No. 361, Burton-Sutton Oil Co. v. Commissioner.

The problem in this case is whether the assignee of an oil and gas lease may deduct either as a rent or royalty the fifty per cent of the net profits derived from the operation of the oil and gas lease paid to the assignor pursuant to the assignment. If the petitioner cannot deduct it, it must treat it as a capital expenditure subject to percentage depletion. In this memorandum I shall deal with the general treatment of the subject in the Tax Court.

The Tax Court except for an occasional deviation has adhered to a simple theory with respect to the depletion deduction. Where the assignor or lessor retained only a right to a share of the net profits derived from the operations under the lease the court has generally held that the lessor has disposed of his entire economic interest in the oil and gas in place; hence the lessor is not permitted to deduct depletion from the net profits paid to him, and the lessee or assignee is not allowed to deduct the amount of the profits paid over to the lessor, but rather the lessee takes percentage depletion on the entire gross income from the property. Where, however, a royalty or other interest in the oil in place in addition to a net profits interest is retained the lessor obtains the depletion deduction and the lessee may deduct as rent or royalty the net profits paid the lessor.

One of the first cases dealing with this problem in the Tax Court was W. S. Green, 26 B.T.A. 1017. There the taxpayer lessor retained a royalty interest and also was to receive one-third of the net profits from operations under the lease. The court held he was entitled to percentage depletion on the net profits, reasoning that the payment received as a share of the net profits is like a cash bonus or advance royalty payment. The court emphasized that the net profits were limited to income derived from the leased property. In Marrs McLean, 41 B.T.A. 565, a similar result was reached. The taxpayer sold and assigned four oil and gas leases. The taxpayer disposed of all his interest in three of these leases and expressly retained a quarter interest in the fourth and was entitled to receive one-quarter of the profits. The taxpayer also received a percentage of the net profits from operations under the other leases, and the assignee obtained exclusive operating rights under all of them. The taxpayer sought percentage depletion on the profits paid by the assignee. The Tax Court held that he was not entitled to the deduction on the profits received from the three leases as to which he had reserved no interest, but that he could deduct it with respect to the fourth, since he had retained an economic interest in part of the oil and gas in place even though payments were not to be made out of any particular portion of the oil. The Elbe case was distinguished because there the taxpayer only

had a contractual right unsecured by an interest in the oil itself. Presumably in this case the retained quarter of the leasehold rights was treated as the equivalent to the royalty interest under the *W. S. Green* case, although analytically all the taxpayer retained in the fourth lease in the *McLean* case was a net profits interest; it was put in the form of an interest in the lease, however.

A slight variation in the factual situation appears in *Schermerhorn Oil Co.*, 46 B.T.A. 151, where the taxpayer, an oil geologist was by contract promised ten per cent of the net profits derived from the oil found on lands which he selected and which were used by his employer. The court held that he was not entitled to deduct depletion from the ten per cent of the profits received because he had only a net profits interest which did not give him a capital investment in the oil and gas in place, citing *Anderson* v. *Helvering*. This is of course consistent with the Tax Court's position that the net profits in and of themselves do not give an economic interest in the oil and gas in place. It should be pointed out, however, that unlike the typical lessor or assignor, the taxpayer never had an economic interest in the oil and gas unless the net profit right gave it to him. Compare *W. R. Murphy*, 6 T.C., No. 42 (slip op. p. 9). The court usually insists on a royalty or some other interest in addition to the net profits, where it permits a deduction

for depletion. Accord, Kirby Petroleum Co., 2 T.C. 1258; Anna Vickers Crawford, unreported. In Estate of Japhet, 3 T.C. 86, the taxpayer acquired an oil and gas sublease by assignment. He assigned his interest to an oil company reserving one-quarter of the net profits. Although the interest was expressly stated to be a sublease, the Tax Court held that it was a sale and the taxpayer was not permitted to deduct depletion from the net profits received. The Tax Court relied on the Elbe and Anderson cases. The Kirby case, supra, was distinguished on the ground that in that case the taxpayer had preserved his economic interest by retaining a right to royalties as well as to net profits.

There are several cases which appear to be inconsistent with the Tax Court's theory as outlined above, one of which is Felix Oil Co., unreported, aff'd 144 F. 2d 276. In that case the taxpayer owned in fee a tract of land in California which was leased for twenty years or so long as oil was produced to an oil company to drill and produce oil. The lessor reserved fifty per cent of the net profits as well as a right to require the sale of fifty per cent of the production to designated purchasers if he was not satisfied with the proceeds of sale. In addition, failure to drill a well within the stipulated time limit was a ground of forfeiture of the lease. No royalty interest was

retained. The court permitted the taxpayer to take percentage depletion on his fifty per cent net profits, emphasizing the fact that the taxpayer was the owner of the fee in the land and had retained the right to compel the lessee to set 50 per cent of the production elsewhere if dissatisfied with the amounts realized by the lessee. It emphasized the fact that the parties intended a lease rather than a sale. The inconsistency of this case with the others cited above and the Burton-Sutton case itself is apparent. The fact that the lessor was the fee owner is irrelevant when dealing with the question of whether he retained an economic interest in the oil and gas in place. Of course, the Felix case is quite correct under this Court's approach in the Kirby case which held that a retention of net profits by a lessee indicates that such an economic interest is owned in the oil as to justify percentage depletion.

