The Role of Agency and Sale in Antitrust: General Electric, Simpson, Schwinn

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The importance of the nature of a vertical\(^1\) relationship—whether it is one of sale or agency—as the test for determining antitrust violations in agreements between noncompetitors was given a stay of execution by the United States Supreme Court in a 1967 antitrust decision\(^2\) after an apparent sentence of death in 1964.\(^3\) These decisions are significant because they involve what are probably the most common noncompetitor agreements which may violate Section 1 of the Sherman Act\(^4\)—price-fixing, territory allocation and customer restriction.

In 1967, the Supreme Court in United States v. Arnold, Schwinn & Company\(^5\) held that vertical customer and territorial restrictions are per se\(^6\) illegal where the relationship between the restrictor and the restricted is one of sale; where the relationship is one of agency, the Rule of Reason\(^7\) is to be applied.

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1. Vertical arrangements have been defined as “[e]conomic arrangements between companies standing in a supplier-customer relationship....” Brown Shoe Co. v. United States, 370 U.S. 294, 323 (1962). Horizontal arrangements have been defined as “[e]conomic arrangement[s] between companies performing similar functions in the production or sale of comparable goods or services ....” Id. at 334.


   Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.... Every person who shall make any contract or engage in any combination or conspiracy declared .... to be illegal shall be deemed guilty of a misdemeanor....


6. The Sherman Act was early interpreted to embrace only practices which operate to the prejudice of the public interest by unduly restricting competition. Standard Oil Co. v. United States, 221 U.S. 1 (1911). However, certain “agreements or practices .... because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable ....” These offenses are per se illegal. No inquiry need be made as to the harm they have caused or the business excuse for their use. Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958).

7. The so-called Rule of Reason refers to judicial analysis of the purpose and effect of a restriction, in the light of the surrounding facts, to determine whether it unreasonably restrains trade.
Three years prior, in *Simpson v. Union Oil Company*, the Court in effect rejected agency as a defense to a vertical price-fixing agreement. It did this even though in 1926 it had ruled, in *United States v. General Electric Company*, a case almost factually identical to *Simpson*, that agency is a defense to vertical price-fixing.

*Schwinn* and *Simpson* are similar in their implied rejection of agency as a defense to the illegality of certain vertical agreements. In so doing they appear to conflict directly with *G.E.* Yet, *Schwinn* and *Simpson* differ conspicuously from each other. In *Schwinn* the nature of the vertical relationship determined the test of illegality to be applied, while in *Simpson* the nature of the relationship was ignored. Thus, *G.E.*, *Simpson*, and *Schwinn* each seem to view the nature of a vertical relationship diversely: *G.E.* as a defense if the relationship is an agency, *Simpson* as having no legal significance, and *Schwinn* as determinative of the test of illegality to be applied.

Since the 1967 *Schwinn* decision did not distinguish *Simpson*, and *Simpson* did not expressly overrule *G.E.*, the role of agency and sale in antitrust law is in a state of confusion. This article is an attempt to arrive at a coherent statement regarding the nature of a vertical relationship in antitrust law. This purpose will be carried out by discussing *G.E.*, *Simpson*, and *Schwinn* in the following contexts:

I. Agency as a Defense in Antitrust Cases

II. The Nature of a Vertical Relationship as Determinative of the Applicable Standard of Illegality in Antitrust Cases

III. The Future of Agency in Antitrust Law

I. AGENCY AS A DEFENSE IN ANTITRUST CASES

The first significant case establishing the importance of the nature of a vertical relationship to alleged violations of the Sherman Act was the *G.E.* case, decided in 1926. The relevant issue in *G.E.* was whether General Electric could set the price at which 21,000 consignees were to sell patented lamps which it

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10. The Court purported to distinguish *Simpson* from *G.E.* on the ground that *G.E.* involved patented products while the products in *Simpson* were unpatented. For a discussion of the meaningfulness of this distinction see note 37, infra, and accompanying text.
The Court first decided that:

The validity of the Electric Company's scheme of distribution of its electric lamps turns . . . on the question whether the sales are by the company through its agents to the consumer, or are in fact by the company to the so-called agents at the time of consignment. After examining the terms of General Electric's agreement with its consignees, the Court concluded that the relationship was a genuine agency, and that "[t]he owner of an article, patented or otherwise, is not violating the common law, or the Anti-

11. G.E. involved two issues. The one with which this article is concerned was whether General Electric could require its consignees to sell at prices set by General Electric. The other issue was whether General Electric could require its licensees to sell at prices it set, the Court holding that it could. The United States sought unsuccessfully to have the portion of the G.E. opinion dealing with licensees overruled in United States v. Line Material Co., 333 U.S. 287 (1947) and in United States v. Huck Mfg. Co., 382 U.S. 197 (1965) (affirmed by equally divided Court).

12. 272 U.S. at 485.

13. The test of whether a relationship is one of principal-agent or seller-purchaser is whether title passes to the intermediary, and then to the ultimate customer, or whether title passes directly from the principal to the ultimate customer. See, e.g., CBS Business Equip. Corp. v. Underwood Corp., 240 F. Supp. 413, 419 (S.D.N.Y. 1964). A court determines whether title has passed by examining the terms of the relationship. No single feature of a relationship is determinative. For example, in G.E. a consignment existed where the agent bore the risk of nonpayment by the ultimate customer, while in Butterick Co. v. FTC, 4 F.2d 910 (2d Cir. 1925), the arrangement was one of sale where the buyer bore the credit risk. Moreover, it does not matter whether the parties call the agreement an agency or a sale. Dr. Miles Medical Co. v. John D. Park & Sons Co., 164 F. 803, 805 (6th Cir. 1908).

The courts appear to employ a type of balancing test to see if factors pointing to agency outweigh factors pointing to sale. In the G.E. case, pointing to agency were the following indicia: General Electric paid all taxes on the stock; General Electric bore all risk of loss from fire, flood, obsolescence and price decline; and title was to remain in General Electric until sold by the consignee. Pointing to sale were the following factors: the consignor was responsible for lost, missing or damaged lamps; was required to pay for storage, transportation, handling, sale and distribution costs; and bore the credit risk. Among cases, other than G.E., using a balancing type of analysis are Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346 (1922); Mathews Conveyor Co. v. Palmer-Bee Co., 135 F.2d 73 (6th Cir. 1943); Ford Motor Co. v. Union Motor Sales Co., 244 F. 156 (6th Cir. 1917).

In categorizing the nature of the relationship, the courts examine the terms of any formal agreement as well as the actual operation of the relationship as well as the terms of the formal agreements. Some cases have labeled as "sham" agencies those arrangements in which the form of the relationship, but not the substance, was one of agency. Thus, in Dr. Miles Medical Co. v. John D. Park & Sons Co., 164 F. 803, 805 (6th Cir. 1908), the court held that the agreement involved was an effort "to disguise the wholesale dealers in the mask of agency."
Trust [sic] law, by ... fixing the price by which his agents transfer the title from him directly to such consumer."

The Court expressly rejected the argument that the large number of agents involved and the extension of the scheme throughout the United States brought General Electric within the antitrust laws. The Court explained that the patent laws gave General Electric a monopoly for making, using and selling the patented article which limited neither the number of articles sold nor the territory of the United States where they were to be sold.

As long as he [the patentee] makes no effort to fasten upon ownership of the articles he sells control of the prices at which his purchaser shall sell, it makes no difference how widespread his monopoly.15

From the time G.E. was decided, until the Simpson decision almost 40 years later, it was unquestioned that an agreement between parties standing in an agency relationship was immune from violation of Section 1 of the Sherman Act.16 Simpson destroyed that assumption.

The Simpson case involved consignment agreements which Union Oil, a gasoline supplier, required the lessees of its retail outlets to sign. The consignment agreements fixed resale prices and were terminated at the end of the lease. Simpson, a consignee-lessee, had his lease terminated because he refused to follow prices set by Union Oil.

The Court held that Union Oil's so-called consignment agreements with approximately 1,978 lessee retailers17 in eight western states fixed prices in violation of the Sherman Act. The basis of the Simpson decision appears to be the same ground rejected by the Court in G.E.; that is, a consignor cannot set the price at which his consignees are to sell where the consignment system is

15. Id. at 485.
However, forewarning the fragility of agency as a defense was United States v. Masonite Corp., 315 U.S. 265 (1942), which held parties to "agency" agreements guilty of price-fixing. Masonite is distinguishable from G.E., Simpson, and Schwinn, however, as all parties, including the "principal" to the agency agreements, were found by the Court to be in fact horizontal competitors.
17. Union Oil on December 31, 1957 supplied gas to 4,133 retail stations in eight western states. Two thousand, three of the stations were owned or leased by Union Oil and leased or subleased to independent retailers. As of that date, Union Oil had consignment agreements with 1,978 (99%) of the lessee-retailers and with 1,327 (63%) of the nonlessee-retailers. Simpson v. Union Oil Co., 377 U.S. 13, 15 n.1 (1964).
vast and fixes prices through many retail outlets. The Court did not analyze the nature of the relationship between Union Oil and its consignees to determine whether it was one of agency or sale as was done in G.E., but looked at the effects of the agreements. Nowhere did the Court indicate that the nature of the relationship between Union Oil and the dealers had any bearing on the legality of the price-fixing. Justice Douglas, author of the majority opinion, noted the coercive effects of the consignment agreement. He said that the consignment agreement and lease “coercively laced”18 dealers into an arrangement under which Union Oil was allowed to impose noncompetitive prices on thousands whose prices otherwise might be competitive. Later Justice Douglas referred to the “present, coercive ‘consignment’”19 and to an agreement for resale price maintenance, “coercively employed.”20

