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Case Comments

Antitrust Law: Securities Exchange Act

Does Not Exempt Exchange From the Sherman Act

The New York Stock Exchange (NYSE) ordered its member firms to sever wire connections with petitioners, nonmember dealers in over-the-counter securities. Petitioners were neither notified of the order, nor given a hearing. When repeated attempts to elicit an explanation from the Exchange failed, they instituted a treble damage suit alleging that the action of the Exchange and its members constituted a concerted refusal to deal, in violation of the Sherman Act. The trial court granted petitioners' motion for summary judgment. The Second Circuit reversed, finding that the antitrust laws were inapplicable because the action of the Exchange was authorized by the Securities Exchange Act of 1934. On certiorari, the Supreme Court af-

1. The Board of Governors of the New York Stock Exchange is empowered to require the discontinuance of connections between member firms and nonmembers. CCH, NYSE Constitution & Rules ¶ 1056 (Const., art. III, § 6) (March, 1959). The rules also provide that "the Exchange may require at any time that any means of communication be discontinued." Id. ¶ 2355 (Rule 355).


Two additional causes of action were alleged; first that the Exchange had tortiously induced its member firms to breach their wire connection contracts with petitioners, see generally Annot., 26 A.L.R.2d 1227 (1952); the second asserted that the Exchange's action constituted a tort of intentional and wrongful harm inflicted without reasonable cause, see, e.g., American Oil Co. v. Towler, 66 Ga. App. 866, 194 S.E. 223 (1937).


firmed the judgment of the trial court and held that the antitrust laws apply to a registered exchange and that the NYSE, by denying petitioners procedural safeguards, failed to justify their boycott under the Securities Exchange Act. Silver v. New York Stock Exch., 373 U.S. 341 (1963).

The Exchange Act is designed to promote fair dealing and to protect investors; the act authorizes registered stock exchanges to regulate their members through rules embodying these goals. The act leaves the day to day regulation of exchange members to the exchanges themselves, subject to limited supervision by the Securities Exchange Commission. The conduct of members is governed by exchange rules providing sanctions that are adequate to deal with violations of fair conduct standards. Although the exchanges do not directly regulate the activities of nonmembers, by prohibiting members from engaging in certain types of transactions, nonmembers who formerly conducted these transactions are affected. In some instances this indirect regulation may violate the antitrust laws.


Various factors influenced the congressional decision to permit exchanges to continue to regulate their members: the tradition of exchange self-regulation, see Westwood & Howard, supra at 518-22 (1952); the opposition of the financial community to governmental control of the daily business of exchange members, see 2 Schlesinger, The Age of Roosevelt, The Coming of the New Deal 463 (1959); and the magnitude of the task of exercising such control for a government agency, see Hearings on Stock Exchange Practices Before the Senate Committee on Banking and Currency, 73d Cong., 1st Sess., pt. 15, at 6582 (1934).

10. The Securities Exchange Act of 1934, § 6(a)(3) requires deposit with the SEC of "copies of its [any exchange's] constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the 'rules of the exchange.'" 48 Stat. 880 (1934), 15 U.S.C. § 78f(a)(9) (1958).

Section 1 of the Sherman Act, which serves the antitrust policy of preserving a competitive economy by outlawing contracts, combinations, and conspiracies in restraint of trade, proscribes group boycotts. A group boycott is a concerted refusal to deal that has an adverse economic effect on third parties. Unlike some alleged trade restraints, such boycotts are illegal even when they result in reasonable restraints of trade; the group boycott is a per se violation of section 1 of the Sherman Act. The per se rule is justified by the restrictive economic effect of a boycott and because anticompetitive results may be achieved by a boycotting group that acts with apparently valid motives. The danger of such results outweighs any desirable effect that

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15. See Eastern States Retail Lumber Dealers' Ass'n v. United States, 234 U.S. 600, 614 (1914).
16. See Standard Oil Co. v. United States, 221 U.S. 1 (1911) (inaugurating the “rule of reason”).
can be expected from permitting the private use of this power. In *Radiant Burners, Inc. v. Peoples Gas Light & Coke Co.*, for example, the refusal of gas companies to sell gas to be used in burners not certified by a testing organization could have the legitimate effect of promoting the sale of gas by insuring that defective burners are not placed on the market; it could also have the anticompetitive effect of creating a monopoly position for approved burner manufacturers by making it impossible for uncertified manufacturers to stay in business. The Court has not recognized a utility in permitting this type of boycott that outweighs the harm proscribed by Congress.

A conflict between the Exchange Act and the Sherman Act arose in the instant case. Although the NYSE's private wire rules were found to be within the Exchange's regulatory authority under the Exchange Act, their enforcement was held to constitute an illegal boycott under the Sherman Act. The private wire rules permitted the NYSE to require its members to discontinue wire connections with nonmembers. These wires are necessary to securities dealers because securities prices fluctuate over short periods of time; rapid communication is essential to guarantee execution of a transaction at or close to the last reported price. Since a large portion of exchange members' business is conducted by means of these private wires, exchange regulation of its members, in order to completely encompass members' use of the wires. On the other hand, the concerted action of the Exchange and its members in the instant case in denying petitioners a business service essential to their ability to compete effectively in the over-the-counter market clearly violated the Sherman Act per se rule against boycotts.

The Exchange Act contains no express exemption from the antitrust laws for a registered exchange, and the Court properly rejected the NYSE's contention that an exemption is implied wherever an exchange enforces rules adopted under the authority

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19. Id. at 659–60.
20. See note 1 supra.
21. On this point the Court agreed with the court of appeals, 302 F.2d at 716, and disagreed with the trial court, 196 F. Supp. at 221–22.
23. See note 17 supra.
of the act. The Court has been reluctant to grant an exemption from the antitrust laws to regulated industries; an irreconcilable conflict between the regulatory statute and the antitrust laws is required. Even then, the exemption is limited to the extent of the conflict. In addition, the securities industry is unlike most regulated industries in that the Exchange itself is statutorily charged with regulative duties, whereas regulation is usually an exclusive responsibility of a government agency. Although the threat of antitrust liability for regulatory acts might discourage the Exchange from exercising its regulatory powers, enforcement of the antitrust laws outweighs this possible adverse effect on Exchange regulation. The antitrust laws are the only check on Exchange abuse of its authority; the SEC, which is the agency representing the public interest in this area, has no power to review Exchange disciplinary actions. Moreover, since there is no provision in the Exchange Act for administrative review of the disciplinary acts of an exchange, petitioners had only a judicial remedy; if the Court had refused to entertain the antitrust claim by finding an implied exemption, petitioners' opportunity for review and redress would have been foreclosed.

In accommodating the underlying purposes of the Exchange Act and the Sherman Act, the Court in the instant case began

26. Ibid.
27. Instant case at 357; see 2 Loss, Securities Regulation 1178 (2d ed. 1961). The Court indicates that if SEC review of exchange disciplinary action were available a different result might obtain. See instant case at 358 n.12, 360. SEC review would not prevent the Court from considering the case at all, but the doctrine of primary jurisdiction would at least require review by the Commission in the first instance. See Latta, Primary Jurisdiction in the Regulated Industries and the Antitrust Laws, 30 U. Cinc. L. Rev. 261 (1961); Note, Regulated Industries and the Antitrust Laws: Substantive and Procedural Coordination, 58 Colum. L. Rev. 673, 691-94 (1958). There is some indication in Radio Corp. of America v. United States, 341 U.S. 412 (1951), that commission review makes antitrust exemption more likely. But see California v. FPC, 369 U.S. 482 (1962).
28. Although petitioners alleged two causes of action in addition to the antitrust claim, see note 2 supra, and the court of appeals remanded the case for consideration of these claims, see note 4 supra, it seems apparent that the defense of justification under the Exchange Act would apply to
with the premise that the Exchange Act is a defense to an antitrust suit only to the extent that exchange action fully reflects the aims of that act. The Court reasoned that an exchange must provide procedural safeguards for disciplinary action against nonmembers because a congressional intent to require such safeguards is implicit in the Exchange Act. Moreover, a hearing and attendant procedural safeguards eliminate the danger of substantive inaccuracy inherent in ex parte proceedings. Since the NYSE had failed to provide these safeguards, it could not justify its action under the Exchange Act.

In so holding, however, the Court neither provided a guide to measure the antitrust liability of an exchange for future regulatory actions, nor clearly decided the basic question of whether an exchange’s power to regulate extends to nonmembers. If an exchange does not have this power under the Exchange Act, it will be unable to avoid antitrust liability by providing the procedural safeguards for nonmembers required by the Court. If it does have this power, however, the Court’s opinion does not define the extent of antitrust immunity an exchange can achieve by providing procedural safeguards in the regulation of nonmembers.

In analyzing the Exchange Act to determine those aspects of exchange self-regulation that might require antitrust immunity, exchange regulation of members should be distinguished from regulation of nonmembers. Exchange regulation of members may require the use or threatened use of a boycott to effectively enforce rules within the aims of the Exchange Act. Unless necessary to accomplish the regulatory purposes of the Exchange Act, the use of boycotts, even against members, should constitute an antitrust violation. The threat of suspension or expulsion is an important sanction enabling an exchange to control the conduct of its members. Although a variety of lesser sanctions may be available to an exchange for rule enforcement purposes, such as fines and loss of privileges, if a member refuses to obey these lesser sanctions or they fail to deter his conduct, the exchange is forced to resort to suspension or expulsion. Suspension or expulsion would come within the antitrust rule against boycotts, but if the self-regulation embodied in the Exchange

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these claims as much as to the antitrust claim. Of course the hardship that would be imposed on petitioners by denying them a remedy is not sufficient reason by itself to refuse to find an implicit exemption. The severe sanctions of treble damages and criminal liability under the antitrust laws make it important to avoid using these laws solely as a means of providing redress for quasi-administrative caprice.

29. Instant case at 361.
Act is to be effective, antitrust immunity must be granted in such a case. This immunity need be no broader than to permit a boycott as a means of enforcing a rule consistent with the objectives of the Exchange Act. Thus, if an antitrust suit against an exchange were predicated on an antitrust violation not connected with a boycott to insure rule compliance, there would be no antitrust immunity. As an example, the minimum commission schedules of the NYSE might be characterized as price-fixing, for which no antitrust immunity is necessary under the Exchange Act. Likewise, if a rule enforcement boycott were imposed against a member for violating an exchange rule against hiring a Negro, no antitrust immunity need be granted since the rule sought to be enforced by a boycott would not be within the aims of the Exchange Act. It is the boycott inherent in rule enforcement that requires some antitrust exemption to preserve the aims of the Exchange Act.

With regard to nonmembers, however, there is less justification for exchange action. Since most nonmember, over-the-counter dealers are members of the National Association of Security Dealers (NASD), an association authorized under the Maloney Act to regulate over-the-counter dealers, there

31. It is open to question whether the antitrust laws should be used to achieve noneconomic goals. See note 17 supra. Perhaps the Sherman Act rule against boycotts should be applied to all group conduct having favorable economic consequences for the group, since for whatever reason a boycott of this type is imposed, it serves to eliminate a competitor. Cf. Note, 105 U. Pa. L. Rev. 977, 995 (1957).
exists an alternative to exchange action. This alternative—the regulation of over-the-counter dealers through the NASD—involves no antitrust problem, for antitrust immunity is provided by the Maloney Act. Given the availability of an alternative, the only justification for permitting an exchange to regulate nonmembers would be that the exchange is better able to do so than the NASD. This is not the case, however, because the NASD has closer contact with its members than does an exchange. Unlike the disciplinary actions of an exchange, NASD disciplinary actions are subject to review by the SEC. This closer supervision makes it more likely that disciplinary activities will be conducted in a fair manner. The Sherman Act rule against boycotts is particularly directed at avoiding private concerted action having a detrimental economic effect on outsiders. Since the supervision of an objective government agency is lacking in the case of exchange regulation of nonmembers, there is danger that an exchange, composed of businessmen whose interests are involved, would regulate competitors improperly if the antitrust laws did not apply when it attempted to regulate nonmembers.