Looking at the cases involving the situation where the lessee or assignee seeks to deduct the net profits paid to the lessor as business expenses or as rent or royalties paid, we find the same type of analysis by the Tax Court. The question continues to be whether the lessor has retained an economic interest in the oil and is solved generally by determining whether the lessor retained a royalty interest in addition to net profits. If both are retained the Tax Court calls

it a lease; if only net profits are retained, it is almost invariably called a sale. But cf. A. B. Innis, CCH-TC Dec. Ser. 22.060; Williams Bar Dredging Co., CCH-TC Dec. Ser. 22.068 (held sub-lessees of gold mines could deduct the net profits reserved by the lessors since the parties intended to make a sub-lease rather than an assignment of the lease).

Thus, in Quintana Petroleum Co., 44 B.T.A. 624, the assignee of an oil and gas lease was obligated to pay one-fourth of the net profits to the original assignor and it sought to deduct this amount as a rent, royalty or business expense. The Commissioner argued that the payments were in the nature of capital investments---a part of the cost of obtaining the lease. Citing the Elbe and Andersen cases, the court agreed with the Commissioner, holding that the assignor did not have an economic interest in the oil and gas in place. See in accord Burton-Sutton Oil Co., 3 T.C. 1187, and Gracey, 5 T.C. 296.

There is evidence that the Tax Court has seen the error of its ways. In W. R. Murphy, 6 T.C. No. 42, it was held that taxpayer-assignors who had retained a net profit interest only were entitled to a depletion deduction under your Kirby case.

It would seem that the proper approach in these cases is to hold that as a matter of federal tax law where the lessor or assignor retains a net profit or royalty interest either alone or in conjunction with the other, he retains such an economic interest as to entitle him

to depletion, and the assignee or lessee may consequently deduct

the payments to the lessor as rent or royalties.

THE CONSTITUTIONALITY OF THE RENEGOTIATION ACT AS RETROACTIVELY APPLIED

The policy of recomputing the price of material ordered by the United States for war purposes and recovering excess profits made in producing such items was inaugurated as a result of the experience of World War I. Subsequent investigations by Congress revealed exorbitant profits in the manufacture of munitions and other materials of war.[1] This Court has judicially noticed at least one such instance of excessive profits.[2] The purpose of compelling renegotiation of war contracts is twofold. One such purpose is to reduce war procurement costs. The Act has not been regarded as a revenue measure.[3] Another may be described as a morale purpose.[4] Congress has thought it desirable that no person shall profit unduly or take advantage of the tragic situation of a nation in war.

The original Renegotiation Act was passed by Congress as part of the Sixth Supplemental National Defense Appropriations Act, 1942. 56 Stat. 219, 245. The Act covered the War Department, Navy Department, and the Maritime Commission and directed the "Secretary" of each "whenever in his opinion excessive profits have been realized, or are likely to be realized, from any contract with such Department or from any subcontract thereunder, (1) to require the contractor or subcontractor[5]

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1. Hensel and McClung, Profit Limitation Controls Prior to the Recent War (1944), 10 Law and Contemporary Problems 187, 205. Sen. Rep. No. 944, 74th Cong., 2d Sess. (the Nye Committee).

2. United States v. Bethlehem Steel Co., 315 U. S. 289 (1942).

3. Sharp, Comments on Renegotiation and the Constitution (1944), 11 U. of Chi. L. Rev. 271, 282; Steadman, Legal Aspects of Renegotiation (1944), 42 Mich. L. Rev. 545, 551. But the Act might conceivably be regarded as a revenue measure--a special additional income tax measured by the amount of excessive profits derived from war contracts. Cf. Hudson v. United States, 299 U. S. 498 (1937), where a tax on profits derived from dealing in silver was treated as a special or additional income tax. It is probable, however, that Congress did not regard the Renegotiation Act as a tax measure.

4. Collier, The Constitutionality of Statutory Renegotiation (1944), 10 Law and Contemporary Problems 353, 357.

5. The discussion is specifically concerned with contracts to which the United States is a party. However, similar issues arise with respect to the validity of the Act as applied to subcontractors. The problem is somewhat easier since contracts between private parties only are involved. Cf. Norman v. B. & O. R. Co., 294 U. S. 240 (1935).

to renegotiate the contract price, (2) to withhold from the contractor or subcontractor any amount of the contract price which is found as a result of such renegotiation to represent excess profits, and (3) in case any amount of the contract price found as a result of such renegotiation to represent excessive profits shall have been paid to the contractor or subcontractor, to recover such amount from such contractor or subcontractor." §403(a) of the Act defined renegotiation to include the refixing by the secretary of the department the contract price. The Act was made applicable "to all contracts and subcontracts hereafter made and to all contracts and subcontracts heretofore made, whether or not such contracts or subcontracts contain a renegotiation or recapture clause, provided that final payment pursuant to such contract or subcontract has not been made prior to the date of the enactment of this Act [April 28, 1942]." The Renegotiation Act was thus made expressly retroactive. The Act has been extensively amended since its passage. The first amendment, approved October 21, 1942, further clarified and defined the scope of the Act. 56 Stat. 982. The Treasury Department was made subject to the Act. The second amendment broadened the coverage of the statute to include subsidiaries of the Reconstruction Finance Corporation, i.e., the Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation and the Rubber Reserve Company. 57 Stat. 347. The Third amendment broadened the definition of "subcontract" to include certain brokers, agents and commission men. 57 Stat. 564. The above amendments were retroactive.

