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THE INTERSTATE COMMERCE COMMISSION AND THE LONG-AND-SHORT-HAUL PROBLEM

CONSIDER a railroad, running from *A* to *C* through an intermediate point, *B*, whose managers charge a greater rate when goods shipped from *A* are unloaded at *B* than when they are carried through *B* to *C*, many miles more distant. This type of rate disparity, known as long-and-short-haul discrimination,¹ appears at first blush to penalize the intermediate point outrageously; but the prevalence of the practice suggests that a consideration of its underlying causes might temper that first impression.

Competition is the theme central to all long-and-short-haul discriminations. The tremendous expansion of the railroads towards the end of the nineteenth century produced wasteful duplication of rail facilities which caused direct

1. The only discussions devoted exclusively to the long-and-short-haul problem which have been found are DEWEY, *THE LONG AND SHORT HAUL PRINCIPLE OF RATE REGULATION* (1935), reviewed by Shulman (1936) 45 YALE L. J. 558; Vanderblue, *The Long and Short Haul Clause Since 1910* (1923) 36 HARV. L. REV. 426. However, most standard works on railroads include some discussion of this problem.

competition between railroads serving the same localities.² The rail carriers also have met direct competition from other modes of transportation, such as waterways,³ pipe-lines,⁴ and, more recently, motor carriers.⁵ Further, market competition at the terminal points is an indirect form of competition relevant to long-and-short-haul discrimination. Market competition results when point *A*, a center of production,⁶ or point *C*, a center of distribution,⁷ is at a geographical disadvantage with respect to competing localities which must be neutralized if *A* or *C* is to survive in the economic struggle and if freight is to move between them. To meet this competition of routes and of markets,⁸ railroads are compelled to reduce the rates between the terminal competitive points, such as *A* and *C*. The urgent need for revenue, however, requires that the rates to intermediate non-competitive points, such as *B*, be maintained at a higher level.⁹

It is argued in justification of long-and-short-haul discrimination as a method of permitting the railroads to retain a substantial portion of the traffic moving between the competitive terminal points that the large investment in the railroad system makes it a matter of public interest that the rail carriers be favored over other forms of transportation.¹⁰ It is also pointed out that where there are alternative transportation facilities between *A* and *C*, long-and-short-haul discrimination does not actually discriminate against the non-competitive point *B*, since *C* already enjoys the advantage of lower rates on the alternate route. Finally, it is contended on behalf of the railroads that long-and-short-

2. Although in 1850 there were but 7310 miles of railroad in the United States, by 1873 the mileage had increased to 68,485, and in 1893 had reached 177,500. See MILLER, RAILWAY TRANSPORTATION (1924) 80-83, 88-90, 122; cf. RIPLEY, RAILROADS, RATES AND REGULATION (1912) 11-35, 78. A major cause of this rapid growth was the extensive public aid extended to the railroads. See HADLEY, RAILROAD TRANSPORTATION (1896) 37-38; MILLER, *supra*, 92-98. It has been estimated that the public contributed to railway construction \$700,000,000 as well as 215,000,000 acres of land, an area equivalent to that of the State of Texas. See DEWEY, *op. cit. supra* note 1, at 20.

3. The greatest canal and river prosperity was between 1840 and 1870. See MOULTON, WATERWAYS VERSUS RAILWAYS (2d ed. 1926) 69. In 1865, the annual tonnage of the Erie Canal was 4,729,654 tons, while the annual tonnage of the railroads competing with the canal was but 3,609,640. See SEN. REP. No. 46, 49th Cong., 1st Sess. (1886) 172 (Cullom Report).

4. See *infra* p. 1440.

5. See *infra* p. 1442.

6. For a more complete discussion of production market competition, see *infra* p. 1453.

7. For a more complete discussion of distribution market competition, see *infra* p. 1452.

8. Professor Dewey cites as the reasons for the existence of this competition which creates long-and-short-haul discrimination (1) the historical overbuilding of railroads, (2) the lack of permanently effective public regulation until 1910, and (3) the nature of the railway industry—the monopoly character of local but not through traffic, and the tendency toward decreasing and joint costs. DEWEY, *op. cit. supra* note 1, at 19-25.

9. See 1st. ANN. REP. I. C. C. (1887) 16. An actual investigation showed that the application of the low competitive rate as a maximum for charges to intermediate points in southern territory in 1911 would have caused a loss of 6.73% of the total freight earnings, which would have wiped out the surplus of 20 lines in that territory. See Fourth Section Violations in the Southeast, 30 I. C. C. 153, 159-162 (1914).

10. See *infra* notes 64, 65, 66.

haul discrimination, by increasing the gross revenues of the road more than the bare out-of-pocket costs of the long haul, benefits intermediate points to the extent that it helps defray the overhead charges which the traffic on the short haul would otherwise have to meet.

Railroad rates, however, have far more significant repercussions than their effect upon rail revenues; for the economic welfare of entire regions depends upon the level at which they are maintained. On behalf of the intermediate points, which usually are smaller communities, the argument is made that long-and-short-haul discriminations give undue preference to the larger terminal points and tend to stifle economic activity at other points. This is particularly true when the reason for the long-and-short-haul discrimination is not the existence of a competing route between the terminal points, but rather is the attempt on the part of the terminal points to extend their sources of raw materials and their markets by exerting pressure on the railroad to reduce rates. Competing lines and modes of transportation, which can carry freight between the terminal points at lower costs and could perform the service at a lower rate were it not for the long-and-short-discrimination, also attack the practice. In its competition with alternative transportation facilities to the terminal point, the railroad, in effect, is subsidized by the greater charge imposed for the shorter haul, and in this manner is enabled to stifle effectively the development of more economical agencies of transportation. In addition to discriminating against intermediate localities and against competing carriers, long-and-short-haul discrimination also meets the objection that it constitutes a gross departure from the distance principle which, in theory at least, has been widely accepted as the proper criterion for rate-making.¹¹ The distance principle, under which rates should vary in general with the relative cost of transportation, permits regions favorably located with respect to raw materials, labor, and centers of population to take advantage of their geographical position by producing goods and shipping them to market at a low total cost. Long-and-short-haul discrimination, departing from that principle by imposing a greater monetary charge for a shorter haul, neutralizes the natural advantages of intermediate points and tends to decrease the national income by encouraging uneconomic and wasteful long hauls.

There can be no easy solution of the problem of long-and-short-haul discrimination. No one argument on either side of the dispute is economically conclusive, nor do considerations of policy clearly point to a simple solution. Furthermore, the struggle of the railroads for increased revenues, the pressure of terminal points seeking to extend their markets and sources of raw materials for lower rates, and the efforts of non-competitive intermediate points to prevent long-and-short-haul discrimination present bitter clashes of vital economic interests rather than problems of economic theory or abstract policy. Economic planning through the readjustment of rates presents further difficulty. An attempt to redistribute population more widely would meet the opposition of

11. See ALLDREDGE, *RATE MAKING FOR COMMON CARRIERS* (1929) 79-84; DAGOETT, *PRINCIPLES OF INLAND TRANSPORTATION* (2d ed. 1934) 360-375; DANIELS, *THE PRICE OF TRANSPORTATION SERVICE* (1932) 72-81; DEWEY, *op. cit. supra* note 1, at 46-56; NOYES, *AMERICAN RAILROAD RATES* (1905) 36-55; RIPLEY, *op. cit. supra* note 2, at 166-184; VANDERBLUE & BURGESS, *RAILROADS—RATES, SERVICE, MANAGEMENT* (1923) 139-156.

commercial and industrial centers where population has clustered because of the economic advantages arising from geographical location; and any planning with the future in mind would be resisted by those interests and localities which have a stake in the railroad rate structure as it exists today.

Whether railroad managers are to be permitted to control the economic destinies of many localities through unrestricted long-and-short-haul discriminations is now a closed question. The arbitrary rate discriminations against persons and localities practiced by railroads during the seventies and eighties of the last century¹² proved the point so well that Section 4 of the Interstate Commerce Act¹³ provided that "it shall be unlawful for any common carrier subject to the provisions of this act to charge or receive any greater compensation in the aggregate for the transportation of passengers or of like kind of property, under substantially similar circumstances and conditions, for a shorter than for a longer distance over the same line, in the same direction, the shorter being included within the longer distance. . . ."¹⁴ The prohibition of long-and-short-haul discrimination, however, was not absolute. There was added to Section 4 the qualification that "upon application to the (Interstate Commerce) Commission . . . such common carrier may, in special cases, after investigation by the Commission, be authorized to charge less for longer than for shorter distances for the transportation of passengers or property; and the Commission may from time to time prescribe the extent to which such designated common carrier may be relieved from the operation of this section of this act."¹⁵

12. See MILLER, *op. cit. supra* note 2, at 137-139; RIPLEY, *op. cit. supra* note 2, at 441-450; SEN. REP. NO. 46, 49th Cong., 1st Sess. (1886) (Cullom Report); 1st ANN. REP. I. C. C. (1887) 4-10.

13. 24 STAT. 379 (1887). To prevent the discriminations which resulted from excessively high or low rates, it was provided in Section 1 that all rates had to be "reasonable and just." Section 3 contained a general prohibition upon "any undue or unreasonable preference or advantage to any particular person, company, firm, corporation, or locality, or any particular description of traffic, in any respect whatsoever." Section 2, making rebates unlawful, was a particular prohibition concerning persons. Likewise, Section 4, containing the long-and-short-haul principle, was a specific prohibition concerning places. Sections 2 and 4 stood in the statute as definite rules on either side of the general and indefinite provision in Section 3 against undue preferences. See 7TH ANN. REP. I. C. C. (1893) 32. All these sections survived in substantially the same form in the Transportation Act, 1920.

14. 24 STAT. 380 (1887), 49 U. S. C. A. § 4 (1) (1926). This statute also provided that this prohibition should "not be construed as authorizing any common carrier . . . to charge and receive as great compensation for a shorter as for a longer distance." However, the Commission in its early rulings ignored this clause. *Rice v. Atchinson, T. & S. F. Rr. Co.*, 4 I. C. C. 228, 247 (1890); *Milk Producers' Protective Ass'n v. Delaware, L. & W. Rr. Co.*, 7 I. C. C. 92, 163 (1897); see 4TH ANN. REP. I. C. C. (1890) 38. And although this clause was reenacted in the 1910 and 1920 amendments, 36 STAT. 547, 41 STAT. 480, 49 U. S. C. A. § 4 (1) (1926), the Commission has continued to ignore it, not only tacitly in the approval of blanket rate adjustments but also expressly in certain instances. Cf. *Birmingham Traffic Bureau v. St. Louis-S. F. Ry. Co.*, 118 I. C. C. 756 (1926); *Schaffner Bros. v. Cleveland, C. C. & St. L. Ry. Co.*, 177 I. C. C. 337 (1931).

15. It is interesting to note that seventeen of the states previous to the passage of the Act to regulate commerce had by statute or by constitutional amendment, beginning in 1850 and from then on to 1895, made illegal the charging of a greater compensation for

The legislative development of Section 4 and the extent to which the Commission has relieved carriers from its operation are the topics to be discussed in this comment.¹⁶

Although many rail carriers immediately commenced to adjust their rates to conform to this section,¹⁷ some carriers, fearing that such a revision would result in a drastic reduction of revenue, maintained the existing discriminatory rates. When complaints as to the fairness of these rates were heard before the newly created Interstate Commerce Commission, interested railroads strenuously defended the existing rate structure.¹⁸ Although these railroads contended that the competition of rail carriers subject to the act was such a "dissimilar circumstance" as would justify a lower charge for a longer haul, the Commission consistently refused to grant relief for this cause alone,¹⁹ for the reason

transportation by railroad for a shorter than for a longer distance over the same line in the same direction. Some of these provisions were broad, others were narrow; but in all but one of these states, the particular rule prescribed admitted of no exceptions. See 4TH ANN. REP. I. C. C. (1890) 39-43.

16. This comment does not discuss passenger rates. Although Section 4 applies to passenger fares as well as to freight rates, comparatively few cases arise which concern the former. See 25TH ANN. REP. I. C. C. (1911) 21. Only with the greatest difficulty could railroads maintain higher rates for shorter than for longer hauls. A passenger going from *A* to an intermediate point *B* can purchase a ticket to the distant point *C* yet can get off the train at *B*. Likewise, a passenger going from *B* may send to *A*, buy a ticket good from *A* to *C*, and use it from *B* to *C*. For an exhaustive discussion of current passenger traffic problems, see Federal Coordinator of Transportation, Passenger Traffic Report (1935).

Nor does this comment concern the suits of individual shippers for recovery of charges collected by the railroads which are illegal under Section 4. This comment considers only the attempts of the railroads to obtain prospective relief from Section 4.

17. See 1ST ANN. REP. I. C. C. (1887) 20-21; 2D ANN. REP. I. C. C. (1888) 14-15; 3D ANN. REP. I. C. C. (1889) 46.

18. The carriers claimed that the following conditions were such dissimilar circumstances and conditions as would justify under Section 4 lower charges to the long haul points. (1) The short haul is of local traffic while the long haul is of through traffic; (2) the low rate for the long haul encouraged manufactures and trade at that point; (3) the cost of carrying local traffic is greater than that of through traffic; (4) the traffic carried to the distant point cannot move at a higher rate; (5) railroads would go bankrupt were the rate system changed. In *re Louisville & N. Rr. Co.*, 1 I. C. C. 31, 60-71 (1887); cf. *Railroad Commission of Georgia v. Clyde S. S. Co.*, 5 I. C. C. 326, 378-388 (1892).

19. In *re Louisville & N. Rr. Co.*, 1 I. C. C. 31, 81 (1887); In *re Chicago, St. P. & K. C. Ry. Co.*, 2 I. C. C. 231, 263-270 (1888); In *re Tariffs & Classifications of Atlanta & W. P. Rr. Co.*, 3 I. C. C. 19, 78 (1889); *Hamilton & Brown v. Chattanooga, R. & C. Rr. Co.*, 4 I. C. C. 686 (1891); *Railroad Commission of Georgia v. Clyde S. S. Co.*, 5 I. C. C. 324, 404, 411 (1892).

This rule was not without exception, for in certain "rare and peculiar" cases relief was granted. See 11TH ANN. REP. I. C. C. (1895) 102; cf. In *re Louisville & N. R. Co.*, 1 I. C. C. 31, 81-83 (1887); *Wright Wire Co. v. Pittsburg & L. E. Rr. Co.*, 21 I. C. C. 64 (1911).

Production market competition was not sufficient to warrant relief from Section 4. *Raworth v. Northern P. Rr. Co.*, 5 I. C. C. 234, 247-251 (1892); *Behlmer v. Memphis & C. Rr. Co.*, 6 I. C. C. 257 (1894). Nor was the competition of markets of distribution. *James & Mayer Buggy Co. v. Cincinnati, N. O. & T. P. Ry. Co.*, 4 I. C. C. 744 (1891); *Railroad Commission of Georgia v. Clyde S. S. Co.*, 5 I. C. C. 324, 403 (1892).

that the chief purpose of the Act was to restrict ruthless competition between carriers by rail which had resulted in many discriminatory practices. However, since carriers by water were subject to no governmental regulation and thus were privileged to make whatever rates they pleased, the Commission early held that the competition of waterways permitted the railroads to charge less for a longer than for a shorter haul over the same line.²⁰ For example, water rates of 9 from New York to Boston justified the carriers by rail in meeting this rate while charging 18 to Readville, Massachusetts, a few miles inland from Boston.²¹ Likewise, the competition of railroads not subject to the Act, such as completely intrastate lines and the Canadian Pacific Railway, was held to justify railroads subject to the Act in making a lower charge for the longer haul when there was active competition for carriage to the long haul point.²² Thus it is seen that the Commission in its early rulings adopted the policy of permitting departures from Section 4 only in order to allow the regulated carriers by rail to compete effectively with the unregulated rail and water carriers.²³

The courts, however, were not so willing to give effect to the spirit of the

20. *In re Louisville & N. Rr. Co.*, 1 I. C. C. 31, 72 (1887); *Rice v. Atchison, T. & S. F. Rr. Co.*, 4 I. C. C. 228, 242 (1890); *Merchants' Union of Spokane Falls v. Northern P. Rr. Co.*, 5 I. C. C. 478, 502 (1892); see *Rice v. Cincinnati, W. & B. Rr. Co.*, 5 I. C. C. 193, 228 (1892); 11TH ANN. REP. I. C. C. (1897) 41.

However, such permission was subject to the conditions that the competition by water be real and not merely potential [*Harwell v. Columbus & W. Rr. Co.*, 1 I. C. C. 236, 248 (1887); *Brewer & Hanleiter v. Louisville & N. Rr. Co.*, 7 I. C. C. 225, 235 (1897)], and that the long haul charge give some revenue above the actual out-of-pocket cost of movement and that the intermediate rates be fair and reasonable. *Merchants' Union of Spokane Falls v. Northern P. Rr. Co.*, 5 I. C. C. 478, 500, 505 (1892); cf. 4TH ANN. REP. I. C. C. (1890) 46.

21. *King & Co. v. New York, N. H. & H. Rr. Co.*, 4 I. C. C. 251 (1890).

22. *In re Louisville & N. Rr. Co.*, 1 I. C. C. 31, 80 (1887); *Business Men's Ass'n v. Chicago, St. P., M. & O. Ry. Co.*, 2 I. C. C. 52, 64-66 (1888); *Rice v. Atchison, T. & S. F. Rr. Co.*, 4 I. C. C. 228, 244 (1890); see 11TH ANN. REP. I. C. C. (1897) 41.

23. Since the Commission could not have handled the many applications for relief from Section 4 were its permission required before a railroad could put into existence a lower charge for a longer haul, it was early held that where dissimilar circumstances did exist, the rail carrier was privileged to establish a lower charge for a longer haul without preliminary resort to the Commission. *In re Louisville & N. Rr. Co.*, 1 I. C. C. 31, 53-60 (1887); cf. *Missouri P. Ry. Co. v. Texas & P. Ry. Co.*, 31 Fed. 862 (C. C. E. D. La. 1887). Thus, though the railroads had the privilege of judging in the first instance whether they were justified in meeting through Section 4 departures the rates of water carriers and of rail carriers not subject to the Act, an order of the Commission was required before any departure could obtain to meet the competition of carriers subject to the Act. *Railroad Commission of Georgia v. Clyde S. S. Co.*, 5 I. C. C. 324, 383-400 (1892); *Gerke Brewing Co. v. Louisville & N. Rr. Co.*, 5 I. C. C. 596, 605-609 (1893); *Board of Trade of Lynchburg v. Old Dominion S. S. Co.*, 6 I. C. C. 633, 645 (1896).

Of course, an interested party was free to test the legality of those rates established in the first instance by the carrier, and, at the hearing, the burden of proof was upon the carrier to justify the greater charge for the shorter haul. *Gerke Brewing Co. v. Louisville & N. Rr. Co.*, 5 I. C. C. 596, 611 (1893); *Board of Trade of Troy v. Alabama M. Ry. Co.*, 6 I. C. C. 1, 15 (1893).

Section. Shortly after the Act was passed, there arose the question of the applicability of Section 4 to the situation wherein two or more separately organized rail carriers had formed joint through rates.²⁴ It was strenuously urged by the Commission that "line" in Section 4 meant a physical line rather than a business unit and hence that, though the portion of a joint rate allotted to one carrier might be less than the carrier's local rate over the same distance, the aggregate joint rate should be greater than the local rate between any two points on the joint line.²⁵ Yet the lower federal courts, refusing to follow this interpretation, held that "line" meant a business unit.²⁶ Under this interpretation, two rail carriers could form a joint rate from San Francisco to Kansas City of 65 while charging 94 to a Kansas point nearer San Francisco than Kansas City, on the theory that the latter rate was a combination of the local rates on each line while the former rate was a joint rate and hence constituted a new "line." Thus, joint rates were completely independent of local rates, and the purpose of Section 4 was largely vitiated.

Though the judicial interpretation of "line" as a business unit had rendered Section 4 less effective in curbing long-and-short-haul abuses, a far greater blow to the efficacy of that Section was struck by the *Alabama Midland* decision in 1897. Upon complaint that higher rates were being charged from the east to Troy, Alabama, than to Montgomery, 52 miles beyond, the Commission had ordered that this discrimination cease.²⁷ When the Alabama Midland Railway failed to conform to this order, the Commission instituted suit in a federal court to compel obedience. On appeal, the Supreme Court, dismissing the suit, held that the competition of rail carriers subject to the Act might create such dissimilar circumstances as would justify a less charge for a longer haul, and that such competition did exist at Montgomery.²⁸ This decision had immediate effects. Within five days, the Trans-Missouri Freight

24. Under the 1887 Act, connecting railroads were under no duty to associate themselves into a through route and to establish a joint through rate. See 5TH ANN. REP. I. C. C. (1891) 41-52. This duty was first declared in 1910, 36 STAT. 545, and was repeated in the Transportation Act, 1920. 41 STAT. 475, 49 U. S. C. A. § 1 (4) (1926). Of course, under the 1887 Act, carriers were under a duty to deliver goods to the connecting carrier. 24 STAT. 380, 49 U. S. C. A. § 3 (3) (1926).

25. *Boston & A. Rr. Co. v. Boston & L. Rr. Co.*, 1 I. C. C. 158, 174-176 (1887); *Lippman & Co. v. Illinois C. Rr. Co.*, 2 I. C. C. 584 (1889); see 6TH ANN. REP. I. C. C. (1892) 32-37.

26. *Chicago & N. W. Ry. Co. v. Osborne*, 52 Fed. 912 (C. C. A. 8th, 1892), cert. denied, 146 U. S. 354 (1892); *Tozer v. United States*, 52 Fed. 917 (C. C. E. D. Mo. 1892); *United States v. Mellen*, 53 Fed. 229 (D. Kan. 1892). But cf. *Cincinnati, N. O. & T. P. Ry. Co. v. I. C. C.*, 162 U. S. 184 (1896); 10TH ANN. REP. I. C. C. (1896) 17-20; *In re Violations of Act to Regulate Commerce*, 8 I. C. C. 290, 302 (1899).

27. *Board of Trade of Troy v. Alabama M. Ry. Co.*, 6 I. C. C. 1 (1893).

28. *I. C. C. v. Alabama M. Ry. Co.*, 168 U. S. 144 (1897). The court further held that, when the competition of carriers subject to the Act existed at long haul points, rail carriers could meet this competition through Section 4 departures without first obtaining the permission of the Commission. This case was approved and followed in later cases. *Louisville & N. Rr. Co. v. Behlmer*, 175 U. S. 648 (1900); *East Tennessee, V. & G. Ry. Co. v. I. C. C.*, 181 U. S. 1 (1901); *I. C. C. v. Louisville & N. Rr. Co.*, 190 U. S. 273 (1903); cf. *Dallas Freight Bureau v. Austin & N. W. Rr. Co.*, 9 I. C. C. 68 (1901).

Bureau raised rates to intermediate points over an area covering more than 100,000 square miles.²⁹ The Commission in its Annual Report stated that "... the fourth section is by this decision eliminated from the act. . . ."³⁰ Since the competition of rail carriers at the terminal points had been the principal force compelling railroads to lower rates on long hauls and since such competition was held a dissimilar circumstance justifying discrimination in terms of Section 4 departures, that Section was quite effectively emasculated. The old practices with their great disparities in rates were largely revived, and the Commission was powerless to prevent the consequent discrimination against intermediate localities.³⁰

After thirteen years of disuse, Section 4 was revived by the Mann-Elkins Act of 1910.³¹ That Act amended Section 4 by eliminating the words "under substantially similar circumstances and conditions" to make absolute the prohibition upon a greater charge for a shorter distance. However, the proviso was repeated that the Commission "in special cases" might permit departures from this prohibition. Further, by applying this prohibition to any "line or route," the distinction between a physical and a business unit which had been used to evade the original act was rendered ineffective.³² Finally, the statute added "the aggregate of intermediates" clause, which prohibited a greater charge to the distant point than the sum of the intermediate rates.³³ This amendment took from the carriers the power to

29. 11TH ANN. REP. I. C. C. (1897) 43.

30. See DEWEY, *op. cit. supra* note 1, at 78; RIPLEY, *op. cit. supra* note 2, at 431-434; 1 SHARFMAN, *THE INTERSTATE COMMERCE COMMISSION* (1931) 30-32. Market competition again justified lower rates for the longer haul. *Gardner & Clark v. Southern Rr. Co.*, 10 I. C. C. 342 (1904) (production market); *Commercial & Industrial Ass'n v. Louisville & N. Rr. Co.*, 12 I. C. C. 372 (1907) (distribution market); *Bovaird Supply Co. v. Atchison, T. & S. F. Ry. Co.*, 13 I. C. C. 56 (1908) (production market); *Columbia Grocery Co. v. Louisville & N. Rr. Co.*, 18 I. C. C. 502 (1910) (distribution market).

Yet there remained a few restrictions upon relief. The competition had to be material and substantial. *Louisville & N. Rr. Co. v. Behlmer*, 175 U. S. 648, 675 (1900). Also, the rates to the intermediate points had to be reasonable in themselves. *I. C. C. v. Southern Ry. Co.*, 117 Fed. 741 (C. C. W. D. Va. 1902); *Lehman-Higginson Co. v. Atchison, T. & S. F. Ry. Co.*, 10 I. C. C. 460, 472 (1905). Finally, the competitive rate had to be above the cost of movement. *Mayor of Wichita v. Atchison, T. & S. F. Ry. Co.*, 9 I. C. C. 534, 555-556 (1903).

And since the burden of proof continued upon the carrier to justify the lower charge to the more distant point [*Phillips, Bailey & Co. v. Louisville & N. Rr. Co.*, 8 I. C. C. 93, 108 (1898)], such a charge would be illegal if dissimilar circumstances were not proved. *Hinton Fruit & Produce Co. v. Chesapeake & O. Ry. Co.*, 17 I. C. C. 578 (1910).

31. 36 STAT. 547, 49 U. S. C. A. § 4 (1926). Although the railroads immediately attacked the constitutionality of this amendment, the Supreme Court upheld its validity in the *Intermountain Rate Cases*, 234 U. S. 476 (1914). Cf. THOM, *CONSTRUCTION AND CONSTITUTIONALITY OF THE LONG AND SHORT HAUL CLAUSE* (1911).

