The Classification and Regulation of Variable Annuities

Minn. L. Rev. Editorial Board

Follow this and additional works at: https://scholarship.law.umn.edu/mlr

Part of the Law Commons

Recommended Citation
https://scholarship.law.umn.edu/mlr/2750

This Article is brought to you for free and open access by the University of Minnesota Law School. It has been accepted for inclusion in Minnesota Law Review collection by an authorized administrator of the Scholarship Repository. For more information, please contact lenzx009@umn.edu.
THE CLASSIFICATION AND REGULATION OF VARIABLE ANNUITIES

I. INTRODUCTION

A substantial segment of the life insurance industry has proposed that a new type of annuity contract be issued which is designed to protect retirement plans from inflation. This contract is called a variable annuity. Instead of the customary fixed sum annuity payments, such contracts provide for dollar benefits which vary in accordance with the current value of a portfolio of common stocks in which the annuity considerations have been invested. The proposal has created a controversy involving some life insurance companies, investment companies, and the corresponding regulatory agencies at both state and federal levels.

A. THE VARIABLE ANNUITY: A DESCRIPTION

A retired person without sufficient capital to live on interest alone has to expend capital to meet ordinary living expenses. Such an individual may apportion his capital by calculations based upon average life expectancy. However, he runs the risk of prematurely exhausting his financial resources if he outlives the average life expectancy. This risk can be avoided by purchasing a life annuity, that is, a contract by which an insurance company agrees to make periodic payments to the purchaser for the duration of his life. The company then distributes the risk among the entire group purchasing annuities.

Traditionally, payments on such annuity contracts have been guaranteed payments of a fixed sum. However, there have been some examples of annuities involving variable benefits, and pay-

1. Of 100 male annuitants living at age 65, although the expectancy is 15 years, at age 80 there will be 48 still alive, and at age 85 there will be 29 still living. Transcript of Public Hearing on Assembly Bills Nos. 450, 451, 452 (Re Variable Annuities), New Jersey Senate Business Affairs Committee, June 22, 1956, p. 4. These figures represent a more favorable indication of life expectancy than the average, however, since the annuity purchaser is usually in better health than the average non-annuitant.

2. The issuance of annuities is not limited to insurance companies. Patterson, Essentials of Insurance Law 11 (2d ed. 1957). For instance, annuities, in the popular sense, may be conferred by a will or trust and the annuity principle is often used by investment companies when no life contingency factor is involved. However, annuity policies normally are issued by insurance companies.

3. See 1956 Life Insurance Fact Book 104, 106. Many variations are possible. An annuity may be purchased for a term of years, for two joint lives, for ten years or life whichever is longer, etc. See Maclean, Life Insurance 48-55 (8th ed. 1957).


ments on conventional annuity contracts do vary to the extent that
the purchaser may participate in the surplus of the company. The
variable annuity to be discussed in this Note applies the annuity
principle (systematic distribution of capital and income) to a com-
mon stock fund created by the purchasers of these annuities.

Although the amount of the periodic payments to be derived
from conventional annuities can be determined at the time a policy
is issued, in determining variable annuity benefits several separate
calculations must be made subsequent to the issuance of the con-
tract. The first type of calculation takes place during the accumula-
tion period, that is, the period of time during which the variable

6. See Johnson, The Variable Annuity: What It is and Why It is
Needed, 1956 Ins. L.J. 357, 362-63. Most annuity contracts, however, are non-
7. For a general description of the variable annuity, see Johnson,
supra note 6, at 362.
8. In several places the text refers to the variable annuity portfolio as
being a common stock “fund.” It is used in this Note as a generally descrip-
tive term, not as a term of art.

The variable annuity principle is already being used in many group
retirement plans. In such plans, the variable annuity is usually balanced
against a fixed program, such as a group annuity; but the payments on the
variable plan depend entirely upon the group experience with expense, in-
vestment, and mortality. These plans are either self-administered by the
employer, or by a trustee, such as a bank, and are not subject to insurance
or securities regulation. See Schechter, Variable Annuities—Boon or Banef,
1956 Ins. L.J. 764, 768. For texts of such plans, see CCH Pension and Profit

A variable annuity plan is available for certain teachers through the
College Retirement Equities Fund. For a detailed description of the CREF
variable annuity see Lloyd, CREF and TIAA Variable Annuity in Action,
95 Trusts & Estates 244 (1956); Johnson, A Safe Retirement Income?, 94
Trusts & Estates 12 (1955). The plan by Jan. 1, 1957 had 31,156 participants
with variable annuity assets of $39,817,951; its annuity unit began with a
value of $10.00 in July 1952 and had a stated value of $18.51 as of Jan. 1,

The variable annuity principle has been incorporated into the Wiscon-
sin public employees retirement program, Wis. Sess. Laws 1957, c. 381, § 3,
and into the Wisconsin teachers' retirement program, Wis. Sess. Laws 1957,
c. 322, § 2, and c. 423, § 2.

There are 3 operating variable annuity companies: Participating An-
nuity Life Insurance Company of Rogers, Arkansas; Variable Annuity Life
Insurance Company, Washington, D.C.; Equity Annuity Life Insurance
Company, Washington, D.C. Morrissey, Dispute Over the Variable An-
nuity, Jan.-Feb. 1957 Harv. Bus. Rev. 75, 77. The Variable Annuity Life
Insurance Company is licensed to do business in the District of Columbia,
Arkansas, Kentucky, and West Virginia. Trial Brief for Defendants, pp.
1957). The VALIC individual policy provides for optional term insurance,
waiver of premiums for disability, and many other typical insurance policy
provisions. There is also a penalty provision for withdrawal during the first
5 years. VALIC assumes the risk of adverse mortality and expense experi-
ence. The policy is reproduced in SEC v. Variable Annuity Life Ins. Co.,
supra at 529-38.
annuity is being purchased by payment to the company of a fixed number of dollars each month or year. The purchaser is credited for each payment with a number of "accumulation units" which is determined by the net consideration divided by the value of a "unit" at the time of payment. The value of a "unit" depends on the value of the common stock fund at that time.

Later, at the time of retirement, the aggregate number of "accumulation units" is mathematically converted into the number of units to be paid annually to the variable annuitant. This calculation involves the same factors as converting premium payments in dollars on a conventional annuity contract into dollar benefits to be returned by installments. The principal factor in this calculation is the mortality table.

After the number of units to be paid out annually is fixed, the value of each unit must be determined. Once again, this value will depend upon the value of the common stock fund which supports the variable annuities. Calculation of this value will be made at the time of each payment.

B. Economic Basis

The basic need for the variable annuity arises from the decrease in monetary purchasing power due to inflation. Most economists predict that this inflation will continue because of inflationary forces.

9. The payment of a fixed sum periodically is the utilization of the dollar averaging method of investment which specifies that the purchaser must buy the same dollar amount of a security no matter how high or low the market value. Since the long term trend is up, the purchaser will gain in the long run and will avoid the risk of guessing about when to buy or sell. See Johnson, Immediate Variable Life Annuities, 95 Trusts & Estates 96 (1956).

Variable annuities could also be purchased in a lump sum. In that event, the calculation of "annuity units" would be accomplished immediately. For explanation of the term "annuity units" see text related to note 10 infra.

10. Called "annuity units."

11. The value of a unit is multiplied by the number of units to be paid in order to determine the dollar amount of the payment.

Several variations of the variable annuity as described may be possible. For instance, the contract might provide for conversion to a conventional annuity at the end of the accumulation period in order to provide for guaranteed benefits. Then the amount of dollar benefits would be calculated at the time of conversion.

12. "The value of the dollar has declined in 44 years, remained constant in 11 years and risen slightly in 19 years of the past 75. At the end of the 75-year period the dollar had a value one third of that which it had at the beginning. Furthermore, it is not possible to find a single 20-year period within the 75 years during which the average value of the dollar is as low as it is in the subsequent 20-year period." Statement by Wilford J. Eiteman, Professor of Finance at the University of Michigan, Hearing, supra note 1, at 137A.

Also, the prices of annuities have risen due to increased longevity and the decline in yield on bonds and mortgages. Johnson, supra note 6, at 357.
now built into our economy. It has also been pointed out that the general trend of common stock values has been upward in the long run, although subject to wide variations in the short term. Further, economists predict that the upward trend in stocks will continue due to technological improvement and expansion of industry through increased consumption.

If these economic assumptions are correct, the variable annuity may prove to be a valuable device for providing for retirement income. But whether or not the economic assumptions are correct and whether or not the life insurance industry should risk goodwill by selling the variable annuity are questions which go beyond the scope of this Note. As a matter of legal policy, the objections of all opponents can be met by adequate regulation, including the assurance that an individual knows what he is buying.

13. See Kvernland, Some Economic and Investment Aspects of Variable Annuities, 1956 Ins. L.J. 373-74; Morrissey, supra note 8, at 77, 84.

But insurance industry opponents to the variable annuity question the economic assumptions upon which it is based. They say that we have had little inflation other than during and after wars, that this feeling of continued inflation is just a recurrence of the “New Era” disease of the '20's, and that when the market goes down the industry goodwill will suffer. See National Underwriter, Dec. 30, 1955, p. 2; Hearing, supra note 1, at 16A. These opponents also believe that the variable annuity is giving up the fight against inflation and that it will encourage the idea of inflation popularly. See Long, The Variable Annuity: A Common Stock Investment Scheme, 1956 Ins. L.J. 393, 395; Hearing, supra note 1, at 108A.

One writer has said that if variable annuities had been sold in the past and balanced against a fixed value program to smooth out the highs and lows, there would have been a remarkably good correlation between the cost of living and the benefits derived from such a policy. See Johnson, supra note 9, at 97-98.

14. See Sedgwick, A New Pension Plan, Jan.-Feb. 1953 Harv. Bus. Rev. 70, 73-74. The average annual increase in stock prices (including dividends) for all industrial common stock on the New York Stock Exchange was 8.8% per year from 1871 to 1937, and 12% per year from 1938 to 1951. Ibid.

Contra, it is said there is a substantial danger that the market could crash in the future due to saturation of consumption or decreased defense spending and that the so-called inflationary elements in the economy would serve to maintain the cost of living in spite of the decline in stock values. See National Underwriter, Dec. 30, 1955, pp. 2, 15. It is also argued that the present sources of investment capital are insufficient and that widespread sale of variable annuities would only cause inflation of common stock prices. See Long, supra note 13, at 398-90; Schechter, supra note 8, at 772.

15. See The Next Twenty Years, Fortune, Jan. 1958, p. 110; Morrissey, supra note 8, at 77; Weston, The Stock Market in Perspective, March-April 1956 Harv. Bus. Rev. 71, 72-77. It has also been argued that there is a need for a greater supply of equity investment in order to support this growth of American industry. See Kvernland, supra note 13, at 378-80; Schechter, supra note 8, at 772.

16. Part of the industry is greatly concerned with possible loss of goodwill. See Hearing, supra note 1, at 126A. Some also fear that the sale of variable annuities would invite federal reconsideration of the tax status of insurance companies and would be the opening wedge for federal regulation. See Pyle, The Case Against Variable Annuities, 1956 Ins. L.J. 776, 778.

17. Some members of the securities industry say that since the variable
This Note is directed at the determination of what constitutes adequate regulation of variable annuities. In solving this problem an examination and evaluation will be made of present regulatory systems. Finally, consideration will be given to the various proposals for regulation of the variable annuity.

II. PRESENT REGULATION

A. THE CONTROVERSY

The securities industry claims that the variable annuity is a security and should be regulated as a security. Part of the life insurance industry claims that the variable annuity is an insurance contract and therefore should be subject to regulation by the state insurance commissions and exempt from federal regulation.

This controversy reached the courts in SEC v. Variable Annuity Life Ins. Co. In that case the SEC sought an injunction in a federal district court restraining VALIC from selling variable annuity contracts. The SEC alleged: (1) that the variable annuity is a security subject to the Securities Act of 1933; (2) that VALIC is an investment company subject to the Investment Company Act of 1940; and, (3) that VALIC had not complied with these acts. VALIC contended that variable annuity contracts are insurance policies, that a company issuing these policies is an insurance company, and that therefore VALIC is not subject to regulation by the SEC since insurance business is exempt from the acts.

The trial court stated the issue to be whether “such contracts [are] insurance policies, or . . . securities evidencing investments or interests in investments.” The opinion which followed is somewhat confusing. First, the court refused to classify the contract as either security or insurance since it found that the variable annuity does not fit either category exactly and because such a choice rests on “broad principles of public policy” within the province of the legislature. Then, the court said that since VALIC was licensed and regulated by the insurance departments of the states in which it op-

19. Day, supra note 5.
21. Id. at 523.
22. Id. at 528.
erates, it is exempt from SEC regulation by "the broad, explicit and
impelling language of the McCarran Act" which exempts "the
business of insurance" from most federal regulation.\textsuperscript{23} Thus, the
court, although it disclaimed making the choice, in effect found that
the variable annuity is insurance.