Civil Rights: Incorporation of All-White City Does Not Violate Negroes’ Rights

In proceedings to incorporate noncontiguous areas of Dearborn Township, Michigan, a “strip,” three blocks wide, was detached from adjacent Inkster Village. Plaintiffs, Negro residents of that village, sought to enjoin the detachment, contending that the boundaries of the strip were drawn along racial lines to exclude Negroes from the new city. On appeal from a ruling adverse to plaintiffs, the Michigan Supreme Court affirmed and

2. The case was remanded for the purpose of exercising continuing jurisdiction to entertain any future suits against the new city should its subsequent conduct prove discriminatory. Taylor v. Township of Dearborn, 120 N.W.2d 737, 744 (Mich. 1963).
held that plaintiffs had failed to prove that they had been discriminated against by the detachment. Taylor v. Township of Dearborn, 120 N.W.2d 737 (Mich. 1963).³

The courts have traditionally acknowledged that the states have plenary power to create, alter, and destroy boundaries of municipal subdivisions; and the courts have generally been reluctant to impose restrictions in this area.⁴ Where it has been alleged that that power has been used to discriminate against minorities, however, the courts have been more willing to review. In the landmark case of Gomillion v. Lightfoot,⁵ for example, state control over municipal boundaries was juxtaposed with claims of Negro disenfranchisement. Dispelling broad language of earlier cases which suggested that state power in this area was not limited by the federal constitution,⁶ the United States Supreme Court held that state-created boundaries are not immune from constitutional attack where their creation results in a denial of voting privileges to Negroes.

In Gomillion the plaintiffs, residents of Tuskegee, Alabama,

³ This case arose out of Village of Inkster v. Wayne County Supervisors, 363 Mich. 165, 108 N.W.2d 822 (1961), in which the village contested the validity of proceedings to incorporate Dearborn Township. The village asserted that all residents had to express approval of the detachment rather than only those who lived in the strip area. The Michigan Supreme Court held that portions of the village could be included in the new city without the express consent of the entire village. During the course of oral argument the racial-constitutional issue was raised by a member of the court. Subsequently, the attorney general intervened and moved to remand in order to take testimony to determine whether or not the incorporation represented an attempt to segregate Negroes or to exclude Negroes from the city. Five members of the court suggested that an original class suit instituted after the court had determined the statutory propriety of the proceedings was the proper procedure to follow. Four justices would have remanded.

⁴ Where the subordinate governmental unit has protested action by the state, the courts have generally upheld the state's power. See, e.g., City of Newark v. New Jersey, 262 U.S. 192 (1923); City of Trenton v. New Jersey, 262 U.S. 182 (1923); Atkin v. Kansas, 191 U.S. 207 (1903). In the leading case of Hunter v. City of Pittsburgh, 207 U.S. 161 (1907), the Supreme Court stated that individual residents of a municipality have no constitutional basis for a complaint against the state for alteration of boundaries even where they suffer inconvenience or their property declines in value.


⁶ See, e.g., Hunter v. City of Pittsburgh, 207 U.S. 161 (1907).
pointed to a redistricting act\textsuperscript{7} that changed a square shaped city into a bizarre, twenty-eight sided figure.\textsuperscript{8} The alleged effect of the redistricting was the removal of virtually all the Negro voters from the city, thereby excluding them from the benefits of municipal residency, including the municipal franchise. In reviewing the dismissal of the complaint, the Supreme Court stated that if plaintiffs' allegations remained uncontroverted they would amount to a "mathematic demonstration" that the gerrymander was aimed at depriving Negroes of their "pre-existing municipal vote."\textsuperscript{9} Looking to the "inescapable human effect" of the change, the Court inferred that segregation of, and discrimination against, Negroes was the primary purpose of the act.\textsuperscript{10} In reaching its decision, the Court weighed the fact that the state had advanced no "countervailing municipal function" to be served by the legislation.\textsuperscript{11}

In the instant case, plaintiffs based their arguments upon a violation of both the fourteenth and fifteenth amendments.\textsuperscript{12} The Michigan court appeared to accept the fifteenth amendment, loss-of-vote, interpretation of \textit{Gomillion} in distinguishing that case on the ground that the petitioners in \textit{Gomillion} were original residents of the city and were deprived of a pre-existing right to vote, while the plaintiffs in the instant case continued to reside and vote in the village. This distinction, however, fails to meet Mr. Justice Whittaker's concurring analysis in \textit{Gomillion} that one has no vested right to vote in a particular political unit.\textsuperscript{13} Even if the instant court's distinction were granted, it could still

\textsuperscript{7} Ala. Sess. Laws 1957, No. 140, at 185.
\textsuperscript{9} \textit{Id.} at 341.
\textsuperscript{10} \textit{Id.} at 347.
\textsuperscript{11} \textit{Id.} at 342.
\textsuperscript{12} Plaintiffs were clearly relying on the equal protection approach since they did not claim a denial of the right to vote. In two cases challenging a New York reapportionment act, class acting Negro and Puerto Rican plaintiffs also relied on the fourteenth amendment. They contended that congressional districts were gerrymandered in order to restrict them to a single district. \textit{Honeywood v. Rockefeller}, 214 F. Supp. 897 (E.D.N.Y.), \textit{aff'd per curiam}, 371 U.S. 1 (1963); \textit{Wright v. Rockefeller}, 211 F. Supp. 460 (S.D.N.Y. 1962), \textit{prob. juris. noted}, 374 U.S. 803 (1963); see \textit{Note}, \textit{Wright v. Rockefeller and Legislative Gerrymanders: The Desegregation Decisions Plus a Problem of Proof}, 72 \textit{YALE L.J.} 1041 (1963).
\textsuperscript{13} 364 U.S. at 349 (1960) (concurring opinion). Since the states have authority to determine the qualifications for voting privileges and can also manipulate boundaries of political units, it follows that one is not assured that he will always cast his vote in a given political district. See \textit{Note}, 72 \textit{YALE L.J.} 1041, 1047-48 (1963).
conceivably be argued that the plaintiffs in the instant case had a pre-existing right to vote in a village that included the detached strip. The Michigan court, however, undoubtedly meant to indicate by this distinction that the Tuskegee plaintiffs had actually been denied the right to vote. Certainly the majority opinion in Gomillion, with its reliance on the fifteenth amendment, suggests that this was the assumption underlying the decision. Nonetheless, the loss of vote in Gomillion was not absolute and unqualified. In addition, the Supreme Court may have seized upon the fifteenth amendment as a way to avoid a decision on legislative apportionment based on the equal protection clause.

While not specifically addressing itself to the fourteenth amendment, the court in the instant case distinguished Gomillion because both white and Negro residents of Inkster Village were excluded from the new city as a result of the detachment. The court also pointed out that the plaintiffs were not prevented from freely crossing back and forth from the village to the new city. Although superficially compelling, these distinctions fail to dispose of some considerations raised by an allegation of discrimination based on the equal protection clause.

If classification based on race is unconstitutional per se, 

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14. Although the weight of the Negro vote in the village was increased by the detachment, such a consideration is irrelevant in determining the constitutionality of the detachment. Certainly the voting weight of the Negroes ousted from Tuskegee would have been substantially greater in a new municipality. See note 15 infra. See also Note, 72 Yale L.J. 1041, 1051–56 (1963).

15. See Lucas, supra note 5, at 210, suggesting that the Negroes could have established a separate municipality on petition of twenty-five persons and voted there. But cf. 109 U. Pa. L. Rev. 1173, 1176 n.25 (1961), which indicates that the petitioners in Gomillion argued that registration to vote in the new area would have been difficult.

16. See Lucas, supra note 5, at 231. Another explanation for the loss-of-vote rationale is simply that the plaintiffs so framed the complaint. Id. at 213.

17. The per curiam decisions following Brown v. Board of Educ., 347 U.S. 483 (1954) (passing on the constitutionality of separate public accommodations) indicate that segregation based on race is unconstitutional per se. See, e.g., New Orleans City Park Improvement Ass'n v. Dettiege, 358 U.S. 54 (1958); Gayle v. Browder, 352 U.S. 903 (1956); Holmes v. City of Atlanta, 350 U.S. 879 (1956). That classification based on race is unconstitutional per se, absent any segregation or discrimination, is not clear. See Note, 72 Yale L.J. 1041, 1048–50 (1963). If any use of race as a standard is unconstitutional per se, then the "benign quota," see note 35 infra, would be invalid even though the classification is aimed at achieving integration. Nonetheless, the use of a racial standard would normally fail under the general requirements of the
plaintiffs alleging discrimination under the equal protection clause need only prove that race has been used as a standard for classification—or as a basis for determining official boundaries—and need not show any harm resulting from the classification, the harm being an inevitable concomitant of the use of a racial standard. Although freedom of access and equal effect on whites are factors indicating that boundaries were not drawn in a discriminatory manner, standing alone they should hardly be determinative of the issue.

In comparing only the number of white and Negro residents of Inkster who were excluded from the city, the court failed to make a more significant comparison, viz., the total number of white and Negroes included in the new city. Such a comparison would have revealed that the population of the new city comprised 80,000 whites from Dearborn Township and 2,080 whites from Inkster Village; nine Negroes from Dearborn Township and none from Inkster Village. Nor should it have been a consideration that the plaintiffs were not physically restrained from crossing back and forth from the village to the new city. The plaintiffs indicated that the outer limits of Negro residence in the village were virtually co-extensive with the west boundary of the strip. They feared that drawing the official limits of the

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18. Although the harm associated with rigid segregation, with its signs, barricades and police enforcement, is not present where race is used as a basis for determining city boundaries, the psychological harm accompanying knowledge that one has been excluded from a city on the basis of race alone is equally as formidable. Cf. Brown v. Board of Educ., 347 U.S. 483, 494 (1954).

19. Treating Negroes and whites equally, however, does not always indicate nondiscrimination. See Anderson v. Martin, 32 U.S.L.W. 1401 (U.S. Jan. 13, 1964), in which the United States Supreme Court held unconstitutional a Louisiana statute requiring the race of both Negro and white candidates to be designated on the ballot.

[B]y placing a racial label on a candidate . . . the State furnishes a vehicle by which racial prejudice may be so aroused as to operate against one group because of race for another . . . Therefore we view the alleged equality as superficial . . .

Id. at 1402.

20. 11,120 whites and 4,600 Negroes were excluded. Instant case at 745.

21. Brief for Plaintiff-Appellants, pp. 4–5. The nine Negroes from Dearborn Township who were included were assumed by plaintiffs to be live-in domestics rather than homeowners.

22. The area of Negro residence began 1750 feet from the west boundary of the strip. Instant case at 741.
new city at that juncture would crystallize the boundary into an "impenetrable wall" effectively circumscribing Negro residence to that area. It might be argued that the inclusion of Negroes in the new city would not assure a more balanced dispersal of the Negro population. Nonetheless, as residents and voters of the city, the Negroes would have secured a voice, and perhaps a measure of influence, in determining the policies of the city.