32. Cf. *Bennett & Son v. Chesapeake & O. Ry. Co.*, 38 I. C. C. 310 (1916).

33. Thus, if the rate from *A* to *B* were 15 and from *B* to *C* were 10, the rate from *A* to *C* could not exceed 25. For a discussion of this clause, see *infra* p. 1444.

The 1910 amendment also included another new provision, designed to prevent railroads from destroying water competition [see *Skinner & Eddy Corp. v. United States*, 249 U. S. 557, 567 (1919)], which provided that, if a railroad reduced its rates to a competitive point

determine in the first instance the existence of conditions justifying a greater charge for a shorter than for a longer distance, and vested it in the Commission.³⁴ Thus, any Section 4 departure initiated by a rail carrier was illegal, even though such departure might be exactly similar to other departures which had been previously authorized by the Commission.³⁵ This elimination of the carrier's privilege to establish greater charges for shorter hauls upon its own volition, which had existed under the original Section 4,³⁶ had immediate effect. Within one year more than 5000 applications were filed by rail carriers for relief from Section 4,³⁷ and since that time the handling of such applications has constituted an important phase of the Commission's work.

In the Transportation Act of 1920, the 1910 amendment to the original Section 4 was reenacted.³⁸ Further, the 1920 act added certain instructions to the Commission in its granting of relief—the "reasonably compensatory" clause,³⁹ which required that all rates established under authorized departures be reasonably compensatory for the service performed; the "equidistant" clause,⁴⁰ applicable only to the situation of competing rail carriers, which set forth certain mathematical restrictions upon relief; and the "potential water competition" clause,⁴¹ which expressly prohibited relief on the ground of water competition not actually in existence—which the Commission in some degree had followed in its rulings before 1920.⁴² Since Section 4 of the Transportation Act is still in force, it is today the statutory basis for long-and-short-haul

because of water competition, such rates could not be increased unless such increase rested upon changed conditions other than the elimination of water competition. 36 STAT. 548. This provision was reenacted in the Transportation Act, 1920. 41 STAT. 480, 49 U. S. C. A. § 4 (2) (1926). By 1924, but three cases had arisen under this clause. See Administration of Fourth Section, 87 I. C. C. 564, 605 (1924).

34. Intermountain Rate Cases, 234 U. S. 476 (1914); United States v. Louisville & N. Rr. Co., 235 U. S. 314 (1914); Rates on Boots and Shoes from Boston, 31 I. C. C. 154 (1914).

The burden of proof continued upon the carrier to justify the proposed departure. Railroad Commission of Nevada v. Southern P. Co., 21 I. C. C. 329, 339 (1911); Transcontinental Commodity Rates, West Bound, 26 I. C. C. 456 (1913).

35. Cf. Railroad Commissioners of Montana v. Butte, A. & P. Ry. Co., 31 I. C. C. 641, 652 (1914).

36. The Commission under the original Act had granted to the rail carriers the power to initiate long-and-short-haul departures in certain instances [see *supra* note 23] and the courts had extended this power. See *supra* note 28.

37. The amended act was approved June 18, 1910. By February 17, 1911, 5030 applications for relief under Section 4 were filed. And since only 4570 applications had been filed from 1887 to 1910, the effect of this amendment upon the work of the Commission is easily seen. See 25TH ANN. REP. I. C. C. (1911) 20-21.

38. 41 STAT. 480, 49 U. S. C. A. § 4 (1926).

39. For a discussion of this clause, see *infra* notes 50, 101.

40. For a discussion of this clause, see *infra* p. 1448.

41. For a discussion of this clause, see *infra* p. 1438.

42. Reasonably compensatory clause: Fourth Section Violations in the Southeast, 30 I. C. C. 153, 175-177 (1914); Commodity Rates to Pacific Coast, 32 I. C. C. 611, 622 (1915). Equidistant clause: New Orleans Cotton Exchange v. Louisville & N. Rr. Co., 46 I. C. C. 712, 748 (1917); Johnston v. Atchison, T. & S. F. Ry. Co., 51 I. C. C. 356 (1918). Potential water competition clause: see *infra* p. 1438.

railroad regulation.⁴³ And as no court decision has been found which overrules a Commission fourth-section order under the 1910 and 1920 Acts,⁴⁴ the Commission's interpretation of this Section comprises the existing case law upon the long-and-short-haul clause.⁴⁵

SECTION 4 ORDERS UNDER THE 1910 AND 1920 ACTS

A. *Water Competition*

In the early days of the Interstate Commerce Commission, since water carriers consisted of small independent unorganized operators incapable of exerting effective economic or political pressure for self-preservation, the Commission allowed the railroads to meet and even to destroy water competition whenever it was feasible from the point of view of the railroads.⁴⁶ Likewise, under the 1910 amendment, the Commission consistently held that actual compelling water competition justified departures from Section 4 at the point of competition.⁴⁷ Thus, for example, railroads were permitted to charge 25%

43. As the statute applies only to "like kind of property . . . over the same line or route," there is no violation of Section 4 when different commodities or different units of the same commodity are involved. In the Matter of Container Service, 173 I. C. C. 377, 440 (1931).

The long and short haul provision does not apply to intrastate movements. *Tuffi Bros. v. Southern P. Co.*, 200 I. C. C. 151 (1934). And since the Commission has no power over Canadian and Mexican railroads, questions of jurisdiction arise concerning rail shipments to these countries. Section 4 is applicable if the intermediate and distant points are located in the United States, even though the point of origin be in a foreign country. *Duluth Iron & Metal Co. v. Director General*, 89 I. C. C. 343 (1924). And though the point of destination be in a foreign country, the Commission has jurisdiction if the original and intermediate points are within the United States. *Commodity Rates to Mexico*, 209 I. C. C. 370 (1935). In this manner the Commission can protect points in the United States against discriminatory rates. Of course, if the intermediate point is in a foreign country while the points of origin and destination are in the United States, no protection is needed, and so the Commission has refused to take jurisdiction over alleged violations arising out of this situation. *Botner v. Gulf Coast Lines*, 192 I. C. C. 503 (1933).

44. Cf. *Dewey*, op. cit. *supra* note 1, at 253.

45. Since each Section 4 order concerns the balancing of many interests, private as well as public, each case must stand upon its own facts, and no one situation can ever furnish an exact precedent for another. *Bluefield Shippers Ass'n v. Norfolk & W. Ry. Co.*, 22 I. C. C. 519, 526 (1912); cf. *Danville v. Southern Ry. Co.*, 8 I. C. C. 409, 426 (1900). However, the many orders can be classified and compared to a certain extent.

46. See *supra* p. 1431. That the railroads through various competitive methods had by 1900 practically destroyed the water carriers is well-known. See *Moultroff*, op. cit. *supra* note 3, at 69-97.

47. *Long and Short Haul Docket No. 1243*, 22 I. C. C. 366 (1912); *Fourth Section Applications Nos. 542 et seq.*, 25 I. C. C. 50, 54 (1912); *Gillis & Son v. Philadelphia, B. & W. Rr. Co.*, 26 I. C. C. 61 (1913).

Of course, the rate to the distant point, established in view of water competition, had to be lower than would otherwise be reasonable. In *re Transportation of Wool*, 23 I. C. C. 151, 178 (1912); *Fourth Section Violations in the Southeast*, 30 I. C. C. 153, 173 (1914). Also, the rates to the intermediate points had to be reasonable in themselves, and there could not result any undue discrimination against these points. *Railroad Com-*

less from New York to Seattle than from New York to Spokane, some 400 miles inland, because of water competition between New York and Seattle.⁴⁸

However, with the development of the American Merchant Marine, greatly accelerated by the demands for ships during the world war, sentiment developed in favor of protecting water carriers against excessive competition, and this change of feeling was reflected in Section 500 of the Transportation Act, 1920, which provided that "it is declared to be the policy of Congress to promote, encourage, and develop water transportation, service, and facilities in connection with the commerce of the United States, and to foster and preserve in full vigor both rail and water transportation."⁴⁹ Under this declaration of policy, the Commission is required to weigh the proposed benefit to the rail carriers caused by the traffic gain which results from the Section 4 departure against the proposed detriment to the water carriers caused by the loss of that traffic which will move by rail under the new low rate. Further, the Transportation Act provided that in no case could a railroad establish a charge to a distant point that was not "reasonably compensatory for the service performed."⁵⁰ Consequently, although the Commission since 1920 has continued to grant Section 4 relief to rail carriers in order to meet compelling water competition,⁵¹

mission of Nevada v. Southern P. Co., 21 I. C. C. 329, 368 (1911); *In re Transportation of Wool*, 23 I. C. C. 151, 178 (1912).

If the railroad seeking relief had such a community of interest with the water carrier that competitive conditions were purely artificial, it was held that Section 4 relief was not justified. *Bowling Green Business Men v. Louisville & N. Rr. Co.*, 24 I. C. C. 228 (1912). It is interesting to note that in the Panama Canal Act of 1912, railroad ownership or control of any competing water carrier was made illegal. 37 STAT. 566, 567, 49 U. S. C. A. §§ 5 (10) (12) (1926).

And if the same water competition existed at both the intermediate and the distant point, there was no cause for departure from Section 4. *Chamber of Commerce v. Baltimore & O. Rr. Co.*, 30 I. C. C. 446, 453 (1914).

48. *City of Spokane v. Northern P. Ry. Co.*, 21 I. C. C. 400, 426 (1911).

49. 41 STAT. 499 (1920), 49 U. S. C. A. § 142 (1926).

50. 41 STAT. 480 (1920), 49 U. S. C. A. § 4 (1) (1926). "Reasonably compensatory" was held to imply that a rate must (1) more than cover the additional expense incurred in handling the traffic to which it applies; (2) be no lower than necessary to meet existing competition; (3) not be so low as to threaten the extinction of legitimate competition by water carriers; and (4) not impose an undue burden on other traffic or jeopardize the appropriate return on the value of carrier property generally. *Transcontinental Cases of 1922*, 74 I. C. C. 48, 68-71 (1922); cf. *Pacific Coast Fourth Section Applications*, 129 I. C. C. 3, 15-19 (1927). For a further discussion of this clause, see *infra* note 101.

51. *Commodity Rates from Jacksonville to Miami*, 101 I. C. C. 347 (1925); *Pacific Coast Fourth Section Applications*, 129 I. C. C. 3 (1927), 165 I. C. C. 373 (1930). Relief need not be confined to an all-rail route, for it has been held that a joint rail-and-water route may obtain Section 4 relief in order to compete upon more equal terms with an all water route. *Transcontinental Cases of 1922*, 74 I. C. C. 48, 83-89 (1922). And the so-called water competition may in fact be caused by a joint rail-and-water line. Thus, relief has been granted to a rail line from Montana points to San Francisco in order to meet the competition of a route from Montana points to Seattle by rail and thence by water to San Francisco. *Canned Goods from Montana*, 102 I. C. C. 3 (1925); cf. *Commodity Rates to South Atlantic Ports*, 186 I. C. C. 675 (1932); *Corporation Commission of New Mexico v. Atchison, T. & S. F. Ry. Co.*, 34 I. C. C. 292, 301 (1915).

proposed departures have been frequently refused even though it is clear that actual water competition does exist.⁵² Whether these denials of relief are based upon the public interest in maintaining water carriers or upon the ground that the proposed rates will not be reasonably compensatory is difficult to determine from the reports of the Commission.⁵³

This trend toward the protection of water carriers, however, apparently has been interrupted in the past few years. For the Commission, impressed by the great need of rail carriers for additional revenue, has granted relief in several recent cases to the carriers by rail in order to meet barge competition on the Mississippi and Ohio rivers,⁵⁴ freighter competition on the Great Lakes,⁵⁵ and the competition of coast-wise steamers along the Gulf Coast and Atlantic seaboard.⁵⁶ Although these particular departures are not numerous enough to justify the generalization that railroads once again are destroying water transportation in this country, yet they may be warnings of a recrudescence of such a rate-making policy.⁵⁷

Since the cost of movement of goods by water is generally less than the cost of shipment by rail between the same points,⁵⁸ it might seem impossible for railroads to destroy water carriers through competition even if the pro-

52. Wool Rates Investigation, 1923, 91 I. C. C. 235, 239-249 (1924); Class Rates to Jacksonville, 157 I. C. C. 215 (1929); Gasolene and Kerosene to Nashville, 200 I. C. C. 676 (1934); Petroleum Products from St. Louis District, 203 I. C. C. 783 (1934); Trans-continental Westbound Automobile Rates, 209 I. C. C. 549 (1935).

Water traffic has shown a tremendous increase since 1920. For example, intercoastal traffic through the Panama Canal grew from 1,372,000 long tons in 1921 to 10,490,000 long tons in 1930. Also, traffic in the Ohio river has increased from 9,382,000 net tons in 1920 to 22,337,000 net tons in 1930. See 45TH ANN. REP. I. C. C. (1931) 98-99. That the denials to railroads of Section 4 relief on the plea of water competition have aided materially this growth of water carriers cannot be doubted.

53. These reports are often long and poorly organized. Frequently, arguments of interested parties are stated without an appraisal of their relative merits. Also, the conclusions of the commission are often scattered through statements of facts and of testimony. Thus, it frequently is impossible to isolate the ratio decidendi of a case. See, e. g., Wool Rates Investigation, 1923, 91 I. C. C. 235, 239-249 (1924).

54. Petroleum Products from New Orleans, 194 I. C. C. 31 (1933); Soap and Soap Powders to the South, 194 I. C. C. 138 (1933), 196 I. C. C. 400 (1933); Cottonseed Oil from Memphis, 208 I. C. C. 310 (1935); cf. Petroleum Products to Augusta, 213 I. C. C. 759 (1936). But cf. Molasses and Sirup to Pittsburgh, 213 I. C. C. 794 (1936).

55. Newsprint Paper to Chicago, 194 I. C. C. 148 (1933); Sewage Sludge to Southern Ports, 195 I. C. C. 311 (1933).

56. Gasolene to River Points in Alabama, 194 I. C. C. 79 (1933); Petroleum, New Orleans Group to Mobile, 198 I. C. C. 359 (1934). And in a most interesting recent case, railroads were granted Section 4 departures on Mondays, Thursdays, Fridays, and Saturdays from Florida points to New England points in order to meet water competition in the carriage of citrus fruits. Citrus Fruits from Florida, 211 I. C. C. 535 (1935).

57. See concurring opinion of Commissioner Eastman in Petroleum Products from New Orleans, 194 I. C. C. 31 (1933), at 44-45.

58. Operative costs per net ton mile of rail carriers was 8.3 mills; of water car-lot carriers (common carriers transporting freight in less than car-lots and in car-lots), 6 mills; of water cargo carriers (private or contract carriers transporting freight in cargo lots), 1.25 mills. Federal Coordinator of Transportation, Freight Traffic Report (1935) v. 1, p. 79.

hibition against a lower charge for a longer than for a shorter haul were removed. In competing with water carriers, however, the railroads have two significant advantages, in that there are two types of traffic for which carriers by water cannot effectively compete. The first consists of fragile or perishable goods which cannot be moved conveniently by water; the second is that traffic which moves to intermediate, inland points. Higher rates upon both types of non-competitive traffic by rail in effect subsidize the railroads in their competition with water carriers for that traffic which can be moved by both. Water carriers, on the other hand, must meet the competition of the railroads at all points and upon shipments of all types of goods. Because of these competitive advantages, railroads were able to drive water carriers practically out of existence in the last decades of the nineteenth century. Such a result is less probable today, however, for truck and pipe-line competition has almost eliminated the class of non-competitive traffic which was at one time "tied to the rails." Further, Section 500 of the Transportation Act and the reasonably compensatory clause of Section 4 probably would prevent the complete destruction of water transport by rail competition. But, while rail carriers today cannot completely eliminate common carriers by water, they do have the power to curtail substantially the present movement of goods by water.

Although actual water competition has usually justified Section 4 departures by competing railroads, there has been some question as to the effect of potential water competition. The Commission early held that departures from Section 4 were justified by railroads from Ohio river points to New Orleans even though no regular service on the Ohio and Mississippi rivers had been furnished for several years, on the theory that the existing rates had been forced down by water competition and that the raising of rates to conform to Section 4 would but cause the reestablishment of this water competition which had formerly existed.⁵⁹ However, the Commission later abandoned this holding, and refused to recognize potential water competition as a justification for departures from Section 4.⁶⁰ And as the 1920 amendment to Section 4, reiterating the rule of these latter decisions, expressly prohibited relief on the ground of potential water competition,⁶¹ the Commission since 1920 has refused to permit Section 4 departures if actual compelling water competition

59. Fourth Section Violations in the Southeast, 30 I. C. C. 153, 185, 230, 263 (1914); cf. *In re Rates on Sugar*, 31 I. C. C. 495, 506 (1914); *Transcontinental Rates*, 46 I. C. C. 236, 246 (1917).

60. *Memphis-Southwestern Investigation*, 55 I. C. C. 515, 565 (1919); *Murfreesboro Board of Trade v. Louisville & N. Rr. Co.*, 55 I. C. C. 648 (1919); *Meridian Traffic Bureau v. Director General*, 57 I. C. C. 107 (1920); cf. *In re Reopening Fourth Section Applications*, 40 I. C. C. 35 (1916).

61. No authorization for departures from Section 4 "shall be granted on account of merely potential water competition not actually in existence." 41 STAT. 480 (1920), 49 U. S. C. A. § 4 (1) (1926).

If there exists a waterway and adequate terminal facilities and a commodity well adapted to water transportation and a barge line which is ready and willing to carry the traffic, actual water competition may be said to exist even though there has been no actual movement by water. *Rags and Paper to Newark*, 208 I. C. C. 327 (1935).

is not shown to exist.⁶² Thus, since the Great Lakes and the Erie Canal are closed to traffic in winter, Section 4 departures by competing railroads because of such water competition are allowed only during the summer months.⁶³

This statutory prohibition upon Section 4 relief because of potential water competition undoubtedly was designed to foster the development of water craft, a policy made explicit in Section 500 of the Transportation Act. For if railroads were permitted to depart from Section 4 at all points at which it was proposed to establish water service, only with the greatest difficulty could water service ever be established. Only by means of the protection of normal rail rates during the period of establishing regular service can water carriers obtain a foothold in the transportation of goods.

Whether this policy of protecting the development of the waterways is more desirable from the standpoint of the country at large than the conflicting policy of reducing the ranks of water carriers through railroad long-and-short-haul discriminations is a question impossible of definite answer. But since each Section 4 rail departure because of water competition is designed to increase the revenue of rail carriers at the expense of the water carriers, the wisdom of such departures depends upon the relative benefits obtained on the one hand from a prosperous rail system and on the other from a prosperous system of water carriers.

As the private investment in railroads greatly exceeds that invested in water carriers,⁶⁴ it might seem better to protect this greater investment at the expense of the smaller one. Also railroads pay much heavier taxes to the government than do water carriers.⁶⁵ Further, railroads employ more

62. Sugar from Key West, 112 I. C. C. 347 (1926); Rates from Eastern Territory, 148 I. C. C. 323 (1928).

63. Crude Sulphur to Erie, 200 I. C. C. 385 (1934); Newsprint Paper from Jonquiere, 201 I. C. C. 686 (1934).

64. Using "book cost" (without depreciation) as the equivalent of investment, and apportioning investment upon an expense basis, the capital invested in freight facilities in 1932 was about 20 billion dollars, of which 18 billion were rail, three quarter billion pipeline, and one half billion water carriers. In addition, there were approximately two billion dollars invested in motor trucks, an unknown part of which was devoted to intercity transportation of freight. Federal Coordinator of Transportation, Freight Traffic Report (1935) v. 1, p. 78.

65. The total taxes paid by Class I steam railroads in 1933 were \$249,539,965 and in 1934 were \$239,498,394. 48TH ANN. REP. I. C. C. (1934) 102, 49TH ANN. REP. I. C. C. (1935) 120. As water carriers are not subject to complete governmental regulation, similar figures for them are not obtainable. However, since their investment is much less than that of railroads, obviously their total tax is much less.

In addition to the total tax, there may be compared the percentage of revenue used in paying taxes. A report prepared by the Association of American Railroads indicates that in 1933 railroads paid taxes amounting to 8.1 cents out of each gross dollar of revenue while the 116 water carriers reporting to the Interstate Commerce Commission paid only 1.56 cents of each gross revenue dollar as taxes. See *Hearing before Committee on Interstate and Foreign Commerce on H. R. 3263, H. R. 3610, H. R. 5362, and H. R. 8364*, 74th Cong., 1st Sess. (1935) 1019.

labor.⁶⁶ The country in time of war requires an efficient system of rail lines. And finally, if railroads are permitted to compete freely with waterways through Section 4 departures, it seems that the intermediate points are not prejudiced by their rate relationships to the terminal ports for such ports already have the advantage of lower rates by water. Yet the public has placed large sums in the improvement of waterways,⁶⁷ and consequently has a direct interest in their use. And the expense of heavy taxes and labor costs ultimately is borne by the shippers who must pay for the increased cost of transportation by rail over that by water. Water carriers are necessary, not only to provide a merchant marine for world trade but also as an alternate means of transportation in case of temporary disability of rail facilities and as an aid to national defense in time of war. And the intermediate points may in fact suffer a real prejudice by railroad Section 4 departures. For the departure will give the terminal port an alternate route available for the movement of goods and thus a wider choice of markets, and, through the competition of such routes, somewhat better service and slightly lower rates. Also, as certain articles are not adapted to movement by water, the terminal port through blanket Section 4 rail departures obtains the benefit of a low rail rate on these non-competitive articles which probably would move by rail even if no departure were in effect. In brief, there is no "proper" course to follow in the formulation of a policy of Section 4 departures because of water competition. Rather, the choice or compromise to be effected involves the adjustment of many conflicting interests articulated with varying degrees of vigor and persuasiveness.

B. Pipe-Lines

In addition to the competition of water carriers, railroads have for many years been forced to contend with the competition of pipe-lines,⁶⁸ which to a large degree have taken oil and oil products from the rails.⁶⁹ Although pipe-

66. The average number of employees of Class I steam railroads during 1933 was 971,196 and in 1934 was 1,007,702. 49TH ANN. REP. I. C. C. (1935) 114. Similar statistics for water carriers have not been discovered.

67. Up to June 30, 1932, the United States had spent, for the cost of new work and for the cost of maintenance, for improving, extending and maintaining navigation by lakes, rivers and canals, \$864,620,237. The sums that have been allocated and appropriated since 1932 for work upon inland waterways greatly increase the amounts spent up to that time. JOHNSON, HUEBNER AND HENRY, *TRANSPORTATION BY WATER* (1935) 547-548.

68. In 1926, there existed in the United States 90,170 miles of trunk and gathering oil pipe lines, while by 1931 this figure had reached 111,660, an increase of 24%. U. S. Bureau of Mines, *Survey of Oil Pipe Line Mileage*, May 3, 1932.

There also is developing the movement of gasoline by pipe line. In a communication from the Petroleum Economics Division of the Bureau of Mines to the *YALE LAW JOURNAL*, May 20, 1936, it was stated: "The first gasoline pipe-line was placed in operation in the last half of 1930; at the present time the total mileage of gasoline lines operated is 4,329.7 miles."

69. In March, 1936, there were delivered to refineries 87,594,000 barrels of domestic crude oil. Of this amount, pipe lines delivered 65,231,000 barrels, tank cars and trucks 2,240,000 barrels, and boats 20,123,000 barrels. U. S. Bureau of Mines, *Crude Petroleum Report by Refineries*, Rep. No. A-943-30, May 15, 1936.

lines are subject in part to the jurisdiction of the Commission,⁷⁰ few complaints have arisen concerning them, and there has been practically no occasion to exercise this jurisdiction.⁷¹ In at least one case, however, in an effort to enable railroads to regain some of this fluid traffic, the Commission has allowed rail carriers to depart from Section 4 in the carriage of oil between certain points on pipe-lines.⁷² To enhance further the revenues of the rail lines, relief from Section 4 has even been granted on shipments of coal by rail from Kentucky mines to Iowa to meet the competition of natural gas, piped from the Oklahoma fields.⁷³ Although the Commission in this case expressly refused to hear the argument that unemployment conditions in the coal industry required relief on the ground that it could consider only conditions of transportation, nevertheless the granting of a departure in effect alleviates the non-transportational factor of unemployment in bituminous coal.

The wisdom of permitting departures from Section 4 to enable the railroads effectively to compete with pipe lines, as in the case of water transportation, depends upon conflicting considerations of policy. Since under existing con-

Gasolene also is being taken from the rails. In a communication from the Petroleum Economics Division of the Bureau of Mines to the YALE LAW JOURNAL, May 20, 1936, it was stated that "The development of motor fuel transportation by pipe-line has had an appreciable effect on the movement by rail. For example, during March, 1936, total deliveries of motor fuel from lines amounted to 3,987,000 [barrels] or the equivalent of more than 10 per cent of the indicated domestic demand for that period."

70. The Hepburn Act of 1906 subjected to regulation by the Interstate Commerce Commission interstate common carrier pipe-lines "engaged in the transportation of oil or other commodity, except water and except natural or artificial gas. . . ." 34 STAT. 584. The constitutionality of this provision was sustained in the *Pipe Line Cases*, 234 U. S. 548 (1914). This statutory provision was repeated in substantially the same form in the Transportation Act, 1920. 41 STAT. 474, 49 U. S. C. A. § 1 (1) (b) (1926).

The act, however, does not apply to those interstate pipe-lines which carry only oil of their own production. *Pipe Line Cases*, *supra*. And as about 50% of the trunk lines owned by a group of large and medium sized oil companies carried no outside oil and only 10% carried in excess of 50% of outside oil [Report on Pipe Lines, H. R. REP. NO. 2192, 72d Cong., 2d Sess. (1933) part 1, LXIII, 443-450], much of the oil moved by pipe-lines is not subject to the jurisdiction of the Commission.

71. See 45TH ANN. REP. I. C. C. (1931) 113.

72. Petroleum and its Products, 183 I. C. C. 24 (1932).

73. Coal from Illinois, Indiana, and Kentucky, 186 I. C. C. 697 (1932), 192 I. C. C. 586 (1933); cf. Coal and Coke to Mississippi Valley, 191 I. C. C. 589, 598-599 (1933), 204 I. C. C. 147 (1934).

