

NOTES

CONSTITUTIONAL AND LEGISLATIVE BASES OF INTERGOVERNMENTAL TAX IMMUNITIES*

Two modifications of the doctrine of *McCulloch v. Maryland*,¹ introduced by the Supreme Court in the present term, necessitate a reappraisal of the entire system of intergovernmental tax immunities. The cases arise from the conflict of two basic principles. On the one hand, the activities of one sovereign should not be hamstrung by the tax laws of the other. On the other hand, to satisfy augmented fiscal needs the sovereign power to tax must also be protected from unnecessary interference.² In order that these objectives may be harmonized, the Court has reconsidered established formulae for determining the validity of the taxes of either sovereign which impinge on the "instrumentalities" of the other. One recently established test casts considerable doubt upon the continued validity of constitutional exemptions when invoked for the benefit of private interests.³ Another decision,⁴ recognizing the broad authority of Congress to confer express exemptions on federal instrumentalities, presages not only a possible narrowing of state tax powers, but also the transformation of intergovernmental tax immunity from constitutional into legislative terms.

In *Alabama v. King & Boozer*,⁵ the Supreme Court considered a vendee sales tax levied upon the purchases of a cost-plus-a-fixed-fee defense contractor.⁶ There was no express legislative provision for immunity, and the Court refused to impute to Congress an intention to forbid the tax. Finding that the contractor was an entity independent of the Government, the Court upheld the tax because it had no "legal incidence" upon an instrumentality of the United States.⁷ Written with the knowledge that the Government

* *Alabama v. King & Boozer*, 62 Sup. Ct. 43 (U. S. 1941); *Federal Land Bank of St. Paul v. Bismarck Lumber Co.*, 62 Sup. Ct. 1 (U. S. 1941).

1. 4 Wheat. 316 (U. S. 1819).

2. *Metcalf & Eddy v. Mitchell*, 269 U. S. 514, 523-24 (1926); *James v. Dravo Contracting Co.*, 302 U. S. 134, 150 (1937).

3. *Alabama v. King & Boozer*, 62 Sup. Ct. 43 (U. S. 1941).

4. *Federal Land Bank of St. Paul v. Bismarck Lumber Co.*, 62 Sup. Ct. 1 (U. S. 1941).

5. 62 Sup. Ct. 43 (U. S. 1941).

6. The Alabama sales tax is a privilege or license tax collected from the vendor, who must collect it in turn from the vendee. ALA. CODE (1940) c. 51, §§ 753, 776. Hence the tax is a "vendee tax." *McPhillips Mfg. Co. v. Curry*, 2 So. (2d) 600, 605 (Ala. 1941). Although the fact that the contractor was working on a Government order would not relieve him from a state tax, *Trinityfarm Construction Co. v. Grosjean*, 291 U. S. 466 (1934), the Government argued that a "cost-plus" contractor was controlled by the United States, and that the tax, falling upon the United States through this agent, was invalid. See Brief for the United States as *amicus curiae*, p. 97, *Alabama v. King & Boozer*, 62 Sup. Ct. 43 (U. S. 1941).

7. *Alabama v. King & Boozer*, 62 Sup. Ct. 43, 47 (U. S. 1941).

must reimburse the contractor,⁸ the opinion emphasizes the present unimportance of the once influential "economic burden" test.⁹ Thus, instead of weighing the relative immediacy of a tax impact upon a sovereign, the courts will henceforth regard the formal identity of the taxpayer, and invalidate the levy only when the legal entity taxed is a public instrumentality.¹⁰ In the light of history and precedent in the field, it is probable that the "legal incidence" test set out in the *King & Boozer* case will find application not only to situations involving state taxation of federal functions, but also to federal taxes on local instrumentalities.¹¹ Moreover, the generality of the test permits no distinction between tax objects which are constitutionally immune, and those which are exempt by legislative fiat. Of course, the general rule forbidding discriminatory taxation of public instrumentalities remains: a tax specifically seeking out a public function, although having its legal incidence upon a private person, would no doubt be invalid.¹² Likewise, the "essential function" test, devised solely to permit federal taxation of proprietary or non-governmental functions of the states, has not been superseded.¹³ But apart from these more narrow doctrines, the *King & Boozer* case establishes the first general yardstick in the immunities field.

In precise application, the *King & Boozer* legal incidence test may be undesirably formalistic. For example, the rule appears to validate all non-discriminatory taxes paid by private persons, in spite of their effect upon public instrumentalities. Contrariwise, taxes laying an ultimate economic burden upon private interests, but collected from and thus having their "incidence" on a public body, seem to be invalid under the *King & Boozer* rule. Hence a sale by an expressly immune federal corporation to a private person will not be subject to a vendor sales tax, nor to a franchise tax measured by the sales price. It will, however, be subject to a vendee sales tax. Conversely, a purchase by the corporation from a private person will be subject

8. The Government estimated that a denial of immunity in this case would subject the United States to a tax liability of \$33,946,177 for 1941 purchases, and \$54,000,000 for purchases made in 1942, in fulfilling 548 "cost-plus" contracts having a gross value of \$6,720,929,777. Brief for the United States as *amicus curiae*, Appendix B, pp. 19-21, *Alabama v. King & Boozer*, 62 Sup. Ct. 43 (U. S. 1941). See Art. II (1)m, C. P. F. F. Form No. 1, Cost-Plus-A-Fixed-Fee Construction Contract, 1 Prentice-Hall 1941 Nat. Defense Serv. ¶4503.

9. Apparently, neither the practical effect of enforcement [*Graves v. Texas Co.*, 298 U. S. 393, 401 (1936)] nor the remoteness of the burden [*Helvering v. Gerhardt*, 304 U. S. 405, 421 (1938); *Graves v. New York*, 306 U. S. 466, 481 (1939)] will be considered.

10. The doctrine was forecast in *Flint v. Stone Tracy & Co.*, 220 U. S. 107, 165 (1911), and was adverted to in *Liggett & Myers Co. v. United States*, 299 U. S. 333, 386 (1937); see 1 WILLOUGHBY, CONSTITUTIONAL LAW (2d ed. 1929) §82.

11. Compare *Helvering v. Gerhardt*, 304 U. S. 405 (1938), and *Graves v. O'Keefe*, 306 U. S. 466 (1939).

12. See *Osborn v. United States Bank*, 9 Wheat. 738 (U. S. 1824); *Miller v. Milwaukee*, 272 U. S. 713 (1927); cf. *James v. Dravo Contracting Co.*, 302 U. S. 134, 160-61 (1927); *Tradesmens Nat. Bank v. Oklahoma Tax Comm.*, 309 U. S. 560, 567 (1940).

13. See *South Carolina v. United States*, 199 U. S. 437 (1905); *California v. United States*, 297 U. S. 175, 184 (1936).

to a vendor sales tax or to a franchise tax,¹⁴ but immune from the vendee sales tax. Similarly paradoxical results may be expected where the transactions involve a federal tax and an "essential" state or local instrumentality. But, while the legal incidence test does not eliminate the fine distinctions commonly associated with the immunity doctrine, there can be little doubt that a practical application of the test will further restrict the field of exemptions historically implied from the Constitution. Thus the rule seems to uphold any non-discriminatory tax having its legal incidence upon public employees, contractors, lessees, or their property, incomes, or operations not specifically exempted by Congress.¹⁵

In sharp contrast to its restriction of immunity in the *King & Booser* case, the Supreme Court in *Federal Land Bank of St. Paul v. Bismarck Lumber Company*¹⁶ reaffirmed the comprehensiveness of the tax exemption specifically conferred by Congress upon Federal Land Banks.¹⁷ The case involved a sales tax¹⁸ upon Land Bank purchases of lumber to be used in the repair of foreclosed premises. The state argued that the operations taxed were proprietary and non-essential, and that, whatever the meaning of the exemption provision, Congress was without power to immunize them against state taxation.¹⁹ But the Court, refusing to investigate the wisdom of the immunity, ruled that the grant of immunity was in aid of the constitutional exercise of delegated powers, and therefore valid under the "necessary and proper" clause of the Constitution.²⁰ In reaching its decision, the Court implicitly assumed an identity between governmental function and

14. Thus the Illinois Retailers' State Occupation Tax, ILL. REV. STAT. (1941) c. 120, § 440, is not a vendee sales tax, and hence the price paid to Illinois vendors by federal instrumentalities will include the tax item. See 17 OPS. COMP. GEN. 863 (1938), *aff'd*, 20 OPS. COMP. GEN. 752 (1941).

15. In recent years, the Court has rapidly eliminated such exemptions, upholding income taxes touching federal employees [*Graves v. New York*, 306 U. S. 466 (1939)], state employees [*Helvering v. Gerhardt*, 304 U. S. 405 (1938)], lessees of state lands [*Helvering v. Mountain Producers Corp.*, 303 U. S. 376 (1938)], federal contractors [*Atkinson v. Tax Commissioner*, 303 U. S. 20 (1938) (net income); *James v. Dravo Contracting Co.*, 302 U. S. 134 (1937) (gross income)], trustees of local street railway [*Helvering v. Powers*, 293 U. S. 214 (1934)], and excise taxes levied against purchases by a Government contractor [*Trinityfarm Constr. Co. v. Grosjean*, 291 U. S. 466 (1934)], storage of oil by a federal land lessee [*Indian Territory Illuminating Oil Co. v. Board*, 288 U. S. 325 (1933)], licensing of copyrights [*Fox Film v. Doyal*, 286 U. S. 123 (1932)], franchise of corporation obtaining part of its income from Government bonds [*Pacific Co. Ltd. v. Johnson*, 285 U. S. 480 (1932)]. Chances of obtaining immunity are diminished in cases of the private interests by the rule placing upon them the burden of establishing an unconstitutional interference with Government powers. This interference has frequently been disclaimed by the Government in recent cases. See argument for the United States, *Graves v. New York*, 306 U. S. 466, 473 (1939).

16. 62 Sup. Ct. 1 (U. S. 1941).

17. 39 STAT. 380 (1916), 12 U. S. C. § 931 (Supp. 1939).

18. Laws of North Dakota (1937) c. 249.

19. *Federal Land Bank of St. Paul v. Bismarck Lumber Co.*, 62 Sup. Ct. 1, 4 (U. S. 1941).

20. U. S. CONST. Art. I, § 8.

constitutional power. A finding that the act creating the Land Bank is constitutional thus includes a finding that the tax exemptions it creates are proper. A more familiar statement of this rationale is that the power to create implies a power to preserve.²¹

On the basis of the *Bismarck* case, Congress apparently has complete license to confer immunities wherever the activity immunized involves an exercise of constitutional powers. Apparently, also, this legislative immunity may be established on the basis of an implied intention of Congress. Literally, if the "cost-plus" contractor in the *King & Boozar* case had been legislatively designated an agent of the United States, the tax would have had its legal incidence upon the Government through its instrumentality, and would thus have been invalid.²² And given an express grant of immunity, the legal incidence test might become an instrument for expanding and enforcing legislative exemptions, since the remoteness of the burden would no longer operate to uphold a tax the legal incidence of which is upon the exempted instrumentality.

In the light of the broadening of immunities created by the legislature, the narrowed scope of exemptions to be implied from the Constitution takes on added significance. While it was long believed, and forcefully expounded, that the legislative immunity was coextensive with that which would be constitutionally implied,²³ the *King & Boozar* and *Bismarck* cases continue a trend toward establishing Congress as the final authority for immunizing federal instrumentalities.²⁴ Although the Court was "not . . . concerned with the extent and the appropriate exercise of the power of Congress to free such transactions from state taxation"²⁵ in the *King & Boozar* case, the decision clearly indicates that a future grant of exemption by Congress to "cost-plus" contractors would be allowed to supersede the judicial denial of constitutional immunity.²⁶ In the *Bismarck* case, moreover, the deference of the Court to Congress was overt.²⁷ Thus the decisions seem to establish

21. See *Pittman v. Home Owners' Loan Corp.*, 308 U. S. 21, 33 (1939).

22. Congress refused an amendment designed to make "cost-plus" contractors agents of the Government for tax purposes. See *Proposed Senate Amendment No. 120 to H. R. 8438*, 76th Cong., 3d Sess. (1940); 86 CONG. REC. 7528-35, 7648 (1940). A bill which would specifically confer exemptions upon "cost-plus" contractors is now pending. H. R. 6049, 77th Cong., 1st Sess. (1941); see 87 CONG. REC., Nov. 18, 1941, at 9228.

23. See Pond, *Intergovernmental Immunity: A Comparative Study of the Federal System* (1941) 26 IOWA L. REV. 272, 300. But cf. *Graves v. New York*, 306 U. S. 466, 478-79 (1939).

24. Thus immunity has been granted only because Congress prescribed it. *Pittman v. HOLC*, 308 U. S. 21, 33 (1939); *Lawrence v. Shaw*, 300 U. S. 245, 249 (1937). And it has been denied because Congress provided no exemption. *James v. Dravo Contracting Co.*, 302 U. S. 134, 161 (1937); *Federal Compress Co. v. McLean*, 291 U. S. 17, 23 (1934); *Shaw v. Oil Corp.*, 276 U. S. 575, 578-79 (1928).

25. 62 Sup. Ct. 43, 45 (U. S. 1941).

26. See note 22 *supra*.

27. *Federal Land Bank of St. Paul v. Bismarck Lumber Co.*, 62 Sup. Ct. 1, 6 (U. S. 1941).

a doctrine analogous to that of the preempted "federal field" in bankruptcy.²⁸ Where Congress has spoken, its mandate will be held conclusive insofar as state taxation of the federal instrumentality is concerned. In *McCulloch v. Maryland* and the decisions descending therefrom, the objectionable state statutes were held void and unconstitutional under an implied limitation on the tax power.²⁹ Under the modern doctrine of legislative immunity, however, the offending statute is held inconsistent with federal legislation, and therefore inoperative.³⁰ The difference is that between constitutional and statutory interpretation. But where Congress has refrained from exercise of legislative power and no intention that the instrumentality be immune may be inferred, the courts will still invoke the doctrine of implied constitutional immunity, and adjudicate according to the legal incidence concept.³¹ Immunity of federal instrumentalities from state taxation is thereby reinforced, while immunity of state instrumentalities from federal tax laws rests upon a circumscribed constitutional basis.

It is thus with reference to the protection of state powers that the problem of constitutional immunity grows acute. State powers are threatened from two directions: first, the spread of federal activities into new fields limits state tax powers wherever the federal supremacy is used to establish legislative immunities; secondly, the narrowed scope of constitutional immunities subjects an increasing number of state instrumentalities to federal tax burdens, in some measure limiting the exercise of sovereign powers. The restriction of constitutional immunities may, however, be defended on the ground that essential state functions can not be directly taxed under the legal incidence test. And the federal supremacy doctrine is often justified by the somewhat jejune argument that state interests are represented in Congress, whereas state levies on federal bodies would involve taxation without representation.³² To be meaningful, this approach probably presupposes that Congress can and will maintain a balance between grants and waivers of exemption with respect to federal instrumentalities, a scarcely realistic assumption. But the argument suggests important problems: if state powers are to be protected through federal waivers of immunity, with respect to what tax objects may the waiver device be employed? Is the power to waive immunity coextensive with the power to confer it? Because of their practical importance, public bonds, for example, comprise a field in which these concepts must soon be investigated.

