NOTES

RIGHT TO RECEIVE LIFE INSURANCE PROCEEDS
WHERE BENEFICIARY PREDECEASES INSURED*

Most modern life insurance policies contain clauses reserving in the insured power to change the beneficiary and "vesting" the proceeds in the insured should the beneficiary predecease him. It has generally been held under these clauses that the beneficiary's representatives take no interest in the proceeds of the policy in the event of his dying before the insured.\(^2\)

The Court of Appeals for the District of Columbia last year chose to disregard this body of precedent. In Kindleberger v. Lincoln National Bank of Washington\(^3\) the insured carried two policies naming his wife beneficiary and containing both revesting and change of beneficiary clauses.\(^4\) His wife died in 1935 and the insured died eight years later without having changed the beneficiary.\(^5\) By a divided decision the beneficiary's administrator recovered the proceeds over the claims of the insured's executor.\(^6\) Thus the majority of the court refused to give effect to the express revesting provision of the policy.

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2. See 2 Appleman, Insurance Law and Practice §§ 901, 1121–8 (1941); 7 Cooley, Briefs on Insurance 6345–6, 6403–7 (2d ed. 1928); Carnahan, loc. cit. supra note 1; Vance, Insurance 544–5 (1930); material in notes 19 and 29 infra.
4. "The Insured may from time to time change the beneficiary, provided this Policy is not then assigned. . . . In the event of the death of any beneficiary before the Insured the interest of such beneficiary shall vest in the Insured, unless otherwise provided herein." Brief for Appellant, Joint Appendix, p. 7, Kindleberger v. Lincoln Nat. Bank, 155 F.2d 281 (App. D.C. 1946).
5. In 1937 the insured assigned the larger of the two policies to the Perpetual Building Association of Washington, D.C. as security for a loan which was paid off in full before the insured's death. Id. at 8. Such an assignment was considered essentially a change of beneficiary, and the assignee was in fact entered in the change of beneficiary column on the policy. On payment no new entry was made. Ibid.
6. The insurer (New York Life Insurance Company), faced with the claims of both parties, had paid the proceeds to the insured's executors with the agreement that the money would be held in trust to await a judicial declaration as to whom it belonged. The beneficiary's administrator brought suit to obtain this determination. The District Court granted defendant's motion to dismiss, but the Court of Appeals reversed and ordered judgment entered for the plaintiff. Kindleberger v. Lincoln National Bank, 155 F.2d 281, 282 (App. D.C. 1946).
The court based its opinion primarily on a standard type statute which provides that the:

"... beneficiary or assignee ... [of a life insurance policy] ... other than the insured or the person effecting such insurance, or his executors or administrators, shall be entitled to its proceeds and avail [sic] against the creditors and representatives of the insured ... whether or not the right to change the beneficiary is reserved or permitted and whether or not the policy is made payable to the person whose life is insured, if the beneficiary or assignee shall predecease such person ..."7

The phrase "or his executors or administrators," according to the majority of the court, referred to the "beneficiary or assignee" rather than to "the insured."8 The dissenting judge observed that the expression "lawful beneficiary, other than the insured, his executor or administrators," seems to be a common one in the insurance field, and concluded that the antecedent for "his" was "insured."9

At best, this section of the District of Columbia Code is clumsily worded. The dissent’s interpretation, however, would seem in accord with the manifest purpose of the section in the light of its legislative history. Adopted in 1934,10 it was taken verbatim from a New York law passed in 192711 as a creditor’s exemption statute designed to immunize the cash surrender value or proceeds from claims of the insured’s creditors during the beneficiary’s lifetime despite reservation of control by the insured through the change of beneficiary clause and retention of a contingent interest by the revesting clause.12

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7. 48 STAT. 1175 (1934), D.C. CODE § 35–716 (1940).
9. Id. at 288-9.
10. 48 STAT. 1175 (1934), D.C. CODE § 35–716 (1940). This section was part of a comprehensive statute passed to regulate the life insurance business in the District of Columbia. See SEN. REP. No. 1420, 73d Cong., 2d Sess. (1934). Agitation for such regulation had started some years before. See Hearing before Subcommittee on Insurance and Banking of the Committee on the District of Columbia on H.R. 3941, 71st Cong., 2nd Sess. 26–7 (1930).
11. N.Y. Laws 1927, c. 468, § 1; INS. LAW § 55–a (Cahill's ed. 1930).
12. As the change of beneficiary and revesting clauses came to be more and more common in insurance policies the question arose whether such interest as the insured retained was available to his trustee in bankruptcy. In Cohen v. Samuels, 245 U.S. 50 (1917), the Supreme Court held that where the insured reserved an absolute power to change beneficiaries the cash surrender value of the policy was an asset of the estate within the meaning of § 70a of the Bankruptcy Act. 30 STAT. 565 (1898), 11 U.S.C. § 110a (1940). The New York Life Underwriters' Association in cooperation with the Association of Life Insurance Presidents succeeded in getting this section of the Insurance Law passed so as to place the proceeds and avails of an insurance policy out of the reach of the insured's creditors, even though the policy itself contained revesting and change of beneficiary clauses. Thus the proceeds now come within § 6 of the Bankruptcy Act as a
Nothing surrounding the passage of the Act indicated that when the beneficiary died first the proceeds were intended to pass to his representatives.\(^{13}\) Nor have the New York courts so construed it either before or after the enactment of the District of Columbia counterpart.\(^{14}\)


Insurance company sponsorship was presumably based on the probability that the statute would increase the desirability and consequently the sales of life insurance policies.

13. All discussion of the act has focused on the relation between the creditors of the insured and the proceeds of the policy in the hands of a beneficiary other than the insured; none of the authorities cited in note 12 supra even suggests that the exemption extends in favor of the representative of a beneficiary who dies before the insured.

It was the careless grammatical draftsmanship, apparently, which produced the confusion in the principal case: the inopportune insertion of the comma preceding the phrase "or his executors or administrators" caused the majority of the court to refer the possessive adjective "his" back to "beneficiary" rather than to "insured." The comma following the words "whose life is insured" in the last sentence is also unhappily placed: grammatically, though unrealistically, it could be said to make the clause beginning "if the beneficiary" apply to the entire section and not just to the "whether" clause. While this construction would underline the result reached by the majority the court did not seize upon it.

Had both these commas been omitted it is hard to imagine how the majority could possibly have come to the same conclusion. See notes 21 and 22 infra.

14. *In re Czarnick's Estate*, 140 Misc. 754, 251 N. Y. Supp. 536 (Surr. Ct. 1931) (proceeds of policy containing both revesting and change of beneficiary clause passed under will of insured where beneficiary died first). *In Matterin v. Gas Co. Employees' Mut. Aid Soc. of N. Y.*, 141 Misc. 510, 253 N. Y. Supp. 124, 126 (N. Y. City Cts. 1931) a predeceased beneficiary's executors were allowed to recover the proceeds, but only because the by-laws of the fraternal insurance society so provided. Moreover, in a series of actions arising out of a "common disaster" where insured and beneficiary died in the same accident, the N. Y. courts have held that where the policy contains both clauses, the proceeds revert to the estate of the insured in the absence of clear proof of survival by the beneficiary. Morgan v. Sackett, 172 Misc. 855, 16 N. Y. S.2d 583 (Sup. Ct. 1939); *In re Burza's Estate*, 155 Misc. 279 N. Y. Supp. 90 (Surr. Ct. 1935); *In re Valverde's Estate*, 148 Misc. 49, 347, 265 N. Y. Supp. 484 (Surr. Ct. 1933), aff'd without opinion, 242 App. Div. 653, 273 N. Y. Supp. 371 (2d Dep't 1934).

15. "When a policy of insurance is effected by any person on his own life or on another life in favor of some person other than himself, having an insurable interest therein, the lawful beneficiary thereof, other than himself or his legal representatives, shall be entitled to its proceeds against the creditors and representatives of the person effecting the same," Ky. Acts 1893, c. 171, § 118. *Carroll's Ky. Stat. § 655* (Baldwin's ed. 1936).

The leading case of *Hall v. Ayer's Guardian*, 32 Ky. L. 288, 105 S. W. 911 (1907) gave the proceeds of the policy to a predeceased beneficiary's daughter (granddaughter of
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of the insurance policies involved in the Kentucky cases, however, contained a modern revesting clause. Furthermore, as early as 1916 the Kentucky legislature indicated possible dissatisfaction with this line of decisions by including in a statute regulating fraternal benefit societies a provision that "no beneficiary shall have or obtain any vested interest in the said benefit until the same has become due and payable upon the death of the said member [insured]." During the last fifteen years, in cases involving policies with modern revesting clauses, moreover, the Kentucky Supreme Court has impliedly distinguished the earlier cases and uniformly followed the prevailing view.

Most states have either appropriated the New York statute verbatim or, like Kentucky, have adopted one similar to the New York statute except for the omission of that portion reading "... whether or not the right to change the beneficiary is reserved or permitted and whether or not the policy is made payable to the person whose life is insured, if the beneficiary or assignee shall predecease such person [i.e. the insured]...." In none of these states

insured) rather than to insured's estate. The court was influenced, however, by a clause in the policy which stated that if the named beneficiaries were not living at the time of insured's death the proceeds should go to the "legal representatives" of the insured. The court construed "legal representatives" to mean heirs and distributees—thereby including the insured's granddaughter—rather than executors and administrators (in which case the proceeds would eventually have gone to the insured's second wife). Id. at 291, 105 S. W. at 913. Only by implication did the court decide that the phrase referred to the beneficiary rather than insured. Ibid., 105 S. W. at 914. On the authority of the Hall decision, the Kentucky courts, in a series of subsequent cases, construed the statute to give beneficiaries' representatives rights superior to those of the insured's estate. Neal's Adm'r's v. Shirley's Adm'r's, 137 Ky. 818, 127 S. W. 471 (1910); Buckler v. Supreme Council of Catholic Knights, 143 Ky. 618, 136 S. W. 1006 (1911); O'Bryan v. England, 173 Ky. 12, 19, 189 S. W. 1126 (1916) ("in the absence of any authority given by the policy"); Bright v. Supreme Council of Catholic Knights, 183 Ky. 388, 209 S. W. 379 (1919); Conn v. White, 189 Ky. 185, 224 S. W. 764 (1923).


17. Colovos Adm'r's v. Gouvas, 269 Ky. 752, 103 S. W. 2d 829 (1937) (common disaster case; since, under Kentucky law, there is no presumption of survivorship, the proceeds revert to the insured's estate where the policy contains an automatic revesting clause). Hunt v. Mutual Life Ins. Co., 243 Ky. 511, 49 S. W. 2d 323 (1932); Hamblin's Adm'x v. Hamblin's Adm'r, 241 Ky. 447, 44 S. W. 2d 249 (1931) (The court stated that to give the proceeds to the beneficiary's estate would be to ignore the specific provisions of the revesting clause). See also McKenty v. Caldwell, 287 Ky. 759, 155 S. W. 2d 193 (1941) (representatives of one of the beneficiaries who predeceased insured could claim no interest in a policy which provided payment to surviving beneficiaries).

18. It was the addition of this clause, which the majority of the court thought significant in distinguishing the result of the Colovos case, cited note 17 supra, from the instant situation. "It is the absence from the Kentucky statute of the language just quoted which has led the Court of Appeals of Kentucky to hold, in the Colovos and earlier cases, that the statute of that state does not apply if the right to change the beneficiary is reserved and if the policy is made payable to the insured in the event of the prior death of the beneficiary. The presence of the quoted provision in the statute here under consideration clearly overrules stipulations to the contrary which may be contained in policies." 155 F.2d 281, 284 (App. D. C. 1946). Yet the addition of this phrase was simply to emphasize the fact that
have the courts interpreted either type of statute to override the revesting provision of the policy by granting the proceeds to a predeceased beneficiary's representatives. Statutes in some states, framed in terms of function, permit little doubt as to their construction. Still other states have used the New

even though the insured has almost complete control over the policy by virtue of these clauses the proceeds still were not available to his creditors. See authorities cited note 12 supra. Following the enactment of Section 55a in New York, twelve other jurisdictions enacted statutes also containing this clause. See Weaver, supra note 12, at 152. See generally on creditors' exemption statutes, 2 APPLEMAN, op. cit. supra note 2, §1342; COOLEY, op. cit. supra note 2, at 6508-17; JOYCE, INSURANCE §879 (2d ed. 1917); VANCE, INSURANCE §162 n.34-6 (1930).

19. The overwhelming weight of authority revests the proceeds in the insured in accordance with the terms of the policy. Merritt v. Scruggs, 172 Tenn. 368, 112 S. W.2d 825 (1938); cf. Columbian Nat. Life Ins. Co. v. Welch, 15 F. Supp. 777 (D. Mass. 1936); Parker v. Potter, 200 N. C. 348, 157 S. E. 68 (1931); cases collected in 2 APPLEMAN, op. cit. supra note 2, § 122 n.9-17 and in VANCE, INSURANCE §149 n.36 (1930).

