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Recent Developments

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RECENT DEVELOPMENTS

CONSTITUTIONAL LAW — CRIMINAL PROCEDURE — TRIAL JUDGE MUST CONVENE COMPETENCY HEARING SUA SPONTE WHEN RECORD PRODUCES "BONA FIDE" DOUBT AS TO DEFENDANT'S FITNESS TO STAND TRIAL NOTWITHSTANDING THE ABSENCE OF A REQUEST.

Pate v. Robinson (U.S. 1966)

Petitioner was convicted of murder and sentenced to life imprisonment in Illinois. At trial, it was conceded that he had killed his wife, and his defense rested primarily on a plea of insanity. Although ample evidence was introduced to indicate a history of pronounced irrational behavior reflecting on petitioner’s past and present mental state, no formal request was made for a hearing to determine his present competency to stand trial.1 On appeal to the Supreme Court of Illinois, petitioner challenged his conviction, claiming that he should have been afforded a hearing to determine his competency. Reversal was denied on the grounds that petitioner had failed to request this hearing at trial and that the evidence on the record was insufficient to require the trial court to convene a competency hearing on its own motion.2 A petition for writ of habeas corpus was denied by the United States District Court for the Northern District of Illinois. The petition was later granted by the Court of Appeals for the Seventh Circuit on a finding that the hasty manner in which the conviction was obtained prevented the development of all the pertinent facts relating both to petitioner's sanity and competency at time of trial.3 The United States Supreme Court granted certiorari4 and remanded the case to the district court with directions to release the petitioner unless he were granted a new trial, holding that when “bona fide” doubt as to a defendant's competency is apparent from the record, the failure of a trial court to convene a competency hearing on its own motion is reversible error, despite defendant’s failure to request such a hearing. Pate v. Robinson, 383 U.S. 375 (1966).

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1. A request, if made, would have been pursuant to ILL. REV. STAT. ch. 38, §§ 104–13 (1963).
3. United States ex rel. Robinson v. Pate, 345 F.2d 691 (7th Cir. 1965). The court also held that when defendant's sanity is in issue, the denial of a reasonable request to obtain the services of a psychiatric witness is tantamount to a suppression of evidence violative of due process.
The paramount issues in the instant case concern a defendant's ability to waive a competency hearing by failing to request it, and the duty of a trial judge to convene such a hearing on his own motion. As to the former issue, a survey of relevant waiver cases indicates a generally accepted view that significant constitutional guarantees may be waived. Whether in particular situations there may be a waiver usually necessitates reference to the classic definition of that concept enunciated in Johnson v. Zerbst, wherein the Court termed it, "an intentional relinquishment or abandonment of a known right or privilege." Indeed, the ability to waive constitutional protections is commonly determined against the backdrop of the Zerbst standard. Thus, considerations of waiver are frequently coupled with judicial recognition that a by-passing of safeguards may reflect a purposeful trial tactic, a prerequisite of which — it would seem — is a competent defendant. Therefore it is reasonable to say that in an atmosphere of questionable competency "where we premise a defendant so deranged that he cannot oversee his lawyers" the concept of waiver is inappropriate. For this reason, the Court in the instant case, after citing Bishop v. United States to explicate that due process requires that a defendant be competent at time of trial, quickly dispensed with petitioner's failure to request a competency hearing by saying that a mentally incompetent person cannot intelligently waive such a defense.

The second and more significant issue of the case centers on the affirmative duty of a trial judge to convene a competency hearing on his own motion when "bona fide doubt" as to defendant's competency is presented. Competence to stand trial has been defined by the Court as a defendant's "sufficient present ability to consult with his lawyer with a reasonable degree of rational understanding — and whether he has a rational as well as factual understanding of the proceedings against him." The test is not identical with that used in determining the sanity or insanity of defendant at time of the crime. Nevertheless, the terms are used indiscriminately, thereby creating much confusion. Not only do the definitions

7. Id. at 464.
8. For the effect a deliberate by-passing of state court procedures may have on federal habeas corpus remedies, see Fay v. Noia, 372 U.S. 391, 438 (1963). But for the effect of mental incompetency on waiver of defenses, see Taylor v. United States, 282 F.2d 16 (8th Cir. 1960).
11. 383 U.S. at 384.
of sanity and competency differ markedly, but the purposes for which these defenses are offered are dissimilar. An insanity plea is generally offered for acquittal whereas a competency plea is offered for postponement of trial.\textsuperscript{14} In fact, a defendant may be insane, but competent, sane, but incompetent, or both insane and incompetent. Evidence offered to prove one condition, may well be evidence of the other, or at least be sufficient to raise a “bona fide” doubt as to competency or sanity.\textsuperscript{16}

The pertinent Illinois statute requires a trial judge to convene a competency hearing on his own motion where a “bona fide” doubt is presented concerning defendant’s competency.\textsuperscript{15} Where the facts or circumstances of a case present such a doubt, an affirmative duty to impanel a jury and hear evidence as to defendant’s competency is imposed upon the judge.\textsuperscript{17} In such a situation, the critical issue, and one which the Court did not expressly decide, is how much evidence is required to raise “bona fide” doubt. The majority found that the evidence presented on petitioner’s mental state both at the commission of the crime and at the time of trial was of such a nature to raise the requisite “bona fide” doubt concerning competency.\textsuperscript{18} The divergence of opinion between the majority and minority revolves around the correct construction to be given the factual situation as presented from the record. Having examined all evidence relating to petitioner’s bizarre conduct, the Court found that “bona fide doubt” could not have been dispelled by the lucid demeanor of defendant during trial, which was exemplified by his “colloquies” with the trial judge.\textsuperscript{19} The dissent, reading the same record, found that demeanor was very significant, sufficient, in fact, to bar a disturbance of the trial judge’s decision, particularly since defense counsel had not indicated any desire for a postponement of trial.\textsuperscript{20}

At first blush, it appears that the Court’s decision was predicated on the existence of the Illinois statute which creates the test of “bona fide” doubt and mandates the competency inquiry. It is clear that the constitutional infirmity in this case was not the disallowance of the defense of incompetency, but the failure to make the required inquiry.\textsuperscript{21} But the decision is unclear insofar as it speaks of a constitutional right to have a competency hearing. The decision seems to indicate, by its emphasis on the presence of the Illinois statute, that not all state trial judges are required to convene a competency hearing on their own motions when a “bona fide” doubt as to competency is presented. Rather, where a state statute mandates such an inquiry, the failure to comply with the statutory procedure violates

\textsuperscript{14} Id. at 391 n.5 (Harlan, J. dissenting).
\textsuperscript{15} Id. at 384 n.6.
\textsuperscript{17} Brown v. People, 8 Ill. 2d 540, 134 N.E.2d 760 (1956).
\textsuperscript{19} Id. at 386.
\textsuperscript{20} Id. at 390-91 & n.5 (Harlan, J. dissenting).
\textsuperscript{21} Id. at 388 n.1 (Harlan, J. dissenting).
due process. The test of "bona fide" doubt was created by the statute; as such, the application of the Court's test is limited to a similar state statute.

Indication of the difficulty with this analysis is presented by a recent District of Columbia Court of Appeals case, *Hansford v. United States*.22 There, a defendant who was addicted to narcotics, testified that he had been using narcotics throughout the trial. According to earlier psychiatric testimony, his use of narcotics on past occasions had produced acute brain syndrome.23 Based on this testimony and other evidence in the record of previous narcotics difficulties, the Court of Appeals found that the failure of the judge to convene a competency hearing violated due process. Principal authority for the court's position was *Pate v. Robinson*.24 The District of Columbia Code provides for commitment of an incompetent defendant when such incompetency appears from "the court's own observations, or from prima facie evidence submitted to the court."25 Chief Judge Bazelon, speaking for the majority, read *Pate* to require the court to convene a hearing on its own motion, without a defense request, where the issue of defendant's competency is clouded by his possible narcotic-induced brain syndrome.26 Demeanor was clearly ruled out as a factor capable of dissolving the doubt; thus, the statutory discretion of the trial judge is severely limited. Additionally, the Court of Appeals in *Hansford* appears to have raised the requirement of a hearing to constitutional dimensions, even absent a statutory provision for a mandatory hearing.27

Looking to the interplay of the two decisions, the fact that the judge's duty to convene a hearing is not statutorily created in the *Hansford* case means that the holding of *Pate* has been broadened by the District of Columbia Court of Appeals. It is, however, possible to reconcile the two cases by remembering that competency is of great constitutional significance in the assurance of a fair trial. Although the Supreme Court did not explicitly state that the failure to follow the state statutory procedure violated due process, it is reasonable to say that where competency is in issue, its importance in protecting the rights of the accused will compel compliance with the state procedure in order to comport with the national standard of due process. It then becomes the trial judge's duty to assure himself that the defendant before him is truly competent to stand trial. By reading *Pate* in that light, the *Hansford* decision follows naturally. Despite the fact that the District of Columbia Code does not provide for a mandatory hearing on the issue of competency, the statute does permit a hearing on

22. 365 F.2d 920 (D.C. Cir. 1966).
23. Id. at 922.
24. Id. at 923.
27. D.C. CODE tit. 24, § 301(a), does not mandate a hearing on the issue of competency unless the Government or the defendant object to the hospital report on which the judge must base his finding of incompetency. Consequently, the statutory duty imposed in the Illinois statute is lacking in *Hansford*, especially where no challenge on the issue of competency was made at trial.
defense objection later in the procedure. Since the *Pate* case indicated that a failure to request the statutory hearing because of his possible incompetency would not prejudice the rights of defendant to raise the issue later, it is not unreasonable to shift the statutory duty from the defense to the trial judge as the *Hansford* court has done.

As suggested above, the question left unresolved by both cases is the quantum of fact necessary to create a bona fide doubt in the trial judge's mind, *i.e.*, sufficient to require him to convene the competency hearing. In both cases, there was extensive evidence in the record indicating irrational behavior by defendant in the past either through brain damage or narcotics addiction. Also each defendant's demeanor at trial indicated lucidity and an awareness of the proceedings. Despite defendants' apparent lucidity, the majorities of both courts determined that the facts in evidence could not be overcome by any "apparent" competency, but had to be tested out in a special competency hearing. How much less evidence would have sufficed to raise the requisite "bona fide" doubt is not made clear, nor is it even alluded to by either court.

A further difficulty posed by the *Hansford* case in this connection is the use of the test of "bona fide" doubt, created by the Illinois statute, in construing the duty of the judge under the District of Columbia provision. The pertinent section of the District of Columbia Code refers to the judge's "own observations" or "prima facie" evidence submitted to him. Since both the *Hansford* and the *Pate* courts indicated that personal observation by the judge will not dispel the doubt created by the record, that part of the statute has almost been nullified or at least ignored. Since neither case instructs as to how little evidence is required to meet the standard of "bona fide" doubt, the judge is best advised to convene a competency hearing every time some evidence is adduced that might prove incompetency. His discretion to trust to his own observations is largely removed.

In order to avoid undesirable results from these cases, it might be better to limit them to their facts. Otherwise, even a scintilla of evidence relating to defendant's competency or sanity might give rise to a duty on the part of the trial judge to halt the trial and convene a competency hearing. Failure to so limit the cases causes the further aspect of defense counsel's control over his case to pose great difficulties. Since the courts have indicated that a failure to request a hearing by the defense will not relieve the judge of his duty to convene the hearing, the defense counsel cannot retain complete control over the strategic moves that normally result in the course of a trial. Furthermore, it appears that the *Pate* court has effectively imputed the potential incompetency of defendant to his counsel,

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28. Ibid.
30. *Id.* at 378–80.
32. 383 U.S. at 385; 365 F.2d at 924.
thereby precluding a voluntary waiver of the right to a competency hearing. Insofar as defense counsel cannot restrict the evidence which the state may wish to offer on defendant’s mental state, the moment that sufficient evidence is presented, the judge must convene a competency hearing, irrespective of defense wishes in the matter. Premising a situation where the accused is innocent, *Pate* places him in an ironic position. If he is unable to meet the test of competency, he stands a good chance of being committed indefinitely to a state institution for the criminally insane until he is fit to stand trial, even though he is innocent.

Although the *Pate* case dealt with the failure of the trial judge to make the appropriate inquiry into defendant’s competency, the defense of incompetency still remains. Consequently, even where no evidence of incompetency is introduced into the record, the defense on appeal may claim that defendant was incompetent at the time of trial. However, if evidence amounting to a “bona fide” doubt as to defendant’s competency has been adduced at trial, the judge will have convened a hearing to determine that issue on his own, thereby preventing the defense of incompetency on appeal. This latter seems to be the preferred procedure, since the Court indicated in *Pate* that it is extremely difficult, if not impossible, to determine competency retrospectively. If competency is not raised at trial, and no hearing is convened at that time, but it is later raised on appeal, it would seem that a new trial would have to be ordered because of the retrospectivity of the competency finding. Procedurally, this is undesirable because evidentiary problems abound with respect to proof of past competency. This is particularly true on appeal when the record will be the sole basis of decision.

The net result of the *Pate* case seems to impose an affirmative duty on the trial judge to assure himself at all costs, where “bona fide” doubt is produced by the record, of the competency of the accused. This is so because of the constitutional significance of competency at time of trial. By failing to indicate clearly whether or not the statute is the sole basis for its decision, the Court has left open the question of whether a statute similar to that of Illinois is required before such duty arises. In addition, the Court’s failure to delineate with greater specificity the outlines of “bona fide” doubt, has left the trial judge to his own imagination to determine when he is best advised to convene a competency hearing on his own motion. A cautious man, desirous of preventing trials wasted by the commission of error, will probably convene such hearings on the basis of minimal evidence on the point.

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34. 383 U.S. at 387.
CONSTITUTIONAL LAW — DUE PROCESS — ADMINISTRATIVE ORDER
REQUIRING UTILITY TO TERMINATE SERVICE UPON NOTICE OF ILLEGAL
USE FROM A LAW ENFORCEMENT AGENCY IS UNCONSTITUTIONAL.