Although the Commission in the first case to arise held that potential gas competition, that is, intention by pipe-line companies to extend their lines along with a solicitation of contracts for the sale of gas, was insufficient to justify Section 4 relief [Coal from Illinois, Indiana, and Kentucky, 186 I. C. C. 697 (1932)], it later reversed this decision to hold that such conditions did warrant relief. Coal from Illinois, Indiana, and Kentucky, 192 I. C. C. 586 (1933).

As pipe-lines carrying natural gas are not subject to regulation by the Commission, perhaps these holdings indicate the long continued liberality in favor of regulated carriers as against unregulated ones. For a discussion of attempts to regulate gas pipe-lines, see Regulation of Transportation Agencies—Report of Federal Coordinator of Transportation, SEN. DOC. NO. 152, 73d Cong., 2d Sess. (1934) 57.

ditions there is not sufficient traffic to enable both railroads and pipe-lines to secure adequate revenue from the traffic affected, the extent to which Section 4 departures are allowed vitally influences the adjustment of that revenue between the two competing agencies. In such adjustment the utility to the nation of rail carriers as contrasted with pipe-lines, the respective needs of the two types of carriers and of the industries and localities dependent upon each, and the economy of operation of each are some of the factors relevant to a well-considered Section 4 policy. Of these considerations, the one which is the least speculative and on that account entitled to the greatest weight is that the cost of transportation by pipe-line is far less than that by rail.⁷⁴

C. Truck Competition

While the inroads of the water carriers and pipe-lines have been serious, in recent years the motor-truck⁷⁵ has rapidly become the most dangerous competitor of the railroads.⁷⁶ In efforts to stem the flow of traffic by motor carrier, railroads often have voluntarily reduced their rates in certain areas on those commodities as to which truck competition exists.⁷⁷ Also, rail carriers

74. The operative cost per net ton mile of rail carriers in 1932 was 8.3 mills, while of pipe-lines was but 3.2 mills. Such cost figures include maintenance of facilities and overhead administration as well as the bare cost of movement of the goods. Federal Coordinator of Transportation, *Freight Traffic Report* (1935) v. 1, p. 79.

75. In 1905, there were produced in the United States but 450 motor trucks. In 1915, the annual production increased to 74,000 units, and by 1925 had reached 530,659. After the peak of 767,499 in 1929, it dropped to 235,187 in 1932, but in 1934 had reached 575,192. *WORLD ALMANAC* (1936) 326.

The number of trucks in all classes of service increased from 85,600 in 1914 to 1,006,082 in 1920, 2,764,222 in 1926, and 3,480,939 in 1930. See *Coordination of Motor Transportation*, 182 I. C. C. 263, 274 (1932). In 1934, there were registered 3,409,335 freight motor vehicles. *WORLD ALMANAC* (1936) 327.

76. In terms of ton-miles, excluding that freight moving in the coast wise and inter coastal trades, it is estimated that domestic freight was distributed as follows:

	1929	1932
Steam Railroads	72.9	73.9
Great Lakes	15.8	7.8
Pipe lines (petroleum)	5.2	6.2
Intercity trucks	4.2	9.4
Inland waterways	1.4	2.5
Electric railways and airplanes	0.5	0.2

Regulation of Transportation Agencies—Report of Federal Coordinator of Transportation, SEN. Doc. No. 152, 73d Cong. 2d Sess. (1934) 3.

Motor truck ton mileage was estimated to be 1.9% of railroad ton mileage in 1925 [see *Motor Bus and Motor Truck Operation*, 140 I. C. C. 685, 719 (1928)], yet in 1929 had increased to 5.8% [see *Coordination of Motor Transportation*, 182 I. C. C. 263, 402 (1932)], and by 1932 had reached 12.7%. *Regulation of Transportation Agencies*, *supra*, at 18.

For a detailed analysis of this diversion of traffic from rail to truck, see *Coordination of Motor Transportation*, 182 I. C. C. 263, 283-309 (1932). Cf. *Freight Traffic Report—Report of Federal Coordinator of Transportation* (1935) v. 1, p. 17, 18, v. 2, pp. 44-53.

77. See *Coordination of Motor Transportation*, 182 I. C. C. 263, 331-334 (1932). Such rate cuts have been quite general in the case of cotton. *Rate Structure Investigation*, Part 3, Cotton, 165 I. C. C. 595 (1930), 174 I. C. C. 9 (1931), 176 I. C. C. 249 (1931).

have entered the field of trucking itself, both by substituting truck for rail service⁷⁸ and by supplementing rail with truck service.⁷⁹ And finally railroads have sought departures from Section 4 in a further attempt to cope with this competition of trucks.

Occasionally, railroads seek relief in order to meet the competition of trucks for the carriage of a single commodity which is moving in comparatively large quantities between two points. Such relief has been granted.⁸⁰ For example, since there is a large movement of sugar from the entry port of Baltimore to Hershey, Pennsylvania, a rail carrier sought and obtained permission to lower its rate from Baltimore to Hershey in order to compete with trucks for this traffic, yet was permitted to retain the existing normal rate level to intermediate points.⁸¹ In such a case, as the commodity is certain to move in any event at the low rate, the chief effect of Section 4 relief seems to be to divert its movement from truck to rail. Therefore, whether such relief should be permitted would seem to depend largely upon the relative public interest in the financial condition of the particular rail and truck carriers engaged in such service. However, there is another consideration involved. Since it is highly probable due to the flexibility of motor carrier routes that the competition of trucks is approximately as effective at intermediate points as at distant points,⁸² these departures because of truck competition are difficult to justify, for it is the volume of traffic for the long haul available for division between rail and highway which determines the railroads' petitions for Section 4 relief, rather than competition between the two forms of transportation. Using the example above, railroads desire to secure for themselves the relatively large amount of sugar moving to Hershey, yet are not willing to compete strenuously for the comparatively small amount of sugar moving to points intermediate between Baltimore and Hershey. To give one point a lower rate by rail than another merely because of its commercial importance is to prefer that point unduly. Although such a practice often has been condemned by the Commission,⁸³ apparently it is tolerated in

78. See *Coordination of Motor Transportation*, 182 I. C. C. 263, 336-338 (1932).

79. These include pick-up and delivery service, the less than carload container, and the devices for line-haul movement of truck bodies. See *Freight Traffic Report* (1935) v. 2, p. 187-230; *Coordination of Motor Transportation*, 182 I. C. C. 263, 338-348 (1932).

80. Cement from Hudson, 186 I. C. C. 8 (1932); Petroleum from Portland, 183 I. C. C. 727 (1932); Petroleum Products to Wyoming Points, 211 I. C. C. 108 (1935); Sugar to Fayetteville, 213 I. C. C. 723 (1936); cf. *Canned Goods in Southwestern Territory*, 203 I. C. C. 497 (1935).

If a circuitous rail line seeks relief in order to meet the rates of a direct line which have been lowered by truck competition, the equidistant clause does not apply. *Sewer Pipe from Texarkana*, 205 I. C. C. 279 (1934); cf. *Livestock in the Southwest*, 203 I. C. C. 557 (1935). For an explanation of the equidistant clause, see *infra* p.

81. *Sugar to Hershey*, 200 I. C. C. 757 (1934).

82. See dissent of Commissioner Farrell in *Cement from Hudson*, 186 I. C. C. 8, at 15 (1932).

83. *Fourth Section Order No. 8900*, 88 I. C. C. 765, 769 (1924); *Standard Paint Co. v. Director General*, 201 I. C. C. 792 (1934); cf. *In re Rates on Salt*, 24 I. C. C. 192 (1912); *Bowling Green Business Men v. Louisville & N. Rr. Co.*, 24 I. C. C. 228, 239 (1912).

these instances of truck competition. To permit long-and-short-haul discrimination in such cases where the competition of trucks appears even more effective on the short haul than on the long is to discriminate against the intermediate points and to disregard the limitation upon governmental regulation of rates to the effect that transportation conditions alone may justify action by the Commission.⁸⁴

There is another way in which railroads have sought to compete with trucks by means of rate adjustments which do violence to the distance principle of rate making. Since truck competition is most effective only for relatively short distances, as, for example, from 50 to 150 miles,⁸⁵ the scheme has been conceived of meeting this competition by lowering rates generally for these short distances while retaining the other rates at the normal level. Thus, if the normal rate on a given commodity were 35 for 100 miles and were 65 for 200 miles, the railroad might reduce the former rate to 30, leaving the latter rate unchanged. Although this adjustment would enable railroads to meet truck competition at short distances with low rates and yet to retain more remunerative rates at the more distant points at which the truck competition is not so keen, it is a plain violation of another clause of Section 4—the aggregate of intermediates clause, passed in 1910 and reenacted in 1920, which provides that “it shall be unlawful . . . to charge any greater compensation as a through rate than the aggregate of the intermediate rates. . . .”⁸⁶ Nevertheless, the Commission, exercising its power to grant

84. The Commission is said to have no power to equalize industrial conditions or to offset economic advantages through adjustments of rates. *Interstate Commerce Commission v. Diffenbaugh*, 222 U. S. 42 (1911); *United States v. Illinois C. Rr. Co.*, 263 U. S. 515 (1924); *Texas & P. Ry. Co. v. United States*, 289 U. S. 627 (1933); *Anchor Coal Co. v. United States*, 25 F. (2d) 462 (S. D. W. Va. 1928); *Ashland Fire Brick Co. v. Southern Ry. Co.*, 22 I. C. C. 115, 121 (1911); cf. ALLDREDGE, *op. cit. supra* note 11, at 36; MANSFIELD, *THE LAKE CARGO COAL RATE CONTROVERSY* (1932) 242-261.

The judicial nullification of the Hoch-Smith resolution, 43 STAT. 801 (1925), apparently designed to empower the Commission to consider economic conditions at least in agriculture, indicates the attitude of the courts toward deliberate economic planning. *Ann Arbor Rr. Co. v. United States*, 281 U. S. 658 (1930); see Robinson, *The Hoch-Smith Resolution and the Future of the Interstate Commerce Commission* (1929) 42 HARV. L. REV. 610; Mansfield, *The Hoch-Smith Resolution and the Consideration of Commercial Conditions in Rate-Fixing* (1931) 16 CORN. L. Q. 339.

85. The section of Transportation Service of the Federal Coordinator has but recently completed an exhaustive factual study of freight traffic. In this study, there was developed a mileage scale of truck costs for twenty-seven principal commodities. There was also developed a synthetic rail mileage scale, depicting the level of average rail charges upon important commodities as evidenced by the revenue received from them. Graphic comparisons of truck costs with this synthetic scale showed, for example, a point of intersection with anthracite coal at 40 miles, with lumber at 70 miles, with canned goods at 130 miles, and with potatoes at 200 miles. That is, at those respective distances or less on each respective commodity, truck costs are less than present average rail charges. *Freight Traffic Report* (1935) v. 1, p. 38-67.

86. 41 STAT. 480 (1920), 49 U. S. C. A. § 4 (1) (1926). Thus, using the example in the text, the through rate of 65 for 200 miles exceeds the sum of the reduced competitive rate of 30 for 100 miles plus the same reduced rate of 30 for the second 100 miles. As

relief in special cases,⁸⁷ has in certain instances permitted rail carriers to adjust their rates in this manner.⁸⁸ Thus, since there exists a large movement of cotton by truck to the port of Galveston, Texas from nearby inland Texas points, railroads have been permitted to reduce rates from points in this competitive zone to Galveston while maintaining the normal rate level from more distant points.⁸⁹

If rail carriers are to be permitted to meet the truck competition by means of rate adjustments other than general rate reductions, this method which concerns the aggregate of intermediates provision of Section 4 should be used in preference to departures from the long and short haul provision of the same Section. For in recognizing the uniformity of truck competition at short distances and the comparative absence of it at longer distances, this system is based upon competitive conditions in transportation and not upon the commercial importance of localities. However, it is impossible to decide whether such a method of competition is desirable, for it necessarily involves the balancing of many interests. If trucks are permitted to carry all the traffic which they can handle most economically, rail revenues necessarily will be drastically reduced. While traffic moving by motor carrier will benefit from the economy of this mode of transportation, the traffic "tied to the rails" will be burdened by higher rates charged to offset the losses incurred by this shift of traffic to trucks. Further, there must be considered the public inconvenience and danger which arise from the prevalence of trucks on highways.⁹⁰ Railroads have a larger investment than trucks,⁹¹ pay more taxes, and employ more men; but the trucks give a cheaper transportation service. To permit Section 4 departures by rail carriers is to discourage the development of competing motor carriers and perhaps even diminish their numbers; to prohibit such departures is to further the growth of the trucking industry. The choice between these two policies or the manner in which they are compromised will depend upon the persuasive articulation of the conflicting interests of rail carriers and motor carriers and of the industries and localities dependent upon each of those two competing modes of transportation.

D. Rail Competition

In addition to the competition of water carriers, trucks, and pipe-lines for the carriage of goods between terminal points, there also exists competition

illustrated, it is the depressed competitive rate of 30 rather than the normal rate of 35 which is to be used in determining whether there exists a violation of this clause. Cf. *Spartanburg Chamber of Commerce v. Southern Ry. Co.*, 34 I. C. C. 484, 494 (1915).

Almost no cases have arisen under this clause, seemingly because the railroads rarely violate it and do not defend the violations which do occur. But with the growth of truck competition, this clause is apt to become increasingly important.

87. *Patterson v. Louisville & N. Rr. Co.*, 269 U. S. 1 (1925).

88. *Rate Structure Investigation*, Part 3, Cotton, 174 I. C. C. 9 (1931); *Refined Petroleum Products in the Southwest*, 174 I. C. C. 745 (1931); *Automobiles and Parts to Louisiana and Arkansas*, 211 I. C. C. 323 (1935); cf. *Gasolene and Kerosene from Norfolk*, 214 I. C. C. 15 (1936). But cf. *Commodity Rates in Official Territory*, 209 I. C. C. 702 (1935).

89. *Rate Structure Investigation*, Part 3, Cotton, 174 I. C. C. 9 (1931).

90. See *Coordination of Motor Transportation*, 182 I. C. C. 263, 355 (1932).

between the rail carriers themselves. It was the discrimination arising out of this competition in the era of rapid railroad expansion that led to the first Act of 1887, and even today this competition is the most pregnant justification of Section 4 departures.⁹¹ However, were all such competition sufficient to permit Section 4 departures by the railroads at all the points of competition, the amended acts of 1910 and 1920 would be rendered as ineffective to check long-and-short-haul discrimination as was the original act after the *Alabama Midland* decision. Consequently, the Commission has uniformly held that the most direct rail line between the two competitive points must conform strictly to Section 4.⁹¹ Yet, if all rail lines between the two points were required to conform to Section 4, the more indirect lines would suffer a loss of revenue. For, on the one hand, if an indirect line did not meet the rate of the direct line at the distant point, it would lose its share of the competitive traffic, and on the other, if the indirect line attempted to compete with the direct line for the traffic between the terminal points at which both lines intersect, compliance with Section 4 would require the reduction of rates to intermediate points on the indirect line. Recognizing this situation and desiring to enable indirect lines to share in traffic between competitive points, the Commission since 1910 has held that indirect rail lines are privileged to meet the rate of the direct rail line at the competitive point and to charge higher rates at intermediate points.⁹²

The question naturally arises as to the degree of circuitry which should justify Section 4 departures by the indirect line. It would seem that the mere difference in length of one mile between two competing routes should not warrant a departure, since the longer road is not at a substantial competitive disadvantage.⁹³ And the Commission under the 1910 act held that Section 4 departures on the plea of circuitry of route were justified only if the indirect route were at least 15% longer than the direct route.⁹⁴ Also, to permit a

91. Class and Commodity Rates from Louisville, 36 I. C. C. 317, 320 (1915); Rates from New Orleans, 44 I. C. C. 727, 735 (1917); cf. Coal and Coke from Kentucky, 151 I. C. C. 543, 549 (1929). Even if a circuitous line has a lower rate to the distant point than does the direct line, the direct line may not depart from Section 4 to meet it. Coal Briquettes from Kansas City, 186 I. C. C. 37 (1932).

92. In re Transportation of Wool, 23 I. C. C. 151, 179 (1912); McCullough v. Louisville & N. Rr. Co., 25 I. C. C. 48 (1912); National Refrigerator & Butchers' Supply Co. v. St. Louis, I. M. & S. Ry. Co., 26 I. C. C. 524 (1913).

Of course, the intermediate rates must be reasonable. Thomas Iron Co. v. Pennsylvania Rr. Co., 28 I. C. C. 608 (1913); Standard Oil Co. v. Pennsylvania Co., 29 I. C. C. 524 (1914).

The circuitous route, however, is not required to meet the rate of the direct line. Grain to Mississippi Valley, 107 I. C. C. 167 (1926). And since Section 4 orders are permissive and not mandatory, the circuitous route need not establish the lower rate to the longer distance even after relief has been granted. Franklin Park Hay & Grain Co. v. Lehigh & N. E. Rr. Co., 178 I. C. C. 363 (1931).

93. See Fourth Section Violations in the Southeast, 30 I. C. C. 153, at 304 (1914). Cf. Rates from New Orleans, 44 I. C. C. 727, 736 (1917).

94. In re Rates on Salt, 24 I. C. C. 192 (1912); Edwards & Bradford Lumber Co. v. Chicago, B. & Q. Rr. Co., 25 I. C. C. 93 (1912); Wiley & Morehouse v. Chicago, B. & Q. Rr. Co., 42 I. C. C. 313 (1916). Thus, when the distance by the direct route was 352

carrier operating a line several times as long as a direct line to share in the transportation of goods between two points is to permit economic waste. Consequently, the Commission also held that lines which were more than 150% circuitous could not depart from Section 4 in order to compete with the direct line.⁹⁵

The 1920 amendment to Section 4 expressed the legislative mandate that no indirect route could compete for traffic unless its rates were reasonably compensatory for the service performed.⁹⁶ Since the Act contains no definition of a reasonably compensatory rate, the Commission has so far been free to impose any limitation upon rates in order to exclude those which it considers are not reasonably compensatory.⁹⁷ The most common limitation has been the percentage-distance restrictions upon circuitous lines. Since 1920, the Commission generally has retained its 15% rule,⁹⁸ but has restricted somewhat its maximum circuitry limitations.⁹⁹ However, in certain instances, the percentage-distance restrictions have been abandoned in favor of a limitation based upon a certain percentage of the maximum reasonable rate between the competitive points over the indirect route.¹⁰⁰

All such restrictions are but attempts to arrive at a generalization which

miles and by the circuitous route was 397 miles, Section 4 relief was denied the indirect route, the circuitry being but 13%. *Marshalltown Buggy Co. v. Wabash Rr. Co.*, 39 I. C. C. 633 (1916). However, occasional departures were sanctioned even though the circuitous line was slightly less than 15% longer than the direct line. See, e. g., *New Orleans Cotton Exchange v. Louisville & N. Rr. Co.*, 46 I. C. C. 712, 753 (1917).

95. *C. F. A. Class Scale Case*, 46 I. C. C. 475 (1917); Cf. *Sugar Rates from New Orleans*, 32 I. C. C. 606 (1915).

96. As the burden of proof is upon the carrier to justify compliance with this clause, [Fourth Section Order No. 8900, 88 I. C. C. 765 (1924)] relief from Section 4 is denied when this burden is not sustained. Cf. *Transcontinental Eastbound Sugar*, 186 I. C. C. 523, 534 (1932).

97. *Class and Commodity Rates in the South*, 191 I. C. C. 613, 617 (1933); cf. *Perrine-Armstrong Co. v. Pennsylvania Rr. Co.*, 169 I. C. C. 553, 555 (1930).

98. *Goldsboro Chamber of Commerce v. Atlantic C. L. Rr. Co.*, 91 I. C. C. 315, 328 (1924); *Plaster and Gypsum Products*, 122 I. C. C. 747 (1927); see *Fourth Section Order No. 8900*, 88 I. C. C. 765, 768 (1924).

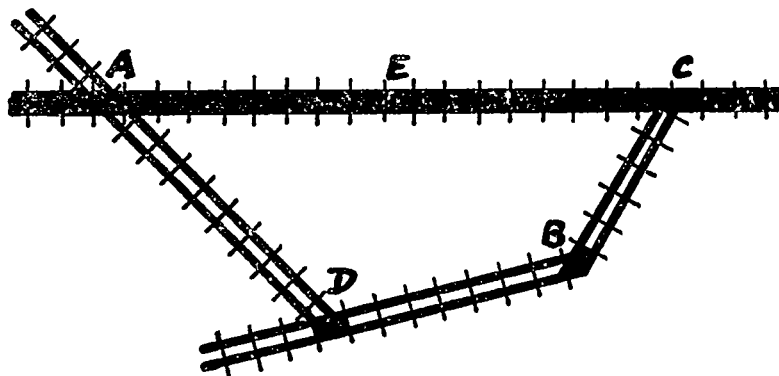
99. *Brick and Clay Products in the South*, 88 I. C. C. 543, 564 (1924) (50% circuitry permitted under reasonably compensatory restriction); *Goldsboro Chamber of Commerce v. Atlantic C. L. Rr. Co.*, 91 I. C. C. 315, 328 (1924) (70%). Since 70% circuitry seemed unreasonable on long hauls, the Commission soon adopted a standard which varied with distance. Thus, although 70% remained the limit of circuitry for direct line distances of 150 miles or less, no more than 50% was allowed for distances from 150 to 1000 miles, and but 33 1-3% was permitted on greater distances. *Iron and Steel Articles*, 155 I. C. C. 517, 582 (1929); *Paper to Springfield*, 182 I. C. C. 611 (1932); see *Rates to Southern Territory*, 191 I. C. C. 507, 546 (1933).

100. The percentage figure which has been used varies from 60 to 75. *Rates to Southern Territory*, 191 I. C. C. 507, 543-552 (1933) (60%, 75%); *Class and Commodity Rates in the South*, 191 I. C. C. 613 (1933) (75%).

As circuitry percentages are based upon distance alone while the percentage of a maximum reasonable rate reflects not only the element of distance but also other elements affecting the transportation charge, it seems that the latter is more adequate in approximating a reasonably compensatory rate.

will indicate the limits of "reasonably compensatory" rates. Though all tests yet devised may be criticized for their inaccuracies,¹⁰¹ it is apparent that they have in some degree eliminated wasteful competitive practices. As long as carriers by rail continue to be regarded as independent competing entities, some restriction upon their freedom to compete, such as the reasonably compensatory clause, seems desirable.

In Section 4 as amended in 1920, there was included the equidistant clause, which provides that "if a circuitous rail line or route is, because of such circuitry, granted authority to meet the charges of a more direct line or route to or from competitive points and to maintain higher charges to or from intermediate points on its line, the authority shall not include intermediate points as to which the haul of the petitioning line or route is not longer than that of the direct line or route between the competitive points."¹⁰² Thus, assuming that *AEC* and *ADBC* are two competing railroads and that



distance *ADB* equals distance *AEC*, the circuitous road may charge more upon traffic moving from *A* to any point between *B* and *C* than upon that moving from *A* through *B* to *C*, but such authority to depart from Section 4 does not extend to traffic moving from *A* to any point on the circuitous road between *A* and *B*.

The equidistant clause apparently was designed to prevent the railroad departing from Section 4 from burdening the intermediate points on the indirect line unduly by requiring that certain of the rates on the indirect line be proportional to the rates on the direct line. Although this clause was strictly enforced in the first cases to arise under it,¹⁰³ several exceptions soon developed.

101. See *Transcontinental Cases of 1922*, 74 I. C. C. 48, 72-80, 87-89 (1922); *Class and Commodity Rates from New Orleans*, 98 I. C. C. 673 (1925); *Commodity Rates to Pacific Coast Terminals*, 107 I. C. C. 421, 430-432 (1926).

For an excellent analysis of this problem, see DANIELS, *op. cit. supra* note 11, at 33-81. See also note 50 *supra*.

102. 41 STAT. 480 (1920), 49 U. S. C. A. § 4 (1) (1926). This clause not applicable when a rail carrier seeks to compete with some other type of carrier, as, for example, motor carriers. *Sugar to Hershey, Pennsylvania*, 200 I. C. C. 757 (1934).

103. *South Bend Chamber of Commerce v. Director General*, 61 I. C. C. 67 (1921); *Tribune v. Butte, A. & P. Ry. Co.*, 64 I. C. C. 557 (1921).

First, if the indirect route was composed of two or more lines, the Commission held that the equidistant clause did not apply,¹⁰⁴ since its application would disrupt the existing differential arrangements on joint-line hauls, an arrangement designed to take care of the extra cost of interchanging traffic from one line to another on the joint-line route.¹⁰⁵ Since this exception disregards the express wording of the equidistant clause, it is justified only if the administrative difficulty of adjusting such rates outweighs the slight prejudice which undoubtedly results to the intermediate points on the indirect lines.¹⁰⁶ And if it be assumed that the indirect joint line could not meet the direct rate were the equidistant clause imposed, then this holding of the Commission seems to foster uneconomical transportation.¹⁰⁷

Second, the equidistant clause does not apply to adjustments of group rates. It is the practice in freight rate making to select certain points which are geographically adjacent to each other, and to give each of these points the same rate either from a single point of origin or to a similar aggregation of points located some distance away. Such rate making units are called groups; and are established sometimes to simplify tariff lists and sometimes to equalize competitive conditions among the various points comprising a group. An indirect railroad running from a point of origin to a distant point located in one group may pass through one or more points which are located in another group. Should the latter group bear a higher rate from the point of origin than does the former group, a departure from Section 4 would result if the traffic is carried by the circuitous railroad at the lower rate. And since this departure exists because the railroad is circuitous, it would seem that the equidistant clause should apply. Yet were this clause applied, the equality of rates of the points in the latter group might be destroyed, and the group arrangement would thus be broken.¹⁰⁸

104. Memphis-Southwestern Investigation, 77 I. C. C. 473, 523 (1923); Vinegar to Texas Points, 98 I. C. C. 688 (1925); Agricultural Limestone from Waukesha, 185 I. C. C. 615 (1932).

105. The Commission often has provided that a route composed of two or more separately owned and operated rail carriers may charge a little more for a given movement of goods than may a single carrier. Such a route is called a joint-line route; the extra charge is the differential. See Memphis-Southwestern Investigation, 77 I. C. C. 473, 592-595 (1923).