28. See Williston, *The Effect of a National Bankruptcy Law upon State Laws* (1909) 22 HARV. L. REV. 547; Note (1940) 49 YALE L. J. 1090.

29. 4 Wheat. 316, 430 (U. S. 1819).

30. See *Graves v. New York*, 306 U. S. 466, 478-79 (1939); *Federal Land Bank v. Crosland*, 261 U. S. 374, 377 (1923).

31. See *Alabama v. King & Boozer*, 62 Sup. Ct. 43, 45 (U. S. 1941). Since the state tax is not automatically valid where the Government has not preempted the field, the analogy to bankruptcy, aliens and interstate commerce "supremacy" is not perfect. See Donelson, *Federal Supremacy and the Davidowitz Case* (1941) 29 GEO. L. J. 755.

32. See Hottenstein, *Survey of Exemption of State Instrumentalities From Federal Taxation*, Rep. No. 20, INSTITUTE OF MUNICIPAL LAW OFFICERS (1937); Gardner, *Tax Immune Bonds* (1939) 8 GEO. WASH. L. REV. 1200, 1212.

In the present state of the law, interest on both local and federal bonds is constitutionally immune from intergovernmental income taxation.³³ Expounded by the decisions of another era, however, the reasoning upon which this immunity depended has been specifically overruled. The power to levy a non-discriminatory tax is no longer held to imply a power to destroy;³⁴ taxation of income is not now regarded as taxation of its source;³⁵ and the ultimate effect of a tax in the direction of increasing costs of government is disregarded in favor of a test looking no further than its legal incidence.³⁶ Despite these inroads into the immunity doctrine, however, it remains true that analogies may be deceptive in the specialized field of public finance.³⁷ Owing to the sensitive nature of the securities market, a tax upon bond interest operates directly to increase the cost of borrowing before the power to borrow is exercised.³⁸ Furthermore, as admitted by Justice Brandeis, the bondholder has given valuable consideration for immunity in the shape of minimized discounts, or acceptance of reduced interest rates.³⁹ Thus the immunity does not redound to the exclusive benefit of the individual, but reflects an equivalent public advantage. Outright judicial repudiation of the immunity, therefore, might be regarded by the Court both as a breach of faith with investors, and as an actual interference with borrowing powers.⁴⁰

33. *Pollock v. Farmers Loan and Trust Co.*, 157 U. S. 429 (1895); *Weston v. Charleston*, 2 Pet. 449 (U. S. 1829). See also INT. REV. CODE § 22(b)4 (1938); 16 STAT. 272 (1870), 31 U. S. C. § 742 (Supp. 1939). But cf. PUB. L. No. 7, 77th Cong., 1st Sess. (Feb. 19, 1941) §§ 3, 4. Bonds of the United States issued after March 1, 1941, are subject to federal income taxation, but remain exempt from state and local taxation.

34. See dissent of Justice Holmes, *Panhandle Oil Co. v. Knox*, 277 U. S. 218, 223 (1928); *James v. Dravo Contracting Co.*, 302 U. S. 134, 158 (1937).

35. *New York ex rel. Cohn v. Graves*, 300 U. S. 308, 314 (1937); *Graves v. New York*, 306 U. S. 466, 480 (1939); cf. *Hale v. State Board*, 302 U. S. 95 (1937).

36. It has been said that the Government, bidding competitively in various markets, seeks not advantages over but equality with private enterprises. See *Helvering v. Gerhardt*, 304 U. S. 405, 421-22 (1938).

37. While the issues giving rise to the legal incidence concept involved instruments other than public bonds, the comprehensive immunity originally attaching to public bond interest has been consistently narrowed. See *Flint v. Stone Tracy Co.*, 220 U. S. 107 (1911) (franchise tax touching gross income of bondholder); *Willcuts v. Bunn*, 282 U. S. 216 (1931) (profit on sale of bonds); *Denman v. Slayton*, 282 U. S. 514 (1931) (deduction for interest on borrowed money invested in bonds); *Greener v. Lewellyn*, 258 U. S. 384 (1922) (inheritance tax touching bonds). See generally, Fellman, *Intergovernmental Relations in the United States* (1940) 207 AM. ACAD. POL. SCI. 27.

38. See *James v. Dravo Contracting Co.*, 302 U. S. 134, 150 (1937), (1939) 37 MICH. L. REV. 1079, 1084.

39. See dissent, *National Life Insurance Company v. United States*, 277 U. S. 503, 528 (1928); *Farmers Bank v. Minnesota*, 232 U. S. 516, 528 (1914).

40. See *Farmers Bank v. Minnesota*, 232 U. S. 516 (1914); *Educational Films Corp. v. Ward*, 282 U. S. 379, 389 (1931). In *Metcalf & Eddy v. Mitchell*, 269 U. S. 514, 525 (1926), Justice Stone invoked a rule in some measure resembling the legal incidence test, but indicated that a tax directly interfering with the functions of government, or a tax that was discriminatory, would be invalid.

The confusion prevailing in this area of the immunities field is illustrated by consideration of a second method of instituting intergovernmental taxation of public bond interest. This plan assumes that the Sixteenth Amendment permits federal taxation of state bond interest, and that the immunity attaching to the interest on federal bonds may be waived by Congress.⁴¹ There is ample authority to the effect that the Sixteenth Amendment was intended to have the effect of its express terms and empower Congress to levy on income "from whatever source derived."⁴² Federal taxation of state bonds might be accomplished, therefore, by judicial reconsideration of the Amendment. But the basis upon which Congress may waive the immunity accruing to the benefit of holders of outstanding issues of Government bonds is not immediately apparent. The general power of Congress to waive exemptions has frequently been asserted,⁴³ but a survey of the cases reveals that the issue of the validity of the power has never been specifically litigated.⁴⁴ In the majority of cases involving waivers, the Government has assumed the burden of the tax, thus justifying the waivers as gifts to local

41. In U. S. DEPARTMENT OF JUSTICE, *THE IMMUNITY RULE AND THE SIXTEENTH AMENDMENT* (1938), the immunity is held to be outmoded; see also Foley, *Reciprocal Taxation of the Income from Federal, State and Municipal Bonds* (1941) 6 *LEGAL NOTES ON LOCAL GOVERNMENT* 178. But see STATE ATTORNEYS GENERAL, *CONSTITUTIONAL IMMUNITY OF STATE AND MUNICIPAL SECURITIES* (1939); Epstein, *Self-Government v. Federal Taxation of Your Local Securities* (1941) 6 *LEGAL NOTES ON LOCAL GOVERNMENT* 187.

42. "Congress shall have the power to lay and collect taxes upon incomes, from whatever source derived . . ." U. S. CONST. AMEND. XVI. For a collection of authorities see DEPARTMENT OF JUSTICE, *THE IMMUNITY RULE AND THE SIXTEENTH AMENDMENT* (1938) Appendix, Vols. 1-6. The plan would necessitate the overruling of *Pollock v. Farmers Loan and Trust Co.*, 158 U. S. 601 (1895). Such reconsideration has been most recently advocated in a concurring opinion by Justice Black. *Helvering v. Gerhardt*, 304 U. S. 405, 427 (1938).

43. See dissent, *James v. Dravo Contracting Co.*, 302 U. S. 134, 181 (1937). In *Van Allen v. Assessors*, 3 Wall. 573, 585 (U. S. 1865), it was argued that Congress could not confer upon the states the right to tax. The Court avoided the issue saying, "But as it respects a subject matter over which Congress and the states may exercise a concurrent power, but from the exercise of which Congress, by reason of its paramount authority, may exclude the states, there is no doubt Congress may withhold the exercise of that authority and leave the states free to act." Thus the Court regarded national bank stock as taxable, in the absence of a specific exemption provision. Justice Marshall had emphasized that state taxation of the operations of the bank was invalid, *McCulloch v. Maryland*, 4 Wheat. 316, 436 (U. S. 1819), but that taxation of its real property or the interests which the citizens of Maryland might hold in the institution was valid. But see *Owensboro Nat. Bank v. Owensboro*, 173 U. S. 664, 668 (1899).

44. At an early date, the immunity of federal currency from state taxation was waived by Congress. 28 STAT. 278 (1894). Congress has also permitted non-discriminatory taxation of national bank stock. REV. STAT. § 5219 (1875), 12 U. S. C. § 548 (Supp. 1939). More recently the device has been utilized with respect to federally owned corporations. See Gardner, *Tax Immune Bonds* (1939) 8 GEO. WASH. L. REV. 1200, 1212, citing 32 instances. See Comment (1934) 44 YALE L. J. 326.

tax units.⁴⁵ On a jurisdictional level, an individual would probably have "insufficient interest" to raise constitutional objections to this exercise of the waiver power.⁴⁶ And, it is probable that waivers subjecting private interests to increased tax burdens would be upheld as conditions on the grant of special rights or privileges.⁴⁷ But the general doctrine remains that just as neither sovereign may deprive the other of a constitutional tax power, so neither may confer upon the other an additional power to tax.⁴⁸ Therefore, it would seem, if the state has no original constitutional power to tax a federal instrumentality, a legislative grant of the power to tax can not be constitutionally given nor received.⁴⁹ This conclusion is strengthened by the doctrine that a state may not waive rights, privileges, or immunities running to private persons.⁵⁰ The power of the Federal Government would appear to be similarly limited. If, therefore, interest on federal obligations remains the subject of a *constitutional* immunity, it does not appear within the power of Congress to waive the tax exempt feature of outstanding obligations.

In the light of the foregoing analysis, little relation between legislative powers to confer and to waive immunity may be perceived. While grants of immunity are justified as aiding the execution of constitutional Acts, waivers can only be justified as gifts to local tax units, enforceable as conditions on special grants. The power to establish immunity is thus unlimited so long as the immunized instrumentality bears a relation to the Act which it is designed to execute; the power to waive is probably limited to those immunities which do not constitutionally accrue to the benefit of private interests. Yet the two powers must be correlative if a cohesive plan of federal supremacy is to be developed. With respect to instrumentalities to be created in the future, Congress—through its powers to grant or withhold the right to tax—should have virtually unlimited discretion to determine what local taxation will burden the exercise of federal powers, and what federal enterprises should bear their proportionate shares under local

45. See *Alabama Power Co. v. Ickes*, 302 U. S. 464, 473 (1938); *United States v. Butler*, 297 U. S. 1, 66 (1936); Rodell, *A Primer on Interstate Taxation* (1935) 44 YALE L. J. 1166, 1183.

46. *Massachusetts v. Mellon*, 262 U. S. 447, 487 (1923); *Alabama Power Co. v. Ickes*, 302 U. S. 464, 478 (1938).

47. See *Tradesmens Nat. Bank v. Oklahoma Tax Comm.*, 309 U. S. 560, 561 (1940); *Flint v. Stone Tracy Co.*, 220 U. S. 107, 151 (1911).

48. See *Van Allen v. Assessors*, 3 Wall. 573, 585 (U. S. 1865); *Gibbons v. Ogden*, 9 Wheat. 1, 199 (U. S. 1824); Schweppe, *State Taxation of National Bank Stocks: Uncertainty of Its Constitutional Basis* (1922) 6 MINN. L. REV. 219, 224.

49. Congress may have power to make a gift of the right to tax—on the order of the right held by a third party beneficiary of a contract—but in such case the duty to pay the tax is owed by the taxpayer to the state government as a contract condition. See RESTATEMENT, CONTRACTS (1932) § 135; 2 WILLISTON, CONTRACTS (rev. ed. 1936) § 368. Unless the Federal Government can command this duty upon some special ground, the individual subjected to a tax liability as a result of the waiver will have both the standing and the ground for objection on the constitutional issue. See *United States v. Butler*, 297 U. S. 1, 57 (1936).

50. *Carter v. Carter Coal Co.*, 298 U. S. 238, 295 (1936).

tax levies.⁵¹ On this basis, Congress could, on the one hand, make future issues of federal bonds subject to state levies. Purchasers of these bonds should be estopped to complain of the local taxes. Or, on the other hand, Congress could confer on federal agencies, old or new, specific exemption like that considered in the *Bismarck* case. A less practical possibility might be a provision making interest on the future issues subject to taxation by those states which provided for federal taxation of the interest on future issues of state and local bonds.⁵² In any case, the Court has indicated, Congress is to judge the advisability of establishing the immunity or tax liability of federal instrumentalities as they are created.

For the future, then, the immunity doctrine with respect to federal instrumentalities assumes a clearer outline of federal supremacy. The trend is toward stringent limitation of the *constitutional* immunity doctrine with regard to the states, and possible elimination with regard to federal instrumentalities. The *King & Boozer* and the *Bismarck* cases each mark a step in the trend toward this ultimate result: in the one case, the scope of constitutional immunity is narrowed toward the minimum necessary for the maintenance of sovereignty;⁵³ in the other, the limits of legislative immunity are broadened to admit the free exercise of legislative intent. After clarification of the bond interest issue, the outlines of the federal supremacy concept will assume a definite pattern. In the meantime, however, the confusion of constitutional and legislative immunities renders uncertain not only the value of public obligations, but the revenue systems of both the states and the Federal Government.⁵⁴

51. See dissent of Justice Roberts, *Brush v. Commissioner*, 300 U. S. 352, 377 (1937). The power to grant immunity is not completely without limit, however. See *National Bank v. Commonwealth*, 9 Wall. 353, 362 (U. S. 1869); cf. (1940) 38 MICH. L. REV. 738, 741.

52. It has been indicated that state consent may in some cases remove the prohibition on the federal power to tax. *United States v. Bekins*, 304 U. S. 27, 52 (1938).

53. See *Board of Trustees v. United States*, 289 U. S. 48, 59 (1933), where the Court said: "The principle . . . of the immunity of state instrumentalities from federal taxation, has its inherent limitations. . . . It is a principle implied from the necessity of maintaining our dual system of government. . . . Springing from that necessity it does not extend beyond it. Protecting the functions of government in its proper province, the implication ceases when the boundary of that province is reached."

54. On June 30, 1940, there were \$70,200,000 in tax exempt bonds outstanding. REP. SEC'Y TREAS. (1940) 812. The interest on part of these obligations is reached by the states through privilege and franchise taxes. See Hervey, *Judicial Delimitation of the Exemption of Federal Instrumentalities from State Taxation* (1938) 12 TEMP. L. Q. 291, 327. It has been suggested that the Federal Government seek out and levy with respect to taxable privileges in the same manner. See *Hearings Before the Subcommittee of the Committee on the Judiciary on S. J. Res. 5 and 154*, 75th Cong., 1st Sess. (1937) 21. The additional tax collectible by the Federal Government, were all tax exempt securities made taxable, would, on the basis of 1937 tax rates, amount to approximately \$275,000,000 annually. Owing to the progressive nature of the surtax rates, it is asserted, this increase in revenue would not be counteracted by a higher interest rate made necessary by the abolition of the tax-exempt feature. See Foley, *Reciprocal Taxation of the Income From Federal, State and Municipal Bonds* (1941) 6 LEGAL NOTES ON LOCAL GOVERNMENT 178.