Sokol v. Public Util. Comm'n (Cal. 1966)

Petitioner operated a club which lawfully supplied its members with predictions, via the telephone, of the respective fleetness of horses running at local racetracks. The local telephone company summarily terminated the club's telephone service as a result of advice received from the San Francisco Chief of Police that the club's telephones were being used in connection with the illegal practice of bookmaking. Authority for the telephone company's action rested on Decision No. 41415 of the California Public Utilities Commission which required any communications utility to summarily terminate service upon receipt of notice from a law enforcement officer that the service was being used illegally. Petitioner sought restoration of his telephone service by challenging the constitutionality of Decision No. 41415 before the Public Utilities Commission which affirmed its previous determination. On direct appeal, the Supreme Court of California reversed, holding, that Decision No. 41415 violates both the state and federal constitutions to the extent that it sanctions the taking of property without due process of law. Due process requires that an impartial tribunal review the bare allegations of a law enforcement official before telephone service may be terminated. Sokol v. Public Util. Comm'n, 65 Cal. 2d 418 P.2d 265, 53 Cal. Rptr. 673 (1966).

It is axiomatic that a public utility must serve without discrimination all members of the public who comply with its reasonable regulations, and damages will lie against a utility for its wrongful refusal or discontinuance of service. Equally well established is that the duty to provide service does not extend to services which will be used illegally, and a reasonable belief that the telephone will be used in furtherance of illegal activity is adequate cause for refusing or discontinuing service. Further-

1. The Decision provides in pertinent part:
[A]ny communications utility . . . must discontinue and disconnect service to a subscriber, whenever it has reasonable cause to believe that the use made . . . is prohibited under any law, ordinance, regulation, or other legal requirement, or is being used as an instrumentality . . . to violate or to aid and abet the violations of the law.

The Decision further provides that receipt of written notice from a duly authorized law enforcement official will constitute reasonable cause. The utility is immunized from a damage suit for a wrongful discontinuance. An aggrieved subscriber's exclusive remedy is a proceeding for restoration of service before the Commission. Decision No. 41415, 47 Cal. P.U.C. 853 (1948).


more, a utility that furnishes service in furtherance of an illegal activity may risk criminal prosecution. Thus, a public utility which receives notice from the police that a subscriber is using the service illegally may find itself pinioned between the horns of a dilemma: if the utility refuses to render service on the unsubstantiated opinion of a law enforcement official it may be found liable to the subscriber and, at the same time, its refusal to terminate service may result in criminal prosecution. To facilitate law enforcement by encouraging cooperation with police officials, relief has been afforded the utilities by the courts, tariff, statute, and administrative orders similar to that of the instant case.

The fourteenth amendment to the United States Constitution forbids a state to take property without due process of law, and telephone service has recently been reaffirmed as a property right protected by the constitution. Indeed, even the temporary deprivation of service constitutes a "taking" of property. Early cases were fairly unanimous in holding that telephone service could be summarily discontinued under a statute or administrative order similar to Decision No. 41415 without resultant liability to the utility even though the beliefs of the law enforcement agency were subsequently proven to be unfounded. Due process requirements were thought to have been fulfilled by a post termination hearing on the merits, at which time the utility normally bore the burden of establishing that it was justified in refusing to restore service. This was an outgrowth of a prevalent belief that the subscriber had an adequate remedy against the law enforcement officials for a wrongful withdrawal of services instigated by them.

The question of whether notice is required before service may be discontinued was often moot as the utility frequently gave notice as a matter of practice, even though not required by order or statute, and thus enabled the subscriber to bring an action in equity to enjoin termination. Andrews v. Chesapeake & Potomac Tel. Co. dealt with a tariff provision that re-

8. Fogarty v. Southern Bell Tel. & Tel. Co., 34 F. Supp. 251 (D.C. La. 1940); Haggerty v. Southern Bell Tel. & Tel. Co., 145 Fla. 515, 199 So. 570 (1940). Relief in these cases took the form of a holding that the utility is justified in discontinuing service upon receipt of notice from a law enforcement agency.
13. Pacific Tel. v. Eshelman, 166 Cal. 640, 664, 137 Pac. 1119, 1127 (1914).
required summary discontinuance upon receipt of notice from a law enforcement agency advising the commission of illegal activity. The federal district court was of the opinion, albeit in dictum, that a public utility would not be justified in summarily terminating service upon an ex parte determination of illegal use of the facility by a law enforcement officer, and a tariff or administrative order which conferred such judicial power would be violative of due process. A statutory provision similar to Decision No. 41415 was before the Delaware Chancery court, under circumstances similar to Andrews, in Tollin v. Diamond State Tel. Co. and was disposed of in no uncertain manner: "I have no doubt but that this particular section is in itself invalid because it purports to permit the cutting off of telephone service without a hearing and to absolve the telephone company from all liability for damages thereby resulting. . . ."

In Telephone News Sys. Inc. v. Illinois Bell Tel. Co., the federal district court, assuming arguendo that the due process question was properly before it, posited that the federal counterpart of Decision No. 41415 was consistent with due process requirements since it provided for reasonable notice of termination and expressly reserved to the subscriber his equitable remedy to prevent wrongful discontinuance. Although the statute immunized the utility from a damage suit by an injured subscriber, the procedure required was thought to guarantee the subscriber a "real opportunity to protect" his rights since he could promptly bring equitable proceedings, upon receipt of notice, to enjoin termination pending an adjudication on the merits.

The instant case squarely presents the issue of whether the method provided by Decision No. 41415 for thwarting allegedly illegal use of communication service results in depriving the subscriber of due process of law by failing to provide for notice or an impartial determination of illegality of use prior to discontinuance of service. Whether action without prior hearing comports with due process is dependent upon a delicate balance of the needs of the individual against the urgency of immediate action, especially where there may exist other means effective to combat the evil sought to be remedied. Unquestionably, the state has a legitimate interest in frustrating illegal activity and one of the most effective means of disrupting criminal activities dependent upon telephone communication is the peremptory termination of such communication. Recognizing that sum-

23. Id. at 259.
27. Id. at 636.
mary action is not always prohibited, the court weighed this interest of the state against the indispensability of communication service to a modern business enterprise and the possibility of fatal damages to a legitimate business that might accrue through a mistaken determination of illegality by law enforcement officials. Deprivation of free speech rights that could result from an unbridled use of Decision No. 41415 were also recognized by the court in arriving at the conclusion that the rights of the subscriber were not adequately protected by the prescribed procedure.

The holding of Sokol that Decision No. 41415 is unconstitutional is not as significant as the minimum due process requirement recommended by the court for incorporation in any new Commission order designed to combat the same evil as Decision No. 41415. In fact, if the court had been so inclined it could have corrected the fatal defect of Decision No. 41415, by invalidating only that provision which immunized the utility from suit for an unjustified discontinuance of service. However, while preserving the remedy of the subscriber and protecting the interest of the state in the suppression of illegal gambling, this course would have remitted the utility to its earlier perilous position. To rectify the Decision's infirmity by such a holding would have ignored its admittedly salutary purpose by condemning what was merely an ill-considered means to achieve that purpose. Another possible tack open to the court was to recommend that reasonable notice be given to the subscriber before termination. This expedient could have salvaged the Decision since it would have given a subscriber an opportunity to secure an injunction restraining termination of service prior to a judicial determination of the truth of the police allegations. But, by the same token, enforcement of such a notice requirement would enable an actual illegal user to notify his customers and shift his operations, thereby avoiding the effect of a later termination of service to his by then abandoned base of operation. This alternative would severely thwart the interest of the state in surprisingly disrupting the essential communication facilities of the gambling industry and emasculate the effectiveness of such termination. Equally disparaging of the state's interest would be a requirement that there be an adjudicative type hearing prior to discontinuance of service. Such a requirement is not constitutionally necessary.

31. See note 1 supra.
34. Damages for wrongful discontinuance of service on the one hand and possible criminal prosecution on the other were the alternatives.
36. "It is sufficient, where only property rights are concerned, that there is at some stage an opportunity for a hearing and a judicial determination." Ewing v. Myttinger & Casselberry, Inc., 339 U.S. 594, 599 (1950); Accord, Fahey v. Mallonee, 332 U.S. 245 (1947); Yakus v. United States, 321 U.S. 414, 442-43 (1944); Bowles
Instead of choosing one of these approaches, all of which have found favor in other jurisdictions, the court recommended a novel means of protecting all interests involved. The court reasoned that had the police desired to search the premises of the petitioner or to seize his property they would have had to satisfy a magistrate that probable cause existed for the issuance of a warrant. Since telephone service is a property right protected by the fourteenth amendment and termination of that service may be fairly regarded to be a seizure of that property, the court theorized that the procedure allowing such a seizure should not be radically dissimilar from that allowing a search of his premises. This analysis led the court to conclude that standards substantially less exacting than those required for obtaining a search warrant—proof of reasonableness of the police allegations before an impartial tribunal prior to the search—could not be constitutionally supported.

It is submitted that the court is correct in positing that due process of law demands, in these circumstances, a procedure coextensive with that which prevents police from ignoring the fourth amendment guarantee of right to privacy. While not enunciated by the court, it is safe to assume that the substantive requirements of obtaining a search warrant must also be met and that mere "rubber stamping" of unsupported police allegations will not be tolerated. The recommended procedure amply protects the rights and interests of all parties. It is true that the subscriber will not ordinarily be advised of this proceeding nor will he have an opportunity to be heard prior to discontinuance, but his rights will be safeguarded through the review that an impartial tribunal will give of the reasonableness of the police allegations and he will still have an opportunity to promptly challenge these allegations in an action to restore service. The interests of the state are equally preserved. Effective suppression of illegal activity does not require that the police act immediately but only unexpectedly. In only an extraordinary situation could irreparable harm to society accrue during the time required to secure the requisite authorization. Besides, any resultant loss in time is more than justified by the protection afforded the subscriber. Finally, assuming that a public utility acting under an authorized request from a law enforcement agency would be immunized from suit, the utility would be relieved of its dilemma.

John P. O'Dea

38. Id. at ___, 418 P.2d at 271, 53 Cal. Rptr. at 679.
40. 65 Cal. 2d at ___, 418 P.2d at 271, 53 Cal. Rptr. at 679. The court pointed out that termination of service did not occur until two days after receipt of notice from the chief of police.
41. See, e.g., Erskine v. Hohnbach, 81 U.S. (14 Wall.) 613, 616 (1871).
EMINENT DOMAIN — PUBLIC SERVICE CORPORATION — TRANSIT COMPANY CAPABLE OF PROFITABLE OPERATION AT A REASONABLE RATE IS ENTITLED AT TIME OF CONDEMNATION TO "GOING CONCERN VALUE" IN ADDITION TO REPRODUCTION COST VALUE.

In re Fifth Ave. Coach Lines, Inc. (N.Y. 1966)

Claimants owned and operated within the city of New York two of the largest privately owned bus lines in the nation. Transit fares were regulated by the city and had been maintained at fifteen cents for several years despite claimants' protests that their net income had been decreasing rapidly in the face of rising overhead costs. In 1962 claimants estimated that their annual losses would exceed six million dollars and sought to have their basic franchise contract revised to permit a fare increase to twenty cents. When the city refused to grant the fare increase, claimants made drastic labor cut-backs resulting in a strike by the transport workers. Shortly thereafter, the city condemned the bus lines and has operated them ever since.¹

At trial before the Supreme Court, Special Term,² the city valued the bus lines at 20.7 million dollars, whereas the claimants placed the value at 92.5 million. The claimants sought compensation for certain going concern assets — routes, schedules, procedures, records, trained personnel and operating rights — but the trial court refused to make allowance for them. The court awarded claimants 30.3 million dollars, the "in use" value of the physical assets measured by their reproduction cost less depreciation. Both parties appealed the award. The Appellate Division affirmed, one judge dissenting.³ The Court of Appeals modified the award and remanded the case, holding, in a four to three decision, that claimants had a right to charge reasonable rates and, because claimants were capable of profitable operations under a reasonable rate, they were entitled to be compensated for their intangible going concern assets. In re Fifth Ave. Coach Lines, Inc., 18 N.Y.2d 212, 219 N.E.2d 410, 273 N.Y.S.2d 52 (1966).

The most distinctive characteristic of the condemnation of a public utility or a public service corporation is that it results in not just the taking of physical property, but in the taking of the entire business itself. Recognizing this, the courts have required the condemning government to pay not merely for the value of the physical property, but for the value of the business, as a functioning entity, itself.⁴ This added measure of compensa-

tion is usually in the form of what is called "going concern value." Defined in this context, "going concern value" is the difference between the value of an established, integrated and efficient business and the value of an identical business that has not yet begun to function as such. It has generally been stated by the writers and the cases that the condemned public service corporation must be a profitable enterprise in order to receive compensation for going concern value. One explanation as to why only a profitable business qualifies for this extra measure of damages is that the value of the business — for purposes of condemnation payments — is measured by the fair market value, or that price a willing purchaser would pay for the business in the open market. If the business is not earning reasonable profits, no such hypothetical purchaser would be likely to pay more than scrap value for it.

When going concern value is to be awarded, the methods used by the tribunals to evaluate this intangible asset have varied, depending upon the evaluator's fundamental conception of what going value is. According to one writer in this field, the cases reveal two wholly different concepts of going concern value. One group of cases deals with going value as a form of overhead cost which is to be considered in arriving at the value of the business measured by the cost of duplicating the entire operation as it is at the time of taking. Thus going value is the estimated

[hereinafter cited as BONBRIGHT]; 2 ORGEL, VALUATION UNDER THE LAW OF EMINENT DOMAIN 58-60 (2d ed. 1953) [hereinafter cited as ORGEL].

5. 2 BONBRIGHT 1147; see, e.g., Appleton Waterworks Co. v. Railroad Comm'n, 154 Wisc. 121, 142 N.W. 476, 484 (1913).


8. "It is usually said that market value is what a willing buyer would pay in cash to a willing seller." United States v. Miller, 317 U.S. 369, 374 (1943). Of course, utilities are not actively dealt in, so there is usually no market to which a court could look to find a current price of similar property. The result is that courts and commissions must dispense with the standards usually denoted by the terms "willing buyer" and "willing seller" and instead measure the worth of the property by its value to the owner. Montgomery County v. Schuylkill Bridge Co., 110 Pa. 54, 59, 20 Atl. 407, 408 (1885). "Value to the owner" is in turn measured by the value of the various tangible and intangible assets estimated usually by their original or reproduction cost. See 2 ORGEL 65-67, 79.

