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Case Comments

Constitutional Law: Sales Tax on Fuel for Ships' Stores Valid Under Import-Export Clause

Shell Oil Company sued for refund of a state sales tax\(^1\) on fuel oil to be consumed by vessels engaged in interstate and foreign commerce.\(^2\) The trial court held the tax valid in its entirety. The district court of appeal upheld the tax on fuel for use in interstate commerce, but, relying upon the import-export clause of the Constitution,\(^3\) invalidated the tax on fuel consumed in foreign commerce. The California Supreme Court vacated the opinion of the district court of appeals and affirmed the trial court decision. *Shell Oil Co. v. State Bd. of Equalization*, 64 Cal. 2d 772, 414 P.2d 820 (1966).

The United States Constitution forbids both state\(^4\) and federal\(^5\) taxation of exports. The denial of federal power to tax exports resulted from Southern suspicion that, unless the federal government was restricted in taxing exports, the North would use its numerical advantage to enact taxes which would discriminate against Southern exports.\(^6\) The prohibition of state taxation of exports stemmed from the fear of the inland states that tax burdens would be imposed upon outgoing goods by the coastal states.\(^7\)

1. CAL. REV. & TAX. CODE §§ 6051, 6052. Section 6051 provides: "For the privilege of selling tangible personal property at retail a tax is hereby imposed upon all retailers at the rate of 2½ percent of the gross receipts . . . ."
2. The parties stipulated that the fuel in question was indispensible to the voyage and actually consumed during the voyage. The vessels receiving the fuel fell into three categories: (1) vessels registered in foreign countries and engaged in foreign commerce; (2) vessels registered in the United States and engaged in foreign commerce; and, (3) vessels registered in the United States and engaged in interstate commerce.
3. "No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection laws . . . ." U.S. CONST. art. I, § 10, cl. 2.
4. Ibid.
5. "No Tax or Duty shall be laid on Articles exported from any State." U.S. CONST. art. I, § 9, cl. 5.
7. Madison aptly stated the point of view of the inland states in a debate over adoption of the prohibitions on export taxation: "The states whose produce is exported by other states, were extremely jealous, lest a contribution should be raised of them by the exporting states,
The problem encountered most frequently in interpreting and applying the constitutional prohibition of state taxation of exports is the determination of when articles destined for foreign countries may be taxed. Generally, goods are considered to be part of the general mass of property in a state and subject to its power of taxation until they have started upon a continuous route or journey to a foreign country. For example, Cornell v. Coyne sustained a nondiscriminatory tax on the process of manufacturing an article intended for export because the export process had not begun. An article not yet in the export process is not protected from state taxation even though, in due course, the plan to export the item will be carried out. However, in A. G. Spalding & Bros. v. Edwards a sales tax was nullified because the sale was considered the initial step in the export process. Thus the cases establish that when the goods have commenced their movement abroad and "certainty of foreign destination is plain," the export process is under way and the goods may not be taxed.

In the instant case, this test was inapplicable because both lower courts and the supreme court agreed that fuel oil for ships' consumption is not an export. The United States Supreme Court has consistently held that for goods to be "exports" must not only be removed from the United States but must be delivered to a foreign country. Thus goods to be consumed

by laying heavy duties on their commodities." 3 FARRAND, op. cit. supra note 6, at 328.

8. Empresa Siderurgica, S.A. v. County of Merced, 337 U.S. 154 (1949); Richfield Oil Corp. v. State Bd. of Equalization, 329 U.S. 69 (1946). 9. 192 U.S. 418 (1904). Although this case deals with the federal prohibition on taxation of exports, the court stated that the state prohibition on taxation of exports was "substantially the same." Id. at 427. See Brown v. Maryland, 25 U.S. (12 Wheat.) 419, 445-46 (1827). 10. Empresa Siderurgica, S.A. v. County of Merced, 337 U.S. 154 (1949). The Court held that a personal property tax on the portion of a cement plant which had not actually been shipped did not violate the import-export clause although the cement plant had been sold to a foreign purchaser for shipment to his country. 11. 262 U.S. 66 (1923). 12. The very act that passed the title and that would have incurred the tax had the transaction been domestic, committed the goods to the carrier that was to take them across the sea, for the purpose of export and with the direction to the foreign port upon the goods. The expected and accomplished effect of the act was to start them for that port. Id. at 69. 13. Richfield Oil Corp. v. State Bd. of Equalization, 329 U.S. 69, 82-83 (1946). See also Gough Indus., Inc. v. State Bd. of Equalization, 51 Cal. 2d 746, 748-49, 336 P.2d 161, 162-63, cert denied, 359 U.S. 1011 (1959). 14. See, e.g., Swan & Finch Co. v. United States, 190 U.S. 143, 144-45 (1903). In Swan the Court stated that export cannot mean simply
ing the voyage of a vessel bound for a foreign destination are not exports.\textsuperscript{16}

The California courts found the issue presented to be whether the tax on the fuel to propel the export cargo is the equivalent of a tax on the cargo. The Supreme Court has held that the import-export clause involves more than immunity from a direct tax on the exported goods.\textsuperscript{16} The tax immunity includes "the process of exportation and the transactions and documents embraced in it."\textsuperscript{17} A stamp tax on foreign bills of lading was struck down as the equivalent of a tax on the articles.\textsuperscript{18} A stamp tax on insurance policies covering exports\textsuperscript{19} and a stamp tax on charter parties in foreign commerce have also been held unconstitutional.\textsuperscript{20}

In \textit{Canton R.R. v. Rogan}\textsuperscript{21} the circle of immunity for indirect taxes on exports was limited. The Court reaffirmed the principle that a tax may be unconstitutional as the "equivalent of a

\footnotesize{\textsuperscript{15} See \textit{Id. at} 144-45; \textit{West India Oil Co. v. Sancho}, 108 F.2d 144, 147 (1st Cir. 1939), aff'd sub. nom., \textit{West India Oil Co. v. Domenech}, 311 U.S. 20 (1940); \textit{Matson Navigation Co. v. State Bd. of Equalization}, 136 Cal. App. 2d 577, 289 P.2d 73 (1955).}
\footnotesize{\textsuperscript{17} \textit{Empresa Siderurgica, S.A. v. County of Merced}, \textit{supra} note 16, at 156.}
\footnotesize{\textsuperscript{18} \textit{Fairbank v. United States}, 181 U.S. 283 (1901). Although the tax was a nominal ten cents on each bill of lading, the court argued the amount of the burden is immaterial because the constitutional provision provides for no tax or duty. \textit{Id. at} 291.}
\footnotesize{\textsuperscript{19} \textit{Thames & Mersey Ins. Co. v. United States}, 237 U.S. 19 (1915).}
\footnotesize{\textsuperscript{20} United States v. Hvoslef, 237 U.S. 1 (1915). \textit{Fairbank, Thames & Mersey} and \textit{Hvoslef} involved article I, section 9, clause 5 which is applicable only to the federal government. However, it is established that the same standards apply to the limitation on state power to tax found in article I, section 10, clause 2. \textit{Brown v. Maryland}, 25 U.S. (12 Wheat.) 419, 445-46 (1827).}
\footnotesize{\textsuperscript{21} 340 U.S. 511 (1951).}
direct tax on the articles," but sustained a franchise tax as applied to the income of a railroad engaged solely in the transportation of goods intended for export. Admitting a broad scope of immunity for exports themselves, the Court held that "when the tax is on activities connected with the export or import the range of immunity cannot be so wide" but must "begin and end at the water's edge." The Court did not decide whether loading for export and unloading for import are immune from taxation but held any activity more remote than loading and unloading not within the constitutional prohibition.