REISSUE OF PATENTS ON BROADENED CLAIMS*

THE right to reissuance of a patent for the remainder of its original term is granted by statute¹ to a patentee whose patent is "wholly or partly inoperative or invalid by reason of the patentee claiming as his own invention more than he had a right to claim as new, if the error has arisen by inadvertence, accident, or mistake and without any fraudulent or deceptive intention." On surrender of the original, the patentee may secure a reissue patent for the same invention, correcting the deficiency but adding no new matter to the specification.² Designed apparently to enable patentees to correct mistakes in their original specifications which threaten the life or usefulness of their patents,³ the statute has frequently been used to secure claims rejected by the Patent Office on the original applications⁴ and to gain unjustifiably broadened claims in order to embarrass competitors.⁵

Perhaps it was the widespread abuse of this grant that motivated the United States Supreme Court, which ordinarily decides patent cases only when circuit courts of appeals conflict,⁶ to grant certiorari in the recent *Carbide & Carbon* case arising in the Fourth Circuit.⁷ In this case, an infringement action, plaintiff's original patent covered a process for manufacturing an automobile radiator anti-freeze by a chemical reaction into which water was voluntarily introduced. Eighteen months later successful application was made for a reissue patent making optional the voluntary introduction of water. During this time interval defendants had experimented with a reaction into which water was not voluntarily introduced, and which therefore would infringe only the later, reissue patent.⁸ Despite defendant's plea of laches and its assertion of a personal, intervening estoppel right against enforcement of the reissue patent, the Federal District Court granted the plaintiff's suit for injunction.⁹ Relying largely upon experiments performed at its order by a neutral expert and upon a presumption of validity attached to the Patent Commissioner's action in granting the reissue, the court found

*United States Industrial Chemicals v. Carbide & Carbon Chemicals Corp., 121 F. (2d) 665 (C. C. A. 4th, 1941), *cert. granted*, 62 Sup. Ct. 187 (U. S. 1941).

1. 45 STAT. 732 (1928), 35 U. S. C. § 64 (1934).

2. *Ibid.*

3. See *Mahn v. Harwood*, 112 U. S. 354 (1884); *Burr v. Duryee*, 68 U. S. 531 (1863).

4. See *Supreme Mfg. Corp. v. Security Mfg. Co.*, 299 Fed. 65, 66 (C. C. A. 9th, 1924), *cert. denied*, 266 U. S. 614 (1924); *Dobson v. Lees*, 137 U. S. 258 (1890).

5. See *Yale Lock Co. v. Berkshire Bank*, 135 U. S. 342 (1890); *Freeman v. Asmus*, 145 U. S. 226 (1892).

6. See *Cuno Engineering Corp. v. Automatic Devices Corp.*, 62 Sup. Ct. 37, 38 (U. S. 1941).

7. *United States Industrial Chemicals v. Carbide & Carbon Chemicals Corp.*, 121 F. (2d) 665 (C. C. A. 4th, 1941), *cert. granted*, 62 Sup. Ct. 187 (U. S. 1941).

8. Defendant built an expensive plant in which to carry on its process commercially, but the District Court found that this had been constructed after plaintiff's application for the reissue patent.

9. *Carbide & Carbon Chemicals Corp. v. United States Industrial Chemicals*, 34 F. Supp. 813 (D. Md. 1940).

no "material variation" between the original and reissue patents. To justify resort to a reissue, the court held the original patent inoperative to protect plaintiff's rights completely. The Court of Appeals found the plaintiff's two patents different in their provisions for the addition of water. It nevertheless held the difference insufficient to make the District Court "clearly erroneous"¹⁰ and therefore affirmed the decision.

Underlying the decision is an unarticulated philosophy which regards patents as a sort of property right, the primary purpose of which is to secure to the inventor a monopoly within broadly construed limits of his invention.¹¹ By thus encouraging inventors, the patent laws are thought to promote individual initiative, progress in the arts, and competitive industry as by-products. In the course of invention from the crude and complex to the efficient and simple, it is the initial idea that is considered deserving of judicial preference and protection as against the improvement,¹² which is often merely a copy of the original with inconsequential variations added to guard against infringement suits.

Liberal application of the reissue statute is one method of achieving this purpose.¹³ For example, although only narrowing of the claim is specifically mentioned in the statute, long judicial construction has sanctioned broadened reissues as corrections of a defective specification within the terminology of the statute.¹⁴ The requirement that patents be wholly or partly inoperative in order to entitle their holders to reissues has been liberalized to include patents which are "narrower than the actual invention"¹⁵ of the holder and which therefore do not afford the broad protection against infringement which they would have had their claims been more inclusive. The statute's prohibition against the addition of new matter in reissues has been avoided by minimizing the importance of the additions.¹⁶ It has also been held that the requirement that the error in the specification which the patentee seeks to correct must have arisen by "inadvertence, accident, or mistake" may be satisfied by negating any inference of fraudulent or deceptive intention.¹⁷ Finally, a presumption of validity has been attached in infringement suits to the finding of the Commissioner of Patents that the reissue is for the

10. The findings of fact made by federal district courts may be set aside on appeal only when they are "clearly erroneous." FED. RULES CIV. PROC., 52a (1938).

11. See *Topliff v. Topliff*, 145 U. S. 156, 171 (1892).

12. See Hosea, *The Dictum of Justice Bradley Examined* (1882) 16 AM. L. REV. 296, 300.

13. See *Topliff v. Topliff*, 145 U. S. 156 (1892).

14. See *Grant v. Raymond*, 6 Pet. 218 (U. S. 1832). Applications for a reissue are often disclaimers plus exceptions which negative the disclaimers so that, under the pretense of waiving, an enlarged claim is made.

15. *Topliff v. Topliff*, 145 U. S. 156, 170 (1892).

16. See *Topliff v. Topliff*, 145 U. S. 156 (1892); *McArthur v. Brooklyn Railway Supply Co.*, 19 Fed. 263 (S. D. N. Y. 1884) (patentee entitled to "equivalent" of original claim).

17. *Perfection Disappearing Bed Co. v. Murphy Wall Bed Co.*, 266 Fed. 698 (C. C. A. 9th, 1920), *cert. denied*, 254 U. S. 652 (1920).

same invention as the original patent.¹⁸ By such liberalization of the reissue privilege, of which the *Carbide & Carbon* case is typical, the statute can be and has been efficacious in preserving and extending patent monopolies.

A more satisfactory climate of opinion, however, which has recently received the approval of the United States Supreme Court,¹⁹ regards the patent not as a property right, but as a "private grant on the public domain,"²⁰ aimed at the promotion of industrial progress, but to be restricted jealously in the light of public interest. In the past patents were typically controlled singly, by their inventors; under contemporary economic organization they are usually controlled in large aggregations, by great corporations. These corporations often use their patent control not to promote industrial progress but to tax and stifle it.²¹ Moreover, not inventors, but corporations as assignees of inventions,²² many of which are mere salable frills or small improvements logically deduced from the prior art by the use of expensive research machinery rather than by inventive genius, receive the rewards which the patent system was intended to confer upon genuine inventors only.

In the light of this shift in the economics of patents, strict construction of the reissue statute is essential if the patent system is to fulfill its purpose. The statute was designed to protect patents from invalidity in the sense of being legally void, not from invalidity in the sense of not being as broad as the patentees might desire.²³ This is made clear by the statute's mention of reissues for the purpose of disclaimer and not reissues for addition to claims.²⁴ Moreover, a reissue patent with broadened claims is anomalous.²⁵ If it covers only what was covered by the original or the equivalent of what was covered by the original, the original could hardly be claimed inoperative or invalid; if, on the other hand, it covers more than what was covered in the original, it violates the statutory prohibition against the addition of new material. Reissues should therefore be granted on applications based on disclaimer alone and not upon applications which broaden the claims

18. *Topliff v. Topliff*, 145 U. S. 156 (1892).

19. *Cuno Engineering Corp. v. The Automatic Devices Corp.*, 62 Sup. Ct. 37 (U. S. 1941).

20. *Id.* at 41.

21. See HAMILTON, *TNEC REP., PATENTS AND FREE ENTERPRISE*, Monograph 31 (1941). This monograph is the best description of contemporary functioning of the patent system.

22. ". . . the corporation seeking to maintain its estate is treated as the man of science demanding his reward." *Id.* at 133.

23. Before the establishment of the Patent Office in 1836, few people were competent to draw up patent specifications, and consequently patents were frequently adjudged defective and invalid. The reissue statute was designed to protect patentees from this hazard. See *Burr v. Duryee*, 68 U. S. 531, 575 (1863). For a history of the development of broadened reissues, see Rice and Grossman, *Reissued Patents and Intervening Rights* (1934) 43 *YALE L. J.* 766, 770 *et seq.*

24. The qualification "partly or wholly defective or invalid," which was added to the Reissue Statute in 1928, may have been designed to include patents of which some of the claims were invalid while others were valid.

25. *Miller v. Brass Co.*, 104 U. S. 350, 354, 355 (1881).

of the original patents; if the patentee has discovered something new, let him patent it independently. They should be granted, moreover, only when the patentee can satisfy the purpose of the statute "to provide that kind of relief which courts of equity have always given in cases of clear accident."²⁶ Mere negating of fraudulent intent should not be held sufficient to satisfy this purpose. Finally, the courts should attach no presumption of validity in an infringement suit to the action of the Commissioner of Patents in granting the reissue. Broadened reissues are almost always secured to cover a slightly different process or machine developed by a competitor after the patentee's original grant. In granting or denying a reissue, the Commissioner is then really settling controversial rights and claims in an *ex parte* proceeding.

One device for limiting the scope of reissue patents is the doctrine of private intervening rights. Developed to prevent the inequitable destruction of investments built up by the patentee's competitors between the original grant and the application for a reissue, this doctrine has long enjoyed the support of lower federal courts;²⁷ recently it received the approval of the United States Supreme Court.²⁸ Under it, a patentee is held to represent that he is dedicating to the public whatever he has not claimed. After a person has expended money for plant or machinery in reliance on such representations, the patentee is estopped from asserting an infringement of the later, reissue patent. By invoking this doctrine, alleged reissue infringers have obtained personal rights amounting to a permanent license to manufacture and sell,²⁹ to dispose of existing stocks,³⁰ and to continue to use machines on hand.³¹ The defendant need not prove he relied upon the terms of the original patent or even that he knew of its existence, for he is presumed to have knowledge of the specifications of granted patents³² just as he is presumed to know the law. This presumption is in the main justified because business houses almost always secure the advice of a patent attorney before embarking upon a manufacturing venture. The attorney's report ordinarily does not mention patents which might be expanded to cover the projected manufacture, although he has noted their contemporary inapplicability.³³ But intervening rights may be claimed only for activity

26. *Mahn v. Harwood*, 112 U. S. 354, 362 (1884).

27. For a review of lower court holdings on intervening rights, see *Otis Elevator Co. v. Atlantic Elevator Co.*, 47 F. (2d) 545 (C. C. A. 2d, 1931).

28. *Sontag Chain Stores Co. v. National Nut Co.*, 310 U. S. 281 (1940).

29. *Ashley v. Samuel C. Tatum Co.*, 240 Fed. 979 (S. D. N. Y. 1917).

30. *Bull Dog Floor Clip Co. v. Munson Mfg. Co.*, 19 F. (2d) 43 (C. C. A. 8th, 1927).

31. *Ashland Fire Brick Co. v. General Refractories Co.*, 27 F. (2d) 744 (C. C. A. 6th, 1928).

32. *Moto Meter Gauge & Equipment Corp. v. E. A. Laboratories*, 55 F. (2d) 936 (E. D. N. Y. 1932); *Sontag Chain Stores Co. v. National Nut Co.*, 310 U. S. 281 (1940) *semble*. It has been held, on the other hand, that the alleged infringer must take notice of the patentee's right to a reissue, and hence cannot gain any intervening rights while it still exists. *Crown Cork & Seal Co. v. Aluminum Stopper Co.*, 108 Fed. 845 (C. C. A. 4th, 1901).

33. See (1940) 8 GEO. WASH. L. REV. 985.

taking place up to the time of the patentee's application for a reissue.³⁴ This limitation seems arbitrary, since the application is not a matter of record, and the alleged infringer often has no notice of it. Another limitation upon intervening rights, based upon equity's "clean hands" doctrine, requires that the defendant's device be an independent invention, not a copy of plaintiff's device.³⁵ This limitation too seems questionable because the defendant is not claiming an invention, but merely a device which does not infringe plaintiff's original patent.

The doctrine of intervening rights, however, fails to protect the important interest which the public has in restriction of reissues. This task is left for the doctrine of laches. The laches doctrine rests, like the rule of private intervening rights,³⁶ upon the proposition that whatever the patentee does not claim he theoretically dedicates to the public.³⁷ Unless he retracts this dedication promptly, his laches will give the public a vested right and thus invalidate his reissue patent. By analogy to the former statutory provision³⁸ that after a device has been in public use for two years, its inventor may not patent it, an unexplained delay of two years between the grant of the original patent and the application for a reissue has ordinarily voided the reissue.³⁹ In some cases, furthermore, unexplained delays of less than the two-year period have been held to invalidate reissue patents⁴⁰ especially when improvements in the art have intervened between the grant of the original patent and the application for the reissue.⁴¹

Even with strict laches rules, however, the public, despite its interest, remains without legal means of asserting its rights. As a result, the public domain is guarded only as it is to the interest of the alleged infringer to guard it. Had the court in the *Carbide & Carbon* case recognized this lack of protection for the public and the need for adjustment of patent law to modern economics, it might have reversed the decision on a number of grounds.

34. See *Otis Elevator Co. v. Atlantic Elevator Co.*, 47 F. (2d) 545, 549 (C. C. A. 2d, 1931).

35. *Albertson & Co. v. Beckley-Ralston Co.*, 258 Fed. 453 (N. D. Ill. 1919); *Bucher & Gibbs Plow Co. v. International Harvester Co.*, 211 Fed. 473 (N. D. Ohio 1913).

36. For a review of both rules, see Rice and Grossman, *supra* note 23, at 775 *et seq.*; (1940) 15 IND. L. J. 451.

37. As a matter of practice, inventors usually claim more rather than less of that to which they are entitled. If a claim is not made, it is probably because the technique in question is so much a part of a common art that the claim would be useless.

38. 46 STAT. 376 (1930), 35 U. S. C. § 31 (1934).

39. *Miller v. Brass Co.*, 104 U. S. 350 (1881); *Wollensak v. Reiher*, 115 U. S. 96 (1885). The delays of successive holders of the original patent may be tacked together to make the two-year period. *Otis Elevator Co. v. Atlantic Elevator Co.*, 47 F. (2d) 545 (C. C. A. 2d, 1931). The two-year statutory period has been shortened to one year. 53 STAT. 1212 (1939), 35 U. S. C. § 31 (Supp. 1939). The amendment took effect on August 5, 1940, and applies to all applications made after it became effective and to all patents granted on such applications. Presumably the analogous judicially-created laches rule will likewise be shortened.