Under "old line policies," which included neither clause, the beneficiary was said to take a vested interest in the proceeds transferable to his estate should he predecease insured. When the power to change is reserved to the insured, on the other hand, the beneficiary's interest has been thought too remote to be transferable to his representatives and take a vested interest in the proceeds transferable to his estate should he predecease beneficiary. See Haskins v. Kendall, 129, 130 (C. C. A. 8th 1938); a mere expectancy, Nance v. Hilliard, 101 F.2d 957, 958 (C. C. A. 8th 1939); a class gift conditioned on survival, Mutual Life Ins. Co. v. Devine, 180 Ill. App. 422, 430 (1913); and even a vested right in the nature of an expectancy, Viles v. Prudential Ins. Co., 124 F.2d 78, 81 (C. C. A. 10th 1941). Similarly, the proceeds of a policy have been likened to a "resulting trust" and a "lapsed legacy" when the beneficiary dies during life of the insured. See Haskins v. Kendall, 158 Mass. 222, 227, 33 N. E. 495, 497 (1893) (resulting trust); Washington Ben. End. Assoc. v. Wood, 4 MacKay 19, 27-8 (App. D. C. 1885) (lapse of legacy); Kruger v. John Hancock Mut. Life Ins. Co., 298 Mass. 124, 129, 10 N. E.2d 97, 100 (1937) (lapsed trust). For a history and criticism of this indiscriminate appropriation of concepts from property law to insurance contracts see VANCE, THE BENEFICIARY'S INTEREST IN A LIFE INSURANCE POLICY, 31 YALE L. J. 343 (1922); VANCE, INSURANCE §§144-8 (1930); CARNANAN, op. cit. supra note 1, § 60; GRISMORE, THE ASSIGNMENT OF A LIFE INSURANCE POLICY, 42 MICH. L. REV. 789, 798-9 (1944); Note 28 YALE L. J. 89 (1918).

Where insured and beneficiary both perish in a common disaster the rule of the New York courts is generally followed (supra note 14), and the proceeds revert to the insurer's estate. McKinney v. Depoy, 213 Ind. 361, 12 N. E.2d 250 (1938); Fleming v. Grimes, 142 Miss. 522, 107 So. 420 (1926); Watkins v. Home Life and Accident Ins. Co., 137 Ark. 207, 208 S. W. 587 (1919); Note 113 A. L. R. 881 (1938). Cf. Northwestern Mut. Life Ins. Co. v. Fink, 118 F.2d 761 (C. C. A. 6th 1941) (wife-beneficiary died 22 hours after insured; her right to receive unpaid share of the proceeds held to terminate on her death; contingent beneficiary rather than her heirs entitled to remainder.

20. "All moneys, avails, cash values, and all and every benefit accruing under any annuity contract or under any policy or certificate of life insurance payable to a beneficiary other than the estate of the insured, and under any accident or health insurance policy, heretofore or hereafter issued, shall be exempt from attachment, garnishment, or other legal or equitable process, and from all claims of creditors of the insured, and of the beneficiary if related to the insured by blood or marriage, in the absence of a written agreement or assignment to the contrary." NEB. REV. STAT. §§ 44-371 (1943). "[T]he proceeds ... shall be exempt from all liability for any debt of the person effecting the in-
York prototype, but have resolved the ambiguity by eliminating a crucial comma or inserting a pair of well-placed parentheses. Two states have explicitly provided that in the event of a beneficiary's prior death, the proceeds shall be made payable to the insured or his estate. The majority in the principal case also leaned on two other sections of the District of Columbia Code to support its construction of the main statute. These sections provide that a policy effected in favor of a wife, children, relatives, or a named creditor shall "vest" in them free of any claims of the insured's general creditors, and that if a wife-beneficiary predeceases her husband the proceeds may be made payable to her children, descendants, or legal representatives. These sections of the Code were borrowed from the laws of Maryland and adopted as part of the original District Code in

21. "... the lawful beneficiary thereof, other than the person effecting the insurance or his legal representatives, shall be entitled to its proceeds against the creditors and representatives of the person effecting the same." (italics supplied) Ky. Rev. Stat. Ann. § 297.150 (Baldwin's ed. 1943).

22. "... the lawful beneficiary or assignee thereof (other than the insured or the person so effecting such insurance, or his executors or administrators) shall be entitled to the proceeds. ..." Mich. Stat. Ann. § 24.287 (Moore, 1943).


24. "All policies of life insurance upon the life of any person maturing on or after January 1, 1902, and which have been or shall be taken out for the benefit of or bona fide assigned to the wife or children or any relative dependent upon such person, or any creditor, shall be vested in such wife or children or other relative or creditor, free and clear from all claims of the creditors of such insured person." 31 Stat. 1375 (1901), D. C. Code § 30-213 (1940).

25. "If the wife shall die before her husband, the amount of such insurance may be payable after her death to the children or descendants for their use, and to their guardians if under age; and if there be no children or descendants of the wife living at the time of her death, to her legal representatives." Id. at § 30-214.

1901, a time when neither the change of beneficiary nor the revesting clause was commonly included in an insurance policy. Similar statutes were passed by most states in the nineteenth century to remove the disabilities of coverture and to provide adequately for the wife and children of an insolvent insured.

It has never before been thought that they would have the effect of placing the proceeds in the representatives of a wife-beneficiary when the policy itself contained a clause stipulating otherwise.

The Maryland statute in a series of early cases was constructed to place the proceeds in the wife's representatives on her predecease even though there was no specific direction in the policy itself. Thomas v. Cochran, 89 Md. 390, 43 Atl. 792 (1899) (proceeds were asset of wife's estate which, upon her predecease, could be divested only by changing the beneficiary); Expressman's Mut. Ben. Ass'n v. Hurlock, 91 Md. 585, 46 Atl. 957 (1900); Preston v. Conn. Mut. Life Ins. Co., 95 Md. 101, 51 Atl. 838 (1902). But in Pratt v. Hill, 124 Md. 252, 92 Atl. 543 (1914) the court said, by way of dictum, at 255, 92 Atl. at 544, that in spite of §10, if the policy provides otherwise the proceeds will not go to the legal representatives of the wife. See also Rosman v. Traveler's Ins. Co., 127 Md. 689, 692-3, 96 Atl. 875, 876 (1916) (when rights of beneficiary are dependent on will of the assured, beneficiary acquires no vested right until death of the insured).


28. Statutes collected, Carnahan, op. cit. supra note 1, §60n. 10. See generally ibid.; Vance, *The Beneficiary's Interest in a Life Insurance Policy, 31 Yale L. J. 349-53 (1922); Weaver, supra note 12, at 164-6; Cohen, supra note 12, at 140, 170. North Carolina has included such a provision in its constitution. N. C. Const. Art. X, §7. In time the scope of statutes exempting proceeds of life insurance policies from claims of creditors was broadened to include not only the wife and children but also any beneficiary whatsoever, save the insured's estate. See note 12 supra. The legislatures unfortunately allowed the older statutes to remain on the books, a fact which has caused some confusion. New York, for instance, in Section 52 of the Domestic Relations Law exempted insurance purchased with premiums less than $500 in favor of a wife-beneficiary. Dom. Rel. Law §52 (Cahill, 1930). Section 55-a of the Insurance Law was enacted without repealing this married women's statute. This put the wife in a less favored position than any other beneficiary since §55-a placed no upper limit on the amount of insurance exempted. The Court of Appeals shortly thereafter held that with respect to any conflict between the two sections, §52 was impliedly repealed. Chatham Phenix Nat. Bank and Trust Co. v. Crosney, 251 N. Y. 189, 167 N. E. 217 (1929). It was not until 1939, however, with the passage of §166 of the new Insurance Law that the two sections were merged and the anomaly officially removed. N. Y. Ins. Law §166 (McKinney, 1940). See Fraenkel, *Creditors' Rights in Life Insurance, 4 Ford. L. Rev. 35, 40-5 (1935); Pierson, supra note 12, at 23.

29. Under these married women's statutes, "old line" and fraternal benefit association policies—i.e. those having neither change of beneficiary nor revesting clauses—were said to confer a "vested" interest in the wife beneficiary, payable to her estate on her prior death. Phoenix Mut. Life. Ins. Co. v. Dunham, 46 Conn. 79, 33 Am. Rep. 14 (1878); In re Peckham, 29 R. I. 250, 69 Atl. 1002 (1908); Condon v. New York Life Ins. Co., 183 Iowa 658, 166 N. W. 452 (1918); similarly, if the wife is a party to the insurance contract, and has paid the premiums the proceeds will descend to her estate. Swan v. Snow, 11 Allen 224, (Mass. 1866); Hutson v. Merrifield, 51 Ind. 24 (1875); Neary v. Metropolitan Life Ins. Co., 92 Conn. 488, 103 Atl. 661 (1918). *Contra: Ryan v. Rothweiler, 50 Ohio St. 595, 35 N. E. 679 (1893); Handwerker v. Diermeyer, 96 Tenn. 619, 36 S. W. 869 (1896);
By interpreting an apparently ambiguous statute without reference to its purpose or legislative history, the court not only reached a result contrary to virtually all authority but also handed the beneficiary's representatives a windfall unjustified by either the insured's intent or public policy. Had the insured intended to avoid the reversion of the proceeds, he could simply have changed the beneficiary. His failure so to do during the eight years following his wife's death would seem to indicate an assumption that the proceeds would be distributed as part of his own estate. Admittedly, an exercise of the change of beneficiary clause would have terminated all rights of his wife's estate. There seems no reason why the insured should not have relied with equal confidence on the companion revesting clause to prevent such rights from ever accruing.\(^{30}\) Though he may not have been acquainted with the law on the subject, it is not unreasonable to assume he was aware of the institutional practice of giving full effect to such a clause.\(^ {31}\) Nor have reasons sounding in public policy heretofore been advanced to support the result of the Kindleberger case.\(^ {32}\) Since the beneficiary must die before the revesting clause can become

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Where the policy has contained the qualifying clauses, however, the wife's position has been considered no different from that of any other beneficiary, and her representatives have been given no claim to the proceeds in event of her prior death. Metropolitan Life Ins. Co. v. Woolf, 138 N.J. Eq. 450, 47 A.2d 340, (1946); Hamblin's Adm'r v. Hamblin's Adm'r, 241 Ky. 447, 44 S.W.2d 299 (1931) cited supra note 17; cf. Staunton v. Provident Life and Accident Ins. Co. 69 Ohio App. 27, 42 N.E.2d 687 (1941) (proceeds to husband's administrator where husband killed wife and then himself). See also cases cited note 19 supra.

30. The majority of the court, however, seemed to feel that the insured's failure to take positive steps to change the beneficiary during the years subsequent to his wife's death indicated an intent on his part that the proceeds should be distributed in accordance with the language of the statute, with which he was presumed to be familiar. 155 F.2d 231, 225 (App. D.C. 1946). Yet, even conceding familiarity with the statute, it would seem more reasonable to assume that the insured relied on the overwhelming line of authority which had previously interpreted similar statutes to reach a result exactly opposite from that of the D. C. court.

31. Virtually all legal reserve policies today contain both revesting and change of beneficiary clauses. See note 1 supra. That the proceeds go to the estate of the insured has not been considered open to question. See Giles, YOUR MONEY AND YOUR LIFE INSURANCE 118 (1935), advising policy-holders to name a contingent (secondary) beneficiary, lest the primary beneficiary die first and the proceeds be distributed as part of the insured's estate by the laws of descent rather than in accordance with his desires. The Life Insurance Association of America and the National Association of Life Underwriters submitted a brief, amicus curiae, in support of a petition for rehearing, to which were appended affidavits of four major life insurance companies (Aetna, Connecticut Mutual, Phoenix Mutual and The Travelers), all reiterating that the universal practice was to pay over the proceeds to the insured's estate in event of prior death of the beneficiary. Brief of Amicus Curiae (in support of appellee's application for a rehearing), pp. 29-33, Kindleberger v. Lincoln National Bank, 155 F.2d 281 (App. D.C. 1946).

32. The legal reserve life insurance companies have not been immune from attack, but
operative, he gets no added protection from the decision. Moreover, the gains of the beneficiary's representatives will often be at the expense of the insured's creditors, whose rights are already severely circumscribed. If further limitation of their rights is deemed desirable, it should at least be sanctioned by an explicit expression of legislative intent rather than by strained judicial construction and the vagaries of a misplaced comma.

LONG-TERM LEASES AND CHAPTER X REORGANIZATIONS: AN EXPANDED CONCEPT OF JURISDICTION

With the enactment of Chapter X of the Bankruptcy Act in 1938, it was generally considered that reorganization legislation had been brought abreast the problems of contemporary corporate finance. However, the question of whether the reorganization courts' jurisdiction and power are yet adequate to their critics have not decried the use of the revesting and change of beneficiary clauses. See Geisel and Howe, Study of Legal Reserve Life Insurance Companies (TNEC Monograph 28, 1940). See also, in a more vitriolic vein, Gilbert and Gilbert, Life Insurance; A Legalized Racket (1936). For an antidote see Speicher, The Truth About Insurance 97 (1936) ("Liberalized by a hundred years of experience, broadened by competition, safeguarded by the activities of legislatures and insurance commissioners, inspired by the spirit of trusteeship which dominates the companies, the life insurance contract of today is the most marvelous and most liberal contract of personal finance ever devised.")