9. "Scrap value" is popularly used to cover any kind of sale of an asset made after its useful service life has expired. 1 BONBRIGHT 201.


11. 2 ORGEL 37; see also 2 BONBRIGHT 1148.

12. Many courts refuse to compensate the condemned utility for the costs of developing routes, trained personnel, and records on the grounds that these costs were written off the books as operating expenses. Therefore, if the corporation has received a fair return on its investment from its inception, these expenses have been shifted to
cost of organizing the assets into an integrated, functioning unit with an established business, and is somehow included in a way not usually articulated in the cost of reproduction figure. A leading case expressing this view is *Appleton Waterworks Co. v. Railroad Comm'n,* in which the Wisconsin Supreme Court, on the subject of measuring going value, said:

> It is not obtained by adding up a number of separate items, but by taking a comprehensive view of each and all of the elements of property, tangible and intangible, including property rights, and considering them all, not as separate things, but as inseparable parts of one harmonious entity, and exercising the judgment as to the value of that entity. In this way the going value goes into the final result, but it would be difficult for even an expert to say how many dollars of the result represent it.\(^{14}\)

Such “lump-sum” awards — as they are called — have been upheld many times by the United States Supreme Court, particularly in “rate cases.”\(^ {15}\) In *Des Moines Gas Co. v. City of Des Moines,* exclusion by the master of a particular item offered as an element of going concern value was approved because he had valued the physical property on the basis of a plant in successful operation. In *Columbus Gas & Fuel Co. v. Public Util. Comm'n,* the Court affirmed the award saying:

> Going value was excluded both by court and by commission as an item of property to be separately appraised and separately reported. The record justifies a holding that it was reflected in the other items and particularly in the appraisal of the physical assets as part of an assembled whole. . . . This, we think, was adequate.\(^ {18}\)


13. 154 Wisc. 121, 142 N.W. 476 (1913).


15. In a rate case, the purpose of valuating the utility property is to establish a base value from which a rate may be determined which will give the utility a reasonable return on its capital investment. This purpose distinguishes rate cases from eminent domain cases, but it is far from clear whether this distinction has any practical importance. While the writers in the field point out several theoretical differences between the two types of valuation and their effects on the final figure arrived at (1 *Bonbright 436-40*; 2 *Bonbright 1147*; 2 *Orzel 78*; *Whitten, op cit. supra* note 1, at 14), in practice the courts do not generally distinguish the purposes and cite both rate and condemnation cases quite indiscriminately when referring to public utility going concern valuation. In People ex rel. Kings County Lighting Co. v. Willcox, 210 N.Y. 479, 486, 104 N.E. 911, 912 (1914), the court expressly rejected any difference in method when valuating going value for one purpose or the other.


According to the other view, going concern value is to be treated as a distinct intangible asset, valued and awarded separately and in addition to the reproduction cost figure. Thus, in *International Ry. Co. v. Prendergast*, the court stated:

"In obtaining reproduction cost new, the value of the business as complete and ready to begin operation is ascertained. There must be added a going value, the value of the plant, not as it is ready to begin operation, but the additional value which accrues because the plant is in operation..."

In the instant case, Special Term found that claimants were incapable of profitable operations at the present rate. However, it rejected the city's contention that claimants were therefore entitled only to scrap or "bare bones" value and proceeded to award claimants the cost of reproducing the physical assets. The court reasoned that since the city continued to operate the bus lines, the bus service was still serving a useful purpose, and consequently the property must be valued as "property in use." The court distinguished this from junk value by assigning an indefinite "full going..."

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19. However, this value, arising as it does from the fact that a hypothetical purchaser would pay more for a "live" plant than a "dead" one, is not generally attributed to the reproduction cost of any specific intangible asset although a definite sum is fixed by the appraiser. This figure, representing going value, is usually an arbitrary percentage of the value of the physical assets measured at reproduction cost. See *McCardle v. Indianapolis Water Co.*, 272 U.S. 400, 414 (1926); *City of Minneapolis v. Rand*, 285 Fed. 818, 830 (8th Cir. 1923); *Pacific Gas & Elec. Co. v. City & County of San Francisco*, 273 Fed. 937, 940-41 (N.D. Cal. 1921); *Missouri So. Pub. Serv. Co.*, P.U.R. (n.s.) 269, 284-86 (Mo. Pub. Serv. Comm'n 1934); *Brookville v. Brookville Elec. Co.*, P.U.R. 1922D 1, 7 (Ind. Pub. Serv. Comm'n 1922).

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value” to the tangible assets despite the lack of earning capacity.\textsuperscript{24} Moreover, the court refused to allow a separate and additional valuation for claimants’ specific going concern assets, including coach routes, operating schedules, systems, records and procedures, trained personnel, garage and shop layout and operating rights.\textsuperscript{25} Thus, the award by Special Term of the reproduction cost new less depreciation of the physical assets viewed “in use” was of the “lump sum” type discussed above, normally awarded only to profitable utilities.\textsuperscript{26}

The Court of Appeals rejected this method of valuation and, in effect, adopted the other concept of going concern value. The court defined “going concern value” as “the component of value in the business which in addition to the value of the tangible assets reflects an efficient operation.”\textsuperscript{27} In accordance with this view of going value, the court held that the award by the lower court of reproduction cost was sufficient only to compensate the claimants for their physical assets.\textsuperscript{28}

The higher court also disagreed with Special Term as to claimants’ capability of earning a profit. The court adopted the claimants’ position\textsuperscript{29} that the city was obligated to permit them to charge a reasonable fare, that the current fifteen cents rate was unreasonable, and that under a reasonable fare they were capable of profitable operations.\textsuperscript{30} Consequently, the court

\textsuperscript{24} There is but meager authority for such an allowance where the utility has been found unprofitable. See 1 \textsc{Bonbright} 440-44; 2 \textsc{Orgel} 141-45. Indeed, the precedents cited by the Special Term in support of its action, \textit{Kimball Laundry Co. v. United States}, 338 U.S. 1 (1949); \textit{City of Denver v. Denver Union Water Co.}, 246 U.S. 178, 190-91 (1918), and \textit{City of Omaha v. Omaha Water Co.}, 218 U.S. 180, 202 (1910), are of doubtful authority since each case dealt with a profitable business.

\textsuperscript{25} 46 Misc.2d at 26, 29, 259 N.Y.S.2d at 328, 331. The court ruled that these “expenses” were not elements of going concern value “in this case,” apparently on the grounds that claimants’ businesses were unprofitable: “[T]he expenditures to which it is sought [by the claimants] to assign a value must have resulted in earning money.” \textit{id.} at 30, 259 N.Y.S.2d at 332. Thus claimants seemingly would have received some compensation for these intangible assets if they were earning money. Whether in such a case Special Term would have assigned a separate and specific value to each item or would have lumped them into the reproduction cost figure is unclear.

\textsuperscript{26} In reviewing the award, the Appellate Division, while noting that the valuation of the physical assets was somewhat “overgenerous,” held it to be essentially fair and recognized that the excess was correctly attributable to claimants’ intangible “in use” value. 23 App. Div. at 466-67, 261 N.Y.S.2d at 788.

\textsuperscript{27} 18 N.Y.2d at 220, 219 N.E.2d at 413, 273 N.Y.S.2d at 55 (1966). (Emphasis added.)

\textsuperscript{28} See cases cited at notes 19 & 21 \textit{supra}. The Court of Appeals appears to have ignored the fact that the lower court purposely inflated its valuation of the physical property to allow for going or “in use” value.

\textsuperscript{29} Brief for Appellant, pp. 7-25, 46-58.

\textsuperscript{30} The lower court rejected these contentions on the grounds that the city had made a legitimate political decision in the public interest to maintain the fare of fifteen cents and that it was economically impossible for the claimants to raise their fare and make profits because roughly 65% of claimants’ bus lines was in competition with the city-owned rapid-transit system which maintained a fare of fifteen cents. Thus, if claimants had raised their fares, they would have lost all of their passengers to the subway. 46 Misc.2d 14, 21-23, 259 N.Y.S.2d 313, 323-25 (1964).
held that the claimants were entitled to compensation for the routes, schedules, systems and other intangible assets not valuated or awarded below. 31

As discussed above, 32 the Court of Appeals defined “going concern value” as an element of value of the business to be added to the value of the physical property. Consequently, the case was remanded for a determination of the value of those going concern assets rejected below as an addition to the amount previously awarded. 33 It may be surmised from this that the court has rejected “lump sum” condemnation awards and seeks to have the intangible going value separately and specifically valued and reported. 34

It is submitted that the majority properly rejected the trial court’s method of valuing and awarding going value. To award going value solely by giving due consideration to the fact that the physical property is “in use” and will be continued “in use” after the taking is just but, at best, imprecise. Imprecision too often leads to inaccuracy. Under this method, inaccuracies by lower tribunals would be hard to detect on appeal, and then only impressionistically. Undoubtedly, going concern valuation is a difficult task, made even more so by the fact that invariably the estimates of going value submitted by the condemnee and the condemnor are grossly distorted to favor their respective sides. However, this should not justify following the line of least resistance. The method this decision illustrates seems to have the advantage of being somewhat more concrete and rational. It is true that going concern value is incapable of definite measurement, but if specific values are assigned to specific intangible assets, courts of last resort will be aided in their review of condemnation awards and be better able to determine whether the condemnee was justly compensated for his property. 35

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31. In support of its finding that the transit companies were capable of earning profits, the Court of Appeals pointed out that in the past, fare increases by claimants caused an increase in its revenue and only a small decrease in its passengers. 18 N.Y.2d at 221, 219 N.E.2d at 413, 273 N.Y.S.2d at 56.

32. See text accompanying notes 27 & 28 supra.

33. An interesting but presently unanswerable question raised by this case is whether the Court of Appeals would have affirmed the “lump sum” award, including the undefined amount awarded for “in use” value, if they also had found the claimants to be incapable of profitable operations.

34. While there is authority for a separate valuation of going value (see cases cited notes 19 and 21 supra), there is virtually no precedent for requiring estimates of the duplication value of routes, records, procedures, personnel and the like. Claimants' brief to the Court of Appeals cited no authority for such action. Brief for Appellant, pp. 29–37. In International Ry. v. Prendergast, 1 F. Supp. 623 (W.D.N.Y. 1932), a rate case, the court stated (at 629) that these items were “the factors of going value,” but then separately valued them at 10% of the value of the physical assets. The cost of reproducing personnel and records was flatly rejected as an element of going value in Northern States Power Co., 55 F.U.R. (n.s.) 257, 265 (N.D. Pub. Serv. Comm’n 1944) and Syracuse Lighting Co., 30 P.U.R. (n.s.) 385, 460 (N.Y. Pub. Serv. Comm’n 1939).

35. “Had the Secretary seen fit to value going concern value as a separate item, it would have been more accurate and simplified our task.” Denver Union Stock Yard Co. v. United States, 21 F. Supp. 83, 89 (D. Colo. 1937).
FEDERAL COURTS — FEDERAL RULE OF CIVIL PROCEDURE 19 — THE INDISPENSABLE PARTY DOCTRINE DECLARED TO BE SUBSTANTIVE LAW AND UNAMENABLE TO ALTERATION BY A PROCEDURAL RULE.

Provident Tradesmens Bank & Trust Co. v. Lumbermens Mut. Cas. Co. (3d Cir. 1966)

Plaintiff, as administrator of the estate of an automobile accident victim, recovered a default judgment against the estate of the driver of the car in which the plaintiff's decedent had been riding. Defendant insured the owner of the car under a policy which extended coverage to persons driving with the owner's permission, and it was plaintiff's contention that the driver was operating the car within the scope of the owner's consent at the time of the accident. After defendant's refusal to defend in the action brought against the estate of the driver, plaintiff commenced the present diversity suit for a declaratory judgment that the driver was an insured within the terms of the policy. Two other victims of the same accident, who were plaintiffs in pending state actions against the car's owner for related injuries, were joined as plaintiffs in the present suit, but the owner himself was not joined as a defendant. The district court rendered the declaratory judgment requested. On appeal, the Third Circuit vacated and remanded, holding, after having raised the issue sua sponte, that the car's owner was an indispensable party in whose absence the suit must be dismissed.1 The court declared that the indispensable party doctrine, as delineated in Shields v. Barrow2 and its progeny, is substantive law which accords a party whose interests may be affected by the outcome of an action a substantive right to be joined. Rule 19 of the Federal Rules of Civil Procedure cannot, consistent with the Federal Rules Enabling Act,3 effect any alteration in the standards by which the existence of an indispensable party is determined. Provident Tradesmens Bank & Trust Co. v. Lumbermens Mut. Cas. Co., 365 F.2d 802 (3d Cir. 1966), cert. granted, 87 S.Ct. 972 (1967).

Rule 19, as it existed prior to a recent amendment, incorporated the phrase "indispensable parties" but, because of the draftsmen's failure to define its meaning, was deemed merely declarative of existing decisional law specifying the standards for determining indispensability.4 For the

1. The car owner's insurance policy with defendant set finite limits on the amount payable for claims arising out of the same accident. The court reasoned that since a judgment against the insurer in the present action would deplete the fund available for the owner's own protection in the pending state actions, his interests would be so affected by the decree as to make him an indispensable party.

2. 58 U.S. (17 How.) 129 (1854).


4. Kuchenig v. California Co., 350 F.2d 551, 553 (5th Cir. 1965), cert. denied, 382 U.S. 985 (1966); Stumpf v. Fidelity Gas Co., 294 F.2d 886, 890 (9th Cir. 1961) ;
most part, the precedent cited by federal courts in specification of these standards was derived from Shields v. Barrow. In the instant case, the majority acted upon the assumption that former rule 19 was applicable and, consequently, did not consider the amended rule. It is believed, however, that the principal significance of the decision is to be found in its bearing upon the new rule 19.