The court of appeals affirmed, adding little to enlightened analy-
sis and giving even greater weight than the district court to the
determination of the insurance commissioners.\textsuperscript{24}

Such an approach seems highly unsatisfactory. First, in de-
ciding a controversy based upon federal statutes a court is bound to
carry out federal policy. While the fact that this contract was con-
sidered to be insurance by a state administrative agency may be
some evidence of its nature, the state determination should not be
controlling.\textsuperscript{25} Secondly, both opinions lack any real analysis of the
problems involved. Such an analysis appears essential.

**The Securities Act of 1933**

The Securities Act of 1933 defines a security to be:

\begin{quote}
[A] ny note, stock, treasury stock, bond, debenture, evidence of
indebtedness, certificate of interest or participation in any profit-
sharing agreement, \ldots investment contract, \ldots or, in general,
any interest or instrument commonly known as a 'security.'
\end{quote}

This definition has been liberally construed,\textsuperscript{26} and as so applied, the
"investment contract" provision might well include annuities and

\textsuperscript{23} 155 F. Supp. at 527. Section 2 of the McCarran Act provides:
(a) The business of insurance, and every person engaged therein,
shall be subject to the laws of the several States which relate to the
regulation or taxation of such business.
(b) No Act of Congress shall be construed to invalidate, impair, or
supersede any law enacted by any State for the purpose of regulating
the business of insurance, or which imposes a fee or tax upon such
business, unless such Act specifically relates to the business of insur-

\textsuperscript{24} 26 U.S.L. Week 2591 (D.C. Cir. May 27, 1958). The court stated:
"The definitions in the Securities Act and the Investment Company Act
indicate that if the insurance commissioner of a state subjects the business to
his supervision, it is the business of insurance." \textit{Ibid.}

\textsuperscript{25} \textit{Cf.} Soc'y for Savings v. Bowers, 349 U.S. 143, 151 (1955); Sola
court in the VALIC case based its result on the broad provisions of the
McCarran Act, it still could not avoid determining whether VALIC was
doing an insurance business. The court apparently felt that the policy of the
McCarran Act was to leave that determination to the states. However, it is
doubtful that such a result was intended when there is a square conflict with
a federal regulatory scheme.

\textsuperscript{26} 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b(1) (1952). (Em-
phasis added.)

\textsuperscript{27} See United States v. Monjar, 47 F. Supp. 421, 426 (D. Del. 1942);
NOTES

the variable annuity.\(^{28}\) However, the act exempts from its provi-
sions:

Any insurance or endowment policy or annuity contract or op-
tional annuity contract, issued by a corporation subject to the
supervision of the insurance commissioner, bank commissioner,
or any agency or officer performing like functions, of any State
or Territory of the United States or the District of Columbia.\(^{29}\)

The question then presented is whether the variable annuity may
properly be characterized as an annuity within the meaning of this
exemption.\(^{30}\)

The most important similarity between the variable annuity and
the conventional annuity is that both involve the systematic dis-
tribution of capital and income. Another similarity is that both the
conventional life annuity and the variable life annuity distribute the
risk of time of death among a group, and shift the risk of group
mortality to the company.

An apparent difference between the conventional and the vari-
able annuity is that the latter provides for variable benefits. In the
past most courts have said that an annuity involves the periodic pay-
ment of a fixed sum.\(^{31}\) However, state statutes defining annuities do
not compel such a result,\(^{32}\) it is not necessarily true historically,\(^ {33}\)
the inclusion of the word fixed is usually dictum and probably un-
considered,\(^{34}\) and there is case law contra.\(^{35}\)


\(^{30}\) In examining the definition of a security and the annuity exemption
together, some writers attempting classification of the variable annuity have
aparently adopted the approach that the variable annuity is either an an-
nuity or a security. E.g., Day, supra note 5. Such an approach is misleading,
however, since it implicitly rejects the possibility that an annuity itself may
be a security. An argument will be presented in this Note that some types
of annuities are a form of security and that other types of annuities are a
form of insurance. See text at notes 48-53 infra. Consequently, the proper
consideration under the Securities Act of 1933 is whether the variable annuity
is an annuity, not whether it is security or annuity.

\(^{31}\) See Mehr and Osler, op. cit. supra note 4, at 84; Haussermann,
supra note 17, at 388-89. From this it has been argued that the variable an-
nuity is not an annuity.

\(^{32}\) See, e.g., N.Y. Ins. Law § 46(2):

"Annuities," meaning all agreements to make periodical payments where
the making or continuance of all or some of e. series of such payments,
or the amount of any such payment, is dependent upon the continuance
of human life.

\(^{33}\) See Day, supra note 5, at 781-82.

\(^{34}\) See, e.g., State ex rel. Thornton v. Probate Court, 186 Minn. 351,
356, 243 N.W. 389, 391 (1932). Further, the cases in which a finding of fixed
benefits was necessary for the result have usually involved tax statutes or
interpretation of wills. See, e.g., Bacon v. Comm'r of Corp. and Tax, 266
Mass. 547, 165 N.E. 664 (1929). It seems clear that since those cases do not
Thus, it appears that the variable annuity may properly be characterized as an annuity. If, however, a court finds that the variable annuity is not an annuity, the contract should be classified as a security since it would not be desirable to have an unregulated no-man's-land between security and annuity.

The Investment Company Act of 1940

Assuming that the variable annuity is a security, it becomes relevant to consider whether a company selling such policies is subject to regulation under the Investment Company Act of 1940. This act defines an investment company to be a company which:

- is engaged ... in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

An insurance company, although it might well be an investment company under this definition, is specifically exempted, and is defined as:

- a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State.

Consequently, it appears that whether or not VALIC is exempt from the act as an insurance company will depend on whether the writing of annuity contracts is "the writing of insurance," that is, whether the annuity is insurance.

consider classification for the purpose of regulation, they are not good law for that purpose.

37. Id. at 797 (1940), 15 U.S.C. § 80a-3(a) (3).
38. Id. at 798, 15 U.S.C. § 80a-3(c) (3).
39. Id. at 793, 15 U.S.C. § 80a-2(a) (17). (Emphasis added.)
40. Although many state statutes define a company issuing annuities to be an insurance company, see, e.g., Minn. Stat. § 61.01 (1953), most courts have held that annuities are not insurance. See, e.g., Hamilton v. Penn Mutual Life Ins. Co., 196 Miss. 345, 17 So. 2d 278 (1944); Couch, Cyclopedia of Insurance Law § 25 (1929). But these cases have usually involved interpretations of local statutes, or tax problems, or both. See, e.g., Corporation Comm'n v. Equitable Life Assur. Soc'y, 73 Ariz. 171, 239 P.2d 360 (1951); State ex rel. Thornton v. Probate Court, 139 Minn. 351, 243 N.W. 389 (1932). Such cases do not consider classification for the purpose of determining the scope of federal regulatory statutes and consequently are not good law for that purpose.
The definition of a security under the Investment Company Act is the same as under the Securities Act of 1933.\textsuperscript{41} It has been pointed out that this definition under the latter act may be broad enough to include annuities as securities.\textsuperscript{42} It is also significant to note the manner in which insurance and annuities are specifically exempted from that act:

Sec. 3. (a) Except as hereinafter expressly provided, the provisions of this subchapter shall not apply to any of the following classes of \textit{securities}:

(8) Any \textit{insurance} or endowment policy or \textit{annuity} contract.\textsuperscript{43}

Although this implies that insurance and annuities are securities,\textsuperscript{44} it has been pointed out that the above provision was actually the product of overcaution.\textsuperscript{45} The House Report states that section 3(a) (8):

\begin{quote}
[M]akes clear what is already implied in the act, namely, that insurance policies are not to be regarded as securities subject to the provisions of the act. . . . The entire tenor of the act would lead, even without this specific exemption, to the exclusion of insurance policies from the provisions of the act, but the specific exemption is included to make misinterpretation impossible.\textsuperscript{46}
\end{quote}

However, this language, while it clearly indicates that \textit{insurance} is not a security, leaves some doubt as to whether \textit{annuities} are securities since the language quoted applies to the House version of the bill which contained no exemption for annuities.\textsuperscript{47}

Since the act does not provide a clear answer, it is necessary to examine the nature of an annuity in order to determine whether it is insurance or security. In doing so, it will be useful to consider separately the annuity for a term of years and the life annuity.

The similarities between the life annuity and insurance may best be seen by comparing the life annuity and life insurance, which concededly is insurance. First, both involve the basic insurance principle of distributing the risk of an occurrence, other than adverse investment experience, among a large group of persons.\textsuperscript{48}

\footnotesize
\begin{itemize}
\item \textsuperscript{42} See note 28 supra and related text.
\item \textsuperscript{43} 48 Stat. 76 (1933), as amended, 15 U.S.C. § 77c(a) (8) (1952).
\item \textsuperscript{44} See Douglas and Bates, \textit{The Federal Securities Act of 1933}, 43 Yale L.J. 171, 182-83 (1933).
\item \textsuperscript{45} Loss, \textit{Securities Regulation} 322 (1951).
\item \textsuperscript{46} H.R. Rep. No. 85, 73d Cong., 1st Sess. 15 (1933).
\item \textsuperscript{47} See 77 Cong. Rec. 3901 (1933). The annuity exemption was later added by the conference committee.
\item \textsuperscript{48} See Mehr and Osler, \textit{op. cit. supra} note 4, at 22.
\end{itemize}
insurance a company distributes the policyholder’s risk that he may
die earlier than the predicted average; through the annuity a com-
pany distributes the policyholder’s risk that he may outlive the pre-
dicted average. Secondly, both contracts normally shift the risk of
group mortality to the insurer. In the case of life insurance, the
company assumes the risk that the group as a whole may die earlier
than the predicted average life expectancy. In the case of annuities,
the company assumes the risk that the group as a whole may live
longer than the predicted average life expectancy. This risk of group
mortality is a substantial risk, at least on annuity policies, since av-
erage life expectancy is constantly increasing.

In summary, it would appear that the life annuity is a species of
the genus insurance, if not the same species as life insurance. It
follows that a company primarily engaged in the sale of life annui-
ties and variable life annuities is an insurance company and conse-
quently not subject to the provisions of the Investment Company
Act of 1940.

Turning to a consideration of the annuity for a term of years, it
appears that such a contract is basically unlike insurance. The only
risk distribution function that the annuity for a term of years pro-
vides is distribution of the risk of adverse investment experience.
Since this is the basic function of investment companies, it can
hardly be a valid basis for classification as insurance. In addition, an
annuity for a term of years seems indistinguishable from a form of
security called the “face amount certificate,” which is defined as:

49. Some courts make the distinction that an annuity is not insurance
since benefits are contingent upon living, not death. See, e.g., Corporation
Comm’n v. Equitable Life Assur. Soc’y, 73 Ariz. 171, 175, 239 P.2d 360, 362
(1951). However, such a distinction wholly disregards the risk distributing
nature of insurance. Also, some courts mistakenly assume that if annuities
are not life insurance they are not insurance. See, e.g., Matter of Southern,
257 App. Div. 574, 577, 14 N.Y.S.2d 1, 3-4 (3d Dep’t 1939).

50. Determination of the criteria for defining “primarily” might raise
some practical problems since many annuities are a mixed life annuity and
annuity for a term of years (annuity for life or 10 years whichever is
longer). However, as long as the calculation involves a contingency based
upon life, it should be considered to be insurance since it still involves risk
distributing and risk shifting and since the insurance commissioners are
better equipped to regulate contracts involving life contingencies than
security regulatory agencies.

51. However, if a state found the variable annuity to be a security and
not insurance, and thereby declined jurisdiction over it as insurance, then a
company primarily engaged in selling such policies could not meet the
statutory exemption. See text at note 39. In that event the SEC could clearly
assume jurisdiction.

52. While an insurance company may not only distribute the individual’s
investment risk but also assume the group risk, such a risk may be assumed
by an investment company on some securities. E.g., bonds and face amount
certificates with guaranteed return,
[A] ny certificate, investment contract, or other security which represents an obligation on the part of its issuer to pay a stated or determinable sum or sums at a fixed or determinable date or dates more than twenty-four months after the date of issuance, in consideration of the payment of periodic installments.53

Thus it would seem that an annuity or variable annuity for a term of years is a security and, therefore, a company primarily engaged in the sale of such policies should be classified as an investment company.

The McCarran Act

The McCarran Act's broad exemption of "the business of insurance" from federal regulation adds little or nothing to the resolution of the problems treated above. Interpretation of that act will depend upon precisely the same consideration, already fully discussed: whether the business activity may properly be characterized as the insurance business.

B. Evaluation of Existing Insurance and Securities Regulation

Although the arguments made above that a variable annuity is an annuity and that the variable life annuity is insurance appear persuasive, the opposing arguments are not entirely without merit. Basically those arguments are, that the variable annuity is not an annuity since it does not involve the traditional guaranteed benefits, and that the variable annuity company is an investment company because it performs more investment than insurance functions.54

It would seem therefore that a more useful approach to the question of classification would be to: (1) determine the probable interests of the variable annuity policyholder;55 and, (2) determine which system of existing regulation, insurance or security, may more adequately protect these interests.