Although the plaintiffs in the instant case did not have the graphic proof that led the Supreme Court in Gomillion to find a "mathematic demonstration" of discrimination, the Michigan court should have concluded that they had established enough to support an inference of discrimination. Whether plaintiffs are required to disprove all possible alternative inferences before a prima facie case is established becomes important, since most plaintiffs rarely have direct evidence of discrimination. A negative answer is suggested by the Gomillion decision. Once the Gomillion plaintiffs had established that they had been excluded from the city, the burden shifted to the state to overcome the inference of discrimination by showing a "countervailing municipal function." While the Supreme Court did not intimate the

23. Plaintiffs argued that Negroes would not be able to move into the new city at will. Brief for Plaintiff-Appellants, p. 22. The argument may have merit. When residents of Dearborn mistook a Negro moving van worker for a new tenant, the residence was stoned. The homeowner is now suing the city, alleging that the Dearborn police failed to restrain the mob. Minneapolis Sunday Tribune, Sept. 8, 1963, p. 8A, cols. 5, 6. Similar events have occurred throughout the country when Negroes have attempted to move into all-white areas. See McGhee & Ginger, The House I Live In, 40 COrNELL L.Q. 194, 245 nn.230-33 (1961). See also Googer v. City of Atlanta, 8 RACE REL. L. REP. 179 (Fulton County Ga. Super. Ct. Mar. 1, 1963) where the city barricaded the streets to separate Negro and white residential districts.


26. On remand, an Alabama district court held the act unconstitutional and the city was enjoined from enforcing it. No oral argument was heard. See TAPIER, op. cit. supra note 5, at 116.
effect a showing of a "municipal function" would have had upon the *Gomillion* decision, the test should be viewed in light of the Court's refusal to recognize the "rational reason" and "state regulatory power" doctrines where the effect of state action has been to subject minorities to unequal treatment. Properly applied, the municipal function test should require the state to show not only a legitimate state purpose, but also that the means chosen to implement that purpose were not chosen to create a discriminatory result. Courts must look beyond the facade of state power and require more than tenuous justifications for the action taken.

The court in the instant case suggested that the incorporators had no duty to show a legitimate municipal function, yet it did present justifications sufficient to overcome any inference of discrimination arising from the facts alleged by plaintiffs. The incorporators showed (a) that it was legally, practically, and politically necessary to join the noncontiguous areas in order to incorporate them; (b) that previous efforts to incorporate the entire village had failed for lack of the requisite majority vote; (c) that the strip taken was three blocks wide, leaving as much area as possible to the village; (d) that the strip afforded convenient water and sewer connections; and (e) that the west boundary was drawn to correspond with the first available

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27. See *Gibson v. Florida Legislative Investigation Comm.*, 372 U.S. 539 (1963) (legislative investigative right cannot compel disclosure of NAACP membership lists); *NAACP v. Button*, 371 U.S. 415 (1963) (state power to regulate the bar cannot be used to curtail civil rights litigation); *Cooper v. Aaron*, 358 U.S. 1 (1958) (integration of schools cannot be delayed to preserve public peace).

28. This test requires the state to show that no feasible alternative means were available to accomplish the purpose. Cf. *Shelton v. Tucker*, 364 U.S. 479, 488 (1960):

> The breadth of legislative abridgement must be viewed in light of less drastic means for achieving the same basic purpose.

29. Instant case at 742. The court did not shift the burden to the state since it ruled the plaintiffs had not established enough to raise an inference of discrimination.

30. Instant case at 740.

31. See note 3 *supra*.

32. The political nature of the controversy in the instant case may have had some influence on the decision. After the village's efforts to halt the detachment failed, *supra* note 3, the council unanimously passed a resolution stating that the fight to preserve the village would be continued, authorizing the attorneys to petition for rehearing of the earlier case and recommending a citizen's complaint on the racial issue. Brief for Defendant-Respondents, p. 35.
major street and not to correspond with the Negro district.\textsuperscript{33}

While in the instant case the incorporators' justifications were adequate to fulfill the test, in Deerfield Park Dist. v. Progress Dev. Corp.,\textsuperscript{34} a recent Illinois case, the municipal function test was construed to require no more than a showing of a legitimate

\textsuperscript{33} This final explanation presents a thorny problem since major streets are often the dividing line between areas of Negro and white residency, but are also natural cut-off points for official boundaries. See Honeywood v. Rockefeller, 214 F. Supp. 897, 901 (E.D.N.Y. 1963). It would seem that other facts would also have to be present, as in the instant case, to uphold the use of that boundary. One area in which official and ghetto boundaries frequently correspond is school districts. Since the educational system in most communities is based on the neighborhood school concept and since the minority ghetto is widespread, de facto segregated schools often arise. Where it can be shown that the state has intentionally gerrymandered boundaries of school districts, the districting will not be upheld. See, \textit{e.g.}, Jackson v. Pasadena City School Dist., 31 Cal. Rep. 606, 882 P.2d 878 (1969); Taylor v. Board of Educ., 191 F. Supp. 181 (S.D.N.Y.), aff'd, 294 F.2d 86 (2d Cir.), cert. denied, 368 U.S. 940 (1961). There is also some support for the position that where the school board fails to update districts for racial reasons, such inaction will not be upheld. See Branche v. Board of Educ., 204 F. Supp. 150, 153 (E.D.N.Y. 1962) (dictum). It has even been asserted that there is an affirmative duty on the board to alleviate racial imbalance in the schools. See Jackson v. Pasadena City School Dist., \textit{supra} at 610, 882 P.2d at 882 (dictum). \textit{Contra}, Bell v. School City of Gary, 213 F. Supp. 819 (N.D. Ind. 1963); Evans v. Buchanan, 207 F. Supp. 820 (D. Del. 1962), 15 STAN. L. REV. 681 (1963). The company also sued in the federal court for injunctive relief, but was unsuccessful. Progress Dev. Corp. v. Mitchell, 182 F. Supp. 681 (N.D. Ill. 1960), 35 NOTRE DAME LAW. 568; \textit{aff'd in part, reversed in part}, 286 F.2d 222 (7th Cir. 1961). For a fictionalized account of the Deerfield story, see ROSEN & ROSEN, BUT NOT NEXT DOOR (1962). Compare City of Creve Coeur v. Weinstein, 329 S.W.2d 999 (Mo. 1959). \textit{Contra}, Wiley v. Richland Water Dist., 5 RACE REL. L. REP. 788 (D. Ore. June 30, 1960).
purpose and a governmental power. In Deerfield the city invoked the power of eminent domain to prevent a real estate company from completing a subdivision in which the developers planned to sell homes according to the "benign quota" theory. If the municipal function test had been applied as suggested above, the city would have been required to articulate the circumstances surrounding the condemnation of the particular tract of land taken.

It has been suggested that issues analogous to those raised by the instant case are more properly resolved in the political sphere than in the courts, but techniques inherent in the legal process, such as judicial notice and the inductive process of reasoning, provide the courts with means to adjudicate these issues. See also Report of the U.S. Comm'n on Civil Rights 161-62 (1963), indicating that land condemned for a public park in Memphis in 1900 to prevent Negroes from moving into the area has never been used for that purpose.

35. The benign quota is a method used by some private real estate developers to introduce and maintain a "proper" interracial composition in a community — the number of units sold or rented to Negroes and whites is controlled by the developer. The constitutionality of this plan has been questioned. See generally Bittker, The Case of the Checker-Board Ordinance: An Experiment in Race Relations, 71 Yale L.J. 1887 (1962); Hellerstein, The Benign Quota, Equal Protection and "The Rule in Shelley's Case," 17 Rutgers L. Rev. 531 (1963); Navasky, The Benevolent Housing Quota, 6 How. L.J. 30 (1960). For a discussion of other problems in this area see Grier, Privately Developed Interracial Housing (1960).

36. One important factor would have been that two previous park board referenda had been defeated. Progress Dev. Corp. v. Mitchell, 182 F. Supp. 681, 696 (N.D. Ill. 1960). Other circumstances surrounding the condemnation were also brought out in the federal court.

The whole community was thrown into an uproar... when it became known... that some of the houses would be sold to Negroes.... Mass meetings were held, protests were lodged and committees were formed to resist the sales program of Progress.

Id. at 705-06.


39. Inferring purpose from a consideration of the consequences attendant to the use of a state power has often been done. See Howell, Legislative Mo-
controversies. If the states continue to use their political powers for discriminatory purposes, and the normal political processes fail to dispose of the issues, the courts will continue to be the forum used by minorities to secure equal treatment.40

NLRB: Reversal of Back-Pay Tolling Rule—

Rule Making Under the Administrative Procedure Act

The National Labor Relations Board recently abandoned its long-standing practice of tolling back-pay awards for the period between a trial examiner’s decision that an unfair labor practice complaint be dismissed1 and the date of the Board’s decision to the contrary.2 The Board ordered an employer to offer an employee who had been wrongfully discharged reinstatement and back pay for the full period from the date of the discharge to the date of the offer of reinstatement.3 On appeal, the Court of
Appeals for the Second Circuit granted enforcement of the order and held that the Board had not abused its discretion by reversing its policy of tolling back-pay awards. *NLRB v. A. P. W. Prods. Co.,* 316 F.2d 899 (2d Cir. 1963).

The practice of tolling back-pay awards for the period between a trial examiner's decision of dismissal and the Board's decision to the contrary was first applied in the case of *E. R. Haffelfinger Co.*, during the Board's first year of operation. Following that case, the Board continued to toll back pay. Tolling was practiced whether the trial examiner based his decision of dismissal upon a finding of no unfair labor practices or upon a finding that the NLRB lacked jurisdiction.

In the instant case, the Second Circuit properly declined to weigh the merits of the NLRB's decision to adopt a non-tolling

4. 1 N.L.R.B. 760 (1936). In *Bell Oil & Gas Co.,* 1 N.L.R.B. 592 (1939), decided one month earlier, the Board had not tolled back pay on similar facts.


rule. Whether a proposed rule or policy violates the express statutory language or the clear purpose of an act is a question that most authorities consider subject to judicial review. The alternatives of tolling or non-tolling of back pay, however, both clearly lie within the scope of the NLRA. Thus, the only question is which alternative will better effectuate the policies underlying that act. Such a policy question is within the expert knowledge and accumulated experience of an administrative agency and not necessarily within the competence of a reviewing court; substitution of judicial judgment in such a situation would be undesirable.

That the Board had the substantive power to reverse its well-established practice of tolling back-pay awards is fairly clear, but it probably should have promulgated its non-tolling rule in the manner prescribed for substantive rules by section 4 of the Administrative Procedure Act. The Board has the authority under the NLRA to "make, amend, and rescind, in the manner

8. Section 10(c) of the NLRA provides that where the Board determines that an unfair labor practice has been or is being committed, it may reinstate employees "with or without back pay, as will effectuate the policies" of the act, 49 Stat. 454 (1935), as amended, 29 U.S.C. § 160(c) (1958). The Board has always been allowed broad discretion in fashioning remedies to effectuate the policies of the NLRA. See, e.g., NLRB v. Seven-Up Bottling Co., 344 U.S. 344, 348-49 (1953); Virginia Elec. & Power Co. v. NLRB, 319 U.S. 533, 539-40 (1943). Originally, in fact, the Board had adopted a non-tolling practice. See Bell Oil & Gas Co., 1 NLRB 662 (1936).
9. See 4 Davis, Administrative Law § 30.01, at 191 (1959); Jaffe, supra note 7, at 261; Kramer, supra note 7, at 87.
10. See note 8 supra and accompanying text. Congressional approval of the Board's original tolling practice, evidenced by two major amendments to the NLRA without pertinent modification of § 10(c), Labor-Management Relations Act (Taft-Hartley Act), 61 Stat. 136 (1947); Labor-Management Reporting and Disclosure Act of 1959 (Landrum-Griffin Act), 73 Stat. 519, cannot be taken to indicate an intention to freeze this interpretation into a statutory mandate. Instead, such approval at most indicates acquiescence in the propriety of this interpretation. See NLRB v. Seven-Up Bottling Co., 344 U.S. 344 (1953).
11. 60 Stat. 258 (1946), 5 U.S.C. § 1003 (1958). Under this provision a general notice of the proposed rule making, including the substance of the proposed rule, must be published in the Federal Register. Interested persons are afforded an opportunity to participate in the rule making through submission of data, views, and arguments. The rule adopted must then be published in the Federal Register not less than 30 days prior to the effective date thereof.
prescribed by the Administrative Procedure Act, such rules and regulations as may be necessary to carry out the provisions" of the NLRA. Assuming this to be a "rule" as defined by the APA, the Second Circuit might well have reversed on the ground of an improper rule-making procedure. The instant court recognized, however, that the Board has discretion in deciding whether to make rules in this manner or to establish them through adjudication of individual cases in the method prescribed by sections 5, 7, and 8 of the APA.