In the instant case the California Supreme Court excluded the sale of fuel oil for ships' consumption from the scope of the prohibition of indirect taxes on exports. The court refused to follow the broad language contained in the decisions recognizing the immunity of insurance, bills of lading, and charter parties which would seem to grant immunity to any process or service necessary for exportation. Since such language encom-

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22. Id. at 513.
23. Mr. Justice Jackson, whom Mr. Justice Frankfurter joined, reserved judgment arguing that the constitutional policy of affording inland farms and factories a fair access to the sea unburdened by taxes levied by coastal states may be frustrated by sustaining a tax upon an incident "unavoidable in the process of exportation." Id. at 516-17.
26. Ibid. See Mohegan Int'l Corp. v. City of New York, 17 Misc. 2d 104, 184 N.Y.S.2d 142 (Sup. Ct. 1959). The Canton Court stated that a broader definition of the constitutional protection would "lead back to every forest, mine, and factory in the land and create a zone of tax immunity never before imagined." 340 U.S. at 515. See Western Md. Ry. v. Rogan, 340 U.S. 520 (1951). The Court's belief that the restriction of the immunity imposed in Canton was necessary to retain the constitutional protection within reasonable bounds seems unjustified. The standard of immunity applied to exports could be applied to the export process also. The application of this test to the activities connected with export would not lead back to every forest, mine, and factory in the land. The range of immunity created thereby would not seem unreasonably broad.
29. The same issue was raised in McGoldrick v. Gulf Oil Corp, 309 U.S. 414 (1940), but the Court refused to rule on it because the point was not raised on appeal. Id. at 429.
passes processes and services previously held taxable, the court was undoubtedly correct.

However, this argument is hardly determinative. These cases, restricted to their facts, seem persuasive authority for finding the tax on the fuel oil invalid. The court attempted to distinguish these cases by arguing that while there is a close relationship between the volume or value of the articles of export and the amount of the tax on the insurance, bills of lading, and charter parties, the amount of the sales tax on the oil does not vary according to the volume or value of exported goods. This distinction appears unjustified since the invalidated tax on bills of lading was the same for every bill of lading regardless of the value or volume of the goods covered. A further distinction apparently made by the court was that fuel used to transport export goods is a "distinct or separable subject." This distinction has some validity. While the documents held immune from taxation are symbolic of the goods being exported, fuel oil does not possess this symbolic relationship. However, in another sense, fuel is not distinct or separable. Fuel is absolutely necessary for the voyage, but the documents, although commonly used, are not indispensable.

While relying generally upon Canton R.R. v. Rogan, the California Supreme Court made no reference to the clear implication of Canton that activities of export occurring at or beyond the water's edge are immune from taxation. Apparently the court believed the water's edge test met by the argument that the tax was on the sale of the oil, not on the voyage. However, in export cases courts have traditionally looked to the effect of

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33. E.g., Canton R.R. v. Rogan, 340 U.S. 511 (1951) (transportation of exports to port); Cornell v. Coyne, 192 U.S. 418 (1904) (manufacturing process).
34. It should be noted that the district court of appeals also concluded that the language was too broad but found the tax invalid.
38. Id. at 515. It should be noted that the water's edge test is not free from criticism. Mr. Justice Jackson, joined by Mr. Justice Frankfurter, reserving judgment, argued that "if the constitutional policy can be avoided by shifting the tax from the exported article itself to some incident such as carriage, unavoidable in the process of exportation, then the policy is a practical nullity." Id. at 517.
39. The district court in Shell Oil stated that the spatial concept of giving immunity "at the water's edge" is too rigid a standard to follow. 46 Cal. Rptr. 653, 657-58 (1965).
the tax on exportation rather than to the incidence of the tax.\textsuperscript{39} Thus in the instant case the court should have judged the sales tax, not by the location of the local incident of taxation, but by the location of the effect of the tax in the export process. Under the Canton analysis, if the burden of the tax falls on a part of the export occurring beyond the water's edge, the tax should be invalid.\textsuperscript{40} Even accepting the court's argument that the tax be judged by the place of the local incident, it is arguable that the delivery of the fuel oil to the fuel tanks of the vessel was "the incident which gave rise to the . . . tax . . . ."\textsuperscript{41}

The strong reliance of the California court upon the incidence of the tax is consonant with many references throughout the Shell Oil opinion to commerce clause principles.\textsuperscript{42} Under the commerce clause, the purchase of supplies for use in interstate business "is not so identified with that commerce as to make the sale immune from a nondiscriminatory tax imposed by the State upon intrastate dealers."\textsuperscript{43} However, the commerce clause is not coterminous with the import-export clause.\textsuperscript{44} Because the commerce clause is a grant of power to Congress rather than a prohibition of state taxation,\textsuperscript{45} the courts, in applying the clause, have been free to balance local and national interests. The import-export clause, on the other hand, is an express denial of state power to tax, admitting no exceptions, and allowing the courts no discretion to balance the interests affected.\textsuperscript{46}

\begin{itemize}
\item \textsuperscript{39} In Richfield Oil Corp. v. State Bd. of Equalization, 329 U.S. 69 (1946), the Court found a tax on the sale of oil destined for a foreign port was a tax on exports prohibited by the import-export clause. The Court rejected the argument that the tax was not an impost because it was measured by the gross receipts of retail sales and levied on retailers for the privilege of selling tangible personal property at retail.
\item \textsuperscript{40} In Crew Levick Co. v. Pennsylvania, 245 U.S. 292 (1917), the Court stated it was "duty bound to determine the questions raised under the Federal Constitution upon our own judgment on the actual operation and effect of the tax, irrespective of the form it bears or how it is characterized by the state courts." Id. at 294.
\item \textsuperscript{41} There is some dispute whether the tax on the fuel actually results in an increase of the cost of exported goods. Appellant's Brief, p. 20.
\item \textsuperscript{42} Richfield Oil Corp. v. State Bd. of Equalization, 329 U.S. 69, 84 (1946).
\item \textsuperscript{43} A tax falling on a local incident is valid under the commerce clause. See American Oil Co. v. Neill, 380 U.S. 451 (1965).
\item \textsuperscript{44} Eastern Air Transport v. Tax Comm'n, 285 U.S. 147, 153 (1932).
\item \textsuperscript{45} Richfield Oil Corp. v. State Bd. of Equalization, 329 U.S. 69, 75 (1946).
\end{itemize}
port-export clause may invalidate a tax valid under the commerce clause.47

The cases interpreting the import-export clause have not developed a consistent position on the policy considerations underlying the constitutional prohibition of taxation of exports. In the instant case the California Supreme Court made no attempt to justify its decision on policy grounds. The historical policy supporting the constitutional prohibition may be the prevention of discrimination against the inland states.48 If this consideration is controlling, it could be argued that the sales tax in Shell Oil is discriminatory because it is levied on an event which only the coastal states have an opportunity to tax.49

However, the Richfield Oil decision rejected discrimination as the basis of the constitutional prohibition. The immunity of exports from state taxation was found to be "only a phase of a larger design"50 which includes the prohibition of federal taxation. The Court held the intent of the clause was that articles of export be free from any burden of taxation.51 Under this analysis, a tax may be sustained only if it is demonstrated that the tax would not affect the cost of exports.

There is some suggestion in Canton that no policy consideration is sufficiently important to justify a broad construction of the constitutional provision. The opinion appears motivated more by a desire to protect state revenue than by the need for protection of exportation. Arguably Canton is based on the premise that there is no longer any significant policy consideration requiring the prohibition of taxation of exports.52

Although the result which the California Supreme Court reached may be correct, the cases and arguments presented do not seem to dictate such a result. A frank discussion of policy considerations should have been undertaken to determine whether the import-export clause was applicable.

49. However, the policy of preventing discrimination may require only that the coastal states be prohibited from assessing taxes which discriminate against exports. Such a rationale would validate the tax in the instant case since it applies equally to all sales of oil made by California retailers and in no way discriminates against sales to vessels engaged in the export process.
50. 329 U.S. at 76-77.
51. Id. at 76. This position is probably correct. By explicitly stating one exception, the language of the import-export clause would appear to exclude all other exceptions. See note 3 supra.
52. See notes 25-29 supra and accompanying text.
Jurisdiction: Quasi In Rem Jurisdiction Obtained
By Attaching Obligations Under an
Automobile Liability Policy

Plaintiffs, residents of New York, were injured in an automobile accident in Vermont allegedly caused by the negligence of defendant, a resident of Quebec. Plaintiff sought jurisdiction over defendant in New York by attaching the contractual obligation of an insurance company, doing business in New York, to defend and indemnify defendant. Defendant's motion to vacate the attachment and service of summons and complaint was denied. The New York Court of Appeals affirmed, holding that as soon as the accident occurred, insurer's contractual obligation to defend and indemnify defendant was an attachable debt within the meaning of state statutes.1 Seider v. Roth, 23 App. Div. 2d 787, 258 N.Y.S.2d 795, aff'd, 17 N.Y.2d 111, 216 N.E.2d 312 (1966).