The policyholder's interests

The average individual in purchasing a variable annuity has several rather important interests. These are: (1) that the salesman be

54. For arguments that the variable annuity is a security, see Bellinger, Hagmann, and Martin, The Meaning and Usage of the Word "Annuity," 9 J. Am. Soc'y C.L.U. 261 (1955); Haussermann, supra note 17; Long, supra note 13.
55. The possibility that the interests of the individual policyholder may collide with the interests of the public as a whole will be discussed infra at text accompanying note 126.
capable and that he use fair methods in making the sale; (2) that
the policy itself be fair; and, (3) that the retirement fund be pro-
tected to some extent from use for speculative investments.

Existing securities regulation

The theory of federal securities regulation is to compel full dis-
closure of all material facts so that the investor may make an in-
formed decision on a particular security. No attempt is made to
pass on the merits of a particular investment, apparently because it
is felt that a free market in securities based upon economic and busi-
ness forces is more desirable.

Full disclosure is sought by requiring that a registration state-
ment be effective before anyone may use the mails or interstate
commerce to sell a security. This statement contains prescribed
information on the issuing company, its officers, and the proposed
venture. Also, the prospective buyer must be furnished with a
prospectus, which contains much of the information in the registra-
tion statement, before the seller may use conventional advertising
material.

While these disclosure provisions are effectively enforced and
provide a significant deterrent to the issuance of fraudulent securi-
ties, there are loopholes in the system. First, once the registration
statement becomes effective there can be oral offers by interstate
telephone. The investor, therefore, may be sold mentally, if not
legally, before he ever sees the prospectus. Secondly, once the pro-
spective buyer has the prospectus the seller is free to use whatever
advertising material he sees fit. The prospect may be so blinded
from the supplementary sales material accompanying or following
the prospectus or from telephone sales presentations that he will be
unable to make a rational choice on the basis of the prospectus.
Further, he either may not read the prospectus, or may not under-
stand it. Thirdly, even if it is clear on the face of the prospectus
that the security is a very bad investment, the SEC cannot prevent
its sale.

56. See McCormick, Understanding the Securities Act and the SEC
24, 195-238 (1948).
(1952); Loss, Securities Regulation 131-47 (1951).
59. For a critical analysis of the act, see Douglas, Protecting the In-
vestor, 23 Yale Rev. (n.s.) 521 (1934).
60. Loss, Securities Regulation 148-49 (1951).
61. Id. at 132. Such advertising materials, however, are subject to the
fraud provisions.
63. Id. at 523; Loss, Securities Regulation 158-61 (1951).
64. McCormick, Understanding the Securities Act and the SEC 197-
98, 298-99 (1948); Douglas, supra note 59, at 527.
Another significant weakness in securities regulation is the lack of effective control over salesmen. There is no provision for federal licensing of salesmen, and while most states require registration of salesmen, only a few states provide for an examination as a prerequisite for selling securities.65

Finally, securities regulation would provide only insignificant control over the type of investments made by a company selling variable annuities.66 This may be an advantage since a company which is not restricted to "blue chips" may be able to provide greater profits for the policyholder. However, since such freedom may lead to abuses, it would seem preferable to impose some reasonable standards for investments.

The Investment Company Act of 1940 does provide for some controls beyond those discussed above.67 However, it does not provide for controls over the substance of the variable annuity contract in many essential areas nor does it set substantial investment standards. Further, since it would not apply to insurance companies selling variable annuities,68 it would affect only a small number of such policies sold.

State regulation of securities, through the Blue Sky Laws, does provide for some evaluation of the merits of securities in certain jurisdictions.69 However, since the Blue Sky Laws generally contain so many exceptions and exemptions and may possibly be avoided in a particular state because of archaic and confused choice of law rules,70 their overall effectiveness seems questionable. Of some importance is the fact that the Securities Act of 1933 was passed because of the inadequacy of the Blue Sky Laws.71 Also, the Blue Sky Laws do not control policy content nor set investment standards.

In spite of the limitations noted above, the disclosure type of regulation is generally effective for the sale of securities since it

66. See The Work of the Securities and Exchange Commission, August 20, 1957, p. 18: "It is important for investors to understand that the Commission does not supervise the investment activities of these companies and that regulation by the Commission does not imply safety of investment in such companies."
67. For general discussions of the act, see Loss, Securities Regulation 94-102, 269-75 (1951); Jaretzki, The Investment Company Act of 1940, 26 Wash. U.L.Q. 303 (1941); Motley, Jackson, and Barnard, Federal Regulation of Investment Companies since 1940, 63 Harv. L. Rev. 1134 (1950).
68. See text at notes 38-40 supra.
69. Loss, Securities Regulation 36-38 (1951).
71. Loss, Securities Regulation 56-58 (1951); McCormick, Understanding the Securities Act and the SEC 12 (1948).
forces the truth out into the open where it is likely to affect the price
and marketability of a security in competition for investor funds,
and since it provides remedies for fraud. Further, such regulation
may be well suited for regulating the sale of securities since the na-
ture of a security is generally well understood and since more
stringent regulation would probably unduly restrain honest capital
raising ventures. But the variable annuity will usually be purchased
by unsophisticated persons who do not understand the nature and
complexity of such a product. No amount of disclosure will be ade-
quate to protect such persons. Further, the sale of variable annuities
is not a capital raising venture, but a means of providing retirement
income. Consequently, it is not necessary to balance the interest of
freedom of investment with the interest of protecting the individual.
It would seem, therefore, that a more comprehensive system than
that offered by securities regulation is desirable for protection of the
variable annuity policyholder.

Existing insurance regulation

The theory of insurance regulation in general requires that fair
methods be used in selling a fair policy and that the company be
maintained in such financial condition that it will be able to pay all
claims present and future.

Regulation of salesmen is accomplished through licensing in all
states. Regulation of salesmen is accomplished through licensing in all
states.\textsuperscript{72} Issuance of the license is generally dependent upon passing
an examination or meeting certain standards of training\textsuperscript{73} and the
license is subject to revocation for a violation of the insurance code.

In most states, insurance policy forms must be filed with and
approved by the insurance commissions.\textsuperscript{74} Approval of such forms
may not be given, or a previously filed form may be suspended, if
the policy does not meet statutory standards or if it is unfair or un-
just.\textsuperscript{75} Unfortunately, some states except annuity policies from all\textsuperscript{76}
or part of\textsuperscript{77} these provisions.

Insurance regulation typically provides for control over business
getting methods through unfair trade practices acts\textsuperscript{78} and misrepre-
sentation and twisting statutes.\textsuperscript{79} While some states have been lax in
enforcement in this area, the recent FTC effort to enter the regula-

\textsuperscript{72} Patterson, Essentials of Insurance Law 45 (2d ed. 1957).
\textsuperscript{73} Id. at 46.
\textsuperscript{74} Id. at 36.
\textsuperscript{75} Mehr and Osler, Modern Life Insurance 693 (Rev. ed. 1956).
\textsuperscript{76} See, e.g., Minn. Stat. § 61.38 (1) (1953).
\textsuperscript{77} See, e.g., Del. Code Ann. tit. 18, § 951(f) (1953).
\textsuperscript{79} E.g., Minn. Stat. § 61.10 (1953).
tion of insurance advertising\textsuperscript{80} has stimulated state legislation to strengthen this type of regulation and its enforcement.\textsuperscript{81}

In almost all states there are effective quantitative and qualitative standards for the investments which may be made by insurance companies in common stocks.\textsuperscript{82} These standards generally limit the company to purchase of stock in liquid companies with good earning records. Although perhaps too restrictive in some respects and not enough in others, these standards clearly do provide a substantial measure of protection to the policyholder.

The Unauthorized Insurers Service of Process Act in effect in forty-two\textsuperscript{83} states serves as an effective aid in enforcement of these insurance laws. As an example, it provides for personal jurisdiction over a company which merely mails advertising or a policy into a state.\textsuperscript{84}

Clearly then the variable annuity should be subject to insurance-type regulation since it would provide more adequate protection for the interests of the variable annuity policyholder than securities regulation. However, whether or not a particular state is sufficiently regulating the variable annuity as insurance to meet the standards of the statutory exemption may be another matter.\textsuperscript{85} For example, in some states, the variable annuity may not even be subject to insurance regulation under existing law.\textsuperscript{86} But if the variable annuity company is not subject to insurance regulation in a particular state,

\textsuperscript{80} See National Casualty Co. v. FTC, 245 F.2d 883 (6th Cir. 1957); cert. granted, 355 U.S. 867 (1957); American Hospital and Life Ins. Co. v. FTC, 243 F.2d 719 (5th Cir. 1957); cert. granted, 355 U.S. 867 (1957).

\textsuperscript{81} See 1957 Proc. N.A.I.C., 329-32.

\textsuperscript{82} See text at notes 126-41 infra.


\textsuperscript{84} Calif. Ins. Code Ann. §§ 1610-11 (West 1956). The act was held constitutional where the only contact with the state was a single policy sent through the mail. McGee v. International Life Ins. Co., 355 U.S. 220 (1957).

\textsuperscript{85} The prerequisite for exemption is that the contract be issued by a corporation "subject to the supervision of the insurance commissioner." 48 Stat. 76 (1933), as amended, 15 U.S.C. § 77c(a)(8) (1952). (Emphasis added.) On its face this exemption does not seem to call for an examination of the adequacy of a particular state's insurance regulation. However, some contend that such an examination is required by the act. For a discussion of this problem in a related area, see Kimball and Boyce, The Adequacy of State Insurance Rate Regulation: The McCarran-Ferguson Act in Historical Perspective, 56 Mich. L. Rev. 545, 566-78 (1958).

\textsuperscript{86} For instance, the Arizona court has held that annuities are not insurance. Corporation Comm'n v. Equitable Life Assur. Soc'y, 73 Ariz. 171, 239 P.2d 360 (1951). Consequently, it could be argued that a variable annuity company would not be subject to insurance regulation in that state. However, if such a company, unregulated by the insurance laws in its home state, attempts to do business in any other state, then the latter state can characterize the nature of the business for itself and may refuse a license to do business on the ground that the company is not sufficiently regulated to protect the purchasers of its contracts. Cf. Minn. Stat. § 71.16 (1953); State
then that portion of its business will not be exempted from federal regulation. Consequently, such a company need not go wholly unregulated.

In the final analysis, since insurance-type regulation is preferable to securities regulation, the choice to regulate should be in the states, as it is in other areas of insurance regulation, since most states would adequately regulate the variable annuity as insurance. Such a result is consistent with the apparent congressional intent of leaving to the states a subject adequately regulated by the states. Dual regulation, that is, regulation by a state as insurance and by the SEC as a security, would be a possibility if the variable annuity is found by a federal court to be exclusively a security and not an annuity. However, it seems that such securities regulation would add little protection not already provided by insurance regulation. The burden of such dual regulation therefore seems unjustified.

III. PROPOSED REGULATION

Although at the present time regulation of the variable annuity under state insurance laws appears preferable to regulation under federal laws, state insurance regulation has some serious defects as a plan for complete protection of the variable annuity policyholder.

In order to fill these gaps, two comprehensive systems for the regulation of variable annuities have been proposed. The first is a set of recommendations by the National Association of Insurance Commissioners (NAIC), and the second is a set of bills proposed ex. rel. American Indemnity Co. v. Brown, 189 Minn. 497, 250 N.W. 2 (1933).

Another defect in state insurance regulation is lack of uniformity. However, the same defect exists in securities regulation since state regulation is specifically preserved. 48 Stat. 85 (1933), 15 U.S.C. § 77r (1952).

87. See text at note 29 supra. If the sale of a contract is not subject to regulation in a particular state, then it should not be exempt under provisions of 48 Stat. 76 (1933), as amended, 15 U.S.C. § 77c(a) (8) (1952).

88. For example, the regulation of insurance advertising, 59 Stat. 34 (1945), as amended, 15 U.S.C. § 1012(b) (1952).

89. It is important to note that the investment industry is not foreclosed from the sale of variable life annuities by classifying them as insurance, since investment companies could enter the field, subject to adequate regulation, by forming insurance companies to sell such contracts. 54 Stat. 808 (1940), 15 U.S.C. § 80a-12(g) (1952).

90. The NAIC has not taken a position either for or against the sale of variable annuities by life insurance companies. However, a committee has drawn up recommendations for regulation in the event sale of these policies is permitted. For the full text of these recommendations, see 1956 Proc. of NAIC 164-65. These recommendations will hereinafter be cited as: NAIC Proposal.