In the majority’s view,21 whether the relationship between Union Oil and its “consignees” was one of agency or sale was immaterial. The crucial factor was whether the “‘consignment’ device [was] used to cover a vast . . . distribution system, fixing prices through many retail outlets.”22 Where this exists, the Court said, the “anti-trust laws prevent calling the ‘consignment’ an agency.”23 This pronouncement is subject to two interpretations. One, Union Oil had an agency relationship with its consignees but agency is not a defense where certain effects are present. Two, the nature of a vertical relationship is unimportant to a determination of legality where certain anti-competitive effects are present. The two views are primarily a difference of semantics since the result is the same under either interpretation. However, the second interpretation seems more accurate, as the first assumes the Court concluded that Union Oil had a genuine agency form of distribution. Such an assumption is unwarranted since the Court did not label the relationship an agency, and, in fact, gave some indication that it did not be-

18. Id. at 21.
19. Id. at 22.
20. Id. at 24. Since Simpson seems to indicate that the consignment agreements were illegal because they were coercively employed by Union Oil's policy of cancelling the lease if the prices set by Union were not maintained, it may be that consignment agreements which fix prices for non-lessees are legal.
21. Five justices took part in the majority opinion. Mr. Justice Brennan and Mr. Justice Goldberg wrote separate opinions, Mr. Justice Stewart wrote a dissenting opinion, and Mr. Justice Harlan took no part in the case.
22. 377 U.S. at 21.
23. Id.
lieve the Union Oil consignment arrangement to be a true agency relationship. 24

The Court obviously avoided a formalistic distinction between agency and sale, as made in G.E., because it feared that if the nature of a relationship is determinative of legality, the result will be a test of skill in draftsmanship. Justice Douglas said that to call a consignment an agency under the circumstances existing in Simpson would result in avoidance of illegality "merely by clever manipulation of words, not by differences in substance." 25

Although the Court ignored the nature of Union Oil's relationship with its consignees as bearing on the issue of illegality, the Court did briefly comment on the relationship. Justice Douglas termed Union Oil's consignment agreements as "somewhat parallel" 26 to those employed by General Electric. Justice Stewart, in dissent, more accurately termed the General Electric and Union Oil consignment agreements as "virtually indistinguishable." 27 In both, the consignor paid some taxes on stock (General Electric paid all taxes and Union Oil paid all property taxes); the consignor had title until sold by the consignee; and the consignee bore the cost of handling, sale, and operation. Justice Douglas indirectly questioned whether the consignments of Union Oil were true consignments by putting quotation marks around the word "consignment" when referring to the Union-Simpson relationship. Also, the Court's statement that the "[d]ealers . . . are independent businessmen; and they have all or most of the indicia of entrepreneurs, except for price-fixing," 28 suggests the Court felt there was not a true consignment. This is further suggested by the Court's attempt to find factors in General Electric's consignment arrangement differentiating it from Union Oil's agreements. 29 However, Justice Douglas does not state that the consignments in Simpson were sham agencies; nor does he label the relationships as either agency or

24. See notes 28 and 29 infra, and accompanying text.
25. 377 U.S. at 13. In a 1942 antitrust case, United States v. Masonite Corp., 316 U.S. 265, 280 (1942), Justice Douglas similarly stated that legality must not turn on counsels' manipulation of the concepts of "sale" and "agency" but on the "significance of the business practices in terms of restraint of trade." However, as indicated previously, courts have avoided deceptive draftsmanship by looking to the substance of the relationship as well as the form. See note 13, supra.
26. 377 U.S. at 22-23.
27. Id. at 26.
28. Id. at 20.
29. Id. at 23 n.10.
The Court might have distinguished *Simpson* from *G.E.* on the ground that Union Oil's marketing arrangements were not true consignments, but really sale arrangements. *Simpson* only hinted at this. Numerous cases have examined a purported agency relationship, weighed factors pointing to sale and those pointing to agency, and held that the relationship was one of sale. In *G.E.*, the Court specifically indicated that the consignment was a "genuine" agency. However, as the General Electric and Simpson consignment arrangements were so factually similar, it seems it would have been difficult for the Court to have distinguished them.

In any case, the Court avoided a formalistic distinction between agency and sale. Instead, the Court distinguished *G.E.* on the ground that it involved patented products while *Simpson* did not. The Court said the *ratio deciden*di of the *G.E.* case was that "patent laws which give a 17-year monopoly on 'making, using, or selling the invention' are *in pari materia* with the antitrust laws and modify them *pro tanto.*" The Court's discussion of patents referred to the portion of the *G.E.* opinion in which the Court rejected the argument that the comprehensiveness and size of the General Electric system brought it within the antitrust laws—the same argument which was accepted by the Court in *Simpson.* Thus the *Simpson* Court limited *G.E.*'s holding to agency arrangements involving patented products. It appears to have done so despite the fact that the Court in *G.E.* expressly stated that its ruling that genuine agency is a defense to vertical price-fixing applies to "article[s], patented and otherwise." Moreover, as the *Simpson* dissent points out, *G.E.* gave no intimation that its result would differ if any of General Electric's lamps had been unpatented. The only issue in *G.E.* was whether the consignees were to be treated as agents, or owners of the lamps consigned to them. In addition, no case prior to *Simpson* suggested that patented articles should be given special treatment in the consignment situation.

30. The dissent, nevertheless, claimed that the majority transformed the relationship from agency to sale. Id. at 26.
31. *Butterick Co. v. FTC,* 4 F.2d 910 (2d Cir. 1925), and cases cited note 13 supra.
34. 377 U.S. at 28.
The outcome of the Simpson decision seems laudatory. Union Oil's price-fixing arrangement had the undesirable effect of stifling price competition among several thousand retailers who were essentially independent businessmen. Thus, it was in the interest of competition to hold such agreements to be illegal. However, to distinguish G.E. on patent grounds seems weak. The rationale of the G.E. case was that the owner of goods has the right to determine the price at which he will sell. It was not that the owner of patented products has the right to set resale prices while the owner of unpatented products does not. To the contrary, G.E. indicated patented and unpatented products should be treated the same.

The status of the law after G.E. and Simpson seems to be as follows: Vertical price-fixing is legal where the article involved is patented and the relationship between the manufacturer and seller is one of genuine agency. However, where the relationship is one of sale, vertical price-fixing violates the antitrust laws whether or not the product is patented. Moreover, where the article upon which a price is fixed is not patented and the distribution arrangement is vast and fixes prices through many retail outlets, the agency nature of the relationship is...
no defense to a charge of price-fixing. Presumably, where the distribution system is not vast, i.e., does not have the effects present in Simpson, and the article involved is not patented, a defense of agency is available.

The Schwinn case, as indicated above, is analogous to Simpson in that it impliedly rejected agency as a defense to price-fixing. Schwinn distributed its bicycles by selling or consigning them to distributors who sold them to retail dealers, or by the "Schwinn plan" whereby Schwinn shipped the bicycles directly to the dealer upon order of the distributor. The distributors were authorized to sell only to franchised dealers in an assigned territory. The franchised dealers were to sell only to consumers. The Government alleged price-fixing, customer restrictions, and territory allocation in violation of Section 1 of the Sherman Act.

The district court rejected the price-fixing charge. It held that the territorial restrictions were illegal per se where imposed upon buyers, but legal where placed upon agents or consignees. In addition, it held that the customer restrictions were valid under the Rule of Reason. The legality of the customer and territorial restrictions was appealed by the United States. The Supreme Court ruled that territorial and customer restrictions were illegal per se where the relationship was one of sale, but that where the relationship was one of agency the Rule of Reason should be applied. The Court thus held Schwinn's restrictions on purchasers illegal per se and those on its agents or consignees protected by the Rule of Reason.

In applying the Rule of Reason to restraints on agents, the Court necessarily rejected agency as an absolute defense. Schwinn, unlike Simpson, made no distinction between patented and unpatented products, but rather, as in G.E., found the determinative factor to be the nature of the vertical relationship. While in G.E. the Court determined illegality, in Schwinn it determined the applicable standard of illegality.

signment device is used to cover a vast . . . distribution system, fixing prices through many retail outlets, the antitrust laws prevent calling the "consignment" an agency." Simpson v. Union Oil Co., 377 U.S. 13, 21 (1964). However, as indicated in the text, Justice Douglas, throughout the majority opinion, emphasized the coercive effects of the arrangement. It is possible that he did so, not as a reason to refuse to recognize any agency relationship, but to show that prices had been coercively maintained within the precepts of United States v. Parke, Davis & Co., 362 U.S. 29 (1960).

Thus, *Schwinn* adds this much to the role of agency as a defense in antitrust law: agency is not a defense to customer or territorial restraints.