In the absence of personal jurisdiction, courts may obtain jurisdiction in rem2 or quasi in rem3 through the presence of property within the territorial jurisdiction of the forum state.4 The forum in which the property is actually located determines the jurisdiction over tangibles.5 However, the jurisdictional location of intangibles6 is often a matter of controversy.7 An appraisal of the requirements of justice, convenience to the parties involved, and efficiency of judicial administration are often significant considerations in determining the situs of an intangible.8

1. N.Y. CIV. PRAC. LAW §§ 5201, 6302.
2. In rem designates proceedings or actions instituted against the thing. See Goodrich, CONFLICT OF LAWS § 68 (4th ed. Scoles 1964). An in rem proceeding is used when both parties have a legal interest in the property itself such as partition of real estate, foreclosure of a mortgage, or enforcement of a lien. See Pennoyer v. Neff, 95 U.S. 715 (1877).
3. Quasi in rem is where no claim upon the thing itself is asserted but the value of the res is sought to satisfy the claim that does exist. See Beale, The Exercise of Jurisdiction In Rem To Compel Payment of a Debt, 27 HARV. L. REV. 107 (1913).
6. Intangible property consists of a right of one individual to have another perform an obligation. See Simmons, Conflict of Laws and Constitutional Law in Respect to Intangibles, 26 CALIF. L. REV. 91, 93 (1937).
One type of intangible which may be the subject matter of quasi in rem jurisdiction is a debt. On the authority of Harris v. Balk, a state court can assume jurisdiction over a debt whenever personal jurisdiction over the debtor can be obtained. Accordingly, most courts have interpreted local statutes to permit attachment of a debt created outside of the state when the debtor is a nonresident corporation doing business within the jurisdiction.

Insurance policies frequently have been recognized as attachable debts under local statutes. Under such statutes most courts require the debt to be absolutely payable at present or in


11. See Minor, Conflict of Laws § 125 (1901). Other courts may be able to assert jurisdiction over the debt, notably where jurisdiction over the creditor can be asserted. See Goodrich, op. cit. supra note 2, § 71; Riesenfeld, Creditors' Remedies and the Conflict of Laws—Part One: Individual Collection of Claims, 60 Colum. L. Rev. 659, 670-78 (1960).

12. Attachment is the process of seizing persons or their property which is used to bring a person before the court or to acquire jurisdiction over the property seized. One species of attachment is known as foreign attachment or garnishment. Garnishment arrests property in the hands of a third person who may become liable to pay it over upon determination of the main action. See Goodrich, op. cit. supra note 2, § 71. In the instant case, foreign attachment, which will be referred to hereinafter as attachment, was the process used for obtaining jurisdiction.


Notice to defendant is necessary if the judgment is to be binding in other states under the full faith and credit clause of the federal constitution. Harris v. Balk, 198 U.S. 215, 228 (1905).

the future, and not dependent on any contingency. But when the existence of an obligation is fixed and the contingency relates merely to the amount or time when due and the amount may be determined with some certainty, many courts have allowed attachment. Cases allowing attachment of insurance policies appear to be based on the theory that the insurer's obligation to the insured is existing and of present value. New York has recognized that an insurance policy may be a debt and has allowed attachment of life insurance and burglary insurance.

In the instant case, the major objection raised to the attachment was that the obligation to defend and indemnify was a contingent debt and therefore not attachable. The court, rejecting this contention, held that the insurer's contractual obligation to defend and indemnify the insured in case of an accident was a debt owing to defendant which could be validly attached. Generally, the determination as to whether a debt is contingent appears to depend upon the following considerations: (1) the existence of an obligation, (2) the indefeasibility of the obligation, and (3) certainty of the value of the obligation.

As soon as an accident occurs, the insurer has an obligation to defend within the policy coverage. While negligence must be


proven, the insurer's obligation to pay for any liability imposed upon the insured also exists from the time of the accident.\textsuperscript{21} Thus, as soon as the accident occurs, an obligation sufficient to create a debtor-creditor relationship between the insurer and the insured exists.

Courts appear to require that a debt must be indefeasibly fixed to be attachable.\textsuperscript{22} Underlying this position is the desire to avoid multiplicity of lawsuits which would result from unenforceable judgments based on attachment of a speculative debt.\textsuperscript{23} In the instant case, the obligation to defend was indefeasibly fixed once the accident occurred and thus was properly attachable. However, the obligation to indemnify was defeasible since it was dependent on proof of negligence. Nevertheless, the objection of attachment of a defeasible debt was not persuasive in the instant case because as soon as negligence was proven this obligation became fixed and was no longer speculative.

In a quasi in rem proceeding, the recovery is limited to the value of the debt;\textsuperscript{24} therefore, the value of the obligation must be determinable in order to enforce the judgment.\textsuperscript{25} However, the pecuniary value of the obligation to defend and indemnify is difficult to determine.\textsuperscript{26} At the time of attachment, the valuation of the insurer's obligation to the insured is unascertainable and will not become certain until the end of the litigation. Nevertheless, New York courts have allowed attachment of the insurer's obligation in previous cases even though the value of the debt was


\textsuperscript{23} Ibid.

\textsuperscript{24} See Beale, supra note 3.


\textsuperscript{26} The question has been raised as to the amount a plaintiff could recover if the defendant defaults. The only logical extension of the court's position would be that if defendant defaults, admitting negligence, plaintiff could recover proven damages up to the limits of the policy. See Comment, N.Y. Civ. Prac. Law § 5201 (Supp. 1965).
not known at the time of attachment but would be determined in the lawsuit. For example, in Matter of Riggle's Estate, relied on by the instant court, the plaintiff, injured in an automobile accident, brought suit in New York against defendant, who died before the lawsuit was completed. In order to continue the lawsuit in the forum, it was necessary to appoint an ancillary administrator who could be served in New York, which was possible only if defendant left real or personal property in the state. The court said that the personal obligation of an indemnity insurance carrier to defend insured was a debt which could be considered personal property. The court was unconcerned with the value of the insurer's obligation, apparently assuming that the value would be determined by the verdict.

The instant court correctly relied on Riggle in deciding that this type of debt is not one a court should be hesitant to attach; once the obligation exists, the fact that it is not indefeasibly fixed and the amount is undetermined at the time of attachment should not be significant if the lawsuit will decide both questions and the judgment can be executed.

The defendant also raised the objection that there was no "attachable debt" because the cause of action was not assignable. In support of his position, the defendant cited a New York statute providing that: "A debt may consist of a cause of action which could be assigned or transferred. However, the court did not discuss assignability, perhaps interpreting the statutory provision as being permissive rather than mandatory. More sig-


28. 11 App. Div. 2d 51, 205 N.Y.S.2d 19 (1962). Even the dissent agreed that the obligation to defend and contingently indemnify was a debt.

29. In Riggle, while only the obligation to defend was considered a debt, the court appears to assume that the obligation to indemnify is part of the obligation to defend. Ibid.

30. A money judgment may be enforced against any debt, which is past due or which is yet to become due, certainly or upon demand of the judgment debtor, whether it was incurred within or without the state, or from a resident or non-resident, unless it is exempt from application to the satisfaction of the judgment. A debt may consist of a cause of action which could be assigned or transferred accruing within or without the state. (Emphasis added.) N.Y. Civ. Prac. Law § 5201.

Any debt against which a money judgment may be enforced is subject to attachment. N.Y. Civ. Prac. Law § 6202.

31. See Brief for Plaintiffs, p. 9.
nificantly, the decision may imply that once the accident oc-
curred the obligation to defend and indemnify was an assignable
cause of action. Traditionally, an indemnity or liability policy
has been considered a personal contract which may not be as-
signed because the insurer has undertaken a given risk.\footnote{32}
However, once the accident has occurred, there is no reason why the
obligation of the insurer to defend or indemnify for the risk as-
sumed may not be assigned since it is a cause of action arising
under the original contract.\footnote{33}

While attachment of an insurer’s obligation to defend and
indemnify is a logical extension of prior cases and existing
statutes, the question remains whether such an extension of
quasi in rem jurisdiction is desirable.