The precise extent of the changes wrought by new rule 19 is uncertain. On the one hand, it has been said that amended rule 19(b) merely codifies the equitable standards which courts have considered in the past in determining whether an absent party is indispensable. This implies that the new rule merely clarifies, rather than changes, the indispensability doctrine laid down by Shields v. Barrow and subsequent cases. If so, the instant decision would present no threat to the validity of the new rule. Rather, in its failure to reason in terms of these standards in arriving at the determination of indispensability, the instant decision would represent no more than another erroneous application of old rule 19.

There is strong reason to believe, however, that amended rule 19, unlike its predecessor, affords the district courts sufficient discretion to proceed with a suit even absent a party who would have been indispensable.


5. But see notes 43, 44 infra and accompanying text.

6. 58 U.S. (17 How.) 129 (1854). The Court defined indispensable parties as:

Persons who not only have an interest in the controversy but an interest of such a nature that a final decree cannot be made without either affecting that interest, or leaving the controversy, in such a condition that its final termination may be wholly inconsistent with equity and good conscience.

Id. at 139.

7. The dissent argued that amended rule 19 was applicable since the appeal was pending on July 1, 1966, the effective date of the amendment. 365 F.2d at 822 (dissenting opinion).

8. FED. R. CIV. P. 19, which reads in applicable part:

(a) Persons to be Joined if Feasible. A person who is subject to service of process and whose joinder will not deprive the court of jurisdiction over the subject matter of the action shall be joined as a party in the action if (1) in his absence complete relief cannot be accorded among those already parties, or (2) he claims an interest relating to the subject of the action and is so situated that the disposition of the action in his absence may (i) as a practical matter impair or impede his ability to protect that interest or (ii) leave any of the persons already parties subject to substantial risk of incurring double, multiple, or otherwise inconsistent obligations by reason of his claimed interest.

(b) Determination by Court Whenever Joinder Not Feasible. If a person as described in subdivision (a) (1)-(2) hereof cannot be made a party, the court shall determine whether in equity and good conscience the action should proceed among the parties before it, or should be dismissed, the absent person being thus regarded as indispensable. The factors to be considered by the court include: first, to what extent a judgment rendered in the person's absence might be prejudicial to him or those already parties; second, the extent to which, by protective provisions in the judgment, by the shaping of relief, or other measures, the prejudice can be lessened or avoided; third, whether a judgment rendered in the person's absence will be adequate; fourth, whether the plaintiff will have an adequate remedy if the action is dismissed for nonjoinder.


under the *Shields v. Barrow* doctrine. If joinder of a party thus defined is impossible, dismissal is no longer automatic. Rather, the court, guided by specified equitable criteria, shall determine whether the action should proceed in his absence. If not, the party is termed "indispensable," but only in a conclusory sense. Thus, to the extent that amended rule 19 makes discretionary any joinder which was formerly mandatory, the instant decision has, in its holding that the indispensable party doctrine of *Shields v. Barrow* confers a substantive right to joinder, augured a future finding that the new rule exceeds the scope of its authoritative source, the Enabling Act, which provides that the rules "shall not abridge, enlarge, or modify any substantive right. . . ."

As the majority concedes, its contention that the indispensability doctrine attains the status of substantive law is novel. Existing precedent offers no direct support for the proposition. Since the majority has failed to clarify the precise bases for its holding, it becomes necessary to speculate concerning the probable grounds for the decision.

In the dissent's view, the majority holding is premised upon the traditional argument employed by courts disfavoring inclusion of the element of discretion in the determination of indispensability — the so-called jurisdictional argument. A significant number of federal cases can be found which appear to regard the absence of an indispensable party as a factor depriving the court of jurisdiction or power to adjudicate, even as between the parties before it, in spite of the fact that *Shields v. Barrow* supports no such conclusion. The effect of the jurisdictional argument is to render any liberalization of the indispensability concept under the guise of procedural reform a jurisdictional change, beyond the scope of the Enabling Act and prohibited by the specific terms of rule 82.

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12. See note 8 supra.
13. 2 BARRON & HOLTZOFF, op. cit. supra note 11, at 25-26; Fink, supra note 11, at 423.
14. See note 8 supra.
18. 365 F.2d at 806.
20. 365 F.2d at 817 (dissenting opinion).
22. Fink, supra note 11, at 416.
23. MOORE, FEDERAL PRACTICE AND PROCEDURE § 3.01, at 111 (1966); Note, 50 IOWA L. REV. 1135, 1150 (1965).
24. Fed. R. Civ. P. 82, which provides: "These rules shall not be construed to extend or limit the jurisdiction of the United States district courts. . . ."
RECENT DEVELOPMENTS

The "jurisdictional" language in many of these cases, however, is readily explicable upon other grounds. With respect to those remaining cases which cannot be explained away, it is sufficient to indicate that today the jurisdictional argument stands almost totally discredited. Thus, historical investigation has shown that present compulsory joinder precepts find their genesis in early equity rules under which all third parties materially interested in the subject matter of the litigation were regarded as merely "necessary," and hence dispensable if joinder were impossible or impracticable. The indispensability concept was a later development arising somewhat anomalously out of equity's obsession with the idea that unless a court could completely dispose of the entire controversy in one suit, it should decline to decide the case at all. Therefore, since "the concept of indispensability . . . was to a large extent self-imposed as a limitation upon federal equity jurisdiction," the view that the absence of an indispensable party deprives the court of jurisdiction to adjudicate the case before it seems inexplicable in terms of the historical development of the rule. Moreover, as recent commentary has indicated, the jurisdictional argument lacks even logical consistency. In the absence of an indispensable party, the court, to be sure, cannot exercise jurisdiction over him or bind him by its decree. But the court clearly does have jurisdiction over the parties actually before it, and the indispensable party's absence cannot logically be said to deprive the court of its power to render a judgment affecting only their interests — assuming such can be done.

The authorities relied upon by the majority, however, indicate that, contrary to the dissent's assumption, it rejected the jurisdictional argument and placed primary emphasis upon the nebulous language in some of the cases to the effect that failure to join a Shields v. Barrow indispensable party is a more basic "fatal error." For the most part, federal

25. Thus, a critical examination of the language in question, as employed in a number of diversity cases, reveals that it relates not to the court's lack of jurisdiction in the absence of an indispensable party, but rather to a lack of diversity of citizenship that would arise if the indispensable party were joined. By this it is meant that there would be no subject matter jurisdiction if the indispensable party were joined as he should have been. Fink, supra note 11, at 416 n.53. For other suggested explanations of the jurisdictional language in some of the cases cited in support of the jurisdictional argument, see Fink, supra note 11, at 416 n.53; Comment, 38 So. CAL. L. REV. 80, 81 (1965).

26. Elmendorf v. Taylor, 23 U.S. (10 Wheat.) 152, 166 (1825); Olson v. Miller, 263 F.2d 738, 740 (D.C. Cir. 1959); Hudson v. Newell, 172 F.2d 848, 850-51 (5th Cir. 1949); Washington v. United States, 87 F.2d 421, 427-28 (9th Cir. 1936); Cohn, supra note 9, at 1206; Reed, Compulsory Joinder of Parties in Civil Actions, 55 MICH. L. REV. 327, 348 n.70 (1957).

27. Fink, supra note 11, at 416 n.53. For other suggested explanations of the jurisdictional language in some of the cases cited in support of the jurisdictional argument, see Fink, supra note 11, at 416 n.53; Comment, 38 So. CAL. L. REV. 80, 81 (1965).


29. E.g., Washington v. United States, 87 F.2d 421, 427-28 (9th Cir. 1936).

30. Several federal decisions, however, can be summoned in support of the proposition that the indispensable party doctrine is not an inflexible rule but is one self-imposed by the court and susceptible to modification, at the court's discretion, in the interest of justice. See, e.g., Mallow v. Hinde, 25 U.S. (12 Wheat.) 193, 197 (1827); Elmendorf v. Taylor, 23 U.S. (10 Wheat.) 152, 166-67 (1825); Gauss v. Kirk, 198 F.2d 83, 85 n.2 (D.C. Cir. 1952).
courts have always regarded the indispensability doctrine as a mandatory rather than discretionary rule of law, necessitating dismissal in the absence of compliance.\footnote{\textsuperscript{32}} One possible interpretation of this apparently broader basis for the decision is that, in the majority's view, considerations of due process prohibit maintenance of a suit in the absence of a party indispensable under traditional standards.\footnote{\textsuperscript{33}} If in fact, this was the court's reasoning, its conclusion finds negligible support. The Supreme Court, it is true, has implied that, under compelling circumstances, the failure to join such a party might amount to a denial of due process,\footnote{\textsuperscript{34}} but this implication hardly elevates the indispensability concept of \textit{Shields v. Barrow} to a rule of constitutional law. The new formulation of the indispensability principle upon which amended rule 19 is predicated takes full cognizance of the fact that the decision as to whether to proceed in an interested party's absence must be made with due process considerations in mind.\footnote{\textsuperscript{35}} The protective provisions of amended rule 19(b)\footnote{\textsuperscript{36}} are sufficiently clear to insure that, properly applied, the rule will not operate to deprive a person of any constitutional right to joinder he may have.\footnote{\textsuperscript{37}}

Rather, the most probable explanation of the instant decision appears to be that the majority implicitly fell prey to the reasoning, heretofore expressed by at least one commentator,\footnote{\textsuperscript{38}} that the mandatory, non-discretionary treatment accorded the indispensability doctrine by the courts invites the conclusion that it is, if not a rule of constitutional or jurisdictional dimension, at least a rule of substantive law. However, the statement that the courts have tended to treat the indispensability doctrine in such a manner appears to beg the question of whether, considered apart from its mode of application, the doctrine is substantive or procedural in nature. It is submitted that the instant court's own fatal error is to be found in its failure to analyze the indispensable party rule in terms of the substantive-procedural dichotomy necessitated by the Enabling Act.

Such an analysis is admittedly difficult, since "substantive" and "procedural" are chameleon-like terms, incapable of precise definition.\footnote{\textsuperscript{39}} Of
some assistance, however, are the decisions involving the status of the indispensability principle as substantive law or procedural rule within the doctrine of *Erie R.R. v. Tompkins.* The substantive-procedural boundaries delineated for purposes of the *Erie* doctrine are clearly not conclusive of those prevailing under the Enabling Act. Nevertheless, it is felt that the *Erie*-based decisions in this area offer an explanation of the indispensability concept which tends to support its classification as procedural for Enabling Act purposes. The decisions in question have not been a model of clarity. Some cases have simply held, without significant explanation, that the determination of whether a party is indispensable is a procedural matter to be decided in accordance with federal law. Other courts, showing greater insight, have reasoned, without reliance upon the outcome-determinative test of *Guaranty Trust Co. v. York,* that since the rights and interests of persons in the subject matter of a diversity suit are created by state substantive law, state law should also prevail in determining which parties must be joined. The correct solution to the problem, however, has been shown to be midway between the two extremes represented by these cases: "[S]tate law determines the nature of the interest a party has in a controversy, while the rules and federal decisions construing them control in determining whether a particular interest, found to exist under state law, should cause the party to be classified as indispensable..." This solution, adopted in a number of better reasoned cases, regards as a strictly procedural function the task of fashioning standards for courts to apply in determining whether a given party, with a predetermined interest in the dispute, must be joined.

The result should be no different when it comes to determining whether the indispensability principle is substantive or procedural for purposes of

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40. 304 U.S. 64 (1938).
43. 326 U.S. 99 (1945). In Kuchenig v. California Co., 350 F.2d 511 (5th Cir. 1965), cert. denied, 382 U.S. 985 (1966), the court relied upon the *York* test to apply state law on the question of indispensability, reasoning that where federal standards would permit maintenance of a suit in the absence of a party deemed indispensable under state law, the result would be outcome-determinative. Because rule 19 now covers the question of indispensability, the validity of the Kuchenig reasoning is uncertain when one considers the sanctity afforded the federal rules by Hanna v. Plumer, 380 U.S. 460 (1965). See Kalodner & Price, Federal Jurisdiction and Practice, Ann. Survey Am. L. 307 (1965). In any event, the reasoning appears, by its very reliance upon the outcome-determinative principle, to assume that the question of indispensability is a procedural, rather than substantive, matter.
the Enabling Act. A rule prescribing what parties are required to be joined is designed, at least in part, to facilitate the orderly dispatch of judicial business and, in this sense, is clearly procedural and within the rule-making power.\(^{47}\) Moreover, the view, expressed in at least some of the decisions\(^{48}\) and seemingly confirmed by historical analysis,\(^{49}\) that the indispensable party rule is essentially a court-made standard, subject to discretionary modification in the interests of justice, appears to point to the procedural, rather than substantive, character of the rule.\(^{50}\) These considerations tend to show that the indispensability principle is, if not clearly, at least arguably procedural in nature. After *Hanna v. Plumer*,\(^{51}\) however, there can be no doubt that it is within the scope of the Enabling Act "to regulate matters which, though falling within the uncertain area between substance and procedure, are rationally capable of classification as either."\(^{52}\) Since the indispensability concept is "rationally capable of classification as" procedural, it follows that if amended rule 19 permits any liberalization of the *Shields v. Barrow* indispensable party doctrine, it is in permissible furtherance of the Enabling Act and not, as the instant case suggests, in violation thereof.

As a final point, it may be noted parenthetically that acceptance of the majority's premise points to an anomaly within the instant decision. For once it is assumed that the indispensable party principle is substantive law for purposes of the Enabling Act, the conclusion is inescapable that it is also substantive law for purposes of the *Erie* doctrine.\(^{53}\) Therefore, unless the majority is prepared to sustain the doubtful proposition that the indispensability principle of *Shields v. Barrow* is a rule of constitutional law,\(^{54}\) the *Erie* doctrine would seem to dictate application of state joinder rules in a diversity suit, rather than federal indispensability standards.