33. See material and authorities, note 12 supra. It has, in fact, been suggested that the present statutes put creditors of the insured in too disfavored a position. See the account of Webb, J., In re Whiting, 3 F.2d 440, 443 (W.D.N.C. 1925). See also Maclean, Life Insurance 467 (1935); Wells, The "Change of Beneficiary" Clause in Life Insurance Policies 2 Va. L. Rev. 49, 50 (1914); Note 3 U. of Chi. L. Rev. 303, 310 (1936).

34. At the present time bills are pending—H.R. 1633 and H.R. 1635—which will revise the statute to eliminate the ambiguity which occasioned the result in the principal case; efforts are also being made to revise in like manner all the state statutes similarly worded. Communication to Yale Law Journal from Mr. Henry R. Glenn, general counsel for the Life Insurance Association of America.


1. 52 Stat. 883-905 (1938), 11 U.S.C. §§ 501-676 (1940). References to the Bankruptcy Act of 1938 with amendments to July 1, 1946 will hereinafter be cited by section number only.

handle a commonly recurrent problem in the rehabilitation of corporate debtors is raised by In re Pittsburgh Railways.\(^3\) The Third Circuit there found it necessary broadly to expand commonly accepted concepts of jurisdiction in order to achieve a desirable reorganization plan for a public utility debtor.

The debtor, Pittsburgh Railways Company, is the operating company in the corporate pyramid embracing the street railway system of Pittsburgh. It is the wholly owned subsidiary of the Philadelphia Company, a public utility holding company. In 1902 the Philadelphia Company effected a unified system of transportation within the city of Pittsburgh by combining with the debtor operating company forty-nine underlying street railway companies through long-term leases and other agreements. Nine of the underliers—the crucial group for the purposes of this case—executed to the debtor 900-year leases of their properties, franchises, and equipment on which the Philadelphia Company guaranteed, in default of payment by the lessee, dividends on their stock, principal and interest on their bonds, corporate expenses, and taxes. The securities of these “guaranteed underliers” are owned by the general public. All the underlying street railway companies except those supported by the guaranteed payments are insolvent.\(^4\) But, since the Philadelphia Company has assumed its obligations under the lease guarantees, the “guaranteed underliers” are all in a highly prosperous condition.\(^5\)

In 1938 the debtor, Pittsburgh Railways, filed a voluntary petition in reorganization under Chapter X, and since that date Pittsburgh’s street railway system has been operated by the reorganization trustees. The trustees proposed a system-wide plan of reorganization providing for the merger of all the underlying street railways into a single new corporation.\(^6\) It was felt that in this way the complex corporate structure could best be simplified and a means provided for reducing the burdensome fixed charges of the system.\(^7\) As the guaranteed underliers would not voluntarily submit to the jurisdiction of the reorganization court, the City of Pittsburgh, in the public interest and as a creditor of the debtor, petitioned the court to assert jurisdiction over them and thus compel their participation in the proceedings.

Section 111 of Chapter X provides that “the court in which a petition is filed shall . . . have exclusive jurisdiction of the debtor and its property, wherever located.” Thus, bringing the underliers within the scope of the re-

\(^3\) 155 F.2d 477 (C.C.A. 3d 1946).
\(^4\) Of the thirty-six underliers whose stock is owned by the Philadelphia Company, all but six are insolvent and even those six have no funds or credits. Special Master’s Report filed in Reorganization Proceedings No. 20225 in Bankruptcy, \(\S\) 55 (W.D. Pa. 1945) (hereinafter cited as S.M.R.). The four unguaranteed underliers whose stock is publicly owned are also insolvent. S.M.R. \(\S\) 56.
\(^5\) In re Pittsburgh Rys., 155 F.2d 477, 481 (C.C.A. 3d 1946); S.M.R. \(\S\) 57.
\(^6\) Amended Revised Plan of Reorganization, with all Amendments to March 1, 1942, filed in Reorganization Proceedings No. 20225 in Bankruptcy (W.D. Pa.).
\(^7\) Brief for Trustee, pp. 9-11, In re Pittsburgh Rys., 155 F.2d 477 (C.C.A. 3d 1946).
organization court's jurisdiction necessarily involves a determination that their property, franchises, and other assets are "property of the debtor" within the meaning of this section. The Third Circuit, reversing the district judge, achieved this result by disregarding the separate corporate entities of the underliers. The Court went on to say that since it was concerned "with the sweep of a federal statute dealing with a subject in which the Congress, under the Constitution, is empowered to act", it was not bound by Pennsylvania real property law in determining the ownership of the reversion in the leases. It did not, however, develop this argument into an affirmative alternative holding and say that there was authority in federal law for treating the underliers' interest in the reversion as property of the debtor.

To preclude the court from disregarding the separate corporations, the underliers argued that the law of the case had been established by a previous decision holding that the separate corporate entities of this system were to be respected in determining the trustees' liability for tax payments. Noting that the corporate fiction may with propriety be recognized for some purposes and disregarded for others, the Court properly rejected this argument. That the underliers were mere corporate shells acting only as conduits for distributing dividends and interest to their security holders furnishes further support for the Court's holding. The physical properties of the underliers had been inextricably commingled in the unified system. Thus it is arguable that functionally a de facto merger had taken place.

Yet pre-existing doctrine would appear to have compelled a contrary conclusion. While the circumstances under which courts have pierced corporate

12. See S.M.R. § 865. "[T]he typical lessor is little more than a corporate shell, whose activities, save for such formal acts as are needed to maintain its corporate existence, have almost ceased." Meek and Masten, Railroad Leases and Reorganization: I, 49 YALE L.J. 626, 652 (1940). See id. at 636-8; Rood, Protecting the User Interest in Railroad Reorganization, 7 LAW & CONTEMP. PROB. 495, 499 (1940).
13. Their routes had been altered (S.M.R. ¶¶ 684, 834, 852), tracks had been abandoned leaving gaps in their franchise lines (S.M.R. ¶¶ 692(2), 834), much of their real estate had been disposed of (S.M.R. ¶¶ 834, 849, 858), power plants had been sold (S.M.R. ¶ 512), bridges had been disposed of (S.M.R. ¶ 848), and almost all their rolling stock had been scrapped (S.M.R. ¶¶ 834, 848, 851). None of the guaranteed underliers had kept any record of their property since 1902 (S.M.R. ¶¶ 842, 859, 873).
form are varied and the rules unsettled, a parent-subsidiary relationship by stock control has always been thought a condition precedent. With this as a datum, the disregard of the separate corporate existence of the subsidiary has been justified most frequently on the rationale that the subsidiary is a mere department, instrumentality, or agent of the parent.

In the instant case, however, the guaranteed underliers had not only been scrupulous in maintaining corporate individuality, but also were not stock-controlled by any of the system corporations. Disregard of their separate existence thus represents a step considerably beyond the established law.

Unfortunately the Circuit Court did not elaborate on its second contention.

15. "An examination of the cases shows that the courts have laid down no convenient rule of thumb which might furnish a safe and accurate test." Note, 4 MINN. L. REV. 219, 221 (1920). For similar statements, see Wang, The Corporate Entity Concept (or Fiction Theory) and the Modern Business Organization, 28 MINN. L. REV. 341 (1944); Wormser, Piercing The Veil of Corporate Entity, 12 COL. L. REV. 496 (1912). On the subject of the corporate entity concept, see generally Ballantine, Separate Entity of Parent and Subsidiary Corporations, 14 CALIF. L. REV. 12 (1925); Canfield, The Scope and Limits of the Corporate Entity Theory, 17 COL. L. REV. 128 (1917); Dix, The Armor of the Juridical Conception, 34 GEO. L. J. 432 (1946); Douglas and Shanks, Insulation from Liability through Subsidiary Corporations, 39 YALE L. J. 193 (1929); Timberg, Corporate Fictions, Logical, Social and International Implications, 46 COL. L. REV. 533 (1946); Wang, supra; Wormser, supra; Comment, 36 YALE L.J. 254 (1926); Notes, 47 COL. L. REV. 109 (1947); 4 MINN. L. REV. 219 (1920).

16. In discussing the circumstances under which claimants against the subsidiary may reach the parent, Douglas and Shanks state that "[o]wnership of all or a majority of the stock of the subsidiary . . . appears as a constant . . . Otherwise the problem would normally not arise." Douglas and Shanks, supra note 15, at 196. See id. at 211.


18. They maintained separate books and accounts, had separate officers and directors, and were highly solvent and profitable corporations. In re Pittsburgh Rys., 155 F.2d 477, 481 (C.C.A. 3d 1946). Neither the Philadelphia Company nor Pittsburgh Railways had influenced their policy making (in fact the guaranteed underliers had sued the Philadelphia Company on several occasions, S. M. R. ¶¶ 861-2), and there was no suggestion of fraud or bad faith.

19. Commenting on the instant case, Professor J. W. Moore says that the court "seems to have gone beyond permissible limits in disregarding corporate entities . . . ." 6 COLLIER, op. cit. supra note 2, at 630 n. 7.
that it was not controlled by state real property law. An argument might have been made that since the provisions of Section 111 are jurisdictional and since state law cannot circumscribe the jurisdiction of federal courts,\textsuperscript{20} the reorganization court was not bound by Pennsylvania precedents in determining whether it had jurisdiction over the reversion in the leases.\textsuperscript{21} Pursuing this argument, the court might have reasoned that under the Bankruptcy Act a reorganization court has the jurisdiction requisite to forestall any action which "would seriously embarrass and probably prevent the formulation and consummation of a plan of reorganization";\textsuperscript{22} that the guaranteed underliers' refusal to join in the reorganization was clearly threatening to do just that;\textsuperscript{23} and that accordingly there was authority to include them in the reorganization plan. Since in many aspects of bankruptcy administration federal courts are not bound by state law, analogous precedent might have been found.\textsuperscript{24}

But so to have argued would have been to ignore the fact that no matter in what sense used—jurisdictional or otherwise—"property" must be defined in some frame of reference. Since Chapter X furnishes no indices of prop-


\textsuperscript{21} An analogy might be drawn from the judicial administration of the internal revenue laws. Just as there the courts will not allow the legal form employed to defeat the over-riding policy consideration that each citizen must pay his fair share of taxes, so it might be said that the doctrinal form in which corporation lawyers choose to frame their inter-corporate alliances will not be allowed to defeat the federal policy that a reorganization plan must be fair, equitable, and feasible. (Bankruptcy Act, Section 216). Thus while recognizing that property may belong to a valid family partnership under state law, the Supreme Court has treated it as belonging to the partners individually for purposes of income taxation. Commissioner v. Tower, 327 U.S. 280 (1946); Lusthaus v. Commissioner, 327 U.S. 293 (1946).


\textsuperscript{23} The four underliers whose stock was held by the general public but whose leases were not guaranteed had voluntarily submitted to the court's jurisdiction. The objection of the thirty-six underliers whose stock was owned by the Philadelphia Company was purely technical. \textit{See} Brief for SEC, pp. 9-11, \textit{In re} Pittsburgh Rys., 155 F.2d 477 (C.C.A. 3d 1946). Thus the guaranteed underliers were the only ones who were seriously impeding the formulation of a system-wide plan.

\textsuperscript{24} Thus, in determining what claims are allowable, what claims are provable, and how a bankrupt's assets shall be distributed, a bankruptcy court does not apply the law of the state where it sits but follows federal law. Vanston Bondholders Protective Committee v. Green, 67 Sup. Ct. 237 (1946), \textit{rehearing denied}, 67 Sup. Ct. 497 (1947); Heiser v. Woodruff, 327 U.S. 726 (1946); American Surety Co. v. Sampsel, 327 U.S. 269 (1946); Prudence Realization Corp. v. Geist, 316 U.S. 89 (1942). And a plan of reorganization approved by a bankruptcy court may disregard valid state statutes that are inimical to the public interest in the reorganization. \textit{In re} New York, N. H. & H. R. R., 147 F.2d 40, 51-3 (C.C.A. 2d 1945), \textit{cert. denied}, 325 U.S. 884 (1945), \textit{rehearing denied}, 326 U.S. 805 (1945).
ney, it would seem that the only ready-made criteria are to be found in state law, under which the property relationships were created. And it has long been well settled that, even in the interpretation of federal statutes, federal courts are relegated to the state precedents of real property law. Thus in its assertion that it was not bound by Pennsylvania law, the court appears to have taken a questionable position.