Upon the rationale of the instant case, a suit may be brought
in any state in which the defendant’s insurer is doing business.
Moreover, the New York court did not restrict attachment of the
insurer’s obligation to situations in which the forum is conveni-
ent. However, New York appears to have had enough interest
in the instant case to make it an appropriate forum. The
plaintiffs were residents of New York, as was the co-defendant,
and medical treatment was obtained in New York. The insurance
company was doing business in New York and could easily
defend the suit in that forum. The only resulting inconvenience
would be to the defendant and witnesses who would have to
travel to New York. The two most significant interests appear to
be the resident plaintiff and the amenable insurance company.

Although the doctrine of forum non conveniens places some
limitations on forum shopping, it may not be adequate to prevent
abuse of this extension of attachment. Not all states recognize
the doctrine of forum non conveniens, and most states are reluc-
tant to apply the doctrine to actions which are quasi in rem.\footnote{34}

Another problem in allowing attachment is that if, as in New

\footnote{32} See, e.g., Tynauer v. Travelers Ins. Co., 15 App. Div. 2d 293,
223 N.Y.S.2d 151 (1961), aff'd, 13 N.Y.2d 613, 240 N.Y.S.2d 603 (1963);
N.Y. 570, 123 N.E. 858 (1919).

\footnote{33} See 30 N.Y. Jur. 243. Some limitation may be placed on as-
signability of insurance claim to third parties not involved in the acci-
dent but there appears to be no reason why the claim could not be
assigned to an interested party.

\footnote{34} The doctrine of forum non conveniens is based on the theory
that defendant is subject to service of process in at least two forums. See Annot., 48 A.L.R.2d 800, 815 (1959). However, the property which
is attached to obtain quasi in rem jurisdiction can only exist in one
forum.
York, the plaintiff is not able to make a limited appearance,\textsuperscript{35} the insured will be required to submit to personal jurisdiction or lose his insurance through noncompliance with the cooperation clause of his insurance contract. Thus, allowing quasi in rem jurisdiction results in in personam jurisdiction over the insured. However, in personam jurisdiction may not be unfair in the instant case because of New York’s substantial interest in the case and the convenience of the forum. Also, since the insured always assumes the risk of liability beyond his insurance coverage even if personal jurisdiction is not obtained, a multiplicity of suits will be avoided.

It might be argued that quasi in rem jurisdiction should not be expanded since personal jurisdiction is available where it is reasonably fair to assert jurisdiction over defendant.\textsuperscript{36} Relevant examples of expanded personal jurisdiction are the universally adopted nonresident motorist statutes.\textsuperscript{37} The theory behind these statutes is that the situs of the accident is the most convenient and desirable place to determine merits of controversies.\textsuperscript{38} Further examples are the direct action statutes which permit the injured party to sue the insurer directly without first establishing liability of the insured.\textsuperscript{39} These statutes are intended to reduce the need for piecemeal litigation and to recognize that insurance companies have the primary interest in litigation.\textsuperscript{40}

While personal jurisdiction has been greatly expanded, there

\begin{itemize}
  \item \textsuperscript{35} The trend today is to refuse limited appearance because personal rights and liabilities should not be subject to decisions of different courts and multiplicity of litigation should be limited by determining all issues in one proceeding. See generally Developments in the Law—State-Court Jurisdiction, 73 Harv. L. Rev. 909 (1960).
  \item \textsuperscript{36} See Carrington, The Modern Utility of Quasi In Rem Jurisdiction, 76 Harv. L. Rev. 303 (1962).
  \item \textsuperscript{37} See generally Gibbons, A Survey of the Modern Nonresident Motorist Statutes, 13 U. Fla. L. Rev. 257 (1960). Personal jurisdiction is obtained over the nonresident motorist in the state of the accident by serving a state official. The nonresident motorist is presumed to have consented to the appointment of this official as his agent by the act of driving on the state highways.
  \item \textsuperscript{38} Id. at 261. The insurer has usually established local contacts which he can utilize in employing counsel to appear at trial, and most of the documents used at trials, such as police reports and medical records, are located in the state of the accident.
  \item \textsuperscript{40} Ibid.
\end{itemize}
still remain some situations where jurisdiction is justifiable but cannot be obtained in personam. In the instant case, New York was an appropriate forum and only quasi in rem jurisdiction could be obtained. By allowing attachment of the obligation to defend and indemnify, New York in effect permits suit against the insurer before liability is established. Thus, New York has used quasi in rem jurisdiction to reach a result similar to that obtained through personal jurisdiction granted under direct action statutes.

This use of quasi in rem, while a logical extension of prior law, could produce undesirable results if not restricted to situations where the state serves as an appropriate forum. However, it does not seem inconsistent with considerations of justice, convenience, and judicial efficiency to allow a plaintiff to sue an insurance company in his state of residence.

41. The argument has been made that a plaintiff should be permitted to sue and obtain in personam jurisdiction at his residence. See Ehrenzweig, Ehrenzweig in Reply, 9 J. Pub. L. 328 (1960).

42. Although New York does not have a direct action statute, it has allowed such suits brought under a foreign statute, Oltarsh v. Aetna Ins. Co., 15 N.Y.2d 111, 256 N.Y.S.2d 577 (1965). It should be noted that achieving this result through direct action statutes has inherent safeguards not present in quasi in rem jurisdiction. For a direct action to be applicable at least one of the following must be present: (1) the plaintiff is a resident of the state, (2) the accident occurred in the state, or (3) the policy was issued in the state. See generally Note, 74 Harv. L. Rev. 357 (1960). However, to obtain quasi in rem jurisdiction under the theory used in Seider, the only requirement is that the insurance company be doing business in the forum.

43. If the accident occurs in the state, another factor would seem to be added in favor of attachment. But see Morris v. Gould, Seventh District of Minn. (1966) (pending appeal), which denied attachment of insurer's obligation to defend and indemnify defendant in motorboat accident despite the facts that plaintiff was a Minnesota resident, the accident occurred in Minnesota, and the insurance company was authorized to do business in Minnesota.
Taxation: Multiple Deductions Allowed Under Literal Statutory Interpretation

Taxpayer borrowed money from a bank and purchased premium bonds\(^1\) callable after thirty days, paying the premium out of his own funds.\(^2\) After holding the bonds for thirty days, taxpayer gave the bonds to a family charity\(^3\) subject to the bank loan. The charity immediately\(^4\) resold the bonds to the bank, paid off the loan, and kept the premium. Taxpayer went through the same routine four times in 1952 and again in 1953, using the same bonds, bank, charity, and broker in each transaction. In each case the taxpayer repurchased the bonds on the same day that the charity sold them. He deducted the amount of the bond premiums from his gross income both as an amortizable bond premium and as a charitable contribution.\(^5\) The Tax Court ruled that the taxpayer was entitled to the double deduction for just one of the transactions in each year, since the last three in each year were shams.\(^6\) The Court of Appeals for the First Circuit reversed and held that the taxpayer was entitled to deduct the amount of all four premiums both as amortizable

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1. Premium bonds are purchased at a price higher than face value. The premium may be paid in order to obtain a higher-than-market interest rate, or for a variety of other reasons. See 1 DSWING, FINANCIAL POLICY OF CORPORATIONS 658-62 (5th ed. 1953). The premium is the difference between the purchase price and the face or call value of the bonds. See Hanover Bank v. Commissioner, 369 U.S. 672, 677 (1962); Commissioner v. Korell, 339 U.S. 619 (1950).

2. In 1952 the taxpayer borrowed $52,000 to finance each transaction, contributing about $3,000 himself; in 1953 he borrowed $25,000 for each transaction, again contributing about $3,000 himself. Brief for Respondent, pp. 2-10.

3. The charity was the Stone Charitable Foundation, Inc. During the years in question the president of the foundation was Stephen A. Stone (taxpayer's nephew), the secretary was Abraham Stone (taxpayer's brother), and the treasurer was Alfred P. Rudnick (attorney for various members of the Stone family). Brief for Respondent, p. 3.