II. THE NATURE OF A VERTICAL RELATIONSHIP AS DETERMINATIVE OF THE APPLICABLE STANDARD OF ILLEGALITY IN ANTITRUST CASES

It has been long recognized that price-fixing, horizontal or vertical, is illegal per se. Likewise, it is well established that horizontal division of territories and customers is illegal per se. However, the standard of illegality to be applied to vertical customer and territorial restrictions was largely undetermined prior to the *Schwinn* decision. In 1944 the Supreme Court stated that vertical restrictions were illegal where price-fixing was an "integral part of the whole distribution system," and in 1963, in *White Motor Company v. United States*, the Court indicated vertical restrictions violated the Sherman Act where they were "ancillary to the price fixing scheme."

In *White Motor*, the Court refused to hold that vertical customer and territorial restrictions, standing alone, were illegal per se. The Court reversed the district court's summary judgment holding of illegality per se on the ground that illegality should be decided only after a trial as the Court knew too little of the actual impact of the restrictions. Three dissenting members of the Court contended that vertical restrictions should be illegal per se.

As had been previously noted, the Court in *Schwinn* ruled that (1) vertical customer and territorial restrictions are illegal...
per se where the vertical relationship is one of sale, and (2) that such restrictions are to be judged by a Rule of Reason where the relationship is one of agency. Applying this ruling to the facts, the Court held that Schwinn's territorial and customer agreements with those to whom it sold bicycles were illegal per se and that its agreements with those who were its agents were protected by the Rule of Reason.

The adoption of the sale-agency distinction as the test of the applicable standard of illegality was a return to the G.E. emphasis on form, and a rejection of Simpson's focus upon the impact of the restraint. While such an approach could lead to a test of skill in draftsmanship, as was feared by Justice Douglas in Simpson and the Court in United States v. Masonite, the Schwinn opinion contained its own safeguard against such a result. The Court made it clear that the Rule of Reason is to be applied only where there is a pure agency, by stating that the owner must retain "all indicia of ownership, including title, dominion and risk," so that the relationship has no elements of sale. Moreover, the Court stated that the dealer must be indistinguishable in position and function from that of an "agent or salesman." By requiring that the restrictor retain all indicia of ownership, the Court apparently denies Rule of Reason treatment to relationships having elements of both sale and agency, as in G.E. and Simpson. Thus the Court eliminated the long-standing judicial practice of balancing these elements and minimized the opportunity for an ingenious draftsman to make a sale appear to be an agency relationship. By requiring that the restricted be indistinguishable, on the facts, from an agent or salesman the Court indicated that it will examine the operation of the relationship and not rely solely on the terms of the written instrument.

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50. 316 U.S. 265, 280 (1942).
52. Id.
53. Note 13 supra lists those factors in G.E. which pointed to sale and those which pointed to agency.
54. In Simpson the following indicia pointed to agency: Union Oil paid all property taxes on gasoline in the consignee's possession; title to the gas remained in Union Oil until sold by the consignee; and the consignee dealt exclusively in Union Oil's gasoline. Pointing to sale were the following: the consignee was required to carry personal liability and property damage insurance; was responsible for all losses of gasoline, save acts of God; and was required to pay all costs of operation.
55. See note 13 supra.
56. The distributors who merited Rule of Reason treatment in Schwinn were like salesmen. Schwinn directly shipped the bicycles to
Using the "purity" of the relationship to determine the applicable standard of illegality seems to be valid for the most part. Certainly if a dealer is indistinguishable in function and position from a salesman, i.e., is in effect the manufacturer's alter ego, the manufacturer should be able to control his customers and sales territory, as long as the restrictions are reasonable. On the other hand, where a relationship is clearly one of sale, the interests of competition dictate that the purchaser have free selection of customers and territories. Also, a per se rule seems appropriate where a relationship has elements of both sale and agency but is similar to that in Simpson where the consignees were actually small struggling competitors. However, it seems unfortunate that the Court has chosen to apply the inflexible per se rule where a relationship has elements of both sale and agency but the customer or territorial restrictions are otherwise reasonable. For example, such restrictions may be reasonable when only one element of sale is present as where the relationship would be a "pure" agency except that the consignee delivers the goods rather than the consignor.

In addition to rejecting the sale-agency distinction as determinative of the standard of illegality, Simpson, in contrast to Schwinn, did not clearly indicate whether it applied a Rule of Reason or a per se rule. Because Simpson emphasized the coercive effects of company restrictions in Union Oil's vast system, that the consignees were in effect struggling retail competitors, and that price competition would have existed but for the price-fixing agreements, it can be argued that the Court applied a Rule of Reason. On the other hand, it is unlikely that the Court intended to overrule the long standing principle that price-fixing is illegal per se. In fact, the Court refused to call the Union Oil consignment an agency in order to prevent avoidance of the result of United States v. Socony-Vacuum, a landmark per se case.

Alternatively, it can be contended that the Simpson Court set aside the per se rule of price-fixing only where agency relationships and restrictions involving nonpatented products exist.

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57. As a practical matter it seems unlikely that customer and territory restrictions imposed on agents would ever be unreasonable.
59. See notes 41 and 42 supra.
The difficulty with this proposition is that the Court in *Simpson* at no point indicated that the relationship was an agency. Yet, it is arguable that the Court would not have had to distinguish G.E. or have been confronted with any difficult issue if it did not strongly suspect that Union Oil had agency relationships with its consignees. In any case, another problem with interpreting *Simpson* as applying a Rule of Reason to an agency relationship, is that *Schwinn* conflicts with this interpretation. In *Simpson* the consignees were much more like independent businessmen than salesmen. Therefore, *Schwinn*, in a vertical customer or territorial restriction situation, would require application of a per se rule to a *Simpson* type arrangement. It seems unlikely that the Court intended to apply the Rule of Reason to price-fixing which arises in a mixed sale-agency context, and yet make customer and territorial restrictions illegal per se under the same circumstances, since price fixing has always been considered more perniciously illegal than customer and territorial restraints. While a converse rule might make some sense, the Court by its opinion in *Schwinn* has eliminated such a possibility.

Thus, technically, it seems more likely that the *Simpson* Court applied a per se rule of illegality than a Rule of Reason. The Court's reason for discussing the coercive effect of the relationship may have been to justify its refusal to call the consignment an agency.

From a practical standpoint, *Simpson* seems to use a two step analysis. First, the Court applied a Rule of Reason to decide if the arrangement should be recognized as an agency. When it found that the effects of the Union Oil distribution system were anti-competitive, it decided to ignore any agency relationship and proceeded to apply a per se rule of illegality. The net effect of this approach, of course, is the use of a Rule of Reason to determine illegality. If the Court had found Union Oil's consignment arrangement to be reasonable, it would probably have held an agency existed and treated this as a defense. As it found the impact unreasonable, it refused to recognize the agency and held the arrangement illegal. Thus, it appears illegality in a *Simpson* situation depends on whether there is an unreasonable anti-competitive effect.

III. THE FUTURE OF AGENCY IN ANTITRUST LAW

In conclusion, several observations may be made regarding both the effect of *Simpson* and *Schwinn* on agency as a defense
to vertical restraints on patented and unpatented products, and the test of illegality to be applied to vertical restrictions.

Present law regarding agency as a defense to vertical restraints requires distinguishing between price-fixing and other vertical limitations. Moreover, when dealing with price-fixing, a distinction must be made between commercial and individual arrangements and between patented and unpatented products. Schwinn, by holding customer and territorial restrictions subject to a Rule of Reason analysis where a "pure" agency existed and illegal per se in all other situations, necessarily rejected agency as a defense to customer and territorial restrictions under all circumstances.

Simpson, contrary to Schwinn, leaves open three situations in which agency may be a defense to vertical price-fixing. First, Simpson would allow an individual consigning an item to a business to require that the item be sold only at the price the owner sets. Justice Douglas said, "[o]ne who sends a rug or a painting or other work of art to a merchant or a gallery for sale at a minimum price can, of course, hold the consignee to the bargain." 61

Secondly, Simpson would seem to allow agency as a defense to price-fixing where the products upon which the price is fixed are patented and the relationship between the supplier and the seller is one of genuine agency (as in the G.E. situation). Although there is some doubt as to why only a patent owner should be able to set the resale price of agents selling a product he has produced, Simpson distinguished G.E. on patent grounds and thus created this possibility. However, to take advantage of this defense the supplier must prove that the relationship is one of agency; he need not prove that it is a "pure" agency as existed in Schwinn but merely that the relationship is more like one of agency than sale. 62

However, reliance on agency as a defense is inadvisable. It seems probable that even if the price-fixing relates to patented products, if the relationship is essentially one between separate concerns and has effects similar to those existing in Simpson, a court will avoid recognizing a defense of agency in an ambigu-

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61. Id. at 18. This type of arrangement would most often be a "pure" agency. However, the Simpson decision gave no significance to such an observation.

62. In G.E. there were elements of both sale and agency. The Court examined factors pointing to sale and agency and concluded that the relationship was one of agency. Other cases have followed the same approach. See note 13 supra.
ous relationship by holding that the agreement, although purporting to be an agency, was actually a sale. Moreover, when the Supreme Court is confronted with restraints on patented products and effects like those in Simpson, it may well ignore its G.E. patent distinction. Such a result seems likely in view of the Court's omission of any patent distinction in the Schwinn case, and the fact that the patent rationale makes little sense. Thus, reliance on G.E. seems treacherous.