Though the instant decision represents an unjustifiable threat to the operative freedom of amended rule 19, it is entirely possible that other federal courts will follow it.\(^{55}\) If so, the liberalization in compulsory joinder requirements which amended rule 19 apparently seeks to effect would be thwarted. For this reason, it is urged that continued thought be given to recent proposals recommending nationwide service of process as a means of remedying the absent party problem. This would empower federal courts to summon and adjudicate the rights of all absent parties, whether indispensable or merely necessary.\(^{56}\)

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48. See note 31 *supra*.
49. See notes 27, 28 *supra* and accompanying text.
50. See Fink, *supra* note 11, at 431.
52. *Id.* at 472.
54. See notes 33–37 *supra* and accompanying text.
55. See Fink, *supra* note 11, at 427.
LABOR LAW — CRAFT SEVERANCE — PETITIONS FILED UNDER SECTION 9(b)(2) WILL BE EVALUATED ON A CASE BY CASE BASIS IN LIGHT OF THE TOTAL INTERESTS OF ALL THOSE CONCERNED.


A member local of the International Brotherhood of Electrical Workers petitioned the National Labor Relations Board for severance of twelve instrument mechanics from a production maintenance unit comprised of 130 production operators and 150 maintenance employees. This group had been represented for twenty-five years by a plant-wide unit. The Mallinckrodt plant is engaged in a continuous processing system of extracting uranium metal from raw ore for sale exclusively to the Atomic Energy Commission. The instrument mechanics work out of physically distinct facilities under separate supervision, with their own seniority, and receive pay commensurate with other instrument mechanics in the industry. Under the hiring policy of the plant, experienced men are hired and then progress under a specific scheme to a "Class A" status. The work of the instrument mechanics is technical in nature and seventy-five per cent of their time is spent on the production line repairing, in coordination with the line employees, the control apparatus that regulates production operations. If an unplanned shutdown occurs, it requires several days to resume production. Petitioner union, while representing no other separate craft units of this nature, does represent such craftsmen in larger plant units. The experience of the union is primarily in representing electricians rather than instrument mechanics like those in the Mallinckrodt plant.

Using the analysis of the heretofore controlling severance policy, the *American Potash* doctrine, the Board initially found that a severable craft unit did exist, but that petitioner union was not a traditional representative of this craft. However, at the request of the employer, the Board took this opportunity to review its severance policy, and in so doing overruled *American Potash*. It adopted a new six point analysis designed to balance the total interests of all the parties and reached the same result it would have under *American Potash*, but on different grounds, holding that the severance petition would be denied because of the essential role played by the instrument mechanics in the actual production of the uranium metal, the existence of an integrated production process and the submergence of the craft's interests into the existing plant unit. *Mallinckrodt Chem. Works*, 2 LAB. REL. REP. (64 L.R.R.M.) 1011 (NLRB Dec. 28, 1966).

The Board's initial problem in formulating a severance policy is to fashion a suitable guideline that effectuates the general purposes of the

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1. The NLRB's policy established in this case was to grant severance when (1) a true craft requests such and (2) the union seeking to represent the craft unit is a traditional representative of the craft. *American Potash & Chem. Corp.*, 107 N.L.R.B. 1418 (1954).
National Labor Relations Act and, at the same time, recognizes the interests of the petitioning craftsmen. Since the inception of section 9(b)(2) as part of the Wagner Act in 1935, the Board has vacillated in its approach to the problem. Unguided by the statute itself, the Board, when confronted with a petition to sever a craft unit, initially interpreted section 9(b)(2) to favor a larger plant unit over the smaller craft unit in order to foster bargaining stability. However, in the 1937 case of Globe Machine & Stamping Co., a new position was adopted permitting self-determination by the craft units when a plant was initially unionized. A quick reversal again took place in 1939 in the American Can Co. case, in which a satisfactory prior bargaining history was considered determinative in denying severance of a craft from an existing production and maintenance unit. The new policy therein exemplified was aimed at continuing existing labor-management stability and fostering responsible bargaining.

In the post World War II period, which was marked by the appointment of a new Board, a drift towards a more permissive policy began to develop. In the International Minerals & Chem. Corp. decision the Globe doctrine of self-determination was partially revived in situations in which a craft unit had never voted in a severance election, or had not done such in the last three or four years. Tempering this development was the coincident decision of the Board to more restrictively define the standards to be met in order to qualify as a "craft." In 1947 Congress passed the Taft-Hartley Act which amended section 9(b)(2) by adding a proviso to sublate the American Can decision.

Shortly after the amendment was passed the Board, in the National Tube Co. decision, interpreted the proviso to mean that Congress had

2. 49 Stat. 453 (1935), 29 U.S.C. § 159(b) (1946), which states:
   The Board shall decide in each case whether, in order to insure to the employees the full benefit of their right to self-organization and to collective bargaining, and otherwise to effectuate the policies of this Act, the unit appropriate for the purposes of collective bargaining shall be the employer unit, craft unit, plant unit, or subdivision thereof.


5. 3 N.L.R.B. 294 (1937).


7. 71 N.L.R.B. 878 (1946). This case was actually a culmination of a more liberal trend initiated in General Elec. Co., 58 N.L.R.B. 57 (1944).

8. 61 Stat. 143 (1947), 29 U.S.C. 159(b) (2) (1964), which added:
   Provided, That the Board shall not . . . (2) decide that any craft unit is inappropriate for such purposes on the ground that a different unit has been established by a prior Board determination, unless a majority of the employees in the proposed craft unit vote against separate representation. . . .

foreclosed the board from making a prior unit determination the controlling test, but that this element could remain as a factor. Under this decision the basic steel industry was held to be most appropriately represented by plant-wide units.\textsuperscript{10} A reversal of policy again took place after the Eisenhower Board was appointed. In the 1954 decision of \textit{American Potash Chem. Co.},\textsuperscript{11} the Board interpreted the Taft-Hartley amendment to section 9(b)(2) as an affirmative mandate to allow self-determination in craft severance cases when a genuine craft requests such, notwithstanding prior bargaining history:

Accordingly we find that the intent of Congress will best be effectuated by a finding . . . that a craft group will be appropriate for severance purposes in cases where a true craft group is sought and where, in addition, the union seeking to represent it is one which traditionally represents the craft.\textsuperscript{12}

The Board specifically indicated that it intended to rigidly enforce both of these requirements.\textsuperscript{13} Also, for the first time since 1935, a definitive statement of policy for departmental units was established.\textsuperscript{14} Under the \textit{American Potash} doctrine, as it evolved, specific factors were of import in qualifying as a craft. Some of these hallmarks of a craft were: necessity of an apprenticeship or comparable experience,\textsuperscript{15} separate supervision,\textsuperscript{16} separate seniority,\textsuperscript{17} and distinct pay scales, hours and working conditions.\textsuperscript{18} In addition, a union would not qualify as a traditional representative if it merely represented similar craftsmen in plant units,\textsuperscript{19} or had a substantial portion of its membership formed of such craftsmen.\textsuperscript{20}

\textsuperscript{10} The \textit{National Tube} doctrine was also extended to the basic aluminum industry in \textit{Permanente Metals Corp.}, 89 N.L.R.B. 804 (1950); the lumber industry in \textit{Weyerhaeuser Timber Co.}, 87 N.L.R.B. 1076 (1949); and the wet milling industry in \textit{Corn Prod. Ref. Co.}, 80 N.L.R.B. 362 (1948).


\textsuperscript{12} 107 N.L.R.B. at 1422.

\textsuperscript{13} The Board set general criteria that would have to be met:

In our opinion a true craft unit consists of a distinct and homogeneous group of skilled journeymen craftsmen, working as such, together with their apprentices and/or helpers. To be a "journeyman craftsmen," an individual must have a kind and degree of skill which is normally acquired only by undergoing a substantial period of apprenticeship or comparable training . . . . Furthermore, such craftsmen must be primarily engaged in the performance of tasks requiring the exercise of their craft skills.

In requiring that the union seeking severance must be the one which traditionally represents the craft we are taking cognizance of the fact that there are unions which have devoted themselves to the special problems of the various craft employees. . . .

\textit{Id.} at 1422-24.

\textsuperscript{14} "In this connection, we also recognize the equities of the employees in certain other minority groups though lacking the hallmark of craft skill, may also require that they be treated as severable units." \textit{Id.} at 1424.

\textsuperscript{15} \textit{Container Corp. of America}, 121 N.L.R.B. 249 (1958).

\textsuperscript{16} \textit{Hughes Aircraft Co.}, 115 N.L.R.B. 504 (1956).

\textsuperscript{17} \textit{Universal Match Corp.}, 116 N.L.R.B. 1388 (1956).


\textsuperscript{19} \textit{Nisset Baking Corp.}, 131 N.L.R.B. 589 (1961).

\textsuperscript{20} \textit{Standard Oil Co.}, 116 N.L.R.B. 1017 (1956).
A history of separate and specialized representation of the craft was re-
quired, but a union that was specifically formed to represent a particular
craft or departmental unit would qualify.\textsuperscript{21} Even though \textit{American Potash}
followed the \textit{Globe} concept of self-determination, it specifically sustained
the vitality of the \textit{National Tube} doctrine. In fact, subsequent to \textit{American Potash}, the \textit{National Tube} doctrine was held applicable to new plants
within the exempted industries.\textsuperscript{22}

Judicial review of severance decisions is unusual,\textsuperscript{23} because an em-
ployer must refuse to bargain with the Board-certified craft union and
then litigate the decision in an unfair labor practice action brought against
the employer for failure to bargain\textsuperscript{24} under section 8(a)(5).\textsuperscript{25} However,
the Fourth Circuit Court of Appeals has been acutely critical of the
Board's policy formulated in \textit{American Potash}. In 1959 this court denied
an enforcement order requested in \textit{NLRB v. Pittsburgh Plate Glass Co.}.\textsuperscript{26}
The criticism of the court was that by using the \textit{Globe} doctrine the Board
had effectively abdicated its statutory duty to make determinations on a
"case by case" basis and had allowed the mere whim of the craftsmen
to govern. Although the court didn't specifically address itself to the
matter, its rationale is equally applicable to and critical of the Board's
extension of the \textit{National Tube} doctrine to a new plant within the four
industries. This is a reasonable inference to draw because in these in-
stances the Board clearly violates the specific proviso of section 9(b)(2)
not "to decide that any craft unit is inappropriate . . . on the ground that
a different unit has been established by prior Board determination. . . ."\textsuperscript{27}
The court refused enforcement of this particular order, because it felt
that the same factors of an integrated production process and prior history
of plant bargaining were found in the Pittsburgh Plate Glass plant that
were found in the \textit{National Tube} case. The court therefore concluded that
it was an arbitrary exercise of discretion to allow one industry to have
a plant unit and to deny the same to another industry on the same essen-
tial facts.\textsuperscript{28} This same circuit in 1962 reaffirmed its disapproval of the
\textit{American Potash} policy and in similar circumstances again denied an
enforcement petition.\textsuperscript{29}

\begin{footnotes}
\textsuperscript{23}. In \textit{AFL v. NLRB}, 308 U.S. 401 (1940), the Court held that union certifica-
tions were not directly reviewable under § 10(f) of the NLRA, 72 Stat. 148 (1958),
\textsuperscript{24}. An alternative means of attaining review is available since Board orders are
not self-enforcing and an enforcement order must be issued by the court of appeals.
It is possible to contest the Board decision in this enforcement proceeding. \textit{E.g.},
\textit{NLRB v. Pittsburgh Plate Glass Co.}, 270 F.2d 167 (4th Cir. 1959), \textit{cert. denied}, 361
U.S. 943 (1960).
with a duly recognized union an unfair labor practice.
\textsuperscript{26}. 270 F.2d 167 (4th Cir. 1959), \textit{cert. denied}, 361 U.S. 943 (1960).
\textsuperscript{28}. See generally Denbo, \textit{Random Thoughts on NLRB's American Potash
\textsuperscript{29}. \textit{Royal McBee Corp. v. NLRB}, 302 F.2d 330 (4th Cir. 1962).
\end{footnotes}
Two seemingly conflicting interests are at issue in formulation by the NLRB of its severance policy. On one hand, a craftsman is entitled to be a member of a union and, as a corollary of this, should be able to select a bargaining representative that is attuned to his peculiar interests. In general, a craft union will be the representative best meeting the needs of a worker so situated. Against this consideration is the overall need for stability in labor-management relations, and the interests of the other plant employees in having a unified bargaining unit in order to present the strongest possible position in collective bargaining. In historical perspective, each of these has at one time or another been the primary goal of the Board's severance policy. The formulation enunciated in Mallinckrodt is designed to equitably balance these interests in making decisions under section 9(b)(2).

By adopting the "total interests" policy the Board has overruled almost two decades of labor law that has developed since National Tube and American Potash. The reason for this reversal is premised on two planes. American Potash rested on the assumption that it was not the essential role of the Board to "dictate the course and pattern of labor organization in our vast industrial complex." The Board now adopts the criticism of its earlier policies as leveled in the Pittsburgh case and acknowledges its unjustified interpretation of the Taft-Hartley amendment, thereby confirming that there is a statutory duty under section 9(b)(2) to decide each case on its individual facts. Resort is also had to the legislative history of this section which, on close reading, indicates that the amendment was not designed to curtail the discretion of the Board, but was in fact intended to free it from any binding effect of its prior determinations. Under the interpretation of section 9(b)(2) in Mallinckrodt, the Board is to meet this duty by reference to the total interests of those involved.

The second plane of approach is to posit this new interpretation of section 9(b)(2), and then to evaluate whether the American Potash policy is in conformity with it. The Board finds its ultimate goal to be attained determined by Congress in the general delegation section of the National Labor Relations Act: "It is the purpose and policy ... to prescribe the legitimate rights of both employees and employers. ..." Since the American Potash doctrine is basically that of the Globe self-determination doctrine, the answer is in the negative. Due to the fact that American Potash serves only the interests of the craft employee and sustains the arbitrary immunization of four industries under National

Tube, a substantially new policy formulation is necessary to assess and protect the interests of all concerned.

The Board, therefore, adopts a six-point criterion to weigh the interests of craft employees, plant employees, the employers and the nation:

1. Whether or not the proposed unit consists of a distinct and homogeneous group of skilled journeymen craftsmen performing the functions of their craft on a nonrepetitive basis, or of employees constituting a functionally distinct department, working in trades or occupations for which a tradition of separate representation exists.

2. The history of collective bargaining of the employees sought and at the plant involved, and at other plants of the employer, with emphasis on whether the existing patterns of bargaining are productive of stability in labor relations, and whether such stability will be unduly disrupted by the destruction of the existing patterns of representation.