As a matter of practice the NLRB has always set forth its substantive policies and practices in conjunction with its published case decisions and opinions; the Board viewing itself as a quasi-judicial rather than a rule-making agency. Rule making is thought to be too inflexible a means of dealing with the complex factual situations arising out of labor-management relations. Adjudication is considered more desirable because of the establishment of precedents identified with the facts of particular cases.

Although generally the Board may be correct, its rationale, as applied to the non-tolling rule, is not persuasive. Situations to which the non-tolling rule applies are not factually varying and complex. In fact, the rule as stated by the Board expressly tran-


13. "'Rule' means the whole or any part of any agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy . . . ." Administrative Procedure Act § 2(c), 60 Stat. 237 (1946), 5 U.S.C. § 1001(c) (1958).


16. See Hearings on Reorganization Plan No. 5 of 1961 Before the Senate Committee on Government Operations, 87th Cong., 1st Sess., Survey and Study of Administrative Organization, Procedure and Practice in the Federal Agencies—Agency Response to Questionnaire 1810–11 (Comm. Print 1967). Recently, it was forcefully argued that the NLRB has abused its discretion in following this course of action. Peck, The Atrophied Rule-Making Powers of the National Labor Relations Board, 70 Yale L.J. 729 (1961). Professor Peck even suggests that the Board's failure to use the formal rule-making provisions of the APA in appropriate situations may be a violation of, rather than an alternative to, these provisions. Id. at 754–55.
scends the facts of the instant case,\textsuperscript{18} and it appears that this decision was merely a vehicle to announce the change in policy.\textsuperscript{19} In this situation, there are even additional arguments favoring general rather than adjudicatory rule making.\textsuperscript{20} This is not a new situation about which the Board needs to accumulate expertise before formulating a general rule\textsuperscript{21} — this question was “ripe” for rule making. Furthermore, interested persons were unable to present arguments on the issue of tolling back-pay awards;\textsuperscript{22} formal rule making, however, provides for a public hearing\textsuperscript{23} for formulation of rules of general applicability. Indeed, the parties themselves, since they were not notified of an anticipated change in the Board’s decision, made no arguments on the point.\textsuperscript{24} Finally, any problem of retroactivity could have been avoided had the Board acted in its legislative rule-making capacity.\textsuperscript{25}

\textsuperscript{18} The Board’s opinion concluded:

we now hold that in this case and in all similar cases hereafter decided, where backpay or other reimbursement is part of the appropriate remedy, we shall make such award for the full period from the date of the discrimination to the date of an offer of reinstatement . . . or other cut off date found in the particular case, regardless of the nature of the Trial Examiner’s recommendation.

\textsuperscript{19} The rule was also said to apply to proceedings involving violations of § 8(b)(2) of the NLRA, 61 Stat. 141 (1947), 29 U.S.C. § 158(b) (2) (1958).


\textsuperscript{21} The tolling concept has been present since 1936. See note 4 \textit{ supra} and accompanying text. The Board stated in the instant case that they recently had given extensive consideration to this problem. 137 N.L.R.B. at 29.

\textsuperscript{22} An analysis of adjudicative, as opposed to formal rule making, indicates that procedure under the latter is not oppressive or burdensome nor has it resulted in hinderance or delay in the disposition of specific cases. Peck, \textit{ supra} note 17, at 733–34, 758–59.


\textsuperscript{24} There was, as a result, a failure of the adversary system. However, the strong dissent by two of the Board members on the merits of tolling back pay probably justified the Second Circuit in finding that the Board had all of the relevant arguments before it. Compare NLRB v. E & B Brewing Co., 276 F.2d 594, 599 (6th Cir. 1960).

\textsuperscript{25} The Board could apply a number of alternative tests: (1) any portion of the period that occurred before the effective date of the new rule could be tolled as before, and the remainder of such period left untolled; (2) the old tolling rule could apply only to those cases in which the trial examiner's
Assuming, however, that the non-tolling rule was properly established through adjudication, the Board might well have applied this decision prospectively and thereby avoided the undesirable consequences which generally accompany retroactive application of a new rule or policy. Arguably, the employer in the instant case relied on the old rule of not assessing back pay for the period between the trial examiner's report and the Board decision; if it had known of the Board's anticipated rule change it might have rehired the discharged employee after receiving the intermediate report and avoided back-pay liability during this period.

It seems, however, that the Second Circuit properly refused to review the Board's retroactive application of the non-tolling rule. Courts generally uphold the retroactive application of administrative rules or policies unless the prejudice or hardship from such application outweighs the benefit to be obtained. Since respondent was not penalized for conduct that the Board had previously ignored or approved and since respondent was not substantially prejudiced by reliance on the previously followed tolling policy, enforcement of the Board's decision was justified. The existence of the tolling rule probably had no effect on the employer's decision to discharge the employee in this case; a company seldom would rehire, even in the absence of a tolling rule, an employee whose discharge had been approved by a trial examiner.

26. Courts have the inherent power to apply new rules of law prospectively, and on occasion they have done so to avoid injustice or hardship. Great No. R’y. v. Sunburst Oil & Ref. Co., 287 U.S. 358, 364 (1932). It follows that administrative agencies should also have such an option in the adjudication of cases. See NLRB v. Guy F. Atkinson Co., 195 F.2d 141, 148–49 (9th Cir. 1952).

27. See, e.g., Pedersen v. NLRB, 284 F.2d 417 (2d Cir. 1960); NLRB v. International Bhd. of Teamsters, 225 F.2d 943 (8th Cir. 1955); NLRB v. Guy F. Atkinson Co., 195 F.2d 141 (9th Cir. 1952). In SEC v. Chenery Corp., 332 U.S. 194 (1947), the Supreme Court held that the evils of retroactivity must be balanced against the harm resulting from a decision contrary to statutory design or legal and equitable principles.

The general scope of judicial review of agency action is set out in the Administrative Procedure Act § 10(e), 60 Stat. 248 (1946), 5 U.S.C. § 1000(e) (1956).

28. Trial examiners' opinions are highly reliable: 20 to 25% of all intermediate reports are accepted without contest by the parties. Over 70% of
the Board — such as in a test case concerning the fairness of certain labor practices or the extension of NLRB jurisdiction into a new industry — would an employer possibly offer reinstatement to an employee after a favorable decision by the trial examiner, because of the higher possibility of a contrary ruling by the Board. This was clearly not the situation in the instant case.

On the merits, the non-tolling rule may tend to discourage unfair labor practices, but its effect on labor relations will probably not be great, partly because the particular situations to which the rule applies occur infrequently. For the five-year period from fiscal 1956 to 1960, only 8.5% of the contested trial examiners’ reports were reversed in full by the Board, and only 17.6% were reversed in part.29

The non-tolling rule should, however, have a fairly substantial effect in favor of the policy underlying the awarding of back pay and the Board’s other remedial orders — the restoration as completely as possible to what would have obtained but for the discriminatory discharge.30 Moreover, the effect of the non-tolling rule on the individual to a dispute, although of secondary importance, seems favorable. An employer or a union that has committed an unfair labor practice is the “wrongdoer” and thus should assume the additional back-pay liability. Also, even if both parties were equally at fault, an employer or union31 is generally financially better able to pay the additional back pay than is an employee able to go without it. The dissenting Board members contended in this case that a tolling rule is desirable because a respondent should not be penalized for his reliance on a trial examiner’s report.32 That the trial examiner’s report was ever intended to be relied on, however, is unlikely; its purpose is rather to aid the Board in its ultimate disposition of the case.33 The basis for the tolling rule was that respondents did rely and should

the contested decisions are affirmed in full by the Board on review; another 17–18% are affirmed in part. Hearings on Reorganization Plan No. 5, supra note 29, at 143.

29. Hearings on Reorganization Plan No. 5, supra note 5, supra note 16, at 143.
31. Labor organizations, as well as employers, that are responsible for discriminatory labor practices may be assessed back pay under § 10(c) of the National Labor Relations Act. 61 Stat. 147 (1947), as amended, 29 U.S.C. § 160(c) (1958).
32. 137 N.L.R.B. at 33, 35.
33. See Automotive Proving Grounds, Inc., 139 N.L.R.B. 431 n.1 (1962). The trial examiner’s responsibility, as an agent of the Board, is to compile
not be penalized for it," but the competing considerations previously mentioned seem to justify the majority’s decision to abandon the old rule in spite of such reliance.

A change in the posture of the Board, with the appointment of two new members (Chairman McCulloch and Member Brown) early in 1961, apparently has led to a change in Board policy. Chairman McCulloch, speaking at the Federal Bar Association’s annual convention later that year, stated that the Board was studying various ways of taking the profit out of unfair labor practices and that it intended to impose harsher remedies in the face of the growing number of such practices. The reversal of the long-standing tolling practice in the instant case may evidence a shifting policy emphasizing a greater concern for the individual employees.

NLRB: Purchases From or Sales to Interstate Enterprise Satisfies Jurisdiction Requirements

Respondent corporation purchased fuel oil and related products from a supplier engaged in interstate commerce. Respondent itself did not engage in interstate commerce; all of its sales were made to New York homeowners and all of its purchases were an adequate and compact record, including a report containing detailed findings of fact, conclusions of law, and a recommended order. This intermediate report is in effect an initial decision on both facts and law. Hearings on the Administration of the Labor-Management Act by the NLRB Before the Subcommittee on National Labor Relations Board of the House Committee on Education and Labor, 87th Cong., 1st Sess., pt. 1, at 143 (1961).

The trial examiner’s decision is filed with the Board and copies are served on the parties. If no exceptions are taken, the findings, conclusions, and recommendations of the trial examiner are automatically adopted by the Board. If exceptions are filed the case comes before the Board for disposition. 28 Fed. Reg. 7974 (1963), amending 29 C.F.R. § 102.48 (1963). In fiscal 1962, 82% of the cases which went to formal hearing before a trial examiner were contested before the Board. 27 NLRB Ann. Rep. 14 (1962).

34. See E. R. Haffelfinger Co., 1 N.L.R.B. 760, 767 (1936).


For another example of the Board’s new policy, see NLRB Press Release, No. 886, Sept. 21, 1963. See generally Comment, Labor Law’s New Frontier: The End of the Per Se Rules, 3 B.C. Ind. & Com. L. Rev. 487, 490 (1962).
made within that state. Nevertheless, the National Labor Relations Board found that respondent's unfair labor practices "affected commerce" because respondent had made substantial purchases from a supplier engaged in interstate commerce. The Board issued a cease-and-desist order and petitioned the Court of Appeals for the Second Circuit for enforcement. Enforcement was denied on the ground that neither the size of a local business nor the amount of its purchases from interstate suppliers sufficiently demonstrates that a labor dispute would "affect commerce." On certiorari, the United States Supreme Court reversed and held that the NLRB has jurisdiction over intrastate businesses that purchase goods from suppliers engaged in interstate commerce. *NLRB v. Reliance Fuel Oil Corp.*, 371 U.S. 224 (1963).