106. Using the figure in the text, *supra* p. 1448, if the rate from *A* to *C* through *E* is 40, then under the equidistant clause the rate to *B* cannot exceed 40. Yet if the indirect route were composed of two or more carriers, there might exist a differential as, for example, 3. Hence, if the equidistant clause did not apply, the indirect route would be justified in charging 43 to *B*, while if the equidistant clause were applied, the rate could not exceed 40. Thus it is seen that this exception to the equidistant clause, by permitting a slightly higher rate to be charged to points such as *B*, causes some prejudice to such points.

107. See dissent of Commissioner Campbell in Memphis-Southwestern Investigation, 77 I. C. C. 473, at 582 (1923).

108. Using the figure *supra* p. 1448, suppose that *A* is the point of origin and that *D* is a point in a group which has a rate of 20 from *A*, while *C* is a point in a group which has a rate of 15 from *A*. If the line *ADBC* is to share in the movement of goods from *A* to *C*, it must carry them at the rate of 15, while if the group adjustment is maintained, this

Since group rates are based upon average distances while the equidistant clause is based upon actual point to point distance, the two cannot be harmonized. One solution is to refuse to permit these circuitous lines which pass through higher rated groups to haul such traffic at the low rate; another is to allow such hauls subject to the equidistant clause, which in effect is an abandonment of the group system of rates; and a third is to ignore the equidistant clause.

While group rates simplify tariff lists and tend to equalize competitive conditions, they favor some points and prejudice others. Competition is fostered if circuitous lines can share in traffic, but economic waste also is encouraged. Most authorities consider the distance principle of rate making upon which the equidistant clause is based theoretically desirable but actually impracticable.¹¹ Although the Commission has vacillated in its views upon the application of the equidistant clause to group rates,¹⁰⁹ in its latest decisions it has held that the public needs are best served if the clause is not applied to this situation.¹¹⁰

Third, if an indirect interstate route seeks relief in order to meet the competition of a more direct intrastate route,¹¹¹ the equidistant clause has been held not to apply.¹¹² This apparently is a reiteration of the old policy of the Commission under the Act of 1887 to give carriers subject to the Act

line must charge 20 from *A* to *D*. Yet the application of the equidistant clause prohibits a higher rate than 15 from *A* to *D*. Thus, if the clause is applied, *D* obtains a rate of 15 while other points in its group pay 20; and thus the equality of rates within the group is destroyed.

109. In the early decisions, the equidistant clause was held not to apply. *Class and Commodity Rates between Western Points*, 104 I. C. C. 578, 586 (1925); *Class and Commodity Rates to Eastern Territories*, 144 I. C. C. 28 (1928). But cf. *Class and Commodity Rates from Pennsylvania*, 115 I. C. C. 331 (1926). Yet in 1929, the Commission, reversing its former holdings, held that the clause had to be applied. *Commodity Rates on Lumber*, 151 I. C. C. 763. However, this holding was reversed the following year. See *infra* note 110.

110. *Commodity Rates on Lumber*, 165 I. C. C. 561 (1930); *Cement in Trunk Line Territory*, 174 I. C. C. 224 (1931); *Scrap Non Ferrous Metals*, 213 I. C. C. 399 (1935). Of course, if the groups are unduly large or in any other manner are unduly preferential to certain localities, they cannot be maintained. *Lumber from the South and Southwest*, 198 I. C. C. 753, 773-774 (1934).

111. The Transportation Act gives the Commission power to change intrastate rates which discriminate against interstate transportation and provides for active cooperation between the Commissions and the various State regulatory bodies on matters concerning intrastate rates. 41 STAT. 484 (1920), 49 U. S. C. A. §§ 13(4), 13(3) (1926). See PERRY, *FEDERAL INTRASTATE RAILROAD RATE REGULATION* (1926) 1-102; Lindahl, *Cooperation Between the Interstate Commerce Commission and the State Commissions in Railroad Regulation* (1935) 33 MICH. L. REV. 338; Comment (1932) 17 IOWA L. REV. 394; Comment (1932) 80 U. of PA. L. REV. 1001; Comment (1934) 44 YALE L. J. 133.

112. *Casinghead Gasolene between Texas Points*, 192 I. C. C. 363 (1933); *Fertilizer Materials in Florida*, 200 I. C. C. 790 (1934); *Manure between Points in Florida*, 214 I. C. C. 20 (1936) Cf. *Class and Commodity Rates in Texas*, 190 I. C. C. 669 (1933); *Live Poultry to Jacksonville*, 196 I. C. C. 288 (1933); *Petroleum Products in Arkansas*, 204 I. C. C. 125 (1934).

greater freedom in competing with carriers not subject to the Act than with other carriers subject to the Act.

Fourth, if the petitioning carrier is a short, financially weak line and the purpose of the Section 4 relief is to increase its revenue, the equidistant clause does not apply even though the weak line in fact is circuitous.¹¹³ Here of course the public interest in the solvency of a carrier is deemed to outweigh the discrimination against the intermediate points on the weak line.

Fifth, the equidistant clause does not apply when departures are sought to maintain territorial classifications on rates, even though the petitioning line in fact is circuitous.¹¹⁴ For example, because of operating conditions on the west side of the Mississippi river, carriers there are granted higher scales of rates than are carriers on the east side of the river.¹¹⁵ A west side carrier competing with an east side carrier from Memphis to New Orleans must meet the east side carrier's rate, yet is considered to deserve higher rates because of higher operating costs. To impose the equidistant clause would reduce its revenues. Here also the financial condition of a carrier is enhanced at the expense of the intermediate points.

The Commission has used the device of the distance rate scale—a rate system which has provoked much controversy—in applying the equidistant clause to protect intermediate points on indirect lines which have departed from Section 4. Whether distance scales should be imposed generally upon railroad freight rates is another question impossible of categorical answer. Though rate scales proportional to distance certainly seem theoretically desirable, they may well be impracticable in the present railroad system of rate making.¹¹ Since there is widespread opposition to the adoption of this scale, and since there have developed so many confusing exceptions to the present equidistant clause, Coordinator Eastman's suggestion of repealing this clause seems expedient.¹¹⁶ The slight hardship which may result to intermediate points on indirect lines probably is overbalanced by the increased simplicity which will be introduced into questions of departures from Section 4 because of rail competition.

Since the Transportation Act implicitly authorizes Section 4 departures on circuitous lines, the Commission's orders permitting departures on such lines can hardly be criticized. Whether an amendment to the statute eliminating circuitry as a ground for relief is advisable depends upon the desirability of competition between rail carriers. The advantages obtained from such competition cannot be weighed neatly against the economic loss of wasteful transportation. As long as railroads remain independent operating units, it is clear that some degree of competition should be permitted. As the

113. *North Carolina Pine Ass'n v. Atlantic C. L. Rr. Co.*, 107 I. C. C. 190 (1926); *Mississippi Railroad Commission v. Alabama & V. Ry. Co.*, 120 I. C. C. 569 (1927); *Lumber from Fayette*, 197 I. C. C. 418 (1933).

114. *Memphis-Southwestern Investigation*, 80 I. C. C. 157 (1923), 142 I. C. C. 139 (1928); *Livestock-Western District Rates*, 194 I. C. C. 637 (1933); *Iron and Steel Rates*, 209 I. C. C. 657, 666 (1935).

115. *Memphis-Southwestern Investigation*, 80 I. C. C. 157 (1923).

116. *Regulation of Transportation Agencies—Report of Federal Coordinator of Transportation*, SEN. DOC. NO. 152, 73d Cong., 2d Sess. (1934) 71.

movement for the consolidation of railroads grows,¹¹⁷ however, competition between them must decrease, and if unified government ownership is ever reached,¹¹⁸ the pressure for Section 4 departures because of circuitry will be considerably lessened.

E. Competition of Distributing Markets

Rail competition may affect rates in ways other than by the competition between two or more railroads which run between the same two points, justifying Section 4 departures when one line is circuitous. Suppose that railroad *A* runs from New York to Macon, Georgia while railroad *B* runs from New York to Atlanta, Georgia. Since Macon and Atlanta are large cities not far apart in the same state, dealers in the two cities compete for the business of distributing goods in the same territory. Carrier *A* is interested in maintaining low rates to Macon which will enlarge the distributing capacity of that city, and hence will increase the flow of traffic to Macon, while carrier *B* similarly is interested in increasing the movement of goods to Atlanta. Although the direct competition is that of rival dealers in the two distributing points for the business of the surrounding territory, yet, the indirect competition is that of the rival carriers serving the respective distributing points.¹¹⁹

The Commission has generally held that such competition is not sufficient cause for Section 4 relief, for the reason that the same conditions which are offered in justification for the lower rates to the more distant point are also present at the intermediate points, and that the latter are entitled to the same

117. Congress first directed the Commission to prepare and to adopt a plan for the consolidation of railroads in the Transportation Act, 1920, 41 STAT. 481, 49 U. S. C. A. §§ 5 (4), (5) (6) (1926), and reiterated this policy in the Emergency Railroad Transportation Act, 1933. 48 STAT. 212, 49 U. S. C. A. §§ 253-255 (1935).

It has been estimated that as much as \$740,000,000, or 30% of the total railroad operating expenses of 1932, could be saved by certain plans of consolidation. However, consolidation to date has been opposed successfully both by railway labor and by railroad management. See *Is There a Need for a Radical Change in The Railroad Industry—Report of Federal Coordinator of Transportation*, SEN. DOC. NO. 119, 73d Cong., 2d Sess. (1934) 40-55; cf. *Report of Federal Coordinator of Transportation on Transportation Legislation*, H. R. DOC. NO. 89, 74th Cong., 1st Sess. (1935) v. 1, pp. 69-75; *Report of Federal Coordinator of Transportation on Economy Possibilities of Regional Coordination Projects*, Feb. 14, 1935; *Second Report of Federal Coordinator of Transportation on Economy Possibilities of Regional Coordination Projects*, July 12, 1935; Simpson, *The Interstate Commerce Commission and Railroad Consolidation* (1929) 43 HARV. L. REV. 192; Comment (1931) 31 COL. L. REV. 651.

118. Ever since the war-time period of government control over railroads, government ownership has often been suggested. See Dunn, *The Plumb Plan for the Control of the Railroads* (1920) 90 CENT. L. J. 3; Fowler, *Federal Power to Own Railroads in Peacetime* (1920) 33 HARV. L. REV. 775. See also reports cited in note 117 *supra*.

119. The competing carriers need not both be railroads. Thus, Chicago distributors of canned goods moving from the Pacific coast by rail may be in competition with New York distributors who have obtained their canned goods from the Pacific coast by water. *Canned Goods from Pacific Coast*, 132 I. C. C. 520, 527-528 (1927).

opportunity as the more distant points to meet those conditions.¹²⁰ If relief were granted because of the competition between distributing centers, in effect there would be revived the old basing point system, so long prevalent in the south, under which the larger communities were usually preferred at the expense of the smaller.¹²¹ The refusal of the Commission to permit Section 4 departures on the ground of competition between cities for the distribution of goods is consistent with its policy of denying Section 4 relief because of the commercial importance of a terminal point,⁸³ and with the limitation upon its authority that it may consider only transportation conditions.⁸⁴

F. Production Market Competition

Another type of indirect competition which railroads often have proposed as a basis for relief from Section 4 is the competition of markets of production. Such competition can best be illustrated by the following example. Chicago plaster distributors may buy plaster either from manufacturers in Grand Rapids, Michigan or in Fort Dodge, Iowa.¹²² These two cities, competing for the trade in plaster to Chicago, may be said to be competing markets of production. Since Grand Rapids is closer to Chicago than Fort Dodge, Grand Rapids plaster ordinarily can move to Chicago at a lower rate than can Fort Dodge plaster. Thus the Grand Rapids manufacturer will be able to undersell his Fort Dodge competitor unless the latter can obtain an equally low rate to Chicago. If the Fort Dodge manufacturer is permitted to compete in the Chicago market, by allowing rail carriers from Fort Dodge through Section 4 departures to meet the rate from Grand Rapids, he will obtain some trade which the Grand Rapids producer would otherwise have had. On the other hand, if a Section 4 departure is denied, Grand Rapids, by getting the Chicago trade, will tend to prosper while Fort Dodge will suffer correspondingly.

Upon no problem under Section 4 is there more confusion and contradiction than upon that of the effect of this competition of producing markets upon rail rates. The many decisions of the Commission upon this point are in such hopeless conflict that accurate generalizations are impossible. When production market competition has been pleaded as a cause for Section 4

120. Fourth Section Violations in the Southeast, 30 I. C. C. 153, 263-266, 277, 279 (1914); Cullman Commercial Club v. Louisville & N. Rr. Co., 33 I. C. C. 634 (1915); Memphis-Southwestern Investigation, 77 I. C. C. 473, 520 (1923). But cf. Bluefield Shippers Ass'n v. Norfolk & W. Ry. Co., 22 I. C. C. 519 (1912); Rates on Bituminous Coal, 36 I. C. C. 401, 418 (1915); Canned Goods from Pacific Coast, 132 I. C. C. 520 (1927).

121. See MILLER, *op. cit. supra* note 2, at 564-578; RIPLEY, *op. cit. supra* note 2, at 238-243; cf. Board of Trade of Carrollton v. Central of G. Ry. Co., 28 I. C. C. 154 (1913).

122. See Grand Rapids Plaster Co. v. Lake S. & M. S. Ry. Co., 41 I. C. C. 1, 7 (1916). In this case, both competing carriers happen to be railroads. However, any type of transportation agency may be a competing carrier. For example, producers in the Chicago area who reach the west-coast by rail are continually in competition for the west-coast trade with producers in the New York City area who reach the west-coast by water. See Railroad Commission of Nevada v. Southern P. Co., 21 I. C. C. 329, 347-365 (1911); City of Spokane v. Northern P. Ry. Co., 21 I. C. C. 400, 422 (1911).

relief and has been denied, the Commission often gives no reason at all for its holding.¹²³ Yet sometimes relief is refused on the ground that the producing point from which the departure is asked already had "a very substantial sale" in the common market,¹²⁴ or that the higher rates to the intermediate points were not proved to be reasonable,¹²⁵ or that uneconomic transportation would result,¹²⁶ or that long standing rate adjustments would be disrupted,¹²⁷ or that certain manufacturers would be given a preference or advantage which would not be "natural,"¹²⁸ or that the proposed rates were not reasonably compensatory,¹²⁹ or that the competing carrier would be injured,¹³⁰ or that intermediate points would be prejudiced.¹³¹ Also, relief has been denied on the ground that it might prove a "double-edged sword," in that were relief granted to one carrier at one point of competition then a competing carrier might with equal reason seek and receive relief at other points of competition.¹³²

And when relief from the long-and-short-haul clause has been granted because of production market competition, it is difficult to determine exactly what factors have prompted the Commission to arrive at its result.¹³³ De-

123. Coffee from Galveston, 64 I. C. C. 26 (1921); Iron and Steel Articles from the South, 198 I. C. C. 417 (1934); Stoves and Ranges to Southern Border Points, 200 I. C. C. 389 (1934); Electric Irons from Leeds, 211 I. C. C. 129 (1935); cf. Lumber from California, 80 I. C. C. 595 (1923); Rates on Sugar, 95 I. C. C. 151 (1924); Paving Brick to Florida, 120 I. C. C. 469 (1927); Fourth Section Departures on Salt, 123 I. C. C. 73 (1927); Coal and Coke from Oklahoma, 153 I. C. C. 409 (1929); Machinery and Machines from the South, 213 I. C. C. 189 (1935).

124. Paper to Southwestern Points, 78 I. C. C. 600 (1923); cf. Sugar Cases of 1922, 81 I. C. C. 448, 461 (1923).

125. In re Lumber Rates, 25 I. C. C. 50, 59 (1912); Pacific Coast Fourth Section Applications, 129 I. C. C. 3, 23 (1927); cf. Railroad Commissioners of Kansas v. Atchison, T. & S. F. Ry. Co., 22 I. C. C. 407, 419 (1912).

126. Iron and Steel to Texas Ports, 206 I. C. C. 249 (1935); cf. Coal and Coke from Kentucky, 151 I. C. C. 543, 549 (1929).

127. Bituminous Coal to Buffalo, 194 I. C. C. 11 (1933).

128. Commodity Rates to Pacific Coast Terminals, 107 I. C. C. 421, 436 (1926); cf. Iron and Steel to Texas Ports, 206 I. C. C. 249 (1935).

129. Wrought-Iron Pipe and Iron Pipe Fittings, 81 I. C. C. 691 (1923); cf. Green Coffee From Texas Ports, 198 I. C. C. 421 (1934).

130. Commodity Rates to Pacific Coast Terminals, 107 I. C. C. 421, 439 (1926).

131. Kellogg Toasted Corn Flake Co. v. Michigan C. Rr. Co., 24 I. C. C. 604 (1912). Cf. Commodity Rates to Pacific Coast Terminals, 107 I. C. C. 421, 437 (1926); Iron and Steel to Texas Ports, 206 I. C. C. 249 (1935).

132. Paper to Southwestern Points, 78 I. C. C. 600 (1923); cf. In re Rates on Salt, 24 I. C. C. 192 (1912).

133. Cf. Railroad Commission of Nevada v. Southern P. Co., 21 I. C. C. 329, 367-370 (1911); In re Rates on Tropical Fruits, 30 I. C. C. 621, 631 (1914); Fourth Section Violations in Rates on Sugar, 31 I. C. C. 511, 527-531 (1914); Corporation Commission of New Mexico v. Atchison, T. & S. F. Ry. Co., 34 I. C. C. 292, 301 (1915); Rates on Bituminous Coal, 36 I. C. C. 401, 407, 413 (1915); Grand Rapids Plaster Co. v. Lake S. & M. S. Ry. Co., 41 I. C. C. 1 (1916); Iron and Steel in the South, 201 I. C. C. 92 (1934); Sugar from Atlantic Seaboard Territory, 204 I. C. C. 253 (1934).

The Commission has imposed two conditions which must be satisfied before such

partures have been justified on the ground that the consuming market will benefit by a second source of supply,¹³⁴ or that the carriers need the additional traffic,¹³⁵ or that the general welfare of the producers and the communities which they represent requires relief,¹³⁶ or that a certain rate parity must be restored.¹³⁷

While the Commission often states that the size or commercial importance of one point is not in itself sufficient reason for permitting Section 4 departures upon traffic moving to it,⁸³ granting relief because of production market competition inevitably tends to prefer the larger communities at the expense of the smaller. Although every producing locality in the United States is subject to the competition of various centers of production, relief from Section 4 on this ground is sought only at the more important points.¹³⁸ In this phase of its work the Commission is furthest from purely transportation issues and closest to regional planning. The confusion of the Commission's opinions on these departures is the inevitable result of using a vocabulary of transportation to express decisions on issues of economic policy and on clashes of economic interest.

G. *Short and Weak Lines*

Section 4 relief has regularly been granted to certain short financially weak lines, located mainly in the southeastern part of the United States, which are in desperate financial straits because of their high operating costs and their location in sparsely settled country.¹³⁹ It is obvious that relief because

competition may justify Section 4 relief. The petitioning carrier must be under a material disadvantage because of having a longer route, and must meet consistently at all intermediate points the competition against which relief is sought. Fourth Section Violations in the Southeast, 30 I. C. C. 153, 279 (1914); Proportional Rates to Ohio River Crossings, 43 I. C. C. 458, 468 (1917); cf. Fourth Section Violations in Rates on Sugar, 31 I. C. C. 511 (1914).

134. *City of Spokane v. Northern P. Ry. Co.*, 21 I. C. C. 400, 423 (1911); *Rates to Gray's Harbor*, 88 I. C. C. 512 (1924).

135. *Meats and Packing House Products*, 136 I. C. C. 651, 663-665 (1928); cf. *Canned Goods from Pacific Coast*, 132 I. C. C. 520, 524 (1927); *Coal to Cincinnati*, 197 I. C. C. 53 (1933), 210 I. C. C. 447 (1935).

136. *Meats and Packing House Products*, 136 I. C. C. 651, 670 (1928); *Sugar Cases of 1933*, 195 I. C. C. 127, 161 (1933); *Canned Goods from Colorado*, 209 I. C. C. 507 (1935); cf. *Graham & Gila County Traffic Ass'n v. Arizona E. Rr. Co.*, 40 I. C. C. 573, 576, 588 (1916).

137. *Sugar Cases of 1933*, 195 I. C. C. 127, 157 (1933); *Coal to St. Louis District*, 198 I. C. C. 603 (1934); cf. *Coal and Coke to Mississippi Valley*, 191 I. C. C. 589, 592 (1933); *Cement to Chicago and St. Louis*, 191 I. C. C. 699 (1933).

138. See dissent of Commissioner Eastman in *Paper and Paper Articles to New Orleans*, 88 I. C. C. 345, at 353 (1924).

139. *Murfreesboro Board of Trade v. Louisville & N. Rr. Co.*, 73 I. C. C. 228 (1922); *Owensboro Chamber of Commerce v. Louisville, H. & St. L. Ry. Co.*, 81 I. C. C. 145, 151 (1923); *Rates from, to, and between Points in Southern Territory*, 191 I. C. C. 507, 514 (1933); *Gasolene from Norfolk*, 214 I. C. C. 15 (1936). Cf. *North Carolina Pine Ass'n v. Atlantic C. L. Rr. Co.*, 85 I. C. C. 270, 292 (1923); *Rates from Eastern Territory to Twin Cities*, 109 I. C. C. 437 (1926); *Lime between Southern Points*, 136 I. C. C. 272 (1927).

of financial condition is granted because the public interest in having the carrier continue to operate is deemed to outweigh the burden of discriminatory rates upon intermediate points. However, since Congress expressly provided for relief to weak railroads in the recapture clause,¹⁴⁰ it is questionable whether the Act was intended to permit Section 4 departures on this ground of financial condition.¹⁴¹ Of course, since the recapture clause has been repealed,¹⁴² the weak lines now must either get relief from Section 4 or be reorganized, or abandoned. Although a vigorous policy of abandoning roads would bring with it new problems, it may seem better to abandon these roads than to continue to require the intermediate points on such lines to support them, especially since the transportation demands of such points probably could be adequately satisfied by trucks.¹⁴³

H. Rate Classifications

As indicated in the discussion of the equidistant clause, departures from Section 4 have been granted in order to maintain certain territorial rate classifications. American freight rates are models of confusing intricacies, involving many classifications of commodities, of whole sections of the country into territories, and of certain points as common producing and distributing groups. A rate territory normally comprises thousands of square miles and is designed to give a region of the country the advantage of a uniform internal rate level. A group, on the other hand, is a small basing point area about 25 or 50 miles in diameter, from which all rates to a given external point are the same. Often Section 4 departures are requested to permit certain railroads to compete for the carriage of goods without disturbing these inflexible freight rate structures. Departures have been permitted when a route between two competitive points passes through one rate territory while a competing carrier traverses a lower rated territory.¹⁴⁴ The system of group rates has led to a similar type of departure. Where group rates have been established and the most direct line passes through a higher rated group, Section 4 relief must be granted to the direct line if the group arrangement is to be maintained.¹⁴⁵

Whether such departures should be permitted depends upon the utility of the existing system of freight rate making. While the present system appears arbitrary in some particulars, the convenience of its administration might more than outweigh the objection that freight rates are not fair at every point.

140. 41 STAT. 488-491 (1920), 49 U. S. C. A. § 15a (1926).

141. See dissent of Commissioner Campbell in *Cotton via Elberton & E. Rr.*, 81 I. C. C. C. 261, at 265 (1923).

142. 48 STAT. 220 (1933), 49 U. S. C. A. § 15b (1935).

143. See *Motor Bus and Motor Truck Operation*, 140 I. C. C. 685, 718 (1928).

144. *Memphis-Southwestern Investigation*, 80 I. C. C. 157 (1923), 142 I. C. C. 139 (1928); *Livestock-Western District Rates*, 194 I. C. C. 637 (1933); *Iron and Steel Rates*, 209 I. C. C. 657, 665, 674 (1935); *Binder Twine from New Orleans*, 214 I. C. C. 126 (1936).

145. *Cement in Trunk-Line Territory*, 174 I. C. C. 224 (1931); *Livestock in Official Territory*, 186 I. C. C. 457 (1932); *Sulphate of Ammonia to the South*, 191 I. C. C. 227 (1933); cf. *In re Lumber Rates*, 25 I. C. C. 50, 51 (1912).

Whether the system is cumbersome and antiquated or sufficiently effective to justify Section 4 departures for its preservation is an issue which must await careful research by the Commission.

I. *Exceptional Relief*

The Commission has also recognized certain exceptional and urgent needs for temporary relief from Section 4. Thus, carriers by rail may transport at very low rates food and other necessities of life to localities suffering from drought or floods or famine without reducing its intermediate rates.¹⁴⁶ Also, if there is a washout or wreck or other emergency of a similar nature, then Section 4 may be disregarded and traffic may move over the most economical and expeditious route available.¹⁴⁷

ALTERNATIVES TO SECTION FOUR

The continual struggle of rail carriers for traffic against the competition of trucks, water carriers,¹⁴⁸ pipe-lines,¹⁴⁹ and even other rail carriers, and the strenuous efforts of competing producers and distributors to gain advantageous freight rates are reflected in the countless Section 4 orders of the Commission in which an attempt has been made to compromise these conflicts. In view of the vitality of these clashes of interest, which are fought out along political as well as economic lines, it is not surprising that much dissatisfaction has been expressed with the existing scheme of long-and-short-haul rate regulation.¹⁵⁰

The future of long-and-short-haul rate regulation is not easy to prescribe or to predict. The path of least resistance would be to retain the existing law, perhaps with minor modifications, such as the repeal of the equidistant clause.¹⁵¹ This policy of prohibiting a greater charge for a shorter haul,

146. See Administration of Fourth Section, 87 I. C. C. 564, 568 (1924); Commodity Rates on Lumber, 165 I. C. C. 561, 565 (1930); cf. Application of Fremont, E. & M. V. Rr. Co., 6 I. C. C. 293 (1895).