4. In 1952, the charity resold the bonds to the bank within a period of days; in 1953, within hours. Brief for Respondent, p. 13.

5. The mechanics of the double deduction may be explained by the following hypothetical: Taxpayer purchases a premium bond for $53,000. The call value of the bond is $50,000. Taxpayer deducts $3,000 from his gross income as amortizable bond premium. When he gives the bond to a charity subject to a $50,000 bank loan, he deducts a further $3,000 from gross income as a charitable contribution. Therefore, the taxpayer receives a $6,000 deduction from a $3,000 outlay. See Fabreeka Prods. Co. v. Commissioner, 294 F.2d 876 (1st Cir. 1961).

6. Stone v. Commissioner, 24 CCH Tax Ct. Mem. 830, 834 (1965). The Tax Court found that the four transactions were part of a prearranged plan whose true economic nature was accurately reflected in one amortization. Ibid.; Brief for Respondent, p. 13.
bond premiums and as charitable contributions since each trans-
action had substance and met the literal requirements of the
applicable statute. Stone v. Commissioner, 360 F.2d 737 (1st Cir.
1966).

The courts have frequently asserted that in tax cases sub-
stance should prevail over form.7 This principle has been in-
voked in attacking almost every kind of tax avoidance plan.3 On
the other hand, there is the frequently enunciated principle
that a taxpayer has the legal right to decrease the amount of
his taxes by any legal means9 and the fact that a transaction was
entered into with the intention of avoiding taxes is immaterial.10
Nevertheless, the courts have realistically refused to accept at
face value every technically correct device which the taxpayers'  
ingenuity has developed in an effort to exploit loopholes in the
tax statutes. One of the most forceful arguments in favor of
closing such loopholes by means of the substance over form
principle is the prevention of the imitation of a successful tax
avoidance scheme.11 Therefore, the courts have repeatedly re-
served the right to scrutinize a transaction in order to determine
whether it is, in substance, a sham.12 Where a transaction is
found to be a sham, it may be ignored for tax purposes.13

The courts have used various approaches in determining

7. E.g., Knetsch v. United States, 364 U.S. 361 (1960). The tax-
payer arranged with an insurance company for a series of loans, using
an annuity which he had just purchased from the company as sole
security. The interest received by the taxpayer on the annuity was less
than the interest he paid on the loans, but the tax deduction on the
latter made the transactions profitable as a whole. In substance, the
taxpayer in Knetsch merely manufactured a tax saving in the form of
interest deductions by going through the motions of purchasing an an-
nuity and borrowing against it. The court looked behind the form of
the transactions and found that neither party intended that the loan
be repaid. Thus, the transactions were held to be a sham. See 2 Bosox
College Ind. & Com. L. Rev. 435 (1961). See also Wolf v. Commissioner,
357 F.2d 483 (9th Cir. 1966); Byerlite Corp. v. Williams, 286 F.2d 285 (6th
Cir. 1960).

8. See Peairs, General Principles of Taxation: An Initial Survey,
6 Tax L. Rev. 471, 494-95 (1951).

9. See, e.g., Chamberlin v. Commissioner, 207 F.2d 462 (6th Cir.

10. See, e.g., Cowden v. Commissioner, 289 F.2d 20 (5th Cir. 1961);
Cravens v. Commissioner, 272 F.2d 895 (10th Cir. 1959).

11. See Rice, Judicial Techniques in Combating Tax Avoidance, 51

12. See, e.g., United States v. Bondurant, 245 F.2d 265 (6th Cir.
1957); Williams v. United States, 219 F.2d 523 (5th Cir. 1955).

13. See, e.g., Helvering v. Tex-Penn Oil Co., 300 U.S. 481 (1937);
Bowers v. Lawyers Mort. Co., 285 U.S. 182 (1932); Particelli v. Commissi-
oner, 212 F.2d 498 (9th Cir. 1954).
whether a technically valid tax maneuver is really a sham which should be disregarded. Several courts, for example, have emphasized the requirement that the challenged transaction be within the underlying purpose of the applicable statute. The appearance of being within the purview of statute is insufficient. Similarly, the Court of Appeals for the Fifth Circuit has emphasized the particular "economic realities" rather than "legal abstractions." Thus, there must be at least the possibility that the taxpayer's financial interest will be affected other than by tax deductions, and the component parts of the plan must be considered together.

However, technically correct transactions have not always been subjected to the close scrutiny which the above principles would seem to suggest. The courts have hesitated to disregard technical adherence to statutory requirements for fear that such action would have unfortunate ramifications in subsequent cases. This hesitancy has been especially apparent in cases arising under section 125 of the Internal Revenue Code of 1939, before its amendment in 1958. This statute, enacted to deal

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14. See generally Rice, supra note 11.
17. Cowden v. Commissioner, 289 F.2d 20, 24 (5th Cir. 1961). The court goes on to say that "the reach of the income tax law is not to be delimited by technical refinements or mere formalism." Ibid. For the principle that income tax law is a practical matter see Commissioner v. Southwest Exploration Co., 350 U.S. 303 (1956); International Trading Co. v. Commissioner, 275 F.2d 578 (7th Cir. 1960).
20. Rice, supra note 11.
21. See, e.g., Eaton v. White, 70 F.2d 449, 452 (1st Cir. 1934).
22. See, e.g., Halle v. United States, 346 F.2d 543 (4th Cir. 1965); Fabreka Prods. Co. v. Commissioner, 294 F.2d 876 (1st Cir. 1961).

AMORTIZABLE BOND PREMIUM.

(a) General Rule.—In the case of any bond, as defined in subsection (d) the following rules shall apply to the amortizable bond premium (determined under subsection (b)) on the bond for any taxable year beginning after December 31, 1941:

(1) Interest wholly or partially taxable.—In the case of a bond (other than a bond the interest on which is excludible from gross income), the amount of the amortizable bond premium for the taxable year shall be allowed as a deduction.
equitably with the peculiar financial nature of premium bonds, allows a deduction to compensate the bondholder for the risk of an early call at face value, and reflects the return of capital nature of the interest paid on such bonds. However, taxpayers soon discovered that the statute afforded an unintended opportunity for tax savings. For example, in *Fabreeka Prods. Co. v. Commissioner*, the taxpayer employed essentially the same machinations found in *Stone*, but did so only once. There, the government argued that the statute was designed to allow deductions only for investment purchases, but the court held that the taxpayer had brought himself within the literal requirements of the statute and was entitled to the deduction.

In the instant case, the government conceded that the taxpayer was entitled to a double deduction for each transaction involving the purchase of premium bonds and their subsequent gift to charity. However, the government contended the taxpayer had really entered into only one transaction in each year and had tried to make it look like four.

(b) Amortizable bond premium.

(1) Amount of bond premium.—For the purposes of paragraph (2), the amount of bond premium, in the case of the holder of any bond, shall be determined with reference to the amount of the basis (for determining loss on sale or exchange) of such bond, and with reference to the amount payable on maturity or on earlier call date, with adjustment proper to reflect unamortized bond premium with respect to the bond, for the period prior to the date as of which subsection (a) becomes applicable with respect to the taxpayer with respect to such bond.

In 1958 Congress eliminated the right to amortize to call date by requiring amortization to be spread over the period to maturity. *Int. Rev. Code of 1954*, § 171(2).


25. See H.R. Rep. No. 1397, 83d Cong., 2d Sess. 26 (1954). The bondholder was allowed to amortize the full premium to the earliest call date to compensate for the risk of an early call of the bonds. See note 6 supra.

26. The premium was often paid to obtain a higher-than-market interest rate, but the interest was paid on the face value of the bond, and was taxed as ordinary income. The deduction was intended to compensate for the fact that the interest earned on premium bonds was in part a return of capital. See Hanover Bank v. Commissioner, 369 U.S. 672 (1962); Commissioner v. Korell, 339 U.S. 619 (1950).

27. 294 F.2d 876 (1st Cir. 1961).

28. Id. at 878. Several other cases have upheld the deductibility of premiums where tax avoidance was the sole consideration. E.g., Halle v. United States, 348 F.2d 543 (4th Cir. 1965); Evans v. Dudley, 295 F.2d 713 (3d Cir. 1961), *cert. denied*, 370 U.S. 909 (1962); Maysteel Prods., Inc. v. Commissioner, 287 F.2d 429 (7th Cir. 1961).