The third context in which Simpson seems to indicate agency may be a defense to vertical price-fixing is where the price maintenance does not have the adverse effects on competition present in Simpson. The Simpson Court, by stating that where certain factors are present the "antitrust laws prevent calling the consignment an agency," implied that where such effects are not present, a consignment may be called an agency, and, presumably, a defense to price-fixing. One seeking to use this defense must show that an agency relationship exists and that anti-competitive effects are not present. This may be difficult in view of the Court's demonstration in Schwinn that it will be tough on vertical restrictions and apparently will never recognize agency as a defense to customer and territorial restraints.

What the Court will do with price-fixing on an unpatented product in a "pure" agency relationship is unclear. However, it seems likely that in view of the Court's decision in Schwinn to apply the Rule of Reason approach to such relationships when the question is vertical customer and territorial restrictions, the Court will not allow "pure" agency as a defense to vertical price-fixing.

Thus, while Schwinn necessarily implied that agency is not a defense to vertical customer and territorial restrictions, Simpson leaves open the possibility that agency may be a defense to price-fixing on patented products and to price-fixing on unpatented products where anti-competitive effects present in Simpson do not exist.

Just as Schwinn and Simpson seem to differ on the question of agency as a defense, they also appear to differ in a practical sense on the standard of illegality to be applied. Technically, Simpson applied a per se rule of illegality to a mixed sale-agency relationship, and Schwinn indicated that it would apply a per se rule to this same relationship by stating that those relationships

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63. 377 U.S. at 21.
in which the agent is not identical in function to a salesman will be judged by a per se rule. Realistically, however, Simpson applied a Rule of Reason. Since the impact of the relationship in Simpson determined whether or not the Court would recognize the consignment as an agency, it in effect also determined the legality of the arrangement. If the Court had found that the effects were not anti-competitive, presumably it would have recognized the agency, and on the basis of G.E., held the price-fixing legal. Instead, the Court found the effects of the price-fixing uncompetitive and refused to call the "consignment" an agency.

As to the "pure" agency relationship, the Schwinn Court clearly stated that a Rule of Reason will be applied. What the Court will do in a "pure" agency price-fixing situation is uncertain. The door is open for it to treat "pure" agency as a defense to price-fixing or to apply either a Rule of Reason or per se test to it.

Thus, Simpson and Schwinn are difficult to reconcile. Simpson seems to leave room for a defense of agency while Schwinn does not. Moreover, the two cases suggest that different standards of illegality will be applied to ambiguous vertical relationships. However, it seems probable that as the law develops the Court will bring Simpson in line with Schwinn. The trend of the Court is toward a more critical view of vertical restrictions. Both Simpson and Schwinn narrowed the agency defense of G.E.; Simpson by refusing to recognize the defense where there was an anti-competitive impact and the product involved was unpatented, Schwinn by eliminating agency as a defense and by holding that at most a "pure" agency merited a Rule of Reason approach while all other relationships were to receive per se treatment. Moreover, the Court's stringent attitude toward customer and territorial restrictions and restraints, generally considered to be less undesirable than price-fixing, seems to indicate the Court will be at least equally severe on price-fixing.

64. The United States has filed a complaint against General Electric alleging that G.E. has illegally fixed the prices at which its consignees sell lamps. United States v. General Elec. Co., Civil No. 663118 (S.D.N.Y., filed Sept. 27, 1966). The Government is taking the position that the old G.E. case no longer reflects the law.
Notes

Dollar Amount "Specific Portion" for Estate Tax Savings—Drafting in the Alternative to Insure Maximum Marital Deduction*

I. INTRODUCTION

Section 2056 of the Internal Revenue Code of 1954 provides for the allowance of a marital deduction from the decedent's gross estate "equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse . . . ." The amount available for deduction is limited to 50 per cent of the adjusted gross estate, and the phrase "interest in property" includes a life estate coupled with a power of appointment. One form the life estate may take is a trust entitling the surviving spouse "to all the income from the entire interest . . . or . . . a specific portion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion. . . ." The Treasury Regulations define "specific portion" re-

* This Note has been entered in the 1969 Estate Planning Competition sponsored by the First National Bank of Chicago.
2. Id., § 2056(c)(1).
3. Id., § 2056(b)(5).
4. The marital deduction is available to either husband or wife. However, for convenience, this Note will frequently refer to the surviving spouse as the "widow."
5. Int. Rev. Code of 1954, § 2056(b)(5). Stated in full the section reads:

(B) LIFE ESTATE WITH POWER OF APPOINTMENT IN SURVIVING SPOUSE—In the case of an interest in property passing from the decedent, if his surviving spouse is entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse—
(A) the interest or such portion thereof so passing shall, for purposes of subsection (a), be considered as passing to the surviving spouse, and
(B) no part of the interest so passing shall, for purposes of paragraph (1)(A), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if such power in the surviving spouse to appoint the entire interest, or such specific portion
strictively, requiring its expression as "a fractional or percentile share of a property interest" before it can qualify as an interest to be deducted.

In recent years, the Treasury's definition has been successfully attacked in the lower courts because of the limitations it places on the availability of the marital deduction. This opposition has recently reached the Supreme Court, which held that the "Regulation improperly restricts the scope of the congressionally granted deduction." This Note will examine the judicial rejection of the Treasury's definition of "specific portion," and recommend changes in that definition which conform with the Supreme Court's apparent present position. Also, an attempt will be made to outline alternative trust provisions which take account of the recent decisions and minimize potential estate tax liability, while at the same time insuring the qualification of the maximum marital deduction.

II. BACKGROUND

The marital deduction was developed to deal with the disparity between common-law and community property states with respect to marital property rights. The community property states place half the interest in property held in the community thereof, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

6. Treas. Reg. § 20.2056(b)-5(c) (1958). The pertinent portion of the regulation reads:
   (c) DEFINITION OF "SPECIFIC PORTION." A partial interest in property is not treated as a specific portion of the entire interest unless the rights of the surviving spouse in income and as to the power constitute a fractional or percentile share of a property interest so that such interest or share in the surviving spouse reflects its proportionate share of the increment or decline in the whole of the property interest to which the income rights and the power relate. Thus, if the right of the spouse to income and the power extend to one-half or a specified percentage of the property, or the equivalent, the interest is considered as a specific portion. On the other hand, if the annual income of the spouse is limited to a specific sum, or if she has a power to appoint only a specific sum out of a larger fund, the interest is not a deductible interest.

7. See, e.g., Citizens Nat'l Bank v. United States, 359 F.2d 817 (7th Cir. 1966); Gelb v. Commissioner, 298 F.2d 544 (2d Cir. 1962); Allen v. United States, 250 F. Supp. 155 (E.D. Mo. 1965).
estate\textsuperscript{10} in each spouse, regardless of relative responsibility for its accumulation\textsuperscript{11} or the name in which title is taken. Thus, when one spouse dies, only his half of the community estate will be included in his estate for tax purposes. The common law states, on the other hand, place property in the estate of the spouse holding title—in most instances the husband. The result, absent the marital deduction, is an estate tax on the property at the husband’s death, and, if the property passes to the widow, again on her death.

The marital deduction first appeared in the Revenue Act of 1948.\textsuperscript{12} As originally enacted, the statute did not present the problem of a “specific portion” since it only allowed marital deductions for trusts which entitled the surviving spouse to “all the income” and the power to appoint the “entire corpus” at death.\textsuperscript{13} This language was construed to disqualify trusts which granted the spouse only a portion of the income and a power to appoint a portion of the corpus.\textsuperscript{14} However, there was no justification for requiring separate trusts for the wife and children as was necessary under the original section, and in 1954, Congress liberalized this provision by allowing a spouse to receive all the income from a “specific portion” of a trust with a power to appoint “such specific portion.”\textsuperscript{15}

Since the amendment, the Treasury Regulations have required that the “specific portion” be expressed in fractional or percentile terms in order to assure that the “share in the surviving spouse reflect its proportionate share of the increment or decline in the whole of the property interest to which the income rights and the power relate.”\textsuperscript{16} The Treasury’s position

\textsuperscript{10} The community estate generally consists of all property, real or personal, acquired by a husband or a wife during their marriage except for that acquired by gift, descent or devise. 4 R. Powell, The Law of Real Property 876–77 (1967).


\textsuperscript{14} See, e.g., Shedd v. Commissioner, 237 F.2d 345 (9th Cir.), cert. denied, 352 U.S. 1024 (1957); Sweet v. Commissioner, 234 F.2d 401 (10th Cir.), cert. denied, 352 U.S. 878 (1956).

\textsuperscript{15} Int. Rev. Code of 1954, § 2056(b)(5).

\textsuperscript{16} Treas. Reg. § 20.2056(b)-5(c) (1958). “That is, that both the government and the surviving spouse share equally in the risk of the property decreasing in value (and thus the ultimate tax decreasing) and of the property increasing in value (and thus the ultimate tax increasing).” Northeastern Pa. Nat’l Bank & Trust Co. v. United States, 235 F. Supp. 941, 945 (D. Pa. 1965).
finds support in the Senate Report on the 1954 Amendment which stated that "a right to income plus a general power of appointment over only an undivided part of the property will qualify that part of the property for the marital deduction."\(^{17}\) Also, the only example given in the House and Senate Reports is expressed in terms of a fractional share.\(^{18}\) It is argued that "undivided" most frequently refers to fractional or percentile portions rather than specified amounts,\(^{19}\) and that the use of a fraction in the example indicates congressional intent to define "specific portion" as a fractional share.