In enacting the National Labor Relations Act, Congress endowed the NLRB with the fullest jurisdictional breadth permissible under the commerce clause, by vesting in the Board jurisdiction over those labor disputes that "affect commerce." Under the commerce clause, Congress has the power to regulate not only interstate activities but also intrastate activities that have such

1. Respondent purchased several hundred dollars worth of goods in New Jersey, but these purchases were treated as *de minimis*. *Reliance Fuel Oil Corp.*, 129 N.L.R.B. 1166, 1170–71 (1961).


4. *NLRB v. Reliance Fuel Oil Corp.*, 297 F.2d 94, 99 (2d Cir. 1961). The court of appeals desired to know what respondent's contractual relationship with the interstate enterprise was, the proportion of respondent's purchases from that enterprise to the enterprise's total sales in the relevant market, the number and availability of alternate distributors who would be able to supply respondent's customers, as well as other possible relevant facts that would provide a reasonably complete picture of the manner in which a work stoppage would affect commerce.


6. Section 10(a) of the National Labor Relations Act (Wagner Act), 49 Stat. 449 (1935), as amended, 29 U.S.C. §§ 151–68 (1958), empowers the NLRB "to prevent any person from engaging in any unfair labor practice (listed in section 8) affecting commerce." Section 2(6) of the act defines "commerce" to mean "trade, traffic, commerce, transportation, or communication among the several States . . ." and § 2(7) declares "the term 'affecting commerce' means in commerce, or burdening or obstructing commerce or the free flow of commerce, or having led or tending to lead to a labor dispute burdening or obstructing commerce . . ."
a close and substantial relation to interstate commerce that their control is essential or appropriate to protect that commerce from burdens or obstructions. The criterion for determining whether activities have a close and substantial relation to interstate commerce is the effect on interstate commerce, not the source of injury. Congress’ exertion of power need not await an actual disruption of that commerce; it is entitled to provide reasonable preventive measures. The particular volume of interstate commerce affected has no bearing on the question of jurisdiction, so long as the volume is more than that to which the courts would apply the maxim de minimis.

In the instant case, the Supreme Court held that the NLRB had properly found that by virtue of respondent’s purchases from a supplier engaged in interstate commerce, respondent’s unfair labor practices “affected commerce.” Respondent’s labor practices did not actually affect commerce; neither purchases nor transportation of products across state lines were diminished. Congress defined the term “affecting commerce,” however, to encompass potential as well as actual effects on interstate commerce in order to empower the Board to resolve labor disputes before they actually disrupt commerce. The Second Circuit recognized this fact, but questioned the reasonableness of the Board’s determination that the purchases created a potential effect sufficient to give the Board jurisdiction. The cases and quoted language relied on by the Supreme Court indicate that the reason-

8. Thus, activities of an employer who is neither in commerce nor ships anything in commerce are subject to Congress’ control. Consolidated Edison Co. v. NLRB, 305 U.S. 197, 222 (1938); see Stern, The Commerce Clause and the National Economy, 1933–1946, 59 Harv. L. Rev. 645, 684 (1946).
11. If there had been an actual effect, no one could reasonably question the Board’s jurisdiction. See note 35 infra.
12. See note 6 supra; Consolidated Edison Co. v. NLRB, 305 U.S. 197, 222 (1938).
13. The court of appeals did not feel that the record disclosed information sufficient to demonstrate the manner in which a labor dispute would affect commerce. NLRB v. Reliance Fuel Oil Corp., 297 F.2d 94, 99 (2d Cir. 1961).
15. The Court quoted from Polish Alliance: Whether or not practices may be deemed by Congress to affect interstate commerce is not to be determined by confining judgment
The ableness of the Board's determination is not to be tested by the quantitative effect of the activities immediately before it, but by the total potential effect of similar situations throughout the country. The Court relied principally on Polish Alliance v. NLRB,\textsuperscript{16} NLRB v. Fainblatt,\textsuperscript{17} and Wickard v. Filburn.\textsuperscript{18} In those cases the Court held that even though the effect of the immediate activities on interstate commerce is insignificant, the existence of similar situations throughout the country is evidence of a potential harm of sufficient magnitude to interstate commerce to give Congress the power to regulate all of them. The fact that there was no evidence in the instant case of the respondent's activities indicates that in future cases the NLRB need not even demonstrate the representative nature of the activities immediately before it, even though the amount of purchases is insignificant.\textsuperscript{19} Since the economic effect of making sales to a company would seem to be the same as those resulting from purchases,\textsuperscript{20} the instant case should be read to give the Board jurisdiction over employers who either purchase goods from or sell goods to companies engaged in interstate commerce.\textsuperscript{21}

\textsuperscript{16} See Polish Alliance Co. v. NLRB, 306 U.S. 601 (1939).
\textsuperscript{17} See Fainblatt v. NLRB, 306 U.S. 601 (1939).
\textsuperscript{18} See Wickard v. Filburn, 317 U.S. 111 (1942).
\textsuperscript{19} See to the quantitative effect of the activities immediately before the Board. Appropriate for judgment is the fact that the immediate situation is representative of many others throughout the country, the total incidence of which if left unchecked may well become far-reaching in its harm to commerce.
\textsuperscript{20} See Santa Cruz Fruit Packing Co. v. NLRB, 306 U.S. 458 (1939); Newport News Shipbuilding & Dry Dock Co. v. NLRB, 101 F.2d 841 (4th Cir.), rev'd on other grounds, 308 U.S. 241 (1939); NLRB v. A. S. Abell Co., 97 F.2d 951 (4th Cir. 1938).

It is immaterial whether the goods ever cross state lines. In NLRB v. Benevento, supra, a local employer supplied sand and gravel to a company that mixed the sand and gravel with cement purchased outside the state and then sold the mixture to consumers within the state. Although the sand and gravel never left the state, the local employer was held to be subject to the Board's jurisdiction. See also NLRB v. Bill Daniels, Inc., 202 F.2d 579 (9th
Since the NLRB's resources are limited and its potential jurisdiction has been extended to cover practically every industry, no matter how small, the Board has been forced to limit its assertion of jurisdiction to those cases having a substantial impact on interstate commerce. To facilitate this, the Board has established monetary jurisdictional requirements. The Board has divided the country's industries into approximately ten categories.

Cir. 1953), rev'd per curiam, 946 U.S. 918 (1954).

In addition, the purchase or sale of services is not distinguishable from the purchase or sale of goods. See Siemons Mailing Service, 122 N.L.R.B. 81 (1958); Hygienic Sanitation Co., 118 N.L.R.B. 1030 (1957).

22. See Fatzer, More State Jurisdiction in Labor Disputes Recommended, 24 J.B.A. KAN. 223, 224 (1956). See also Cox, Federalism in the Law of Labor Relations, 67 Harv. L. Rev. 1927, 1929 (1954). In NLRB v. Stoller, 207 F.2d 805 (9th Cir. 1953), a dry cleaning establishment located on government property was held to be subject to the Board's jurisdiction because it purchased $12,000 worth of goods outside the state. See Lamar Hotel, 127 N.L.R.B. 885 (1960) (purchase of $4,800 worth of goods).

23. See Fatzer, More State Jurisdiction in Labor Disputes Recommended, 24 J.B.A. KAN. 223, 224 (1956). See also Cox, Federalism in the Law of Labor Relations, 67 Harv. L. Rev. 1927, 1929 (1954). In NLRB v. Stoller, 207 F.2d 805 (9th Cir. 1953), a dry cleaning establishment located on government property was held to be subject to the Board's jurisdiction because it purchased $12,000 worth of goods outside the state. See Lamar Hotel, 127 N.L.R.B. 885 (1960) (purchase of $4,800 worth of goods).

24. Prior to 1950, the NLRB determined whether it would exercise jurisdiction over labor disputes within its full statutory (legal) jurisdiction on an ad hoc or case-by-case approach. 39 L.R.R.M. 44 (1957); see Cohen, Congress Clears the Labor No Man's Land: A Long Awaited Solution Spawns a Host of New Problems, 56 Nw. U.L. Rev. 333, 385 (1961). In 1950, the Board adopted written standards to aid in deciding whether jurisdiction should be exercised. These were announced in Hollow Tree Lumber Co., 91 N.L.R.B. 685 (1950), and a group of companion cases. 15 NLRB Ann. Rep. 5 & n.10 (1950). These standards reflected, for the most part, results reached by the ad hoc approach. Id. at 5. They were not intended to bind the Board in its exercise of jurisdiction and permitted the Board to decline jurisdiction over entire groups of employers without the necessity of examining the particular facts relevant to each individual employer's operation. See 16 NLRB Ann. Rep. 15-39 (1951); 107 U. Pa. L. Rev. 1027, 1029 & n.10 (1959). The standards were revised in 1954 with the view of further restricting the Board's jurisdiction. See Symposium, NLRB Jurisdictional Standards and State Jurisdiction, 50 Nw. U.L. Rev. 190 (1955). These were announced in NLRB Press Release, No. 467, Oct. 28, 1954, together with the first cases formulating and applying the new standards. In 1958 new jurisdictional standards were promulgated in order to extend the labor policies embodied in the Wagner Act as close to the legal limits of the Board's jurisdiction as possible. These standards were announced in NLRB Press Release, R-576, Oct. 2, 1958, and are enumerated in 23 NLRB Ann. Rep. 7-12 (1958); 42 L.R.R.M. 96-97 (1958); Comment, 28 Fordham L. Rev. 737, 747-48 (1960). In 1959 the standards were extended to include the hotel industry. NLRB Press Release, No. G10, May 14, 1959; 44 L.R.R.M. 70 (1959). Those standards announced in 1958 and 1959 are the standards presently in force. See note 19 supra. See generally Peck, The Atrophied Rule-Making Powers of the National Labor Relations Board, 70 Yale L.J. 729, 735-88 (1961).

In 1959 Congress approved this method of declining jurisdiction. See note 38 infra; Michael Benevento, 138 N.L.R.B. 110 (1962).
and established minimum monetary standards for each category. The monetary standards are basically of two types: the first utilizes an inflow and outflow test; the second utilizes a gross volume test. The monetary standard for the non-retail category, for example, utilizes an inflow and outflow test. If a non-retailer's purchases from or sales to suppliers engaged in interstate commerce exceeds $50,000, the monetary jurisdictional requirement is met. The monetary standard for the retail category, however, utilizes a gross volume test. A retailer satisfies the monetary jurisdictional requirement if his gross income exceeds $500,000.

Where monetary standards utilizing an inflow or outflow test are applicable, it is apparent that the Board has legal jurisdiction over any employer who meets such standards. This is due to

25. The standards presently in effect are: (1) non-retail concerns—$50,000 outflow or inflow, direct or indirect; (2) office buildings—gross revenue of $100,000 of which $25,000 or more is derived from organizations which meet any of the standards; (3) retail concerns—$500,000 gross volume of business; (4) instrumentalities, links, and channels of interstate commerce—$50,000 from interstate (or linkage) part of enterprise, or from services performed for employers in commerce; (5) public utilities—$250,000 gross volume, or meet non-retail standards; (6) transit systems—$250,000 gross volume (except taxicabs, as to which the retail test applies); (7) newspapers and communication systems—$200,000 gross volume (newspapers), $100,000 gross volume (radio, television, telegraph, and telephone); (8) national defense—substantial impact on national defense; (9) business in the territories or District of Columbia—regular standards apply (territories), plenary (District of Columbia); (10) hotel industry—$500,000 gross volume; (11) associations—regarded as single employer. A.B.A. SECTION OF LABOR RELATIONS LAW, COMM. ON DEVELOPMENT OF THE LAW UNDER THE NATIONAL LABOR RELATIONS ACT 7 (1959).

