (C.C.A. 2d 1923), *cert. denied sub nom.* Thosmil v. Interstate Coal and Dock Co., 262 U.S. 751 (1923); *In re* Margolies, 266 Fed. 203 (C.C.A. 2d 1920); Fox v. Knickerbocker Engraving Co., 165 Fed. 442 (C.C.A. 2d 1908). The remedy of appeal has been criticized in that the "final judgment" rule may gravely jeopardize the rights of parties. See Crick, *Final Judgment Rule*, 41 YALE L. J. 539, 553 (1932). In reorganization proceedings it would seem that the senior circuit judge should give consideration to the deleterious effect which continuous appeal from orders of a recalcitrant judge must entail.

20. Judicial Code § 262, 36 STAT. 1162 (1911), as amended, 28 U.S.C. § 377 (1940). FED. R. CIV. P., 81(b), abolishing writs of mandamus and scire facias, does not apply to circuit courts. Armour & Co. v. Kloeb, 109 F.2d 72, 73, (C.C.A. 6th 1939), *rev'd on other grounds*, 311 U.S. 199 (1940).

21. McClellan v. Carland, 217 U.S. 268 (1910); *see* United States v. Byers, 144 F.2d 455, 456 (C.C.A. 2d 1944); Petition of Henneman, 137 F.2d 627, 630 (C.C.A. 1st 1943).

22. *In re* National Labor Relations Board, 304 U.S. 486 (1938); *Ex parte* Bradley, 7 Wall. 364 (U.S. 1868); *Ex parte* Crane, 5 Pet. 190 (U.S. 1831). But a writ may not be used to control the way in which discretion is exercised. *Ex parte* Bradstreet, 7 Pet. 634 (1833); Vacuum Cleaner Co. v. Platt, 196 Fed. 398 (C.C.A. 2d 1912); *Cf.* Prince v. Klune, 148 F.2d 18, 19 (App. D.C. 1945). Nor may it generally be used to direct a lower judicial officer how to decide a specified question. *See* Evaporated Milk Ass'n v. Roche, 130 F.2d 843, 845 (C.C.A. 9th 1942), *rev'd on other grounds*, 319 U.S. 21 (1943).

23. Cheston v. Igoe, 162 F.2d 257 (C.C.A. 7th 1947).

24. Whether grounds of complaint are presented to the senior circuit judge privately or by formal petition, the matter essentially remains one of calling to the latter's attention existence of certain facts requiring administrative action. Outside interested parties, however, such as the SEC in corporate reorganizations or the ICC in railroad reorganizations, might invoke the Section by calling to the senior circuit judge's attention facts which indicate that the public interest would be best served by appointment of a circuit judge to take over a district court case.

express criterion of the Section [25]—appears to involve more than the condition of district court dockets. A more adequate conception of the Section's function would seem to be that the senior circuit judge is granted authority to make a broad policy decision based on his theory of what the public interest requires.[26]

In framing this decision as to what constitutes the public interest, the senior circuit judge should weigh such considerations as need for prompt and efficient conduct of litigation,[27] correctness of judicial demeanor in district courts,[28] improvement of the machinery of judicial administration [29]—in

25. The Supreme Court has definitely stated that the express criterion of the statute is the public interest. *See* Johnson v. Manhattan Ry., 289 U.S. 479, 501 (1933); United States v. Gill, 292 Fed. 136, 137 (C.C.A. 4th 1923) (where the court stated that the public interest "is involved in the dispatch of all the business of the courts.").

26. The public interest is to be determined solely by the assigning authority. Johnson v. Manhattan Ry., 289 U.S. 479, 501 (1933). Such determination is not open to collateral attack. Johnson v. Manhattan Ry., *supra*; *Ex parte* American Steel Barrel Co., 230 U.S. 35, 45 (1913). *Cf.* People *ex rel.* Saranac Land & Timber Co. v. Supreme Court, 220 N.Y. 487, 491, 116 N.E. 384, 385 (1917); People v. Ballard, 134 N.Y. 269, 293, 32 N.E. 54, 59 (1892).

27. "Delay in the administration of justice is still the outstanding defect of our Federal Judicial System," REP. ATT'Y GEN. 1 (1937). ". . . [It] has done more than any one single thing to arouse adverse criticism of the courts." Address of Arthur T. Vanderbilt before Ohio State Bar Association, Jan. 28, 1938, reported 21 J. AM. JUD. SOC'Y 195, 197 (1938). See address of Chief Justice Taft to American Bar Association, reported 5 J. AM. JUD. SOC'Y 37, 38 (1921), and Pound, *The Causes of Popular Dissatisfaction with the Administration of Justice,* 29 A.B.A. REP., pt. 1, pp. 395, 408 (1906).