Although the Treasury has attempted to limit the use of the "specific portion" provisions of section 2056, the courts have been reluctant to accept this restrictive treatment. *Gelb v. Commissioner*\(^{20}\) was the first case to reject the Treasury Regulation's definition. The Commissioner attempted to deny the deductibility of a trust, which granted the widow a power of appointment over the entire trust principal, on the ground that trustees were granted the right to invade the trust corpus for up to $5000 per year to provide for the support and education of a daughter. The Second Circuit determined that the widow's power extended over the entire trust less the value of the maximum yearly invasion multiplied by the joint expectancies of the widow and the daughter.\(^{21}\) While recognizing that this formula creates a disproportionate risk to the widow in case of trust appreciation,\(^{22}\) the court contended that Congress spoke in terms of a specific portion rather than a fractional or percentile share, and did not intend the validity of the marital deduction to depend on whether


\(^{18}\) For example, if the decedent in his will provided for the creation of a trust under the terms of which the income from one-half of the trust property is payable to the surviving spouse with uncontrolled power in the spouse to appoint such one-half of the trust property by will, such interest will qualify. . . . S. Rep. No. 1662, 83d Cong., 2d Sess. 475 (1954); H.R. Rep. No. 1337, 83d Cong., 2d Sess. A319 (1954).


\(^{20}\) 298 F.2d 544 (2d Cir. 1962).

\(^{21}\) The court pointed out that "the use of actuarial tables for dealing with estate tax problems has been so widespread and of such long standing that we cannot assume Congress would have balked at it here; the law of averages has ample opportunity to work." *Id.* at 551-52.

\(^{22}\) The *Gelb* court points out that any increase in value of the entire trust will be taxed to the widow's share, including that increase attributable to other shares. *Id.* at 550.
the widow's portion shared the risk of a value change in the trust corpus. Arguing that the marital deduction was designed to reduce discrimination against taxpayers in non-community property states and to permit inclusion of certain normal testamentary dispositions without total forfeiture of the deduction, the court found that the fractional interest example in the House and Senate Reports did not foreclose other instances "fairly within the language and the underlying policy." The tax consequence of depreciation of Gelb-type trust assets raises the possibility of estate tax avoidance. If the trust corpus were to decrease in value, the widow's share would absorb all losses and her estate taxes would be lowered accordingly. Of course, any appreciation in the trust corpus will be included in the widow's share and will be taxed to her estate at her death. Thus, Gelb seems to allow a testator to speculate as to the future value of assets he will place in a marital deduction trust that is subject to invasion. If he guesses correctly, the widow's estate taxes will be lowered.

The elements of disproportionate risk and possible estate tax avoidance that Gelb appears to allow would not be possible in a community property state where the widow's estate is a fractional share and reflects only its own gains and losses. Thus, Gelb can be criticized for failure to promote equality of tax treatment between common law and community property jurisdictions. But the Gelb result does advance Congress's "underlying policy" of allowing certain normal property dispositions without complete loss of the deduction. Also, in a time of rising market values, a Gelb trust will result in more estate taxes than a fractional share trust, and it seems unlikely that a trustee would fail to replace those assets decreasing in value simply because of the greater possible loss deduction. Thus, the testator should probably be allowed to assume the disproportionate risk without losing the marital deduction.

24. Id.
25. E.g., A trust corpus valued at $100,000 with an excluded amount of $50,000. If the trust were to decrease $50,000 in value prior to the widow's death, there would be nothing to include in her estate. On the other hand, if the total trust value increased to $150,000, $100,000 would be included in her estate.
27. See Covey, supra note 19, at 392.
Since Gelb, two other circuit courts have dealt with the “specific portion” issue. However, the most significant case in the area is Northeastern Pennsylvania National Bank & Trust Company v. United States, a recent Supreme Court decision. There, the widow was given the right to a $300 monthly income with a power to appoint the entire corpus at death. The circuit court had disallowed the deduction on the ground that there were too many variables involved to accurately compute the specific portion. The Supreme Court reversed and remanded, holding...

Mr. Covey argues that the Treasury's main concern is with a power over a specific dollar amount as opposed to a power over the entire trust less a dollar amount. In the former situation, the marital portion, unlike the portion subject to taxes, is unaffected by gain or loss whereas in the latter the marital share does “share equally” in the increases and decreases of the trust principal. Of course, the marital share in the Gelb situation is also absorbing the increases and losses from the dollar amount exclusion which accentuates its allowable loss deductions as well as its taxable gains.

In Allen v. United States, 250 F. Supp. 155 (E.D. Mo. 1965), the widow had a right to the income from the trust for life but no power of appointment over the corpus. She did, however, have the right to receive on demand $5000 annually from the corpus. The court allowed the marital deduction contending that $5000 is “specific” as defined by BLACK's LAW DICTIONARY 1571 (4th ed. 1951), and that the Government's position as to the fractional requirement had been rejected by every court which had examined the problem.

In Citizens Nat'l Bank v. United States, 359 F.2d 817 (7th Cir. 1966), the widow was granted the right to a monthly payment of $200 with a power of appointment over the entire corpus. The issue, simplified by the government's concession that a dollar amount could be a “specific portion,” was whether she had the right to “all the income” from a specific portion of the trust. Id. at 820 n.8. The court allowed the marital deduction in an amount which, at 3½% interest, would yield $200 per month income, relying on Gelb's rejection of the Government's arguments as to the uncertainties involved in actuarial computations and the acceptance of Gelb in the district court decision of the Northeastern case.

31. Northeastern Pa. Nat'l Bank & Trust Co., 363 F.2d 476, 482-84 (2d Cir. 1966). The District Court had allowed the marital deduction in an amount computed actuarially by an annuity valuation, relying on the Gelb rejection of the fractional requirement and acceptance of actuarial tables in computing the value of the marital deduction. Northeastern Pa. Nat'l Bank & Trust Co. v. United States, 235 F. Supp. 941, 946 (D. Pa. 1965). The Circuit Court did not reject the Gelb reasoning as to the specific portion requirement, but did reject the annuity-valuation computation of the amount. It argued that the annuity computation necessarily results in dissipation of the fund, a factor not contemplated by the testator, and that the monthly payment figure arrived at by application of the actuarial formula does not represent pure income as claimed, but rather, income plus any trust principal necessary to make the payment.

The court also referred to variable market investment conditions, which would dictate the necessity for trust principal invasions, as well as the power to invade the corpus for illness and financial emergencies...
that the specific portion need not always be expressed as a fractional or percentile amount. It rejected the circuit court's view as to the impossibility of computing the marital share, but agreed that an annuity-valuation computation was incorrect.\textsuperscript{32}

While recognizing that the underlying purpose of the marital deduction is to equalize the incidence of estate taxation in community property and common law jurisdictions,\textsuperscript{33} the Northeastern Court noted that the statute did not pretend to equalize all the qualitative ownership aspects of the two property systems.\textsuperscript{34} The legislative history of section 2056 indicates congressional willingness to recognize "customary modes of transfer of property in common law States,"\textsuperscript{35} and the Court accepts this liberal

involving both the widow and the children. It has been argued that this latter factor, by itself, should have been sufficient grounds for rejection of the deduction since invasion of the trust corpus for each emergency would detract from the required exclusive power in the widow. Comment, 15 Kan. L. Rev. 204, 206 (1966). This issue was never raised. See Comment, 36 Geo. Wash. L. Rev. 250, 252 n.17 (1967).

32. The Court, citing Gelb, pointed out that "the use of projected rates of return in the administration of the federal tax laws is hardly an innovation." Northeastern at 224. The Court, however, did agree with the circuit court's condemnation of the annuity-valuation approach and indicated that the proper method would be to determine the amount of corpus needed to produce the monthly payments. \textit{Id.} at 224 n.15.


34. \textit{Id.} The relationship between community property and common law jurisdictions as regards the marital deduction has been discussed in terms of qualitative and quantitative similarities and differences. See Anderson, \textit{The Marital Deduction and Equalization Under the Federal Estate and Gift Taxes Between Common Law and Community Property States,} 54 Mich. L. Rev. 1087, 1104 (1956); Note, 19 Stan. L. Rev. 468 (1967). The surviving spouse in the community property jurisdiction has the absolute right to one-half the property and this ownership right is a qualitative factor. Any interest less than outright ownership (e.g., a life estate in a trust), held by the surviving spouse in a common law jurisdiction, would thus automatically create qualitative inequality between the two jurisdictions. Quantitative inequality, on the other hand, would result from disparity in the incidence of estate taxes between the two types of jurisdictions.

Some of the "inherent" variances between the two property systems are: (1) the goal of dividing the estate equally between husband and wife can only be achieved in common law jurisdictions when the husband owns all the property; (2) in common law states an annuity can be designed that will avoid estate taxes on both the husband's and wife's estates, but this is not available in community property jurisdictions; (3) there will frequently be double probate and death duties in common law jurisdictions since they are levied on the entire estate at the death of each spouse; (4) in common law jurisdictions the assets intended for the marital deduction can include those that are considered "wasting." See Anderson \textit{supra.}

attitude as the touchstone of its decision. As in Gelb, the Northeastern Court found no evidence in the legislative history that would dictate disqualification of a marital trust "merely" because the specific portion was not in fractional or percentile terms. On the contrary, the Court stated that the intent of Congress was to afford liberal "'estate-splitting' possibilities to married couples," and that it was plain "such a provision should not be construed so as to impose unwarranted restrictions upon the availability of the deduction."