147. Shipments Forwarded via Unusual Routes, 167 I. C. C. 249 (1930).

148. Besides the independent competition of water lines and of trucks which has been increasingly effective in recent years, there has of late arisen a new menace to rail prosperity—the water-truck line, which may prove even more harmful to railroads. Section 4 departures have been granted to enable rail carriers to meet this new form of competition. Citrus Fruits from Florida, 211 I. C. C. 535 (1935); Scrap Iron from Cohoes, 214 I. C. C. 23 (1936); Coke to Portland District, 214 I. C. C. 32 (1936).

149. See *infra* p. 1440.

150. The blanket prohibition of long-and-short-haul discrimination, appearing even in the first Act of 1887, seems to have been based upon the theory that railroads had a substantial monopoly of transportation. As competing types of carriers have made increasingly serious inroads into the business of the railroads, however, Section 4 policy becomes more confused, and dissatisfaction with it increases.

151. See *supra* note 116. Coordinator Eastman also has suggested that the reasonably compensatory and potential water competition clauses may be repealed, on the theory that the confusion and controversy now existing as to the meaning of these clauses may thus be avoided and yet the Commission can be trusted in administering such an amended statute to follow the general policy enunciated by these clauses. See Regulation of Transportation Agencies—Report of Federal Coordinator of Transportation, SEN. DOC.

while giving the Commission discretion to permit exceptions, vests in the Commission a tremendous power to formulate a social policy for itself. The fact that the existing regulation satisfies neither water lines¹⁵² nor railroads might be some evidence that the Commission has avoided at least the more obvious errors in its work of compromise.

While the railroads have continually objected to the restriction upon their earning power which they feel Section 4 has imposed, their precarious financial condition today increases their drive for more revenue and intensifies their dissatisfaction with Section 4. Even under the existing status of long-and-short-haul rate regulation, however, there are several methods other than departures from or repeal of Section 4 whereby railroads might increase their net revenues. Economies through more efficient management and operation,¹⁵³ abandonment of unprofitable spur lines,¹⁵⁴ consolidation of railroads,¹⁵⁵ horizontal increases in freight rates,¹⁵⁶ and, paradoxically, general reductions in rates,¹⁵⁶ have been proposed and to some extent adopted. The railroads,

No. 152, 73d Cong., 2d Sess. (1934) 71-72. Such a Bill, restoring Section 4 to its status prior to the 1920 amendment, has been presented to Congress. H. R. 5362 (Rayburn-Eastman Bill).

152. There have often been proposed before Congress Bills designed to eliminate entirely or in part water competition as a ground for Section 4 relief. See, e. g., S. 2327, 68th Cong., 1st Sess. (1924) (first Gooding Bill); S. 575, 69th Cong., 1st Sess. (1926) (second Gooding Bill); S. 563, 71st Cong., 2d Sess. (1930) (Pittman Bill). Such bills have had little success. See DEWEY, *op. cit. supra* note 1, at 221-224.

153. In an attempt to improve their financial position, the railroads in recent years have engaged in strict economy programs, and have succeeded in cutting expenses to the bone. Consequently, it is improbable if much more reduction of expense can be secured in this manner. For a comprehensive discussion of current railroad financial problems, see Comment (1935) 48 HARV. L. REV. 1382.

154. In 1930 railroads sought to abandon 980 miles of track, while in 1935 this figure had increased to 2,537. See 48TH ANN. REP. I. C. C. (1934) 20; 49TH ANN. REP. I. C. C. (1935) 23. The actual monetary savings resulting from such abandonment frequently cannot be determined.

Abandonment has been rendered difficult because of the opposition of local communities from which rail service would be removed [see San Antonio S. Ry. Co. Abandonment, 189 I. C. C. 114, 116-118 (1932)], and of labor interests, who caused restrictions upon the reduction of railroad employment to be written into the Emergency Transportation Act of 1933. 48 STAT. 214, 49 U. S. C. A. § 257 (b) (1935).

155. In 1931, the railroads applied to the Commission for a general increase of 15% in freight rates. Although this blanket increase was denied, provision was made for temporary surcharges on specific products. Fifteen Per Cent Case, 1931, 178 I. C. C. 539 (1931).

In 1935, the carriers again petitioned for a general increase, this time only on those products which they believed could bear the increase and still move by rail. Again, although the Commission denied the general increase requested, it did grant a temporary increase on certain products. Emergency Freight Charges, 1935, 208 I. C. C. 4 (1935).

156. In 1933, shippers petitioned the Commission for a general reduction in rail freight rates. This was denied. General Rate Level Investigation, 1933, 195 I. C. C. 5 (1933). However, railroads have voluntarily reduced thousands of rates to meet competition. See General Rate Level Investigation, 1933, *supra* at pp. 47, 48, 70, 71; Comment (1935) 48 HARV. L. REV. 1382, 1397-1398. Whether the demand for commodities carried by rail

however, have not been satisfied with the results of these attempts to increase their revenues, and consequently urge the repeal of Section 4 to enable them more effectively to compete with unregulated carriers.

The Pettengill Bill, recently passed by the House of Representatives and now pending before the Senate,¹⁵⁷ is designed to aid the railroads by repealing the long-and-short-haul clause of Section 4. Under this Bill, shippers at intermediate points who complain of lower charges to more distant points may obtain relief only if such rates violate other sections of the Transportation Act.¹⁵⁸

It is impossible to predict accurately the effect upon the transportation system of this Bill should it become law. While the discriminatory practices so common between 1897 and 1910 might reappear, that result is improbable in view of the changes since that time in business and in the machinery for the administrative control of the railroad rate structure. Although the elimination of the long-and-short-haul clause as a weapon of control might reduce even the present effectiveness of the general scheme of railroad regulation, the Commission now has the minimum and maximum rate making powers as well as the power of suspension of rates—none of which existed under the original Act.¹⁵⁹ And moreover, there exists today much more competition in the field of transportation. Pipe lines, water carriers, and trucks, which did not threaten the existence of the railroads in that early period, today are effectively competing for the carriage of goods. To what extent these changes will prevent a return of the long-and-short-haul abuses at the turn of the century is impossible to determine; but speculation is irresistible.

The repeal of Section 4 will enable railroads to meet water competition

is sufficiently elastic so that a downward revision of freight rates will bring higher net revenues is still a matter for speculation. The reduction in passenger fares to go into effect this month may furnish useful data for freight traffic.

157. H. R. 3263, 74th Cong., 2d Sess. (1936). This Bill on March 24 passed the House of Representatives by a vote of 215 to 41. See 80 Cong. Rec., March 24, 1936, at 4478. Two days later, it was referred to the Senate Committee on Interstate Commerce. See 80 Cong. Rec., March 26, 1936, at 4533.

158. The Bill retains in Section 4 only the aggregate of intermediates clause with provision for relief from it by the Commission "from time to time," and the clause prohibiting rail rates depressed by water competition from being raised unless such proposed increase rests upon changed conditions other than the elimination of water competition. For a discussion of the latter clause, see *supra* note 33.

The Bill also provides that "in any case before the Commission where there is brought in issue a lower rate or charge for the transportation of like kind of property, for a longer than for a shorter distance over the same line or route in the same direction, the shorter being included within the longer distance, the burden of proof shall be upon the carrier to justify the rate or charge for the longer distance against any claim of a violation of sections 1, 2, and 3 of the Interstate Commerce Act."

159. The power to prescribe maximum rates was given to the Commission in 1920. 41 STAT. 485, 49 U. S. C. A. § 15 (1) (1926). The Commission has had the maximum rate making power since 1906. 34 STAT. 589, 49 U. S. C. A. § 15 (1) (1926). And the power of suspension was conferred in 1910. 36 STAT. 552, 49 U. S. C. A. § 15 (7) (1926). Cf. Mansfield, *The Minimum Rate Power and the Control of Carrier Competition* (1936) 45 YALE L. J. 1406.

more effectively.¹⁶⁰ As the Transportation Act prohibits railroads from meeting potential water competition, water carriers are free to compete with railroads for the carriage of goods, and rail carriers may not obtain Section 4 relief until such water competition has become quite real. Railroads also must obtain permission of the Commission before carrying goods at reduced rates to meet water competition, even after it has become well established. The resulting delay enables water carriers to gain a strong foothold. And as soon as the Commission has approved a departure because of water competition, water carriers are free to lower their rates further, while the railroads must appeal again to the Commission for permission to meet this new water rate. While the Pettengill Bill will give railroads greater freedom in meeting water competition, Section 500 of the Transportation Act purports to protect the interests of the water carriers. It is probable, however, that by the repeal of Section 4 the railroads will be able to take a sizeable portion of that traffic now moving by water.¹⁶¹

The repeal of Section 4 also will allow railroads to regain some of that traffic which now moves by truck. Since motor carriers have but recently been placed under the jurisdiction of the Commission,¹⁶² it is unlikely that railroads could or would be permitted to stifle truck competition completely. More probable is some diversion from truck to rail of those goods now moving on the highway.

In addition to shifting traffic from water carriers and trucks to railroads, the repeal of Section 4 will effect a readjustment of traffic among rail carriers. Unhampered by the prohibition against long-and-short-haul discrimination and by the restriction of the reasonably compensatory clause, circuitous rail lines would be able to take more traffic from direct rail lines between two points. Market competition will cause long-and-short-haul discrimination without the intervention of the Commission to pass upon the significance of that competition. This rate policy undoubtedly will alter further the flow of traffic among railroads as they compete more vigorously for the carriage of goods from competing producing points to competing points of distribution.

Although the chief justification for the abolition of Section 4 is that rail revenues would thereby be increased, it is doubtful whether such an increase actually would result. Since the added traffic is to be carried at reduced competitive rates, it is possible that the net revenue of the railroads may

160. See *Hearings before Committee on Interstate and Foreign Commerce on H. R. 3263, H. R. 3610, H. R. 5362, and H. R. 8364*, 74th Cong. 1st Sess. (1935) 64, 90, 180, 202, 230, 242; N. Y. Times, May 12, 1936, at 41, col. 1.

161. The railroads themselves cannot give an accurate estimate of the amount of traffic they would recover were the Pettengill Bill enacted. N. Y. Times, May 25, 1936, at 29, col. 2.

162. 49 STAT. 543, 49 U. S. C. A. §§ 301-327 (1935). This Act empowers the Commission, inter alia, to prescribe maximum and minimum rates for common carriers by motor vehicle and minimum rates for contract carriers, 'to prescribe reasonable requirements for service and management, to prevent undue preferences or prejudices among common carriers, and to prescribe reasonable rates for common carriers. There is no express prohibition upon long-and-short-haul discrimination in this Act. See Comment (1936) 36 COL. L. REV. 945.

not be increased and the new rail competition that will be made possible may offset the gains from water and motor competition for individual carriers if not for the whole industry. Even if it be assumed that rail revenues will be enhanced by the Pettengill Bill, there still is grave doubt as to the wisdom of such legislation. Whatever benefits this Bill would make possible for the railway industry¹⁶³ would be gained at the expense of shipping and trucking industries in which the public interest is not negligible.⁶⁴ Furthermore, the repeal of Section 4 would subject small shippers by rail and small intermediate points to undue discrimination because of their limited bargaining power.¹⁶⁴

Thus it appears that the benefit to the public from this Bill not only is difficult to evaluate but may prove to be illusory. And since the abuses which often result from inadequate regulation of common carriers are so well known, it might be better to abandon the Pettengill Bill in favor of an alternative policy of railroad relief—that of adequate regulation of all transportation agencies.

The Emergency Transportation Act of 1933 created the office of Federal Coordinator of Transportation, with power, among other things, to "investigate and consider means . . . of improving transportation conditions throughout the country."¹⁶⁵ Carrying out this mandate, Coordinator Eastman initiated a far flung investigation of the transportation industry. In his reports, the Coordinator recommended and has continued to urge complete regulation by the government of all common carriers as the best solution of the present transportation problem.¹⁶⁶ Pursuant to these suggestions, Congress has recently placed interstate motor carriers under the jurisdictions of the Interstate Commerce Commission.¹⁶² Further, a bill proposing similar regulation of water carriers has been presented to Congress.¹⁶⁷

163. Advocates of the bill claim that it may mean the re-employment of as many as 100,000 railroad workers. See *Hearings, supra* note 160, at 300; *N. Y. Times*, May 13, 1936, at 35, col. 1.

164. The railroads contend that small interests will be amply protected by other sections of the Transportation Act, as, for example, those which give the Commission the power to prescribe maximum and minimum rates [§ 15 (1)], to suspend and investigate rates [§ 15 (7)], to prevent unreasonable rates [§ 1 (5)], and to prevent undue preferences to persons and to places [§§ 2, 3 (1)]. See *Hearings, supra* note 160, at 22, 186, 218.

Yet railroads in their rate making policies undoubtedly will tend to favor large interests. And since under the Pettengill Bill railroads will be free to place into effect lower charges for longer distances unless interested parties raise objections, smaller interests can avoid discriminations only by appealing to the Commission. Despite the fact that the burden of proof is placed upon the carriers, the expense and inconvenience of such procedure probably will prevent small shippers and localities from resisting long-and-short-haul discriminations effectively.

165. 48 STAT. 216, 49 U. S. C. A. § 263 (1935).

166. Regulation of Transportation Agencies—Report of Federal Coordinator of Transportation, SEN. DOC. NO. 152, 73d Cong., 2d Sess. (1934) 10-13, 23-41, 53, 58, 95-97; Report of Federal Coordinator of Transportation on Transportation Legislation, H. R. DOC. NO. 89, 74th Cong., 1st Sess. (1935) v. 1, pp. 14-27; Fourth Report of Federal Coordinator on Transportation Legislation, Jan. 21, 1936, pp. 3-7.

167. S. 1632, 74th Cong., 1st Sess. (1935). For a discussion of this Bill, see Report of Fed-

One of the purposes of the system recommended by the Coordinator is to end discrimination against railroads in their competition with unregulated or partially regulated water carriers and trucks. Another purpose is to enable the Commission to improve the financial condition of all carriers by adjusting the rate levels of all. A third is to eliminate wasteful cross-hauling and the necessity for long-and-short-haul discrimination by permitting each agency of transportation to dominate the field in which it can act most efficiently. Finally, by expanding the power of the Commission, Coordinator Eastman's proposal will enable the Commission to compromise more equitably the interests vitally affected by rate regulation.

CONCLUSION

The repercussions which might result from a relaxation of governmental regulation as proposed in the Pettengill Bill on the one hand or from the extension of Commission control to all carriers on the other, are difficult to visualize or to evaluate. Even from a purely economic standpoint there is no single proper course to adopt. Economic theory, however, will play little part in the resolution of this problem. Sharp clashes of economic interests, impinging directly upon the regulation of transportation charges, find expression through political pressure. Conflicts between shippers, between terminal and intermediate localities, between producing areas, between distributing areas, between railroads, and between the various types of carriers, all competing vigorously for the production, transportation, or distribution of goods, are among those represented with varying degrees of effectiveness along political lines. There is also fundamental disagreement as to policy. Economy of transportation, permitting that carrier to haul which can do so the cheapest, is balanced against protection of the billions of dollars which have been invested in the railways; and the distance principle of rate making conflicts both with the policy of permitting carriers freedom in increasing their revenues and with the American pride in conquering distance and having goods transported freely from one end of the country to another. Since the impossibility of determining the actual cost of moving a particular quantity of a given commodity between two known points makes the distance principle difficult of application, perhaps frankly acknowledged considerations of social and regional welfare, rather than a futile quest for costs, would serve as standards in a system of rate regulation.¹⁶⁸ A simple formula, however, like the long-and-short-haul clause, will always be inadequate to resolve these conflicts of interest and policy.

eral Coordinator of Transportation, op. cit. *supra* note 166, at 41-45, 164-169, 333; Fourth Report of Federal Coordinator, op. cit. *supra* note 166, at 10-33. This Bill does not contain an express prohibition against long-and-short-haul discrimination.

Although common and contract carriers by water at present are in part subject to the jurisdiction of the Interstate Commerce Commission and the Shipping Board, these tribunals have insufficient power to regulate them adequately.

168. See Shulman, Book Review (1936) 45 YALE L. J. 558.

PROBLEMS RAISED BY THE HOLZER CASE: SUABILITY OF
A FOREIGN GOVERNMENT OWNED CORPORATION;
EXTRATERRITORIAL APPLICATION OF THE
GERMAN NON-ARYAN LAWS

ONE of the features of the 1924 reparations agreement between Germany and the Allies was a provision that Germany should turn over the operation of its government owned railroad system to a corporate entity, which was to pay a portion of its earnings to the reparations trustee.¹ Pursuant to that agreement, the German government organized, and acquired a major portion of the stock in a corporation known as the Deutsche Reichsbahngesellschaft (hereafter called the Reichsbahn) which took over the operation of the German railroads. In 1931 the plaintiff, a German citizen of Jewish extraction, was a partner in the forwarding firm of Schenker & Co., the successful development of which had been due largely to the plaintiff's efforts. At the close of that year, the Schenker partnership was transformed into a corporation and ultimate control of the business was centered in the Reichsbahn through a pyramid of holding companies involving two intermediate corporations. In the course of that transaction, a contract was entered into by the new corporation, the intermediate holding companies, and the Reichsbahn whereby the plaintiff was engaged to act as general manager of the new corporation from 1932 until 1934. In 1933 the plaintiff was discharged by the Director General of the Reichsbahn, acting on behalf of all four corporations, the dismissal being based solely on the ground that the German Non-Aryan legislation made such a dismissal imperative.² The plaintiff commenced suit in New York against all four corporations by attaching property of the Reichsbahn and the new corporation in that jurisdiction, claiming damages primarily for wrongful discharge on the theory first that the Non-Aryan legislation did not require his dismissal, second, that the particular act under which he was dismissed was unconstitutional, or at least enacted in excess of delegated powers, and third, that the defendants could not rely on the Non-Aryan law as a defense because of its repugnancy to the public policy of New York. In addition to other defenses, the Reichsbahn claimed immunity from suit on the ground that it was a government instrumentality, and the German government itself intervened to obtain immunity for the Reichsbahn as its property. Although the case has not yet proceeded to a final adjudication on its merits,³ it presents several questions of inter-

1. London Convention of August 16, 1924 (Dawes Plan); see *Deutsches Reichsgesetzblatt* 1924, II, 289; George A. Finch, *The London Conference on the Application of the Dawes Plan* (1924) 18 AM. J. INT. L. 707.

2. The German statutes and ordinances referred to are as follows: Gesetz zur Wiederherstellung des Berufsbeamtentums of April 7, 1933, *Reichsgesetzblatt* 1933, I, 175; 2. Ausfuehrungsverordnung zum Berufsbeamtengesetz of May 4, 1933, *Reichsgesetzblatt* 1933, I, 233; Ordinances of the Reichsbahn of April 18, 1933 and June 14, 1933.

3. It has been decided that the complaint states a cause of action. *Holzer v. Deutsche-Reichsbahn-Gesellschaft*, N. Y. L. J., March 28, 1936, at 1579, col. 1 (App. Div., 1st Dep't). Jurisdiction exists as to the intermediate corporations because their corporate entity had been ignored by officials of the Reichsbahn. *Holzer v. Deutsche Reichsbahngesellschaft*, N. Y.

national law and the conflict of laws. Two of these will be discussed in this Comment: first, the liability of the Reichsbahn to suit; and second, the applicability of the German Non-Aryan laws in proceedings before American tribunals.

I

Whether the immunity from suit universally accorded a sovereign state is to be extended to a corporation such as the Reichsbahn depends on international law regarding the suability of a government owned corporation as applied by the American courts. As governments have made increasing use of the corporate device to invade the field of economic enterprise, there has been a decided, although not entirely clear-cut tendency in international law to subject such corporations to suit.⁴ The American decisions applying international law have to some extent followed this general trend,⁵ a result which is not surprising in view of the fact that in the field of domestic law, federal and state owned corporations have almost always been denied immunity.⁶ There are cases, however, in which a unit owned by a foreign government has been held not liable to suit.⁷ Although the rationale of these decisions is far from clear, they appear to be founded on one or both of two interrelated premises: first, that the unit operating the enterprise is not suable if it can be said that it is not a separate corporate entity, either because the usual steps in creating a corporation were not taken, or because the corporate paraphernalia has been entirely disregarded by the government, the business being directly controlled by government administrative officials rather than by corporate officers in accordance

L. J., Feb. 5, 1936, at 655, col. 1 (Sup. Ct.). So far as the affidavits disclose, the Reichsbahn is not entitled to sovereign immunity. See *Holzer v. Deutsche Reichsbahn Gesellschaft*, N. Y. L. J., April 11, 1936, at 1839, col. 5 (Sup. Ct.). See decision in *Holzer v. Deutsche Reichsbahn et al.*, N. Y. L. J. June 22, 1936, p. 3171 (Sup. Ct.): Motion to strike out defense based on the German Non-Aryan laws granted, since these laws are repugnant to American public policy (Collins, J.).

4. See comment on article 26 of the Draft Convention on "Competence of Courts in Regard to Foreign States" of the Harvard Law School Research in International Law (1932) 26 AM. J. INT. L. SUPP. 716.

5. *Coale v. Société Coopérative Suisse des Charbons Bâle*, 21 F. (2d) 180 (S. D. N. Y. 1921); *United States v. Deutsches Kalisyndikat-Gesellschaft*, 31 F. (2d) 199 (S. D. N. Y. 1929); cf. *Amtorg Trading Corporation v. United States*, 71 F. (2d) 524, 528 (C. C. P. A. 1934) (the doctrine of "piercing the veil" of a government owned corporation was sharply rejected).

6. *Bank of the United States v. Planters' Bank of Ga.*, 9 Wheat. 904 (U. S. 1824); *Sloan Shipyards Corp. v. United States Shipping Bd. Emergency Fleet Corp.*, 258 U. S. 549 (1922); *Haines v. Lone Star Shipbuilding Co.*, 268 Pa. 92, 110 Atl. 788 (1920); see *Thurston, Government Proprietary Corporations* (1935) 21 VA. L. REV. 351, 372-396; Comment (1936) 45 YALE L. J. 1235, 1236. *Contra: McCarthy v. U. S. Shipping Bd. Merchant Fleet Corp.*, 53 F. (2d) 923 (App. D. C. 1931), cert. denied, 285 U. S. 547 (1932).

7. *Oliver American Trading Co., Inc. v. Government of Mexico*, 5 F. (2d) 659 (C. C. A. 2d, 1924); *Dexter & Carpenter, Inc. v. Kunglig Jarnvagsstyrelsen*, 43 F. (2d) 705 (C. C. A. 2d, 1930); *Mason v. Intercolonial Railway of Canada*, 197 Mass. 349, 83 N. E. 876 (1908); *Bradford v. Director General of Railroads of Mexico*, 278 S. W. 251 (Tex. Civ. App. 1925).

with the conventional corporate ritual; second, that even though a separate corporate entity exists, the corporation is entitled to immunity if it is operating an enterprise which is considered governmental in nature where the business is conducted, regardless of the fact that it might be treated as a private enterprise in the United States.

The chief factors to be considered in determining whether the Reichsbahn is entitled to immunity under either of these principles relate to its organization and structure. The present status of the Reichsbahn is regulated by the law of August 30, 1924,⁸ as amended by the law of March 13, 1930,⁹ which organized the Reichsbahn as a separate legal entity in accordance with the reparations agreement.¹⁰ In order to enable the new organization to pay its share of the reparations, the German Reich transferred to it the exclusive right of operating the entire German railway system, all the rights connected therewith, the cash on hand, and the fixtures and movable property necessary for the conduct of the enterprise. The Reich, however, retained ownership of the immovable property and rolling stock. The Reichsbahn is capitalized at 15 billion Reichsmark, 13 billion being represented by common stock owned by the Reich, and 2 billion being represented by preferred stock held at least predominantly by the general public. The preferred stockholders have certain limited rights of membership, among which is the right to elect a minority of the 18 members of the Board of Management. Far-reaching control is assured to the Reich, however, since it can veto the appointment of members of the Board of Management and of the Directorate and its powers in this regard are not dependent upon the retention of its stock. Furthermore, the Reichsbahn is under certain obligations to the Reich, the chief of which is the duty to operate the railway system with a view to the general political and economic interests of Germany. The management of the Reichsbahn is in the hands of its own officers who are not officials of the German government, although the Reich takes some part in their appointment. It therefore appears that the Reichsbahn occupies a somewhat anomalous position. While its structure is undoubtedly that of a corporation, it is neither an ordinary private corporation subject to the commercial code, nor can it be classified as any particular type of public corporation. Its legal nature is highly controversial,¹¹ and may best

8. Gesetz ueber die Deutsche Reichsbahngesellschaft, Reichsgesetzblatt 1924, II, 272; Satzung der Deutschen Reichsbahngesellschaft, id. at 281.

9. Gesetz zur Aenderung des Reichsbahngesetzes, Reichsgesetzblatt 1930, II, 359.

10. An ordinance of February 12, 1924 had already partially emancipated the Reichsbahn from the general budget of the Reich in anticipation of the ultimate separation. Reichsgesetzblatt 1924, I, 57.

11. Compare Lassar, *Reichsseigene Verwaltung* (1926) 14 JAHRBUCH DES OEFFENTLICHEN RECHTS 186, 198; O. Buehler, in 1 HANDBUCH DES DEUTSCHEN STAATRECHTS (1930) 599; v. Kienitz, V^o "Eisenbahnstaatsrecht," in 2 HANDWOERTERBUCH DER RECHTSWISSENSCHAFT (1927) 231, 235; HILLEBRAND, DIE AUFSICHTSRECHTE DES DEUTSCHEN REICHS UEBER DIE DEUTSCHE REICHSBAHNGESELLSCHAFT NACH GELTENDEM RECHT (1934) 2 et seq. (with extensive further references); K. FRITSCH, EISENBAHNGESETZGEBUNG IM DEUTSCHEN REICH (1930) 26, n. 3; SIGLOCH, DIE UNTERNEHMUNGEN DER OEFFENTLICHEN HAND (1929) 85; ANSCHUETZ, DIE VERFASSUNG DES DEUTSCHEN REICHS (1929) 391; Groeschner, *Zur rechtlichen Stellung der Deutschen Reichsbahngesellschaft* (1926) DEUTSCHE JURISTENZEITUNG 439.

be characterized as a peculiar, *sui generis* combination of private and public law elements.