The most extensive amendment of the 1942 Act, one which amounted to a complete revision thereof was contained in §701 of the Revenue Act of 1943 which was passed over the veto of the President on February 25, 1944. 58 Stat. 21, 78. The Act was extended to cover the War Shipping Administration; it established a War Contracts Price Adjustment Board, consisting of an officer of each department or agency covered by the act. Standards for determining the amount of excessive profits were set out in more detail than in the 1942 Act as previously amended, numerous exemptions from the renegotiation process were granted, and review of a unilateral

determination of excessive profits was provided for in the Tax Court. The Tax Court is given exclusive jurisdiction to redetermine de novo without judicial review the amount of excessive profits found by the Board. The Tax Court also may redetermine the amount of profits found by a Secretary to be excessive prior to the date of the enactment of the Revenue Act of 1943 with respect to a fiscal year ending before July 1, 1943. The 1943 Act was made retroactive only to the beginning of the 1943 fiscal year with certain exceptions not here relevant. Renegotiation generally proceeds on an overall profits basis, rather than by considering each war contract separately.[6]

The various amendments to the 1942 Act which expanded its coverage also tended to increase the retroactive features of the Act as it was originally passed. Thus the addition of the subsidiaries of the RFC by the second amendment made it applicable to completely executed contracts on which final payments have been made after April 28, 1942, but before the passage of the amendment.

I shall discuss in this memorandum only such aspects of the constitutionality of the Renegotiation Act as concern its retroactive application. There are of course many other possible grounds for attacking the validity of the Act, such as excessive delegation of powers, failure to provide judicial review, etc.

At the outset it would be well to outline the state of the law with respect to contracts made by the United States with private persons. In the first place, the United States cannot be sued without its own consent.[7] Thus the question of direct court review of the constitutionality of the Renegotiation Act and of proceedings thereunder is subject to serious doubt at the present time in several of the cases

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6 Fain and Watt, War Procurement--A New Pattern in Contracts (1944), 44 Col. L. Rev. 127, 149.

7 De Groot v. United States, 5 Wall. 419 (1866). See Lynch v. United States, 292 U. S. 571, 581-82 (1934).

which have been already brought.[8] It may be that the question could be raised in a suit by the United States against a contractor for the recovery of excessive profits already paid over to the latter. The statute authorizes such a suit.[9] However, if the United States is a party to a contract and has consented to a suit thereon, it has been held to be in the same position as a private person. Sinking Fund Cases, 99 U. S. 700, 719 (1878); Lynch v. United States, 292 U. S. 571 (1934). Cf. Chicago & Northwestern Ry. v. United States, 104 U. S. 680 (1881). In the Lynch case suit was brought on a yearly renewable term insurance contract, the rights in which Congress had attempted to repeal. There the court stated, per Brandeis, J., (at p. 579):

> "When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals. That the contracts of war risk insurance were valid when made is not questioned. As Congress had the power to authorize the Bureau of War Risk Insurance to issue them, the due process clause prohibits the United States from annulling them, unless, indeed, the action taken falls within the federal police power or some other paramount power."

In Perry v. United States, 294 U. S. 330 (1935), the issue was the validity of the congressional abrogation of the gold clause in government bonds. Although holding that the petitioner had suffered no actual damages and hence could not recover, the court stated that Congress could not change the obligation of its contract to pay off the bonds in gold of the specified weight. In short, while Congress in the exercise of some paramount power may change the obligations of contracts

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8 Several cases have been brought in three-judge district courts weeking on the ground of unconstitutionality to enjoin on the ground of unconstitutionality the Secretary of the Navy from applying the Renegotiation Act to the plaintiffs' contracts. The defense has been lack of consent to sue the United States. Lincoln Electric Co. v. Knox, 56 F. Supp. 308 (D. C. 1944), held that the suit was not against the United States but against an officer to restrain the enforcement of an unconstitutional law in such a way as to injure the plaintiff's property rights. But see Mine Safety Appliances v. Forrestal, 59 F. Supp. 733 (D. C. 1945), where the suit was dismissed and the Lincoln case distinguished. The latter case is presently on appeal here, No. 71, 1945 Term. A number of cases have also been filed in the Tax Court under the 1944 Amendment to the Act, but no appeal can be taken from its decision.

9. Section 403(c)(2) of the Act as amended provides for suits against a contractor to recover excessive profits.

between private persons,[10] it has been said to be unconstitutional for Congress to break contracts to which the United States is a party. But see the concurring opinion of Chief Justice Stone in the Perry case, at 358, where he suggests that the United States through its sovereign power to regulate the value of money was able to relieve itself of the obligation of its domestic bonds.

On the other hand, in negotiating contracts, "Like private individuals and businesses, the Government enjoys the unrestricted power to . . . determine those with whom it will deal, and to fix the terms and conditions upon which it will make the needed purchases." Perkins v. Lukens Steel Co., 310 U. S. 113 (1940).