Furthermore, long term leases are well established in the legal syntax of corporate law, and their implications have always been respected by the courts. Though jurisdiction over the lessee's leasehold estate has enabled the

25. To circumvent narrow and diverse judicial constructions of the word "property" in subsection 75(n) of the Bankruptcy Act, Congress amended that subsection in 1935 to broaden the scope of the interests included within the term "property". As now defined in subsection 75(n), property of the debtor includes "all real or personal property, or any equity or right in any such property, including, among others, contracts for purchase, contracts for deed, or conditional sales contracts, the right or the equity of redemption where the period of redemption has not or had not expired, or where a deed of trust has been given as security, or where the sale has not or had not been confirmed, or where deed had not been delivered, at the time of filing the petition." See 5 COLLIER, BANKRUPTCY 182-90 (14th ed. 1943). But even under this expanded definition bankruptcy courts look to state law to determine the existence of these defined interests. State Bank of Hardinsburg v. Brown, 317 U.S. 135 (1942), 18 Ind. L. J. 239 (1943). But cf. Wragg v. Federal Land Bank, 317 U.S. 325, 328-9 (1943).


In support of its conclusion that it was not bound by the state law of real property, the court cited, at 155 F.2d 483 n.13, Clark, State Law in the Federal Courts: the Brooding Omnipresence of Erie v. Tompkins, 55 YALE L. J. 267 (1946). In the same article, however, Judge Clark notes that much of the law of bankruptcy administration "depends on interpretation of local law, statutory or common, involving such matters as conditional sales, chattel mortgages, conveyances in fraud of creditors, pledges, and so on.... [T]hese are matters of local property law which even under the Texas doctrine were relegated to the state precedents." Id. at 281.

However, as Judge Clark points out, not only are federal courts freed from state precedents in some aspects of bankruptcy administration (see note 24 supra), but the rule of Erie R.R. v. Tompkins, 304 U.S. 64 (1938) has been whittled away in recent years by the development of what Judge Clark has called the "federal fields." See Clarke, supra at 284; 43 Col. L. Rev. 520, 521 n.8-10 (1943).

27. A more tenable position might have been for the court to concede that although it was bound by state law nevertheless in the peculiar facts of this case state law justified treating the lessor's property as that of the debtor. Thus it might have been argued that in acquiescing in the commingling of their property in the system assets and in permitting their routes to be altered and tracks to be abandoned (see note 13 supra), the underliers had waived their right to be considered the owners of the reversion.

28. "Since conveyancers and business men alike have long utilized the characteristic provisions of leases to accomplish transfers of rights in real estate for extensive periods without payment of the purchase price, such long term agreements have become a well recognized legal implement, especially in corporate realty transactions and railroad consolidations and mergers. Its reservations of rent, provisions for taxes and operation are
courts to exercise some power over the lessor, they have consistently paid doctrinal obeisance to the lessor's ownership of the reversion.

However tenuous the court's doctrinal argument may be, the result in the instant case nonetheless appears highly desirable. By providing a means of radically reducing fixed charges, it enabled the street railway system of Pittsburgh to be re-established on a sound financial basis and thus assured the continuance of adequate, co-ordinated service to the travelling public. But the holding will probably not be extended. Here the unique facts made the result almost inescapable. First, since separate operation by the underliers was not feasible, the debtor had to operate the system. Second, because of the guarantee by a solvent third party, there was no alternative method of dealing with the guaranteed underliers and of reducing the fixed charges. The threat of rejection, normally a powerful weapon in persuading lessors to renegotiate, was rendered ineffective. Where these compelling facts are not present and rejection remains a practical mode of inducing rental reduction, it seems unlikely that the tenuous doctrinal argument here forced on the court will be re-employed.

Accordingly it is submitted that Chapter X be amended to give the courts authority in public utility reorganizations to include long-term lessors in the reorganization where such inclusion is certified by the commission having regulatory jurisdiction to be in the public interest. Such an amendment firmly imbedded in our financial, corporate and title structures.
would adjust legal doctrine to functional realities. The long-term lease has been said to be a mere alternative to a mortgage as a method of financing the acquisition of property.\textsuperscript{32} And it is recognized in the railroad industry as serving the same purpose as a merger, consolidation, or sale of assets.\textsuperscript{33} These pragmatic similarities would seem to militate for similarity of treatment.\textsuperscript{34}

\textsuperscript{106}(13) of Chapter X. Section 129 permits them to reorganize in the same court with their parent. Moreover, a petition by or against the subsidiary may be filed in the parent's proceeding. \textit{In re} Realty Associates Securities Corp., 55 F.Supp. 546 (E.D.N.Y. 1944). And two proceedings in the same court involving a parent and subsidiary may be ordered consolidated. \textit{In re} Mallow Hotel Corp., 17 F. Supp. 877 (M.D.Pa. 1937). See 6 \textit{Collier, op. cit. supra} note 2, \S 4.12.

Furthermore, Section 177 provides that, in the case of a public utility other than an intrastate public utility, the commission having regulatory jurisdiction may suggest amendments and offer objections to a plan. And Section 178 specifies that a condition precedent to judicial acceptance of any plan for the reorganization of an intra-state public utility is the prior approval of that plan by the state public utility commission. See 6 \textit{Collier, op. cit. supra} note 2, \S 7.34. In fact, in the instant case the Pennsylvania Public Utility Commission had approved unitary reorganization for the Pittsburgh street railway system. \textit{See 22 Decisions of Pa. P. U. C.} 67, 73 (1940); 23 id. at 65 (1941); 23 id. at 309 (1942). Unitary reorganization was also urged by the Securities and Exchange Commission. \textit{See Brief for SEC, pp. 2-11, In re} Pittsburgh Rys., 115 F.2d 477 (C.C.A. 3d 1946).

Since the problem would arise with greater frequency in the reorganization of interstate railroads, this suggests a similar amendment to Section 77 of the Bankruptcy Act.

\textsuperscript{32} See Douglas and Frank, \textit{Landlords' Claims in Reorganizations}, 42 \textit{Yale L. J.} 1003, 1049 (1933); Meck and Masten, \textit{supra} note 12, at 630-1; Comment, 48 \textit{Yale L. J.} 1400, 1406-11 (1939) (pointing out the relative merits of the lease and the mortgage). A few cases support this view. \textit{In re} Hotel Gibson Co., 11 F.Supp. 30 (S.D. Ohio 1935) (lessor's interest under a 99-year lease renewable forever held a security device with lessor as secured creditor of debtor-lessee); \textit{In re} Euclid Doan Co., 104 F.2d 712 (C.C.A. 6th 1939) (under the peculiar facts a 99-year lease renewable forever construed as a mortgage); \textit{Note 52 Harv. L. Rev.} 1149, 1153 n.29 (1939).

\textsuperscript{33} See Meck and Masten, \textit{supra} note 12, at 628-30.


In some jurisdictions, it is recognized, for purposes of taxation, that there is no practical distinction between a lessee under a long-term lease and a fee-simple owner and the lessee is accordingly so treated. Ohio: \textit{Ohio General Code} § 5330 (Page, 1945); Village of St. Bernard v. Kemper, 60 Ohio St. 244, 54 N.E. 267, 45 L.R.A. 692 (1899) (other than tax purposes); Cincinnati College v. Yeatman, 30 Ohio St. 276 (1876); \textit{see} Loring v. Melendey, 11 Ohio 355, 358 (1842). Connecticut: Connecticut Spiritualist Camp Meeting Ass'n v. East Lyme, 54 Conn. 152 (1886). Pennsylvania: Philadelphia Library Co. v. Ingham, 1 Whart. 72 (Pa. 1836). Note, 55 A.L.R. 154 (1928).
FEDERAL QUESTION—THE JURISDICTIONAL ENIGMA
OF THE INSUFFICIENT COMPLAINT*

Propriety of jurisdiction must be the first inquiry of a federal court. But
where jurisdiction is allegedly grounded on a federal claim, an enigma results
in that this initial question seems inextricably related to the validity of the
cause of action stated. Thus, adjudication of a damage suit brought under a
federal regulatory statute, which does not expressly impose civil liability,
necessarily involves determination of whether a private remedy is implicit.
Resolution of this question may then equally be considered an interpretation
of the act on the merits, or a jurisdictional decision as to the existence of a
federal question.2

The logical difficulties and implications of this problem are illustrated by
Downing v. Howard.2 A minority stockholder in the United Corporation
brought a derivative suit against former and present directors and third
parties, alleged to have deliberately violated the Public Utilities Holding Com-
pany Act.3 Plaintiff charged that prior to registration with the SEC, United
had owned and voted securities of subsidiaries and had acquired shares in a
company formed by consolidation of two subsidiaries—actions which Section
4(a) made unlawful for unregistered companies.4 This unlawful activity was
said to implement a conspiracy whereby defendant bankers continued to con-
trol United so as to retain its profitable financial business.5 By reason of the
shrinkage in value of the securities thus illegally owned, the loss of dividends
under the merger agreement, and the profits of the bankers at the expense of
United, damages were claimed in the sum of $100,000,000.

Upon defendants' appearance to attack the jurisdiction,6 the district court
dismissed the complaint, stating that the action was simply a traditional suit

1. See 1 Moore, Federal Practice 178 (1938); Simkins, Federal Practice 35-6
(1938).
2. 68 F. Supp. 6 (D. Del. 1946).
Act).
4. Section 4(a) makes it unlawful for a holding company not registered under Section
5 to carry on most of the normal activities of a holding company, including holding,
owning, or acquiring securities of any subsidiary company. 49 Stat. 812 (1935), 15
The complaint also alleged a violation § 11(e), 49 Stat. 822 (1935), 15 U.S.C.
§ 79k(e) (1940), which allows any registered holding company to submit a plan for
divestment of control, securities or other assets. The court noted a previous decision con-
struing this section as permissive, not mandatory, and thus refused jurisdiction of that
See note 26 infra.
5. For the history of United's organization by banking groups, see The United Corp.,
13 S.E.C. 854, 856-71 (1943).
for breach of fiduciary duty and not an action to enforce any duty or liability under the Act. The court reasoned that the transactions complained of would have been legal had United registered, yet the loss would have been the same. Thus the real cause of the loss could not have been the violation of the statute. Furthermore, the court held that the plaintiff had no standing to sue because the Act gave no private right of action for a violation of Section 4(a). Since the court determined that on either ground this was not a case arising under the laws of the United States, the dismissal was stated to be for lack of jurisdiction.\footnote{7}

The denial of plaintiff's standing to sue seems to run counter to the current of decisions, which has expanded rather than contracted the kinds of actions which may be brought to seek redress for violations of this and related legislation.\footnote{8} The court's decision was based on three grounds: (1) the specific sanctions provided in the Act do not include a private damage suit for violation of Section 4(a),\footnote{9} whereas for two other violations Congress explicitly granted a private remedy;\footnote{10} (2) the purpose of Section 4(a) is to enforce compliance with the registration provisions of Section 5;\footnote{11} and (3) the SEC has the primary duty of enforcing the Act. This rationale should be contrasted with that of the Second Circuit in \textit{Goldstein v. Groesbeck},\footnote{12} in which a minority stockholder recovered, on behalf of a subsidiary, money paid to a parent holding company under a contract illegal under Section 4(a).\footnote{13} There the court declared that the specific sanctions provided by the Act were inadequate to carry out its purpose, that the SEC's usual jurisdiction should not preclude supplemental judicial remedies, and that "... a denial of a private right of action..." has been analogized to the tort problem of determining who the statute was designed to protect. Steckler v. Pennroad Corp., 136 F.2d 197, 201 (C.C.A. 3d 1943), \textit{cert. denied}, 320 U.S. 757 (1943). See \textit{Restatement, Torts} \S 288 (1934).\footnote{14}
to those for whose ultimate protection the legislation is intended leaves legisla-
tion highly publicized as in the public interest in fact sadly wanting, and even
delusive, to that end." 14 Similarly, since one of the purposes of the Act is to
protect holding company investors, 15 it would seem that this policy would be
best served by granting a right of action to a representative of that group,
who claims injury from a violation of the Act. 16

Although it may be argued that the plaintiff had standing to sue, that alone
would not dispose of the case, for, as the court pointed out, it is difficult to see
how the violations of the Act caused the loss to the corporation. 17 Much more
important as a causative factor would seem to be the declining securities
market which coincided with the period of alleged illegality. 18 Perhaps the
court would have been more willing to find a private remedy, if plaintiff had
presented a more persuasive claim for relief.