29. Brief for Respondent, pp. 11-12.

30. Id. at 12. The government's argument was similar to the posi-
Since the recipient of the bonds was a family foundation, the government contended that the change in ownership was especially suspect. The government implicitly drew upon the principle that where parties to a transaction are relatives, the transaction is not necessarily a sham, but such transactions are carefully scrutinized to see if actual control passed with the legal title. Here the four transactions were clearly part of a prearranged plan, and the petitioner could be confident of the cooperation of the foundation. In effect, it was argued that the taxpayer never relinquished control, and hence ownership, of the bonds.

The government bolstered this argument with the point that there was not a sufficient interval between the disposition and reacquisition of the bonds to constitute separate transactions. The brief period of time for which the taxpayer relinquished technical ownership, coupled with the fact that the same bonds were immediately repurchased, resulted in one actual risk to be sustained by the taxpayer, and that one risk was adequately reflected by one deduction. Finally the government stressed the fact that the taxpayer's last three maneuvers had no relationship to the original purposes of the statute. The government's arguments were closely related to one another and culminated in the assertion that the last three transactions in each year were without economic substance.

31. The relevant point is that the charity cooperated with the taxpayer in the procurement of a series of tax deductions in return for a series of contributions. The fact that this was a family charity lends support to the government's contention that the charity was merely a receptacle for bare legal title and that the last three transactions in each year were illusory. See Brief for Respondent, p. 18.

32. See, e.g., Johnson v. Commissioner, 86 F.2d 710 (2d Cir. 1936), where a husband gave funds to his wife, then borrowed them back and deducted the interest she charged. The court allowed the deduction, noting that the wife might have collected the note.

33. See Boyce v. United States, 190 F. Supp. 950 (W.D. La. 1961), aff'd per curiam, 296 F.2d 731 (5th Cir. 1961), David L. Laeb, 40 T.C. 161 (1963). In the Laeb case, the husband purchased premium bonds, sold them to his wife, repurchased them, and claimed a deduction on both purchases. The Tax Court disallowed the second deduction. See also Shaw Constr. Co. v. Commissioner, 323 F.2d 316 (9th Cir. 1963), where the court ignored a corporation set up solely for tax purposes, noting that "bare legal title and real ownership are not necessarily synonymous." Id. at 320.


35. The risk of call in the last three transactions was the same risk for which the taxpayer had been given the first deduction since the
The court, in rejecting the government's argument, concluded that the taxpayer had valid reasons for entering into four separate transactions. The court was persuaded that the separate transactions significantly minimized taxpayer's risk in the event that the bonds were called and allowed him to make a sizable investment which lack of funds would otherwise have made more difficult. Beyond this the court was remarkably cursory in its reasoning. It declared itself unpersuaded by the government's arguments, cited a few cases noting the folly of judicially legislating away a loophole in the tax law, and, significantly noted that Stone had been frolicking in a "short-lived playing ground." Since the court felt that the danger of imitation was not present, it was apparently unwilling to change the rules retrospectively on a contestant who had been "shrewd" and "well advised." Further, the taxpayer had complied with the literal requirements of the statute and that procedure had been sufficient in prior cases.

The court in Stone was admittedly faced with a difficult problem. Clearly each transaction met the literal requirements of section 125 and there had been a technical sale and repurchase of the bonds in each cycle. Nevertheless, in view of the repetitive nature of the taxpayer's transactions the instant case is undeniably an extremely liberal application of the principle that literal compliance with a tax statute is the essential factor in such cases, and a retreat from the often articulated principle that substance should prevail over form.

same bonds were repurchased and since there was only a one day interval in the taxpayer's ownership of the bonds. One of the cases relied upon by the court noted the importance that the risk sustained by the taxpayer has in assessing ownership. See Maysteel Prods., Inc. v. Commissioner, 287 F.2d 429 (7th Cir. 1961).

36. 360 F.2d at 740.
37. Ibid.
38. See, e.g., Halle v. United States, 346 F.2d 543, 551 (4th Cir. 1965); cf. United States v. Rhode Island Hosp.-Trust Co., 355 F.2d 7-7-1 (lst Cir. 1966).
39. 360 F.2d at 740.
40. Ibid.
41. Ibid.
42. Id. at 739-40.
43. The mere repetitiveness of the transactions did not stamp the scheme as a sham, especially after similar single transactions had been upheld in Fabreka and Halle; however, the artificial appearance of the plan when viewed as a whole might well have spurred the court to a closer look at the changes in ownership and control. See Treas. Reg. § 1.171-2(a)(3) where the Commissioner declares his intention to scrutinize immediate purchases and transfers of premium bonds.
A careful analysis of the situation in the instant case reveals that the last three transactions in each year had no possibility of affecting the taxpayer's financial position other than by way of a tax deduction, since the same bonds were repurchased almost immediately after being given to the charity and resold to the bank. Moreover, the transactions were entered into by the taxpayer and an entity which could reasonably be found to be under his control. Finally, the four transactions were planned in advance in an effort to gain four tax deductions out of one continuous $50,000 investment. In view of the above, it would have been quite possible, indeed more logical, for the court to have disregarded the last three transactions of each year. Had the taxpayer used different charities and different bonds in each transaction, the court's holding would be more defensible since the taxpayer would have incurred a different risk of early recall of the bonds, or would not have been able to control the charity's subsequent dealings with the bonds. Further, the court did not need to "legislate" in order to invalidate the last three transactions in each year; it had only to look behind their form and find them to be shams. That the court chose not to do so may be traced to the fact that Congress had put an end to such maneuvers in 1958.

It is true that Congress had closed this particular loophole, and the court may have felt that it was not setting a dangerous precedent for related areas of tax law since, especially in tax cases, "each case turns upon the particular facts involved." However, since Stone may be cited as precedent for upholding the validity of illusory transactions, the court has added to the government's burden in combatting subsequent sham tax transactions.

44. The court seemed to attach some significance to the taxpayer's assertions that the four transactions were motivated by a desire to minimize the risk and to avoid the need for arranging for large amounts at one time. 360 F.2d at 740. Other courts have been more discerning when viewing a taxpayer's purported "reasons" for his operations. See, e.g., Shaw Constr. Co. v. Commissioner, 323 F.2d 316 (9th Cir. 1963); Gilbert v. Commissioner, 248 F.2d 399 (2d Cir. 1957).

45. Otherwise, if the taxpayer could arrange the financing, it would have been simple enough to arrange one $200,000 purchase.

46. See Boyce v. United States, 190 F. Supp. 950 (W.D. La. 1961), aff'd per curiam, 296 F.2d 731 (5th Cir. 1961).

47. Nassau Lens Co. v. Commissioner, 308 F.2d 39, 44 (2d Cir. 1962).
Trade Regulation: Section 5 of FTCA Requires No Demonstration of Anti-Competitive Possibilities in Exclusive Dealing Agreements

Petitioner, the second largest shoe manufacturer in the United States, had entered into franchising agreements with its customers requiring the customer to concentrate its "business within the grades and price lines of shoes representing Brown Shoe Company... and... have no lines conflicting with Brown Division Brands of the Brown Shoe Company." Retailers participating in this franchise program received valuable benefits and services without cost. The Federal Trade Commission, finding that such agreements violated Section 5 of the Federal Trade Commission Act as "unfair methods of competition," ordered petitioner to cease and desist from this practice. The Eighth Circuit dismissed the order after finding that there was no tying agreement and no illegal exclusive dealing agreement. The Supreme Court reversed, holding that the program conflicted with the underlying policy of the Sherman and Clayton Acts and was thus an "unfair method of competition" within the meaning of Section 5 of the Federal Trade Commission Act, even though the FTC did not prove that the effect of the exclusive dealing agreement "may be to substantially lessen competition." FTC v. Brown Shoe Co., 384 U.S. 316 (1966).

1. Brown, as of 1959, was the third largest manufacturer of shoes by pairage. However, they were second in dollar volume of business. Brown Shoe Co., 9 CCH TRADE REG. REP. (Complaints, Orders, Stipulations) ¶ 16316, at 21145 (1963).