40. *H. W. Roos Co. v. McMillan*, 64 F. (2d) 568 (C. C. A. 6th, 1933) (17 months).

41. *Coon v. Wilson*, 113 U. S. 268 (1885) (3 months).

The eighteen months delay in applying for the reissue patent might well have justified application of the doctrine of laches. The defendant's experiments with the optional water process were fully sufficient to invest it with an intervening right against enforcement of the reissue patent.⁴² Rejecting liberal construction of the statute, the court should have found the claim of the optional water process in the reissue patent invalid as an addition of new material to the original, as the Supreme Court has held in a closely analogous infringement suit.⁴³ Any of these holdings would have been a commendable step towards returning the reissue statute to its original function of encouraging inventive progress within the limits of public interest.

STATUS OF THE SHOP COMMITTEE AS A COLLECTIVE BARGAINING REPRESENTATIVE*

SINCE the advent of the Wagner Act,¹ the National Labor Relations Board has been concerned largely with issues arising from the desire of employees to be represented by an independent labor organization in general matters pertaining to the employer-employee relationship. One important question accompanying the increased recognition that the independent union is here to stay concerns the position of the employees' shop committee in carrying out the terms of a collective bargaining agreement.

In a recent case before the Labor Board,² a contract had been signed by the Clayton-Lambert Company and Local 155 of the Automobile Workers' Union³ which included a stipulation that "the employees shall have the right

42. See *Otis Elevator Co. v. Atlantic Elevator Co.*, 47 F. (2d) 545, 548 (C. C. A. 2d, 1931) (patentee should not be allowed to wait until a competitor's experiments have proved successful and then cover them with a reissue patent).

43. *Russell v. Dodge*, 93 U. S. 460 (1876). In that case, plaintiff's original patent covered a process for treating lamb or sheep skin by a compound of which heated fat liquor was an essential ingredient. The reissue patent, making the use of fat liquor optional, was held void. However, fat liquor was not produced as a by-product in the reaction, while in the *Carbide & Carbon* case, water was so produced and was therefore present in the reaction whether voluntarily added or not.

*Clayton & Lambert Mfg. Co. and Local 155, 34 N. L. R. B. No. 74, (Aug. 20, 1941).

1. 49 STAT. 449 (1935), 29 U. S. C. §§ 151-63 (Supp. 1939).

2. Clayton & Lambert Mfg. Co. and Local 155, 34 N. L. R. B. No. 74, (Aug. 20, 1941).

3. United Automobile Workers of America (CIO) Local 155, which draws its membership from sixty companies engaged in the manufacture of automobiles or automobile parts on the east side of Detroit, Michigan, maintains a division for the employees of the Clayton & Lambert Company. Approximately 95% of the 370 eligible employees are members of this division. About 60% of the eligible employees participate in elections of the company shop committee, with the voting limited to union members. Communication to YALE LAW JOURNAL from Business Agent of Local 155, Nov. 14, 1941.

to be represented by a shop committee who shall be elected in any manner determined by the employees," and whose members shall have top plant seniority while in office.⁴ In accordance with this provision, the Clayton-Lambert employees elected eleven of their number shop committeemen. Subsequently, because of a substantial decrease in orders and the alleged necessity of taking inventory, the plant was shut down.⁵ Then, as a condition of reopening before the original contract expired, the company demanded a new contract and a new shop committee to be composed of no more than five employees chosen by those actively reemployed by the company from their own number. The company, in alleging that the old committee contained many Communists and that its members engendered disturbances and lack of discipline, singled out four committeemen as being especially objectionable. While negotiating the new contract, the company was undoubtedly aware that, since the members of the old committee would lose their preferred seniority, several of them would not have sufficient regular seniority ranking to compel their immediate reengagement and, consequently, that they would be ineligible for committee membership. The company was able, however, to secure a new contractual provision providing for a revised shop committee to be set up in accordance with its demand. When the plant reopened, the four particularly objectionable committeemen were not reemployed.⁶

When these facts were presented to the NLRB, following charges of unfair labor practices brought by the union against the company, it found that the contractual provision pertaining to replacement of the original shop committee did not infringe employee rights established by the Wagner Act,⁷ even though the provision was included at the insistence of the employer.⁸

4. In addition to recognizing the local as the exclusive representative of the company's employees, the contract provided for plant-wide seniority, the elimination of piece work and the substitution of hourly wages therefor, wage increases and a minimum wage, an eight-hour day, a forty-hour week with time and a half for overtime, and a grievance procedure.

5. Although the management had informed the shop committee that the closure was merely temporary, the plant was made to appear as if in a state of indefinite shut-down.

6. Rehiring was based upon new seniority lists prepared solely by the company during the shut-down. The Board found that the company unfairly discriminated against three of these men by reducing their seniority without justification. Clayton & Lambert Mfg. Co. and Local 155, 34 N. L. R. B. No. 74 (Aug. 20, 1941).

7. "Employees shall have the right of self-organization, to form, join or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in concerted activities, for the purpose of collective bargaining or other mutual aid or protection." 49 STAT. 452 (1935), 29 U. S. C. § 157 (Supp. 1939).

8. "(4) The term 'representatives' includes any 'individual or labor organization.' (5) The term 'labor organization' means any organization of any kind, or any agency or employee representation committee or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers concerning grievances, labor disputes, wages, rates of pay, hours of employment, or conditions of work." 49 STAT. 450 (1935), 29 U. S. C. § 152 (Supp. 1939).

In relationships between employer and employees, the Clayton-Lambert shop committee⁹ played a very active role. After joining with the management in preparing seniority lists, this committee protested any deviation from the lists during lay-offs and rehiring, and resolved administrative difficulties arising in connection with inter-department and inter-job transfer of employees. Production standards for the particular jobs were determined by negotiation between the committee and the management. The committee also investigated company proposals to abolish certain departments for the purpose of discovering whether unionism was being undermined by an unwarranted subletting of work. Other similar functions included ascertaining the company's reasons for proposed shut-downs and discussing the question of reopenings, explaining the management's position to the employees, maintaining and fostering the employees' union spirit, and watching for all violations of the general contract. Lastly, the committee sought to satisfy the individual employee's grievances when such matters were not settled by negotiations between the foreman and the shop steward.

Performance of these functions, unhampered by employer interference, is essential to a full realization of the collective bargaining process. Because settlement by the shop committee usually terminates a controversy, it is incongruous to permit the employer to sit on both sides of the table when labor problems are considered at this initial stage, since he is not allowed to do so if he should ultimately be compelled to deal with the local. If an employer can eliminate those militant committeemen who are objectionable to him, the local and the plant workers are divested of a large share of bargaining equality. When shop committeemen know that their tenure is subject to their employer's whims, their pro-employee ardor may be mollified.¹⁰

It may be argued, however, that the present shop committee is primarily concerned with grievance adjustment. Even so, firmness is essential.¹¹ When the independent union's position has been established and the general agreement signed, the individual employee becomes interested primarily in seeing the advantages obtained by the local applied directly to his individual problems. If he has a complaint, he turns to the shop committee, and his judgment of the success of collective bargaining is based largely on the committee's ability to compel the management to redress his grievance. But a non-militant committee is not likely to present employee grievances with the requisite

9. For a list of functions to be performed by shop committeemen and stewards, see UAW-CIO INTERNATIONAL CORRESPONDENCE COURSE, *COLLECTIVE BARGAINING* (Lesson Four). See also *HANDBOOK FOR C. I. O. LOCAL INDUSTRIAL UNIONS* (1939) 38.

10. "It is the committeeman's duty to represent in all relationships with management the interests of the workers as the workers see them . . . little impartiality can be expected from the company." UAW-CIO, *HOW TO WIN FOR THE UNION: A DISCUSSION FOR U. A. W. STEWARDS AND COMMITTEEMEN* (3d ed. 1941).

11. "It is no exaggeration to say that the progress of the establishment of collective bargaining as an industrial modus operandi can best be judged by how smoothly meshed are the gears of the grievance adjustment machinery. . . . If grievance adjustment is the alpha it is also the omega of the collective bargaining process." ROSENFELD, *THE NATIONAL LABOR POLICY* (1940) 196. See also BROOKS, *WHEN LABOR ORGANIZES* (1937) 220, 221.

vigor and determination. When this condition exists, grievances accumulate, employee dissatisfaction is engendered in the plant, and union spirit is undermined, resulting ultimately in a weakening of the local's position at the conference table.

It would seem, therefore, that obtaining the benefits inherent in each provision of the contract is as important as securing the contract.¹² But the Board has assumed the position that the functions which the committee performed relative to achieving these benefits, while classifiable as bargaining, were merely supplementary to the collective bargaining activities of Local 155 and the International; consequently, it was not essential that they be conducted by freely chosen representatives.¹³ In so deciding, the Board failed to recognize the mutual dependence of the inside and outside representatives upon each other in respect to their attainment of the objectives of the collective bargaining procedure.¹⁴ The general agreement secured by Local 155 and the daily agreements obtained by the shop committee in its settlement of grievances are each component parts of the whole process¹⁵ of collective bargaining which is protected by Section 7 of the Act.¹⁶

A further question arises as to whether the class of employees from which the shop committee is to be chosen is a proper subject of collective bargaining. Here the Clayton-Lambert Company refused to enter into an agreement

12. "This power of organized labor is brought to bear against management through the shop stewards and plant committeemen, who are elected representatives of the organized workers. *On these committeemen or stewards depends the success or failure of labor in the automobile industry.*" UAW-CIO INTERNATIONAL CORRESPONDENCE COURSE, COLLECTIVE BARGAINING (Lesson Four) 2. Even more emphatic is the caveat expressed in the UAW-CIO educational booklet distributed to shop committeemen and stewards. "The best contract in the world may be signed between union officers and corporation executives; but, unless that contract is enforced and put into effect throughout the shop it is worth a little bit less than the paper it's written on." UAW-CIO, *HOW TO WIN FOR THE UNION: A DISCUSSION FOR U. A. W. STEWARDS AND COMMITTEEMEN* (3d ed. 1941).

13. See "E. Conclusions with respect to interference, restraint, and coercion during the shut-down, and as to discrimination against shop committeemen." Clayton & Lambert Mfg. Co. and Local 155, 34 N. L. R. B., No. 74 (Aug. 20, 1941).

14. The dependence of the local and the international upon shop committeemen and stewards is acknowledged forcefully throughout the UAW-CIO educational booklet, *HOW TO WIN FOR THE UNION: A DISCUSSION FOR U. A. W. STEWARDS AND COMMITTEEMEN* (3d ed. 1941). The principle that the general agreement itself merely provides a *modus vivendi* as a guide to future conduct, with the result dependent the outcome of day-to-day human endeavors, has been recognized. See *NLRB v. Highland Park Mfg. Co.*, 110 F. (2d) 632 (C. C. A. 4th, 1940).

15. See UAW-CIO INTERNATIONAL CORRESPONDENCE COURSE, COLLECTIVE BARGAINING (Lesson Five) 4.

16. This concept was once recognized by present Board Chairman Millis while he was acting as an arbitrator. Arbitration between UAW and General Motors Corp., Chevrolet Gear & Axle Division, 7 L. R. R. 922 (1940), wherein Dr. Millis stated: "The success of collective bargaining depends quite as much upon personal qualities, attitudes, and the handling of grievances as upon the terms of agreements negotiated around a conference table."

unless committee membership was restricted to those employees who were actively reengaged. Its motive undoubtedly was to eliminate the objectionable members of the old committee, but the Board declared that the company could bargain for such a provision, and that there was no unlawful interference with the right of employees to choose their own representatives.¹⁷ The Board argued that such provisions were customary in the automobile industry. It is quite possible, however, that the custom is not the product of any bargaining negotiation, but rather was born of the employees' desire to insure that the shop committee representatives would be chosen from among their own members.¹⁸

It might be argued that the employees waived their rights by their acceptance of the provision through Local 155. But this objection has been refuted in the past by the courts¹⁹ and by the Board itself²⁰ on the ground that an employer cannot induce his employees to refrain from demanding the performance of the duties which he owes to them under the Act. If any such provision is included in a contract, the employees may invalidate it if subsequently they so desire. Such a desire is conceivable in this case, because those employees not reengaged have an interest in the conditions of employment to which they probably will return.

It seems, therefore, that the Board has underestimated the usefulness of the functions performed by the shop committee, and that it has withheld from employees their right to representatives of their own free choice in an important element of collective bargaining. The Board, of course, should not be expected to draw up a list of bargaining activities with the purpose of declaring that every person engaged in one of the listed activities is immune from all employer objection. Situations may exist in which the employees will benefit from a change in representatives. But the principal case seems not to have presented such a situation, and the Board should not have countenanced so substantial an interference by the employer.²¹

17. Clayton & Lambert Mfg. Co. and Local 155, 34 N.L.R.B. No. 74 (Aug. 20, 1941).

18. Of the three principal employers in the automobile industry, General Motors, Ford, and Chrysler, only the General Motors contract requires that committeemen shall be actively employed in the plant. See 6 L. R. R. Man. 1180, 1184 (1940). The Chrysler contract permits committeemen to be chosen from employees who are on the seniority list. See 5 L. R. R. Man. 1055, 1057 (1939).

19. National Licorice Co. v. NLRB, 309 U. S. 350 (1940), *aff'g as mod.*, 104 F. (2d) 655 (C. C. A. 2d, 1939), *enf'g as mod.*, 7 N. L. R. B. 537 (1938); McQuay-Norris Mfg. Co. v. NLRB, 116 F. (2d) 748 (C. C. A. 7th, 1940), *enf'g*, 21 N. L. R. B. 709 (1940).

20. Peter Pan Co., Inc. and United Garment Workers of America (AFL), 21 N. L. R. B. 522 (1940); Killefer Mfg. Corp. and Steel Workers Organization Committee (CIO) 22 N. L. R. B. 484 (1940). See Donnelly Garment Co. and Internat'l Ladies Garment Workers Union, 21 N. L. R. B. 164 (1940).

21. For a dictum that the legislature intended the collective bargaining process to be free from even subtle employer interference, see International Ass'n of Machinists v. NLRB, 311 U. S. 72 (1940), *aff'g*, 110 F. (2d) 29 (App. D. C. 1939). At the very least, it may be said that the employer in the principal case subtly interfered with the collective bargaining process, even if that phrase be narrowly construed.

NLRB JURISDICTION OVER UNFAIR LABOR PRACTICES WHICH VIOLATE COLLECTIVE BARGAINING AGREEMENTS*

REPEATED victories in the courts have firmly established the National Labor Relations Board as protector of Labor's rights to organize free from interference and to bargain collectively with employers. Where, however, preliminary negotiations have been successfully concluded by the signing of a collective agreement by an accredited union, the continuing jurisdiction of the NLRB is less well defined. Whether the Board may countenance or assist any challenge to the majority status of a union protected by some form of unexpired exclusive contract, has been the subject of constant debate.¹ Of perhaps even greater obscurity has been the authority of the Board over discriminatory labor practices when they occur subsequent to the inauguration of a direct contractual relationship between the employer and an approved bargaining agent of a majority of his employees. This latter problem develops in perhaps its most crucial form where the particular unfair practice has been expressly proscribed by the terms of the collective agreement.