On the other hand, the National Association of Commissioners on Uniform State Laws and the National Association of Securities Administrators are apparently not in doubt on the subject. The new Uniform Securities Act provides for regulation of variable annuities as securities. See Loss and Cowett, Blue Sky Law 350-51, 356-67 (1958).
for enactment in New Jersey. Also, the Insurance Commissioner of West Virginia has actually promulgated rules based upon these proposals to regulate the sale of variable annuities in that state.

A. Authorization to Issue Variable Annuity Policies

Insurance companies

The proposed New Jersey bills specifically authorize issuance of variable annuities by an insurance company. This may be unnecessary since strong arguments can be made that insurance companies could engage in the sale of variable annuities in most states without changing existing statutes. However, specific legislative authorization would resolve any possible controversy and therefore appears advisable.

Separate companies

The NAIC and a number of companies in the insurance industry advocate that the sale of variable annuities be limited "to separate and distinct companies limited to such activity." On behalf of this proposal it has been argued that the use of separate companies would reduce the chance of public misunderstanding of the nature of the contract by avoiding confusion with conventional insurance. In addition, it is believed by some that this separation will protect

91. New Jersey Assembly Bills Nos. 11, 12, and 13, introduced January 24, 1957 and referred to the Committee on Business Affairs. These and similar bills have been approved by the New Jersey Department of Banking and Insurance but have failed to pass in 1955, 1956, and 1957. It is planned to re-introduce the bills in 1958. See National Underwriter, Dec. 23, 1957, p. 9, col. 3. No. 11 is a modification of New Jersey reserve laws; No. 12 authorizes an insurance company to establish a separate variable contract account; and No. 13 contains most of the regulatory provisions for variable annuities. The bills are sponsored by the Prudential Insurance Company of America which has its home office in New Jersey. Bill No. 13 will hereinafter be cited as: New Jersey Proposed Bill.


93. New Jersey Proposed Bill No. 12, § 1.

94. A fraternal benefit society was enjoined from issuing a variable endowment policy in Spellacy v. American Life Ins. Ass'n, 144 Conn. 346, 131 A.2d 834 (1957). An endowment is really a combined annuity and life insurance policy. The court held that since "endowment" meant payment of fixed sum benefits, the association was not authorized either by charter or law to issue such variable policies.

95. NAIC Proposal 1.

the insurance industry from losing goodwill due to possible unfavorable experience with the variable annuity.\textsuperscript{97}

However, it seems doubtful that these ends will be accomplished by using the legal sophistication of the separate corporate entity. First, the relationship of the subsidiary to the parent may be revealed by the name of the subsidiary, advertising, or through representations made by agents. Secondly, if the same salesmen sell both conventional insurance and variable annuities, the separation will be indiscernible to the public. That this method of distribution probably will be used seems clear. It is cheaper than employing new salesmen to sell only variable annuities since present salesmen already have established contacts, and natural since the average individual seeking information about the variable annuity will probably ask his present agent. Furthermore, this method of distribution seems more desirable than distribution by salesmen selling only variable annuities since misrepresentation is less likely to occur when a salesman has more than one product to sell.

Another claimed advantage of the separate company proposal is that it may limit the scope of federal regulation to the subsidiary if the variable annuity is found to be subject to such regulation.\textsuperscript{98} However, it seems doubtful that federal agents will be effectively restrained by corporate form from probing into activities of the parent which affect the subsidiary.

Finally, the proposal will cause economic waste. Most insurance companies will incur large expenses in organizing a subsidiary and licensing it in many states. Further, transfers of funds between the two organizations due to changes in mortality experience and transfers back and forth from fixed to variable plans would be more difficult and expensive than transfers within a single company.\textsuperscript{99}

\section*{B. Licensing of Agents}

Along with the usual requirement for examination and licensing of agents,\textsuperscript{100} the West Virginia commissioner requires that agents selling variable annuities pass a special examination on that subject.\textsuperscript{101}

\begin{itemize}
\item \textsuperscript{97} See National Underwriter, Dec. 30, 1955, pp. 2, 15-16.
\item \textsuperscript{98} See id. at p. 15.
\item \textsuperscript{99} For a statement of objections to the use of separate companies, see Kvernland, \textit{supra} note 13, at 377-78.
\item \textsuperscript{100} \textit{E.g.,} N.Y. Ins. Law § 114(2) ; see text at note 70 \textit{supra}.
\item \textsuperscript{101} W. Va. Rules § IV.
\end{itemize}
C. Policy Forms

In addition to the normal insurance regulatory controls over the contents of policies, the proposals provide for certain other policy standards. First, they require a clear statement on the first page in "bold face type in contrasting color and in contrast with other portions of the text" that the benefits are not guaranteed but variable. Second, the policy must contain a guarantee of mortality and expense factors. Third, there must be a complete statement of the specific procedures to be used in calculating payments and benefits. Fourth, there is a limitation on the amount of the first payment to the policyholder which may be guaranteed. This limitation is apparently designed to eliminate the possibility of the policyholder being misled by an unreasonably high guaranteed first payment to expect similar amounts thereafter. Fifth, in order to discourage use of the variable annuity as a means of speculation, the proposals provide that the cash value of the annuity cannot be withdrawn in a lump sum. Along this same line, the New Jersey bill provides that the withdrawal payments must be made on a variable basis over a period of three years.

D. Business Getting Methods

The insurance commissioner in most states already seems to have sufficient power to regulate business getting methods through misrepresentation and twisting statutes and the unfair trade practices acts. The NAIC recommends these statutes. The New

102. See text at notes 74-77 supra. All three regulatory schemes provide for filing and approval of variable annuity policy forms. W. Va. Rules § III(A); New Jersey Proposed Bill § 3(a); NAIC Proposal 5. Two of the plans require nonforfeiture clauses. W. Va. Rules § III(E); New Jersey Proposed Bill § 3(c)(1).

103. In addition to the proposals discussed in the text, all three plans provide for annual reports to policyholders indicating the number of units credited and accumulated and the value per unit. New Jersey Proposed Bill § 3(c)(iii); NAIC Proposal 6; W. Va. Rule § VIII. All three provide for limitations on the percentage of appreciated assets which may be withdrawn for stockholders of a stock company. New Jersey Proposed Bill No. 12 § 8; NAIC Proposal 10; W. Va. Rules § IX. Two prohibit borrowing for the variable annuity fund or pledging its assets. New Jersey Proposed Bill No. 12 § 4; NAIC Proposal 12.

104. W. Va. Rules § III(C); see New Jersey Proposed Bill § 2.

105. W. Va. Rules § I(1); New Jersey Proposed Bill § 3(e); NAIC Proposal 9 (expenses only).

106. W. Va. Rules § III(B); New Jersey Proposed Bill § 3(e).

107. W. Va. Rules § III (H); New Jersey Proposed Bill § 3(e).

108. NAIC Proposal 8; New Jersey Proposed Bill § 3(d).

109. New Jersey Proposed Bill § 3(d); NAIC Proposal 8 (3-5 years).

110. See notes 78-81 supra and accompanying text. The New Jersey Proposed Bill adds a sanction by providing that approval of the policy form can be suspended if "sales of such contracts are being solicited by any
Jersey bill, as an additional safeguard, specifically prohibits illustrations of benefits through projections of past investment experience into the future. However, such a prohibition seems of little value since the prospective purchaser will instinctively make the projection for himself. The West Virginia commissioner has added a seemingly worthwhile provision that disclosure must be made of whose past investment experience is being illustrated during sales presentations and specifically that it is not the actual experience of the selling company. Another safeguard could be provided by requiring on the application for the policy a statement to the effect that the applicant understands that the benefits are variable and may go down as well as up, and that he understands the importance of maintaining balance and continuing payments in low market years.

E. SEGREGATION OF PORTFOLIO

Unless separate companies are formed to sell variable annuities, the issuing company will have to segregate a portion of its investment portfolio to establish the variable annuity fund. While no statutes governing the investments and reserves of insurance companies have been found which expressly prohibit such a segregation, it is not the traditional practice. However, since it is clear that establishment of the fund is merely a means of accounting for payments and calculating benefits and is not intended to grant to the variable annuity policyholder any preferred right to the segregated assets in the event of liquidation, the practice should be allowed. Nevertheless, specific legislative authorization for the segregation has been sought in New Jersey and may be advisable in other states to resolve any possible controversy.

F. BALANCING

To reduce the effect of the severity of stock market lows on the variable annuity policyholders, it is agreed by all concerned that some sort of "balance," that is, combination of fixed
and variable plans, is desirable. Proposals have varied from requiring balance to only recommending balance to the annuitant. The proposed New Jersey legislation and the rules promulgated by the West Virginia commissioner require that balance be achieved only at the time a policy is purchased. This is accomplished by prohibiting a company from accepting an application for a variable annuity policy unless the applicant already has, or simultaneously will purchase, fixed value plans to balance against the variable benefit plans. The NAIC would require not only initial establishment but also maintenance of balance.

While the theory of insurance regulation is to some extent paternalistic, the requirement of balance, referred to by some as the “brother’s keeper clause,” appears unprecedented. Such a requirement is apparently designed to keep the purchaser from spending his money foolishly. But the law has never attempted to prohibit an individual from spending his money unwisely on insurance. For instance, the purchaser of conventional insurance is not prohibited by law from overbuying, which may eventually result in loss of his entire program; or from spending all his money on nonconvertible term insurance, although the results may be disastrous. Further, it appears that most insurance companies will voluntarily either impose appropriate balancing requirements or strongly urge balance since goodwill may suffer if policyholders have too much of their insurance programs in variable annuities during a period of low stock prices. Also, overselling of variable annuities could lead to cancelled policies which are costly to the company. Finally, it is clear that any legal requirement of balance would be extremely difficult to administer and enforce.

Probably the only real dangers in this area are from operations of fly-by-night companies and overselling by agents. There are

---

116. Balancing thus establishes a floor on the benefits to be received, i.e., the amount of fixed benefits will be the least that the annuitant would receive. However, balancing also results in reducing the peaks in the market.


118. Kvernland, supra note 13, at 375-77.

119. New Jersey Proposed Bill § 3(a) (iii).

120. W. Va. Rules § II.

121. This requirement is enforced through the power to revoke approval of use of the variable annuity policy form. See New Jersey Proposed Bill § 3(a) (iii). Regarding what may be considered as “fixed” benefit plans, see Kvernland, supra note 13, at 375-77; Mitchell, supra note 96, at p. 1.

122. NAIC Proposal 2.

123. See Kvernland, supra note 13, at 375.

124. Id. at 375-77; Mitchell, supra note 96, at p. 16.
effective ways to limit such activities without restricting the amount of policies which a purchaser may acquire. First, companies can be discouraged from entering this field by placing limitations on the amount which can be deducted from the gross premium by the company for expenses and management fees. If this amount is placed at a relatively low, although reasonable, level in comparison with other insurance policies, there will be little temptation for the “fast buck” promoter to enter this field for a “killing.” Further, agents can be discouraged from overselling variable annuities by requiring commissions on such policies to be substantially lower than commissions on other insurance policies. Although not traditional in the regulation of insurance, such requirements would effectively prevent large scale overselling and fly-by-night operations and yet preserve the freedom of an individual to choose the program best suited to his needs.

G. INVESTMENT CONTROLS

While protection of policyholders through controls on investments may restrict a public interest in freedom of investment, this conflict has traditionally been resolved in favor of the former.

Quantitative standards

Typically, insurance companies are allowed to invest only five to ten percent of their total assets in common stocks. Consequently, it will not be long until the variable annuity portfolio will reach such a size that a company will have to liquidate other common stocks held by the company so that the overall proportion of common stocks to the entire assets will not exceed the amount allowed by law. However, policyholder suits could result from such action since dividends on conventional policies probably would decrease if the company has to allocate all of its common stock to the variable annuity account. This problem should be solved at an early stage in order to avoid such difficulties in later years.

In order to avoid control of other corporations by insurance companies, state insurance codes commonly provide a limit, typi-
cally five percent,\textsuperscript{127} on the percentage of the stock of another corporation which may be held by an insurance company. The West Virginia rules specify that this limitation shall be five percent for any company which sells variable annuities,\textsuperscript{128} while the NAIC recommends three percent.\textsuperscript{129} Such a standard appears to afford substantial protection from use of the fund as a vehicle for control without unduly restraining freedom of investment.

To insure that any one loss will not have a substantial adverse effect on the entire portfolio, it is common practice to diversify investments. However present insurance laws do not adequately require such diversification. When such requirements exist,\textsuperscript{130} they are phrased in terms of percentages of the entire assets of the company which may be invested in any one corporation. While such limitations may provide sufficient protection for the policyholders as a whole of a conventional insurance company, they are grossly inadequate to protect variable annuity policyholders. The insurance company can invest the entire variable annuity fund in one corporation and yet remain within a percentage of total assets limitation. It would seem advisable, therefore, to set a limit on the percentage of the variable annuity fund, considered separately, which may be used to hold the stock of any one company.