26. Inflow and outflow may be regarded as direct or indirect. Direct outflow refers to goods or services furnished by employers outside the state to an employer within the state (who consequently has a direct inflow). Indirect outflow refers to sales of goods or services to users meeting any of the Board's jurisdictional standards except the indirect inflow or indirect outflow standard. Indirect inflow refers to the purchase of goods or services which originated outside the employer's state but which he purchased from a seller within the state who received such goods or services from outside the state. The Board will add direct and indirect outflow or direct and indirect inflow, but it will not add outflow and inflow. Siemons Mailing Service, 122 N.L.R.B. 81, 85 (1958).

27. See note 25 supra.

28. Carolina Supplies & Cement Co., 122 N.L.R.B. 88 (1958). It appears that the reason the Board does not utilize the inflow and outflow test in all categories is that it would be too difficult to apply in some cases. Ibid.

29. NLRB v. Benton & Co., 318 F.2d 629 (5th Cir. 1963) (indirect inflow); NLRB v. Benevento, 316 F.2d 224 (1st Cir. 1963) (indirect outflow); Better Elect. Co., 129 N.L.R.B. 1012 (1960) (indirect inflow); Borg-Warner Con-
the fact that the only difference between the inflow and outflow test and the test of legal jurisdiction espoused by the instant case is that the former specifies a minimum amount. In *M. Benevento Sand & Gravel Co.*, for example, a local non-retail business sold products valued in excess of $100,000 to a company engaged in interstate commerce. Relying on the instant case, the First Circuit properly found that these sales satisfied both the monetary standards for non-retail concerns (inflow or outflow in excess of $50,000) and the legal jurisdictional requirement ("affecting commerce").

Where monetary standards that utilize a gross volume test are applicable, however, the Board does not have legal jurisdiction merely because such standards are satisfied; obviously, the employer's income may exceed the amount set by the Board even though the employer has no business dealings with enterprises engaged in interstate commerce. In the instant case, for example, respondent's gross income exceeded the retail standard of $500,000. If the products sold to New York homeowners had been purchased from a supplier not engaged in interstate commerce, respondent's operations would not have met the legal jurisdictional requirement although they would still have met the Board's monetary standard. In such a case legal jurisdiction may

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31. Originally, the First Circuit had held that the sales did not give the Board legal jurisdiction. *NLRB v. Benevento*, 297 F.2d 873 (1st Cir. 1961). Upon remand the Board protested this action, but made findings showing that the employer's unfair labor activities actually affected interstate commerce. *M. Benevento Sand & Gravel Co.*, 138 N.L.R.B. 110 (1962). The Board again petitioned for enforcement and in *NLRB v. Benevento*, 316 F.2d 224 (1st Cir. 1963), the court stated:

> It seems to us clear that the Board's assertion of jurisdiction is well founded, particularly in view of the Per Curiam reversal by the Supreme Court of the United States . . . [*N.L.R.B. v. Reliance Fuel Oil Corp.*, 297 F.2d 94 (2d Cir. 1961)] upon which we relied in part in our earlier opinion.


Respondent believed that the Board asserted its legal jurisdiction by virtue of the fact that respondent's income exceeded $500,000. Brief for Respondent, pp. 3, 12-13. If this were the case, the source of goods would have no effect on the question of jurisdiction. But the Trial Examiner's report,
be established by an inflow or outflow of goods or services, an actual impact on interstate commerce, contractual relationships, or by other means. But since it is very unlikely that an employer having a gross income exceeding the large amounts set by the Board would not have an inflow or outflow of goods and services sufficient to satisfy the “purchase or sale” test, the Board probably has jurisdiction over all employers meeting the gross volume standard.

In light of the National Labor Relations Board’s jurisdictional standards, the “purchase or sale” test espoused by the instant case should simplify jurisdictional issues in labor disputes. By doing so, the test will reduce the amount of time, energy, and funds required to resolve jurisdictional issues and the uncertainty as to whether federal or state laws are applicable to particular labor disputes. adopted by the Board, made it clear that the Board relied solely on the purchases. “It is enough to find . . . that the Respondent . . . purchased a substantial amount of fuel oil from . . . [a company engaged in interstate commerce]. Therefore, interstate commerce was affected by the Respondent’s operations.” Reliance Fuel Oil Corp., 129 N.L.R.B. 1166, 1171 (1961). This type of error has been made before. See 55 Wash. L. Rev. 106, 208-04 (1960).


35. NLRB v. Hearst, 102 F.2d 658 (9th Cir. 1939); NLRB v. Bell Oil & Gas Co., 91 F.2d 509 (5th Cir. 1937); Hygienic Sanitation Co., 118 N.L.R.B. 1030 (1957).


37. The Board will assert jurisdiction over employers who refuse to furnish data relevant to the Board’s jurisdictional determinations upon the reasonable request of the Board’s agents, where the record developed at a hearing, duly noticed, scheduled, and held, demonstrates the Board’s statutory jurisdiction irrespective of whether the Board’s standards are satisfied. Tropicana Prods., Inc., 122 N.L.R.B. 121 (1958); 23 NLRB Ann. Rep. 9-10 (1958). In such a case the test will aid the Board in establishing statutory jurisdiction at a hearing.

38. The test eliminates uncertainty as to whether the Board has statutory jurisdiction since the activities of almost any company will satisfy it. Federal and state jurisdiction is not concurrent; in Garner v. Teamsters Union, 346 U.S. 485 (1953), and Guss v. Utah Labor Relations Bd., 353 U.S. 1 (1957), the Supreme Court held that the states could not take any action with respect to labor disputes over which the Board had jurisdiction, even though the Board had declined to act. This created a “no man’s land”; inhabited by employers, employees, and unions with no forum able or willing to provide a remedy. Cohen, Congress Clears the Labor No Man’s Land: A Long-Awaited Solution Spawns a Host of New Problems, 56 Nw. U.L. Rev. 333 (1961);
Federal Income Tax: Depreciation Deduction
Reducing Basis Below Sales Price Allowed

Taxpayer, a corporation engaged in the manufacture and sale of outboard motors, sold its operating assets during the third quarter of its fiscal year to a purchaser who continued to carry on the same business. That portion of the sale price allocated to depreciable assets by the taxpayer exceeded the basis of those assets at the beginning of the fiscal year. In computing its federal income tax for the year of the sale, the taxpayer claimed a deduction for depreciation on the assets sold. The deduction was disallowed on the ground that a taxpayer cannot deduct as depreciation an amount that reduces the basis of its property below sale price. In a suit to recover the additional taxes paid, the district court held that a depreciation deduction cannot be disallowed in the year of sale of depreciable property merely because the selling price exceeds the basis of the property at the

Rothman, Federal-State Relationships as Affected by the Landrum-Griffin Provisions, 40 U. Det. L.J. 228 (1962); Shute, State Versus Federal Jurisdiction in Labor Disputes: The Garner Case, 19 Mo. L. Rev. 119 (1954); 73 Harv. L. Rev. 1086 (1960); 48 Va. L. Rev. 793 (1967). In order to eliminate the "no man's land," Congress added section 14(c) to the Wagner Act. 73 Stat. 541 (1959), 29 U.S.C. § 164(c) (Supp. 1962); see McCoid, State Regulation of Labor Management Relations: The Impact of Garmon and Landrum-Griffin, 48 Iowa L. Rev. 578, 581 (1963). The statute gave the Board discretionary power to decline to assert jurisdiction by published rules or by rule of decision over labor disputes involving any class of employers that, in the Board's opinion, did not have enough of an effect on commerce to warrant the exercise of jurisdiction, provided that the Board could not decline to assert jurisdiction over any labor dispute over which it would have asserted jurisdiction under the standards prevailing on August 1, 1959. It also removed the bar to assertion of jurisdiction by state agencies or courts over labor disputes the Board declined.

In order to reduce the cost of determining which forum has jurisdiction, the Board adopted procedural rules permitting a party or tribunal to seek an advisory opinion as to whether the Board would decline jurisdiction over a labor dispute pending in state tribunals. 25 NLRB Ann. Rep. 19 (1960); cf. Note, 70 Yale L.J. 441 (1961). 29 C.F.R. §§ 102.98-104 (1963) sets out the procedures to be followed in petitioning the Board for an advisory opinion. Related to the advisory opinion procedure is the procedure by which the general counsel may obtain a declaratory order when there is doubt whether the Board would assert jurisdiction. Where both an unfair labor and a representation case relating to the same employer are contemporaneously on file in a regional office of the Board, the General Counsel may obtain a declaratory order disposing of the jurisdictional issue. 29 C.F.R. § 102.105 (1963); see Comment, 28 Fordham L. Rev. 737, 752 n.65 (1960).

Section 167 of the Internal Revenue Code of 1954 permits a taxpayer to deduct a reasonable annual allowance for depreciation in computing taxable income. 2 Depreciation is allowed on the theory that the value of productive capital decreases through use, as a result of the effects of wear and obsolescence. 3 This decrease in value is considered a cost of producing income, similar to wages and raw materials; the total cost of using any asset is the purchase price of that asset less its resale price. Since depreciation deductions are taken annually during the period an asset is actually used by the taxpayer and since taxpayers seldom know the amount that will be recovered upon disposal of an asset, total depreciation is, of necessity, an estimate. This total amount must be spread over the years the asset is actually held, in accordance with a consistent plan. 4 Since taxpayers can only estimate the length of time an asset will actually be held, annual depreciation is, in fact, a double estimate—an estimated proportion of an estimated total.

Prior to 1956 the proper criteria for estimating useful life and salvage value was not settled. Some taxpayers used their

2. General rule.
   There shall be allowed as a depreciation deduction a reasonable allowance for exhaustion, wear and tear (including a reasonable allowance for obsolescence)—
   (1) of property used in the trade or business, or
   (2) of property held for the production of income.
3. See United States v. Ludey, 274 U.S. 295, 301 (1927). In recent years the depreciation allowance has played an increasingly significant role in the financing of capital expansion and plant modernization. This added importance has led to the use of depreciation as a means of implementing national economic policy. See Keith, Importance of the Depreciation Deduction to the Economy, 40 Taxes 163 (1962); Yellon, Depreciation Developments in Congress and the Courts, 38 Taxes 952 (1960).
4. The following methods are specifically allowed by Int. Rev. Code of 1954, § 167(b): 1) straight line method, which consists of equal annual deductions; 2) declining balance method, which consists of deducting a uniform percentage of the remaining undepreciated balance; 3) sum of the years-digits method, which consists of deducting a decreasing percentage of the initial undepreciated balance. See Treas. Reg. § 1.167(g) (1956). In the instant case the taxpayer used the straight line method of computing depreciation.
intended holding period for an asset as useful life and their anticipated resale price for salvage value, while other taxpayers used the period of economic life inherent in the asset and its scrap value. These estimates, and the depreciation computed thereon, provided a source of frequent controversy between taxpayers and the Commissioner. In 1956 the Treasury Department promulgated Regulations pursuant to the Internal Revenue Code of 1954. These Regulations, the first to define useful life and salvage value, phrased the definitions in terms of the expectation of the individual taxpayer. In Massey Motors, Inc. v. United States, the Supreme Court indirectly gave support to the propriety of the Regulations by declaring that the proper measure of useful life for taxable years governed by the 1939 Code was the estimated period that the asset would be held in the business, and salvage value was the estimated price that would be received for the asset upon its retirement. Prior to Massey, in Cohn v. United


7. (b) Useful Life. . . . the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. . . .

(c) Salvage. Salvage value is the amount (determined at the time of acquisition) which is estimated will be realized upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer. . . . The time at which an asset is retired from service may vary according to the policy of the taxpayer. If the taxpayer's policy is to dispose of assets which are still in good operating condition, the salvage value may represent a relatively large proportion of the original basis of the asset. However, if the taxpayer customarily uses an asset until its inherent useful life has been substantially exhausted, salvage value may represent no more than junk value. . . .