The issues involved in such a situation came before the courts for the first time in the recent case of *NLRB v. Newark Morning Ledger*.² An employee had been discharged by the Ledger Company because of her membership and activity in the American Newspaper Guild. By this action the company breached a collective agreement which contained a specific provision that employees should not be discharged because of their union affiliations.³ Either the employee or the union might have gone into court and asserted a cause of action in breach of contract against the employer. Instead of resorting to judicial remedies, however, both the union and its injured member joined in petitioning the NLRB for protection and relief against the discharge as an unfair labor practice within the definition of the National Labor Relations Act.⁴ There was no claim that the NLRB had powers to remedy the breach of contract as such;⁵ whether jurisdiction under the Act could

**NLRB v. Newark Morning Ledger*, 120 F. (2d) 262 (C. C. A. 3d, 1941), *cert. denied*, 10 U. S. L. WEEK 3195 (U. S. 1941).

1. See Comment (1942) 51 YALE L. J. 465.

2. 120 F. (2d) 262 (C. C. A. 3d, 1941), *cert. denied*, 10 U. S. L. WEEK 3195 (U. S. 1941).

3. The contract stipulated that "The Publisher shall not discharge or otherwise discriminate against any employee because of Guild membership or because of his activity in the Guild." The NLRB found as a fact that the discharge had been for such activity. *Newark Morning Ledger Co.*, 21 NLRB 988, 1017 (1940).

4. 49 STAT. 449 (1935), 29 U. S. C. § 151 (Supp. 1939). The Act will hereafter be cited by section number only.

5. It has usually been assumed that the Labor Board is not authorized to take such action. See Witmer, *Collective Labor Agreements in the Courts* (1938) 48 YALE L. J. 195, 198, n. 5; Wolf, *The Enforcement of Collective Labor Agreements: A Proposal* (1938) 5 LAW & CONTEMP. PROB. 273, 282; Comment (1939) 52 HARV. L. REV. 970, 973, n. 29, 974. The NLRB can void a collective bargaining agreement if it is the result or cause of unfair labor practices. *National Licorice Co. v. NLRB*, 309 U. S. 350 (1940); *Consolidated Edison Co. v. NLRB*, 305 U. S. 197 (1938); *NLRB v.*

be based on the commission of an act already outlawed by private contract was at least debatable.⁶ The Board, however, without considering the jurisdictional issues, ordered the Ledger Company to reinstate the dismissed employee and to reimburse her for lost back wages.⁷

The Board's petition to the Third Circuit Court of Appeals for enforcement of the order was initially denied, however, on the ground that the discriminatory discharge did not constitute an unfair labor practice within the Board's jurisdiction under the National Labor Relations Act.⁸ According to the court, the discharge of any employee for union activity was an unfair labor practice only where it had "the effect of interfering with, restraining, or coercing employees in the exercise of the right of collective bargaining."⁹ No unfair practice could, therefore, exist after the bargaining process had successfully culminated in a contract defining employer-employee relations and enforceable in the courts.¹⁰

The decision denying Board jurisdiction was, however, not allowed to stand; on rehearing the court, sitting en banc, completely reversed its earlier position.¹¹ In so doing it asserted a much broader conception of collective bargaining and, therefore, of the unfair labor practices outlawed by the Act. Stating that the right of collective bargaining is "not a detached or isolated procedure which, once reflected in a written agreement, becomes a final and permanent result,"¹² a majority of the court concluded that protection by the NLRB against unfair labor practices must necessarily continue as long as the prospect of future bargaining remains.

National Motor Bearing Co., 105 F. (2d) 652 (C. C. A. 9th, 1939) (an agreement which is the cause or result of an unfair labor practice is itself an unfair labor practice). Where the employer secures an agreement in the time lapse between the hearings of the Board and its order, it has been held that once the jurisdiction of the Board has been plainly established no agreement by private parties can affect it. Compare *NLRB v. General Motors Corp.*, 116 F. (2d) 306 (C. C. A. 7th, 1940), and *NLRB v. Oregon Worsted Co.*, 96 F. (2d) 193 (C. C. A. 9th, 1938), with *NLRB v. Delaware-New Jersey Ferry*, 90 F. (2d) 520 (C. C. A. 3d, 1937).

6. The legal uncertainty on this point is attested by the variety of judicial views expressed in the *Newark Morning Ledger* case itself. See dissenting opinion of Judge Clark in *NLRB v. Newark Morning Ledger Co.*, 120 F. (2d) 262, 269 (C. C. A. 3d, 1941), and original decision of the Circuit Court of Appeals for the Third Circuit in *NLRB v. Newark Morning Ledger Co.*, 120 F. (2d) 262 (C. C. A. 3d, 1941). Although review of this case by the Supreme Court has not been granted, it is likely that the issue will continue to be litigated until a conflict between circuit courts of appeals is reached and the Supreme Court passes upon it.

7. *Newark Morning Ledger Co.*, 21 NLRB 988 (1940).

8. *NLRB v. Newark Morning Ledger Co.*, 120 F. (2d) 262 (C. C. A. 3d, 1941).

9. *Ibid.* Unfair labor practices are defined by the five subdivisions of Section 8 of the Act. The first of these relates to discharge of an employee for union activity. Under it a practice is unfair if it interferes with any of the rights granted under Section 7 of the Act. That section guarantees the right of collective bargaining and all rights incident thereto.

10. The enforceability of the contract is an assumption by the court which, as is shown below, may not be warranted in certain jurisdictions.

11. *NLRB v. Newark Morning Ledger Co.*, 120 F. (2d) 262 (C. C. A. 3rd, 1941).

12. *Ibid.*

The chief argument against the court's ultimate conclusion rests in a contention that the Board is not the proper tribunal to enforce valid labor contracts. Board enforcement of such contracts is claimed to be contrary to legislative intent; no such power is expressly granted by the Act,¹³ and amendments proposed to effectuate this end, though repeatedly suggested, have never been adopted by Congress.¹⁴ Furthermore, the dissenting judge questioned the wisdom of giving power to enforce contracts to the same agency that protects their formation — a step, to him, towards dictation of the substance of the agreements.¹⁵

In evaluating these arguments it should be noted that the court did not assert that the NLRB has any direct power to enforce the general provisions of collective agreements.¹⁶ The dissent, therefore, would seem principally to be objecting to the fact that the majority opinion permits indirect Board enforcement of certain contract violations by calling them unfair labor practices. But the argument, even as so qualified, is only partially accurate; under the decision the Board might enforce certain rights which could also be subject to court action, but neither would nor could enforce any contract provision which is not independently an unfair labor practice as defined by the Act. And the abortive amendments do not prove a contrary legislative intent since the amendments sought to make any breach of a collective agreement an unfair labor practice rather than proscribing only those which would be unfair practices independently of the breach.¹⁷

An alternative objection to the decision is that it might destroy any function of fair labor practice guarantees in collective agreements. With the availability of the "more advantageous" Labor Board remedy, employees, it is claimed, will rarely resort to court proceedings.¹⁸ They might even

13. Rice, *The Legal Significance of Labor Contracts Under the National Labor Relations Act* (1939) 37 MICH. L. REV. 693; *Hearings before Committee on Education and Labor on S. 1000*, 76th Cong., 1st Sess. (1939) 998, 1607. William Leiserson, now a member of the NLRB, said in the hearings, ". . . the authority of the Labor Relations Board ends, at bringing the employer and employee together. . . . In other words, it is like the novel, when the hero and heroine get together they live happily ever after." Senator Wagner himself has questioned Board jurisdiction after a valid contract has gone into effect. *Wagner Challenges Critics of His Act*, N. Y. Times, July 25, 1937, Magazine Section, p. 1.

14. Projected amendments advocated that Section 8 be amended to make breach of a collective bargaining agreement an unfair labor practice, and that the NLRB or some other administrative agency be given the authority to administer the contract. *Hearings before Committee on Education and Labor on S. 1958*, 74th Cong., 1st Sess. (1935) 715, 720; Comment (1939) 52 HARV. L. REV. 970.

15. See dissenting opinion of Judge Clark in *NLRB v. Newark Morning Ledger Co.*, 120 F. (2d) 262, 275-76 (C. C. A. 3rd, 1941).

16. See note 5 *supra*.

17. But see Pipin, *Enforcement of Rights Under Collective Bargaining Agreements* (1939) 6 U. OF CHI. L. REV. 651; Slichter, *The Government and Collective Bargaining* (1935) 178 ANNALS 107.

18. It is possible, of course, that in some instances of discharge contractual damages would be higher than the back pay and other remedies awarded by the Board. Cf. Witmer, *Collective Labor Agreements in the Courts* (1938) 48 YALE L. J. 195.

be required to exhaust the administrative remedies before resorting to court action,¹⁹ and denial of relief by the Board might be res judicata in a subsequent legal action.²⁰

While the decision may, in fact, result in a deemphasis of such clauses in collective agreements (at least to the extent that the unions do not secure added protection by a choice of remedies), denial of administrative procedure in favor of the judicial alone may prove highly disadvantageous to Labor in the protection of its admitted rights. Collective bargaining agreements are unenforceable in many jurisdictions under certain conditions or enforceable only by inadequate remedies. Under the laws of some states, for example, unions, as unincorporated associations, may neither sue nor be sued.²¹ Likewise, individual employees may be hampered in obtaining redress by requirements that they ratify or accept the collective agreement.²² Even where a suit is permitted, recovery may be limited to an inadequate damage remedy; reinstatement after discharge and particularly preservation of seniority status are often denied.²³ Nor should the positive advantages of the administrative process be ignored: simple and expedited procedure, relaxed rules of evidence, and specialization by the examining tribunal.

Any unfortunate consequences which might conceivably follow as a result of Board jurisdiction over unfair labor practices, even though they are proscribed by contract, would seem to be far outweighed by the policy considerations favorable to the majority opinion. Collective bargaining, though occurring on specific occasions, must be a continuous process; even where there is an existing contract, it will not be of permanent duration or cover all eventualities, and additional bargaining will, therefore, be necessary in the future. Recognition was given to this truism by the Supreme Court in *NLRB v. Sands Manufacturing Company*²⁴ where the Court indicated that the refusal of an employer to consider proposed changes in or interpretation of a labor agreement would be an unfair labor practice. It follows that it

19. Compare *Myers v. Bethlehem Shipbuilding Corp.*, 303 U. S. 41 (1938); see Berger, *Exhaustion of Administrative Remedies* (1939) 48 YALE L. J. 981.

20. See Comment, *Res Judicata in Administrative Law* (1940) 49 YALE L. J. 1250, 1268-72.

21. *O'Jay Spread Co. v. Hicks*, 185 Ga. 507, 195 S. E. 564 (1938); *Brown v. Protestant Episcopal Church*, 8 F. (2d) 149 (E. D. La. 1925); *Malloy v. Carroll*, 287 Mass. 376, 191 N. E. 661 (1934); *St. Paul Typothetae v. Bookbinders*, 94 Minn. 351, 102 N. W. 725 (1905); *Saxer v. Democratic Committee of Erie County*, 161 Misc. 35, 291 N. Y. Supp. 18 (Sup. Ct. 1936); *West v. Baltimore & O. R. R.*, 103 W. Va. 417, 137 S. E. 654 (1927).

22. See *Swart v. Huston*, 117 P. (2d) 576 (Kan. 1941); *Rotnofsky v. Capitol Distributors*, 262 App. Div. 521, 30 N. Y. S. (2d) 563 (1st Dep't 1941). See also Witmer, *Collective Labor Agreements in the Courts* (1938) 48 YALE L. J. 195, 227-29; Wolf, *The Enforcement of Collective Labor Agreements: A Proposal* (1938) 5 LAW & CONTEMP. PROB. 273, 275.

23. This is often done on a rationale that personal service contracts may not be specifically enforced. See Pipin, *Enforcement of Rights Under Collective Bargaining Agreements* (1939) 6 U. OF CHI. L. REV. 651, 659-60; Witmer, *Collective Labor Agreements in the Courts* (1938) 48 YALE L. J. 195, 203-05.

24. 306 U. S. 332, 342 (1939).

is necessary to prevent coercion and discrimination in labor relations even after an agreement has been consummated, if the mandates of the Act are to be fully carried out.

Where the union contract lacks a clause prohibiting "unfair labor practices," the dissenting position might be susceptible of an even more unfortunate result. In such circumstances the Board's jurisdiction over any subsequent discriminatory practice, might, under the minority view, be denied on grounds that the collective bargaining process had reached its fruition in the contract. Or this extreme position might be avoided, and the Board allowed to take jurisdiction in the absence of any alternative legal remedy. But in that case the availability of administrative rather than legal relief would depend arbitrarily on whether the particular union contract happened to include prohibitions against unfair practices within its express terms.

TRADING IN COMMODITY FUTURES UNDER FEDERAL INCOME TAX STATUTES*

SINCE trading in commodity futures¹ can be branded a wagering transaction,² its legality has frequently been challenged.³ Despite occasional judicial hostility, however, its validity is now firmly established.⁴ As a legitimate

* *Commissioner v. Covington*, 120 F. (2d) 768 (C. C. A. 5th, 1941); *Commissioner v. Farmers & Ginners Cotton Oil Co.*, 120 F. (2d) 772 (C. C. A. 5th, 1941), *cert. denied*, 62 Sup. Ct. 185 (U. S. 1941).

1. For a general description of trading in commodity futures on organized commodity exchanges, see HOFFMAN, *FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS* (1932); BAER AND WOODRUFF, *COMMODITY EXCHANGES* (3d ed. 1935).

2. A contract to sell for future delivery is invalid at common law if the parties intend, instead of actual delivery, a settlement of differences at the time the transaction is closed. *Irwin v. Williar*, 110 U. S. 499 (1884); *Lyons Milling Co. v. Goffe & Car-kener*, 46 F. (2d) 241 (C. C. A. 10th, 1931); *Willhite v. Houston*, 200 Fed. 390 (C. C. A. 8th, 1912); *Hoover Grain Co. v. Amundson*, 70 N. D. 186, 293 N. W. 196 (1940). The intention of one party does not invalidate the contract. *Browne v. Thorn*, 260 U. S. 137 (1922); *cf. Williamson v. Majors*, 169 Fed. 754 (C. C. A. 5th, 1909). For a discussion of the common law rule and cases, see MEYER, *THE LAW OF STOCK BROKERS AND STOCK EXCHANGES* (1931) § 34.

3. The issue usually arises in two types of action: (1) suits by brokers for commissions or for advances made on the customer's account [see, *e.g.*, *Ware v. Pearsons*, 173 Fed. 878 (C. C. A. 8th, 1909)]; (2) suits by customers for margins deposited with the broker under statutes allowing recovery against the winner of a wager [*Van Pelt v. Schauble*, 68 N. J. L. 638, 54 Atl. 437 (1903)]. See Comment (1927) 40 HARV. L. REV. 638, n. 11.