\textbf{Qualitative standards}

Most states impose qualitative standards for the common stocks which may be purchased by an insurance company. The standard most often used is that the company whose stock is purchased must have had a specified percentage of earnings available for dividends on its common stock during a certain number of years,\textsuperscript{131} usually about four, immediately prior to the purchase. On the whole, these standards are satisfactory, although they may prove too restrictive during and just after a severe recession.

Another common qualitative standard is the requirement that only stocks listed on a national exchange may be purchased.\textsuperscript{132} Both the NAIC\textsuperscript{133} and the West Virginia rules\textsuperscript{134} provide for such

\begin{itemize}
\item \textsuperscript{127} E.g., Ill. Ann. Stat. c. 73, § 737(3) (Smith-Hurd 1957) (5%).
\item \textsuperscript{128} W. Va. Rules § VI(2).
\item \textsuperscript{129} NAIC Proposal 3(b).
\item \textsuperscript{131} E.g., Minn. Stat. Ann. § 61.11(5)(b) (Supp. 1957). The NAIC has recommended such a provision. NAIC Proposal 3(c). In West Virginia and New Jersey, the company would be subject to the usual laws governing investment of insurance companies. The Minnesota standards, cited above, are based on the meaningless concept of par value, unfortunately.
\item \textsuperscript{132} E.g., Ill. Ann. Stat. c. 73, § 737(3) (Smith-Hurd 1957).
\item \textsuperscript{133} NAIC Proposal 3(d).
\item \textsuperscript{134} W. Va. Rules § VI(5).
\end{itemize}
a limitation. Considering the protections furnished through regulation of listed stocks and the volume of such stocks available, it seems that the advantages of such a restriction outweigh the disadvantages.

The NAIC and the West Virginia rules provide for a prohibition on purchases of stock which will result in "conflicts of interest, including any between officers and directors of the variable annuity company and the corporation whose stock is purchased." If strictly interpreted and enforced, such a provision could be a serious limitation both on the stocks which could be purchased and the availability of capable officers and directors to head insurance companies. Further, the proposal seems unnecessary since the common law already provides sufficient controls over abuses arising out of conflicts of interest.

Both the NAIC and West Virginia prohibit investment in the common stock of any insurance company, national or state bank, or trust company. This restriction is probably designed to avoid interlocking of institutional investors and acquisition of stocks which may be subject to assessment.

When taken together, the limitations recommended above may restrict investments of insurance companies to such a narrow market that inflation in value of eligible stocks will eventually result. It would seem that the dangers which these limitations are designed to prevent can be largely eliminated by expressing certain restrictions in terms of percentage limitations rather than as absolute prohibitions. For example, a small percentage of the variable annuity portfolio, perhaps five to ten percent, could be allowed for purchasing unlisted securities and institutional stocks not subject to assessment.

135. National exchanges must register with the SEC under provisions of the Securities Act of 1934. The exchanges regulate and discipline members for violations of the securities law and exchange rules; the SEC has power over certain substantive areas of these rules. Over-the-counter brokers are subject to some regulation, however. See Loss, Securities Regulation 84-85 (1951).
136. As of June 30, 1956 there were 2,659 stocks listed; on Dec. 31, 1955, the unduplicated market value of listed stock issues was $238,832,003,000. 22 SEC Ann. Rep. 91-94 (1956).
137. NAIC Proposal 3(e).
139. NAIC Proposal 3(e).
FEDERAL ENFORCEMENT OF GRIEVANCE ARBITRATION PROVISIONS UNDER THE DOCTRINE OF LINCOLN MILLS

INTRODUCTION

A collective bargaining agreement is an agreement resulting from negotiations between an employer and the union representing its employees, which provides standards to govern their labor relations. The agreement differs from the familiar commercial contract in which the parties generally provide for every essential term of the particular transaction involved. The commercial contract is usually intended to fix as rigidly as possible the legal obligations of each party notwithstanding future changes in economic conditions. In the collective bargaining agreement, however, the parties almost invariably intend to keep their obligations adaptable to changing conditions through the process of renegotiation. No matter how much time the parties devote to negotiation, a careful consideration of all the problem areas—for example, new work processes, overtime, promotions, and layoffs—in the light of all possible changes in economic and social conditions would be impossible. The agreement provides only the framework for an autonomous system of self-government under which the private enterprise can function effectively in spite of changing circumstances or unforeseeable problems.  

Labor relations problems frequently arise for which the existing agreement provides no specific solution. These problems are generally handled through a grievance settlement procedure, established by the agreement, which includes conferences between various company and union officials. If all the conferences are unsuccessful, the agreements commonly provide for arbitration of the dispute as the final step in the grievance procedure. The purpose of this Note is to survey the extent to which these arbitration agreements can be enforced in the federal courts, particularly under the recent Supreme Court decision in Textile Workers Union v. Lincoln Mills, and to suggest some possible improvements in the law regarding their enforcement.

THE ARBITRATION Process

Arbitration has been defined as:

The reference of a dispute by voluntary agreement of the parties to an impartial person for determination on the basis of evi-

dence and argument presented by such parties, who agree in advance to accept the decision of the arbitrator as final and binding. Arbitration, therefore, is a judicial proceeding and different in nature from mediation, conciliation, negotiation and other forms of dispute settlement.  

But the arbitrator, like a probate or juvenile court, has only limited jurisdiction as opposed to the general jurisdiction of a district court. The arbitrator's jurisdiction extends only to disputes which he is authorized to arbitrate under the terms of the particular contract arbitration provision, that is, only to arbitrable disputes. The arbitration clause may be strictly limited to a few carefully defined types of disputes, it may be applicable to all problems of interpreting and applying the other provisions of the contract, or it may extend to any dispute concerning the employment relationship during the time the contract is in effect even though the contract does not deal with the particular problem area. Thus, when negotiating the terms of the agreement, the parties determine on which issues an arbitrator's award would be acceptable should they themselves fail to reach a settlement.

A court may be called upon to enforce the arbitration provision in three ways. First, damages may, and often will, be awarded for losses suffered due to the defendant's failure to arbitrate, although in many cases it is very difficult to establish the amount of damages.


4. Although most collective bargaining agreement arbitration clauses provide for arbitration of grievances, some provide for arbitration of disagreements during the negotiation of terms for a new contract. This Note is concerned with grievance arbitration but a brief comment on new contract arbitration is appropriate. In Boston Printing Pressmen's Union v. Potter Press, 241 F.2d 787 (1st Cir. 1957), the Court of Appeals distinguished between enforceable "quasi-judicial" arbitration of grievances under an existing contract, and unenforceable "quasi-legislative" arbitration of disputes over new contract terms. This distinction turned on the court's construction of the United States Arbitration Act, 61 Stat. 669 (1947), 9 U.S.C. § 1 (1952), but it was apparently based on the policy that no arbitrator should perform the function of making the parties' contract for them. However, the whole arbitration process is contrary to this policy; each time an arbitrator settles a dispute by handing down an enforceable final award, he is in effect making a new contract provision. There seems to be little justification for permitting the arbitrator to form new provisions for an existing contract, but not to form provisions for a future contract to replace the existing one when it expires; in either case, the parties have voluntarily agreed to let the arbitrator settle their dispute. Nevertheless, the distinction has been made, and it is possible that some courts might consider "quasi-legislative" arbitration agreements unenforceable as contrary to public policy. See Note, Federal Enforcement of Agreements to Arbitrate New Contract Terms, 52 Nw. U.L. Rev. 284 (1957).

5. See, e.g., International Brotherhood of Teamsters, Local 25 v. W. L. Mead, Inc., 230 F.2d 576 (1st Cir. 1956) (employer awarded $359,000 damages). In awarding damages, the courts enforce the party's common law right to damages for breach of contract.
Second, the parties may be ordered to comply with the arbitrator's final award on the rationale that the award is an addendum to the contract. Courts have been very willing to follow this method. Third, a mandatory injunction may be issued ordering a defaulting party to submit to arbitration. The court compels the parties to accept their own voluntary selection of arbitration as the procedure for settling their disputes. This Note is concerned primarily with the third method, specific enforcement of executory arbitration agreements.

At common law an agreement to arbitrate future grievances was unenforceable, apparently because the courts were opposed to compelling a reluctant party to submit to an arbitrator instead of to the courts for adjudication of his dispute. Nevertheless, once the parties submitted to arbitration, courts would enforce the final award. However, modern legislative policy has favored enforcing even executory arbitration agreements in order to promote industrial peace.

**UNITED STATES ARBITRATION ACT**

The United States Arbitration Act provides that contract arbitration clauses "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." The act empowers a federal court having jurisdiction under a separate statute to order compliance with an arbitration agreement.

---


7. Katz and Jaffe, supra note 6, at 81.


tration clause in a "contract evidencing a transaction involving commerce." Although that language tends to indicate that the act should apply to collective bargaining agreements, the legislative history and the contemporaneous commentaries support the conclusion that Congress was concerned solely with the enforcement of arbitration agreements in commercial contracts. Prior to 1947, there were apparently no cases in which the provisions of the act were invoked to enforce a collective bargaining arbitration clause. More recently, however, there have been frequent attempts to enforce such clauses under the act, and the courts have split on the question whether a collective bargaining agreement is a "contract of employment," to which the act is expressly inapplicable.

The United States Supreme Court has not clearly resolved the question of applicability of the act to collective bargaining agreements even though cases adopting each view have reached the Court. In one case, where the lower court had granted specific

---


For cases holding that the Arbitration Act does not apply to collective bargaining agreements, see United Steelworkers v. Galland-Henning Manufacturing Co., 241 F.2d 323 (7th Cir. 1957); Textile Workers Union v. Lincoln Mills, 230 F.2d 81 (5th Cir. 1956), rev'd on other grounds, 353 U.S. 448 (1957); Pennsylvania Greyhound Lines v. Amalgamated Ass'n of Street Coach Employees, Division 1063, 193 F.2d 327 (3d Cir. 1952); International Union United Furniture Workers v. Colonial Hardware Flooring Co., 168 F.2d 33 (4th Cir. 1948).

For contrary holdings, see Local 205, United Electrical Workers v. General Electric Co., 233 F.2d 85 (1st Cir. 1956), aff'd on other grounds, 353 U.S. 547 (1957); Hoover Motor Express Co. v. Teamsters Union, Local 327, 217 F.2d 49 (6th Cir. 1954); Lewittes & Sons v. United Furniture Workers, 95 F. Supp. 585 (S.D.N.Y. 1951).

For a discussion of these cases, see Mendelsohn, Enforceability of Arbitration Agreements Under Taft-Hartley Section 301, 66 Yale L.J. 167, 172-79 (1956).

enforcement of the arbitration agreement on the basis of the act, the Court implied that the act was not applicable:

We follow in part a different path than the Court of Appeals, though we reach the same result. 18

Nevertheless some provisions of the act may be useful guides for federal courts in enforcing arbitration agreements, and these provision will be discussed in greater detail later in this Note.

**TAFT-HARTLEY § 301 AND LINCOLN MILLS**

The different path followed by the Supreme Court was § 301 of the Taft-Hartley Act which provides, in part:

(a) Suits for violation of contracts between an employer and a labor organization representing employees in an industry affecting commerce as defined in this Act, or between any such labor organizations, may be brought in any district court of the United States having jurisdiction of the parties, without respect to the amount in controversy or without regard to the citizenship of the parties.

(b) Any labor organization which represents employees in an industry affecting commerce as defined in this Act shall be bound by the acts of its agents. Any such labor organization may sue or be sued as an entity and in behalf of the employees whom it represents in the courts of the United States. Any money judgment against a labor organization in a district court of the United States shall be enforceable only against the organization as an entity and against its assets, and shall not be enforceable against any individual member or his assets. 19

Section 301 obviously was designed to confer federal jurisdiction over cases involving breach of a collective bargaining agreement without regard to diversity of citizenship or amount in controversy, but it is not clear whether or not Congress also intended the section to create federal substantive rights. This problem was raised in *Lincoln Mills* and two companion cases, *General Electric Co. v. Local 205, United Electric Workers* 20 and *Goodall-Sanford, Inc. v. United Textile Workers, Local 1882*, 21 where the Supreme Court held that an arbitration agreement is enforceable as a matter of substantive right under § 301 (a). 22 Although in each of these cases

---


Mr. Justice Douglas' majority opinion was joined by Mr. Chief Justice
it was the union which sought an injunction compelling the employer to arbitrate, the Court interpreted Taft-Hartley to express broad legislative policy for enforcing collective bargaining agreements both on behalf of and against labor organizations.\textsuperscript{23}

The \textit{Lincoln Mills} doctrine runs clearly contrary to the philosophy that the law serves no useful function in the adjustment of labor disputes. Mr. Justice Frankfurter, dissenting in \textit{Lincoln Mills}, states:

\begin{quote}
\textit{[J]udicial intervention is ill-suited to the special characteristics of the arbitration process in labor disputes. \ldots The arbitration is an integral part of the system of self-government. And the system is designed to aid management in its quest for efficiency, to assist union leadership in its participation in the enterprise, and to secure justice for the employees. It is a means of making collective bargaining work and thus preserving private enterprise in a free government. When it works fairly well, it does not need the sanction of the law of contracts or the law of arbitration. It is only when the system breaks down completely that the courts' aid in these respects is invoked. But the courts cannot, by occasional sporadic decision, restore the parties' continuing relationship; and their intervention in such cases may seriously affect the going systems of self-government. When their autonomous system breaks down, might not the parties better be left to the usual methods for adjustment of labor disputes rather than to court actions on the contract or on the arbitration award?}^{24}
\end{quote}

But enforcing the arbitration agreement may not be entirely in-

---


\textsuperscript{24} 353 U.S. at 462-64 (emphasis added). The quotation is from Shulman, \textit{Reason, Contract, and Law in Labor Relations}, 68 Harv. L. Rev. 999, 1024 (1955).
consistent with this judicial "hands-off" policy. The court intervenes only to the extent of compelling submission of the dispute to arbitration. It is the arbitrator and not the court who resolves the dispute. The arbitrator, selected by the parties themselves to make these decisions, is normally a labor relations expert who understands the "special characteristics" of the dispute far better than do courts. He often deals primarily or even exclusively with labor problems. Unlike a court, the arbitrator could be considered an essential part of a successful autonomous system of self-government. Unhampered by rigid and formal procedural requirements, the arbitrator is better able to arrive at a sound and speedy result.