The need for speedy and efficient handling of railroad reorganizations is particularly important in this connection. "The delay and expense incident to railroad receiverships and foreclosure sales constituted, probably, the chief reasons which induced passage of § 77; and to permit the perpetuation of either of these evils under this new legislation would be subversive of the spirit in which it was conceived and adopted." Continental Illinois Nat. Bank & Trust Co. v. Chicago, R.I. & Pac. Ry., 294 U.S. 648, 685 (1935). For discussion of delays in railroad reorganizations, see Dembitz, *Progress and Delay in Railroad Reorganizations Since 1933,* 7 LAW & CONTEMP. PROB. 393 (1940). Extended delay has in many cases been detrimental both to the railroad and its security holders. Will, *Railroad Reorganization—The Long and the Short of It,* 41 ILL. L. REV. 608, 611 (1947).

28. The problem of supervising the conduct of trial judges has provoked much discussion. They are the judges who have inspired much critical comment concerning federal courts. Shartel, *Federal Judges—Appointment, Supervision and Removal,* 28 MICH. L. REV. 485, 725 (1930). See address of Chief Justice Hughes to American Law Institute, reported 22 A.B.A.J. 374, 376 (1936); Kales, *Methods of Selecting and Retiring Judges,* 11 J. AM. JUD. SOC'Y 133, 143 (1928). Necessity for such supervision has contributed towards agitation for an alternative to impeachment. See note 16 *supra.* "There will be a continuing need for judicial supervision in order to maintain a healthy condition among the judges." MOORE AND COCKRILL, BRIEF IN SUPPORT OF RESOLUTION OF AMERICAN BAR ASSOCIATION FAVORING ENACTMENT BY CONGRESS OF LEGISLATION PROVIDING FOR TRIALS OF AND JUDGMENTS UPON THE ISSUE OF GOOD BEHAVIOR IN THE CASE OF CERTAIN FEDERAL JUDGES 14 (1941). The Journal of the American Judicature Society and the American Bar Association Journal have carried many articles on this subject.

sum, the retention of public confidence in courts. Although the right of a sitting district judge to a case depends on no more than the district court rules so appointing him,[30] the senior circuit judge must recognize the inherent peril in substituting one judge for another. Public interest in the maintenance of an independent judiciary,[31] free from coercion by litigants and public alike,[32] the inevitable blow to the prestige of the district bench, the loss of efficiency in appointing a judge unfamiliar with the case, and the adequacy of remedies presently available to litigants are all factors which mitigate against the frequent use of Section 18 to replace a sitting judge. Admittedly, only an unusual state of affairs would justify its exercise.[33]

Had Judge Evans found that Section 18 conferred authority to displace a sitting district judge, he might justifiably have decided that the facts of the instant case did not warrant present exercise of that authority. But in concluding that the section could under no circumstances authorize displacement of a sitting judge, this decision seems to impose a needless restriction on the flexible administration of federal justice.

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29. In addition to legislation enabling courts to regulate their own practice, the creation of the Conference of Senior Circuit Judges, 42 STAT. 838 (1922), as amended, 28 U.S.C. § 218 (1940), and of an Administrative Office for the United States Courts, 53 STAT. 1223 (1939), 28 U.S.C. §§ 444-7 (1940), has effected a substantial improvement in the administrative efficiency of the courts. See *Federal Judicial System Nears End of Reform Program*, 24 J. AM. JUD. SOC'Y 106 (1940). However, an arbitrary restriction on the assignment of circuit judges would seem to be "a serious departure from the policy of promoting a flexible and efficient system for supervising the work of the federal courts which it was the purpose of the Administrative Office Act to strengthen." REPORT OF THE JUDICIAL CONFERENCE OF SENIOR CIRCUIT JUDGES 7 (1941), in opposing H.R. 138, 77th Cong., 1st Sess. (1941). See note 13 *supra*.

30. The district judge was assigned to this case by the executive committee of the district judges for the Northern District of Illinois, acting pursuant to District Rule 21(c). It was an explicit holding of *Johnson v. Manhattan Ry.*, 289 U.S. 479, 503 (1933), that a circuit judge appointed under § 18 is not obliged to comply with any district court rule which would prevent him from performing his statutory duty of carrying out the assignment.

31. Much of the pressure for amendment to § 18 came from fear that abuse of this power would undermine the independence of the district bench. See *Hearings before Senate Judiciary Committee on H.R. 138*, 77th Cong., 1st Sess., 64 (1941) and 87 CONG. REC. 1068 (1941). It has been suggested that adequate safeguard against improper exercise of this power would be afforded by a provision that assignment be made by the judicial council of the circuit. REPORT OF THE JUDICIAL CONFERENCE OF SENIOR CIRCUIT JUDGES 7 (1941). But, as has been pointed out, inability to control by flexible procedure a few offenders may result in more serious threats to the independence of the federal judiciary. MOORE AND COCKRILL, *op. cit. supra* note 23, at 16.

32. In a rather unusual action, the other district judges of the Northern District of Illinois filed a memorandum with Judge Evans, while the instant petition was pending, to the effect that the proceeding was an attempt to coerce the district judge.

33. "In its very nature this power is one which should be sparingly exercised, and then only in special exigencies and with commensurate care and discretion." Johnson v. Manhattan Ry., 289 U.S. 479, 504 (1933).