Whether the court was right or wrong in its determination that plaintiff
could not recover on his federal claim, the dismissal for lack of jurisdiction
seems erroneous. The decision that there was no causal relation between the
violations of the Act and the loss is a determination that the facts alleged are
legally insufficient to state a cause of action. As such it requires a dismissal
on the merits just as if the court had decided after trial that the facts proven
were insufficient to allow recovery. 19 Admittedly, whenever a court decides
that plaintiff has not stated a good cause of action, doubts may arise as to the
substantiality of his federal claim; but if the court's action in this case were
correct, then jurisdiction would stand or fall on plaintiff's success or failure.
Jurisdiction, however, is the power to decide a case either way, not merely in
favor of the plaintiff. 20

The refusal of a private action under Section 4(a) likewise necessitates a
dismissal on the merits, according to the latest Supreme Court doctrine. In
Bell v. Hood, 21 neither referred to nor distinguished in the instant case, plain-
tiffs sought damages from agents of the Federal Bureau of Investigation for
illegal arrest, false imprisonment, and unlawful searches and seizures, basing

§ 1(b) of the Act, 49 Stat. 803 (1935), 15 U.S.C. § 79a(b) (1940); H.R. Doc. No. 137,
16. Cf. cases cited note 8 supra; Deckert v. Independence Shares Corp., 311 U.S. 282,
287-8 (1940).
17. 68 F. Supp. 6, 10 (D.Del. 1946).
18. The history of United's security losses is detailed in The United Corp., 13 S.E.C.
854, 871-5 (1943).
U.S. 291 (1923); Flanders v. Coleman, 250 U.S. 223 (1919); The Fair v. Kohler Die &
Specialty Co., 228 U.S. 22 (1913); Pacific Electric Ry. v. Los Angeles, 194 U.S. 112
(1904); Illinois Central R.R. v. Adams, 180 U.S. 28 (1901); City Ry. v. Citizens' Street
R.R., 166 U.S. 557 (1897).
federal jurisdiction on violations of the Fourth and Fifth Amendments. The district court's dismissal for lack of jurisdiction on the ground that the Constitution did not provide for money recovery and that therefore there was not involved a controversy arising under the federal Constitution, was reversed by the Supreme Court. The *ratio decidendi* was that plaintiff's right of recovery depended upon the scope of the Fourth and Fifth Amendments' protection, so that recovery would be had if the Amendments were construed in one way, and denied if construed in another. This was said to be a question of law which could be decided only after the court had assumed jurisdiction over the controversy. So, in the instant case, plaintiff's right of recovery depends upon the scope of the civil protection afforded by the Act. Nor does plaintiff's claim seem to fall within the exceptions, noted in the *Bell* case, that allow a federal court to refuse jurisdiction of a complaint seeking recovery directly under a federal statute. For here the federal question is neither immaterial, nor insubstantial or frivolous.

That the dismissal of the federal claim ought to have been on the merits rather than on jurisdictional grounds imports more than a technical nicety in the form of the decree. Where the cause of action is based on two grounds, one of which presents a federal question and the other a question of state common law, the court must normally adjudicate the non-federal claim even though the federal claim is decided adversely to plaintiff. Thus in the

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22. The district court's unreported opinion was affirmed by the Ninth Circuit. *Bell v. Hood*, 150 F.2d 96 (C.C.A. 9th 1945).


instant case, having dismissed on the merits the federal ground for relief, the court would have been required to hear the claim for breach of fiduciary duty. This, of course, raises the objection presented in the Bell dissent—that it is unreasonable to require disposal of a question of federal law on the merits where the only effect is to require the federal court to decide questions of state law. Whereas in the Bell case the state question involved only a simple trespass claim, in the instant case it presented one of the most time consuming and complicated of common law actions. On the other hand, to the extent that the instant decision becomes authoritative on the issue of civil liability, a dismissal on the merits would have imposed the burden of local law decision uniquely on this court. Henceforth, litigants pressing a similar claim under the Act would be met with a valid jurisdictional bar under the doctrine that a federal question is no longer substantial if it has been authoritatively decided contrary to their claim of right.

It may be argued, moreover, that the plaintiff, without any prior decisions pointing his error, has incurred the cost of presenting a bona fide claim under federal law to a federal court and should not be remitted to another forum for the adjudication of his other grounds. Considerations of efficiency and economy require that all issues be decided by a single court instead of shunting the litigant from one forum to another. From the point of view of the

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Compare with this doctrine, the cases in which federal courts postpone determination of state law constitutionality until state courts construe the statute, Railroad Commission v. Pullman Co., 312 U.S. 496 (1941); Chicago v. Fieldcrest Dairies, 316 U.S. 168 (1942); or delay granting an injunction against a state tax, Spector Motor Service v. McLaughlin, 323 U.S. 101 (1944); or avoid unsettled local law questions, Thompson v. Magnolia Petroleum Co., 309 U.S. 478 (1940); or decline to exercise equity jurisdiction, Burford v. Sun Oil Co., 319 U.S. 315 (1943). See 1 Moore, Federal Practice 180 (Supp. 1946); Note, 53 Yale L. J. 788 (1944).

29. The application of the doctrine of Hurn v. Oursler, supra note 27, depends upon the breadth of the concept of the cause of action. See 1 Moore, Federal Practice 93 (Supp. 1946), for a criticism of the Second Circuit’s narrow conception to avoid the decision of state law questions, while purporting to follow the Hurn case.

Even if the court in the instant case, could have refused to hear the state law question on the ground that it involved a separate cause of action, the actual decision demonstrates that the problem was not even considered. In fact, the court noted that the transactions complained of as violating federal law constituted facts showing a breach of fiduciary duty.


31. See note 26 supra.

layman, it is also better that his claim be adjudicated on the merits rather than disposed of by what must appear to him to be judicial sleight-of-hand. If the plaintiff, relying on the dogma that a jurisdictional dismissal is not a judgment on the merits and does not preclude a subsequent suit on the same cause of action, renews his claim under the Act in a state court, he may be met with the bar of “direct” estoppel. Thus may a litigant be misled into accepting, as without prejudice to his substantive rights, a dismissal that is actually conclusive. Finally, the Bell case seems close enough in point to have compelled considering the issues as questions of merit rather than of jurisdiction.

**TORTIOUS INTERFERENCE WITH CONDUCT OF A BUSINESS**

That one has a common law right “to conduct one’s business without the wrongful interference of others” has been recognized at least since 1621. Three frequent types of violation of this right have been categorized as the torts of “inducing breach of contract,” “unfair competition,” and “trade libel.” A fourth generic label, “wrongful interference with the conduct of a

35. The term “direct” estoppel is applied in the Restatement of Judgments to the situation where a judgment has a binding effect on the matter litigated, although a subsequent suit on the same cause of action is not precluded. Restatement, Judgments §45 (c), comment d (1942); id. at §49, comment b; Scott, Collateral Estoppel by Judgment, 56 Harv. L. Rev. 1, 3 n.5 (1942). See Wiggins Ferry Co. v. Ohio & Miss. Ry., 142 U.S. 396, 410 (1892).

3. Similar to “trade libel” are torts called “slander of title,” “disparagement of property,” or “injurious falsehood.”
business," has been applied to a conglomerate of transactions often including or overlapping the more crystallized torts. Its bounds vague and flexible, this fourth cause of action may offer assistance to any businessman with a grievance which does not fit the more familiar molds; it also presents a possible occasion for evading policies embodied in the requirements for a cause of action along more traditional lines.

Its cue taken from a line of recent New York decisions,4 the complaint in Munson Line v. Green5 was designed to state a claim for "wrongful interference with the conduct of a business" as well as for malicious prosecution.6 The plaintiff Line alleged execution of a conspiracy to harass it into buying stock owned by the defendants, and accordingly charged them with "willfully, intentionally, and maliciously" damaging its business. The campaign against the Line was allegedly conducted by instituting successive lawsuits "maliciously and without probable cause," by threatening receivership and liquidation, and by using false representations to induce suits by other stockholders. The complaint further accused the defendants of making false allegations intending that they would be republished in newspapers, of using confidential information entrusted to Green as a director, of circulating rumors maligning the integrity and ability of the Line's management, and of concealing the identity of the real parties in interest so as to permit suit on acts which had been approved by Green while a director and to permit allegations in one suit inconsistent with those in another.

Because, under applicable law,8 an action for malicious prosecution of a civil suit would not lie without "special injury" involving harassment to an extraordinary degree—as by arrest, attachment, or injunction9—the court

7. A third claim for relief was based on the contention that the defendants had been guilty of criminal conspiracy under Section 580 of the New York Penal Law, which provides: "If two or more persons conspire . . . falsely to institute or maintain an action or special proceeding . . . each of them is guilty of a misdemeanor." The court rejected plaintiff's assertion that a violation of this section gives rise to a civil action. But cf. Kellogg v. Sowerby, 190 N.Y. 370, 83 N.E. 47 (1907).
8. The conspiracy was allegedly conceived in New York, and the suits were brought in Maryland and the District of Columbia. The court determined that the law of all three jurisdictions was the same on the issues presented.
dismissed the claim based on malicious prosecution. The alleged application for the appointment of a receiver and the bringing of three successive suits, it was held, did not amount to the necessary "special injury."^{10}

What saved the complaint was the claim for "wrongful interference with the conduct of a business." Insisting that the plaintiff stated "more than a glorified cause of action for malicious prosecution," the court based its approval of the claim on a conclusion that the tort of "wrongful interference" was generally recognized and on the total lack of authority in bar.

Although the decisions cited by the court involved facts unlike those in the case before it,^{11} other authorities seem clear that a general claim of unjustified injury to the business, credit and reputation of the plaintiff is enough to bring a case within the range of interests protected in the name of "conduct of a business."^{12} Most commonly the interest to which that or similar language has been applied is a course of dealing or prospective dealing with an identifiable person or group,^{13} but the language of the opinions imposes no stricter limitation on the interest protected than that it be one of business.

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13. In addition to cases cited note 11 supra, see e.g., Dunsee v. Standard Oil Co., 152 Iowa 618, 132 N.W. 371 (1911) (competition for sole purpose of destroying plaintiff’s business); Green v. Samuelson, 168 Md. 421, 178 Atl. 109 (1935) (picketing to force em-
With respect to the conduct condemned, as distinguished from the interest allegedly damaged, the court was on less certain ground. In only one other case found was a complaint alleging malicious bringing of a legal proceeding upheld on a "wrongful interference" theory. On the other hand, no contrary authority has been located. And supporting the court are numerous dicta which assert that whatever the pattern of conduct, the plaintiff can succeed, if the defendant's conduct indicates that he acted "maliciously" or to inflict "intentional harm" on the plaintiff, that his acts were "unjustifiable," and that the result was injury to a business interest.

In using the label "wrongful interference" the courts have apparently applied to the protection of business relations the rule which Holmes contended was (or ought to be) a general principle of the common law: that "when a responsible defendant seeks to escape from liability for an act which he had notice was likely to cause temporal damage to another, and which has caused such damage in fact, he must show a justification." A justification arises when other considerations of public policy are stronger than the policy of protecting business enterprise. Courts commonly regard as justified injuries resulting from a labor union's pursuit of "legitimate" labor objectives or from bona fide "fair" competition.

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Application of the rule requiring compensation for harm intentionally done seems especially desirable in the field of business relations. Courses and customs of dealing, reputation and credit standing are genuine business assets, often more valuable to an entrepreneur than physical plant; the protection of such intangibles would appear essential to a system which aims at distributing wealth on a basis of rewarding the enterprising. The variety of forms which such assets may take and the infinite possibilities for unjustified interference with them require that the doctrinal basis for their protection remain flexible.

Yet this very flexibility presents opportunity for the tailoring of cases which may be nothing more than claims insufficient under one of the traditional tort theories to fit the language of “wrongful interference.” Although the court in Munson Line v. Green did not explicitly consider whether any policy reflected in the conditions to the maintenance of an action for malicious prosecution would be subverted by upholding the complaint, it is evident that the decision was made in the conviction that something more was alleged than is to be found in a malicious prosecution suit.

The asserted reason that courts in about half the states impose onerous conditions on actions for malicious prosecution is that a contrary rule might deter sincere resort to the courts. Potential litigants might be discouraged if they knew that successful defendants could subject them to counterclaims for malicious prosecution. The conduct alleged in Munson Line v. Green, it would seem, went far beyond the probable actions of the most assiduous protector of his rights, and thus beyond the protection required to effectuate this policy of unobstructed access to the court. In this particular case, then, the “court’s conclusion that it was more than a dressed-up, deceptively labelled suit for malicious prosecution seems justified.

The decision suggests, however, other possibilities for use of a “wrongful interference” theory. Applied to a set of facts of the sort ordinarily alleged in an action for defamation, the theory might deceive an ingenuous judge or tempt a discerning one to circumvent the accepted prerequisites or defenses.

18. See Paul v. Fargo, 84 App. Div. 9, 18, 82 N.Y. Supp. 369, 375 (4th Dep’t 1903); Melvin v. Pence, 130 F.2d 423, 426 (App. D.C. 1942). In England an award of costs is said to be sufficient compensation for the victim of a malicious civil action, Quartz Hill Consolidated Gold Mining Co. v. Eyre, 11 Q.B.D. 674, 690 (C.A. 1883); but in this country costs are recognized as inadequate compensation, Paul v. Fargo, supra.

19. The successful use of this theory to get around requirements of other torts is especially likely where the policy behind the requirements is obscure or obsolete. The
The assault on the flanks has already started; two recent decisions\(^{20}\) have employed "wrongful interference" or similar language to defeat the doctrine that "special damage" is a necessary element of "trade libel."\(^{21}\) Although that requirement is usually satisfied only by pleading loss of particular customers or sales,\(^{22}\) plaintiffs succeeded under the "interference" label with most general allegations of injury to business or reputation from disparagement of property. Similarly vulnerable is the slander doctrine, calling for "special damage" when the defamatory utterance, though not imputing traits inconsistent with able business conduct, injures the plaintiff's trade.\(^{23}\) "Wrongful

requirement of "special damages" in most slander cases is a good example. See reference to this rule in Prosser, Torts 808 (1941): "Nothing but historical survival of the relics of forgotten jurisdictional conflicts accounts for a state of affairs peculiar to the common law, and unknown elsewhere in the civilized world."