The question to be considered then is whether Congress in the exercise of its paramount power to wage war and to make all laws necessary and proper carrying into execution such power may, consistent with the Fifth Amendment, establish a policy retroactively which enables the several procurement agencies to fix unilaterally the amount of profit a contractor may retain, regardless of the express terms of the prior agreement.

It seems to me that the United States would be sound in arguing (1) that the United States, under its war power may establish a policy that no person in supplying the government with war materials shall receive excessive profits, and that the application of such a policy is not to be thwarted by the fact that certain contracts were entered into prior to the time such a policy was enacted into law; (2) that in any event a contractor under the Fifth Amendment is not entitled to receive more than "just compensation" for the manufacture of goods and any taking by the United States of his property rights in such goods in excess of such sum is valid; (3) that a possible argument is that the United States may prevent persons from being unjustly enriched in providing it with the goods and services necessary to wage war.

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10 Legal Tender Cases, 12 Wall. 557 (1870); Norman v. B. & O. R. Co., 294 U. S. 240 (1935).

I

In the Bethlehem Steel case Congress had not acted to establish a general policy that excessive profits on war contracts were contrary to public policy. Thus the United States was forced to rely on its common law remedies. In that case Justice Black said (at p. 309):

> "The problem of war profits is not new. In this country, every war we have engaged in has provided opportunities for profiteering and they have been too often scandalously seized. See Hearings before the House Committee on Military Affairs on H. R. 3 and H. R. 5293, 74th Cong., 1st Sess., 590-598. To meet this recurrent evil, Congress has at times taken various measures. It has authorized price fixing. It has placed a fixed limit on profits, or has recaptured high profits through taxation. It has expressly reserved for the Government the right to cancel contracts after they have been made. Pursuant to Congressional authority, the Government has requisitioned existing production facilities or itself built and operated new ones to provide needed war materials. It may be that one or some or all of these measures should be utilized more comprehensively, or that still other measures must be devised. But if the Executive is in need of additional laws by which to protect the nation against war profiteering, the Constitution has given to Congress, not to this Court, the power to make them."

In Lynch v. United States, supra, we find the statement that the United States is not justified in annulling a contract "unless, indeed, the action taken falls within the federal police power or some other paramount power." The cases cited for that proposition were ones in which private contracts and activities were abrogated or prohibited by the action of Congress under the Commerce or other power.[11/] In short while the obligation of the United States on a contract is as great as that of a private person, it is no greater. Congress may in exercising a delegated power set aside private contracts.[12/] There is no reason why the United States because it is a party to a contract should be powerless to enact general legislation which is necessary to the fulfillment of sovereign policy,[13/] such as the limitation of war profits,

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11 The decisions cited were: The Lottery Case, 188 U. S. 321 (1903); Hipolite Egg Co. v. United States, 220 U. S. 45, 58 (1911); Hoke v. United States, 227 U. S. 308, 323 (1913); Hamilton v. Kentucky Distilleries & Warehouse Co., 251 U. S. 146 (1919); Calhoun v. Massie, 253 U. S. 170, 175 (1920); Compare Home Building and Loan Assn. v. Blaisdell, 290 U. S. 398, 430 (1934).

12. See above note 10.

13. A similar idea was expressed by Justice Holmes in Ellis v. United States, 206 U. S. 246, 256 (1907):
"The Government purely as a contractor, in the absence of special

even though such contract is affected thereby. There is similar reasoning in the concurring opinion of Chief Justice Stone in Perry v. United States, supra, at 358. He suggests that since Congress had the constitutional power "to coin money" and to "regulate the value thereof" it is free to disregard the terms of any contract it has made limiting such power, precisely as it may disregard the provisions of a private contract. Justice Stone adds (at 359):

> "In this posture of the case it is unnecessary, and I think undesirable, for the Court to undertake to say that the obligation of the gold clause in Government bonds is greater than in the bonds of private individuals, or that in some situation not described, and in some manner and in some measure undefined, it has imposed restrictions upon the future exercise of the power to regulate the currency. I am not persuaded that we should needlessly intimate any opinion which implies that the obligation may so operate, for example, as to interpose a serious obstacle to the adoption of measures for stabilization of the dollar, should Congress think it wise to accomplish that purpose by resumption of gold payments, in dollars of the present or any other gold content less than that specified in the gold clause, and by the re-establishment of a free market for gold and its free exportation."

It seems to me that the discussion by the majority of the power of Congress to abrogate the gold clause is dicta; it was not necessary to the result since the holding was that the petitioner had sustained no damages by reason of the fact that he could not receive payment in gold.

The majority opinion went further than the Lynch case, on which it mainly relied, justifies. The Court in that case made no distinction between the binding effect of the obligations in contracts between private persons and contracts to which the United States is a party. The former are clearly subject to the impact of legislation making the performance of the contract illegal or otherwise impossible. The question is whether a statute having such an effect is a reasonable exercise of a congressional power. The answer was negative on the facts

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laws, may stand like a private person, but by making a contract it does not give up its power to make a law, and it may make a law like the present for the reasons we have stated."