3. The extent to which the employees in the proposed unit have established and maintained their separate identity during the period of inclusion in a broader unit, and the extent of their participation or lack of participation in the establishment and maintenance of the existing pattern of representation and the prior opportunities, if any, afforded them to obtain separate representation.

4. The history and pattern of collective bargaining in the industry involved.

5. The degree of integration of the employer’s production processes, including the extent to which the continued normal operation of the production processes is dependent upon the performance of the assigned functions of the employees in the proposed unit.

6. The qualifications of the union seeking to “carve out” a separate unit, including that union’s experience in representing employees like those involved in the severance action. These six factors are not new, but are rather a composite of the diverse considerations that the Board has utilized since the original Wagner Act. These factors are not to be considered exclusive, but are the dominant ones in light of the existing circumstances in plant organizational schemes.


35. All of the policy decisions of the NLRB in the craft severance area have been enunciated in actual cases before the Board. Professor Peck criticizes this method charging that it is an improper means of performing the Board’s rule-making function, because it does not conform to the method stipulated by the Administrative Procedure Act. Peck, The Atrophied Rule-Making Powers of the National Labor Relations Board, 70 YALE L.J. 729, 743-46 (1961).

36. The Board left open what steps and policies it might adopt in the future in order to conform to technological changes. Mallinckrodt Chem. Works, 2 LAB. REL. REP. (64 L.R.R.M.) 1011, 1016-17 & n.16 (NLRB Dec. 28, 1966). On the problem of technological change and craft severance, see generally Fanning, The Challenge of Automation in the Light of the Natural Law, 11 LAB. L.J. 875, 881-82 (1960); Gitlow,
A seventh factor may be added which the Board has not expressly articulated. This is the role played by a particular plant or industry in national defense, and the resultant necessity of labor stability. *Mallinckrodt* refers specifically to this, although not within its stated six considerations. "The Employer is engaged in production of uranium metal. It is the only enterprise in the country which is engaged in all phases of production. . . . Continued stability . . . is vital to our national defense." 37 The *National Tube* case also made reference to the role of basic steel: "[A]nd would necessarily have an adverse effect upon its productive capacity in an industry of vital national concern." 38 Both of these cases indicate that there may well be denials of severance premised on the vital interests of the nation which are involved. Of course, the question is what industries will fall into such a classification. One can argue that at least those similar to *Mallinckrodt* will.

*Mallinckrodt* and its two companion cases, *E. I. Du Pont* 39 and *Holmberg Inc.*, 40 decided the same day, present three applications of the new policy. An attempt will be made to analyze these applications of the new standards in order to focus on the critical factors that might be determinative in the consideration of a severance petition.

In none of the three cases was the factor of industry-wide bargaining history at issue. However, in each case the Board applied the standards developed under *American Potash* to determine whether a craft unit existed. It should be noted, moreover, that the Board in *Mallinckrodt* made specific reference to its intent to be more demanding in the standards that must be met in order to qualify as a "craft." 41 It seems clear that this particular point is not merely one which the Board weighs in its balancing of interests, but rather is a condition precedent to the weighing of other factors in the "total interests" test. The determination of whether a severance should be granted in light of all considerations necessarily assumes


39. 2 Lab. Rel. Rep. (64 L.R.R.M.) 1021 (NLRB Dec. 28, 1966). Severance was granted to an electrician's unit which spends 90% of its time performing craft skills on the production line in coordination with the production employees. The electricians serve an apprenticeship, have separate supervision, facilities, seniority and wage scale. There was no prior bargaining history on a plant-wide basis. The Board held that there was a distinct community of interests in the unit even though there was an integrated production process. Mr. Fanning concurred in the result, but excepted to the emphasis placed on the lack of a prior bargaining history.

40. 2 Lab. Rel. Rep. (64 L.R.R.M.) 1025 (NLRB Dec. 28, 1966). A tool room unit was denied severance from a production maintenance group that had bargained for it during the past twenty-four years, and had won special recognition for the tool room unit. Physical facilities were used by others and an overall seniority system was used with members of the tool room working on the lines during work-downs. The Board held there was an identity of interests between the two groups. Mr. Fanning, dissenting, argued that the Regional Director's decision to allow severance should be affirmed. He objected to what he considered to be the determining effect given to the prior bargaining history.

that there is a unit that would be appropriate if the other factors weigh in its favor.

Only Mallinckrodt presented an issue of whether the union seeking the severance was a traditional representative of such craftsmen. Again the Board utilized its American Potash guidelines and found that the union did not qualify as such a representative. Under the new policy this was not to be considered determinative, and therefore this requirement will no longer be a necessary condition to severance. The wisdom of this change is dubious. If a union is not able to adapt to the needs of the craft unit a disruption of labor-management relations is likely to occur. The inability of the non-traditional union to adequately represent the craft may also have the detrimental effect of leading to a series of union changeovers.

The remaining three factors in the "total interests" test — prior bargaining history, the identity of interests norm and the integrated production process — were crucial in each of the three cases. Little insight can be gained from the tests themselves since they are merely stated in the abstract. However, the application of these in the trilogy of cases is enlightening in that it reveals two distinct points of departure. Initially it must be determined whether a particular factor will weigh in favor of granting severance or towards denial of such. A corollary inquiry is whether or not one factor will be weighed more heavily than another. The second point of departure is whether these separately enunciated considerations interplay one with another, and if so, to what extent. A divergence of approach exists between the majority of the Board and the dissenting member, Mr. Fanning, in regard to these points. The subsequent analysis is designed to elucidate and evaluate the merits of these conflicting approaches.

In both Mallinckrodt and Dupont, the Board found that a physically integrated production process of craft functions and production functions existed. Integration in the Board's sense is defined in the test itself: "[T]he extent to which the continued normal operation of the production processes is dependent upon the performance of the assigned functions of the employees in the proposed units." In Mallinckrodt a severance was denied, but in Dupont it was granted. This bears out the reference by the Board that National Tube was overruled only to the extent that

42. Mr. Fanning concurs in the reevaluation of American Potash, but objects to the application of the new analysis. Id. at 1016–17 (dissenting opinion).

43. See note 34 supra and accompanying text.

44. A difference of degree might also be noted in regard to the integration of function in Mallinckrodt and Dupont. The instrument mechanics in the Mallinckrodt plant were absolutely essential to the production process since most of their work was in repairing control apparatus that was necessary to the process. Whereas, in the Dupont operation, the majority of the electrician's work was preventive maintenance of the operating machinery and in-the-shop repair of electrical equipment. It is also pertinent that in the Dupont plant there were instrument mechanics which performed tasks similar to those performed by their counterparts in the Mallinckrodt plant.
severance would not automatically be denied, but that physical integra-
tion would remain a factor.46

Ultimately, all three cases turn on the identity of interests norm that
the Board has established in the third consideration. In both Mallinckrodt
and Holmberg the Board found that there was a submerging of the unique
interests of the unit to be severed — and therefore a loss of whatever
separate identity the unit might otherwise have had — into the overall
interests of the existing plant unit. But in Dupont the finding was to the
contrary. The Board considers this as a finding of fact to be determined
from all the factual circumstances; including the subjective relationship
of the craftsmen to the other employees insofar as there is a mutual
identity in the existing plant unit. A differing position is taken by Mr.
Fanning who approaches this question from a standpoint similar to that
which is used in the physical integration test as understood by the major-
ity. The actual role of the craftsmen in the production process is the
criterion that is indicative of the identity of interests. By example he
states that the following are indicative of a merging of interests: "... 
direct participation in the production process itself; the repetitive per-
formance of routine tasks at a more or less fixed work station along the
assembly line . . . or the acquisition of special skills . . . to enable them
to work on their employer's specialized equipment."46 The majority of
the Board considers this physical interrelationship of function as only
one element in making the factual determination of whether or not a
single community of interests exists, and that the lack of such will not
bar an affirmative finding on this point.47 Mr. Fanning's approach to this
point is related to his divergent conception of the bearing that prior bar-
gaining history should play in making severance decisions.

Under the majority's approach the identity of interest is considered
in light of prior bargaining history. In both Mallinckrodt and Holmberg
the Board weighed the prior stable bargaining history in which the crafts
had received special recognition by different wage scales, hours and
seniority as indicative of a merging of the craft interests into the plant
unit, because the plant unit by recognizing these special needs had absorbed
these interests into its makeup. Mr. Fanning sees the recognition of the
special needs of the craft as an objectively discernible indication of the
existence of a separate identity in the craft. This divergence of approach
may be explained by the fact that Mr. Fanning posits a formal right in
every genuine craft unit to be severed from the plant unit, and also views
section 9(b) (2) as giving rise to a presumption that a severance request
should be granted.48 He thus requires objective indications of the merg-

45. Mallinckrodt Chem. Works, 2 LAB. REL. REP. (64 L.R.R.M.) 1011, 1017 n.17
46. Id. at 1019 (dissenting opinion).
47. For an example of this difference of approach in application, see North Am.
48. Mallinckrodt Chem. Works, 2 LAB. REL. REP. (64 L.R.R.M.) 1011, 1018
(NLRB Dec. 28, 1966) (dissenting opinion).
Mr. Fanning fails to recognize the depth of the prior bargaining test as applied by the majority. The Board evaluates the prior history in light of the effects it has had: "[W]hether the existing patterns of bargaining are productive of stability in labor relations, and whether such stability in labor relations will be unduly disrupted by the destruction of the existing patterns of representation."\[49\] Therefore, when the existing pattern of bargaining fulfills the underlying purpose of the National Labor Relations Act, that is, to promote stability in bargaining, and the severance order would adversely affect the smooth functioning of the plant unit and orderly bargaining patterns, the prior history will have weighted effect against severance. In this perspective there is justification in giving this factor weighted bearing.

Aside from the stated qualifications of the bargaining history test, the Board in Mallinckrodt and Holmberg has engrafted another qualification onto the test. In both instances the Board specifically found that the employees requesting a craft severance had benefited from wages, hours and working conditions that were commensurate with their status qua craftsmen. Therefore, the test, at least as presently applied, seems to require that bargaining history be given a weighted bearing only upon evidence showing fair representation of the interests of the craftsmen in the plant unit. If this were not the case the Board would presumably favor severance.

From the newly enunciated analytical tests of Mallinckrodt, and their subsequent applications in Dupont and Holmberg, a fundamentally new policy has evolved. In formulating prior policies the Board had a basic difficulty because the right of craftsmen to have craft representation was traditionally viewed as almost absolute in nature, and any divergence from this had to be substantiated by specific countervailing factors militating against severance. Under the Mallinckrodt approach, this right is acknowledged only when the reason for the right, the unique needs and interests of the craftsmen, requires it. Even when this need is found, a severance might not be granted when there is an overriding national interest. The possibilities of craft severance have been substantially lessened by the Mallinckrodt decision. The requirements to qualify as a craft unit may be more stringent in the future, and the Board's new approach of viewing the right to craft representation from a substantial rather than formal perspective will also militate against a finding that a craft unit is appropriate.

**Walter John Taggart**

49. See text accompanying note 34 supra.
TAXATION — FEDERAL ESTATE TAX — SETTLOR'S DISCRETIONARY POWER AS CO-TRUSTEE TO DISTRIBUTE OR ACCUMULATE INCOME Requires That Accumulated Trust Income Be Included in the Settlor's Gross Estate.

United States v. O'Malley (U.S. 1966)

Decedent had created five irrevocable trusts during 1936 and 1937, each substantially identical except for the identities of the beneficiaries, naming himself as one of three trustees. Each instrument vested with the trustees the right to either accumulate or distribute income and required that accumulated income be added to the principal. By surrendering all power to revoke, change, or modify the terms of the trust, the decedent effectively divested himself of all financial interest in the corpus or income. At the time of his death the combined value of the trusts was more than three times the original corpus. The increment was attributable solely to the accumulation of income and its judicious reinvestment.

The Commissioner of Internal Revenue valued the gross estate to include both the principal of the combined original trusts and the income subsequently accumulated. Decedent’s executors paid an assessed deficiency under protest and instituted an action in the federal district court to secure a refund of the sum. The district court¹ decided that the original corpus of the combined trusts was includable in the estate,² but excluded that portion of the estate which represented accumulated income. The Commissioner appealed solely to challenge the exclusion of accumulated income but the Seventh Circuit affirmed.³ The Supreme Court reversed, holding that the accumulated income should be included in the gross estate because under section 811(c)(1)(B)(ii) of the Internal Revenue Code of 1939:⁴ (1) the power of the decedent, as one of the trustees, to distribute or accumulate trust income was sufficient to be deemed the power to “designate the persons who shall possess or enjoy the property or the income therefrom,” and (2) that a “transfer” had been made with regard to accumulated income included in the principal. United States v. O'Malley, 383 U.S. 627 (1966).

² The court held that decedent’s power as one of the trustees to designate whether to accumulate income was of such significance as to bring the trust within the purview of § 811(c)(1)(B)(ii) of the Int. Rev. Code of 1939 (now Int. Rev. Code of 1954, § 2036(a)(2)).
³ O'Malley v. United States, 340 F.2d 930 (7th Cir. 1964).
⁴ To the extent of any interest therein of which the decedent has at any time made a transfer ... by trust or otherwise — ... (B) Under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom. ... Int. Rev. Code of 1939, § 811(c)(1)(B), 46 Stat. 1516 (now Int. Rev. Code of 1954, § 2036(a)(2)).
The intent of Congress in enacting the federal estate tax was to levy upon transfers of property which occur at death. The original act passed in 1916 was comparatively simple. However, this simplicity, coupled with the Supreme Court's reluctance to interpret the statute liberally and the ingenuity of taxpayers in seeking to avoid the intent of the law, has caused the present statutory maze. The particular section considered in the present case is one of those designed to alleviate the effects of a combination of taxpayer creativity and the narrow construction given the section's forerunner by the Supreme Court in May v. Heiner, and the affirmation of that decision in three subsequent per curiam opinions.