4. *Board of Trade v. Christie Grain & Stock Co.*, 198 U. S. 236 (1905); *Mullinix v. Hubbard*, 6 F. (2d) 109 (C. C. A. 8th, 1925); *Gettys v. Newburger*, 272 Fed. 209 (C. C. A. 8th, 1921); *Springs v. James*, 137 App. Div. 110, 121 N. Y. Supp. 1054 (1st Dep't 1910). The set-off or ringing-off transactions under the rules of the exchanges are considered to be legal deliveries. *Board of Trade v. Christie Grain & Stock Co.*, *supra*. For a history of the legality of the future contract, see HOFFMAN, *op. cit. supra* note 1, at 112. For a consideration of federal statutory regulation of futures trading, see Comment (1941) 54 HARV. L. REV. 1373.

form of investment, the purchase or sale of commodity future contracts, standardized under rules of organized exchanges,⁵ has been sanctioned by business and the law. When used as a hedging device, moreover, dealing in futures operates as a valuable form of price insurance by offsetting present risks in cash transactions.⁶ But identification of a particular transaction as an illegal speculation or a valid business institution is a recurrent problem for the courts.

When losses have resulted from trading in commodity futures, the determination of their deductibility under income tax statutes makes problems of identification acute. If a transaction is declared by the courts to be a wager, specific statutory provision permits deduction of losses only to the extent of gains from similar speculations.⁷ Where, on the other hand, the dealing in futures is found to be a legitimate investment, doubt arises whether deductibility is governed by the capital loss limitation⁸ or fully allowed under the ordinary loss provisions.⁹ And in the case of the hedge the application of the statute has not been fully settled. Since hedging is almost entirely a form of price insurance, losses from it might be held fully deductible as ordinary and necessary business expenses.¹⁰ Where, however, the distinction from investment is blurred, the hedging transaction might be subject to the restricted deductibility of the capital loss.

The treatment of commissions creates an additional difficulty in the computation of taxes on futures dealings. While commissions paid in strict hedging transactions are apparently classifiable with losses as business expenses,¹¹ their deductibility in cases of legitimate investment remains undefined. Despite taxpayer claims that they are items of expense, it is settled in ordinary securities investment by non-dealers that commissions on purchases must be added to purchase price for computing capital gains or losses.¹² Commissions on sales on the other hand have been allowed full deduction as expenses.¹³ Since, however, commissions in futures trading are ordinarily payable

5. See BAER AND WOODRUFF, *op. cit. supra* note 1, at 6.

6. For various definitions and descriptions of hedging, see *Browne v. Thorn*, 260 U. S. 137, 139 (1922); *Board of Trade v. Christie Grain & Stock Co.*, 198 U. S. 236, 249 (1905); *Buckeye Cotton Oil Co. v. Sloan*, 272 Fed. 615, 620 (C. C. A. 6th, 1921); *Fagerberg v. Phoenix Flour Mills Co.*, 50 Ariz. 227, 242, 71 P. (2d) 1022, 1028-29 (1937); *Whorley v. Patton-Kjose Co.*, 90 Mont. 461, 475, 5 P. (2d) 210, 214 (1931); BAER AND WOODRUFF, *op. cit. supra* note 1, at 86 *et seq.*; Patterson, *Hedging and Wagering on Produce Exchanges* (1931) 40 YALE L. J. 843, 846.

7. INT. REV. CODE § 23(h) (1939).

8. INT. REV. CODE § 117(d) (1939). See *Staerker v. United States*, 4 C. C. H. 1938 Fed. Tax Serv. ¶ 9514 (N. D. Tex. 1938), *appeal dismissed*, 4 C. C. H. 1940 Fed. Tax Serv. ¶ 9339 (C. C. A. 5th, 1940).

9. INT. REV. CODE §§ 23(e) [individuals], 23(f) [corporations] (1939).

10. *Ben Grote*, 41 B. T. A. 247 (1940); *Bacon v. Reinecke*, 26 F. (2d) 705 (N. D. Ill. 1928), *aff'd*, 54 F. (2d) 1078 (C. C. A. 7th, 1929) (by implication); *cf. Commissioner v. Banfield*, 122 F. (2d) 1017 (C. C. A. 9th, 1941). See G. C. M. 17322, XV-2 CUM. BULL. 151 (1936).

11. G. C. M. 17322, XV-2 CUM. BULL. 151 (1936).

12. *Helvering v. Winmill*, 305 U. S. 79 (1938).

13. *Neuberger v. Commissioner*, 104 F. (2d) 649 (C. C. A. 2d, 1939), *rev'd on another issue*, 311 U. S. 83 (1940).

only on consummation of the commodity transaction,¹⁴ the applicability of rules in securities has been doubtful.

These uncertainties surrounding the taxation of futures have been partially dispelled by recent decisions of the Fifth Circuit.¹⁵ Losses from hedging were declared fully deductible as ordinary and necessary business expenses.¹⁶ Investment futures, found to fall within the statutory definition of capital assets, were made subject to the limitation on capital losses.¹⁷ In addition, by extending the rule on securities purchases to commissions on sales, the court held that all commissions paid in futures investment transactions must be assimilated in purchase and sale price.¹⁸

The classification of losses from hedging, confirming already existing authority, is justified commercially and legally. Since the hedge has been judicially exempted from the stigma of wagering,¹⁹ it should escape the specific tax provision for speculating losses.²⁰ The cost of hedging, moreover, including losses sustained, seems clearly to satisfy criteria which the courts have formulated for ordinary and necessary business expenses. Now an established business institution, hedging transactions are comprised of purchases and sales of the cash commodity and futures in equivalent amounts, a purchase of one balancing a sale of the other.²¹ Since cash and futures markets tend to move together,²² gains in one market offset losses in the other. The hedger is primarily concerned with insuring himself against wide price fluctuations in the cash market to make certain his ordinary operating profits.²³ Thus used as protection against risks, and not as capital investment, hedging offers the only method of price insurance available to manufacturers, dealers, and others who must make commodity contracts of purchase and sale in advance.²⁴ Losses from hedging, therefore, conform to the judicial requirement that business expenses, to be deductible, must be helpful to, or

14. See George W. Covington, 42 B. T. A. 601, 606 (1940); *HOFFMAN, op. cit. supra* note 1, at 157.

15. *Commissioner v. Covington*, 120 F. (2d) 768 (C. C. A. 5th, 1941); *Commissioner v. Farmers & Ginners Cotton Oil Co.*, 120 F. (2d) 772 (C. C. A. 5th, 1941), *cert. denied*, 62 Sup. Ct. 185 (U. S. 1941).

16. This statement, however, was dictum. The decision was that the transactions in question were not hedges. *Commissioner v. Farmers & Ginners Cotton Oil Co.*, 120 F. (2d) 772, 774 (C. C. A. 5th, 1941), *cert. denied*, 62 Sup. Ct. 185 (U. S. 1941).

17. *Commissioner v. Covington*, 120 F. (2d) 768, 770 (C. C. A. 5th, 1941).

18. *Commissioner v. Covington*, 120 F. (2d) 768, 771 (C. C. A. 5th, 1941).

19. See notes 4 and 6 *supra*.

20. INT. REV. CODE § 23(h) (1939). For decisions on wagering losses under the tax statutes, see 1 Prentice-Hall 1941 Fed. Tax. Serv. ¶ 13,760.

21. For a clear discussion of the operation of the hedge, see *Patterson, supra* note 6, at 846.

22. "Hedging is based upon the assumption that cash and future prices will parallel each other in movement after due allowance has been made for any seasonal trend in cash prices. In the broader price movements, this assumption . . . is substantially accurate." *HOFFMAN, op. cit. supra* note 1, at 381. See also *id.* at 254 *et seq.*

23. *HOFFMAN, op. cit. supra* note 1, at 387; see *Lyons Milling Co. v. Goffe & Car-kener*, 46 F. (2d) 241, 247 (C. C. A. 10th, 1931).

24. See G. C. M. 17322, XV-2 CUM. BULL. 151, 152 (1936).

proximately result from, the taxpayer's business.²⁵ Gains realized from hedges, moreover, are reflected in net income either by compensating for losses in the commodity transaction or by offsetting fluctuations in the market price of the commodity through inclusion in net income. Consequently allowance of full deductibility of losses ordinarily has no appreciable effect on net income.²⁶

The investment future contract, however, lacks both insurance and accounting grounds on which to base a claim of full deductibility.²⁷ Taxpayers assert, nevertheless, that such losses are allowable under the ordinary loss provisions,²⁸ rather than subject to the capital loss limitation.²⁹ The basis for this argument is that under the statutory definition of a capital asset property must be held by the taxpayer,³⁰ and there must be a sale or exchange to produce taxable capital gain or loss.³¹ It is contended that the trader in future contracts does not hold property, but simply executory contracts to buy property in the future if the futures are not closed out on the exchange before the time for delivery. The process of purchase and extinguishment of contracts, moreover, is alleged not to represent a sale or exchange.³²

The effect of this argument, however, is to drive legitimate investment into a category of wagering transaction.³³ Both business and law, on the other hand, have consistently treated future contracts as representing purchases and sales of property in order to distinguish them from illegal wagering bargains. Legal rationales applied to the future contract, moreover, add an additional refutation to the argument. On one hand, the contract slips evidencing the purchases and sales are considered bought and sold notes.³⁴ According to other authorities, the commodity itself is bought or sold by means of the contract.³⁵ Then the ringing-off or set-off transaction that closes out the future

25. *Deputy v. duPont*, 308 U. S. 488 (1940); *Welch v. Helvering*, 290 U. S. 111 (1933); *Kornhauser v. United States*, 276 U. S. 145 (1928); *Pyne v. United States*, 35 F. Supp. 81 (Ct. Cl. 1940). See Comments (1941) 27 V.A. L. Rev. 349, (1939) 13 TEMP. L. Q. 511.

26. See G. C. M. 17322, XV-2 CUM. BULL. 151, 152 (1936). Net income will be affected in the unexpected case when the two markets, cash and futures, fall sharply out of line so as to produce a large loss or gain. See note 22 *supra*.

27. See G. C. M. 17322, XV-2 CUM. BULL. 151 (1936).

28. INT. REV. CODE §§ 23(e), (f) (1939).

29. The present statute provides that long-term capital losses (from sale or exchange of a capital asset held over 18 months) shall be allowed in full, but short-term capital losses (asset held less than 18 months) shall be allowed only to the extent of short-term capital gains. INT. REV. CODE § 117(d) (1939). The limitation controlling the *Covington* case restricted allowable capital losses to \$2,000, plus capital gains. Revenue Act of 1936, § 117(d).

30. INT. REV. CODE § 117(a)(1) (1939).

31. INT. REV. CODE § 117(a)(2) *et seq.* (1939).

32. See *Commissioner v. Covington*, 120 F. (2d) 768, 769 (C. C. A. 5th, 1941).

33. *Irwin v. Williar*, 110 U. S. 499 (1884); *Cleage v. Laidley*, 149 Fed. 346 (C. C. A. 8th, 1906).

34. *Bibb v. Allen*, 149 U. S. 481 (1893); see *George W. Covington*, 42 B. T. A. 601, 605 (1940); *HOFFMAN, op. cit. supra* note 1, at 111.

35. *GARSDALE, COTTON GOES TO MARKET* (1935) 136.

on the exchange is in legal effect a delivery of the commodity.³⁶ This rationale derives support from the fact that in clearance the commodity is regarded as being bought and sold by the clearing house.³⁷ Either theory characterizes the future contract as property, capable of ownership and of being transferred by the parties to the contract or by operation of law.³⁸

Conceding the future contract of the legitimate investment type to be property within the capital asset definition, it must further be shown not to be one of the kinds of property expressly excluded.³⁹ If the transaction is entered into as an investment, that very fact would appear to disqualify the contract as an exception. A dealer⁴⁰ in futures can presumably include his contracts in the excluded categories. Futures are his stock in trade, to be sold to customers in the ordinary course of business.⁴¹ The trader for investment, however, buys for his own account and for the sake of profit.⁴² Congress, in addition, has removed any doubt as to the application of the section to trading losses.⁴³ Previously one who made it his business to trade in securities or futures might be excepted.⁴⁴ Now he is clearly labeled a capitalist,⁴⁵ and the deductibility of his losses is limited.

The treatment of commissions, however, is complicated by both the statute and legal precedents. Costs incurred in acquiring and selling property are ordinarily classified as capital expenditures, to be added to the purchase price or deducted from the sale price of the property.⁴⁶ In tax computation, either

36. Board of Trade v. Christie Grain & Stock Co., 198 U. S. 236 (1905).

37. HOFFMAN, *op. cit. supra* note 1, at 203.

38. See the analysis of futures transactions in Valley Waste Mills v. Page, 115 F. (2d) 466, 468 (C. C. A. 5th, 1940), *cert. denied*, 61 S. Ct. 549 (U. S. 1941).

39. ". . . stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1)." INT. REV. CODE § 117(a) (1) (1939). See U. S. Treas. Reg. 103, § 19.117-1.

40. See the definition of a dealer in securities in U. S. Treas. Reg. 103, § 19.22(c)-5.

41. This is reflected in the permission given dealers to inventory securities held for the purpose of resale. U. S. Treas. Reg. 103, § 19.22(c)-5. See *Helvering v. Fried*, 299 U. S. 175 (1936).

42. *Schafer v. Helvering*, 299 U. S. 171 (1936); *Edward E. Trost*, 34 B. T. A. 24 (1936); *Oil Shares, Inc.*, 29 B. T. A. 664 (1934); G. C. M. 9656, X-2 CUM. BULL. 127 (1931).

43. See *Neuberger v. Commissioner*, 311 U. S. 83, 85 *et seq.* (1940). The words "to customers" were inserted after "held primarily for sale" in the Revenue Act of 1934. See O. L. Burnett, 40 B. T. A. 605, 607 (1939), *aff'd on this point*, 118 F. (2d) 659 (C. C. A. 5th, 1941); G. C. M. 21497, 1939-2 CUM. BULL. 187, 188 (1939).

44. *Charles W. Purdy*, 36 B. T. A. 572 (1937); *Francis M. Weld*, 31 B. T. A. 600 (1934); G. C. M. 9958, X-2 CUM. BULL. 158 (1931).

45. *Cf. United States v. New York Coffee and Sugar Exchange*, 263 U. S. 611, 619 (1924).