The case, however, involved a prospective rather than a retroactive application of a statute.

in the Lynch case. The Court there pointed out that "The Solicitor General does not suggest, either in brief or argument, that there were supervening conditions which authorized Congress to abrogate these contracts in the exercise of the police or any other power." (579-80) There is no reason for treating contracts to which the government is a party differently except perhaps to require a stronger showing that the congressional power otherwise exists and its exercise is reasonable under the circumstances. What might be reasonable in wartime may be arbitrary in time of peace. See United States v. MacIntosh, 283 U. S. 605, 622 (1931). It has been suggested that the Perry case may be distinguished too on the ground that there the United States had directly pledged its credit in the form of forced obligations pursuant to its power "to borrow money on the credit of the United States," whereas procurement contracts are made pursuant to the war powers.[14] But there is no hierarchy of government contracts. Every contract made by the United States pledges its credit, whether the consideration it receives be goods or money.

It should be noted that sovereign states, including the United States, have a power to repudiate contracts in the form of a refusal to consent to be sued thereon. This power is an attribute of sovereignty and is guaranteed to the states by the Eleventh Amendment. Whether refusal to consent is termed a repudiation of a contract or merely a "matter of procedure" the practical result is the same. It is not particularly shocking, therefore, for the United States by general legislation to modify certain of the obligations in its contracts. But the majority in the Perry case, while recognizing the right of the United States to withdraw its consent to be sued, stated (at p. 350):

> "There is a clear distinction between the power of the Congress to control or interdict the contracts of private parties when they interfere with the exercise of its constitutional authority, and the power of the Congress to alter or repudiate the substance of its own engagements when it has borrowed money under the authority which

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14 Compare Steadman, Legal Aspects of Renegotiation (1944), 42 Mich. L. Rev. 545, 557.

> the Constitution confers. In authorizing the Congress to borrow money, the Constitution empowers the Congress to fix the amount to be borrowed and the terms of payment. By virtue of the power to borrow money 'on the credit of the United States,' the Congress is authorized to pledge that credit as an assurance of payment as stipulated,--as the highest assurance the Government can give, its plighted faith. To say that the Congress may withdraw or ignore that pledge, is to assume that the Constitution contemplates a vain promise, a pledge having no other sanction than the pleasure and convenience of the pledgor. This Court has given no sanction to such a conception of the obligations of our Government."

I find difficulty in following this distinction but I must admit that if it is followed it would be very difficult to sustain the Act as applied retroactively. Since Congress may by reasonable use of its express legislative power control private contracts, similarly it may control government contracts which can be said to be made subject to the possible future use of such power. See Home Bldg. & Loan Assoc. v. Blaisdell, 290 U. S. 398, 435 (1934). If this were not so, one Congress might bargain away valuable powers which because of changed circumstances might later be necessary for the preservation of the nation. The Court in the Lynch case recognized this possibility by not foreclosing the question.

The war powers of Congress are to some extent undefined. This must be so since the manner and means of waging war are always changing, and to wage war effectively the exercise of those powers must be molded to meet changing conditions. While it is true that extraordinary circumstances do not create constitutional power, they may justify the full use of such power as exists. Cf. Home Building & Loan Assn. v. Blaisdell, supra, at 426. Chief Justice Hughes speaking for the Court in that case said (at 426):

> "Thus, the war power of the Federal Government is not created by the emergency of war, but it is a power given to meet that emergency. It is a power to wage war successfully, and thus it permits the harnessing of the entire energies of the people in a supreme cooperative effort to preserve the nation."

Again he stated (at 434-35):

> "Not only is the constitutional provision qualified by the measure of control which the State retains over remedial processes, but the State also continues to possess authority to safeguard the vital interests of its people. It does not matter that legislation appropriate to that end 'has the result

of modifying or abrogating contracts already in effect.' Stephenson v. Binford, 287 U. S. 251, 276. Not only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order. The policy of protecting contracts against impairment presupposes the maintenance of a government by virtue of which contractual relations are worth while,--a government which retains adequate authority to secure the peace and good order of society. This principle of harmonizing the constitutional prohibition with the necessary residuum of state power has had progressive recognition in the decisions of this Court."

Of course, the Blaisdell case dealt with the validity of legislation affecting existing contracts between private individuals, not with contracts to which the state was a party. But, as we have seen, there is no real difference between the power to deal with contracts involving only private persons and contracts to which a state or the United States is a party. If the action taken by the United States "falls within the federal police power or some other paramount power," Lynch v. United States, supra, it is no less valid because it changes the terms of a contract to which it is a party. The same rule should apply to public contracts as the Court has stated applies to private contracts:

"Contracts, however express, cannot fetter the constitutional authority of the Congress. Contracts may create rights of property, but when contracts deal with a subject matter which lies within the control of the Congress, they have a congenital infirmity. Parties cannot remove their transactions from the reach of dominant constitutional power by making contracts about them. See Hudson Water Co. v. McCarter, 209 U. S. 349, 357." Norman v. B. & O. R. Co., 294 U. S. 240, 307-8, (1935).

Under its war power the United States may draft men and resources, fix the prices of goods, the wages of labor and in general mobilize the total energies of the people. In doing so it may prevent the dissipation of its resources in procuring the materials of war by an express statutory policy of readjusting procurement contracts to prevent excess profits. Congress had a reasonable basis for finding that uncontrolled war profits lead to inefficiency in production, have a deliterious effect on national morale, and unduly increase the cost of war. It would seem then that Congress under its power to declare war, raise and support armies, and provide and maintain a navy and to

make all laws necessary and proper for carrying into execution those powers, can properly abrogate existing procurement contracts to the extent that they yield excessive profits to contractors.