In another branch of torts, analogous attempts have been made to avoid the defenses of contributory negligence or governmental immunity by labelling the cause of action "nuisance." E.g., McFarlane v. Niagara Falls, 247 N.Y. 340, 160 N.E. 391 (1928); Hubbard v. Wichita, 98 Kan. 498, 159 Pac. 399 (1916).

20. In Advance Music Corp. v. American Tobacco Co., 296 N.Y. 79, 70 N.E.2d 401 (1946) the complaint alleged that the defendant, sponsor of the "Hit Parade," consistently gave songs published by the plaintiff a lower ranking than was due them, and that as a result "exploitation" of the songs was "frustrated," their value depreciated, plaintiff's revenue diminished, and its "property right" and business prestige impaired. A "trade libel" theory had been unsuccessful in a lower court, 268 App. Div. 707, 53 N.Y.S.2d 337 (1st Dep't 1945). In Carter v. Knapp Motor Co., 243 Ala. 600, 11 So.2d 383 (1943) defendant allegedly parked a Hudson car with a large white elephant on it near plaintiff's Hudson salesroom. As a result plaintiff's business was "irreparably harmed." Cf. Paramount Pictures Inc. v. Leader Press, 106 F.2d 229 (C.C.A. 10th 1939). Early cases indicate that "trade libel," in combination with other wrongs, is actionable as "wrongful interference." Leach v. Farmers' Tobacco Warehouse Co., 171 Ky. 791, 188 S.W. 86 (1916); Virtue v. Creamery Pkg. Mfg. Co., 123 Minn. 17, 142 N.W. 930 (1913); Stebbins v. Edwards, 101 Okla. 188, 224 Pac. 714 (1924).

21. The doctrine is that "special damages" are those which follow naturally, but not necessarily, from defendant's utterance. For a full discussion and collection of cases, see Smith, Disparagement of Property, 13 Col. L. Rev. 13, 121 (1913).

22. Stevenson v. Love, 106 Fed. 466 (C.C.N.J. 1901); Ebersole v. Fields, 181 Ala. 421, 62 So. 73 (1913); Dooling v. Budget Publishing Co., 144 Mass. 258, 10 N.E. 809 (1887); Wilson v. Dubois, 35 Minn. 271, 29 N.W. 68 (1886); Hubbard v. Scott, 85 Ore. 1, 166 Pac. 33 (1917); Denney v. Northwestern Credit Ass'n, 55 Wash. 331, 104 Pac. 769 (1909); Barquin v. Hall Oil Co., 28 Wyo. 164, 201 Pac. 352 (1921). A minority of cases sustain general allegations of loss of sales "in exceptional cases." The plaintiff must aver the amount of sales before publication, the amount of sales after publication, and that it was impossible for him to allege the names of particular customers who withdrew their business. Erich Bowman Remedy Co. v. Jensen Salsbury Laboratories, 17 F.2d 255 (C.C.A. 8th 1926); Ratcliffe v. Evans [1892] 2 Q. B. 524 (C.A.).

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"interference" might also assist in avoiding a Statute of Limitations applicable to defamation only,\(^\text{24}\) the defense of truth,\(^\text{25}\) the absolute privilege of witnesses\(^\text{26}\) and counsel\(^\text{27}\) in judicial proceedings, or the requirement that defamatory language be set out in the complaint.\(^\text{28}\) The theory is especially promising where, as in Munson Line v. Green, the interfering defamation is repeated, or is combined with other injurious conduct not in itself actionable.

DEBT CANCELLATION AND TAX BASIS REDUCTION IN CHAIRET X REORGANIZATION\(^*\)

The scaling down of debt to a level which will free the corporation of a heavy burden of fixed charges is a goal of every reorganization under Chapter X of the Bankruptcy Act.\(^\text{1}\) Impeding attempts to reach that goal is the rule that taxable income may result from cancellation of indebtedness. Sanctioned fifteen years ago by the Supreme Court in United States v. Kirby Lumber Company,\(^\text{2}\) the rule has since been unsystematically fashioned by the courts

\[24\] Cf. Ledwith v. International Paper Co., 64 N.Y.S.2d 810 (Sup. Ct. 1946) in which the court denied defendant's motion to dismiss an action filed after the one-year libel Statute of Limitations had run, characterizing the cause of action as one for "damage wilfully and intentionally done," to which a longer limitation applied. The complaint alleged that defendant brought about plaintiff's "disgrace, contempt, and ruin" by firing him and notifying the trade of the discharge on the pretense that plaintiff's work had deteriorated.

\[25\] Restatement, Torts § 582 (1938): "The truth of a defamatory statement of fact is a complete defense to an action for defamation." This rule is followed in all but a few states which have changed it by statute. Cases and statutes are collected in Ray, Truth: A Defense in Libel, 16 Minn. L. Rev. 43 (1931). The tort of "invasion of the right of privacy" has been useful in evading the rule in many cases. Wolff, Unfair Competition by Truthful Disparagement, 47 Yale L. J. 1304, 1303-9 (1938). For a discussion questioning the validity of the rule as applied in business relations, see Wolff, supra. The defense of truth and the privileges of parties to judicial proceedings are recognized in actions for trade libel and slander of title. Restatement, Torts §§ 634-9 (1938).

\[26\] Material statements made in judicial proceedings are absolutely privileged and cannot successfully be made the subject of actions for libel or slander. Luang v. Mitten, 185 Mass. 233, 70 N.E. 128 (1904) ; Huncel v. Voneiff, 69 Md. 179, 14 Atl. 500 (1889) ; Cooley v. Galyon, 109 Tenn. 1, 70 S.W. 607 (1902) ; Restatement, Torts § 588 (1938).

\[27\] Carpenter v. Ashley, 148 Cal. 422, 83 Pac. 444 (1906) ; McDavitt v. Boyer, 169 Ill. 475, 48 N.E. 317 (1897) ; Irwin v. Ashurst, 158 Ore. 61, 74 P.2d 1127 (1938) ; Restatement, Torts § 586 (1938).


2. 264 U.S. 1 (1931). The Treasury had adopted the rule in its regulations as
and Congress to meet the conflicting needs of revenue and of debtor's relief.

To an increasing extent the courts have attempted to mitigate the harshness of the Kirby doctrine as applied to financially embarrassed debtors. One of the judicially-devised exceptions relates to a debtor corporation which is permitted to issue stock in exchange for its outstanding bonds. According to the Tax Court this amounts to "continuation of the obligation in another form," according to the latest pronouncement of the First Circuit it is "payment." Under either theory no taxable income has been found to arise out of the exchange.

Congressional action in lightening the debtor's tax load under the Kirby rule has both supplemented and duplicated that of the courts. When Chapter X of the Bankruptcy Act was enacted in 1938 it was provided in Section early as 1921. U.S. Treas. Reg. 62, Art. 545 (1) (c) under Revenue Act of 1921. For discussion of the Kirby case, see Magill, Taxable Income 241 et seq. (rev. ed. 1945). The Kirby rule is an inducement to trustees and reorganizing corporations to keep the proportion of bonds to stock as high as the requirement that the plan of reorganization be "feasible" permits.


4. Motor Mart Trust v. Commissioner, 4 T.C. 931 (1945); Alcazar Hotel, Inc. v. Commissioner, 1 T.C. 872, 879 (1943); Capento Securities Corp. v. Commissioner, 47 B.T.A. 691 (1942), aff'd, 140 F.2d 382 (C.C.A. 1st 1944).


6. "Sec. 268. Except as provided in section 270 of this Act, no income or profit taxable under any law of the United States or of any State now in force or which may hereafter be enacted, shall, in respect to the adjustment of the indebtedness of a debtor in a proceeding under this chapter, be deemed to have accrued to or to have been realized by a debtor, by a trustee provided for in a plan under this chapter, or by a corporation organized or made use of for effectuating a plan under this chapter by reason of a modification in or cancellation in whole or in part of any of the indebtedness of the debtor in a proceeding under this chapter." 52 Stat. 904 (1938), 11 U.S.C. § 668 (1940) (italics added).

Other statutory exceptions to the Kirby rule were included in the Bankruptcy Act of 1938: §§ 395 and 396, 52 Stat. 915 (1938), 11 U.S.C. §§ 795-6 (1940), applied to Chapter XI Arrangements provisions for nonrecognition of cancellation of indebtedness...
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268 that no income shall be deemed to have accrued by reason of a “modification or cancellation” of indebtedness in a Chapter X reorganization except as required by Section 270. Under Section 270 the debtor must reduce the tax basis of its property by the amount of any “cancellation or reduction,” but not to a figure less than the fair market value of the property as of the date the plan is confirmed. Since reduction of the basis lowers allowable deductions for depreciation and either increases capital gains or decreases capital losses on sale of the property, Section 270 results in raising the reorganized corporation’s taxable income in subsequent years. In effect it thus requires the debtor—where future operations are profitable—eventually to make up for the taxes forgiven by Section 268.

and for basis reduction similar to §§ 268 and 270; §§ 520 and 522, 52 Stat. 929 (1938), 11 U.S.C. §§ 920, 922 (1940), made similar provisions with respect to Chapter XII Real Property Arrangements; § 679, 52 Stat. 938 (1938), 11 U.S.C. § 1079 (1940), provided for nonrecognition of cancellations in Chapter XIII Wage Earners’ Plans, but no basis reduction requirement was included. Int. Rev. Code §§ 22 (b) (9), 113 (b) (3), permit a corporation receiving a taxable cancellation of indebtedness outside of a bankruptcy reorganization to exclude the amount of the cancellation from taxable income, if it elects to be subject to a corresponding basis reduction. Int. Rev. Code § 22 (b) (10), provides for nonrecognition of cancellations in railroad reorganization or receivership proceedings.

7. “Sec. 270. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor’s property (other than money) or of such property (other than money) as is transferred to any person required to use the debtor’s basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be reduced to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan...” 52 Stat. 904 (1938), as amended, 54 Stat. 709, 11 U.S.C. § 670 (1940) (italics added).

8. Roughly, the basis reduction is accomplished by reducing the basis of each unit of the debtor’s property according to the following proportion:

\[
\text{old basis of unit} - \left( \frac{\text{total debt reduction}}{\text{old basis of all corporate property}} \right) = \text{new basis of unit.}
\]

For detailed instructions see U.S. Treas. Reg. 111, Art. 29. 113 (b) (1)-2.


10. Deductions for depreciation are limited to “a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)” of the corporation’s property. Int. Rev. Code § 23 (1). See also U.S. Treas. Reg. 111, § 29.23 (1)-1: “... The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate) whereby the aggregate of the amounts so set aside plus the salvage value, will, at the end of the useful life of the depreciable property, equal the cost or other basis of the property.”


12. The full amount of taxes forgiven would probably not be made up by basis re-
The troublesome question is whether Section 270 does more than take back the gift granted by Section 268: whether it also requires reduction of the debtor's basis even where, without Section 268, the debtor would not have taxable income from the extinguishment of debt, as when the debt extinction falls within an exception to the Kirby rule. Section 270 is not expressly limited in application to debtor corporations which would have income to report but for Section 268. Therefore, the possibility was created that the fruits of the judicially-devised exceptions might not be retained by debtors reorganizing under Chapter X.

The first appellate court to rule on this point, the Seventh Circuit, held that Section 270 controlled and that the debtor's basis must be reduced. The question was again presented to the Circuit Court of Appeals for the First Circuit in Commissioner of Internal Revenue v. Motor Mart Trust. In 1937 Motor Mart, a Massachusetts trust taxable as a corporation, initiated a reorganization proceeding under Section 77B of the Bankruptcy Act. As the proceeding continued through 1938, Sections 268 and 270 were held to apply.

Assume, for example, that the debt cancellation amounted to $1,000,000. If the whole amount were taxed in one year, the maximum rate would be applied to the entire amount. If, because of basis reduction, the corporation had $25,000 additional income for each of forty subsequent years instead of $1,000,000 in one year, and its income without the basis reduction would have been $10,000 (making a total of $35,000 a year), none of its income would be taxed at the maximum rate. On the other hand, if the corporate income other than that attributable to basis reduction exceeded $25,000 in every one of the ten years, the whole $1,000,000 would be taxed at the maximum rate. See 55 Stat. 692 (1941), 59 Stat. 568 (1945), 26 U.S.C. §§ 13, 15 (Supp. 1946).

Furthermore, the corporation is forced to gamble on future tax rates by taking the basis reduction, because of the graduated tax rates. Assume, for example, that the debt cancellation amounted to $1,000,000. If the whole amount were taxed in one year, the maximum rate would be applied to the entire amount. If, because of basis reduction, the corporation had $25,000 additional income for each of forty subsequent years instead of $1,000,000 in one year, and its income without the basis reduction would have been $10,000 (making a total of $35,000 a year), none of its income would be taxed at the maximum rate. On the other hand, if the corporate income other than that attributable to basis reduction exceeded $25,000 in every one of the ten years, the whole $1,000,000 would be taxed at the maximum rate. See 55 Stat. 692 (1941), 59 Stat. 568 (1945), 26 U.S.C. §§ 13, 15 (Supp. 1946).