The "hands-off" philosophy tends to minimize the public interest in preventing the tremendous impact of industrial warfare on the public, aside from its affect on the employers and workers in the particular industry involved. Perhaps the Court felt this substantial public interest outweighed the interest of preventing judicial intervention into this type of labor relations problem. The *Lincoln Mills* majority stated:

> Plainly the agreement to arbitrate grievance disputes is the *quid pro quo* for an agreement not to strike. Viewed in this light, the legislation does more than confer jurisdiction in the federal courts over labor organizations. It expresses a federal policy that federal courts should enforce these agreements on behalf of or against labor organizations and that *industrial peace* can be best obtained only in that way. . . . We would undercut the Act and defeat its policy if we read § 301 narrowly as only conferring jurisdiction over labor organizations.\(^{26}\)

Desirable or not, the *Lincoln Mills* doctrine has been established, and the law must develop accordingly. Analysis of this doctrine will show that the development of federal substantive law may be arduous for three reasons: (1) the scope of federal jurisdiction under § 301 is unclear; (2) the courts are given insufficient procedural guidance to develop federal law of labor arbitration effectively; and (3) the power of the court to enjoin certain acts may conflict with the federal anti-injunction laws.

**A. Scope of Federal Jurisdiction**

*The Westinghouse Case*

Jurisdiction under § 301 is limited to violations of a contract between an employer and a labor organization or a contract between labor organizations.\(^{26}\) Thus, a union has no standing under § 301

\(^{25}\) 353 U.S. at 455, 456.

to enforce rights of an employee which do not arise from the collective bargaining agreement. Association of Westinghouse Salaried Employees v. Westinghouse Electric Corp.\(^2\) presented the question whether employee claims to back pay wrongfully withheld arose from the collective bargaining agreement or whether such claims were uniquely personal rights arising solely from the individual hiring contracts. By a sharply divided Supreme Court, it was held that the union had no standing to enforce these claims.

In Lincoln Mills and its companion cases the Court enforced the arbitration of grievances similar to those in Westinghouse. Thus, the question arises whether Westinghouse is still good law. A comparison of Westinghouse with these later cases suggests three alternative conclusions: (1) the later cases are distinguishable from Westinghouse on the basis of the type of grievance involved; (2) Westinghouse is now, in effect, overruled; or (3) "enforcing arbitration clauses benefits the union, and so the union may sue in its own right, whereas a claim for wages concerns only the men, and so must be sued for by them."\(^2\)

Under the first alternative, standing would depend upon the facts involved in the underlying grievance. Close inquiry into the facts of the four cases discloses that there is no relevant distinction among them. The grievances involved were as follows: Lincoln Mills—work loads and work assignments;\(^{29}\) General Electric—wage rates and a wrongful discharge;\(^{30}\) Goodall-Sanford—wrongful lay-offs;\(^{31}\) Westinghouse—wage claims.\(^{32}\) In all four cases the union was pressing for settlement of grievances between the employer and individual identified employees, not between the employer and the union in its representative capacity. One authority has properly concluded that:

The only factual difference... between the cases is that in Westinghouse the contract did not obligate the parties to arbitrate disputes, so that when the grievance procedure of the contract had been carried through without success the only action left was one for wages.\(^{33}\)

\(^{27}\) 348 U.S. 437 (1955).


\(^{29}\) 353 U.S. at 449.

\(^{30}\) For a statement of the facts, see Local 205, United Electrical Workers v. General Electric Co., 233 F.2d 85, 89 (1st Cir. 1956).


\(^{32}\) 348 U.S. at 439.

It follows that the first conclusion is not correct. Therefore, so long as the grievance is arbitrable, the union does have standing under § 301 to sue for enforcement of the arbitration clause, because either the second or third conclusion, if correct, would clearly require that result. Consequently, the Westinghouse issue can be avoided in every case where the collective bargaining agreement contains an arbitration clause broad enough to encompass all the important incidents of the employment relationship.

Unfair labor practices

Exclusive jurisdiction of the National Labor Relations Board over cases involving "unfair labor practices" as defined in § 8 of the National Labor Relations Act could interfere with § 301 suits in two ways. First, a court may hold that an act which is contrary to the arbitration provision is not an actionable breach of contract when it is done solely in protest to an act by the other party which could reasonably be deemed an unfair labor practice within the Board's jurisdiction. For example, when a union strikes to protest the employer's unfair labor practice, a court may hold that the strike does not violate the contract arbitration or no-strike clauses.

Second, the court has no jurisdiction over a controversy where the plaintiff is complaining of an act or omission which itself is an unfair labor practice. Thus, compensating employees for wages lost due to the employer's unfair labor practice is a matter for the NLRB exclusively. It is well settled that violation of a collective bargaining agreement does not in itself constitute an unfair labor practice.

The Board has stated:

The Board is not the proper forum for parties seeking to remedy an alleged breach of contract or to obtain specific enforcement of its terms.

It could be argued, though, that refusing to arbitrate in accord with the grievance procedure is refusing to bargain collectively, an
unfair labor practice under §§ 8(a)(5) or 8(b)(3). At least refusal by one party to arbitrate can be used as a defense by the other party to a charge that the latter has refused to bargain; the latter party can insist that bargaining follow the prescribed grievance settlement procedure. One authority has stated that:

If either of the parties to a collective bargaining agreement requests the other to participate in the processing of a grievance in accordance with the procedure established therein, the refusal of the other will constitute a violation of Section 8(a)(5) or 8(b)(3).

However, no court has held that refusal to arbitrate is an unfair labor practice, and the Board has carefully avoided making that ruling.

The history of the Taft-Hartley Act seems persuasive that Congress did not intend § 8 to include a refusal to arbitrate. The House and Senate bills on the Taft-Hartley Act both included provisions referring to arbitration. The Conference Committee stated:

[The provision] would have made it an unfair labor practice to violate the terms of a collective bargaining agreement or an agreement to submit a labor dispute to arbitration. The conference agreement omits [these provisions]. Once parties have made a collective bargaining contract the enforcement of that contract should be left to the usual processes of the law and not to the National Labor Relations Board.

Unless this policy is changed, it seems likely that courts will lose jurisdiction to the Board only when the grievance the plaintiff seeks to have arbitrated is itself an unfair labor practice. Except in the two situations mentioned above — where the alleged breach of contract is a protest against an unfair labor practice or where the grievance is itself an unfair labor practice — enforcement of an arbitration agreement under § 301 probably will not be precluded by the exclusive jurisdiction of the NLRB.

40. Timken Roller Bearing Co. v. NLRB, 161 F.2d 949 (6th Cir. 1947).
41. Mathews, Labor Relations and the Law 359 (1953). (Emphasis added.)
42. "[T]he Board does not hold that a failure to arbitrate a dispute is in itself a refusal to bargain in violation of the [National Labor Relations] Act." United Telephone Co. of the West and International Brotherhood of Electrical Workers, 112 N.L.R.B. 779, 781 (1955); See also Textron Puerto Rico (Tricot Division) and Textile Workers Union, Local 24,877, 107 N.L.R.B. 583 (1953).
B. INSUFFICIENT GUIDANCE

In *Lincoln Mills* the Supreme Court ruled that courts must create the substantive law which is to apply in § 301 cases:

We conclude that the substantive law to apply in suits under § 301 (a) is federal law, which the courts must fashion from the policy of our national labor laws... The Labor Management Relations Act expressly furnishes some substantive law. It points out what the parties may or may not do in certain situations. Other problems will lie in the penumbra of express statutory mandates. Some will lack express statutory sanction but will be solved by looking at the policy of the legislation and fashioning a remedy that will effectuate that policy. The range of judicial inventiveness will be determined by the nature of the problem.45

Thus, a court enforcing an arbitration clause under § 301 faces the formidable task of creating applicable law, guided only by the general policy of the national labor laws.

Although the *Lincoln Mills* dictum quoted above delegates to lower courts the tremendous responsibility of molding an entire body of collective bargaining contract law, the courts’ task in connection with enforcing arbitration clauses is limited primarily to developing a standard procedure for court enforcement. Suits for enforcement of an arbitration clause will reach a court in one of four ways. The plaintiff may seek: (1) damages for breach of an arbitration clause; (2) a mandatory injunction ordering the defendant’s submission to arbitration in accordance with the contract clause; (3) a stay of proceedings against him pending arbitration under the clause; or (4) confirmation, modification or vacation of an arbitrator’s final award. In each type of case, once the court has determined that the parties’ grievance is arbitrable within the provisions of a valid collective bargaining contract—a matter of contract law and contract interpretation—the court need only determine the proper procedure for enforcing the arbitration clause. Still, unanswered questions may arise whether, for example, the court can appoint an arbitrator for the parties if they themselves are unable to agree upon one; whether the court can compel witnesses to appear before the arbitrator; whether the court must have personal jurisdiction over both parties before confirming, modifying or changing the arbitrator’s award. Courts must find answers to these and other similar procedural questions before they can develop a consistent federal policy toward labor arbitration. The Taft-Hartley Act does not provide any standard enforcement procedures, and it

45. 353 U.S. at 456-57. (Emphasis added.)
is a little difficult to find answers to the procedural questions in the "policy of our national labor laws."\textsuperscript{46}

The United States Arbitration Act provides standard procedures for court enforcement of arbitration agreements, but that act was apparently never intended to be a "national labor law."\textsuperscript{47} Mr. Justice Frankfurter states in his Lincoln Mills dissent:

Naturally enough, I find rejection, though not explicit, of the availability of the Federal Arbitration Act to enforce arbitration clauses in collective-bargaining agreements in the silent treatment given that Act by the Court's opinion.\textsuperscript{48}

If Justice Frankfurter's reading of the Lincoln Mills majority opinion is correct, then the Arbitration Act is not one of the national labor laws to which courts must look for guidance in § 301 cases. Nevertheless, at least one federal court has been willing to rely on a procedural provision of the act for power to appoint an arbitrator, although the court rejected the act as a basis for enforcing a collective bargaining contract arbitration clause.\textsuperscript{49} This practice of lifting particular sections from federal statutes and applying them out of context according to the particular needs of the case before the court is not likely to promote either sound or uniform law.

The Lincoln Mills Court further instructed the lower courts:

Federal interpretation of the federal law will govern, not state law. . . . But state law, if compatible with the purpose of § 301, may be resorted to in order to find the rule that will best effectuate the federal policy. . . . Any state law applied, however, will be absorbed as federal law and will not be an independent source of private rights.\textsuperscript{50}

This rule allows a court to freely apply or reject the state law depending upon whether, in the judge's opinion, that law is compatible with the purpose of § 301.\textsuperscript{51} Whether or not a particular state rule

\begin{itemize}
  \item \textsuperscript{46} See text at note 45 supra.
  \item \textsuperscript{47} See note 15 supra.
  \item \textsuperscript{48} 353 U.S. at 466.
  \item \textsuperscript{50} 353 U.S. at 457.
  \item \textsuperscript{51} Procedural rules differ considerably among the states. A comparison of state provisions for judicial review of arbitrator's awards, for example, discloses that in Arizona an award is final unless the right of appeal is expressly reserved in the arbitration agreement, although the Arizona court has indicated that an award may be challenged on grounds of fraud or mistake. Ariz. Rev. Stat. Ann. § 12-1506 (1956); U.S. v. Ellis, 2 Ariz. 253, 14 Pac. 300 (1887). In New Mexico an arbitration agreement must contain a provision that the parties agree not to question the arbitrator's award. N.M. Stat. Ann. § 22-3-4 (1953). But in Maine the award must be submitted to a court, and that court has discretion to accept, reject, or recommit the award. Me. Rev. Stat. Ann. c. 121, § 5 (1954). Many states have provisions for vacation or correction of awards on grounds of fraud, corruption or mistake; many others have no provision at all for judicial review of the award.
\end{itemize}
is compatible with the elusive "purpose" of § 301 appears to be a rather speculative matter on which courts are likely to reach conflicting decisions. The Supreme Court divided sharply over the congressional purpose of § 301, and subsequent action by the Court has possibly made even the position of the majority equivocal.