It is reasonable to conclude therefore that the due process clause of the Fifth Amendment does not require that the national welfare be prejudiced to the extent that the United States may not change its contractual obligations regardless of circumstances.

II

A contract with the United States or a private contract is property. Lynch v. United States, supra; see Omnia Commercial Co. v. United States, 261 U. S. 502, 208-9 (1923). If the war powers of Congress afford a sufficient justification for changing the consideration of the contract, it may be argued that the Fifth Amendment in addition to the requirement of due process of law, provides "nor shall private property be taken for public use, without just compensation," and that the reduction in the consideration in the contract is a taking for which just compensation must be paid. It seems to me that such an argument provides its own answer. The Renegotiation Act does not destroy the contract; it merely seeks to avoid the payment of excessive compensation for the services the contractors render the government. In other words, the private contractor is entitled under the statute to a reasonable profit or in constitutional terms to "just compensation" for the services and materials he provides. Procurement under wartime conditions means that normal market conditions do not exist.[15] There is a seller's market; the government is not protected by a group of sellers of similar commodities who are competing and hence keeping prices in hand. Instead, the insatiable wartime demand for goods and services both on the part of the government and private persons could not be fully met. Each producer thus has a monopoly of his portion of the market.[16] An

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15 Fain and Watt, War Procurement--A New Pattern in Contracts (1944), 44 Col. L. Rev. 127, 140.

16 Id., 141-42.

abnormal inflationary situation results. The high prices of producers of war goods under contracts with the government should not be the test of the value of the contracts and the goods and services provided pursuant thereto; rather the test should be one based on a price which yields reasonable profits. This is what the Renegotiation Act provides.

The question of how much of the earnings are excessive is not finally subject to the unilateral determination of the contracting department under the act, as amended. The Tax Court is given final authority to find the amount of excess profits in a trial de novo.[17/] The fact that its decision is not subject to review does not deprive the contractor of procedural due process, since judicial process is not the only means of providing due process. See Davidson v. New Orleans, 96 U. S. 97, 106-7 (1877). No particular type of proceeding need by employed in determining what is just compensation. The test if fairness. United States v. Jones, 109 U. S. 512 (1883).

Thus if the Renegotiation Act is regarded as a taking of the contractor's property in the contract, he is paid "just compensation" therefor.

III

A possible argument in support of the Act under the Fifth Amendment is that Congress in the Renegotiation Act adopted a policy that the suppliers of war materials should not be unjustly enriched at the expense of the United States, and that this policy is not dissimilar to principles prevailing at common law.

War procurement involves many problems not faced by the government in time of peace. The need for speed and quantity is great. In

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17 The two cases mentioned in note 8 above were brought prior to the 1944 amendment giving the Tax Court exclusive and final jurisdiction to review an order determining the amount of excess profits. It is not clear whether the Tax Court has exclusive jurisdiction of the constitutional problems raised by the Act, or whether the appellant in the Mine Safety case should have brought proceedings in the Tax Court. This question will be argued in that case. The statute in terms gives the Tax Court exclusive jurisdiction only "to finally determine the amount, if any, of such excess profits received or accrued by the contractor . . ." 58 Stat. 78, 86 (1944). The Act seems to leave other questions open.

many if not most instances the manufacturer is called upon to produce new types of equipment—types with which it has no cost experience. Nor is there time for detailed study and analysis of cost problems, particularly the extent to which mass production would reduce the cost of items which had not theretofore been so produced. The net result is uncertainty on both the part of the government and the private manufacturer as to what is a proper price.[18/] Even in the case where standard items are purchased by the government the peace time prices may be no guide in view of the enormous quantities the government requires and the resulting economies of mass production.[19/]

The government, of course, has a choice of contracting methods. It may make very short term contracts in order to learn what the price should be in the light of actual operating experience. This is the technique employed in Canada.[20/] But frequently this is not possible, since a short term contract for a new type of material may require a disproportionate outlay of capital, and the unit price would be distorted over a short period. Or the cost plus a fixed fee type of contract may be used. In that way the amount of profit the manufacturer is to receive is established at the beginning. This kind of contract involves no risk to the manufacturer, but the manufacturer has no incentive to reduce costs either. The tendency is to avoid using this method if possible.[21/] A third type is based merely on the unit price of the articles purchased and would extend over a longer period. This fixed-price method is commonly employed.[22/] Such a contract involves

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18 Fain and Watt, War Procurement (1944), 44 Col. L. Rev. 127, 141, 144.

19 Hearings before the Senate Committee on Finance on H. R. 3687, 78th Cong., 1st Sess., 1079, 1095-96.

20 Winthrop, Jr., The Control of War Profits in the United States and Canada (1942), 91 U. of Pa. L. Rev. 194, 219. England also has no similar statute.