46. *Bonwit Teller & Co. v. Commissioner*, 53 F. (2d) 381 (C. C. A. 2d, 1931) (fee for negotiation of long-term lease); *Hutton v. Commissioner*, 39 F. (2d) 459 (C. C. A. 5th, 1930) (commissions on purchase of securities); *Simmons Co. v. Commissioner*, 33 F. (2d) 75 (C. C. A. 1st, 1929) (bankers' commissions paid by corporate taxpayer on sale

capital gain is reduced or capital loss is increased by such charges.⁴⁷ Although commissions paid on futures investment are paid only on the consummation of the transaction, they would seem clearly to be costs incident to the acquisition and sale of property. Tax policy and commercial usage, therefore, support the court's refusal to allow their deduction as business expenses. Despite the cogency of reasons for its adoption, however, the decision required reversal of previous authority. The *Winmill* rule for securities transactions was confined to forbidding deduction of commissions on purchases as expenses and calling for their addition to purchase price.⁴⁸ A subsequent circuit court decision refused to extend the Supreme Court's principle to sales commissions.⁴⁹ Adhering to both decisions, the Board of Tax Appeals found the tax treatment of securities appropriate for futures transactions.⁵⁰ To apply the two rules to futures trading, where payment of commissions is deferred and then made in lump sum, the Board was forced to presume that half of the total commissions were paid on sales.

The Board's use of securities precedents was nevertheless of doubtful propriety. Although the Supreme Court in the *Winmill* case did not cover commissions on sales, its silence can be attributed to the absence of the issue on certiorari. Moreover, the rationale for its decision—tacit approval of administrative rulings by Congressional reenactment⁵¹—seems equally applicable to require deduction of sales commissions from sale price.⁵² In addition, there is no apparent policy basis for making a distinction between the two types of commissions. Even if the distinction is valid for securities investment, it should not be applied to futures in which lump-sum commissions are institutional. This is emphasized by the Board's resort to a presumption in

of own capital stock); Briarcliff Investment Co., 30 B. T. A. 1269 (1934) (real estate commissions); Odorono Co., 26 B. T. A. 1355 (1932) (attorney's fees in connection with sale of assets).

47. See *Odorono Co.*, 26 B. T. A. 1355, 1358 (1932).

48. *Helvering v. Winmill*, 305 U. S. 79 (1938).

49. The Second Circuit had held both purchase and sale commissions of a trader in securities deductible as business expenses. *Winmill v. Commissioner*, 93 F. (2d) 494 (C. C. A. 2d, 1937). Although the Supreme Court, in *Helvering v. Winmill*, reversed that decision as to the purchase commissions, the Circuit Court, in a *per curiam* opinion, announced that its rule as to sale commissions would still be applied. *Neuberger v. Commissioner*, 104 F. (2d) 649 (C. C. A. 2d, 1939), *rev'd on another issue*, 311 U. S. 83 (1940).

50. *George W. Covington*, 42 B. T. A. 601 (1940).

51. See Brown, *Regulations, Reenactment, and the Revenue Acts* (1941) 54 HARV. L. REV. 377; Griswold, *A Summary of the Regulations Problem* (1941) 54 HARV. L. REV. 398.

52. See U. S. Treas. Reg. 103, §19.24-2. The clause "when such commissions are not an ordinary and necessary business expense" was inserted to permit a dealer in securities to deduct selling commissions because of practical accounting difficulties peculiar to a dealer. G. C. M. 15430, XIV-2 CUM. BULL. 59 (1935). The Board of Tax Appeals, however, has followed the *Neuberger* decision allowing a non-dealer to make similar deduction. *Alice D. Ortiz*, 42 B. T. A. 173 (1940). A recent decision has reversed the Board's position and subjected sales commissions to the *Winmill* principle. *Spreckels v. Commissioner*, 119 F. (2d) 667 (C. C. A. 9th, 1941), *cert. granted*, 62 Sup. Ct. 130 (U. S. 1941).

calculating the commissions on sales. From the point of view of administration, therefore, the court's decision is additionally justified.

If the adopted principles are upheld, definition of the taxation of commodity futures is assured. But the problem of identification remains. While the stigma of wagering will be rarely applied, the distinction between hedging and legitimate investment will survive as a recurrent issue. In the *Farmers & Ginnners* case, for example, the Board of Tax Appeals held the dealings to be substantially hedges.⁵³ Since, however, the transactions deviated from the pattern of the true hedge in that refined futures were purchased after disposal of the crude commodity, the Circuit Court considered them capital investments.⁵⁴ But the deviation was necessitated by the lack of a futures market for the crude and the need for disposing of the perishable commodity at unsatisfactory prices. Under the circumstances the delayed future transaction was presumably the only method of price insurance available.⁵⁵ Related thus to the taxpayer's trade, losses from the dealings, although not strictly hedging losses, might still have been treated as business expenses. When such deviational futures transactions reappear in the future, more reliable identification for tax purposes can be achieved by applying the principles which initially determined the taxability of the institutional forms of dealing.

AVAILABILITY OF A DECLARATORY JUDGMENT WHEN ANOTHER SUIT IS PENDING*

ATTEMPTS to delineate the ambit of judicial discretion under the Federal Declaratory Judgments Act¹ have been frequently impeded by the basic misconception that it is mandatory for a court to assume jurisdiction of a declaratory judgment suit whenever the jurisdictional facts are present. Responsibility for that error may be attributed in part to the silence of the federal law regarding discretion in contrast with a specific provision for it in the Uniform Declaratory Judgments Act adopted by the majority of states.² To a large extent, however, the erroneous conclusion stems from

53. *Farmers & Ginnners Cotton Oil Co.*, 41 B. T. A. 1083 (1940). This opinion superseded an earlier holding that the transactions were not hedges. *Farmers & Ginnners Cotton Oil Co.*, 41 B. T. A. 255 (1940).

54. *Commissioner v. Farmers & Ginnners Cotton Oil Co.*, 120 F. (2d) 772, 775 (C. C. A. 5th, 1941), *cert. denied*, 62 Sup. Ct. 185 (U. S. 1941). The court held that the purchase of refined gave no price insurance.

55. See *Farmers & Ginnners Cotton Oil Co.*, 41 B. T. A. 1083, 1085 (1940).

**Associated Indemnity Corp. v. Garrow Co.*, 39 F. Supp. 100 (S. D. N. Y. 1941).

1. 48 STAT. 995, 28 U. S. C. § 400 (1934).

2. Section 6 of the Uniform Act provides: "The court may refuse to render or enter a declaratory judgment or decree where such judgment or decree, if rendered or entered would not terminate the uncertainty or controversy giving rise to the proceedings." Thus far twenty-seven states have adopted the Uniform Act. See BORDMAN, *DECLARATORY JUDGMENTS* (2d ed. 1941) 133. Maine and West Virginia are the latest recruits. ME. REV. STAT. (Supp. 1941) c.233; W. VA. CODE ANN. (Michie & Sublett,

a failure to distinguish between the preliminary question of the possession of jurisdiction by a court and the secondary issue of the proper exercise of that jurisdiction when it concededly exists.³ Conscious of that cleavage now, courts generally recognize that the assumption of jurisdiction as well as the granting or withholding of a declaratory judgment is discretionary.⁴

When a declaratory judgment is sought while another suit is pending in a different court, the propriety of mandatory jurisdiction seems particularly doubtful. In such cases, therefore, most federal courts regard the issuance of a declaratory judgment as a matter within their discretion.⁵ When confronted with that issue, however, the reaction of a federal district court in New York was deviational.⁶ After suit was begun in a state court upon a conventional liability policy, the insurer, alleging failure to furnish an immediate written notice of the accident as required by the insurance contract, sought a declaratory judgment in federal court that the policy was null and void in respect to that particular claim. The court ruled that the

Supp. 1941) § 5516. For the sake of brevity the drafters of the Federal Act made no specific reference to discretion. There was no intent, however, to abandon the rule of discretion established in foreign courts. *Id.* at 293, 313. To banish any lingering doubts, the Committee Note to Federal Rule 57 states that the Uniform Act, which allows discretion, is to be a guide to procedure under the Federal Act. NOTES TO FED. RULES CIV. PROC. 57. See *Aetna Casualty & Surety Co. v. Quarles*, 92 F. (2d) 321 (C. C. A. 4th, 1937); *American Automobile Ins. Co. v. Freundt*, 103 F. (2d) 613 (C. C. A. 7th, 1939).

3. See *Maryland Casualty Co. v. United Corp. of Mass.*, 29 F. Supp. 986 (D. Mass. 1939), *rev'd*, 111 F. (2d) 443 (C. C. A. 1st, 1940) (declaratory judgment not granted due to lack of jurisdiction); *Aetna Life Ins. Co. v. Martin*, 108 F. (2d) 824 (C. C. A. 8th, 1940) (dismissed below "for want of jurisdiction"); *cf.* *Pacific Mutual Life Ins. Co. v. Rhame*, 32 F. Supp. 59 (E. D. S. C. 1940) (no discretion to refuse jurisdiction of appropriate case).

Insurance lawyers, in particular, frequently confuse the existence of jurisdiction with the exercise of jurisdiction when they insist that a declaratory judgment must be granted by a court whenever the jurisdictional facts are presented. Whether their attitude is due to conceptual difficulties or a desire to expand the use of the declaratory action is not clear. See Morrison, *Availability of the Federal Declaratory Judgment Act for Life Insurance Cases* (1937) 23 A. B. A. J. 788, 791; Morrison, *Federal Declaratory Actions and Casualty Insurance* (1941) 9 U. OF KAN. CITY L. REV. 211, 213; Shackelford, *The Importance of the Federal Declaratory Procedure to Insurance Carriers* (1939) 6 INS. COUNSEL J. 38; Aitken, *Use of Federal Declaratory Judgment Act In Controversies Involving Insurance Contracts* (1938) 17 NEB. L. BULL. 107, 112; Appleman, *Federal Declaratory Judgments On Automobile Insurance* [1939] WIS. L. REV. 496, 499.

4. *Aetna Casualty & Surety Co. v. Quarles*, 92 F. (2d) 321, 324 (C. C. A. 4th, 1937); *American Automobile Ins. Co. v. Freundt*, 103 F. (2d) 613, 619 (C. C. A. 7th, 1939); *United States Fidelity & Guaranty Co. v. Koch*, 102 F. (2d) 288, 294 (C. C. A. 3d, 1939); *Maryland Casualty Co. v. Consumers Finance Service*, 101 F. (2d) 514, 515 (C. C. A. 3d, 1938). Cases involving discretion are collected in ANDERSON, *DECLARATORY JUDGMENTS* (1940) 515 *et seq.* The grounds for refusing jurisdiction or judgment are subject to appeal. See BORCHARD, *op. cit. supra* note 2, at 293, 299, 313.

5. See cases cited *infra* note 11 and, generally, Comment (1941) 9 GEO. WASH. L. REV. 440.

6. *Associated Indemnity Corp. v. Garrow Co.*, 39 F. Supp. 100 (S. D. N. Y. 1941).

matter had been settled by the case of *Maryland Casualty Company v. Pacific Coal and Oil Company*.⁷ There, according to the District Judge, the Supreme Court held declaratory relief available as a matter of law rather than judicial discretion in an analogous situation. No further precedents were cited; no other pertinent arguments were advanced.

Careful scrutiny of the *Maryland Casualty Company* opinion, however, reveals no intent to make mandatory the issuance of a declaratory judgment by a federal court when another suit is pending. In that case a state action had been initiated against the insured, but the insurer had not been joined as a defendant. When the insurer applied for a declaration of rights in the federal court, it joined the injured party as defendant. The vital issue was whether the company had an interest as against the injured party. Neither expressly nor by inference did the Court decide more than that an actual controversy between insurer and party injured was presented which would justify a declaratory remedy. Significant also is the fact that in a subsequent circuit court decision⁸ it has been held, without allusion to the *Maryland Casualty Company* case, that full discretion existed when another action was pending in a state court.

That the reaction of the court in the principal case was deviational is emphasized by a review of judicial precedents. The discretionary theory emerges repeatedly in general dicta, even where the narrow question of its propriety during the pendency of another suit is not squarely put.⁹ The rule appears directly, however, where an earlier action involving similar questions and parties is pending in a state tribunal.¹⁰ If sheer weight of authority be determinative, virtually all pertinent decisions in the various

7. 312 U. S. 270 (1941), *rev'g* 111 F. (2d) 214 (C. C. A. 6th, 1940).

8. *Excess Ins. Co. of America v. Brillhart*, 121 F. (2d) 776 (C. C. A. 10th, 1941).

9. Most frequently cited as authority for permitting full discretion when another suit is pending is *Aetna Casualty & Surety Co. v. Quarles*, 92 F. (2d) 321 (C. C. A. 4th, 1937). Its force as a binding precedent on that precise question may, however, be diminished somewhat by the fact that another judgment had already been recovered settling all vital issues. Only a routine action to enforce that judgment against the insurer was "pending" when declaratory relief was sought.

Elsewhere, because of additional complicating facts, dicta have supplanted clear cut holdings on the existence of discretion when another suit is pending. See *Maryland Casualty Co. v. Consumers Finance Service*, 101 F. (2d) 514 (C. C. A. 3d, 1938) (state suit did not embrace all issues); *American Automobile Ins. Co. v. Freundt*, 103 F. (2d) 613 (C. C. A. 7th, 1939) (garnishment proceedings already begun in state court).

10. See *Excess Ins. Co. of America v. Brillhart*, 121 F. (2d) 776, 778 (C. C. A. 10th, 1941): "Ordinarily a court having jurisdiction of the subject matter and over the parties to a justiciable controversy must exercise that jurisdiction. This is, however, not an absolute mandate and the court has some discretionary power as to whether it will in each instance assume and exercise the jurisdiction which the statute confers. . . . Where a prior action has been filed in a court of concurrent jurisdiction between the same parties and involving the same issues and a decision by that court would adjudicate all the rights of the parties, a federal court, although having jurisdiction to entertain an action brought by a defendant in the pending cause, may within its discretionary powers refuse to entertain jurisdiction . . ."

circuits subscribe to the discretionary theory under those conditions.¹¹ Unless the principal case prevails, the mandatory concept now seems to retain vitality only in the Fifth Circuit. Adherence there dates from a dictum that when a petition for a declaratory judgment presents an actual controversy of which the court has jurisdiction, it is bound to give the remedy regardless of a pending suit embracing identical issues.¹² Yet a district court in that circuit has since, in effect, repudiated that opinion.¹³

Occasional flurries in other dicta and sallies by insurance lawyers in the legal literature indicate, however, that proponents of the mandatory theory have a pattern of objections to the discretionary rule. Silence in the federal act regarding discretion is alleged to imply an intent to reject extensive precedents for complete discretion rather than a purpose to follow that established practice.¹⁴ More specifically, discretion to refuse a declaratory judgment when another suit is pending is said to be a violation of the Federal Rules which forbid denial of a declaratory judgment merely because of the availability of another remedy.¹⁵ Invariably it is argued that a court cannot refuse relief once its jurisdiction is invoked.¹⁶ Abatement of a federal action solely on the basis that a similar suit has been filed in the state court is thought to run counter to settled jurisdictional practice which permits such simultaneous actions.¹⁷

Even in non-declaratory judgment cases, however, the federal courts often recognize their discretionary power to decline to exercise the jurisdiction

11. *Western Supplies Co. v. Freeman*, 109 F. (2d) 693 (C. C. A. 6th, 1940); *Mutual Life Ins. Co. v. Brannen*, 31 F. Supp. 123 (S. D. Ia. 1940); *Ohio Casualty Ins. Co. v. Murphy*, 28 F. Supp. 252 (W. D. Ky. 1939). For representative dicta upholding discretion of courts to decline jurisdiction or refuse declaratory relief, see *Excess Ins. Co. of America v. Brillhart*, 121 F. (2d) 776, 778 (C. C. A. 10th, 1941); *Maryland Casualty Co. v. United Corp. of Mass.*, 111 F. (2d) 443, 446 (C. C. A. 1st, 1940); *U. S. Fidelity & Guaranty Co. v. Koch*, 102 F. (2d) 288, 294 (C. C. A. 3d, 1939); *American Automobile Ins. Co. v. Freundt*, 103 F. (2d) 613, 618, 619 (C. C. A. 7th, 1939); *Aetna Casualty & Surety Co. v. Yeatts*, 99 F. (2d) 665, 669 (C. C. A. 4th, 1938); *General Accident Fire & Life Ass. Corp. v. Morgan*, 30 F. Supp. 753, 754 (W. D. N. Y. 1939); *American Motorists Ins. Co. v. Busch*, 22 F. Supp. 72 (S. D. Cal. 1938). See also 3 MOORE, *FEDERAL PRACTICE* (1938) 3229.