Since the Taft-Hartley Act does not express pre-empt § 301 jurisdiction to the federal courts, state courts probably will also take part in developing the applicable substantive law. At least one state court has already deemed it proper to enforce the federal rights created by § 301, and recent federal action may encourage more state litigation of § 301 cases. The confusion likely to result from conflicting decisions among the courts of the federal circuits will be multiplied by decisions of state and territorial courts.

C. CONFLICT WITH THE FEDERAL ANTI-INJUNCTION ACT

The Lincoln Mills decision established that a federal court's order compelling a party to submit to arbitration does not violate the Norris-LaGuardia Act, which restricts federal jurisdiction to issue injunctions in labor disputes. Norris-LaGuardia § 1 provides, in part:

That no court of the United States, as herein defined, shall have jurisdiction to issue any restraining order or temporary or permanent injunction in a case involving or growing out of a

53. See note 56 infra.
56. Compare Bull S.S. Co. v. Seafarers' Int'l Union, 250 F.2d 326 (2d Cir. 1957), cert. denied, 355 U.S. 932 (1958) (federal court has no jurisdiction to grant a strike injunction to enforce § 301 rights), with McCarroll v. Los Angeles County District Council of Carpenters, 315 P.2d 322 (Cal. 1957), cert. denied, 355 U.S. 932 (1958) (state court has jurisdiction to grant a strike injunction to enforce § 301 rights where state statutes do not preclude that power).
labor dispute, except in strict conformity with the provisions of this Act.\textsuperscript{57}

Section 7 of the act prescribes strict requirements which must be met before an injunction may be granted in a labor dispute. The petitioner must prove:

(a) That unlawful acts have been threatened and will be committed unless restrained or have been committed and will be continued unless restrained . . . ;

(b) That substantial and irreparable injury to complainant’s property will follow;

(c) That . . . greater injury will be inflicted upon complainant by the denial of relief than will be inflicted upon defendants by the granting of relief;

(d) That complainant has no adequate remedy at law; and

(e) That the public officers charged with the duty to protect complainant’s property are unable or unwilling to furnish adequate protection.\textsuperscript{58}

These requirements were clearly designed to limit injunctions to acts of violence, and the petitioner ordinarily cannot satisfy the requirements in an action to enforce an arbitration clause.\textsuperscript{59} The Lincoln Mills Court stated:

Though a literal reading might bring the dispute within the terms of the [Norris-LaGuardia] Act . . . we see no justification for restricting § 301(a) to damage suits, leaving specific performance of a contract to arbitrate grievance disputes to the inapposite procedural requirements of that act.\textsuperscript{60}

The decision raised the question whether or not § 301 suits are exempt from other more specific provisions of the Norris-LaGuardia Act when the Court can see no policy justification for applying

\textsuperscript{59} See Local 205, United Electrical Workers v. General Electric Co., 233 F.2d 85, 92 (1st Cir. 1956), aff'd, 353 U.S. 547 (1957).
\textsuperscript{60} 353 U.S. at 458. (Emphasis added.)

In a footnote following the word inapposite the Court cited Local 205, United Electrical Workers v. General Electric Co., 233 F.2d 85, 92 (1st Cir. 1956), where the circuit court had concluded that:

The enumerated requisites [in § 7], which draw a logical line in relation to union conduct in strikes and picketing (and perhaps to some employer activities), are not at all compatible with the situation where one party merely demands that the other be compelled to arbitrate a grievance in accordance with a contract provision for arbitration, in which latter situation the required findings seldom, if ever, could be made either affirmatively or negatively.

The Supreme Court did not indicate whether it approved the circuit court’s position that “an order to arbitrate could not be accompanied by an injunction against the strike,” 233 F.2d at 95 (emphasis added), or whether it would approve a strike injunction in order to effectively enforce the arbitration clause and promote industrial peace.
those provisions. Section 4 provides that no federal court has jurisdiction to issue "any restraining order or temporary or permanent injunction" against striking or peaceful picketing in a labor dispute case, except in conformity with the stringent requirements of § 7.61 Section 4 applies regardless of the strikers' motives or whether the strike is justified.62

The Taft-Hartley Act does not expressly authorize a federal court to enjoin a strike which violates the arbitration clause or its companion63 no-strike clause, and the question arose in the Bull Steamship cases64 whether the Lincoln Mills interpretation of § 301 lifted the Norris-LaGuardia injunction ban with respect to strikes in breach of the collective bargaining agreement.

The Bull Steamship Cases

The federal district court granted temporary strike injunctions in these cases reasoning that according to Lincoln Mills, § 301 was meant to "insure faithful performance of the entire [collective bargaining] agreement to the end that there should be industrial peace."65 These decisions were reversed by the Court of Appeals:

In the case at bar the Union's conduct comes squarely within § 4 of the Norris-LaGuardia Act. This is a lawful and peaceful strike which Congress said a federal court may not enjoin. The Supreme Court in Lincoln Mills was concerned with a refusal to arbitrate — conduct not protected by § 4 and at odds with congressional policy. It did not involve a strike — the issue here. The ultimate question in Lincoln Mills was whether or not Congress by § 301 of the Taft-Hartley Act authorized the federal courts to compel arbitration. The question here is whether or not Congress by that same provision intended to repeal the Norris-LaGuardia Act pro tanto. This is not the question which before the Supreme Court.66

The Norris-LaGuardia Act was designed primarily to prevent federal courts from abusing their injunctive powers to stop strikes —

62. Milk Wagon Drivers' Union, Local 753 v. Lake Valley Farm Products, Inc., 311 U.S. 91 (1940); Brotherhood of Railroad Trainmen, Local 721 v. Central of Georgia Ry., 229 F.2d 901 (5th Cir. 1956).
63. An agreement to arbitrate grievances has been considered the quid pro quo for an agreement not to strike. See text at note 25 supra.
the traditional labor injunction. Although the act applies to injunctions against the union or the employer, its provisions are much more specific in protecting the union, and the circuit court felt bound by the clear meaning and purpose of § 4 which precludes injunctions against peaceful picketing. The anomalous result of the decision is that although the system of autonomous self-government is subjected to the intervention of the courts, that intervention fails to promote industrial peace; yet, promoting industrial peace is the very purpose for allowing courts to intervene at all. Of course, both parties generally are willing to submit grievances to arbitration in accord with their contract and to abide by the arbitrator's final award. In these cases the courts are not needed. But, when the parties do not so agree, the whole purpose of arbitration becomes frustrated under the Bull Steamship rule, a result contrary to the present policy of Congress as interpreted in Lincoln Mills.

The Supreme Court denied certiorari in Bull Steamship. Thus, as the law now stands, the Lincoln Mills doctrine permits a mandatory injunction compelling arbitration under the contract provision, but it does not permit a prohibitory injunction against acts protected by Norris-LaGuardia. This position has been supported by reasoning that the employer has an adequate remedy at law for damages resulting from the strike, and therefore that equitable relief is unnecessary. It is argued that the threat of a suit for damages against the union treasury would generally be a sufficient deterrent to a union which is contemplating a strike in violation of a no-strike clause. A second reason supporting Bull Steamship is that allowing strike injunctions to enforce the arbitration agreements would "fly in the face of Section 4 of the Norris-LaGuardia Act." Section 4 clearly prohibits a permanent injunction against peaceful striking. Allowing an injunction to enforce an arbitration

---

69. But see Feinsinger, Enforcement of Labor Agreements—A New Era in Collective Bargaining, 43 Va. L. Rev. 1261, 1273-74 (1957), where the author suggests that unions may refuse to accept arbitration provisions in their contracts if strike injunctions to enforce those provisions were available.
70. 355 U.S. 932 (1958). Denial of certiorari is, of course, not equivalent to approval of the circuit ruling. See Maryland v. Baltimore Radio Show, Inc., 338 U.S. 912 (1950) (opinion of Mr. Justice Frankfurter respecting the denial of the petition for writ of certiorari).
71. This is the position taken by the circuit court in the General Electric case, 233 F.2d at 93. Professor Cox contends that this grants only "partial, ineffective relief unless the union yielded to moral pressure." Cox, Grievance Arbitration in the Federal Courts, 67 Harv. L. Rev. 591, 603 (1954).
72. See Local 205, United Electrical Workers v. General Electric Co., 233 F.2d 85, 93 (1st Cir. 1956).
clause would violate the union’s traditional privilege to exercise unilateral coercive conduct while bargaining with an employer. More important, though, § 4 also prohibits temporary strike injunctions, which are the primary tools for strike-breaking. If the Norris-LaGuardia provisions were inapplicable to an arbitration case, an employer could resort to the unfair tactics of procuring a temporary strike injunction merely by alleging that the particular dispute is arbitrable within the contract terms. Although the injunction would be lifted if the dispute were later found not within the arbitration provision, the purpose of the strike might by that time have been defeated. Since most collective bargaining agreements now include some form of arbitration provision, allowing federal courts to enjoin strikes which allegedly violate that provision could nearly nullify the restrictions imposed on those courts by the Norris-LaGuardia Act.

The first argument supporting the Bull Steamship result, that an employer has an adequate remedy in damages, misses the crucial objection that industrial peace is disrupted. Damages do not compensate the public for the adverse impact of the strike, even though the public interest in preventing industrial strife is apparently the justification for court intervention in arbitration cases. Although the threat of a damage suit by an employer may deter a strike in many cases, the argument does not account for those cases in which the union does in fact strike.

The second argument in support of the Bull Steamship result, that allowing strike injunctions to enforce arbitration agreements would defeat the purposes of the Norris-LaGuardia Act, also conflicts with the policy of promoting industrial peace. The union’s interest in preventing permanent injunctions against striking over arbitrable disputes must be weighed against the public interest in enforcing collective bargaining contract obligations in order to prevent disruption of industry. When the union has agreed to settle a dispute by arbitration, there seems to be no reason to protect its privilege to strike over that dispute. One authority has further reasoned that:

74. Congress’ concern with the public interest in promoting industrial peace is apparent in the legislative history of § 301. The Senate Committee’s Report stated:

If unions can break agreements with relative impunity then such agreements do not tend to stabilize industrial relations. . . . Consequently, to encourage the making of agreements and to promote industrial peace through faithful performance by the parties, collective agreements affecting interstate commerce should be enforceable in the Federal courts. S. Rep. No. 105, 80th Cong., 1st Sess. 16 (1947). (Emphasis added.)
[E]ven if [lifting the Norris-LaGuardia ban on strike injunctions in arbitration cases] be viewed as a return to the era of labor injunctions, this anathema of a generation past must be viewed from a present day perspective. Labor organization has now reached a stage of development where it should be as bound by its contractual obligations as is any ordinary individual. If in return for collective benefits the union agrees not to strike, it should be held to both the benefits and the burdens of the contract. If the parties agree to arbitrate, the agreement should be enforceable—and effectively—regardless upon whom the onus may fall. . . . The zealous protection and humanitarian immunization formerly accorded to organized labor were necessary and desirable in a period when labor-management equality was not a reality but an ever sought after goal. If the goal has been achieved and a contract has been freely and voluntarily made, the protection and immunization become anachronisms—unsuitable for current conditions and indeed hindrances to the development of responsible unionism.\(^7\)

The most persuasive support for the *Bull Steamship* rule is in the danger that summarily granted temporary injunctions could be used to defeat strikes over disputes which the union has not agreed to arbitrate under the terms of the contract. Obviously, granting a temporary strike injunction on the groundless contention that the particular dispute is arbitrable would be inexcusable. Section 301 binds the union only to its contract obligations, and that section cannot justify enjoining a strike over a clearly non-arbitrable dispute. However, courts cannot effectively enforce the contract arbitration obligations without the power to issue temporary injunctions. If a union is always privileged to strike until the particular dispute has been held arbitrable, the goal of peaceful relations under the contract is unattainable. It seems necessary to allow temporary injunctions at least when there are reasonable grounds for deciding that the dispute is within the scope of the arbitration provision.\(^8\)


\(^8\) The question arises whether the district courts should pass on the merits of a request for arbitration before ordering submission to arbitration or whether the courts should order submission and allow the arbitrator to decide whether the request raises an arbitrable dispute. In *Local 149, American Federation of Technical Engineers v. General Electric Co.* 250 F.2d 922 (1st Cir. 1957), it was held that before an order compelling arbitration of a particular dispute can be issued, the court must first decide the question of arbitrability. The court reasoned that since the arbitrator has only the limited jurisdiction to decide questions the arbitration provision authorizes him to decide, the question of arbitrability is for the arbitrator only if the parties' contract so provides. Many authorities are of the contrary view that the arbitrator and not a court should always decide the question of arbitrability. See 250 F.2d at 926.