21 Fain and Watt, War Procurement (1944), 44 Col. L. Rev. 127, 143.

22 Id., 143.

both a risk to the government and to the manufacturer, although the amount of risk to the latter in practice is slight.[23] The former might be obligating itself to pay a price which would result in excessive profits to the manufacturer; the latter might have set its price too low and thereby run the risk of loss. The Renegotiation Act avoids the difficulty in this third type of contract so far as the government is concerned. The Act permits future pricing in the light of actual cost experience, and obviates the original pricing difficulties due to inadequate knowledge of costs by permitting the government to recover the excessive profits. The contractor has no similar right to recover for excessive losses under the Act, but he may be given relief if losses result.[24]

In considering this argument several possibilities must be put aside: First, that the government and the manufacturer were not in equal bargaining positions. United States v. Bethlehem Steel Co., supra. Second, that there was fraud or improper conduct involved in making the contract, or in estimating the price of the goods sold to the government. See Muschany v. United States, 324 U. S. 49, 59 (1945); third, that the contract was unconscionable in that it established a price out of all reasonable proportion to the value of the goods sold. Hume v. United States, 132 U. S. 406 (1889). The common law provides a remeby for the second and third items above if the facts of the particular case justify it.

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23 Cf. U. S. v. Bethlehem Steel Co., 315 U. S. 289, 293, n. 2 (1942). Fain and Watt, War Procurement (1944) 44 Col. L. Rev. 127, painstakingly analyze the nature of the risk a manufacturer has been deemed to bear under this type of contract and compare it with the protection which the government actually affords the contractor. Their conclusion is that the manufacturer bears practically no risk at all, and if any event there are methods of obtaining relief if a loss occurs. See especially pp. 128-29, 194-215. It might be thus argued that the Renegotiation Act merely operates to protect the government from the risk of paying too high a price for war materials, and affords a protection to it similar to that given the contractor. This would certainly be relevant in considering the reasonableness of the statute under the Fifth Amendment. If we could disregard the formalities of contract and look at the transaction as constituting a course of dealing between the manufacturer and the government, the net result has been to make the contractual risks on either party negligible.

24 Fain and Watt, War Procurement (1944), 44 Col. L. Rev. 127, 194-206.

We have then the ordinary situation in which the contract price yields an excessive profit to the manufacturer because of the difficulty and uncertainty in establishing the original price in the absence of operating data. Both parties were aware of the difficulties of fixing a contract price at the time the agreement was made. They contracted with their eyes wide open. It is difficult thus to contend that the excessive profits were caused by mutual mistake.[25/] The law of unjust enrichment provides relief from the consequences of mutual mistake of fact under certain conditions. It might, however, be argued that the uncertainty under which the contracts were entered into in the first few months of the war was akin to mistake.[26/] Thus while aware of the pricing difficulties and the uncertainties, both parties realized that costs were rather a matter of guesswork than knowledge.[27/]

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25 Williston, Contracts (Rev. Ed. 1936) §1543.

Alma Motor Co. v. Timken-Detroit Axle Co., No. 16, awaiting reargument, involves a different if analogous problem. The Royalty Adjustment Act, the validity of which is there in issue, applies only to private contracts--license agreements between the owner of the patent and its licencee. Contracts to which the United States is a party are not involved. The Act was passed to avoid excessive royalty costs to the government arising from the fact that the license agreements had been entered into before the war started, and the greatly increased volume of war time sales to the government resulted in the licensor receiving excessive royalties, which were paid largely by the government in its purchases from the licensed manufacturer. Thus there was a change of circumstances rendering the license agreement far more profitable than either party could have foreseen at the time it was made, and the increase was largely at the government's expense. There are further complications in the Alma case because of the fact that the plaintiff below had recovered a judgment for royalties owed it by the licensee prior to the time the Act was applied.

In the case of contracts subject to renegotiation, the parties were initially aware of the difficulties of determining costs and prices and might have contracted with respect thereto. Furthermore the Renegotiation Act involves contracts to which the United States is a party and so might turn on somewhat different considerations.

26 Sharp, Comments on Renegotiation and the Constitution (1944), 11 U. of Chi. L. Rev. 271, 275-79.

27 Fain and Watt, War Procurement (1944), 44 Col. L. Rev. 127, 144.

The subsequent congressional policy might be treated merely as a method of relieving the government from the consequences of a basic lack of knowledge of cost conditions--one which could not have been remedied at the time, and despite which procurement contracts of necessity were made. It has even been suggested that government contracts entered under such conditions are only tentative,[28/] or have a "congenital defect" which make them subject to later congressional action.[29/] I don't think there is much in this. The contracts were intended to be binding just like other government contracts. The mere fact that the parties are not sure of the percentage of profit the manufacturer will ultimately receive in executing them does not prevent them from having a binding effect under ordinary contract law.

The policy of unjust enrichment in the law assumes as a basic premise that the benefit which A has conferred on B is unjust. The unjustness of it in the legal sense, it seems to me, must be determined in this kind of situation as of the time the acts were done out of which the alleged obligation to make restitution in whole or in part arose. If we examine the contracts in that light it is difficult to see how the contractor was unjustly enriched. The cost situation was uncertain. Both parties knew this and took the risk, one of excessive profits, the other of losses; yet they had to proceed to make the contracts in the light of the knowledge they then had. The government might have protected itself in one of several ways. One way was to make a short term contract. While this was not possible in all instances, it might have been done when practicable. Thus prices could be set in the light of actual operating experience. Another way was to provide for renegotiation of the price in the contract itself. In fact, renegotiation clauses were included in some army contracts before the Act itself was passed.[30/]

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28 Collier, Constitutionality of Statutory Renegotiation (1944), 10 Law and Contemporary Problems 353, 374.