2. Brown marketed its shoes through mail order houses and a substantial number of company owned retail shoe stores. They also distributed shoes through approximately 6,000 independent retail shoe stores of which only 700 participated in the franchising program. Brief for Petitioner, p. 4.


4. The services included: merchandising records and advice, services of a field representative, the right to participate in group insurance plans, retail sales training programs, an expensive accounting system, signs and business forms, and special prices on canvas and rubber footwear. Brown Shoe Co., 9 CCH TRADE REG. REP. (Complaints, Orders, Stipulations) ¶ 16316, at 21135 (1963).


Although exclusive dealing arrangements may violate both Sections 1 and 2 of the Sherman Act, Section 3 of the Clayton Act makes explicit reference to exclusive dealing and has been the primary tool for preventing such practices. A section 3 violation is shown only if the effect of the conduct in question "may be to substantially lessen competition or tend to create a monopoly in any line of commerce." Since the Clayton Act was intended to supplement the Sherman Act, the standards of illegality are generally less rigorous than those applied in Sherman Act cases. Nevertheless, specifying the degree of lessened competition which must be shown to establish a violation has caused much difficulty.

Prior to 1949, the courts applied a detailed ad hoc economic analysis to determine whether the conduct in question constituted a substantial competitive deterrent. In that year, the quanti-

8. Exclusive dealing may be defined as the situation in which goods, commodities or services are sold or leased on the condition that the purchaser or lessee will not handle products of a competing supplier.

9. Section 1 provides: "Every contract, combination... or conspiracy, in restraint of trade... is hereby declared to be illegal..." Section 2 provides: "Every person who shall monopolize, or attempt to monopolize... shall be deemed guilty of a misdemeanor..." 26 Stat. 209 (1890), 15 U.S.C. § 1 (1964).

10. That it shall be unlawful for any person engaged in commerce... to lease or make a sale or contract for sale of goods... or other commodities... or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods... or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce. 38 Stat. 731 (1914), 15 U.S.C. § 14 (1964).

11. "Standards of illegality" are conditions which must be proven in order to find a violation. As used in this comment, the term applies primarily to the question of the degree of competitive effect which must be demonstrated and whether or not there is economic justification for the particular act; it does not pertain to a consideration of whether the conduct in question is technically within the wording of the statute.

tative substantiability\textsuperscript{15} rule was introduced which simply required a showing that competition was foreclosed in a substantial share of the market.\textsuperscript{16} No consideration was given to economic justification for the practice. However, this trend toward a lesser burden of proof was reversed by \textit{Tampa Elec. Co. v. Nashville Coal Co.}\textsuperscript{17} The Court held that application of the competitive standard required a consideration of the relative bargaining strengths of the parties, the proportionate volume of commerce involved in relation to the total volume of commerce in the relevant market, and the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein. \textit{Tampa Electric} rejected the suggestion that the standard of illegality established by \textit{Standard Stations} required only a showing that the exclusive dealing arrangement involved a substantial number of dollars.\textsuperscript{18} While the “standards of illegality” are still ambiguous, the most plausible interpretation of the Court’s requirements is that a higher standard of illegality must be met.\textsuperscript{19}

It is well established that acts and practices which violate the specific terms of the Sherman or Clayton Acts are within the meaning of “unfair methods of competition” of Section 5 of the

\textsuperscript{15} Quantitative substantiability may be distinguished from qualitative substantiability primarily by means of an examination of the type of proof required to meet the standards of illegality. Quantitative requires only a demonstration that competition has been foreclosed in a substantial share of the relevant market area affected. Qualitative would require a more extended economic analysis and would consider economic justification or necessity a defense. See \textit{Lockhart & Sacks, supra} note 11, at 922-928 for a list of possible economic considerations.


\textsuperscript{17} 365 U.S. 320 (1961).

\textsuperscript{18} The court noticeably avoids the statement that demonstration of mere market percentage is not enough. Furthermore, inasmuch as the economic considerations, e.g., the fact that Tampa was a public utility and the purchasers in \textit{Standard Stations} were retail outlets and that Tampa was interested in the agreement whereas there may have been an element of coercion in \textit{Standard Stations}, were quite diverse, it is doubtful that \textit{Tampa} overrules \textit{Standard Stations}. However, it may be argued that a substantial percentage of the market would be intrinsically unreasonable to the point that it would create a per se illegality if it exceeded the \textit{Standard Stations} amounts.

\textsuperscript{19} \textit{See, e.g., Sandura Co. v. FTC}, 339 F.2d 847 (6th Cir. 1964); \textit{Susser v. Carvel Corp.}, 332 F.2d 505 (2d Cir. 1964).
It has also been held that certain acts and practices similar to those prohibited by other antitrust legislation are within the scope of section 5 even though the conduct is beyond the specific provisions of those acts. In so finding, the standards of illegality of the act whose provisions the behavior approximates have been applied. Finally, incipient Sherman Act violations, those where the anti-competitive effect does not presently violate Sherman Act standards, are also within the scope of section 5.

Dicta has appeared in several decisions of the Court suggesting that section 5 may also include incipient Clayton Act violations. Fashion Originators', Inc. v. FTC outlawed under section 5 a group boycott organized within the garment industry against retailers who sold garments copied from designs created by Guild members. Although the boycott was well within the prohibitive policy of Sherman and met the competitive standard established under that act, the Court also discussed the application of Clayton Act policies to the facts presented, concluding that the Commission has the power to

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22. See Grand Union Co. v. FTC, 300 F.2d 92 (2d Cir. 1962); Foremost Dairies Inc., 52 F.T.C. 1480 (1955); Carnation Co., 9 CCH TRADE REP. (Complaints, Orders, Stipulations) ¶ 15911, at 20728 (1962).


24. 312 U.S. 457 (1941).

25. See Eastern States Retail Lumber Dealers' Ass'n v. United States, 234 U.S. 600, 609-11 (1914); Addyston Pipe & Steel Co. v. United States, 85 Fed. 271 (6th Cir. 1898), aff'd, 175 U.S. 211 (1899); Comment, 58 YALE L.J. 1121, 1136-40 (1949).

26. The practices of the Fashion Originators' Guild were of the type designated per se illegalities. See Eastern States Retail Lumber Dealers' Ass'n v. United States, supra note 25; Addyston Pipe & Steel Co. v. United States, supra note 25. To meet the tests of per se illegality the conduct itself need only be demonstrated to constitute a transgression of the law. FTC v. Pacific States Paper Trade Ass'n, 273 U.S. 52, 62 (1927). See also cases cited in note 34 infra.
suppress practices in which the defendant’s “purpose and practice... runs counter to the public policy declared in the Sherman and Clayton Acts.”\(^\text{27}\)

In *FTC v. Motion Picture Advertising Serv. Co.*,\(^\text{28}\) the FTC prohibited, under section 5, a distributor of advertising films from securing exclusive exhibition rights in a large number of motion picture theaters for more than one year.\(^\text{29}\) Citing *Fashion Originators’,* the Court made the broad and ambiguous statement: “It is also clear that the Federal Trade Commission Act was designed to supplement and bolster the Sherman Act and the Clayton Act... to stop in their incipiency acts and practices which, when full blown, would violate those Acts.”\(^\text{30}\) However, it has been argued that the discussion of incipient Clayton violations was inapplicable because the exclusive screening arrangements fell technically outside the provisions of the Clayton Act.\(^\text{31}\)

In a later case, *Atlantic Ref. Co. v. FTC*,\(^\text{32}\) the Court stated that “all that is necessary in Section 5 proceedings to find a violation is to discover conduct that ‘runs counter to the public policy declared in the’ Act.” Since the conduct in this case was similar to a tying arrangement,\(^\text{33}\) which is a violation of both the Sherman and Clayton Acts,\(^\text{34}\) such language could be in-

\(^{27}\) 312 U.S. 457, 463 (1941).

\(^{28}\) 344 U.S. 392 (1953).

\(^{29}\) It is interesting to note that the Court did not say that all screening agreements were illegal. After taking the business conditions into consideration, the Court decided that all agreements which lasted for more than one year were illegal. It appears that this result would lend a great deal of support to the argument that economic justification is a defense to exclusive dealing activities. The majority did not cite the holding of *Standard Stations* that economic justification may not be considered.