An arbitrator could almost invariably reach a more speedy decision
From the discussion above it is clear that the policy of Norris-LaGuardia as interpreted in *Bull Steamship* conflicts with the policy of § 301 as interpreted in *Lincoln Mills*, and that resolution of the conflict rests in a value judgment on the interests involved. In *Brotherhood of Railroad Trainmen v. Chicago River & Indiana R.R.*, a case decided just two months before *Lincoln Mills*, the Supreme Court was faced with a similar conflict and decided in favor of promoting industrial peace.

**The Railway Labor Act Cases**

In *Chicago River* the Court held that the Norris-LaGuardia Act was inapplicable to a permanent strike injunction in a railway labor case involving a "minor dispute" which was pending before the National Railroad Adjustment Board. A "minor dispute" under the Railway Labor Act is a grievance arising under the terms of an existing collective bargaining contract, as compared with a "major dispute" which results from a disagreement in bargaining for the terms of a new contract. The act provides that "minor disputes" may be referred by either party to the Adjustment Board for arbitration, and that the Board's award is final and binding upon both parties to the dispute; in effect, it imposes on the parties an agreement to arbitrate all grievances arising during the course of the contract. The Railway Labor Act, like Taft-Hartley § 301, does not expressly exempt cases enforcing its provisions from the provisions of Norris-LaGuardia.

The Court alluded to "fundamental premises and principles" of the Railway Act which differed from those of Taft-Hartley, and it said one of these differences underlay the controversy in the *Chicago River* case. The Court never disclosed the difference to than could a court on the question of arbitrability. Normally, more time is needed to get a case before a court than to get a hearing before an arbitrator. Then too, the arbitrator will often have the benefit of experience from prior hearings under the particular arbitration provision. If the arbitrator were to decide arbitrability, the argument that there is a danger of strike-breaking temporary injunctions would become less persuasive. A union probably would not be seriously hurt if its strike were delayed only for a few weeks until the arbitrator ruled that the dispute was not arbitrable. The public interest in enforcing labor contracts to prevent disruption of industry would in these circumstances seem to outweigh the danger of temporary injunctions against strikes over non-arbitrable disputes.

77. 353 U.S. 30 (1957).
80. 48 Stat. 1191 (1934), as amended, 45 U.S.C. § 153 (First) (i), (m) (1952).
81. 353 U.S. at 31 n. 2.
which it was referring. It appears that there are only two principal

differences relevant to a strike injunction enforcing arbitration

agreements. First, while arbitration under the Railway Act is

mandatory in all minor disputes, arbitration under § 301, in light

of Lincoln Mills, is mandatory only in those cases in which the

dispute falls within the scope of the arbitration provision of the

contract. Although this difference might arguably indicate more

congressional concern with preventing interruptions in transporta-

tion industries than in other industries, it does not negative con-

gressional concern with industrial peace in other industries. The

history of § 301 leaves no doubt that Congress intended to mini-

mize industrial strife in all industries. But there is a greater public

interest in uninterrupted transportation than in promoting indus-

trial peace in other industries; at least a strike in a transportation

industry has a more immediate and direct crippling affect on the

public. Perhaps this difference in itself is a sufficient ground for

treating Railway Act cases differently from § 301 cases, but it would

lead to the conclusion that Norris-LaGuardia does not apply to any

case seeking a strike injunction to enforce arbitration of a dispute

in a transportation industry, whether the action arises under the

Railway Act or under § 301. It seems unlikely that the Supreme

Court intended to read into the Norris-LaGuardia Act a blanket

exemption of the transportation industry’s collective bargaining

agreements.

The second principal difference is that the Railway Act estab-

lishes a carefully defined procedure for arbitration by the Adjust-

ment Board, while § 301 provides no specific procedure for the

private arbitration. Perhaps this difference would justify the op-
In Chicago River the Court distinguished an earlier case that held that Norris-LaGuardia precluded an injunction in a "major dispute" under the Railway Labor Act:

In such a case, of course, the Railway Labor Act does not provide a process for a final decision like that of the Adjustment Board in a "minor dispute" case.

The act's provision for enforceable arbitration, which had the approval of the national railway labor organizations, established a fair method for settling disputes without a strike. The Court said that controversies in which the opposing economic forces are channeled into this special process intended to compromise them "are not the same as those [controversies] in which the injunction strips labor of its primary weapon without substituting any reasonable alternative." This reasoning logically suggests that the strike injunction should have been granted in the Bull Steamship case, because the parties in that case also had an enforceable agreement to arbitrate their disputes. The Court's apparent approval of the opposite conclusion seems to be inconsistent with its Chicago River reasoning, leaving other courts unsure of the Supreme Court's position regarding the development of the Lincoln Mills doctrine. These courts will probably find it difficult to fashion substantive law under Lincoln Mills when they are uncertain of the fundamental policy of that law.

The McCarroll Case

McCarroll v. Los Angeles County District Council of Carpenters, a recent California case, presented the question whether a state court is precluded from enjoining a strike while enforcing

88. Brotherhood of Railroad Trainmen v. Chicago River & Indiana R.R., 353 U.S. 30, 42 n. 24 (1957). Apparently the Court intended to establish a policy distinction between granting injunctions in minor dispute cases and doing so in major dispute cases because the earlier case was easily distinguishable on other grounds. The earlier case was a request for an injunction against acts of violence and not against peaceful picketing. The holding of the case was not based on § 4 but rather on § 8 of the Norris-LaGuardia Act; § 8 provides that the complainant cannot be granted an injunction unless he has made every reasonable effort to settle the dispute. The complainant in the earlier case had failed to voluntarily submit to mediation by the Mediation Board. Presumably § 8 could be the basis for denying an injunction even in a minor dispute case. The Court went out of its way to establish a distinction on facts not even alluded to in the earlier case.
90. Id. at 41. (Emphasis added.)
§ 301 because that remedy is not available in a federal court, although the state law would permit a strike injunction. The state court granted the injunction, reasoning that while the state must apply federal law in these cases, it is free to furnish a state remedy because the Norris-LaGuardia Act does not restrict the injunctive powers of state courts, and neither the provisions nor the purposes of § 301 require that a strike injunction must be denied. If the McCarroll view is generally accepted, employers may be able to avoid the Bull Steamship rule by seeking enforcement of their arbitration agreements in the appropriate state court, provided that the state has no anti-injunction statute. The union probably could not prevent a strike injunction by removing the case to a federal court because removal normally will be denied when relief sought by the plaintiff would be available only in the state court. However, many states do have “little Norris-LaGuardia Acts” interpreted similar to the federal act, and in these states both state and federal courts will be powerless to stop the union’s strike.

92. The court’s assumption that the Norris-LaGuardia Act precludes a federal court from enjoining a strike while enforcing a collective bargaining contract arbitration clause under § 301 is correct according to the Bull Steamship case. See text at note 66 supra.

93. The California court held that federal and not state law must be applied under § 301 because “otherwise the scope of the litigants’ rights will depend on the accident of the forum in which the action is brought.” McCarroll v. Los Angeles County District Council of Carpenters, 315 P.2d 322, 330 (Cal. 1957). Yet, the result of its own decision makes the extent to which an arbitration clause can be enforced depend on the “accident” of the forum chosen. The decision might be justified by the conceptual distinction between rights and remedies, the latter traditionally being a matter of the law of the forum even when the court is enforcing foreign law.

The McCarroll case is an example of the many difficult state court problems raised under Lincoln Mills. Other courts will likely be called upon to answer similar questions: (1) whether Norris-LaGuardia is a national labor act, the policy of which is binding on state courts thereby precluding strike injunctions; (2) whether the substantive law applicable in a state court is state or federal law; (3) whether state courts enforcing § 301 rights must apply federal procedural rules. A discussion and resolution of these and other related problems is beyond the scope of this Note. See Note, 9 Hastings L.J. 203 (1958).

94. Under 62 Stat. 937 (1948), 28 U.S.C. § 1441 (1952), removal to a federal court is authorized of “any civil action brought in a State court of which the district courts of the United States have original jurisdiction.”


96. See Lab. Rel. Rep. (L.R.X. 548-49) (1957). However, state courts typically are more willing to grant injunctions than are federal courts, even though the applicable state statute is closely patterned after the Norris-LaGuardia Act. Some state statutes expressly except cases involving a breach of a labor contract. For example, the Pennsylvania Anti-Injunction Act, Pa. Stat. Ann. tit. 43, § 206d (Purdon 1952), provides that the act does not apply to a labor dispute “which is in disregard, breach, or violation of, or which tends to procure the disregard, breach, or violation of, a valid subsisting labor agreement.”
NOTES

SUMMARY AND CONCLUSION

A literal reading of Taft-Hartley § 301 discloses only a grant of federal jurisdiction over cases involving breach of a labor contract. The Supreme Court's sweeping interpretation in *Lincoln Mills* read into § 301 a grant of federal substantive rights, and courts were given the task of defining as well as enforcing these rights. The problems discussed in this Note were raised by the *Lincoln Mills* decision and by subsequent decisions of other courts attempting to apply the *Lincoln Mills* ruling to suits for enforcement of a collective bargaining agreement arbitration clause. The solutions to these problems turn on basic federal policy toward enforcement of labor arbitration agreements. According to the Supreme Court, federal policy is in favor of enforcing arbitration clauses to promote industrial peace during the time the contract is in force. Assuming this conclusion is correct, it is appropriate to suggest the ways this policy should be applied to alleviate the problems raised.

First, federal courts should enforce an arbitration clause whether or not the grievance sought to be arbitrated involves "uniquely personal" rights of the employees. Even if the *Westinghouse* case is still good law, the reasoning underlying its limitations on § 301 jurisdiction is inapplicable to arbitration cases where the union clearly sues to enforce a provision of the collective bargaining agreement rather than the individual hiring contract. Furthermore, exclusive jurisdiction of the NLRB should not be extended to oust courts of § 301 arbitration cases; the courts are better suited than the Board to the tasks of contract interpretation and enforcement, the two primary functions performed in an arbitration case.

Second, the procedural provisions of the United States Arbitration Act should govern suits for enforcement of labor arbitration agreements. The Arbitration Act prescribes procedures for ordering a stay of separate court proceedings when there is an arbitrable grievance in dispute, for appointing arbitrators, for compelling witnesses to appear at the arbitration hearing, for confirming the arbitrator's award, for vacating, modifying or correcting a faulty award within designated limits, and for ordering specific enforcement of the award.97 These provisions outline standard procedures which are well calculated to encourage arbitration as a private method for settling grievances, and they resolve many of the procedural problems likely to face courts enforcing arbitration clauses. Congress could require courts to apply the procedures out-

lined in the Arbitration Act by incorporating identical provisions into § 301, or by making the Arbitration Act applicable to collective bargaining agreements; either method would accomplish the desired result. A bill recently introduced before the House of Representatives adopts the latter method by proposing appropriate amendments to the Arbitration Act.98

Third, suits for enforcement of labor arbitration agreements should be exempted from the provisions of the Norris-LaGuardia Act. Labor injunctions—even strike injunctions—which are granted to enforce an arbitration clause are in complete harmony with the policy of § 301, at least as it is now interpreted, that arbitration clauses should be completely binding upon both employer and union. Courts cannot effectively promote peaceful industrial relations under the contract unless they have power to compel full reliance on arbitration where that method of handling grievance disputes presents a "reasonable alternative" for reaching a fair settlement.

These three steps would lay the skeleton foundation on which courts could build a sound and uniform law of labor arbitration.


The bill does not expressly recognize one technical difficulty presented by language of the Arbitration Act. Section 4 of the act, as amended in 1954, provides that a party may petition any "United States district court which . . . would have jurisdiction under Title 28 . . . of a suit arising out of the controversy . . . ." 61 Stat. 669 (1947), as amended, 9 U.S.C. § 4 (Supp. IV, 1957). (Emphasis added.) For the purpose of the 1954 amendment, see 3 U.S. Code Cong. & Ad. News 3998 (1954). The relevant sections of Title 28 provide that a federal district court will have jurisdiction where the controversy arises under federal laws and "exceeds the sum or value of $3,000," 62 Stat. 930 (1948), 28 U.S.C. § 1331 (1952), or where there is diversity of citizenship and the amount in controversy "exceeds . . . $3,000." 62 Stat 930 (1948), 28 U.S.C. § 1332a(1) (1952). (Emphasis added.) The Arbitration Act presently makes no provision for federal jurisdiction of cases involving less than $3,000, although Taft-Hartley § 301 expressly waives the jurisdictional amount requirement. There seems to be no reason for retaining this requirement which would obviously exclude many typical arbitration cases involving individual grievances where the amount in controversy is less than $3,000. Removal of this technical defect will help avoid confusion in applying the Arbitration Act to labor controversies.