12. *Carpenter v. Edmonson*, 92 F. (2d) 895, 897 (C. C. A. 5th, 1937): "Even if the two suits involved identical matters . . . we think it plain that under the Federal Declaratory Judgments Act the petition stated a cause of actual controversy as to which the court's jurisdiction was invoked and of which it was bound to take cognizance." For criticism of this case, see BORCHARD, *op. cit. supra* note 2, at 659.

13. *Travelers Ins. Co. v. Wechsler*, 34 F. Supp. 717 (S. D. Fla. 1940). Although there was no express reference to discretion, the court appeared to exercise its discretion in dismissing a declaratory judgment action because of pending suits.

14. See Morrison, *supra* note 3, 23 A. B. A. J., at 793.

15. *FED. RULES CIV. PROC.*, 57. See *Employers Liability Assurance Corp. v. Ryan*, 109 F. (2d) 690, 691 (C. C. A. 6th, 1940).

16. See Morrison, *supra* note 3, 23 A. B. A. J., at 791, 792; Shackelford, *supra* note 3, at 39, 40.

17. *Kline v. Burke Construction Co.*, 260 U. S. 226 (1922); *Armour & Co. v. Miller*, 91 F. (2d) 521 (C. C. A. 8th, 1937); see 1 MOORE, *op. cit. supra* note 11, at 227.

conferred by statute.¹⁸ Furthermore, one of the chief attributes of declaratory judgment procedure is the opportunity it provides for reducing jurisdictional friction.¹⁹ Therefore, even if federal courts in most cases must act once their jurisdiction is properly invoked, the same rule is not ipso facto to be applied where declaratory relief is sought.²⁰ The allegation of a violation of the Federal Rules is likewise unsound. When another suit is pending, the reason for dismissing a declaratory action is its failure to serve a useful purpose, not the availability of another remedy.²¹ If, finally, any inference is to be drawn from the silence of the federal statute on the matter of discretion, testimony of its drafters and judicial interpretations indicate that agreement with, rather than rejection of, the established discretionary rule is implied.²²

Besides substantial judicial precedent, additional reasons of policy should impel the courts to adopt the rule of discretion. It is almost certain to promote economy of litigation. Because of already overcrowded dockets and the expense entailed, there is no justification for conducting simultaneous actions involving similar interests and parties in federal and state courts when one tribunal can settle all issues satisfactorily. Moreover, procedural fencing may be eliminated²³ if courts are allowed to decide in each case whether circumstances justify the remedy. Out-of-state insurance companies may be blocked from using the declaratory action as a substitute for the removal privilege in the expectation of obtaining a more favorable hearing in federal court.²⁴ Harassing of impecunious litigants by forcing them to participate in dual suits would be minimized. Parties may also be prevented from engaging in a race for res judicata after invoking the jurisdiction of both state and federal courts.²⁵ Furthermore, despite its flexibility, the discretionary theory may be adopted with assurance that the rights of the parties will be fully protected. Opportunity for appeal offers adequate redress for any abuse of discretion.²⁶ Now that early antipathies have vanished and the nature of the remedy is more thoroughly understood, perhaps the federal

18. See *Massachusetts v. Missouri*, 308 U. S. 1, 19 (1939); *Rogers v. Guaranty Trust Co.*, 288 U. S. 123, 130, 131 (1933); *Canada Malting Co. v. Paterson Co.*, 285 U. S. 413, 422 (1932).

19. See p. 518 *infra*.

20. See *Aetna Casualty & Surety Co. v. Quarles*, 92 F. (2d) 321, 324 (C. C. A. 4th, 1937); *American Automobile Ins. Co. v. Freundt*, 103 F. (2d) 613, 617 (C. C. A. 7th, 1939); *Excess Ins. Co. of America v. Brillhart*, 121 F. (2d) 776, 777 (C. C. A. 10th, 1941).

21. The availability of another remedy signifies that there is another, but unused, remedy in that particular action. See *Stephenson v. Equitable Life Assurance Society*, 92 F. (2d) 406, 408, 409 (C. C. A. 4th, 1937).

22. See note 2 *supra*.

23. See *Continental Casualty Co. v. National Household Distributors*, 32 F. Supp. 849, 851 (E. D. Wis. 1940).

24. See *American Automobile Ins. Co. v. Freundt*, 103 F. (2d) 613, 617 (C. C. A. 7th, 1939).

25. For examples of the use of declaratory judgment actions to encourage such a practice, see *Carpenter v. Edmonson*, 92 F. (2d) 895 (C. C. A. 5th, 1937); *Central Surety & Ins. Corp. v. Norris*, 103 F. (2d) 116 (C. C. A. 5th, 1939).

26. BORCHARD, *op. cit. supra* note 2, at 293, 299, 313.

courts will err, if at all, on the side of liberality in allowing declaratory relief. At least it may be expected that each application will be considered on its merits rather than in blind adherence to a mandate which would force the court to grant the remedy whenever its jurisdiction is invoked, irrespective of whether a useful purpose would be served.

Even where the discretionary theory prevails, the proper mode of employing that discretion presents new problems. General criteria, however, have already emerged to form a basis for solution of the problems. The declaratory judgment should not be used to settle controversies piecemeal.²⁷ An effort should be made to weigh the relative ability of the alternative courts to furnish a comprehensive settlement of all vital issues.²⁸ Thus, when an action relating to identical subject matter and parties is being considered by another court, a federal court generally ought to deny an application for declaratory relief.²⁹ It is evident that no actual judgment need have been recovered in the state suit to justify withholding a declaration. Moreover, it has been intimated that mere convenience to litigants might be controlling in a choice of courts.³⁰ Since concurrent suits where the issues and parties are precisely the same do not appear frequently,³¹ it would be unwise to adopt an immutable rule that the whole controversy must be capable of settlement in the pending action to warrant a refusal of declaratory relief. On the other hand, even though the issues in the federal and state suits are interdependent, declaratory relief should not necessarily be refused. Where, for example, an insurance company's federal suit seeking exoneration under a policy is concurrent with the injured party's state action for negligence, with or without the company as a potential defendant, the federal issue may be decided since it is autonomous and crucial to the whole litigation.³²

Aside from the broader problems of an application of the court's discretion, difficulties arise when it is necessary to determine whether an "identity

27. *Aetna Casualty & Surety Co. v. Quarles*, 92 F. (2d) 321 (C. C. A. 4th, 1937).

28. *Maryland Casualty Co. v. Consumers Finance Service*, 101 F. (2d) 514 (C. C. A. 3d, 1938).

29. *Excess Ins. Co. of America v. Brillhart*, 121 F. (2d) 776 (C. C. A. 10th, 1941); *Aetna Casualty & Surety Co. v. Quarles*, 92 F. (2d) 321 (C. C. A. 4th, 1937).

Frequently it may be very convenient to determine the insurer's liability in the state suit when the insurer volunteers to defend or could easily be joined in the state litigation. Complications may arise, however, in those states which have a procedural taboo against admitting insurance companies as parties to a negligence action. See COUCH, *CYCLOPEDIA OF INSURANCE LAW* (1931) §2254. Usually in such situations a declaratory judgment should be granted where it would be advantageous both for the insurer and for a plaintiff of limited means reluctant to proceed if he has only the prospect of an uncertain judgment against an insured with doubtful ability to pay. On the use of declaratory judgments in insurance cases, see BORCHARD, *Declaratory Judgments and Insurance Litigation* (1939) 34 ILL. L. REV. 245; Comment (1938) 26 GEO. L. J. 988.

30. See *Ohio Casualty Ins. Co. v. Richards*, 27 F. Supp. 18, 20 (D. Ore. 1939).

31. In some insurance actions where the issues of fact in the state negligence suit may be poles apart from those in the federal action to declare the policy void or inapplicable, the declaratory judgment may be properly granted.

32. See BORCHARD, *op. cit. supra* note 2, at 298. In such cases, it may be argued that the issues are not identical.

of issues" exists in a particular case.³³ Since the federal court has had no opportunity to analyze the conflicting interests, identity may be especially hard to detect when the state suit has not progressed far and the question comes up originally on a motion to dismiss the declaratory judgment.³⁴ When the issues are similar but the parties different, there is authority for the view that the state court should be allowed to proceed and retain sole jurisdiction if such deference would be an important contribution to economy of litigation.³⁵ The soundest practice is to grant a declaratory judgment if there is any reasonable doubt as to similarity of interests, so long as other jurisdictional prerequisites are satisfied.

The term "pendency" also becomes elusive when its meaning is relevant to the issue of granting or withholding a declaratory judgment. Both time of filing and the condition of the dockets are important in determining the status of the state proceedings. If the state suit has only been filed recently and the docket is congested or litigation is moving slowly, relief by the federal court may be desirable though the earlier suit would eventually settle all issues. Should it happen that the federal docket in a particular district is more crowded than that of the state court, the Federal Rules permit a declaratory judgment action to be advanced upon the calendar.³⁶ But if the state suit is nearing a judgment that would comprehend all essential questions, there would be little need of the declaratory remedy. Nice distinctions must be made, however, when a suit is only imminent or threatened. If the filing of a state action is imminent and would provide a much more comprehensive settlement than a declaratory judgment on a narrow issue, there might seem to be justification for the federal court to decline jurisdiction. But courts are reluctant to depart from the usual practice of granting declaratory relief when there is only a supposition that another suit may be instituted.³⁷

Finally, discretion should be employed wherever possible as a lubricant to avoid jurisdictional friction. Usually a federal court will refuse to entertain any action when a similar suit is pending in another federal court.³⁸

33. Although most courts agree that a declaratory judgment should be denied where another pending suit involves identical parties and issues, there is a dearth of criteria for detecting "identity."

34. See Shackleford, *supra* note 3, at 43.

35. See BORCHARD, *op. cit. supra* note 2, at 351 (only state precedents are cited).

36. FED. RULES CIV. PROC. 57.

37. "There is no discretion in the district court to refuse to proceed in a declaratory judgment because in some other action in the future the other party might be entitled to relief which would dispose of the issues involved in the declaratory judgment action." *Aetna Life Ins. Co. v. Martin*, 108 F. (2d) 824, 828 (C. C. A. 8th, 1940) citing *Columbian National Life Ins. Co. v. Foulke*, 89 F. (2d) 261 (C. C. A. 8th, 1937); *Western Casualty and Surety Co. v. Beverforden*, 93 F. (2d) 166 (C. C. A. 8th, 1937); *New York Life Ins. Co. v. Roe*, 102 F. (2d) 28 (C. C. A. 8th, 1939).

38. See *Bush v. Texas & P. Ry.*, 290 Fed. 1008, 1011 (W. D. La. 1922); *Ryan v. Seaboard & R. R.*, 89 Fed. 397, 407 (E. D. Va. 1898); 1 MOORE, *op. cit. supra* note 11, at 237.

Applications for declaratory judgments in patent litigation are often denied because a previous suit is being heard by another federal court. *Western Supplies Co. v.*

State tribunals likewise ordinarily decline to interfere with prior acquired state jurisdiction.³⁹ Yet a general sanction permits state and federal courts to conduct simultaneous suits in personam involving similar issues and parties.⁴⁰ Though tempted to take advantage of this sanction when a declaratory judgment is sought, federal courts should use discretion to avoid not only duplication of litigation, but conflicts incident to the rule of *res judicata*. Moreover, injunctions have frequently been sought in federal court to stay state proceedings until disposal of a declaratory action. Despite an express prohibition against enjoining state suits,⁴¹ federal courts were formerly liberal in granting these injunctions.⁴² Recently, however, the courts appear to respect the prohibition and thus tacitly encourage a race for priority of judgment.⁴³ Discretion, properly exercised, would remove the necessity for injunctions and eliminate attendant jurisdictional clashes and wasteful litigation.

If the recent revival of the mandatory theory is rejected, the rule of full discretion will be more firmly established. In future litigation the initial distinction between the assumption and exercise of jurisdiction should be more consistently observed. When another suit is pending, the courts should be particularly discriminating in the exercise of discretion. If the advantages of declaratory judgment procedure are recognized, discretion can be adapted to insure that any declaratory judgments granted will serve that useful purpose envisaged by the Act.

Freeman, 109 F. (2d) 693 (C. C. A. 6th, 1940); *Staley Elevator Co., Inc. v. Otis Elevator Co.*, 35 F. Supp. 778 (D. N. J. 1940); *Link-Belt Co. v. Dorr Co.*, 15 F. Supp. 663 (D. Del. 1936).

39. See *American Automobile Ins. Co. v. Freundt*, 103 F. (2d) 613, 616 (C. C. A. 7th, 1939).

40. *Kline v. Burke Construction Co.*, 260 U. S. 226 (1922); *Armour & Co. v. Miller*, 91 F. (2d) 521 (C. C. A. 8th, 1937); see 1 MOORE, *op. cit. supra* note 11, at 227.

41. 36 STAT. 1162 (1911), 28 U. S. C. § 379 (1934).

42. See, generally, BORCHARD, *op. cit. supra* note 2, at 661 *et seq.*

43. See *Maryland Casualty Co. v. Pacific Coal & Oil Co.*, 312 U. S. 270 (1941); *Aetna Casualty & Surety Co. v. Yeatts*, 99 F. (2d) 665 (C. C. A. 4th, 1938); *Maryland Casualty Co. v. Consumers Finance Service*, 101 F. (2d) 514 (C. C. A. 3d, 1938); *Central Surety & Ins. Corp. v. Norris*, 103 F. (2d) 116 (C. C. A. 5th, 1939); *Ballard v. Mutual Life Ins. Co.*, 109 F. (2d) 388 (C. C. A. 5th, 1940). For the most recent expression of general reluctance to permit federal courts to enjoin state proceedings, see *Toucey v. New York Life Ins. Co.*, 62 Sup. Ct. 139 (U. S. 1941).