When confined to its facts, Northeastern's rejection of the Treasury's definition of "specific portion" can be supported. Since the widow's power of appointment extends over the entire trust, there is no danger of any quantitative variance between this beneficiary and her counterpart in a community property state. Her taxable estate will include the entire trust corpus at her death even though her income rights are limited to the monthly payment. Although the legislative history of the fractional or percentile requirement can be read to support the Treasury's interpretation, the Court was concerned here with the fact that a trust provision, specifically allowed by statute (even though qualitatively less restrictive than the typical community property interest), would result in the complete loss of the marital deduction "merely" because not expressed in fractional or percentile terms. The spouse would be deprived of

36. Some of the technical arguments against allowing a monthly sum to be capitalized, and thus qualify as specific portion, are the uncertainty that "all the income" from the dollar amount will be necessary to make the payment and the uncertainty that the estimated rate of return will stay constant in the future. The court made short shrift of these arguments by citing the Gelb language, see note 21 supra, as to the widespread judicial use of actuarial tables. Northeastern at 224.

37. In answer to the Government's argument that the example used in the Senate and House Reports was in fractional terms and thus indicated Congressional intent, the Court observed: "[O]bviously this example was not intended to limit the meaning of the new language." Northeastern at 221 n.11.

38. Northeastern at 221. The Government had also argued that the legislative history requires the interest of the surviving spouse to be virtually equivalent to outright ownership and that only a fractional or percentile share would carry with it the value fluctuation risks normally incident to ordinary ownership. The Court dismissed this argument as "simply irrelevant," pointing out that the "virtual owner" language was used only for the purpose of prohibiting anyone other than the surviving spouse to have any power over the trust income or corpus. Id. at 222.

39. INT. Rv. CODE of 1954, § 2041(a)(2). This section essentially provides that property over which the widow has a general power of appointment at her death will be included in her estate.

40. See Covey, supra note 19, at 392 & n.15.
any benefit from the marital deduction, a narrow result which
the Court felt was not warranted by common sense, the statute,
or its history.\textsuperscript{41}

III. RAMIFICATIONS OF NORTHEASTERN

Although Northeastern does approve an estate planning
method whereby the testator can provide his widow with equal
monthly payments after his death while retaining the benefits of
the marital deduction,\textsuperscript{42} the real significance of the case lies in
the likelihood, pointed to by the dissent, of tax avoidance possibil-
ities.\textsuperscript{43} Since the majority allowed a monthly payment require-
ment to be capitalized to determine the dollar amount of the
specific portion, the dissent saw no good reason not to do away
with future capitalization computations altogether by simply al-
lowing the settlor to limit his spouse to a specified dollar amount
of corpus.\textsuperscript{44} However, the dissent argues that once a dollar
amount specific portion is allowed where the power is over the
entire trust corpus, a dollar amount specific portion where the
power to appoint is limited to the dollar amount will also have
to be permitted. This argument is supported by the language of
the Code to the effect that the surviving spouse need only have
the right to “all the income from . . . a specific portion . . .
with power in the surviving spouse to appoint . . . such specific portion”\textsuperscript{45} in order to qualify for the deduction. The dissent
does not see how it is possible to read “a specific portion” as not
referring to “such specific portion.” Thus the “specific portion”
referred to in connection with income rights must necessarily be
identical to that referred to in connection with the power of ap-
pointment.\textsuperscript{46}

\textsuperscript{41} Northeastern at 221-22.
\textsuperscript{42} The widow’s estate will be taxed on any appreciation of the
trust corpus in both cases. Thus, the only practical difference between
a Northeastern trust and one expressed in fractional or percentile terms
is the greater control available to the testator in the former. The widow
will receive all the income from the fractional share, but with a North-
eastern trust the testator is able to limit her receipt of income to a pre-
arranged amount.
\textsuperscript{43} Northeastern at 227 (dissenting opinion).
\textsuperscript{44} The only difference between a trust which gives the wife
income from a fixed amount of corpus and the one the Court
has before it today is that the former does not require capital-
izing a stream of payments into a lump sum, since it defines the
sum at the outset.
\textsuperscript{45} INT. REV. CODE of 1954, § 2056 (b) (5) (emphasis added).
\textsuperscript{46} Northeastern at 227 (dissenting opinion). The dissent illus-
trates this result by the following hypothetical situation: Assume a
While the logic of the dissent's argument is strong, it is not clear that the majority intended its holding to be read so broadly. The Court noted that, in addition to jurisdictional equalization, the purpose of the marital deduction is to permit a married couple's property to be taxed in two stages, not to allow a wholly tax-free transfer to the succeeding generation.\footnote{47} The Court referred to the liberal "estate-splitting" intent behind the statute, designed, in part, for cases "where the deductible half of the decedent's estate would ultimately—if not consumed—be taxable in the estate of the survivor..."\footnote{48} The majority was careful to point out that the Regulation improperly restricted the congressional intent only in the context of that case,\footnote{49} and emphasized that there would be no chance of any of the husband and wife's combined estate escaping ultimate taxation.\footnote{50} Although the Government apparently did not argue the case posed by the dissent\footnote{51} as a possible ramification of this decision, it did argue that Gelb facts as an example of possible estate tax avoidance. The Court cautiously avoided any comment on the validity of this argument, stating that it was a "quite different problem" and not in issue in the Northeastern case.\footnote{52} Since Gelb, like Northeastern, did involve the question of a dollar amount interest qualifying as a "specific portion," this reasoning is supportable only because in Northeastern there was no possibility of tax avoidance.

The weight which the Court gives to the presence or absence of potential tax avoidance is clearly demonstrated by comparing Northeastern to Commissioner v. Bosch,\footnote{53} handed down fourteen days after Northeastern. Both Bosch and Northeastern involve the qualification of an interest for the marital deduction, trust estate of $200,000, with the widow receiving the right to the income from $100,000 of its corpus and a power of appointment over that $100,000, and the children of the testator receiving income from the balance of the corpus during the widow's life, their remainders to vest when she dies. Now suppose that when the widow dies the trust corpus has doubled in value to $400,000. The wife's power of appointment over $100,000 applies only to make $100,000 taxable to her estate. The remaining $300,000 passes tax free to the children. \textit{Id.} at 227 n.2.


\footnote{48} Northeastern at 221.

\footnote{49} Id. at 218.

\footnote{50} Id. at 224.

\footnote{51} See note 46, supra.

\footnote{52} Northeastern at 225.

\footnote{53} 387 U.S. 456 (1967).
but Bosch, unlike Northeastern, adopts a narrow construction of the marital deduction section. In that case, the Court, in a marital deduction context, held that the federal courts are bound for federal tax purposes by state probate court decisions regarding the character of property interests. The Bosch Court recognized the importance of eliminating tax avoidance possibilities, noting that Code sections 2056(b), (c), and (d) "indicate . . . a definite concern with the elimination of loop-holes and escape hatches that might jeopardize the federal revenue." The common denominator in both cases is the basic requirement that none of the combined estate escapes ultimate taxation. Thus, both cases can be viewed as supporting a single policy regarding the marital deduction: a liberal construction of the provision so long as it does not create tax avoidance possibilities.

Against this background of expressed willingness to allow a marital deduction only if it will not result in tax avoidance, it seems unlikely the dissent's hypothetical case of a power over only a dollar amount interest would be allowed to qualify for deduction. Yet, as the dissent points out, once a dollar amount...
does qualify as a "specific portion," it is difficult to escape the
tax avoidance possibility under a literal reading of the statute.
To limit Northeastern to its facts, thus precluding any tax
avoidance, a distinction must be drawn between the income re-
quirements and the power requirements of the specific portion. 57

One somewhat technical argument which supports this dis-
tinction is based on the Code language limiting the qualification
of a life estate with power of appointment in the surviving
spouse to those cases where the power is exercisable by the
spouse "alone and in all events." 58 A power of appointment lim-
ited to a specified dollar amount specific portion would not be
exercisable "in all events" because the trust might decrease in
value below the level of the specific dollar amount at which time
the power, as granted, would not be exercisable. 59 If the wife
has a power to appoint all, or a fraction, of the corpus and it
decreases to zero, there is arguably the same situation. But in
this latter case, there is no literal inconsistency in speaking of
her power over all, or a fraction of the corpus whether it is
zero or $100,000. In the former case, there is a literal incon-
sistency in saying she has the power, in all events, to appoint
$100,000 when, in fact, there is not $100,000 to appoint. 60 There

appear that the same problems will arise as in cases involving power-
over-a-dollar-amount trusts. Although the share in Ellis is expressed in
fractional terms and the example uses tenancy in common, there is no
expressed disapproval of specifying the widow's share in an "estate
trust" as a dollar amount, thus allowing any appreciation to pour into
the terminable interest portion. In order to avoid the revenue loss, it
seems the Court would have to limit this type of interest to one ex-
pressed in fractional terms.