\(^{30}\) 344 U.S. 392, 394-95 (1953).

\(^{31}\) Rahl, supra note 20, at 541. The item sold or leased was only screening time and thus might not be a “commodity” within the language of Clayton.

\(^{32}\) 381 U.S. 357 (1965), 50 M\(\text{N.}\) L. REV. 765 (1966).

\(^{33}\) A tying agreement exists when the seller conditions the sale of the tying product, a unique item which is usually either patented or copyrighted, on the buyer’s corresponding purchase of a nonunique item, the tied product. Thus the seller coerces the purchaser into acceptance of the tied product. See Bowman, *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19 (1957).

\(^{34}\) United States v. Loew’s Inc., 371 U.S. 38 (1962) (block booking of motion pictures to television stations); Northern Pacific Ry. v. United States, 356 U.S. 1 (1958) (railroad contracts tied to the sale of land); Times-Picayune Publishing Co. v. United States, 345 U.S. 594 (1953) (advertisers required to buy equal time in morning and evening paper); International Salt Co. v. United States, 332 U.S. 392 (1947) (sale of salt tied to dispenser); See also Weisbard, *Resale Price Maintenance,*
interpreted as referring to an incipient Clayton Act violation. However, the Court clearly emphasized that the conduct before it was not a technical violation of the Clayton Act but only similar to one. Furthermore, the Court stated that it was applying the same competitive standards that would have been applied if the action could have been brought within the provisions of the Clayton Act.

Thus the case law prior to Brown Shoe expanded section 5 only to include actual violations of other antitrust legislation, conduct resembling that proscribed by the Sherman and Clayton Acts, and conduct which may lead to a Sherman Act violation. Since none of the cases defining the scope of section 5 required a lessening of the competitive standards of the Clayton Act, it may be argued that all references to incipient Clayton Act violations were intended to mean only behaviorally incipient violations, practices behaviorally similar to Clayton Act violations but technically beyond its scope.

In holding that an exclusive dealing arrangement may be found unlawful under section 5 even though the competitive effects of such arrangement do not satisfy the standards of illegality established under section 3, the Court has gone beyond its prior decisions to authorize a test of competitive incipiency. While section 5 was designed to stop potential violations of the antitrust laws in their incipiency, the application of a competitive incipiency test to exclusive dealing arrangements may be contrary to congressional intent. In contrast to the general language of most antitrust legislation, Section 3 of the Clayton Act specifically declares exclusive dealing arrangements to be unlawful. Therefore, it may be argued that the general statement of the Federal Trade Commission Act was not intended to reduce the specific requirements of Clayton. Furthermore, the Clayton Act was enacted after the Federal Trade Commission Act, ne-
gating any possibility that FTCA could have been intended to amend Clayton.37

However, the consequence of a finding of illegality under the Clayton Act differs substantially from a condemnation of the same conduct under section 5. No private party can bring suit under section 5, and the remedy available to the Federal Trade Commission is limited to cease and desist orders.38 If the conduct is violative of the Clayton Act, however, the offending party may be subject to criminal prosecution and civil treble damage suits in addition to government actions designed only to stop the illegal conduct.39 Thus, while Congress clearly intended that the severe remedies available under the Clayton Act be limited to cases in which the conduct "may substantially lessen competition," the existence of the Clayton Act would not seem to show a statutory intent that exclusive dealing arrangements having a lesser competitive effect not be subject to the less severe liabilities flowing from section 5.

It may be argued that the standards of illegality established under the Clayton Act are sufficiently inclusive to reach any exclusive dealing arrangement potentially injurious to competition. Therefore, a test of competitive incipiency would serve only to condemn practices in no way contrary to the public interest. However, such a position is difficult to document. Available economic data does not foreclose the possibility that certain conduct, competitively incipient to the Clayton Act, may adversely affect competition to the injury of the public. The Federal Trade Commission, as an expert body designed to evaluate complex and difficult economic considerations, is best able to make such determinations. Thus Brown Shoe, by refusing to withdraw conduct of this type from the power of the FTC, has taken a necessary step toward a fully effective system for the policing of anti-competitive practices.

Nevertheless, much confusion is likely to result from the failure of the Brown Shoe opinion to set forth guidelines to be followed in cases involving competitively incipient Clayton Act violations in their incipiency. FTC v. Raladam Co., 283 U.S. 643, 647 (1931); Oppenheim, supra note 16, at 823-24. Thus any attempt to include incipient Clayton Act violations within § 5 causes what authorities have termed "incipient-incipiency" or "incipiency squared." Butler, supra note 36, at 164-71; Howrey, supra note 14, at 173; Rahl, supra note 20, at 541.

37. The Clayton Act was itself intended to stop Sherman Act violations in their incipiency. FTC v. Raladam Co., 283 U.S. 643, 647 (1931); Oppenheim, supra note 16, at 823-24. Thus any attempt to include incipient Clayton Act violations within § 5 causes what authorities have termed "incipient-incipiency" or "incipiency squared." Butler, supra note 36, at 164-71; Howrey, supra note 14, at 173; Rahl, supra note 20, at 541.
violations. Although the purpose of the holding can be accomplished only if the Commission is given broad discretion in such cases, some definition of the considerations to be weighed would seem appropriate and necessary. If a practice can be found to be an unfair method of competition upon no showing of injury to competition, section 5 will be extended far beyond the intended scope of the antitrust laws. The opinion of the FTC in *Brown Shoe* apparently applied a standard based on market position and structure rather than market percentages and relative bargaining position. The Commission found an increasing degree of vertical integration among the leading shoe manufacturers which had operated to substantially weaken the ability of the smaller manufacturers to compete effectively.\(^{40}\) The exclusive dealing arrangements of Brown and other leaders in the industry were found to complement the trend toward vertical integration and further reduce industry competition.\(^{41}\) Consequently, prohibition of the Brown franchise program was found necessary "to foster the competitive position of the smaller manufacturers."\(^{42}\) The Court’s repeated reference to Brown as the country’s second largest manufacturer of shoes suggests approval of this line of reasoning.

However, such analysis would not seem to encompass all competitively incipient Clayton Act violations which are injurious to the public interest. Cases demanding application of section 5 may arise in which the structure of the market and the respondent’s position in the market are not relevant competitive considerations. Approval of the FTC rationale in *Brown Shoe* does suggest, however, that all economic considerations bearing upon the competitive effects of the specific conduct in question must be considered and evaluated.

It is submitted that economic justification should also be considered in determining the legality of competitively incipient Clayton Act violations. *Brown Shoe* involved an exclusive dealing arrangement for which there appears no legitimate business justification. The arrangement did not guarantee the retailer a constant source of supply. It was not necessary to make Brown an effective competitor in the industry. The only benefits to the retailer were the collateral incentives offered by Brown exclusively to participants in the program. Brown was advantaged

\(^{40}\) *Brown Shoe Co.*, 9 CCH TRADE REG. REP. (Complaints, Orders, Stipulations) ¶ 16316, at 21146 (1963).
\(^{41}\) Ibid.
\(^{42}\) *Ibid.* at 21146–47.
only by the restraint on competition. There is no reason why such an arrangement should not be found unlawful on a showing of a modicum of anti-competitive potentiality.

Other exclusive dealing arrangements may be justified by legitimate business considerations. For example, such arrangements may substantially aid a newcomer to become an effective competitor in its industry. Also, a purchaser may risk serious losses of business unless continuity is assured by a guaranteed source of supply. If a legitimate economic justification is shown, the offending conduct should be prohibited only if the injury to competition, potential or present, is found to outweigh the legitimate interests of the parties and the public served by continuance of the practice. Since the competitive incipiency test was established only to reach conduct which does not satisfy the "substantially lessen competition" test of the Clayton Act, the public interest furthered by prohibition of such conduct would not seem sufficient to require that substantial inconvenience or loss be imposed upon the defendant.

In conclusion, while Brown Shoe has taken a desirable and necessary step by extending section 5 to reach competitively incipient Clayton Act violations, the decision leaves unanswered many questions crucial to the application of this new and significant development.