The judicial history of the issue presented in O'Malley has its genesis in the 1956 decision of the Seventh Circuit in Commissioner v. Estate of McDermott. Under circumstances virtually identical with those of the present case, the court ruled that the accumulated income of the trust was not to be included in the gross estate because there had been no "transfer" of the income to the trust by the decedent as required by the statute. Justification for this rule was based upon earlier decisions which had considered the question of whether to include the accumulated income of trusts whose principals were included in the gross estate because the trust had been deemed to have been created in contemplation of death. It had been uniformly held that the accumulated income was to be excluded from the gross estate because the settlor had completely divested himself of any interest in the property at the time of the creation of the trust and therefore did not possess the control or ownership necessary to "transfer" the after-accumulated income to the trust.

Although criticized, the rule of the Seventh Circuit was followed until 1964 when the Court of Appeals for the First Circuit expressly refused to adopt it and affirmed a decision of the tax court which had held that

7. See Lowndes & Kramer, supra note 5, at 80–98.
11. Commissioner v. Gidwitz, 196 F.2d 813 (7th Cir. 1952); Burns v. Commissioner, 177 F.2d 739 (5th Cir. 1949).
12. O'Malley v. United States, 340 F.2d 930, 933 (7th Cir. 1964) (concurring opinion); O'Malley v. United States, 220 F. Supp. 30, 34 (N.D. Ill. 1963); Lowndes & Kramer, supra note 5, at 434.
the accumulated income of a similar trust was includable in the gross estate of the decedent. Judge Hartigan reasoned that:

The accumulations remained subject to the same control by decedent that caused the corpus to be included in his gross estate. And since the transfer of the trust property was incomplete until decedent, by his death, relinquished the control he held over such property, it follows that the property must be valued at the time of death, when the transfer is complete and the accumulations included in the valuation.16

The opinion was particularly critical of the reliance placed by the Seventh Circuit on Commissioner v. Gidwitz17 and Burns v. Commissioner18 to support its ruling that accumulated income is not includable in the gross estate where the decedent has retained the power to designate the disposition of the income. Judge Hartigan distinguished these cases on the ground that both involved transfers of property in contemplation of death which were complete in all respects at the time they were made, whereas a trust in which the settlor has retained the power of designation is not a complete transfer until he relinquishes that power.

In the principal case, the Supreme Court declared that the applicability of the statute depends upon the answer to two inquiries:

Whether . . . [decedent] retained a power “to designate the person who shall possess or enjoy the property or the income therefrom”, and second, whether the property sought to be included, namely, the portions of the trust principal representing accumulated income, was the subject of a previous transfer by . . . [decedent].19

The ability of the settlor to distribute or accumulate income, thereby denying immediate enjoyment by the beneficiaries and conditioning their eventual enjoyment upon their surviving the termination of the trust, has long been held to be a significant power which necessitates the inclusion of the corpus in the gross estate.20 With this principle in mind the Court concluded that “the first condition to taxing accumulated income added to principal is satisfied, for the income from these increments to principal was subject to the identical power in . . . [decedent] to distribute or accumulate until the very moment of death.”21 Having answered this threshold question, the Court turned to the concept of “transfer” which had been the crux of the problem in the lower courts. In unequivocal terms, Mr. Justice White declared that the decedent had made the requisite transfer not only of property earmarked for the corpus, but of the accumu-
lated income as well. His conclusion is based on two lines of reasoning:
First, decedent had given up all interest in the trust property except con-
trol over the disposition of the income. When he decided to accumulate
rather than to distribute it he "transferred" the income in a very real sense,
that is to say, all increments in the corpus made possible by the addition
of accumulated income were directly traceable to the acts of decedent.
Second, the establishment of the trust was not complete at the time of its
inception as long as the settlor retained a certain degree of control over it.
The transfer did not become complete until this string was cut at the time
of his demise. It necessarily follows that any income accumulated before
his death was transferred together with the trust corpus when the control
was finally relinquished.

An examination of the judicial construction of a closely related section
of the Code reveals a substantial argument that the decision in the instant
case has created an inconsistency in the law. Subdivision (c)(1)(A) of
section 811\[22 requires the inclusion in the decedent's gross estate of any
transfers made in contemplation of death. It has been uniformly held that
accumulated income generated by an irrevocable trust, created in contem-
plation of death, over which the settlor retained no power, is not in-
cluded in the estate even though the corpus is included.\[23 Reasoning
analogically, it would seem that this rule should be applied to each type of
trust, both of which are inter vivos attempts to avoid the estate tax and
which have been included by Congress because of their basically testa-
mentary nature. Prior to the First Circuit's decision this analysis was
accepted by all courts which had entertained the issue. The issue therefore
narrows to whether the Supreme Court is justified in setting aside this
established doctrine and imposing two different procedures in such closely
related areas.

Although there are persuasive arguments which deny that the Court's
treatment is justifiable,\[24 the cogency of those in favor of it is more impres-
sive. The intent of the estate tax laws is to impose a tax upon the transfer
of property at death. In order to avoid this tax individuals have devised a
number of inter vivos passages of title which appear not to be transfers
of property at death but which accomplish the same purpose. Over the
years Congress has dealt with each new innovation, and court opinion
sustaining it, on an ad hoc basis in order to further its basic tax policy.\[25
The two sections now under consideration are examples of such corrective
measures.

In the contemplation of death situation the settlor unequivocally
transfers property to the transferee. His ordinary motive is to avoid the

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or 1954, § 2035).
23. Commissioner v. Gidwitz, 196 F.2d 813 (7th Cir. 1952); Burns v. Commiss-
ioner, 177 F.2d 739 (5th Cir. 1949), affirming Estate of Frizzell, 9 T.C. 979 (1947).
25. See LOWNDES & KRAMER, supra note 8, at 80-99.
tax on this property only, and not on future income which is now completely in the control of the transferee. Therefore, it is held that the income is not the subject of testamentary transfer. When a power is retained, however, the underlying philosophy justifying the imposition of an estate tax is generally stated to be:

An estate tax should be imposed upon property transferred during life where the transfer is essentially testamentary. A transfer is essentially testamentary when possession or enjoyment by the transferee must wait the death of the transferor. 26

Since the accumulated income cannot be enjoyed until the settlor relinquishes his control at the time of his death, the income is basically a testamentary disposition and should be included in the estate.

A second reason for confusion in this area is that the Seventh Circuit in McDermott insisted upon applying traditional property concepts of ownership to tax problems. 27 That court reasoned that when the settlor created the trust he gave up his property interest in the corpus. There is no question that traditionally this is true. The legal ownership vested in the trustee and the equitable interest in the beneficiary. Since the transferor had neither the legal or equitable ownership it was impossible for him to "transfer" the income to the trust as is required by the statute. But this analysis is insufficient for tax purposes. The intent of the statute is not to determine ownership but to place the tax on the person who has control of the economic benefit. 28 Therefore, for tax purposes, the transfer is not effective until the string retained by the grantor is cut at his death. When this occurs, both the corpus and the accumulated income are "transferred" to the trustee.

In addition to the two arguments above, a very practical reason for including the accumulated income in the gross estate merits consideration. If a settlor who is the controlling stockholder in a closely held family corporation seeks to avoid the heavy estate tax on the transfer of that stock at his death, yet also wishes to retain a degree of control over his property, he might transfer a large percentage of his holdings to a trustee but retain control over the distribution of the trust income. He could not avoid the tax on the stock which is transferred, but by regulating the value of the stock subsequent to its transfer, he could limit the tax. This phenomenon is not readily apparent until one considers that the value of the stock is influenced very greatly by income which has been retained by the corporation. If after the establishment of the trust the settlor is able, by virtue of his controlling interest, to have a sufficient percentage of the retained earnings distributed by dividend, the total value of trust property will remain the same, but for estate tax purposes, the amount of this

dividend which has been accumulated will be excluded from the estate.\textsuperscript{29} This dividend will necessarily reduce the market value of the stock, thus allowing for a lower estate tax. The inequity of the \textit{McDermott} rule is obvious and to further it would, as the government argued,\textsuperscript{30} be in contradiction to the intention of Congress.

Tied very closely to the federal estate tax system are the federal gift tax provisions. An examination of a development in the former would be incomplete without a consideration of the ramifications of the latter. In light of this, it has been argued in support of the \textit{McDermott} rule that the excluded accumulated income will not go untaxed because it is subject to the gift tax provisions.\textsuperscript{31} This analysis, though plausible, fails to consider that in most cases the amount of the gift tax will be less than that assessed as the estate tax.\textsuperscript{32} Since effective use of such a trust is almost entirely limited to large accumulations of wealth, the difference in application of the gift tax as opposed to the estate tax would be substantial in monetary terms.

Secondly, inherent in this argument is the assumption that the gift tax should be construed in \textit{pari materia} with the estate tax. If this were true the two taxes would be mutually exclusive because the requirement of the gift tax that the transfer be complete, and the requirement of the estate tax that the decedent have control over the property included in his estate, are in direct opposition. This assumption, while conceptually very inviting, has not been evident in application. In fact, it has been rejected by the Supreme Court.\textsuperscript{33} There are numerous situations where a transfer is incomplete and therefore includable in the gross estate for estate tax purposes and yet is taxed at its inception under gift tax regulations.\textsuperscript{34} The times when the two taxes are correlated appear to be products of coincidence rather than plan.\textsuperscript{35} It should then be evident that the possible subjection of the accumulated income in the instant case to the provisions of the gift tax does not militate against its inclusion in the estate tax.\textsuperscript{36}

\textsuperscript{29} This is the situation in the present case.
\textsuperscript{30} Brief for Petitioner, pp. 10-12. In an attempt to refute the Government's contention that a tax loophole has been created by the Seventh Circuit, respondent asserts that this arrangement would reward the decedent with one limited benefit, the ability to dictate whether the income will be accumulated. He contends that there is no tax saving created because the settlor could eliminate the entire estate tax liability by merely relinquishing this "narrow right" of a retained power to designate the disposition of trust income. Brief for Respondent, pp. 10-11. However, this analysis disregards an essential consideration. Congress has declared that the retention of this type of power and an avoidance of the estate tax are mutually exclusive. In order for the decedent to avoid the estate tax he must give up this right or, in the alternative, he must pay the tax in order to retain the power.
\textsuperscript{32} Compare the rate schedule in § 2001 of the INT. REV. CODE of 1954, with that in § 2502 of the INT. REV. CODE of 1954.
\textsuperscript{33} Smith v. Shaughnessy, 318 U.S. 176 (1943). This case negated any inference that the two taxes should be construed in \textit{pari materia} which might have been drawn from the earlier case of Sanford's Estate v. Commissioner, 308 U.S. 39 (1939).
\textsuperscript{34} See LOWDINES & KRAMER, supra note 8, at 671-81, for a comprehensive analysis of cases in which the two taxes are not correlated.
\textsuperscript{35} \textit{Id.} at 672.
\textsuperscript{36} The foregoing discussion does not exhaust the catalogue of arguments favoring retention of the \textit{McDermott} rule; two other reasons have been advanced: (1) the
In the final analysis, it must be concluded that the opinion of the Court is sound. Its holding appears to be fully consonant with the intent of Congress in enacting the relevant section. By focusing on the underlying policy of the estate tax the Court has avoided regressing to its earlier fault of employing excessively formalistic interpretations of the Code. The instant case manifests the present Court's more enlightened attitude.

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Commissioner v. Tellier (U.S. 1966)

Taxpayer, who was engaged in the business of underwriting the public sale of stock offerings and purchasing securities for resale to customers, was charged with violating the fraud section of the Securities Act, the mail fraud statute, and with conspiring to violate these statutes. He was convicted and sentenced to pay an 18,000 dollars fine and to serve four and one-half years in prison. The judgment of conviction was affirmed on appeal. Respondent incurred approximately 23,000 dollars in legal expenses during his unsuccessful defense and claimed a deduction for that amount on his federal income tax return. The Commissioner statute is ambiguous and should therefore be interpreted in favor of the taxpayer, and (2) there is significance in the fact that the McDermott rule has been applied for nine years and Congress has not acted to correct this alleged misinterpretation of its intent. See 40 N.Y.U.L. Rev. 387 (1965).

The effect of both of these starch-collar maxims is to avoid all substantive considerations and substitute mere procedural fiats for logic and reasonable implementation of the broad congressional policies. It is an inherent difficulty in statutory codification to effectively manifests the legislative intent in each and every possible factual situation that may arise in the future. The best that can be substituted is a manifestation of the overall policy of the legislature coupled with the implicit authorization to the courts to extend that policy to the myriad of future situations which inevitably follow. On less lofty grounds, it is arguable that these maxims have been extracted from their original sources in such a fashion as to impart to them a more pervasive nature than was intended by their authors. See United States v. Davis, 370 U.S. 65, 71 (1962); Burns v. Commissioner, 177 F.2d 739, 741 (5th Cir. 1949).