Treas. Reg. §§ 1.167(a)–1(b), (c) (1956); see Graves, Depreciation Problems, 102 J. ACCOUNTANCY 48 (1956).


9. See text accompanying note 20 infra.

10. The taxpayers in Massey were engaged in the automobile rental business. The cars that they purchased were depreciated on the basis of a useful life of four years, with no residual salvage value. In fact, the cars
another case involving taxable years governed by the 1939 Code, the Sixth Circuit held that where a taxpayer fails to estimate any salvage value and disposes of assets at the end of their properly estimated useful life, the court may set the actual sale price of the assets as their reasonable salvage value.

Unlike the instant case, both *Massey* and *Cohn* involved the sale of individual assets at the end of the period the taxpayer expected to use those assets in his business. The Commissioner contended, however, that these differences were legally irrelevant. He argued that the rationale of *Massey*, illustrated in were used six to 18 months and sold for a sum that nearly equaled their cost. This was done because of the demand in the industry for modern equipment.

The dispute between the taxpayer and the Commissioner centered on the construction of the *Treasury Regulations* defining the reasonable allowance for depreciation as the annual amount that, plus salvage value, will total cost “at the end of the useful life of the property in the business.” The taxpayer contended that “in the business” referred to “property” and defined the class of assets on which depreciation was allowable. The Court, however, sustained the Commissioner’s contention that “in the business” referred to “useful life” and defined the period of time over which depreciation could be computed.

In order to fully appreciate this case, it must be considered in the context of the previous controversy between the Commissioner and taxpayers engaged in the car rental business. That controversy was whether the cars were business assets held for use in the business and subject to a deprecation allowance, or nondepreciable inventory. See *Philber Equip. Corp. v. Commissioner*, 237 F.2d 129 (3d Cir. 1956), 35 Tex. L. Rev. 610 (1957).

The assets involved in this case were used in the operation of three flight schools during World War II. It was estimated that the flight training contracts would terminate at the end of 1944 and that date was used as the end of the useful life of the assets for purposes of computing depreciation. The assets of one of the schools were sold in August, 1944, and the assets of the other two schools were sold in October and November, 1944. Upon sale, an amount considerably in excess of the undepreciated basis was realized. The district court disallowed the claimed depreciation on all three groups of assets in the year of sale, because the actual salvage value was known at the end of those tax years to be considerably in excess of the book value of those assets at the beginning of the year. Depreciation claimed on one group of assets for the year preceding sale was also denied because it was reasonably estimable, by reason of the prices for which similar equipment had been sold during that year, what the salvage value of those assets would be and this exceeded the book value of those assets at the beginning of the year preceding sale.

12. A distinction between the sale of depreciable assets prior to the end of their useful life and a sale of assets at the end of their useful life was first made by the Tax Court in *Wier Long Leaf Lumber Co.*, 9 T.C. 900.
Cohn, admits that both useful life and salvage value are estimated initially but that when the assets are disposed of the actual holding period and amount realized upon sale are to be used, not the original estimates. Since the Treasury Regulations limit the amount of total depreciation to cost less salvage value, depreciation that reduces the basis of property below the known sale price should be disallowed in the year of sale.

The Commissioner's position was rejected by the instant court as an unwarranted extension of the existing law. The court decided that the useful life of an asset is the period it can reasonably be expected to be used in the taxpayer's business — the useful life does not terminate when a business is sold as a going concern. Thus, the court concluded that the sale price reflected the market value of the assets at a point in time prior to when salvage value is to be judged, not salvage value. Under these circumstances the fact that the sale price exceeded the basis of the assets did not mean that total depreciation exceeded cost less salvage value.


15. Treas. Reg. 1.167(a)-1-(a) (1966) defines the reasonable allowance for depreciation as the amount "set aside for the taxable year . . . so that the aggregate of the amounts set aside, plus salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property. . . ." Treas. Reg. 1.167(a)-1-(c) provides that "in no event shall an asset (or an account) be depreciated below a reasonable salvage value."

16. This is the same position stated in Rev. Rul. 62-92, 1962-1 Cum. Bull. 29, §1:

Therefore, the deduction for depreciation of an asset used in the trade or business or in the production of income shall be adjusted in the year of disposition so that the deduction, otherwise properly allowable for such year under the taxpayer's method of accounting for depreciation, is limited to the amount, if any, by which the adjusted basis of the property at the beginning of such year exceeds the amount realized from sale or exchange. . . .
ported by both authority and reason. Neither Massey nor Cohn controlled the question presented. The taxpayer in Massey had intentionally over-depreciated assets that he disposed of at regular intervals, in an effort to take an undue tax advantage; the decision of the Court in Massey was directed toward preventing such a misuse of the tax law. No such danger existed in the instant case. The sale of an entire business is a single nonrecurring event that is not likely to be induced by a relatively small tax advantage. Cohn involved a taxpayer who failed to consider any salvage value in the computation of depreciation, even though it was anticipated that the assets would be disposed of near the end of a war, when they would demand a substantial price due to the scarcity of goods. In the instant case the taxpayer's estimate of salvage value was reasonable, based on facts known by him when the estimate was made.

Since prior cases did not address themselves to the question, the court in the instant case was required to determine initially whether the proper measure of useful life is the period assets are useful to the taxpayer, or the period assets are useful to the business. The Commissioner seized upon language in Massey to support the proposition that useful life was the period that the assets were useful to the taxpayer. The court rejected this argument on the ground that the language relied on by the Commissioner was addressed to the distinction between usefulness in a particular business and economic usefulness. Even if the language used by the Court in Massey were deemed persuasive, it is quite evident from that case and from the statute.

19. Instant case at 681, 682.
20. In effect the question is whether the emphasis in the phrase “useful in the taxpayer’s business” is placed on “the taxpayer” or on “the business.”
21. “This requires that the useful life of the asset be related to the period for which it may reasonably be expected to be employed in the taxpayer’s business.” 364 U.S. at 107, cited in Brief for Defendant, p. 9, instant case.
22. In the original Act, Congress did provide that a reasonable allowance would be permitted for “wear and tear of property arising out of its use or employment in the business.” . . . This language, particularly that emphasized above, may be fairly construed to mean that the wear and tear to the property must arise from its use in the business of the taxpayer . . . .
364 U.S. at 97. (Emphasis added by Court.)

The alternative is to estimate the period the asset will be held in the
that usefulness to the business is the proper measurement of useful
life.\footnote{24}{\footnotesize If the conclusion were otherwise, the retirement and life expectancy of the taxpayer would be relevant in the computation of depreciation. For example, if two proprietors purchased identical business assets at the same time and both expected to use the assets in their business for a period of 20 years, but one taxpayer was an elderly man who intended to turn his business over to his son in a few years while the other taxpayer was a young man who expected to retain ownership of his business, these expectations would limit the useful life and rate of depreciation of the assets. Such a result does not appear economically sound; nor does it appear to be within the design of the statute.}

Where a taxpayer properly estimates the useful life of his business assets but sells those assets prior to the time he intended to dispose of them and where the assets are sold as part of a going concern to a purchaser who continues to carry on the business of the taxpayer, the sale price is a reflection of the assets’ remaining usefulness in that business. If they had no remaining usefulness the purchaser would not buy them for that purpose. Such a sale does not change the useful life of the assets; rather it lends support to the original estimate. Where assets are sold prior to the end of their useful lives the sale price is the market value of the remaining usefulness plus salvage value, not salvage value alone.\footnote{25}{\footnotesize Cf. Hertz Corp. v. United States, 364 U.S. 122 (1960), 38 CHI-KENT L. REV. 188 (1961), in which the taxpayer depreciated assets using the declining balance method. The assets were sold at the end of their estimated useful life for a price that exceeded the residual undepreciated balance at the end of their useful life. The Commissioner disallowed the portion of the claimed depreciation that would have reduced the balance below sale price, on the ground that the claimed depreciation would reduce the balance below a reasonable salvage value. The Commissioner’s position was sustained, because the assets involved were sold at the end of their estimated useful life. The Court said, however, “that if an asset is disposed of early in what was expected to be its useful life in the business, the depreciation taken may greatly exceed the difference between the purchase price of the asset and its retirement price..." Id. at 127.}

The denial of a depreciation allowance in the year a depreciable asset is sold, merely because the sale price equals or exceeds business and the price that will be received for it on retirement.

\footnote{364 U.S. at 105.}{\footnotesize The approach taken by the Commissioner computes depreciation expense in a manner which is far more likely to reflect correctly the actual cost over the years in which the asset is employed in the business.}

\footnote{364 U.S. at 106.}{\footnotesize \footnotesize Quoted note 2 \textit{supra}.}

\footnote{23.}{\footnotesize The approach taken by the Commissioner computes depreciation expense in a manner which is far more likely to reflect correctly the actual cost over the years in which the asset is employed in the business.}

\footnote{24.}{\footnotesize If the conclusion were otherwise, the retirement and life expectancy of the taxpayer would be relevant in the computation of depreciation. For example, if two proprietors purchased identical business assets at the same time and both expected to use the assets in their business for a period of 20 years, but one taxpayer was an elderly man who intended to turn his business over to his son in a few years while the other taxpayer was a young man who expected to retain ownership of his business, these expectations would limit the useful life and rate of depreciation of the assets. Such a result does not appear economically sound; nor does it appear to be within the design of the statute.}

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the asset's basis, implies that prior depreciation was greater than actual wear and obsolescence would warrant; but other causes may account for such a gain. An increase in value that corresponds to capital asset appreciation that is taxed at the preferential capital gain rate may have been responsible. If so, it should be taxed at the preferential rate in the absence of a specific congressional declaration to the contrary. It should not be conclusively assumed that the gain realized upon sale of a depreciable asset is caused by excessive depreciation without a showing that the prior depreciation was excessive and without allowing the taxpayer to show that the gain was the result of other causes.

Labor Law: Dissenting Employees Entitled to Refund of Union Shop Dues Used for Political Purposes

Respondents, employees of the Southern Railway Company, brought an action in the North Carolina courts to restrain petitioner unions from collecting dues from them under a union shop agreement authorized by section 2 (Eleventh) of the Railway Labor Act. Respondents alleged, and a jury found, that a portion of the dues collected was to be used for political contrib-

26. Examples of other factors which would cause an increase in the value of a depreciable asset are: (1) A general increase in the price level; (2) A fluctuation in the market demand for the asset; (3) An adaptation of the asset to more productive alternative uses.

27. During the taxable years involved in the instant case, the gain or loss on the sale of depreciable assets was subject to the provisions of Int. Rev. Code of 1954, § 1231. The treatment of a gain from such a sale has subsequently been changed by the enactment of the Revenue Act of 1962, 76 Stat. 960, Int. Rev. Code of 1954, § 1245. With certain exceptions this provision taxes as ordinary income that portion of the proceeds from the sale of depreciable assets that exceeds the present basis but is less than the original basis of the asset. This change was part of a major change in the treatment of depreciation. It does not demonstrate a diminution of the interest in capital mobility and plan modernization, but a change in the method of accomplishing those ends.

While the problem involved in the instant case will not arise with respect to transactions to which § 1245 is applicable, the position of taxpayer and Commissioner remain in opposition in the disposal of depreciable assets not subject to § 1245.

For an analysis of recent developments in the treatment of depreciable assets, see Goldstein, Developments in Tax Depreciation and Related Areas, 49 Va. L. Rev. 411 (1963); Shapiro, Recapture of Depreciation and Section 1245 of the Internal Revenue Code, 72 Yale L.J. 1483 (1963).

tions and for a death benefits system, matters unrelated to collective bargaining. The trial court temporarily enjoined petitioners from collecting dues from respondents; the injunction was subject to modification, however, to the extent of that proportion of dues that the unions showed was required for collective bargaining. The Supreme Court of North Carolina reversed, but on rehearing divided evenly and affirmed the lower court's decision. On certiorari, the Supreme Court of the United States, Mr. Justice Black concurring and Mr. Justice Harlan dissenting, reversed and held that although the allegation sufficiently stated a cause of action, the injunctive remedy was improper for it interfered with activities in which the union had a right to engage. *Brotherhood of Ry. & S.S. Clerks v. Allen*, 373 U.S. 113 (1963).