57. See Comment, 36 GEO. WASH. L. REV. 250, 253 (1967).
58. INT. REV. CODE of 1954, § 2056(b)(5). The applicable portion
reads:
This paragraph shall apply only if such power in the surviving
spouse to appoint the entire interest, or such specific portion
thereof, whether exercisable by will or during life, is exercisable
by such spouse alone and in all events.
59. The opinion has been expressed, see Covey, supra note 19, at
393, that this would not operate to disqualify the deduction. This is
based on an analogy to a term for years charitable donation where the
guaranteed annual rate is higher than the rate in the actuarial tables.
Apparently, the Treasury has not questioned such a deduction, even
though the principal might decrease to the point where payments could
no longer be made. Technically, however, the "all events" argument
against the dollar amount is sound and is reinforced by strong policy
considerations. Thus, it could be used if the Court were looking for a
way to avoid the literal language of the statute.
60. The marital deduction has frequently been denied for failure to
meet a strict "all events" test: See, e.g., Commissioner v. Ellis, 252 F.2d
109 (3d Cir. 1958) (spouse given unlimited power to invade principal
but state law limited power to reasonable use); Matteson v. United
is no guarantee of value when an amount is expressed as “all” or a fraction, however, there is such guarantee when it is expressed by a value.

The above argument provides a logically satisfactory distinction between the income “specific portion” and the power of appointment “specific portion.” In addition, it is consistent with the desire of the Northeastern majority to promote “liberal ‘estate-splitting’ possibilities” in order to equalize tax consequences while guarding against situations which will jeopardize the federal revenue. The espousal of this distinction would constitute judicial rewriting of the Regulation to permit the income from a dollar-amount “specific portion” to qualify for the marital deduction only when the power is over the entire corpus. The Court would be justified in taking this step due to the importance of equalizing the incidence of estate tax between community property and common law jurisdictions, giving effect to the customary modes of property transfer in common law states, and preventing tax exempt transfer of wealth into succeeding generations.

While the “all events” test, buttressed by the policy considerations described above, would disqualify the power-over-a-dollar-amount interest, it would not change the Gelb situation where the power is over the entire corpus less a dollar amount. Although the “all events” test is satisfied, any depreciation of the trust corpus, including that attributable to the excluded portion, will result in a smaller estate and consequently a smaller

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States, 147 F. Supp. 535 (N.D.N.Y.), aff'd, 240 F.2d 517 (2d Cir. 1956) (power to invade principal if income insufficient held to require good faith determination of insufficiency); Estate of Noble, 31 T.C. 888 (1959) (discretionary power in the beneficiary to invade corpus for maintenance, support and comfort held restrictive); Estate of Comer, 31 T.C. 1193 (1959) (power to invade principal for maintenance, comfort and general welfare not an unlimited power); In re Estate of Gramm, 420 Pa. 510, 218 A.2d 342 (1966) (full power of consumption over principal limited by widow's judgment as to her needs). See generally 1 A. Casner, ESTATE PLANNING 846-51, 846 n.128 (3d ed. 1961); Id. at 691-99 (Supp. 1967).

61. The distinction could be incorporated into the “specific portion” definition as follows:

A partial interest expressed by fractional or percentile share shall be qualified for deduction so long as the surviving spouse has the requisite income rights and a power to appoint such share. A partial interest in property, ascertainable in amount, will qualify as a “specific portion” so long as the power over the portion which is expressed other than by fractional or percentile share shall extend over the entire property interest.


estate tax upon the death of the trust beneficiary. The Northeastern majority was very careful to avoid giving any opinion as to the validity of the Gelb result, confining its approval to Gelb's rejection of the Government's argument that the fractional requirement was necessary in order to make the surviving spouse's share subject to economic fluctuations, and its acceptance of actuarial principles in determining the amount of the share. But this is not the obvious case of tax avoidance posed by the Northeastern dissent, nor indeed is tax avoidance likely. The testator's purpose in creating a Gelb trust cannot be faulted since this vehicle may reduce costs and allow the widow to receive the maximum income while still providing for any needs of the children. This could be done with two separate trusts, but a single instrument, which balances the disadvantage of a disproportionate risk of excessive taxes against the advantages of equalization of tax treatment and the relative remoteness of the possibility of a loss in revenue, may well be more appropriate. There is no need to disallow the deduction and require two separate trusts in such a situation.

IV. DRAFTING IN THE ALTERNATIVE

The potential estate tax savings from the power-over-a-dollar-amount provision, when considered in light of the uncertainty as to its tax treatment, creates problems for the estate planner. He must strive to take full advantage of the potential tax savings, while insuring a maximum marital deduction if the power-over-a-dollar-amount provision fails to qualify. One way to accomplish these objectives is to use a clause containing alternative provisions. The discussion below will consider several such clauses, each containing: (1) a "power-over-a-dollar-amount provision" and (2) an "assured-marital-deduction" pro-

64. See note 27 supra and accompanying text.
65. Of course, the single trust is not always preferable to multiple trusts. There are many independent factors that would affect any convenient estimate. See Lovell, Marital Deduction Simplified, 93 T. & E. 760 (1954).
66. There are, of course, situations where the courts could salvage the marital deduction even though a power-over-a-dollar-amount provision did not qualify. An example would be a power-over-a-dollar-amount trust where the dollar amount equaled the total value of the trust assets. If the dollar amount were deemed non-qualifying, a court could find that there is simply a power over the entire corpus and no actual specific portion involved. The argument is double-edged, however, since it might be used to limit tax avoidance if the power-over-a-dollar-amount provision is found to be valid. See Covey, supra note 19, at 393 n.21.
vision to become operative in case of failure of the first. Before specific clauses are discussed, however, it is necessary to consider possible objections to the use of alternative drafting in the marital deduction context.

The first hurdle for provisions drafted in the alternative is found in section 2056(b)(1) which allows no deduction for an interest that will “terminate or fail” upon the “occurrence of an event or contingency, or on the failure of an event or contingency to occur. . . .” Because the “assured-marital-deduction” provision would only be needed if the power-over-a-dollar-amount portion did not qualify, the former provision might be disqualified because it is subject to a contingency. If this happened, and the power-over-a-dollar-amount provision was then determined non-qualifying, the entire marital deduction would be lost. However, this result is neither warranted by the purpose of the terminable interest rule nor consistent with the contingencies intended to be disqualifying. The purpose of the terminable interest rule is essentially to “preserve the parallel between the marital deduction and community property jurisdictions” by denying the deduction to a limited interest in property which passes to the surviving spouse but “which will not be taxable to her estate at her death.” The only contingency in that case is the amount of the share that qualifies for the marital deduction. The Regulations speak of the life estate, term for years, annuity, patents and copyrights as examples of interests that will terminate. But, in the proposed alternative provisions, any interest she does get will pass through her estate and the only thing that needs to be determined is the amount. There is no danger that the interest she will receive will escape taxation in her estate. Also, this type of contingency is commonplace in the marital deduction formula gift context where the funding of a marital deduction formula trust depends on whether other specific interests will qualify for the deduction. Thus, while there is still a possible blanket contingency objection, it should not prevail.

A second hurdle for a clause containing alternative drafting provisions is the objection that such a clause forces the court to construe the will and to render a declaratory judgment in a moot case. The leading case in support of this argument is Commissioner v. Proctor, involving a remainder interest placed

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68. Id.
70. 142 F.2d 824 (4th Cir.), cert. denied, 323 U.S. 756 (1944).
in trust with the provision that the corpus should pass to the donor's children if no gift tax is assessed. The court held that the gift tax should be assessed and that the provision designed to avoid it was without tax effect as contrary to public policy. The court supported its decision by noting three objections to clauses containing alternative provisions: (1) they tend to discourage collection of the tax by public officials charged with its collection; (2) they obstruct the administration of justice by requiring courts to pass on moot cases; (3) they operate so as to require courts to make a declaratory judgment.\footnote{71}{The actual language of the opinion stated that they operate to render the final judgment of a court to be held for naught. The court noted that essentially this would be a declaratory judgment of the type barred by the Declaratory Judgment Act, 28 U.S.C. §§ 2201-02 (1964), which authorizes declaratory judgments over actual controversies except those involving federal tax issues. 142 F.2d at 827.}

Applied to an alternative provision in a marital deduction case, the Proctor argument is that the judgment would have no effect as to the parties involved. If the power-over-a-dollar-amount provision was not allowed as a deduction, the clause would operate to substitute the qualifying alternative. There would be no change in the tax picture of the husband's estate. As far as discouraging the collection efforts of public officials, if the Service were only worried about the tax consequences on the husband's estate, there would be no reason to seek a deficiency since it is clear that the court would either approve the dollar amount and deny the deduction, or deny the dollar amount thereby substituting the alternative provision. The declaratory judgment argument contends that the court is being asked to determine which interest will pass by demonstrating the tax consequences of the alternatives, thus being forced to construe the will.

These moot case and declaratory judgment arguments, while valid in some cases, do not stand up under close scrutiny in the marital deduction context. Although the decision of the court would not operate to change the tax burdens on the husband's estate, there would still be incentive for the Government to deny the power-over-a-dollar-amount and attempt to collect the deficiency. This is because of the potential estate tax revenue loss when the widow's estate tax return is filed. This same fact serves to rebut the argument that the decision would have no tax consequences.