But despite the ambiguous nature of the Reichsbahn, there can be little, if any doubt that it is a distinct legal entity, and hence not entitled to immunity from suit on the ground that it is merely an administrative department of the German government. This conclusion seems entirely justified by the fact that the chief purpose in organizing the Reichsbahn was to create a separate corporate entity to satisfy the terms of the reparations agreement, that a portion of the stock carrying some voting rights is privately held, and that the management of the enterprise is delegated to corporate officers rather than to administrative officials of the Reich.

There is room for more dissension as to whether the Reichsbahn should be granted immunity on the ground that it performs a governmental function. In support of this basis for immunity, it can be urged that the operation of the railroads has traditionally been regarded as a governmental function in Germany, and that this attitude is embodied in the present organization of the Reichsbahn, both in the provisions vesting partial control in the Reich apart from its stock ownership, and in those imposing a duty on the Reichsbahn to operate the railroads in furtherance of the political and economic welfare of Germany. On the other hand, it can be argued that although the operation of the German railroads may formerly have been considered governmental in character, the deliberate transfer of that function from the government to a separate corporate entity indicates that it is no longer to be so considered, particularly since the experts chiefly responsible for drafting the reparations agreement providing for this transfer came from countries in which the operation of the railroads has traditionally been considered a private enterprise.¹² An additional, though not decisive argument against classifying the Reichsbahn as a public corporation may be derived from the President's Ordinance of October 6, 1931, relating in part to the salaries of public and quasi-public officials, which provides that for the purposes of that Ordinance the Reichsbahn is not to be considered a corporation of public law.¹³ While the proper solution of the problem is therefore open to some doubt, it appears justifiable to deny the Reichsbahn immunity on this ground also, in view of the present commendable tendency to subject to suit government owned corporations which engage in enterprises of an economic nature.

Since the Reichsbahn bases its claim to immunity on its alleged character as both a governmental agency and property of the Reich, the question arises as to whether an additional ground for denying immunity may be found in Article 281 of the Berlin Treaty of November 14, 1921, restoring friendly relations between the United States and Germany.¹⁴ The Article provides that "if the German government engages in international trade, it shall not in respect thereof have or be deemed to have any rights, privileges or immunities of sovereignty." It is identical with similar clauses of the principal peace

12. See Lassar, *op. cit. supra* note 11, at 187; Buehler, *op. cit. supra* note 11, at 600.

13. Part III, c. 5, subsection 1, par. 15, Reichsgesetzblatt 1931, I, 537, 548.

14. U. S. Treaty Series, No. 658.

treaties from which it was borrowed,¹⁵ and must be interpreted in light of the meaning commonly attributed to those clauses.¹⁶ These provisions are generally understood as an express recognition of the doctrine that state immunity is to be limited to strictly governmental, as distinguished from economic activities. It might therefore be urged that if the Reichsbahn is considered as a part of the Reich, it is subject to suit under this Article. But it appears doubtful that the provision should be thus applied. The phrase "engages in international trade" seems to exclude from its purview the entire complex of the railway business. In the only known decision involving its interpretation, it has been construed to cover only those trade activities whose immediate object is the exchange of commodities.¹⁷ Accordingly, it would not apply to the Reichsbahn, despite the activities engaged in by a New York branch of that organization.¹⁸ Under this interpretation, Article 281 of the Berlin Treaty of 1921 cannot be invoked as a further argument for subjecting the Reichsbahn to suit, and if the Reichsbahn were found to be identical with the Reich, it would be entitled to immunity.

II

It is clear that the relations between the parties in the instant case, including those concerning the termination of the contract, would ordinarily be governed by German law, since the contract was made in Germany by parties domiciled there, and was to be performed in that country. Accordingly, if the discharge of the plaintiff was authorized by the German Non-Aryan law, a complete defense would be available to the defendants in the absence of further considerations. But the plaintiff maintains that the defendants cannot rely on that law as justifying his discharge because it violates fundamental conceptions of American public policy by discriminating between Jews and non-Jews, and hence, under well-recognized doctrine, must not be applied in the courts of this country.

It requires no close examination of the German anti-Semitic statutes eliminating Jews from the political, cultural and economic life of Germany, to conclude that they are opposed to deeply rooted principles of American social morality

15. Treaty of Versailles, Art. 281; Treaty of St. Germain, Art. 233; Treaty of Trianon, Art. 216; Treaty of Neuilly, Art. 161.

16. For general discussions of these provisions, see Trachtenberg, *L'immunité judiciaire de l'état et les représentations commerciales de l'U. R. S. S. à l'étranger* (1931) 26 *REVUE DARRAS* 757, 761; Ch. de Visscher, *Les gouvernements étrangers en justice* (1922) *REVUE DE DROIT INTERNATIONAL ET DE LÉGISLATION COMPARÉE* 308; NOLDE, *RECUEIL DES COURS AC. DR. INT.*, 1924, II, 368; Niboyet, note in *SIREY* (1930) 49; WATKINS, *THE STATE AS A PARTY LITIGANT* (1927) 190; SCHENK v. STAUFFENBERG, *DIE RECHTSTELLUNG DER RUSSISCHEN HANDELSVERTRETUNGEN* (1930) 89.

17. Decision N. RI. 1360/22 of the Supreme Court of Czechoslovakia (1922), partly reprinted in (1932) 26 *AM. J. INT. L. SUPP.* 602-604.

18. The plaintiff argues that the transaction of business by the New York branch of the Reichsbahn brings the latter within the phrase "engages in international trade." The Reichsbahn denies, however, that the New York branch does active business, except for performing such functions as giving information to shippers.

embodied in the equal protection clause of the Federal Constitution.¹⁹ Since the adoption of the Fourteenth Amendment, numerous decisions have interpreted this provision as prohibiting legal discrimination by the states based on distinctions of race or color.²⁰ Whatever apparent exceptions to this general principle have been established are not only of minor importance, but have also been rationalized by arguments which purport to leave the principle itself unimpaired.²¹ Little emphasis is needed to point out that the public policy expressed in the Fourteenth Amendment is sufficiently imperative to render inoperative ordinary rules as to the conflict of laws. Consequently there are strong reasons for considering the entire body of the German Non-Aryan legislation, including the particular acts here involved, as repugnant to the public policy of this country.²² But whether the New York court should, in the present case, resort to the public policy argument and refuse to apply the German Non-Aryan law depends upon further considerations.

Under the more liberal modern conceptions as to the proper function of the public policy doctrine in any system of conflict of laws, it is well recognized that unless checked it may be destructively applied as a factor interfering with the normal play of private international law principles. Although numerous attempts to reduce its vagueness and unpredictability and to circumscribe closely its sphere of operation have proved futile, its application has been limited to some extent.

19. It is well settled that public policy in the sense here used may find expression either in constitutions, statutes or judicial records. *Hartford Ins. Co. v. Chicago, Milwaukee & St. Paul Ry.*, 175 U. S. 91, 100 (1899); *Becker v. Interstate Business Men's Ass'n*, 265 Fed. 508 (C. C. A. 8th, 1920); *Swann v. Swann*, 21 Fed. 299 (C. C. E. D. Ark. 1884); *Chubbuck v. Holloway*, 182 Minn. 225, 234 N. W. 314 (1931); *People v. Hawkins*, 157 N. Y. 1, 12, 51 N. E. 257, 260 (1898); *Taylor v. Leonard*, 275 S. W. 134 (Tex. Civ. App. 1925).

20. *Strauder v. West Virginia*, 100 U. S. 303 (1879); *Yick Wo v. Hopkins*, 118 U. S. 356, 369 (1886); *Norris v. Alabama*, 294 U. S. 587 (1935); *Opinion of the Supreme Court of Judicature of Massachusetts*, 207 Mass. 601, 94 N. E. 558 (1911); *Riggsbee v. Town of Durham*, 94 N. C. 800 (1886).

For discussions of the equal protection clause and the general policy behind it, see COOLEY, *CONSTITUTIONAL LAW* (4th ed. 1931) 283; FLACK, *THE ADOPTION OF THE FOURTEENTH AMENDMENT* (1908).

21. The most important exception concerns miscegenation laws which are upheld as not discriminating against either white or colored persons since they apply to both. *State v. Tutty*, 41 Fed. 753 (C. C. S. D. Ga. 1890); *State v. Jackson*, 80 Mo. 175 (1883).

22. As to what extent the German Non-Aryan laws may clash with the local policies of other states, compare Neuner, *Das neue reichsdeutsche Eherecht und die tschechoslovakische Rechtsordnung* (1935) 15 PRAGER JURISTISCHE ZEITSCHRIFT 797, 802 (the German prohibition of intermarriage between Aryans and Non-Aryans believed repugnant to Czechoslovakian public policy); W. van Hille, *La loi allemande défendant les mariages entre aryens et juifs peut-elle être appliquée en Belgique*, LA BELGIQUE JUDICIAIRE, Jan. 1, 1936, col. 29; and see extensive references in (1936) 34 BULLETIN DE L'INSTITUT JURIDIQUE INTERNATIONAL 32, 220, regarding Holland, Belgium, Hungary, Dutch East Indies. The situation in Holland, for instance, is complicated by the fact that Holland is bound to Germany by the Hague convention of 1902 concerning entrance into marriage, which limits the scope of the public policy exception. For general description of these statutes see *The "Non-Aryan" in German Law* (1936) 181 L. T. 152, 173.

Mention should first be made of a restriction which is often said to exist, but which is apparently not observed in the majority of cases. It has become usual to distinguish between two possible applications of the public policy doctrine. If, in a particular case, it is employed to nullify a foreign law which is relied upon as a basis for recovery, its application results in prohibiting a recovery which would otherwise be granted. If, on the other hand, the law in question is relied upon as a defense, as in the instant case, the application of the doctrine results in permitting a recovery otherwise unobtainable.²³ This distinction between the prohibitive and permissive aspects of the doctrine is of little significance so far as continental rules as to the conflict of laws are concerned, provided that the other prerequisites of the public policy principle are fulfilled.²⁴ But in regard to the American system of the conflict of laws, Professor Lorenzen has stated that as a general rule, the doctrine is applied in this country only to prohibit and not to permit recovery.²⁵ And this view finds further support in the wording of Section 612 of the Conflict of Laws Restatement, which merely provides that "No action can be maintained upon a cause of action created in another state the enforcement of which is contrary to the strong public policy of the forum,"²⁶ thus apparently excluding by implication the possibility of employing the doctrine in its permissive aspect. The actual trend of the decisions, however, seems to move in the opposite direction, affirmative relief being granted in a large number of cases in which it would have been denied had the law ordinarily controlling not been considered repugnant to the public policy of the forum.²⁷ In most of these cases, the local

23. Obviously, in the majority of cases the public policy doctrine operates in a prohibitive manner. The other alternative is, however, by no means negligible. But its infrequent occurrence explains why the distinction referred to has come to be used only comparatively recently. See LEWALD, *DAS DEUTSCHE INTERNATIONALE PRIVATRECHT* (1931) 36.

24. See LEWALD, *loc. cit. supra* note 23. But see MELCHIOR, *DIE GRUNDLAGEN DES DEUTSCHEN INTERNATIONALEN PRIVATRECHTS* (1932) 334, 341.

25. Lorenzen, *Territoriality, Public Policy and the Conflict of Laws* (1924) 33 YALE L. J. 736, 747.

26. RESTATEMENT, *CONFLICT OF LAWS* (1934) § 612.

27. *Railroad Co. v. Lockwood*, 17 Wall. 357 (U. S. 1873); *The Kensington*, 183 U. S. 263 (1902); *Northern Pacific Ry. Co. v. Kempton*, 138 Fed. 992 (C. C. A. 9th, 1905); *Oceanic Steam Navigation Co. v. Corcoran*, 9 F. (2d) 724 (C. C. A. 2d, 1925); *Hathaway v. The Brantford City*, 29 Fed. 373, 396 (S. D. N. Y. 1886); *Monroe v. The Iowa*, 50 Fed. 561 (D. Mass. 1892); *Lewisohn v. National Steamship Co.*, 56 Fed. 602 (E. D. N. Y. 1893); *The Hugo*, 57 Fed. 403 (S. D. N. Y. 1893); *The Guildhall*, 58 Fed. 796 (S. D. N. Y. 1893); *The Glenmavis*, 69 Fed. 472 (E. D. Pa. 1895); *Vandalia Rr. Co. v. Kelley*, 187 Ind. 323, 119 N. E. 257 (1918); *Hagenbeck and Great Wallace Show Co. v. Randall*, 75 Ind. App. 417, 126 N. E. 501 (1920); *Chicago, B. & Q. Rr. Co. v. Gardner*, 51 Neb. 70, 70 N. W. 508 (1897); *Meacham v. Jamestown Rr. Co.*, 211 N. Y. 346, 105 N. E. 653 (1914); *James & Co. v. Second Russian Insurance Co.*, 239 N. Y. 248, 146 N. E. 369 (1925); *Petrogradsky M. K. Bank v. National City Bank*, 253 N. Y. 23, 170 N. E. 479 (1930); *Strauss v. Canadian Pacific Ry. Co.*, 254 N. Y. 407, 173 N. E. 564 (1930), noted in (1931) 31 COL. L. REV. 495; *The Vladikavkazsky Railway Co. v. The New York Trust Co.*, 263 N. Y. 369, 189 N. E. 456 (1934); *Fox v. Postal Telegraph Cable Co.*, 138 Wis. 648, 120 N. W. 399 (1909); see *Joint Stock Co. v. National City Bank*, 240 N. Y. 368, 377, 148 N. E. 552, 555 (1925); 1 WHARTON, *CONFLICT OF LAWS* (1905) §§ 127, 150, 150 a,

public policy operated to bar a defense which would have been available under foreign law, thereby sustaining the plaintiff's action. In view of this line of authorities, it may be stated as a general rule that whenever a stringent public policy of the forum requires, not only foreign laws sustaining, but also foreign laws denying recovery may be disregarded. Under this rule, there should be no hesitation in the instant case to strike out the defense based on the German statute as contravening public policy merely because in so doing, the court would be giving a permissive rather than a prohibitive effect to the public policy doctrine.

There is another restrictive principle, however, which is more generally operative, a principle which may be described as a rule of relativity, in that the public policy concept is not only given diverse application as between different states and within the same state at different periods, but furthermore it is applied in varying degrees in the same place and at the same time so as to affect a foreign law in one situation and leave it unimpaired in another. The criterion determining whether the local policy is to nullify a foreign law in a particular case is the closeness of the relation between the case and the forum. Just how directly local interests must be affected in order to bring the public policy doctrine into play cannot be precisely defined. Clearly the mere fact that a case is pending before a court does not suffice, for the doctrine is not to be used by the judges of one country as a convenient vehicle for pronouncing their condemnation of legislative policies adopted elsewhere. But what additional points of contact between the particular case and the forum must be shown lies in the sound discretion of the local courts to determine as each case arises.

This principle of relativity is firmly established in the United States.²⁸ Implicit in many of the older cases,²⁹ it has been expressly referred to in a series of recent decisions.³⁰ It has even been indicated that a refusal to apply

150 c, 154, 162; RESTATEMENT, CONFLICT OF LAWS, N. Y. ANNOT. (1934) § 612, p. 386; Comment (1926) 35 YALE L. J. 997, 1001 et seq. *Contra*: Forepaugh v. Railroad Co., 128 Pa. 217, 18 Atl. 503 (1889) (one judge dissenting).

28. *Strauss & Co. v. Canadian Pacific Rr. Co.*, 254 N. Y. 407, 173 N. E. 564 (1930); see RESTATEMENT, CONFLICT OF LAWS, N. Y. ANNOT. (1934) p. 388; Comment (1933) 33 COL. L. REV. 750, 751.

29. See, e. g., *The Kensington*, 94 Fed. 885 (C. C. A. 2d, 1899), rev'd on other grounds, 183 U. S. 263 (1902), where the local policy could operate since the connection with the forum was sufficiently close.

30. Thus, in *Citizens National Bank v. Waugh*, 78 F. (2d) 325 (C. C. A. 4th, 1935), it was said at 327 that the courts may not refuse on grounds of public policy to enforce a contract which is valid under the law of the state where it was made if "the interests of the forum have but slight connection with the substance of the contract obligation." And in *The Fri*, 154 Fed. 333, 338 (C. C. A. 2d, 1907), the court refused to consider a contract which was valid where made, and which was not to be performed within the forum in any possible way, as "concerning particularly the public policy of the United States." Similar pronouncements are to be found in other recent cases. See, e. g., *Hartford Acc. & Ind. Co. v. Delta & Pine Land Co.*, 292 U. S. 143, 150 (1934); *Bradford Electric Light Co. v. Clapper*, 286 U. S. 145, 160 (1932); *Dougherty v. Equitable Life Assurance Society of the U. S.*, 266 N. Y. 71, 90, 193 N. E. 897, 903 (1934). See also *Kosters*,

foreign rules of law because of local policy when sufficient points of contact between the case and the forum are lacking could be considered a denial of due process of law.³¹ Moreover, the requirement that there be a close connection between the case and the forum may be applied more strictly whenever it is attempted to give the public policy principle a permissive rather than a prohibitory effect.³²

In light of these considerations, a refusal to apply the public policy doctrine so as to invalidate the defense raised in the instant case would seem proper. All the important operative elements in the case appear to be connected with Germany rather than the United States. Thus, the contract was entered into and was to be performed there; all interested parties were German citizens and domiciled in Germany when the agreement was made; and the alleged breach occurred in that country. The only incidents tending to connect the case with the New York forum are the fact that the plaintiff transferred his residence to that state and commenced suit by attaching property within the court's jurisdiction. These facts hardly seem of sufficient importance to justify the application of the public policy doctrine. Accordingly, even if it be granted that the German Non-Aryan legislation as a whole, as well as the particular act here in question, contravene fundamental principles of American public policy, and if it be further conceded that this affords a sufficient basis for permitting, as well as for denying relief, local interests do not appear to be so directly concerned as to require that the courts deny extraterritorial effect to the German law involved.

Sigmund Sichel†

THE RIGHT OF A PARENT CORPORATION TO PROVE A CLAIM IN THE BANKRUPTCY OF ITS SUBSIDIARY

THE courts have been extremely inarticulate in disposing of the legal problems which are raised when a parent corporation attempts to prove a claim as a creditor in the bankruptcy or receivership of its subsidiary,¹ and most judicial

Public Policy in Private International Law (1920) 29 YALE L. J. 745, 757, 758; Comment (1923) 32 YALE L. J. 471, 473.

31. See *Home Insurance Co. v. Dick*, 281 U. S. 397, 408 (1930); *Hartford Acc. & Ind. Co. v. Delta & Pine Land Co.*, 292 U. S. 143, 150 (1934); Note (1931) 31 COL. L. REV. 495, 496, 497.

32. See MELCHIOR, *op. cit. supra* note 24, at 335, 341. Cf., however, decision of Collins, J., referred to *supra* note 3.

†Research Assistant, Harvard Research in International Law.

1. Similar problems are presented where the sole stockholder in a "one-man corporation" attempts to prove a claim under similar circumstances, and while the discussion herein will relate to parent and subsidiary corporations, for the most part it will be equally applicable to the case of the "one-man corporation." See Comment (1932) 45 HARV. L. REV. 1084; Comment (1925) 13 CALIF. L. REV. 235. But see *Vennerbeck & Case Co. v. Juergens Jewelry Co.*, 53 R. I. 135, 139, 140, 164 Atl. 509, 511 (1933). For a recent discussion of the problems, see LATTY, *SUBSIDIARIES AND AFFILIATED CORPORATIONS* (1936) 142-155.

explanations in this field have simply restated results. In language similar to that used in the cases where a creditor of the subsidiary corporation seeks to hold the parent liable on his claim, the courts say that where the subsidiary is a mere "instrumentality," "adjunct," "agent," or "alter ego" of the parent, the corporate entity of the subsidiary will be disregarded, and the parent's claim disallowed on the ground that a debtor cannot prove a claim in his own bankruptcy.²

Although the language of the courts is of little assistance in formulating general propositions, the actual facts of the cases suggest lines of analysis by which it may be possible to reach desirable results in many circumstances without such frequent resort to unenlightening verbiage. As a device to simplify exposition, assume that the Jones Oil Corporation, engaged in the production of oil, causes the Jones Oil Sales Corporation to be formed as a medium through which to market its oil products. The Oil Corporation owns the entire capital stock of the Sales Corporation, the boards of directors are composed of the same individuals, and many of the officers of the Oil Corporation are also officers of the Sales Corporation. In the course of the Sales Corporation's existence it becomes indebted to the Oil Corporation for advances of money by the latter and for the purchase price of oil. Subsequently the Sales Corporation becomes bankrupt, the Oil Corporation files a claim for \$300,000 as the amount owed to it by the Sales Corporation, and contends that it is entitled to participate pro rata with the other creditors in the distribution of the assets of the Sales Corporation.

There appear to be two grounds upon which the Oil Corporation can properly be barred from participation in the distribution. First, the Oil Corporation clearly cannot participate if it does not establish itself as a creditor of the Sales Corporation. Second, it cannot participate if it can justifiably be maintained that the corporations are not separate entities, so that allowing the Oil Corporation to participate would be equivalent to permitting an individual to prove a claim against himself in his own bankruptcy. By varying and adding to the facts of the basic situation assumed, cases readily suggest themselves in which the claim of the Oil Corporation could properly be disallowed on one or both of these grounds.

There are several situations in which the Oil Corporation could be barred

2. Cases illustrating the use of these or similar terms are *In re Kentucky Wagon Mfg. Co.*, 71 F. (2d) 802 (C. C. A. 6th, 1934); *Centmont Corporation v. Marsch*, 68 F. (2d) 460 (C. C. A. 1st, 1933); *New York Trust Co. v. Carpenter*, 250 Fed. 668 (C. C. A. 6th, 1918); *In re Watertown Paper Co.*, 169 Fed. 252 (C. C. A. 2d, 1909); *In re Otsego Waxed Paper Co.*, 28 Am. B. R. (N. S.) 508 (W. D. Mich. 1935); *Pagel, Horton & Co. v. Harmon Paper Co.*, 236 App. Div. 47, 258 N. Y. Supp. 168 (4th Dep't 1932). See also POWELL, *PARENT AND SUBSIDIARY CORPORATIONS* (1931) 4, 89; Douglas and Shanks, *Insulation from Liability through Subsidiary Corporations* (1929) 39 YALE L. J. 193; Comment (1936) 24 CALIF. L. REV. 447; Comment (1933) 46 HARV. L. REV. 823. Similar language is found in cases disallowing the claims of individuals owning all or substantially all the stock of the corporation. *Gordon v. Baton Rouge Stores Co., Inc.*, 168 La. 247, 121 So. 759 (1929); *Samuel Cupples Wooden-Ware Co. v. Illinois Pickling and Mfg. Co.*, 51 La. Ann. 64, 24 So. 604 (1898); cf. *Potts & Co. v. Schmucker*, 84 Md. 535, 36 Atl. 592 (1897); *In re Burntside Lodge*, 7 F. Supp. 785 (D. Minn. 1934) (minority stockholders' claim disallowed).

because it is not a creditor. One such situation is that in which the bankruptcy receiver or trustee of the Sales Corporation is able to show that the advances of money to the Sales Corporation and the purchases of oil by the Sales Corporation were transactions entered into with no intent on either side to create enforceable contractual obligations. On recognized principles of contract law the Oil Corporation is not a creditor and therefore its claim cannot be allowed.³ Again, the court may refuse to treat the Oil Corporation as a creditor if the Sales Corporation was inadequately capitalized at the outset of its existence, even though the two corporations intended to create enforceable contractual obligations. Assume that the Oil Corporation set up the Sales Corporation with an authorized capital stock of one thousand shares of \$100 par value, of which only three shares were actually issued to the Oil Corporation, thus giving the subsidiary a paid-in capital of only \$300. Assume further that the Sales Corporation thereafter incurred the purported indebtedness of \$300,000 for cash advances and oil. Under such a state of facts a few recent cases suggest that the \$300,000, or at least that portion of it necessary to give the Sales Corporation an adequate paid-in capital,⁴ will be regarded as a capital contribution by the Oil Corporation on the ground that it cannot be permitted to start the Sales Corporation in business life with a paid-in capital grossly disproportionate to the amount of capital necessary for the normal operation of such an enterprise.⁵ If the Oil Corporation is a contributor of capital and not a creditor, it cannot compete with the legitimate creditors of the Sales Corporation for that portion of its claim necessary to give the Sales Corporation a proper capital structure. Finally, the Oil Corporation may be denied recognition as a creditor and hence excluded from participation in the Sales Corporation's bankruptcy on the ground that it is estopped from asserting that it is a creditor. Assume that the Oil Corporation advances money to the Sales Corporation, both corporations intending to create an enforceable contractual

3. *New York Trust Co. v. Island Oil and Transport Corp.*, 34 F. (2d) 655 (C. C. A. 2d, 1929) (presenting the converse situation where the parent was the bankrupt); *Consolidated American Royalty Corp. v. Taliaferro*, 78 F. (2d) 802 (C. C. A. 10th, 1935); cf. *Duffy v. Treide*, 75 F. (2d) 17 (C. C. A. 4th, 1935); *Gay v. Hudson Electric Power Co.*, 187 Fed. 12 (C. C. A. 2d, 1911); *Samuel Cupples Wooden-Ware Co. v. Illinois Pickling and Mfg. Co.*, 51 La. Ann. 64, 24 So. 604 (1898).

4. The cases are not clear as to whether the entire claim would be disallowed or only that portion necessary to constitute an adequate paid-in capital. The latter would seem to be the more reasonable result, but its consequence is to place on the courts the burden of deciding the difficult question as to what constitutes an adequate paid-in capital.