In every case where the basis reduction is substituted for an immediate tax the corporation will, of course, have the advantage of having available for investment, until the total tax abatement is made up, funds which otherwise would have had to be paid in taxes in the reorganization year.

13. For other discussions of this question see Paul, Debt and Basis Reduction under the Chandler Act, 15 Tulane L. Rev. 1, 5 (1940); Banks, Section 270 of the National Bankruptcy Act, 19 Temp. L. Q. 31, 42 (1945); Comment, 6 U. of Chi. L. Rev. 447, 455 (1939).

14. Claridge Apartments Co. v. Commissioner, 138 F.2d 962 (1943), rev'd on other grounds, 323 U.S. 141 (1944). The court argued that Congress, "dealing with realities," wanted to eliminate the "fictitious depreciation basis" when the reorganization valuation of the property was much less than the basis, 138 F.2d at 965.

15. 156 F.2d 122 (1946).


17. The plan was confirmed June 21, 1938, and a final decree was entered early in 1939. The First Circuit followed the dictum of the Supreme Court in Claridge Apart-
new common and preferred shares of a total par value of $500,000 in exchange for outstanding bonds and accrued interest totalling $1,900,000. When the reorganized Trust continued to use the original cost of its fixed assets as a basis for depreciation, the Commissioner, claiming that the basis should be reduced to the fair market value of the property in accordance with Section 270, asserted deficiencies in the Trust's income tax for 1939 and 1940. The appellate court confirmed the Tax Court's decision that Section 270 does not apply to an exchange of stocks for bonds. Relying on its earlier holding in Commissioner v. Capento Securities Corporation\(^{18}\) that an exchange of stock for bonds is not a taxable cancellation of indebtedness within the Kirby rule, the court reasoned that the Trust received no tax advantage from Section 268. Applying Section 270 would have meant increased taxes; but Congress, according to Supreme Court dictum, intended Sections 268 and 270 as tax-relief measures.\(^{19}\) Therefore, the court decided that implementing the Congressional intent required its decision that the exchange was a "payment" and not a "cancellation or reduction" of debt within the meaning of Section 270,\(^{20}\) and held that the Trust could continue to use its old basis. The court conceded that Section 270 might apply in some situations where no benefit was received from Section 268, but argued that doubtful phrases should be construed to carry out the Congressional intent.

Although the court correctly found a Congressional intent to grant tax relief to debtors availing themselves of Chapter X, it was not drawing an inevitable conclusion when it determined that this particular case should be

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\(^{18}\) Claridge Apartments Co. v. Commissioner, 323 U.S. 141 (1944), in which § 276 (c), 52 Stat. 905 (1938), 11 U.S.C. § 676 (c) (1940) was construed to make §§ 268 and 270 apply to 77B proceedings pending on Sept. 22, 1938.

\(^{19}\) "... in its brief the Government asserts... 'This contention, although plausible, neglects the fact that Sections 268 and 270 are essentially tax provisions... To this it may be answered that the sections, in origin, purpose, and function were 'essentially reorganization provisions' or to put it differently, 'essentially tax relief provisions.'" Claridge Apartments Co. v. Commissioner, 323 U.S. 141, 163 n.35 (1944). See also: "The general purpose of the provisions... was to postpone the tax consequences which otherwise might ensue upon transactions occurring in such circumstances that immediate imposition was regarded as economically unjustifiable." Id. at 147.

\(^{20}\) The First Circuit's shift in rationale, from declaring the exchange to be a continuance of the obligation in the Capento case, to describing it as "payment" in the Motor Mart case, was unnecessary to the result. Nor does the newer rationale seem more satisfactory. "Payment" may be made, but if less is paid than originally contemplated, there would seem to be a taxable accretion within the Kirby rule. Adequacy of payment, undiscussed by the court, rather than the fact of payment represents the real issue.
decided, if possible, so as to ease the taxpayer's burden. Had the court taken an appropriate selection of material from the Congressional reports, it could have shown that Congress, on the advice of the Treasury, rejected a proposal specifically designed to make Section 270 recapture only the amount of income which would have been taxable but for Section 268.21 In addition, the Supreme Court had indicated that Congress intended to do away with the uncertainty prevailing in the taxation of bankruptcy reorganizations.22 That purpose would embrace wiping the slate clean of the Kirby rule and its exceptions as applied to reorganizations. A decision for the taxpayer in the Motor Mart case preserves one of those exceptions, tending to give new life to the uncertainty which Congress desired to eliminate.

Finally, it could be contended that Sections 268 and 270 represent a fitting of the basis provisions governing reorganized corporations into the framework of the Internal Revenue Code basis provisions. With few exceptions, the basis of an asset is its cost.23 To the extent that debt incurred to purchase a particular asset is cancelled or exchanged for property worth less than the amount of the debt, in effect the cost of that asset is reduced. Treated as a reduction in purchase price, the debt cancellation would not be taxed,24 but consistency would require modifying the basis to reflect the actual cost. Failure so to modify the basis would result in income escaping taxation, as the corporation could deduct as depreciation more than it paid for the property. There would, it could be argued, be nothing unreasonable about finding such a Congressional purpose. After a Chapter X reorganization a corpora-

21. This was the proposal of the National Bankruptcy Conference. What happened to the proposal in Congress is set forth in a letter from Representative Chandler to J. B. Faegre, Minneapolis attorney: “The story is too long to tell in a letter, but the cause of the trouble can be traced to the Treasury Department, which promised to submit an equitable paragraph to be inserted in the bill in lieu of sections 270 et al., but failed to do so after the bill reached the Senate floor in 1938. Therefore the language in the sections referred to is not the language which I preferred, but Senator O'Mahoney and I had to accept the language rather than let the bill fail of passage because of the shortness of time.” Hearings before Subcommittee of House Committee on the Judiciary on H.R. 9864, 76th Cong., 3d Sess. 58 (1940). In 1940 the proposal was aired at length in the hearings on the amendment to Section 270 (see note 9 supra) which was not adopted. A possible reason for its rejection was suggested by Representative Michener: “We cannot start by the piecemeal method in these items to readjust the inequalities in connection with revenue and reduce revenues, if we are going to meet the necessary financial demands on the Government right now.” Id. at 8. A Treasury representative opposed the amendment on the ground that it would create insuperable administrative difficulties. Id. at 62.

22. “It [Section 268] had no other object and there was no other reason for its being, than to free Chapter X reorganizations from the tax deterrents, including tax uncertainties, imposed by the existing revenue provisions.” Claridge Apartments Co. v. Commissioner, 323 U.S. 141, 149 (1944).

23. For the general rule and a list of exceptions, see Int. Rev. Code § 113 (a).

tion is essentially a new organization; its old obligations are largely forgiven, its old owners displaced. In the general housecleaning, the overstated basis might be replaced by one reflecting current property values, just as a new corporation would have to use a basis of cost, which presumably would be related to current values.

The result the court reached, however, carries out the Bankruptcy Act policy of treating reorganizations alike, whatever form they take. Where stock is exchanged for bonds in non-bankruptcy reorganizations, under the Capano rule there is no taxable income and nothing in the Internal Revenue Code to force reduction of the old basis. If the court had construed Section 270 to require a basis reduction where the same exchange took place in a Chapter X recapitalization, a corporation would have a strong incentive to attempt an extra-bankruptcy reorganization even though the resulting financial structure might be weaker than if the corporation took advantage of Chapter X. Furthermore, since 1943 Chapter X recapitalizations would have been at a disadvantage in comparison with Chapter X reorganizations involving the transfer of assets to a new corporation, for Section 113 (a) (22) of the Internal Revenue Code, adopted in that year, expressly preserves "notwithstanding the provisions of Section 270" the debtor’s old basis on property so transferred. The Motor Mart decision, by allowing a recapitalized corporation to retain its old basis, avoids this possibility of tax discrimination between forms of reorganization.

Nor was the other policy consideration present, the taxing of income however it arises, sacrificed by the court. Although there was a paper increment on the books of the Trust, the owners of the Trust received no income in the sense of resources available for dividends or for use in the business. By the time the reorganization proceeding began the interest of the stockholders had been dissipated, and, in all but form, the bondholders had the only beneficial interest. The reorganization merely recast the form to correspond to the substance.


26. 58 STAT. 42 (1944). The House version of the 1943 Revenue Bill contained no section corresponding to § 113 (a) (22). The Senate bill included the present § 113 (a) (22) and a provision that a corporation reorganized by the adjustment of capital and debt structure of the existing corporation should be deemed to be a new corporation organized to effectuate the plan of reorganization. Sen. Rep. No. 627, 78 Cong., 1st Sess. 51 (1943). The conference committee eliminated the latter provision without explanation.

27. The Motor Mart case is thus distinguishable from the Kirby case. In that case a going concern purchased its own bonds on the open market at less than their face value. The original stockholders remained in control. The purchase made available for other use company resources which would have been needed to pay off the bonds at their face value.
The Motor Mart case, together with Section 113(a)(23) of the Internal Revenue Code, reduces the applicability of Section 270 to a small fraction of Chapter X reorganizations. There will be left within that section only those rare reorganizations in which the old corporate form is retained and the debt is reduced by means other than an exchange of stock for bonds. For example, the section might apply to a reorganization which incorporated an agreement by creditors voluntarily to reduce their claims. Although in such case a claim for tax exemption with respect to the cancellation of indebtedness could be based on the doctrine that gratuitous cancellation of indebtedness is a "gift" as well as on Section 268, the Treasury might insist on a basis reduction according to Section 270. The rationale of the Motor Mart opinion suggests that the First Circuit would try to avoid applying Section 270; yet doubt is cast by the court's admission that "it is possible that the reduction in basis required by section 270 is not entirely limited to cases where discharges of debt would have given rise to taxable gain but for the saving provision of Section 268." Thus, with tax consequences uncertain, corporations will try to obtain agreement with creditors to carry out a reorganization outside the bankruptcy courts, or, until the Supreme Court or Congress settles the Motor Mart issue, bankruptcy trustees and courts will go through the added motion of transferring assets to new corporations so as to take advantage of Section 113(a)(23).

GROSS RECEIPTS TAXES: A CHANGE IN DOCTRINE

In the late thirties the United States Supreme Court evolved a new constitutional test for state taxes on gross receipts from interstate commerce. Traditionally a tax had fallen when its effect on interstate commerce was held

30. The Treasury Regulation is couched in the language of § 270: "... a further adjustment is required in certain cases in which there has been a cancellation or reduction of indebtedness in a proceeding under the Bankruptcy Act, as amended." U.S. Treas. Reg. 111, Art. 29.113(b)(1)-2.
32. One can only speculate as to why the Government did not petition for certiorari from the Motor Mart decision. Perhaps it was felt that, since the trustees had relied upon an earlier opinion of the Commissioner given at their request, the equities were on the side of the taxpayer. Id. at 124.

1. The cases that heralded the change are discussed infra. See also Johnson, Multi-State Taxation of Interstate Sales, 27 Calif. L. Rev. 549 (1939); Lockhart, State Tax
to be "direct" and had stood when the effect was only "indirect." Under the newer doctrine the commerce clause seemed to permit gross receipts taxes if they were either (1) apportioned to intrastate activities or (2) incapable of duplication by any other state. Implicit in the change was a promise to measure taxes by economic effect rather than by correspondence to verbal categories. The promise was soon qualified, and three decisions in the present term indicate that the Court may be forsaking the economic tests altogether.

The first of these cases, *Freeman v. Hewitt,* disposed of an attempted application of the Indiana Gross Income Tax without considering the possibility of multiple tax burdens or lack of apportionment. The taxpayer, a resident of Indiana, had sold securities on the New York Stock Exchange, the transactions being handled by a local broker through his New York correspondent. On the gross receipts thereof, which had already borne the New York Stock Transfer Tax, Indiana imposed its 1% levy. The Court, in an opinion by Mr. Justice Frankfurter for himself and four other justices, invalidated the tax as a "direct imposition on that very Freedom of commercial flow which for more than a hundred and fifty years has been the ward of the Commerce Clause." Mr. Justice Rutledge concurred in the result, but declared that to stand on such a ground meant a repudiation of the recently developed pragmatic approach and a return to once rejected doctrine. The inference to be drawn from the language of the majority opinion was that neither apportionment to intrastate activities nor the impossibility of multiple taxation would save a tax if it were "directly" imposed on gross receipts from interstate transactions.

Before 1938 the rule was recognized that any tax on gross receipts from interstate commerce was a direct burden on that commerce and thus forbidden by the Constitution. But in reality states could and did tax gross receipts.
This apparent contradiction resulted from the Court's recognition of a difference between a tax "on" gross receipts and a tax "measured by" gross receipts. A tax "on" property,9 or use,10 or manufacturing,11 "measured by" gross receipts was considered to be on a local activity with only a remote or indirect effect on interstate commerce. The legislative description seemed more determinative than economic effect.