Of course, the foregoing objections to alternative drafting provisions carry different weights when applied to specific pro-
visions. Thus, further consideration of these objections will be included in the following discussion of various possible clauses containing alternative provisions. While the alternative provisions could be expressed in several different ways, such clauses would probably employ either one of two basic approaches: alternative powers over the same trust assets or multiple trusts.

A. ALTERNATIVE POWERS OVER THE SAME TRUST ASSETS

In clauses employing this approach, there would be a power-over-a-dollar-amount “specific portion” and, in the event such a power failed to qualify for the marital deduction, a power over the entire trust assets in lieu of the “specific portion” power. The manner of funding the trust is not significant under this approach to stating the alternative provisions, and any one of the common forms of describing the bequest to the marital trust may be used: non-formula pecuniary amount; formula pecuniary amount; non-formula fractional share; formula fractional share. Since the second alternative power is over the entire trust assets, any “specific portion” difficulties are eliminated.

If both the amount of the trust corpus and the specified dollar-amount power were identical—as, for example, where both are stated by a formula clause to be the exact maximum marital deduction—this raises the danger that the dollar amount power would be construed to be a power over the entire corpus, thus defeating the purpose of the dollar-amount provision. This danger would be lessened by a funding of the trust in excess of the dollar-amount power. While this might result in overfunding the marital share, the excess amount can be kept to a minimum.

Another example of the first approach to alternative provisions would express the alternative “assured-marital-deduction” power in fractional terms so that the amount determined by the fraction would equal the specified dollar amount. In the event the power-over-a-dollar-amount specific portion did not qualify for the marital deduction, the alternative power would be over that fraction of the total corpus formed by using the dollar amount interest as numerator and the total corpus value as denominator. There is no contingency in the marital deduction amount here; the only question is how the interest is defined. However, the second alternative would clearly include in the wife’s estate any increase in the value of the appointive assets subsequent to the husband’s death.

72. See note 66 supra.
73. It is true that the alternatives here could accurately be ex-
The first category of alternatives does raise the possibility of a stronger declaratory judgment argument. If the testator is allowed to set up one alternative, he could conceivably set up several, simply arranging them in descending order of preference. The court would have to decide which alternative qualified for the deduction. Carried to this extreme a court might be justified in relying on the Declaratory Judgment Act to invalidate the clause.

B. MULTIPLE TRUSTS

A more promising category of clauses using alternative provisions provides for a power-over-a-dollar-amount trust and an “assured-marital-deduction” clause in the form of a marital deduction formula trust. The marital deduction formula clause assures that the widow will receive an amount exactly equal to the maximum marital deduction of 50 per cent of the decedent’s adjusted gross estate. It does so by providing for the adjustment of the widow’s share after considering all the interests she has received, other than under decedent’s will, that are part of the decedent’s gross estate and qualify for the marital deduction. Since its goal is an amount equal to the maximum marital deduction and nothing more, the use of the formula trust as an alternative drafting measure eliminates any terminable interest objection due to difficulty in calculating the amount the widow will receive. As will be seen, the use of the formula trust should also defeat any remaining contingency arguments.

Using this approach the amount of assets passing to the second trust would be determined by whether or not the assets in the first trust containing a power-over-a-dollar-amount qualified for the marital deduction. Such power-over-a-dollar-amount would be exercisable only in the event it qualified for the marital deduction in the husband’s estate as a power over a

pressed as a power-over-a-dollar-amount portion or a power-over-a-dollar-amount portion plus any appreciation or minus any depreciation that might occur during the life of the surviving spouse. However, looking at the situation at the time the amount of the marital deduction is determined, no appreciation or depreciation can be considered.

74. A typical legacy formula provision is:
If my wife shall survive me, I give to her a legacy [either outright or in trust] in an amount equal to one-half of the value of my adjusted gross estate, as finally determined in the United States estate tax proceeding relating to my estate, reduced by the total of any other amounts allowed as a marital deduction in said proceeding.

specific portion. The executor would file the estate tax return with the dollar amount making up the marital deduction. If it were determined that the dollar amount did not qualify, then the executor would fund the marital trust pursuant to the formula's instructions and the deductions would be secured. There would be no danger of double taxation here since the widow's interest in the dollar amount trust would be limited to income rights. The absence of the power of appointment would preclude its inclusion in her estate.\(^75\)

If the power of appointment were not conditional, and if the dollar amount specific portion did not qualify, then the dollar amount trust corpus would be taxed in both the husband's and the wife's estates.\(^76\) Thus, before using this approach the planner would have to balance the potential estate tax savings in case of asset appreciation against the possibility of double estate taxation.\(^77\) Of course, if the power were not conditional there could be no possible terminable interest objection.

The declaratory judgment and terminable interest arguments lose force against this category. The need for a determination of whether one interest qualifies for the deduction is commonplace.\(^78\)

75. INT. REV. CODE of 1954, § 2041.
76. INT. REV. CODE of 1954, § 2041. A simple example would be a testator with a $400,000 estate. The first trust would receive $200,000 with the widow receiving income from $100,000 and the power to appoint that “specific portion.” The children would receive rights to the other $100,000 and possibly the appreciation from the widow’s $100,000. If the dollar amount interest does qualify the formula trust would receive $100,000. If the dollar amount interest does not qualify then the formula would operate to fund the alternative trust to $200,000. Of course the widow would still receive the income from the original $100,000, but that amount would not be taxed to her estate.

77. A related suggestion has been made, see Covey, New Doctrines on Marital Deductions, 101 T. & E. 322, 395 (1962), combining a formula provision marital trust and a trust from which the spouse has a right to withdraw the greater of $5000 or five per cent of the principal each year. Using actuarial computations, as sanctioned by Gelb, the value of the withdrawal right can be computed to give a dollar amount which might qualify for the marital deduction. If the dollar amount qualified, a substantial tax avoidance would be possible, but if not, the formula provision would operate to secure the maximum marital deduction. However, Covey points out that the plan should not succeed since the power is really a number of powers coming into existence at the rate of one per year and thus could not be considered as exercisable “in all events.” Id. at 394.

As an alternative, Covey suggests a right to withdraw, in addition to the $5000 or five per cent, the present actuarial value of the power. This appears to satisfy the “all events” requirement thereby qualifying the actuarial amount.

78. The typical formula provision states that the final determinations in the United States estate tax proceeding shall be used
and thus a necessary exception to the exclusion of federal tax cases from the declaratory judgment power of the federal courts. Certainly the marital deduction formula clause would be an example where such a decision would have to be made in order for the formula to operate. The executor has a duty to fund the marital trust to achieve the maximum marital deduction. When he files the estate tax return, claiming that other interests besides the formula trust qualify for the deduction, and one of these interests is held not to qualify, he would have the duty to fund the trust with an additional amount in order to make up for the loss in deductions.79

V. CONCLUSION

There is no doubt that the dissent in Northeastern is correct in pointing to a possible estate tax "loop-hole" opened up by the majority's decision. A literal reading of the statute combined with acceptance of dollar amount, as well as fractional shares, as "specific portions" would give this result. But the tone of the majority opinion does not justify the belief that such a result is either intended or inevitable. The requirement of a fractional or percentile share on the Northeastern facts was not necessary to prevent revenue loss and it is not clear that Congress intended to restrict the flexibility of the deduction provision by imposing such a limitation. The majority indicated its desire to secure flexibility for testators in common law jurisdictions while retaining tax parity with community property jurisdictions. The Court specifically limits qualification of dollar amount provisions to the facts of the case and positively states that nothing in the opinion is intended to apply to cases involving potential tax avoidance. It therefore seems probable that a case involving possible tax avoidance, such as the one posed by the dissent, would be decided differently.

Even if presented with a case involving potential tax avoid-

79. An example of a case where this might occur is the typical widow's allowance dispute where the Government attempts to deny a deduction in the amount of the allowance on the ground that it is a terminable interest. See, e.g., Jackson v. United States, 376 U.S. 503 (1964); Rev. Rul. 83, 1953-1 Cum. Bull. 395. If the estate involved a marital deduction formula trust, once the allowance was deemed terminable (and thus non-deductible) the executor would have to add to the marital trust pursuant to the formula provisions.
ance, it is conceivable that the Court would leave the "loop-hole" for Congress to fill. Considering the size of the potential estate tax savings, it would be wise for the estate planner to attempt to take advantage of this possibility if at the same time he can avoid the risk of losing the marital deduction altogether. A clause containing alternative power-over-a-dollar-amount and "assured-marital-deduction" provisions appears to achieve this result. Although the contingency and the declarative judgment objections exist, they should not be a bar to the use of such a clause in the marital deduction context.80

80. It would seem that the public policy arguments, as set forth in Proctor, could be successfully answered in the context of a marital deduction formula trust alternative proposal. However, if there were sufficient doubt to deter the estate planner from attempting such an alternative proposal, there is a third possible provision that incorporates the formula trust without being subject to the declarative judgment arguments. This would be a power-over-a-dollar-amount trust and alternative marital deduction formula trust with the power contingent upon the dollar amount deduction being allowed as a settled matter of law at the time of the testator's death. Any questions could be decided by the appropriate probate court, since the determination would not be whether the dollar amount did qualify, but whether it was a settled matter that it qualified. Of course, this alternative would not provide an opportunity for tax avoidance if the matter had not previously been decided, but it would do so for the cases following such a decision.