5. *Albert Richards Co. v. The Mayfair*, 287 Mass. 280, 191 N. E. 430 (1934) (the same individual was treasurer, a director, and the holder of all but one share of the stock of a corporation; he was denied standing as a creditor, his "loans" being considered "capital contributions"); *Luckenbach S. S. Co. v. W. R. Grace Co.*, 267 Fed. 676 (C. C. A. 4th, 1920) (one individual owned over 90% of the stock of two corporations); see *In re Rickshaw*, 12 F. Supp. 424, 426 (D. Mass. 1935); *S. G. V. Co. of Del. v. S. G. V. Co. of Pa.*, 264 Pa. 265, 269, 107 Atl. 721, 722 (1919); cf. *Revere Copper and Brass, Inc. v. Adriance Machine Works*, 76 F. (2d) 876 (C. C. A. 2d, 1935); *Finn v. George T. Mickle Lumber Co.*, 41 F. (2d) 676 (C. C. A. 9th, 1930); *In re Mill Run Lumber Co.*, 4 F. Supp. 807 (W. D. Pa. 1933). But see *Vennerbeck and Clase Co. v. Juergens Jewelry Co.*, 53 R. I. 135, 139, 140, 164 Atl. 509, 511 (1933).

obligation. Assume further that the Oil Corporation induces certain individuals to extend credit to the Sales Corporation by representing that the advance was not a loan and that the Sales Corporation is under no obligation to repay it. Under these conditions, the Oil Corporation will not be heard to say that it is a creditor, and will be excluded from participation at the instance of the class of creditors who have been misled.⁶

But even if the Oil Corporation can establish itself as a creditor of the Sales Corporation, it may nevertheless be excluded if it can properly be said that the corporations are not separate entities so that the Oil Corporation is in a position analogous to that of an individual attempting to prove a claim against himself in his own bankruptcy. One situation to which this rule may be applied is that in which there has been some defect in the process of incorporating the Sales Corporation so that it does not possess even a *de facto* existence. Stockholders of a defectively organized corporation which is said to lack even a *de facto* existence are ordinarily held liable to its creditors as if they were partners or joint adventurers in the enterprise.⁷ An attempt by one of those stockholders to prove a claim in the bankruptcy of the defectively organized corporation might therefore be defeated on the ground that it was an effort by a partner to prove a claim in the bankruptcy of the partnership in competition with partnership creditors—in effect an attempt to prove a claim against himself. The same result should follow in the case of the Oil Corporation. Thus, where the Oil Corporation is the majority stockholder in the defectively organized Sales Corporation, it would have the status of a partner or joint adventurer, or if it were the sole stockholder, it would be in effect an individual proprietor. In either case its claim could properly be disallowed as a claim against itself.

Another situation in which this principle could be applied to bar the Oil Corporation is that in which the Oil Corporation has so completely assimilated the Sales Corporation and its business that the corporate entities may justifiably be disregarded, and the two corporations treated as one unit. Thus, in addition to the facts originally suggested, it may be assumed that the Oil Corporation conducts the marketing enterprise directly as if the Sales Corporation had no existence whatsoever. The Sales Corporation keeps no books of accounts, all selling transactions being entered on the books of the Oil Corporation. One bank account serves both corporations. No meetings are held purporting to be meetings of the board of directors of the Sales Corporation. The officers of the Sales Corporation consult and follow the directions of the Oil Corporation in renting offices, hiring and firing employees, and making all contracts, whether for the sale of oil or otherwise. In other words, the Oil Corporation has taken over the business of the Sales Corporation to such an extent that the affairs of one are indistinguishable from those of the other. Because the parties themselves have chosen to disregard the separate corporate entity of the Sales

6. *E. E. Gray Corp. v. Meehan*, 54 F. (2d) 223 (C. C. A. 1st, 1931).

7. *Beck v. Stimmel*, 39 Ohio App. 510, 177 N. E. 920 (1931); Dodd, *Partnership Liability of Stockholders in Defective Corporations* (1927) 40 HARV. L. REV. 521, and Appendix A thereto in which the cases are collected; Magruder, *A Note on Partnership Liability of Stockholders in Defective Corporations* (1927) 40 HARV. L. REV. 733.

Corporation, the courts may properly do likewise. Accordingly, since the two corporations can be considered as a single corporation, the attempt of the Oil Corporation to prove its claim in the Sales Corporation's bankruptcy places it in a position analogous to that of an individual attempting to prove a claim against himself in his own bankruptcy, and the Oil Corporation's claim can justifiably be disallowed.⁸

In one other situation, the same result may be reached even though both corporations have been correctly organized and the functions, ritual and activities of each have been separately maintained, so that it is impossible to disregard the individual corporate entities without disregarding the corporation law under which they were established. Assume that the Oil Corporation has induced the extension of credit to the Sales Corporation by representations that the assets of the two corporations are singly owned, and that the two corporations are different in name only. So far as the creditors who have relied on such representations are concerned, the Oil Corporation is estopped to deny that the two corporations are in fact one.⁹ It might therefore be barred from

8. Parents' claims were disallowed in the following cases on the basis of assimilation. *In re Kentucky Wagon Co.*, 71 F. (2d) 802 (C. C. A. 6th, 1934); *Centmont Corp. v. Marsch*, 68 F. (2d) 460 (C. C. A. 1st, 1933); *Page v. Arkansas Natural Gas Corp.*, 53 F. (2d) 27 (C. C. A. 8th, 1931) (business trusts); *Edward Finch Co. v. Robie*, 12 F. (2d) 360 (C. C. A. 8th, 1926) (corporation's claim in bankruptcy of majority stockholder disallowed); *Clere Clothing Co. v. Union Trust & Savings Bank*, 224 Fed. 363 (C. C. A. 9th, 1915); *In re Muncie Pulp Co.*, 139 Fed. 546 (C. C. A. 2d, 1905). Similarly where an individual owns all or substantially all the stock of a corporation, his claim has been disallowed on the ground that his business and that of the corporation were indistinguishable. *Gordon v. Baton Rouge Stores Co.*, 168 La. 247, 121 So. 759 (1929); *Samuel Cupples Wooden-Ware Co. v. Illinois Pickling and Mfg. Co.*, 51 La. Ann. 64, 24 So. 604 (1893); cf. *In the Matter of Burntside Lodge*, 7 F. Supp. 785 (D. Minn. 1934) (minority stockholders' claim disallowed); *Potts & Co. v. Schmucker*, 84 Md. 535, 36 Atl. 592 (1897). But where there is sufficient separation, the claim of a parent corporation or that of a sole or majority stockholder has been allowed. *Duffy v. Treide*, 78 F. (2d) 17 (C. C. A. 4th, 1935); *Wheeler v. Smith*, 30 F. (2d) 59 (C. C. A. 9th, 1929); cf. *Pagel, Horton & Co. v. Harmon Paper Co.*, 236 App. Div. 47, 258 N. Y. Supp. 168 (4th Dep't, 1932). In many cases the courts hold that the assimilation is sufficient to permit the administration of the assets of a parent and its subsidiary in a single bankruptcy or receivership. *Trustee System Co. v. Payne*, 65 F. (2d) 103 (C. C. A. 3d, 1933); *Central Republic Bank & Trust Co. v. Caldwell*, 58 F. (2d) 721 (C. C. A. 8th, 1932); *In re Muncie Pulp Co.*, 139 Fed. 546 (C. C. A. 2d, 1905); *In re Rieger, Kapner & Altmark*, 157 Fed. 609 (S. D. Ohio 1907); cf. *Commerce Trust Co. v. Woodbury*, 77 F. (2d) 478 (C. C. A. 8th, 1935), noted in (1936) 3 U. OF CHI. L. REV. 330, (1936) 45 YALE L. J. 717; *First Nat. Bank of Seattle v. Walton*, 146 Wash. 367, 262 Pac. 984 (1928); *Comment* (1933) 46 HARV. L. REV. 823, 827.

The fact that the legal title to certain assets may be in the Sales Corporation would be no impediment to regarding such assets as singly-owned, for the title of the Sales Corporation may be treated as merely a naked legal title without any beneficial interest, a title frequently termed that of a "straw man." Cf. *Metropolitan Holding Co. v. Snyder*, 79 F. (2d) 263 (C. C. A. 8th, 1935); *Alliance Trust Co. v. Streater*, 182 La. 102, 161 So. 168 (1935); *Phillips v. McIlrath*, 237 N. W. 212 (Iowa, 1931).

9. *Stark Electric Rr. Co. v. McGinty Contracting Co.*, 238 Fed. 657 (C. C. A. 6th, 1917); cf. *Platt v. Bradner Co.*, 131 Wash. 573, 230 Pac. 633 (1924).

competing with that class of creditors in the bankruptcy of the Sales Corporation, since they can maintain that it is attempting to prove a claim against itself.

Aside from the two grounds just considered, another basis upon which the Oil Corporation's claim might be disallowed has been suggested by some courts. In substance, it is that the Oil Corporation should be excluded if it is competing with creditors of the Sales Corporation whose claim against the Sales Corporation is also enforceable against the Oil Corporation.¹⁰ For two reasons, however, this theory is of doubtful utility as a ground for excluding the Oil Corporation. In the first place, aside from the cases already considered in which the two corporations can justifiably be treated as one, the situations where creditors can logically be said to have a claim enforceable against both the Sales Corporation and the Oil Corporation are not very numerous; and secondly, even though there are some factual situations where the Sales Corporation's creditors might have such a claim, it is difficult to find any logical basis for the theory itself.

Assume that the Oil Corporation and the Sales Corporation carefully observe the ritual and reality of separate existence. The boards of directors of each hold separate meetings; each corporation keeps separate books and bank accounts; the Sales Corporation rents its offices and employs its clerical force entirely independent of the supervision of the Oil Corporation. Nor is there any representation to third persons that the two corporations are one unit. But secondly, assume that in the conduct of the business of the Sales Corporation, its primary function of selling oil is entirely controlled and supervised by the Oil Corporation. For example, the Oil Corporation directs the hiring and firing of all the oil salesmen of the Sales Corporation and all contracts for the sale of oil are subject to the Oil Corporation's supervision. Under such facts it is very probable that many courts would hold both corporations liable to a creditor whose claim arose in connection with a sale of oil, even though the facts do not disclose the complete assimilation of the Sales Corporation by the Oil Corporation heretofore considered.¹¹ But this dual liability can be justified only in certain narrowly circumscribed factual situations.

It is possible that a creditor might be said to have a claim enforceable against both corporations because the Sales Corporation is the agent of the Oil Corporation. This result, however, is not inevitable. In the first place, although the courts frequently say that under such conditions the Sales Corporation is an agent of the Oil Corporation, this description is in most cases extremely inaccurate, due to the absence of the consensual relationship necessary for true agency.¹² But conceivably it could be found that the Oil Corporation

10. See *Peckett v. Wood*, 234 Fed. 833, 838 (C. C. A. 3d, 1916); *Hunter v. Baker Motor Vehicle Co.*, 225 Fed. 1006, 1016 (N. D. N. Y. 1915), *aff'd* 238 Fed. 894 (C. C. A. 2d, 1916).

11. *The William Van Driel, Sr.*, 252 Fed. 35 (C. C. A. 4th, 1918); *Dillard & Coffin Co. v. Richmond Cotton Oil Co.*, 140 Tenn. 290, 204 S. W. 758 (1918); *Mangan v. Terminal Transportation System*, 157 Misc. 627, 284 N. Y. Supp. 183 (Sup. Ct. 1935). But cf. *Finn v. George T. Mickle Lumber Co.*, 41 F. (2d) 676 (C. C. A. 9th, 1930); *Martin v. Development Co. of America*, 240 Fed. 42 (C. C. A. 9th, 1917).

12. See *Kingston Dry Dock Co. v. Lake Champlain Transp. Co.*, 31 F. (2d) 265, 267 (C. C. A. 2d, 1929); *Berkey v. Third Avenue Ry. Co.*, 244 N. Y. 84, 94, 155 N. E. 58, 61 (1926); cf. *Majestic Co. v. Orpheum Circuit*, 21 F. (2d) 720 (C. C. A. 8th, 1927).

expressly appointed the Sales Corporation to act as its agent in making sales of oil to third persons, or that the facts present warrant the implication of such an appointment. Assuming, however, that such an agency relationship actually exists, it does not necessarily follow that a person having a claim arising out of a sale of oil would be able to enforce it against both corporations. For example, if the claim were based on contract and the agency were disclosed, accepted rules of agency would make the principal alone liable—in this case the Oil Corporation—and the claim would not be enforceable against the Sales Corporation as agent, unless, of course, it gave its own promise in addition to that of the Oil Corporation, its principal.¹³ Likewise, if a contract claim arose where the agency was undisclosed, the doctrine of election would require that the claimant, upon ascertaining the relationship of principal and agent, elect which of the two corporations to hold liable, and after his election to hold one, his claim would not be enforceable against the other.¹⁴ On the other hand, if the claim sounded in tort, as where a creditor contracted to purchase oil in reliance on false representations by the Sales Corporation, the making of which had been expressly authorized by the Oil Corporation, the doctrine of election might be inapplicable,¹⁵ in which case both the Sales Corporation and the Oil Corporation would be liable in an action of deceit, whether the agency were disclosed or not. In this case, then, and in that where the Sales Corporation gives its own promise in addition to giving that of the Oil Corporation as principal, it can logically be said that a creditor has a claim enforceable against both corporations.

Other lines of analysis, however, would lead to the conclusion that no dual liability whatsoever existed. For example, in the factual situation under discussion, the Oil Corporation and the Sales Corporation might be treated as independent contracting parties.¹⁶ This relationship negatives any dual liability of the two corporations. To illustrate, it might be said that in controlling the sales of oil the Oil Corporation is acting pursuant to a contract with the Sales Corporation whereby the latter has allocated the function of selling oil to the Oil Corporation. If a creditor contracts to buy oil on the basis of false representations made by salesmen directly under the Oil Corporation's control, the

13. See RESTATEMENT, AGENCY (1933) §§ 320, 323; MECHEM, AGENCY (1914) §§ 1406, 1419-1421; cf. *New York Trust Co. v. Island Oil & Transport Corp.*, 56 F. (2d) 580 (C. C. A. 2d, 1932).

14. For the general rule of agency, see *Barrell v. Newby*, 127 Fed. 656 (C. C. A. 7th, 1904); RESTATEMENT, AGENCY (1933) §§ 208-210, 337; MECHEM, *op. cit. supra* note 13, §§ 1750-1762. For an application of the rule to the situation under discussion, see *Portsmouth Cotton Oil Refining Corp. v. Fourth Nat. Bank*, 280 Fed. 879, 881 (M. D. Ala. 1922).

15. See *The Jungshoved*, 272 Fed. 122, 127 (S. D. N. Y. 1921); cf. *Mirabito v. San Francisco Dairy Co.*, 8 Cal. App. (2d) 54, 47 P. (2d) 530 (1935). *Contra*: *Raymond v. Capobianco*, 107 Vt. 295, 178 Atl. 896, 98 A. L. R. 1051 (1935), noted in (1936) 45 YALE L. J. 920; (1936) 36 COL. L. REV. 324.

16. *E. g. Costan v. Manila Electric Co.*, 24 F. (2d) 383 (C. C. A. 2d, 1923); cf. *Erickson v. Minnesota & Ontario Power Co.*, 134 Minn. 209, 158 N. W. 979 (1916); *Joseph R. Foard Co. v. State of Maryland*, 219 Fed. 827 (C. C. A. 4th, 1914).

Oil Corporation will be liable in an action of deceit.¹⁷ At the same time, if the Sales Corporation has no part in the making of the false representations, it will not be liable in a similar action, since it has delegated the function of selling to the Oil Corporation. Likewise, if the creditor sues for damages for breach of contract, and the Oil Corporation had made the contract in its own name, clearly the Sales Corporation cannot be held on the contract. Moreover, even if the Oil Corporation had named the Sales Corporation as the obligor in the contract, it would seem that in view of the independent contractor relationship such a use of the Sales Corporation's name would be unauthorized and the Sales Corporation would not be bound.

But even if the courts would hold both the Oil Corporation and the Sales Corporation liable to a creditor whose claim arose in connection with a sale of oil, despite the weakness of the doctrines purporting to fix such double liability, it is still difficult to see why the fact of this dual liability affords any ground for excluding the Oil Corporation from participating in the bankruptcy of the Sales Corporation. Assume that an individual has one claim against the Sales Corporation arising out of some transaction entirely apart from the selling of oil, such as the sale of office supplies to the Sales Corporation, and a separate and independent claim against the Oil Corporation arising out of a loan to the latter corporation. There appears no reason why the Oil Corporation should be excluded from competing with that individual in the Sales Corporation's bankruptcy. And there seems to be even less reason for preventing the Oil Corporation from competing with a creditor who has a single claim enforceable against both corporations, since such a creditor could recover against the Oil Corporation for any deficiency in his recovery in the Sales Corporation's bankruptcy.

In conclusion, it would seem that once the parent corporation is able to establish itself as a creditor of the subsidiary, it should always be able to prove its claim no matter who the creditors are with whom it will compete, so long as there has been no complete assimilation of the subsidiary's corporate entity or business by the parent nor any other basis upon which it can be said that the parent is proving a claim against itself. Of course, in the actual cases, the facts are not so clearly defined as in the hypothetical cases assumed. Moreover, it is not to be expected that a strictly logical system will be followed out in the face of strong psychological factors. For example, if the parent had at one time been liable as undisclosed principal to a creditor of the subsidiary, but due to the harsh doctrine of election that liability had been extinguished when the creditor chose to file his claim in the bankruptcy of the subsidiary, a court might be reluctant to allow the parent to compete with the creditor in the subsidiary's bankruptcy, even though the doctrine of election would bar the recovery of any deficiency against the parent only where the creditor chose to hold the subsidiary knowing of the agency relationship. Nevertheless, if in the trial of a case a record is built up which indicates with considerable clarity the relationship between the parent and the subsidiary,

17. Cf. *Joseph R. Foard Co. v. State of Maryland*, 219 Fed. 827 (C. C. A. 4th, 1914); *Ross v. Pennsylvania Rr. Co.*, 106 N. J. L. 536, 148 Atl. 741 (1930); *Mitchell v. Lea Lumber Co.*, 43 Wash. 195, 86 Pac. 405 (1906).

in many instances the court will be able to make a proper disposition of the case without resort to the unsatisfactory verbiage which has often characterized the decisions in this field.

FEDERAL JURISDICTION IN CASES INVOLVING COUNTER-CLAIMS

WHEN the jurisdiction of a federal court is invoked in cases involving counterclaims,¹ conflicting considerations of policy lead to confusion. On the one hand, the modern tendency to allow almost all claims between the parties to be litigated in the same suit, subject only to the limitations of trial convenience,² and the element of justice in providing security to each party for his claim against the other, at least in cases where both claims are for money,³ both suggest an expansive view of jurisdiction. On the other hand, a policy of deference to the power of the state courts, begotten of federalism, indicates that the federal courts should not assume any jurisdiction in excess of that clearly granted by the Judicial Code under proper constitutional authority.

In general, there are two important types of cases to which the jurisdiction of the federal courts may attach, viz., those in which the parties are citizens of different states and those involving determination of a claim arising under the Constitution or laws of the United States. In both types of cases the Judicial Code provides that the matter in controversy must exceed the sum or value of \$3,000, exclusive of interest and costs.⁴ There is no difficulty, of course, as to the jurisdiction of the federal courts when both the original claim and the counterclaim satisfy these requisites of federal jurisdiction. Trouble of this sort appears only when either the original claim or the counterclaim alone satisfies the requisites of federal jurisdiction.

The problem is then presented whether the fact that the federal courts have jurisdiction over one claim is sufficient reason for them to assume jurisdiction also over another claim which could not be litigated independently in the federal courts, but which could properly be tried along with the first claim if no question of federal jurisdiction were involved. Constitutionally the problem would seem to be whether the two claims constituted a single case or controversy, for the relevant provisions are that "The judicial Power shall

1. As here used, "counterclaim" refers to a claim by the defendant against the plaintiff which is affirmative in nature and could be the subject of an independent suit even after the adjudication of the plaintiff's claim, unless some other meaning is expressly indicated.

2. See CLARK, CODE PLEADING (1928) 455.

3. This consideration is pointed out in Shulman and Jaegerman, *Some Jurisdictional Limitations on Federal Procedure* (1936) 45 YALE L. J. 393, 410, at 415.

4. This jurisdiction may be invoked either originally or by removal of a case brought originally in the state courts. 36 STAT. 1091 (1911), 28 U. S. C. A. § 41 (1926), defines the original jurisdiction, setting forth these requisites. 36 STAT. 1094 (1911), 28 U. S. C. A. § 71 (1926), defines the jurisdiction on removal, which is limited to suits of which the district courts are given original jurisdiction.

extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their authority; . . . to Controversies . . . between Citizens of different States . . ."⁵ The Judicial Code makes no attempt to define the scope of a case or controversy, conferring jurisdiction over "suits of a civil nature, at common law or in equity."⁶ But as might have been expected, it has become established that where jurisdiction is acquired over a claim, it attaches also to all matters ancillary and incidental to that claim, by necessary implication.⁷ From this proposition has been developed the doctrine that jurisdiction over the original claim embraces power to determine any counterclaim involving the same subject matter as the original claim and dependent upon it, so that it relates to substantially the same controversy and its disposition is necessary to afford complete relief to the parties.⁸ It is implicit that there is no jurisdiction over independent counterclaims which do not themselves satisfy the requisites of federal jurisdiction.⁹

These tests are indefinite at best, and give little indication of how borderline cases will be decided. A little more certainty is perhaps to be derived in the case of equitable counterclaims from the distinction drawn by Equity

5. U. S. CONST., Art. III, § 2. Ordinarily the problem will arise only under the first of these provisions, where jurisdiction is invoked because of a federal question. In the diversity of citizenship controversies a constitutional issue will seldom arise, since if the diversity requirement is met in one claim, it will ordinarily be satisfied in the other as well, where no additional parties are involved.

6. 36 STAT. 1091 (1911), 28 U. S. C. A. § 41 (1926). In the cases where the requisite in question is the amount in controversy, no constitutional issue is involved. But since this requisite is treated in the Judicial Code as coordinate with the federal question and diversity requirements, it is unlikely that it will receive different treatment from the courts. And Congress probably did not mean anything different by "suit" than the Constitution does by "case" or "controversy."

7. See DOBIE, *FEDERAL PROCEDURE* (1928) § 84.

8. *Cleveland Engineering Co. v. Galion Dynamic Motor Truck Co.*, 243 Fed. 405 (N. D. Ohio, 1917); *Badger v. E. B. Badger & Sons Co.*, 288 Fed. 419 (D. Mass. 1923); *Mathis v. Ligon*, 39 F. (2d) 455 (C. C. A. 10th, 1930), cert. denied, 282 U. S. 846 (1930); cf. *Morgan's Louisiana and Texas Rr. & S. S. Co. v. Texas Central Ry. Co.*, 137 U. S. 171 (1890); *Ames Realty Co. v. Big Indian Mining Co.*, 146 Fed. 166 (C. C. D. Mont. 1906), approved in *Rickey Land & Cattle Co. v. Miller & Lux*, 218 U. S. 258, 263 (1910); *United States v. Mackey*, 214 Fed. 137, 153 (E. D. Okla. 1913).

It is an interesting fact, but is not thought to be significant, that the jurisdictional amount is not brought into question in any of the cases discussing the interdependence of the claim and counterclaim. No reason appears, however, why lack of the requisite jurisdictional amount would not be as fatal to an independent counterclaim as would the absence of a federal question or diversity of citizenship, since the requirements are treated as coordinate in the Judicial Code. It is true that there are different considerations at the basis of each requirement, but it is felt that a uniform treatment will be the more satisfactory method of handling the problem.

9. And there are a few express holdings to that effect. *Electric Boat Co. v. Lake Torpedo Boat Co.*, 215 Fed. 377 (D. N. J. 1914); *United States Expansion Bolt Co. v. H. G. Kroncke Hardware Co.*, 234 Fed. 868 (C. C. A. 7th, 1916); *Badger v. E. B. Badger & Sons Co.*, 288 Fed. 419 (D. Mass. 1923); and cases cited *infra* note 13.

Rule 30, which provides that the defendant must plead his claims against the plaintiff which arise "out of the transaction which is the subject matter of the suit" and that he may plead any claim which might be the subject of an independent suit in equity.¹⁰ Although the Supreme Court has not passed on the question,¹¹ it seems to be established that the classification of counterclaims made in Equity Rule 30 affords the proper criterion for determining whether the counterclaim is closely enough related to the original claim to be carried along with it regardless of failure to satisfy independently the federal requisites. Thus, the first type of counterclaim, which must be filed or lost, is held to be available in the federal courts if the original claim satisfies the requisites of federal jurisdiction;¹² the second type, which the defendant may plead or not at his option, must itself satisfy those requisites in order to be available.¹³ But where legal counterclaims are involved, authority is lacking. Under the present provisions of the Judicial Code, state law is determinative of the federal procedure. It is clear, however, that the fact that state law provides that a given type of counterclaim may be pleaded cannot operate to give the federal courts jurisdiction over the counterclaim unless that jurisdiction is embraced within the constitutional grant of the federal judicial power.¹⁴ Accordingly, it becomes apparent that state procedure might require a defendant, upon pain of losing a counterclaim, to file it even though it is not closely enough connected with the original claim to warrant a federal court in assuming jurisdiction over it as ancillary to its jurisdiction over the original claim. Thus, it would seem that the defendant would necessarily be deprived of his claim if the plaintiff brought suit in the federal court, unless it should be held that the statute could not be applied

10. 268 U. S. 710 (1925), 28 U. S. C. A. § 723 (1926).

11. See *Moore v. New York Cotton Exchange*, 270 U. S. 593, 607 (1926), at p. 609: "... we need not consider the point that, under the second branch [of Equity Rule 30], Federal jurisdiction independent of the original bill must appear. . . ."

12. *Moore v. New York Cotton Exchange*, 270 U. S. 593, 607 (1926); *Kaumagraph Co. v. General Trade Mark Corp.*, 12 F. Supp. 230 (S. D. N. Y. 1935).

13. *Electric Boat Co. v. Lake Torpedo Boat Co.*, 215 Fed. 377 (D. N. J. 1914); *Noma Electric Corp. v. Rainbow Electric Mfg. Corp.*, 12 F. Supp. 229 (S. D. N. Y. 1928); *Frankhart, Inc. v. Metal Lamp Corp.*, 32 F. (2d) 920 (E. D. N. Y. 1929); *McCabe & Schoenholz, Inc. v. Frank J. Quigan, Inc.*, 36 F. (2d) 1000 (E. D. N. Y. 1929); *Tennessee Products Corp. v. Warner*, 39 F. (2d) 200 (M. D. Tenn. 1929); *Universal Radiator Products Co., Inc. v. Craftsman Radiator Enclosure Co., Inc.*, 2 F. Supp. 205 (E. D. N. Y. 1933).