Section 2 (Eleventh) of the Railway Labor Act permits a carrier and a labor union to agree to a union shop in which all employees are required to pay dues, fees, and assessments to the union. In enacting this statute Congress felt that it would be inequitable to provide for collective bargaining by employees and then to allow nonunion employees to reap the benefits of

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4. Mr. Justice Black dissented from the opinion of the Court in the earlier case of International Ass'n of Machinists v. Street, 367 U.S. 740, 780 (1961). Apparently, he concurred here solely on the ground that the instant decision was consistent with the holding in *Street*. *Brotherhood of Ry. & S.S. Clerks v. Allen*, 373 U.S. 113, 124 (1963).
5. Respondents did not enumerate specific political expenditures to which they objected. In upholding the complaint over Mr. Justice Harlan's dissent, the Court apparently overruled *Lathrop v. Donohue*, 367 U.S. 820 (1961), in which specific objections were required. The result of the instant case better guarantees the dissenting member's first amendment right to be exempt from political contributions; the first amendment freedom of expression includes the freedom to refrain from support of all causes as well as the freedom to disapprove of specific causes. See text accompanying note 10 infra.

The Court also decided that it is sufficient to first make the objection in the complaint. Instant case at 119 n.6. The propriety of such a procedure is questionable. In order to reduce litigation some notice prior to the complaint would be more desirable, as the instant Court itself implied when it suggested that unions should strive for internal solution of such problems. Instant case at 123. Under the Labor-Management Reporting and Disclosure Act of 1959, which did not apply to the prior trial of the instant case, a union member may be required to exhaust internal union remedies before resorting to court action. 73 Stat. 522 (1959), 29 U.S.C. § 411(4) (Supp. IV, 1963).
bargaining without contributing to its expense. Literally read, the statute places no restriction on the use of dues collected under a collective bargaining agreement; the Supreme Court in *International Ass'n of Machinists v. Street,* however, construed section 2 (Eleventh) to deny unions the power to spend a dissenting employee's money for political purposes. The Court apparently felt that the exaction of dues for political purposes violates an individual's first amendment right of free expression, and by this construction it avoided invalidating the statute on constitutional grounds.

The *Street* case, however, failed to establish criteria to be followed in fashioning a remedy for dissenting employees. In the instant case, the Court rejected the temporary injunction issued by the North Carolina court on the ground that prior to final

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9. The Court, however, noted that "dissent is not to be presumed" and required that the dissenting employee affirmatively make his objection known to the union. 367 U.S. at 774. See Railway Employes' Dep't v. Hanson, 351 U.S. 225 (1956).

10. The statute had previously been upheld as a legitimate exercise of congressional power in maintaining industrial peace in interstate transportation, Railway Employes' Dep't v. Hanson, 351 U.S. 225 (1956); it therefore pre-empted North Carolina "right-to-work" statutes forbidding a union shop, N.C. Gen. Stat., 95-78 to -84 (1958), which would otherwise have been applicable. See Hudson v. Atlantic Coast Line R.R., 242 N.C. 650, 89 S.E.2d 441 (1955).

Commentators on the decision in *Street* have felt that the Court should have met the constitutional question squarely. See Wellington, *supra* note, 49; 1961 U. Ill. L.F. 526. The Court has also avoided the thorny problem of whether the infringement on the member's freedom of speech is governmental action, or merely private action not protected by the Constitution. Aside from Mr. Justice Douglas' view, expressed in a separate opinion in *Street,* 367 U.S. at 777 n.3, that the infringement would be state action, the Court has not ruled on whether it is state action through judicial enforcement. See Barrows v. Jackson, 349 U.S. 249 (1955); *Shelley v. Kraemer,* 334 U.S. 1 (1948); Comment, *The Impact of Shelley v. Kraemer on the State Action Concept,* 44 Calif. L. Rev. 718 (1956). See also Rice v. Sioux City Cemetery, 349 U.S. 70 (1955). It would appear, however, that the union could be considered an "instrumentality" of the government—an organization to which the government has given coercive authority under the Railway Labor Act. See Burton v. Wilmington Parking Authority, 385 U.S. 715 (1962); Comment, 44 Calif. L. Rev. 718 (1956).

judgment in favor of the dissenting employees the union must be free to collect dues from all. Since dissenting employees may recover improperly paid assessments at the conclusion of the suit, this distinction affects only the time of payment of dues and not the amount paid. Nevertheless, it allows the union to proceed normally with its functions until final judgment, which seems more consistent with the court's holding that the dissenting employee is not entitled to be relieved of the payment of all dues.

Instead, the Court provided that the union refund to dissenting employees a portion of their dues already paid corresponding to the proportion that union political expenditures bear to total union expenditures; the Court also provided that the union reduce the dissenters' future dues in the same proportion.12 Since the unions have possession of all pertinent records, the Court in the instant case required that the burden of proving the proportion of expenditures used for political purposes be on the unions. At the trial below, the unions did not introduce evidence to show the amount of union expenditures for political purposes;13 the Court failed to expressly indicate, however, the procedure to be followed if, on remand, the union should fail to bear its burden of proof. The inference to be drawn from the opinion is that the Court would not permit an injunction restraining a union from collecting any dues. If a union default, the union's accounting records could be subpoenaed and a court could independently determine the probable maximum proportion of total expenditures used for political purposes.

In formulating a remedy, the Court apparently rejected an injunction restraining the union from spending money for political purposes.14 Although such an injunction has much to commend it—it would be relatively easy to administer, it would not need periodic modification, and it would protect the rights of dissenting members—it might violate a right of the majority members to use the union as a vehicle to express their political

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12. Instant case at 122. It would appear that the refund is to encompass the period beginning when the employee voices his objection and ending with the time of final judgment.

13. The record indicated, however, that the trial court probably had allowed the unions an opportunity to satisfy their burden of proof.

14. Another possible remedy, an injunction restraining unions from compelling employees to pay any money, was held improper in Street. 367 U.S. at 771.
views. Whether such a right exists seems open to question. Voluntary associations do have such a right, but, under a union shop agreement, union membership is not necessarily voluntary since dissenting members cannot withdraw and keep their jobs. By electing the benefits of compulsory membership, arguably unions should assume the burden of protecting minority interests. Yet perhaps the instant case, by relieving dissenting members from compulsory contribution to political causes, adequately protects these rights.

15. The Supreme Court apparently recognizes such a right. The fact that these expenditures are made for political activities is an additional reason for reluctance to impose such an injunctive remedy. . . . As to such expenditures [those made to disseminate information on candidates and to publicize the unions’ position on them] an injunction would work a restraint on the expression of political ideas which might be offensive to the First Amendment. For the majority also has an interest in stating its views without being silenced by the dissenters. To attain the appropriate reconciliation between majority and dissenting interests in the area of political expression, we think the courts in administering the Act should select remedies which protect both interests to the maximum extent possible without undue impingement of one on the other.


It is unlawful for any . . . labor organization to make a contribution or expenditure in connection with any election at which Presidential and Vice Presidential electors or a Senator or Representative in, or a Delegate or Resident Commissioner to Congress are to be voted for, or in connection with any primary election or political convention or caucus held to select candidates for any of the foregoing offices. . . .

The constitutionality of this statute has been questioned. See Clover, Political Contributions by Labor Unions, 40 Texas L. Rev. 655 (1962); Ruark, Labor’s Political Spending and Free Speech, 53 Nw. U.L. Rev. 61 (1958); Note, An Attempt To Restrict Union and Corporate Political Activity, 46 Marq. L. Rev. 364 (1963). In several decisions involving activities prosecuted under this provision the courts have avoided the constitutional question by determining that the litigated activity fell outside the proscribed area of political action. In this manner the statute has been effectively emasculated. See, e.g., United States v. CIO, 335 U.S. 106 (1948) (statute does not forbid publication of union periodical for members expressing views on candidates); United States v. Painters Local 481, 172 F.2d 854 (2d Cir. 1949) (statute does not apply to purchases of radio and newspaper advertising in connection with Republican Convention by union not owning a newspaper). A recent exception in which the Court nonetheless did not discuss the constitutionality of the statute is United States v. UAW, 352 U.S. 567 (1957) (use of union dues to sponsor television broadcast designed to influence election would violate statute).

16. Admittedly, in striking a balance between the rights of the majority
Although the issue appears to have been squarely presented in the instant case, the Court failed to establish a guide for determining those expenditures for which the union has the right to compel the payment of dues and those to which objectors may properly dissent. The injunction granted by the North Carolina court included contributions to a death benefits system. By rejecting that injunction as a remedy that "sweeps too broadly," the Court may have limited the right to dissent to those expenditures that are political in nature. Many nonpolitical expenditures, such as payment to a death benefits system, arguably do not affect the individual's freedom of expression sufficiently to override the rights of the majority of the union.

The Street decision, which emphasized that Congress designed section 2 (Eleventh) to require all employees who benefit from collective bargaining to share its cost, may be read, however, to allow dissenters to obtain a refund of dues in proportion to expenditures not germane to collective bargaining. Under this view, a dissenter's constitutional right may be violated even with regard to contributions to a death benefits system.

In either case the Court has left unclear what types of expenditures fall into the class from which members may dissent. If any expenditures not germane to collective bargaining are the proper subject of dissent, the Court would have avoided a substantial amount of future appellate review by an express statement to that effect. Similarly, if only political expenditures are subject to dissent the instant case has left unclear what constitutes a recoverable political expenditure. If the Court

and those of the dissenters, the dissenting member does not receive one element of protection available under an injunction against all political expenditures: Insofar as dissenting members object not only to the contributions to political causes but also to having the union that purports to represent them supporting political positions adverse to their own, a refund of dues does not afford complete relief.

17. Instead, the Court expressly refused to treat this subject. Instant case at 121.
18. Instant case at 117; Brief for Petitioners, pp. 3-4.
19. Instant case at 120.
20. See 367 U.S. at 761-62. Much of the language in Street suggests that recovery of political expenditures was allowed in that decision primarily because they fell outside the area of expenditures germane to collective bargaining. See 367 U.S. at 768, 777, 778, 790. The instant case also occasionally used such language. The instant Court seemed to feel that there is a distinction between "political expenditures" and "those germane to collective bargaining." 373 U.S. at 121.
21. It might be contended that the Court intended to adopt the test for "political objects" set out in the British Trade Union Act included in an ap-
intended to limit dissent to those expenditures that are political in nature, it could have adopted substantially the following test: Any expenditure is political that is designed to gain support for any political candidate, party, or item of legislation. This test encompasses all expenditures relating directly to the influence of the conduct of government—the common definition of the term “political”22—while not unduly restricting a union’s legitimate sphere of activity that is consistent with the union shop.23


23. Such a test would cover direct contributions in support of any political candidate or party and expenditures for advertisements advocating a candidate or party. Lobbying for favorable labor legislation, while perhaps in a sense germane to collective bargaining, is also political in nature and under this test dissenting members would be exempt from supporting it. Cf. International Ass’n of Machinists v. Street, 367 U.S. 740, 777–78 (1961) (Douglas, J., dissenting). Union newspapers containing political editorials create a problem under this analysis. Aside from the political portions, the union should be able to collect funds to maintain a newspaper. However, unless some rational allocation of those funds between political editorials and the remainder of the publication could be made, dissenting members should be exempted from supporting such a newspaper.
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