See Lownders & Kramer, supra note 5, at 80-99.

disallowed the deduction and his decision was affirmed by the Tax Court.\(^5\) The Court of Appeals\(^6\) for the Second Circuit reversed unanimously.\(^7\) On appeal, the Supreme Court affirmed, holding that the legal expenses were deductible since the fees fell within the "ordinary and necessary" requirements of section 162(a) of the Internal Revenue Code\(^8\) and that the allowance of a deduction for expenses incurred in the unsuccessful defense of a criminal charge does not frustrate any sharply defined public policy. \textit{Commissioner v. Tellier}, 383 U.S. 687 (1966).\(^9\)

There is nothing in the Internal Revenue Code or accompanying regulations that prohibits the deduction of "ordinary and necessary" expenses on the basis that the expenses violate federal or state law or frustrate public policy.\(^10\) However, in many cases the courts have denied deductions for expenses incurred in illegal activity on the ground that their allowance would frustrate public policy.\(^11\) The underlying rationale of the public policy argument, or the frustration doctrine as it is called, appears to be that the allowance of such a deduction will, through the decrease of tax liability, benefit and thereby encourage illegal activity.\(^12\)

Prior to the instant case, the Supreme Court had considered a number of cases where the Commissioner had sought to have certain expenses, arguably "ordinary and necessary", disallowed on public policy grounds.\(^13\) As a result of these cases and lower federal court decisions, several types of expenses were considered nondeductible. These included: (1) expenses illegal in themselves;\(^14\) (2) penalties and punitive sanctions imposed for violation of law;\(^15\) and (3) attorney's fees incurred in an unsuccessful

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7. The opinion is noted in 65 Colum. L. Rev. 1111 (1965); 34 Fordham L. Rev. 155 (1965); 54 Geo. L.J. 394 (1965); 40 N.Y.U. L. Rev. 1003 (1965); 114 U. Pa. L. Rev. 274 (1965); and 40 Wash. L. Rev. 920 (1965).
8. "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business...." \textit{Int. Rev. Code of 1954, § 162(a) [hereinafter cited only by section].}
9. The Court noted that the Commissioner conceded that the legal expenses were within the meaning of § 162(a), and this note is concerned with the contention that even though the expenditures fall within § 162(a), the deduction must nevertheless be disallowed on the basis of public policy.
14. See, e.g., Boyle, Flagg & Seaman, Inc., 25 T.C. 43 (1955); Frank A. Maddas, 40 B.T.A. 571 (1939), aff'd, 114 F.2d 548 (3d Cir. 1940). Deductions have been allowed generally for expenses which are themselves legal although incurred in the conduct of an illegal activity. Courts have justified this on the ground that the Internal Revenue Code taxes net, not gross, income. See Note, 51 Colum. L. Rev. 752, 755 (1951).
defense of a criminal charge.\textsuperscript{16} In regard to expenses illegal in themselves, the Court, in \textit{Tank Truck Rentals v. Commissioner},\textsuperscript{17} stated that the frustration of public policy is most direct when the expense sought to be deducted is itself prohibited by statute.\textsuperscript{18} As an illustration of this type of expense, the Court noted that state prohibited "kick-back" payments were not deductible.\textsuperscript{19} Deductions for penalties have been denied where a taxpayer in a business related activity has violated a federal,\textsuperscript{20} state,\textsuperscript{21} or local ordinance\textsuperscript{22} and as a result has been required to pay a penalty authorized by the statute. The justification for the denial is that to allow the deduction of such fines would mitigate the deterrent effect of the statute.\textsuperscript{23} Such deductions have been disallowed even where there has been no finding that the violation was intentional.\textsuperscript{24} Litigation fees incurred in an unsuccessful defense of criminal charges which resulted in fines being imposed on the taxpayer have been disallowed on the rationale that if the fines cannot be deducted, the legal expenses incurred in litigating the question of whether the fine should be imposed should fall with the fine.\textsuperscript{25}

Application of the frustration doctrine has been limited by the general principle that the federal income tax is a tax on net income, not gross income or gross receipts.\textsuperscript{26} Thus, on the same day as the \textit{Tank Truck

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  \item Acker v. Commissioner, 258 F.2d 568 (6th Cir. 1958); Burroughs Bldg. Material Co. v. Commissioner, 47 F.2d 178 (2d Cir. 1931).
  \item 356 U.S. 30 (1958). The case is concerned with a penalty deduction; however, the Court does address itself to expenses illegal per se. \textit{Id.} at 35.
  \item However, everyday expenses such as rent and wages, even though paid in violation of state law, are deductible under the rule of Commissioner v. Sullivan, 356 U.S. 27 (1958). See text accompanying note 27 infra.
  \item Tunnel R.R. v. Commissioner, 61 F.2d 166 (8th Cir. 1932), \textit{cert. denied}, 288 U.S. 604 (1933); Great Northern Ry. v. Commissioner, 40 F.2d 372 (8th Cir.), \textit{cert. denied}, 282 U.S. 855 (1930).
  \item Harry Wiedets, 2 T.C. 1262 (1943).
  \item "Deduction of fines and penalties uniformly has been held to frustrate state policy in severe and direct fashion by reducing the 'sting' of the penalty prescribed by the statute." \textit{Tank Truck Rentals v. Commissioner}, 356 U.S. 30, 35-36 (1958).
  \item Compare Hoover Motor Express Co. v. United States, 356 U.S. 38, 40 (1958) (alternative holding), where the Court stated that even if the taxpayer acted without willful intent and with all due care, the deduction would severely and directly frustrate state policy, \textit{with} Jerry Rossman Corp. v. Commissioner, 175 F.2d 711 (2d Cir. 1949), which allowed a deduction for damages paid for violating the Emergency Price Control Act. The court ruled that it would not frustrate the Price Control Act to allow the deduction of the payment limited to an amount of an innocent overcharge. See Note, 51 COLO. L. REV. 752 (1951).
  \item The Committee report accompanying the 1913 Revenue Act rejected a proposal to limit losses and deductions to those incurred in a legitimate or lawful trade. In the Congressional debates, Senator Williams, who was in charge of the bill, stated "The object of the bill is to tax a man's net income; ... what he has at the end of the year after deducting from his receipts, his expenditures or losses." 50 CONG. REC. 3849 (1913). This position was reaffirmed in 1951 when Congress rejected a proposal for disallowing deductions under \S\ 162 for expenses incurred in connection with illegal wagering. 97 CONG. REC. 12230-44 (1951). Senator George added that
\end{itemize}
Rentals decision, the Court held in Commissioner v. Sullivan\(^{27}\) that payments for rent and employee salaries in the conduct of a gambling establishment (both the payments and the “business” were in violation of state law) were deductible, since to find otherwise would come close to taxing the business on the basis of gross receipts, while all other businesses are taxed on a net income basis.

The application of the frustration doctrine and the net income principle would appear to lead to inconsistent results. That is, if the allowance of a deduction for fines or penalties paid for violation of a law would frustrate the law, why would not the allowance of deductions for operation expenses incurred for violating a law equally frustrate the law?\(^{28}\)

In order to reconcile the congressional intent to tax only net income as well as the presumption against congressional intent to encourage violation of public policy,\(^{29}\) the Court has laid down a stringent test to determine when an expense which is otherwise “necessary and ordinary” should be disallowed on public policy grounds. The mere fact that an expense arises out of, or in connection with, an illegal purpose does not of itself make it nondeductible, even if allowance of the deduction may arguably frustrate public policy.\(^{30}\) Rather, the public policy alleged to be frustrated must be sharply defined and evidenced by some governmental declaration,\(^{31}\) and the frustration must be severe and immediate.\(^{32}\)

The question of whether the deductibility of legal fees would violate public policy was before the Court in Commissioner v. Heininger.\(^{33}\) There the deductions claimed by the taxpayer for legal fees incurred in an unsuccessful defense against an administrative fraud order issued by the Postmaster General were upheld. The Commissioner argued that to allow the deduction would be contrary to public policy because the fees were incurred in an unsuccessful effort to defend activities Congress had condemned, and to permit deduction would tend to subsidize the defense of

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\(^{28}\) See Lamont, Controversial Aspects of Ordinary and Necessary Business Expenses, 42 Taxes 808, 821 (1964).


\(^{31}\) Lilly v. Commissioner, 343 U.S. 90 (1952).


\(^{33}\) 320 U.S. 467 (1943).
illegal conduct. The Court rejected this argument and stated that public policy must be found in express words of the Internal Revenue Code, or in a sharply defined policy of the law which was violated. Until Tellier, the Commissioner and the courts had refused to extend Heininger to include litigation fees incurred in an unsuccessful defense of a criminal charge, but rather had restricted it to situations involving administrative findings of "guilt" or other government instituted civil proceedings which are inconclusive as to the "guilt" of the taxpayer. But in Tellier, the question of whether or not the Heininger decision should be extended to legal fees incurred in an unsuccessful defense of a criminal prosecution was clearly before the Court.

Relying on prior decisions, the Court first ruled that the payments deducted by the taxpayer were business expenses. The Court reasoned that since the criminal charges against the respondent originated because of his business activities, and that the legal fees paid were in defense of these charges, the fees were incurred in the carrying on of his business within the meaning of section 162(a). The Court then concluded that the legal fees were also "ordinary and necessary" business expenses and therefore deductible. The Commissioner, however, argued that public policy prohibited the deduction even though the expenditures were "ordinary and necessary." In refuting the Commissioner's reliance on the frustration of public policy doctrine, the Court reiterated the principle that the federal income tax is concerned with taxing net income and not with imposing sanctions for misconduct. The Court reasoned that just as the tax does not concern itself with the legality of the income that it

36. United States v. Gilmore, 372 U.S. 39 (1963); Deputv v. DuPont, 308 U.S. 488 (1940); Kornhauser v. United States, 276 U.S. 145 (1928). Gilmore held that "the origin and character of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer, is the controlling basic test of whether the expense was 'business' or 'personal' within the meaning of § 162(a)."
37. 383 U.S. at 689.
38. The Court, quoting Welch v. Helvering, 290 U.S. 111, 113 (1933), and citing Lilly v. Commissioner, 343 U.S. 90, 93-94 (1952), Commissioner v. Heininger, 320 U.S. 467, 471 (1943), Kornhouser v. United States, 276 U.S. 145, 152 (1928), and McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 413-15 (1819), stated that "necessary" required only that the expense be "appropriate" and "helpful" to the taxpayer's business, and that the function of the term "ordinary" is to distinguish between expenses which are currently deductible and capital expenditures which, if deductible at all, must be amortized over the asset's life expectancy. The legal fees were classified in the former category and therefore "ordinary" and deductible even though such a lawsuit may occur only once in the lifetime of a business. 383 U.S. at 689-90.
39. The Commissioner argued that since the legal fees were the direct result of violation of three federal criminal statutes, their deductibility must be considered in light of the public policy embodied in those statutes. In addition, denial of the deduction does not impair the defendant's freedom to select any attorney, but rather allowance of the deduction would subsidize the defendant's legal expense. Brief for Commissioner, pp. 9-10.
taxes, neither does the Code require that the expenses sought to be deducted arise out of lawful activities. Thus, expenses which fall within section 162(a) are deductible with a few limited exceptions which have been found where Congress, by specific legislation, has disallowed them or where long standing Treasury Regulations have prohibited the deduction. But where Congress is silent, a deduction will be denied only if its allowance will clearly frustrate public policy. Citing Heininger, Lilly v. Commissioner and Tank Truck Rentals, the Court, affirming the test established by those cases which by its limitations accommodates the net income rationale, stated that the public policy frustrated must be sharply defined, evidenced by some governmental declaration and be affected in a severe and immediate manner.

Before Tellier, the deduction of legal fees incurred in defending a taxpayer against penalties imposed for illegal activities was disallowed on the rationale that since it is against public policy to allow a deduction for a fine or penalty, it would also frustrate public policy to permit a deduction for the connected legal fees. The weakness of this reasoning is that the basis for not permitting the deduction of penalties — that is, that allowance would mitigate their punitive effect — will not support the disallowance of a deduction for legal fees since the fees are not part of the penalty and therefore their allowance does not mitigate it. Accordingly, the Court in Tellier, after stating that the hiring of counsel to defend a criminal charge is not proscribed conduct, but rather a constitutional right, reasoned that to deny the deduction without Congressional warrant would add to the sanction already proscribed by Congress for criminal offenses, and would impose a penalty measured by the cost of counsel and the defendants' tax bracket rather than by the seriousness of the offense or the sentence imposed.

40. 383 U.S. at 693. Among the examples of specific legislation denying deductions, the Court cited the INT. REV. CODE or 1954, § 162(c) (disallowance of deduction for payments to officials and employees of foreign countries in circumstances where the payments would be illegal if federal law were applicable); § 165(d) (deduction for wagering losses limited to extent of wagering gains).

41. In Cammarano v. United States, 358 U.S. 498 (1959), and Textile Mills Sec. Corp. v. Commissioner, 314 U.S. 326 (1941), the Court denied deductions for specified lobbying expenses. The Regulations denying the lobbying expenses, which had been of long standing, were assumed to be approved by Congress through subsequent re-enactment of the Code.

42. 320 U.S. 467 (1943).

43. 343 U.S. 90 (1952).


49. The opinion cites Paul, supra note 10, at 730–31, to the effect that § 162(a) is not intended to punish taxpayers.

50. 383 U.S. at 695. See Krassner, Can A Deduction for Legal Fees Be Against Public Policy?, 26 TAXES 447, 448 (1948); McDonald, Deduction for Attorneys' Fees for Federal Income Tax Purposes, 103 U.PA.L. REV. 168, 180 (1954). An argument against allowing the deductibility of legal fees incurred in defense of a criminal charge,
The instant case settles the question regarding whether *Heininger* was to be restricted to its facts or extended to legal fees incurred in an unsuccessful criminal defense. The extension of deductibility of legal fees incurred in an unsuccessful criminal defense is entirely consistent with *Heininger* since if it is "ordinary and necessary" to defend against a civil suit to put one out of business, which was the case in *Heininger*, it is equally so where the case is criminal. In addition, since the Constitution guarantees the assistance of counsel in criminal prosecutions and since this right belongs to the convicted as well as to the acquitted, to disallow the deduction as against public policy would be to say that this policy overrides the constitutional recognition of the right to counsel. *Tellier* has thus served several functions. It has established that an expense can be "necessary and ordinary" and still be disallowed if the strict test of the frustration doctrine is met; it has rightfully distinguished fees from penalties and, by allowing the deductibility of legal fees incurred in an unsuccessful criminal defense, it has extended the right to counsel into the tax area.

*Harry C. J. Himes*

is that to approve the deduction would in effect have the federal government partially supporting the defense and therefore would be against public policy, plus the higher the defendant's income level the larger the burden shifted to the public. See Brookes, *supra* note 34, at 266; 51 *COLUM. L. REV.* 752, 757 (1951).


52. See *id.* at 267–68; *Note, 72* *YALE L.J.* 108, 135–36 (1962).

53. In denying a deduction based on public policy, some courts have reasoned that an expense arising from illegal activity cannot be "necessary" since it is never necessary to violate the law. See National Outdoor Advertising Bureau, Inc. v. Helvering, 89 F.2d 878, 881 (2d Cir. 1937); Brookes, *supra* note 34, at 248. In Tank Truck Rentals v. Commissioner, 356 U.S. 30 (1958), the Court, citing Commissioner v. Heininger, 320 U.S. 467, 474 (1943), stated that if the deduction would frustrate the public policy standard then it cannot be necessary. 356 U.S. at 33–34.