It is not suggested that even this criterion makes prediction safe. For, although the only recurring type of case in which the problem arises is that of a claim for infringement of patent and a counterclaim for unfair competition, the decisions conflict despite the fact that they agree on the criterion. For an inquiry into the distinction between the two types of counterclaims see Shulman and Jaegerman, *supra* note 3, at 411 et seq.

14. R. S. § 914 (1875), 28 U. S. C. A. § 724 (1926). But the rule seems to be that non-federal issues can be settled in the federal courts, despite broader state rules, only when they can be considered "non-federal grounds" of a single cause of action, supported also by a proper federal ground. Cf. *Hurn v. Oursler*, 289 U. S. 238 (1933), discussed in Shulman and Jaegermann, *supra* note 3, at 398-400, 412; note (1936) 45 YALE L. J. 1287.

to such a situation on the ground that so to apply it would interfere with the control of the federal courts over the effect of their judgments or would contravene the Fourteenth Amendment in depriving the defendant of all opportunity to have his claim litigated. But it is unlikely that this theoretical difficulty will ever materialize, for the code requirements that a counterclaim must be set up or lost apparently apply only to counterclaims "upon a cause arising out of the transaction set forth in the complaint as the foundation of the plaintiff's claim,"¹⁵ and these would seem to be closely enough related to be considered a part of the same case or controversy for the purpose of federal jurisdiction. Furthermore, the conclusion seems reasonable that counterclaims available under the typical code provision as "arising out of the contract or transaction set forth in the complaint as the foundation of the plaintiff's claim, or connected with the subject of the action"¹⁶ should be treated in the same way as those falling under the first branch of Equity Rule 30 for purposes of federal jurisdiction, whereas those available solely under the other frequent provision in an action arising upon contract because themselves arising upon contract,¹⁷ should be adjudicated in the federal courts only if the counterclaim itself satisfies the requisites of federal jurisdiction.

The difficulties arising from the variety of provisions applicable to legal counterclaims under the Conformity Act will no doubt be eliminated when the Supreme Court promulgates uniform rules of procedure for the federal courts. It is interesting to note that the first preliminary draft submitted to the Supreme Court by the Advisory Committee recommends the adoption in substance of Equity Rule 30, as interpreted, for the rule governing both legal and equitable counterclaims. If this recommendation is approved, it seems likely that the desirable result will be achieved that the criterion for determining whether jurisdiction over the plaintiff's claim will carry with it jurisdiction over the counterclaim will be identical with that determining whether the counterclaim must be pleaded, viz., whether the counterclaim "arises out of the transaction which is the subject matter of the plaintiff's claim."¹⁸

15. CLARK, CODE PLEADING, (1928) 446. 16. *Id.* at 444.

17. *Ibid.*

18. Rules of Civil Procedure for the District Courts of the United States and the Supreme Court of the District of Columbia (Preliminary Draft of Advisory Committee, 1936) Rule 18: "The answer must state as a counterclaim any claim which the defendant has at the time against a plaintiff, which arises out of the transaction which is the subject matter of the action, provided the court has jurisdiction to entertain the claim and can, if the presence of third parties is essential for its adjudication, acquire jurisdiction of such parties. If the action proceeds to judgment without such a claim being set up, the claim shall be barred.

"The answer may also state as a counterclaim any claim against a plaintiff which might be the subject of an independent action, provided likewise that the court has jurisdiction to entertain the claim and can, if the presence of third parties is essential for its adjudication, acquire jurisdiction of such parties.

"A counterclaim need not defeat or diminish the recovery sought by the plaintiff."

There is still the possibility under the proposed rules, however, for some confusion arising out of applying state laws in suits removed from the state courts, for Rule 90 (d) provides, "These rules shall apply to civil actions removed to the district courts of

An even more complicated problem is posed when the original claim does not satisfy the requisites of federal jurisdiction, but the counterclaim fulfills all those requirements. Here the question would seem to be whether the counterclaim can be considered the principal suit and the original claim regarded as ancillary to it. The cases do not discuss the interdependence of the original claim and the counterclaim in these cases, perhaps because the necessary relationship has been assumed to exist. It seems clear, at any rate, that a sufficiently close connection between the two must be established so that they can be considered to constitute a single case or controversy in order for a federal court to assume jurisdiction over the whole case in such a situation.¹⁴ If this condition is concededly met, the question remains whether the jurisdiction of the federal courts can properly be invoked on the basis of a counterclaim alone. The cases on the point discuss only whether the amount involved in the counterclaim may be considered in determining the amount in controversy, but the same principles should be decisive in regard to the other requisites of federal jurisdiction.¹⁹ The problem may arise either when the suit is brought originally in the federal court or when the federal jurisdiction is invoked on removal from the state courts.

In the first type of situation, the requisites of federal jurisdiction are not met until the counterclaim is filed and the suit would therefore be dismissed if that fact were brought to the court's attention before that time. Consequently, the question is resolved into whether the defendant, by filing his counterclaim, has cured the defect and thereby waived his right to a dismissal. Since the counterclaim fulfills the jurisdictional requirements, the defect can be regarded as procedural in nature and not going to the subject matter. It could, therefore, be held to be waived unless the defendant made his objection seasonably.²⁰ If the claims are not closely enough related to be considered as grounds of the same cause of action, so as to warrant assumption of jurisdiction over the plaintiff's non-federal claim when the defendant's claim satisfies the jurisdictional requisites, it seems more orderly to dismiss the whole case rather than to retain jurisdiction over the defendant's claim.²¹

When the suit is brought originally in a state court and the jurisdictional

the United States from the state courts, and shall govern all procedure after removal, and a repleading shall not be ordered unless the court deems it advisable." It would be unfortunate if this rule should result in applying the state rule as to counterclaims in a situation where its criterion for determining what counterclaims must be pleaded does not jibe with that determining whether the counterclaim may be regarded as ancillary to the plaintiff's claim.

19. Cf. notes 6 and 8, *supra*, and note 22, *infra*.

20. *Ginsburg v. Pacific Mut. Life Ins. Co.*, 69 F. (2d) 97 (C. C. A. 2d, 1934), rev'g 5 F. Supp. 296 (S. D. N. Y. 1933); cf. *O. J. Lewis Mercantile Co. v. Klepner*, 176 Fed. 343 (C. C. A. 2d, 1910), cert. denied, 216 U. S. 620 (1910). But cf. *American Sheet & Tin Plate Co. v. Winzeler*, 227 Fed. 321 (N. D. Ohio, 1915) (holding that defendant may defeat jurisdiction by a voluntary dismissal of his counterclaim when it appears that the plaintiff's claim was insufficient to confer jurisdiction).

21. See discussion, *infra* p. 1487, of the same problem in cases in which the jurisdiction of the federal court is invoked upon removal from a state court.

question is raised by a petition to remove or a motion to remand, the problem of whether the defendant's claim can be the basis of federal jurisdiction is squarely presented. Since, in cases involving a single claim, the rules have been developed that only the allegations of the complaint can be considered in determining whether a federal question is involved and that the amount in controversy is to be reckoned by computing the value to the plaintiff of establishing the right which he asserts in his complaint, the theory has been advanced that the federal jurisdiction attaches only to those cases in which the requisites of federal jurisdiction are satisfied from the point of view of the plaintiff. This "plaintiff-viewpoint theory" is then invoked as compelling the holding that a counterclaim cannot be considered in determining whether the requisites of federal jurisdiction are satisfied.²² But even if this theory is sound, it seems that it does not necessarily dictate the conclusion urged. The question to be decided is whether the defendant is to be treated as a plaintiff for the purpose of determining whether his affirmative claim may be the basis of federal jurisdiction. The plaintiff-viewpoint theory cannot be helpful in answering this question; it cannot be applied until one decides who is a plaintiff within its meaning. Neither the theory nor the cases from which it was derived aid in this decision, for they do not indicate whether they are based on the fact that the plaintiff was the nominal plaintiff as a matter of procedure or on the fact that his claim was affirmative in nature. The decision must be made, therefore, with reference to considerations of policy. If the defendant could have brought his counterclaim as an original suit in the federal courts, it would seem an unwarranted penalty for his lack of diligence in bringing suit to hold that because the plaintiff first filed his claim the defendant must forego either whatever benefit he might derive from having his claim determined in the federal courts or the privilege of having the two claims litigated together. Especially unfair would it be to hold that he could not invoke federal jurisdiction on the basis of his counterclaim when it is of the sort which must be set up in the suit brought against him or be forever barred, since all possibility of having his claim litigated in the federal courts would then be precluded by the filing of the original claim against him in the state courts.²³ Likewise, if the plaintiff could have removed

22. DOBIE, *op. cit. supra* note 7, at 144; DOBIE, *Jurisdictional Amount in the United States Court* (1925) 38 HARV. L. REV. 733. Although the theory refers specifically only to the amount in controversy, it is apparent that the author would reach the same conclusion as to the federal question if he considered that point, since he uses as a support for his theory the analogy that the federal question must appear from an examination of the complaint.

It is conceivable, however, that the plaintiff-viewpoint theory could lead to the conclusion that the federal question could not be raised in a counterclaim, yet that the requisite jurisdictional amount could be so supplied. For, while the plaintiff would not be relying on a federal right simply because the counterclaim did, the amount in controversy, even from the plaintiff's viewpoint, seems to be at least partly determined by the defendant's counterclaim. Certainly the amount which the plaintiff has at stake in the suit is affected by the counterclaim. See *infra* p. 1485.

23. Whether the counterclaim is of this type has accordingly been held to be the factor determining whether federal jurisdiction can be invoked on the basis of the counterclaim.

the counterclaim had it been brought as an original suit in the state courts, it is equally harsh to hold that he has lost his right to resort to the federal courts because he chose to file his claim in the state courts, which alone were available, rather than await the possible filing of the claim against him. From either point of view, the doctrine urged seems to place the choice of forum where it does not belong and where it would not be if the defendant's claim did not take the procedural form of a counterclaim, and to give unjustifiable significance to the trivial fact that the plaintiff filed his claim first. It would, therefore, be preferable to hold that federal jurisdiction may properly be derived from a counterclaim which is closely enough connected with the original claim that the two may be held to constitute a single case or controversy, or suit. The counterclaim should be regarded for this purpose as an original suit in which the nominal defendant is plaintiff.²⁴

One special problem occasionally arises with respect to the requisite jurisdictional amount, where neither the original claim nor the counterclaim alone fulfills that requirement. There is some authority for the proposition that not only may the counterclaim be considered in determining what is the amount in controversy, but it may be added to the plaintiff's claim to compute that amount.²⁵ The argument advanced is that a party has at stake both

Lee v. Continental Ins. Co., 74 Fed. 424 (C. C. D. Utah, 1896); *Fearon Lumber & Veneer Co. v. Lawson*, 166 Ky. 123, 178 S. W. 1121 (1915); cf. *Merchants Heat and Light Co. v. J. B. Clow & Sons*, 204 U. S. 286 (1907); *McKown v. Kansas & T. Coal Co.*, 105 Fed. 657 (C. C. W. D. Ark. 1901).

24. The cases split on the question. The following hold that jurisdiction may be assumed on the basis of the counterclaim: *Clarkson v. Manson*, 4 Fed. 257 (C. C. S. D. N. Y. 1880), rev'g 59 How. Pr. 480 (N. Y. Mar. Ct. 1880); *American Sheet & Tin Plate Co. v. Winzeler*, 227 Fed. 321 (N. D. Ohio, 1915) *semble*; *Central Commercial Co. v. Jones-Dusenbury Co.*, 251 Fed. 13, 19 (C. C. A. 7th, 1918); *Ginsburg v. Pacific Mut. Life Ins. Co.*, 69 F. (2d) 97 (C. C. A. 2d, 1934), rev'g 5 F. Supp. 296 (S. D. N. Y. 1933); cf. *Wolcott v. Sprague*, 55 Fed. 545 (C. C. D. Kan. 1891); *Sturgeon River Boom Co. v. W. H. Sawyer Lumber Co.*, 89 Fed. 113 (C. C. W. D. Mich. 1898); *Union Oil Co. of California v. Spradley*, 49 F. (2d) 815 (W. D. Wash. 1931) *Contra*: *Falls Wire Manuf'g Co. v. Broderick*, 6 Fed. 654 (C. C. E. D. Mo. 1881); *LaMontagne v. T. W. Harvey Lumber Co.*, 44 Fed. 705 (C. C. E. D. Wis. 1891); cf. *McKown v. Kansas & T. Coal Co.*, 105 Fed. 657 (C. C. W. D. Ark. 1901); *Crane Co. v. Guancia Centrale*, 132 Fed. 713 (C. C. S. D. N. Y. 1904); *Fearon Lumber & Veneer Co. v. Lawson*, 166 Ky. 123, 178 S. W. 1121 (1915).

It should be remembered that all these cases deal with the jurisdictional amount. The considerations might conceivably be different in federal question cases, for it may be said that here the amount of the defendant's counterclaim is considered in determining the amount which the plaintiff has in controversy. See note 22, *supra*. In diversity of citizenship cases, of course, if the requisite diversity exists as to one party, it ordinarily will exist as to both. Where additional parties are concerned, as upon cross-bills, see *Shulman and Jaegerman*, *supra* note 3, at 417.

25. *Lee v. Continental Ins. Co.*, 74 Fed. 424 (C. C. D. Utah, 1896) *semble*; *American Sheet & Tin Plate Co. v. Winzeler*, 227 Fed. 321 (N. D. Ohio, 1915) *semble*; *Central Commercial Co. v. Jones-Dusenbury Co.*, 251 Fed. 13, 19 (C. C. A. 7th, 1918) *semble*; cf. *Fearon Lumber & Veneer Co. v. Lawson*, 166 Ky. 123, 178 S. W. 1121 (1915) (if counterclaim must be filed). *Contra*: *Harley v. Fireman's Fund Ins. Co.*, 245 Fed. 471 (W.

his right to the amount which he claims and his immunity to the claim of the other party; he stands to gain or lose not only one of these, but their total, so that the sum of the claims constitutes the real amount in controversy. Mathematically, the proposition commands respect. Yet its acceptance would lead to the result that the federal courts could assume jurisdiction of a suit involving two claims neither of which satisfied the requisites of federal jurisdiction. Such an expansion of federal jurisdiction is not warranted by the policy considerations which suggest that jurisdiction can properly be assumed when the defendant has a claim itself satisfying the requisites of federal jurisdiction.²⁶

In this type of case, in which the plaintiff's claim does not satisfy the requisites of federal jurisdiction, even if it is established that the substantive requirements of federal jurisdiction are met because those requisites are satisfied when the counterclaim is also considered, the problem is usually further complicated by the procedural difficulty involved in determining who may remove the case from the state to the federal courts. This privilege is restricted by the Judicial Code to defendants.²⁷ Therefore, plaintiffs have been held not entitled to remove because they are not defendants.²⁸ On the other hand, defendants have been held not entitled to remove because by filing a counterclaim they become plaintiffs.²⁹ Logic would seem to require that if

D. Wash. 1913); *Fearon Lumber & Veneer Co. v. Lawson*, *supra*; cf. *Home Life Ins. Co. v. Sipp*, 11 F. (2d) 474 (C. C. A. 3rd, 1926); see *Bennett v. Devine*, 45 Fed. 705 (C. C. S. D. Iowa, 1891); *Crane Co. v. Guancia Centrale*, 132 Fed. 713 (C. C. S. D. N. Y. 1904).

26. Where there are two or more plaintiffs, their claims are not allowed to be added to determine the amount in controversy, unless those claims are really but one claim in which they all have an interest. *Pinel v. Pinel*, 240 U. S. 594 (1916); *Woods v. Thompson*, 14 F. (2d) 951 (C. C. A. 7th, 1936).

27. In diversity cases there is the added requirement that the defendant must be a non-resident of the state in which suit is brought. 36 STAT. 1094 (1911), 28 U. S. C. A. § 71 (1926).

28. *Waco Hardware Co. v. Michigan Stove Co.*, 91 Fed. 289 (C. C. A. 5th, 1899); *Indian Mountain Jellico Coal Co. v. Asheville Ice & Coal Co.*, 135 Fed. 837 (C. C. W. D. N. C. 1905); *Illinois Central R. Co. v. A. Waller & Co.*, 164 Fed. 358 (C. C. W. D. Ky. 1908); *Glover Mach. Works v. Cooke Jellico Coal Co.*, 222 Fed. 531 (E. D. Ky. 1915); *Mohawk Rubber Co. of New York, Inc. v. Terrell*, 13 F. (2d) 266 (W. D. Mo. 1926); *Chappell v. Chappell*, 86 Md. 532, 39 Atl. 984 (1898); *J. T. Smithers v. T. Smith*, 35 Tex. Civ. App. 508, 80 S. W. 646 (1904), writ of error dismissed, 98 Tex. 83, 81 S. W. 283 (1904); cf. *West v. Aurora City*, 6 Wall. 139 (U. S. 1867). *Contra*: *Carson & Rand Lumber Co. v. Holtzclaw*, 44 Fed. 785 (C. C. E. D. Mo. 1889); *Walcott v. Watson*, 46 Fed. 529 (C. C. D. Nev. 1891); *Price & Hart v. T. J. Ellis & Co.*, 129 Fed. 482 (C. C. E. D. Ark. 1904); *Pirce v. Desmond*, 11 F. (2d) 327 (D. Minn. 1926); *Zumbrunn v. Schwartz*, 17 F. (2d) 609 (D. Ind. 1927); *San Antonio Suburban Irrigated Farms v. Shandy*, 29 F. (2d) 579 (D. Kan. 1928); *American Fruit Growers, Inc. v. La Roche*, 39 F. (2d) 243 (E. D. S. C. 1928); cf. *Hagerla v. Mississippi River Power Co.*, 202 Fed. 771 (S. D. Iowa, 1912).

29. *Bennett v. Devine*, 45 Fed. 705 (C. C. S. D. Iowa, 1891); *Hansen v. Pacific Coast Asphalt Cement Co.*, 243 Fed. 283 (S. D. Cal. 1917); cf. *Zumbrunn v. Schwartz*, 17 F. (2d) 609 (D. Ind. 1927). *Contra*: *La Montagne v. T. W. Harvey Lumber Co.*, 44 Fed. 645 (C. C. E. D. Wis. 1891); *McKown v. Kansas & T. Coal Co.*, 105 Fed. 657 (C. C. W. D. Ark. 1901) *semble*.

the defendant's claim is to be regarded as an original suit in which the defendant is plaintiff for the purpose of determining whether federal jurisdiction can attach, only the nominal plaintiff should be allowed to remove since he alone is the defendant to the claim which satisfies the requisites of federal jurisdiction. But the same reasoning which leads to the conclusion that the defendant's claim may properly form the basis of federal jurisdiction dictates that the defendant also should be allowed to remove, especially if his claim is of the sort which he must plead or lose. And this result can be attained easily by literal construction of the Judicial Code, for the formal defendant is technically a defendant. Despite its inconsistency, therefore, the better view probably is that either party should be allowed to remove in this situation.³⁰ Some further difficulty may be conjured up, however, because the defendant's counterclaim has been submitted to the state court at the time of the filing of the petition for removal. The Judicial Code apparently contemplates that the petition for removal will be made before the defendant files any pleadings, since it provides that the parties removing shall "plead, answer, or demur to the declaration or complaint" within thirty days after filing of a certified copy of the record.³¹ But the petition may be filed "at the time, or any time before the defendant is required by the laws of the State or the rule of the State court in which suit is brought to answer or plead to the declaration or complaint of the plaintiff,"³² there being no requirement that it must be filed before answer. And it seems to be established that the filing of defensive pleadings does not constitute a waiver of the right to remove.³³ While a different result might be reached when the pleading filed was a counterclaim, on the ground that the defendant thereby affirmatively invoked the jurisdiction of the state court, the essential elements of a waiver are lacking since he had no right to remove until the requisites of federal jurisdiction were satisfied by the counterclaim's becoming a part of the suit.

Again the problem arises of what should be done with the litigation if the original claim and counterclaim are not closely enough connected for the federal court to assume jurisdiction over the original claim simply because the counterclaim meets the requirements for federal jurisdiction. Perhaps jurisdiction could be retained over the counterclaim, and the plaintiff's claim alone remanded. But this would seem to be a procedural anomaly, and might raise embarrassing questions of venue and jurisdiction over the person of the plaintiff. It would, therefore, be preferable to remand the whole cause to the state court. This result might be objected to on the ground that it imposes a condition on the right to remove not found in the Judicial Code, viz., that the defendant's and plaintiff's claims must be closely connected. But this requirement may be said to be embodied in the Judicial Code on the theory that the two claims are not sufficiently interdependent to be part

30. But cf. *DOBIE*, op. cit. *supra* note 7, at 404.

31. 36 STAT. 1095 (1911), 28 U. S. C. A. § 72 (1926).

32. *Ibid.*

33. *Wahl, Is the Filing of Pleadings in the State Court a Waiver of the Right to Remove?* (1934) 8 FLA. L. J. 57, and authorities there cited.

of a single "suit" which may be removed. Or, if this answer is considered unsatisfactory, since the problem would ordinarily arise only on the type of counterclaim which need not be pleaded in the suit brought in the state court, the objection may be met by holding that the defendant, by filing his claim in that cause, chose to have the two claims litigated together and thereby waived his right to invoke the jurisdiction of the federal court, which was without power to adjudicate both claims. Such a result has to commend it the fact that it will tend to put an end to the litigation, but it may be considered that the defendant should still be given an opportunity to dismiss his claim without prejudice and bring an independent action in the federal court, since his attempt to remove indicates that he did not intend to abandon his right to pursue his claim there.

There may also be some question of the right to remove in cases in which both the plaintiff's claim and the defendant's counterclaim satisfy the requisites of federal jurisdiction. Either party might be denied the right on the ground of waiver. The defendant could have removed before filing his counterclaim and by failing to do so might be held to have submitted voluntarily to the jurisdiction of the state court.³⁴ But this result would place upon the defendant the risk of determining for himself whether the plaintiff's claim satisfied the requisites of federal jurisdiction, with the possible loss of his counterclaim if, after the time for filing the counterclaim in the state court had expired, the federal court decided that it lacked jurisdiction;³⁵ it would force the defendant to rely on a single ground for invoking federal jurisdiction when in fact he has two grounds. A similar danger would not threaten the plaintiff if he invoked federal jurisdiction originally, for if his suit were dismissed he could begin anew in the state courts, unless the statute of limitations had meanwhile run on his claim. But there is less reason for holding that he has waived his right to resort to the federal courts on the counterclaim by reason of filing his own suit in the state courts, for he has not voluntarily submitted the counterclaim to the state court for its determination. Unless he is to be expected to predict that the defendant will set up a counterclaim, he should be given an opportunity to have it litigated in the federal courts, for it may be important that he should have it determined there although he was indifferent as to the forum in which his own claim was determined.³⁶

34. *O. J. Lewis Mercantile Co. v. Klepner*, 176 Fed. 343 (C. C. A. 2d, 1910), cert. denied, 216 U. S. 620 (1910) *semble*; cf. *Merchants Heat & Light Co. v. J. B. Clow & Sons*, 204 U. S. 286 (1907) (recoupment, defects in service); *Texas & Pacific Ry. Co. v. Eastin & Knox*, 214 U. S. 153, 160 (1909). But cf. *American Sheet & Tin Plate Co. v. Winzeler*, 227 Fed. 321 (N. D. Ohio, 1915) (suit brought originally in federal court; filing of counterclaim not a waiver of right to dismissal).

35. *Morbeck v. Bradford-Kennedy Co.*, 19 Idaho 83, 113 Pac. 89 (1910); see Wahl, *supra* note 33.

36. The one case in point denies the right to remove. *West v. Aurora City*, 6 Wall. 139 (U. S. 1867). It suggests that the plaintiff may properly bear the burden of predicting whether the counterclaim will be filed, "The right of removal is given only to a defendant who has not submitted himself to that jurisdiction; not to an original plain-

The existing confusion and apparent difficulty in dealing with the problem of federal jurisdiction in cases involving counterclaims³⁷ may be attributed in large measure to the facts that the Judicial Code makes no particular provision for their treatment and that the courts have consequently dealt with them on the basis of rules designed for and developed in cases in which there is only one affirmative claim. A systematic procedure is not impossible, but it is hardly to be expected to evolve from a haphazard application of inappropriate regulations, especially against a background of conflicting policies.

tiff in a state court who, by resorting to that jurisdiction, has become liable under the state laws to a cross-action." *Id.* at 141.

37. A few other relatively simple subordinate propositions not treated in the text herewith have been developed. Thus, if the plaintiff's claim does not fulfill the jurisdictional requisites, the defendant will not lose his right to a dismissal by filing a counterclaim which does not itself fulfill those requisites, the defect being one of jurisdiction over the subject matter. *American Sheet & Tin Plate Co. v. Winzeler*, 227 Fed. 321 (N. D. Ohio 1915) *semble*; *Home Life Ins. Co. v. Sipp*, 11 F. (2d) 474 (C. C. A. 3rd, 1926). But cf. *O. J. Lewis Mercantile Co. v. Klepner*, 176 Fed. 343 (C. C. A. 2d, 1910), *cert. denied*, 216 U. S. 620 (1910). On the other hand, any irregularities in the procedure of removal can be waived by failure to make a motion to remand if the essential substantive grounds for federal jurisdiction exist, so that the court may be said to have jurisdiction over the subject matter. *Mackay v. Vinta Development Co.*, 229 U. S. 173 (1913). Again, once jurisdiction has attached, it is not defeated by reason of a voluntary dismissal of the claim which forms the basis of federal jurisdiction, but will be retained to dispose finally of the whole case. *Kirby v. American Soda Fountain Co.*, 194 U. S. 141 (1904); *New York Life Ins. Co. v. Kaufman*, 78 F. (2d) 398 (C. C. A. 9th, 1935), *cert. denied*, 296 U. S. 626 (1935). Further, when a case is removed from a court of limited jurisdiction, the limitations on that jurisdiction survive removal. *Hummell, Adm'r v. Moore*, 25 Fed. 380 (C. C. D. Colo. 1885); *New York I. & P. Co. v. Milburn Gin & Machine Co.*, 35 Fed. 225 (C. C. W. D. Tenn. 1888); *Bennett v. Forrest*, 69 Fed. 421 (D. Alaska, 1895).