The dominance of this formalistic approach was challenged in *Western Live Stock v. Bureau of Revenue*,12 where the Court upheld a tax imposed on the gross receipts from sales of advertising space by a magazine with an interstate circulation. Mr. Justice Stone, for the majority, stated that the tax was really on the local operation of the business and did not conflict with the commerce clause. This was the traditional rationale. But he gave an "added reason."13 There was, he said, no possibility of another state imposing a similar tax, and, further, gross receipts taxes had been invalidated in the past only when capable of duplication by other states and not fairly apportioned to local activities. It is arguable that Mr. Justice Stone was wrong on both counts. As a practical matter, a sales tax in an outside state would have subjected the publisher in the *Western Live Stock* case to a tax additional to those borne by a wholly local publication. And the interpretation of past decisions is contradicted by some of the cases cited to support it.14

But whatever the basis for the "added reason" at its inception, it was further developed in *Adams Manufacturing Co. v. Storen*15 and *Gwin, White* 1872), where the prohibition against state taxes on gross receipts from interstate commerce got its start, one of the reasons given was the possibility of multiple tax burdens. The reason was forgotten, though the rule remained. Lockhart, *Gross Receipts Taxes on Interstate Transportation and Communication*, 57 Harv. L. Rev. 40, 67 (1943); Morrison, *supra* note 1, at 732.


14. Two cases, for example, cited for the proposition that state taxes were invalidated only when they could be duplicated by other states, involved wholly intrastate businesses, and the possibility of multiple taxation was very slim. Galveston, H. & S. A. Ry. v. Texas, 210 U. S. 217 (1908) (intrastate railroad); Fisher's Blend Station, Inc. v. State Tax Comm., 297 U. S. 650 (1936) (intrastate radio station). In connection with the latter case, Mr. Justice Stone said "if broadcasting could be taxed so also could reception," and referred to a British tax on radio receivers. Such a tax seems no more probable or burdensome than a sales tax on magazines or even a gross receipts tax levied by a state where the magazines are sold. *Western Live Stock* v. Bureau of Revenue, 303 U. S. 250, 260 and n. 2 (1938). Lockhart, *Gross Receipts Taxes on Interstate Transportation and Communication*, 57 Harv. L. Rev. 40, 71 (1943).

15. 304 U. S. 307 (1938), 4 Mo. L. Rev. 64 (1939).
and Prince v. Henneford. Both cases involved taxes on gross receipts derived in large part from sales outside the taxing state. The Court declared both taxes invalid because not apportioned to intrastate activities, and because, if sustained, they could be duplicated by other states touched by the sales. These decisions required that an earlier holding, American Manufacturing Co. v. St. Louis, be distinguished or overruled. In that case a gross receipts tax had been sustained because it was nominally on manufacturing, though measured by the gross proceeds from sales both in and out of the taxing state. The Court accepted this verbalism as a valid ground for distinction; the American Manufacturing case therefore did not control the Adams and Gwin cases where the taxes were "on" gross receipts.

Despite the refusal to overrule American Manufacturing Co. v. St. Louis, the pragmatic approach developed in the above cases seemed to justify a belief that the Court would henceforth disregard labels and measure a tax by its dollars-and-cents effect on interstate commerce. Interstate commerce would have to pay its share toward supporting the local governments that gave it protection, but it need not bear cumulative tax burdens that would place it at a competitive disadvantage with intrastate commerce. Where a concern operated almost exclusively within one state, as in Western Live Stock v. Bureau of Revenue, an unapportioned gross receipts tax would be allowable. But where a substantial portion of the business was conducted outside the taxing state, as in the Adams and Gwin cases, the tax must be apportioned to be valid.

This doctrine, developed in cases where the taxing state was that of the seller, did not operate as smoothly when applied to taxes imposed by the buyer's state. A sales tax on an interstate sale is in effect a gross receipts tax on interstate commerce. But while the state of the seller can administer an apportioned tax without great difficulty, it is virtually impossible to apportion a sales tax. In many cases the seller may maintain no place of business within the taxing state, delivery being made direct to the buyer from out-of-state. Thus to require a buyer state to apportion a sales tax amounts to a prohibition of the tax and an apparent competitive advantage in the market place to interstate commerce. On the other hand, to allow a sales tax on the

20. See McGoldrick v. Felt & Tarrant Co., 309 U. S. 70 (1940) (delivery f.o.b. a factory outside the taxing state).
full proceeds of an interstate sale would appear to permit multiple taxation, at least to the extent that other states touched by the commerce exact apportioned levies.

Although the problem was not discussed in these practical terms, some such considerations may have led to the subsequent qualification of the cumulative-tax-burden test. Sales and use taxes on the full proceeds of interstate sales have been upheld on reasoning that sought help from the pre-1938 doctrine. There could be no duplication of a sales tax, the argument ran, because the tax was on the local incident of delivery and transfer. Thus the possibility of double taxation was not fatal so long as the tax was pegged to a local incident which could not be the basis of taxation in another state. An interstate transaction was regarded as a series of taxable events, and taxes levied on each event did not amount to a cumulative burden. The local incident that once saved a tax by making its effect on interstate commerce "indirect," now saved it by preventing, on a verbal (legal) level, multiple taxation.

Introduction of this qualification to the cumulative burden test reopened the question of the validity of taxes imposed by the seller state. Here, too, the concept of the local incident has been revived and combined with the newer doctrine. In *International Harvester v. Evatt*, decided this term, the Court upheld a capital stock tax which included in the numerator of the allocation fraction the sales proceeds from goods manufactured within, but


22. A use tax operates on the full proceeds of a sale as does a sales tax. The two are indistinguishable in effect, but the former is said to be on the use of the goods within the taxing state after the sale is complete. The "use" label may save a tax against the objection that the state is not sufficiently connected with a sale to tax it. Compare McLeod v. Dilworth Co., 322 U. S. 327 (1944), with General Trading Co. v. State Tax Commission, 322 U. S. 335 (1944); Comment, 32 CALIF. L. REV. 281 (1944); Note, 57 HARV. L. REV. 1086 (1944).


26. It is always necessary to single out a taxable event within the taxing state in order to provide jurisdiction to tax at all. The question of jurisdiction to tax, however, arises when objection is raised under the due process clause, and that question is distinct from those involved under the commerce clause and under discussion here. For the due process aspect of the problem, see Merrill, *Jurisdiction to Tax—Another Word*, 44 YALE L. J. 582 (1935); 50 YALE L. J. 900 (1941).

27. 67 Sup. Ct. 444 (1947). The decision was unanimous, Mr. Justice Rutledge concurring in a separate opinion.
sold outside, the taxing state. Holding the apportionment formula to be a fair one, the Court disposed of the possibility of multiple taxation by asserting what the statute asserted: that the tax was "on" the privilege of manufacturing or doing business in Ohio—a privilege which no other state could tax.

This denial of the possibility of double taxation, though in fact it seemed to exist, found its opposite two months later when the Court declared invalid a gross receipts tax which apparently could not have been duplicated. In *Joseph v. Carter & Wekes Strvedoring Co.* the taxpayer, a stevedoring corporation in New York city, protested the imposition of an unapportioned gross receipts tax. While in *Freeman v. Hewit* the majority simply ignored the cumulative burden test, here it was expressly noted that there was little danger of multiple taxation. Nevertheless, the court held the tax repugnant to the commerce clause, saying, "Stevedoring . . . is essentially a part of the [interstate] commerce itself and therefore a tax upon its gross receipts . . . is invalid." It is possible of course that the reasoning here will be restricted to cases where the taxpayer is an agency of interstate transportation. Even if so limited, it is an important exception to the cumulative burden test, noteworthy in particular since the cases relied on to support that test when first announced dealt primarily with taxes on transportation.

Accordingly the words of the Court do not give much indication of just what does make a tax on gross receipts unconstitutional. If the possibility of double taxation is not determinative, the Court is apparently left with the pre-1938 doctrine of "direct" or "indirect" effect—a distinction that does little more than state a conclusion. But, ignoring the opinions, a fairly consistent pattern of decision seems to appear. The Court has almost uniformly upheld taxes imposed by the state of the buyer, and apportioned taxes by the state of the seller are apparently unexceptionable. An unapportioned tax by the seller state is invalid if admittedly on gross receipts, while the fate of taxes on manufacturing, measured by gross receipts, is a matter of doubt.

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28. 67 Sup. Ct. 815 (1947). Mr. Justice Reed spoke for the majority. Mr. Justice Douglas, joined by Justices Rutledge and Murphy, dissented from the holding that the tax burdened interstate commerce and declared that it did not conflict with the commerce clause because impossible of duplication. Mr. Justice Black dissented without opinion.

29. *Id.* at 821.


31. The one apparent exception is McLeod v. Dilworth, 322 U. S. 327 (1944); and there the grounds for invalidating the sales tax were primarily lack of jurisdiction to tax.

32. The reliance on legislative description of the tax in *International Harvester v. Evatt* may mean that a levy pegged to a local incident will be approved even if unapportioned. But in *Freeman v. Hewit*, Mr. Justice Frankfurter distinguished *American Manufacturing Co. v. St. Louis*, where such a tax was upheld, so as to seem to imply that the tax there had really been apportioned. Mr. Justice Rutledge maintained that the latter case had never been successfully distinguished, that it had been in effect overruled, and that only the state of the market should be allowed to tax sales to the limit. *Freeman v. Hewit*, 67 Sup. Ct. 274, 285, 290 (1946).
Finally, a tax on the gross receipts of an agency of interstate transportation will evidently fall even though duplication is impossible.

It is perhaps not surprising that the cumulative burden test should be abandoned with the departure from the Court of its foremost advocate, the late Chief Justice Stone. The opinions in Freeman v. Hewit indicate that Justice Rutledge is the only remaining enthusiastic disciple. Justice Black has never subscribed to any doctrine limiting a state's right to levy non-discriminating taxes. He has consistently maintained that both the Constitution and the complexities involved demand Congressional rather than judicial action and that piecemeal supervision by the Court encourages legislative inertia. Justice Black has never subscribed to any doctrine limiting a state's right to levy non-discriminating taxes. He has consistently maintained that both the Constitution and the complexities involved demand Congressional rather than judicial action and that piecemeal supervision by the Court encourages legislative inertia.33 Justices Douglas and Murphy have at times taken the same position, but seem most frequently to defend taxes on their individual merits with arguments cast in more familiar legal terms. Of the five justices who constituted the majority in the Freeman and Joseph cases, two (Chief Justice Vinson and Justice Burton) have yet to articulate their position, and two (Justices Frankfurter and Reed) have in the past advanced views far from consistent with their most recent opinions. Thus it would be hazardous to predict great longevity for the pronouncements of the present term. A minority of four strongly disapproves, and both the unity and consistency of the majority are open to doubt.

But whatever the Court does with the individual taxes that come before it, its decisions affect only the periphery of the problem of interstate commerce and state taxation. Whether goods moving across state lines carry too heavy a tax burden depends not on what taxes are imposed, but on the amount of the tax bill in dollars and cents. A heavy property tax may add more to costs than an unapportioned gross receipts levy. Taxwise, the competitive position

34. See dissents, Nipper v. Richmond, 327 U. S. 416, 435 (1946) (Douglas and Murphy); Southern Pacific Co. v. Arizona, 325 U. S. 761, 795 (1945) (Douglas); McCarroll v. Dixie Greyhound Lines, 309 U. S. 176, 183 (1940) (Black, Douglas, and Frankfurter). These cases did not involve gross receipts taxes, but the views expressed as to the extent of the Court's power under the commerce clause to supervise state action apply equally well to gross receipts tax cases.
37. A net income tax is thought to be an indirect burden on commerce since it operates only when there is a profit and could not of itself produce a deficit. United States Glue Co. v. Oak Creek, 247 U. S. 321, 329 (1918). A gross receipts tax, however, is inherently no more burdensome than property or franchise taxes, which are legitimate state
of interstate commerce will vary with the tax structure of both the state of the source and the state of the market.Goods moving from state $A$ to state $B$ may bear both a manufacturing tax and a sales tax, while goods flowing from $B$ to $A$ pay neither. The difficulties inherent in regulating this complex structure through intermittent court action lend support to the position of Mr. Justice Black. Since his brethren evidently think differently, the immediate concern is with the nature of the supervision to be exercised by the Court. The same practical considerations that argue against judicial control, argue equally for regulation that is concerned with the practical consequences of state taxes. It is to be hoped that the future will not confirm Mr. Justice Rutledge's fears of a return to doctrine that emphasized syntax rather than economics.

levies. These taxes are all costs, and the burden varies with the amount of the cost, not its name.

38. With the 48 states and the District of Columbia there are 2352 combinations of taxes mathematically possible, and this does not take into account taxes on agencies of transportation. For discussion and collection of literature on the interstate tax jungle, see Lockhart, *State Tax Barriers to Interstate Trade*, 53 Harv. L. Rev. 1253 (1940).