29 Id., 371, 372-3, 374.

30 Marbury and Bowie, Renegotiation and Procurement (1944), 10 Law and Contemporary Problems 218, 220.

Unless it can be shown in the particular case that the contractor did not act in good faith in estimating the contract price, it is difficult to see how it was unjustly enriched, for in some instances the contractor took the risk of losing money.[31] It is true that this court has recognized that the principle of unjust enrichment applies to dealings with the government. Thus in the Perry case, supra, the plaintiff was refused damages because he was "not entitled to be enriched." (P. 345) Had he received the gold coin he would have been required immediately to turn it back to the Treasury. He could not deal in it either in the domestic or foreign markets, and there was no showing that the purchasing power of dollars had declined. See also Muschany v. United States, supra, at 59.

Generally, the courts will not examine the question of whether the consideration in a contract is adequate.[32] There are instances, however, in which the question will be considered either explicitly or implicitly.[33] These involve situations where there is unequal bargaining power, or where the circumstances indicate improper dealing not quite amounting to fraud. In some jurisdictions specific performance of a contract will not be granted if the consideration is grossly inadequate [which implies that the plaintiff is receiving an excessive consideration].[34] Another type of case is where the contract may be avoided for "lack of mutuality" because the contract turned out to be more favorable to one party than the other expected at the time it was made.[35] This situation occurs most often where the buyer agrees

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31 It has been estimated that between six and seven percent of contracting companies lose money on their war business. Fain and Watt, War Procurement (1944), 44 Col. L. Rev. 127, 211.

32 Williston, Contracts (Rev. Ed. 1936) §115.

33 Note (1927), 27 Col. L. Rev. 430; Note (1935) 35 Col. L. Rev. 1090.

34 Williston, Contracts (Rev. Ed. 1936) §1428.

35 See note (1927), 27 Col. L. Rev. 430, 433-34. Compare (1939) 52 Harv. L. Rev. 836. See Williston, Contracts, (Rev. Ed. 1936) §104A.

to purchase his entire requirements of a given commodity from one seller and the latter agrees to fill these requirements. The rationale for these decisions is apparently that there was absence of a fair exchange, rather than a "lack of mutuality." But many of these situations were presented to the court in the Bethlehem Steel case, supra, by the government[36] which sought unsuccessfully to avoid a contract on the basis of duress and unconscionable profits.

It is apparent then that the Renegotiation Act goes considerably beyond the law of unjust enrichment; it is true that the Act was passed to prevent excessive profits to those who furnish the government with the supplies with which to fight a war. It is a reflection of a widely held belief that there should be no war profiteers. This is rather a matter of public policy than the legal principles of unjust enrichment. A government should have the power to protect itself from the dissipation of its resources in a time of great peril. But on the other hand, it is not in the position of an incompetent which needs a guardian to protect it. It has ample power to deal with the problems of war procurement as above indicated. To say then that one who has received a large profit in the course of dealing with the government, furnishing it goods and services, has been unjustly enriched in the absence of special circumstances is to assume that the government is incapable of safeguarding its own interests, an assumption without basis in fact or law.

My conclusion then is that the Renegotiation Act is constitutional as applied to contracts existing at the time the Act was passed (1) because the Act was necessary to the effective prosecution of the war and contracts with the government are no more immune to general legislation than purely private contracts, and (2) the contractors receive "just compensation" under the Act for the goods and services they provide. The statute goes well beyond the existing law of unjust enrichment making it difficult to seek guidance in that field.

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36 Government's brief in the Bethlehem Steel case, 75-85.

[DRAFT OPINION]

Nos. 254-55 -- S.R.A., Inc., Petitioner v. State of Minnesota.

These two cases present another aspect of the problem of intergovernmental immunities from taxation. Petitioner seeks to take advantage of the immunity of the Federal Government from state taxation on the real estate held by it under an executory contract to purchase the land from the United States; the contract requires petitioner to pay for the land by instalments, the final payment entitling petitioner to a conveyance of the legal title retained by the United States. Because of the varying treatment of the problem of immunity in this context in the Federal and state courts, certiorari was granted. _____ U. S. _____.[1]

In 1867 the United States became the owner of the premises in question which are located in Saint Paul, Minnesota, by deed from various private parties. In 1870 a building was erected on the site by the United States; it was used as a post office, custom house and as an office building for various departments of the United States until some years prior to 1939, when it was vacated. In 1939 the Director of Procurement in the Procurement Division of the Treasury Department acting under a statute authorizing the disposal of surplus federal real property,[2] 49 Stat. 885,

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1 Lincoln Co. v. Pacific Spruce Corp., 26 F. 2d 435; Ken Realty Co. v. Johnson, 138 F. 2d 809; Mint Realty Co. v. Philadelphia, 218 Pa. 104; Copp v. State, 69 W. Va. 439; A.B.R. Corp. v. City of Newark, 133 N.J.L. 34. See also Bancroft Investment Corp. v. City of Jacksonville, ___ Fla. ___, decided January 15, 1946.

2 " . . . That notwithstanding any other provisions of law, whenever any real property located outside of the District of Columbia, exclusive of military or naval reservations, heretofore or hereafter acquired by any Federal agency, by judicial process or otherwise in the collection of debts, purchase, donation, condemnation, devise, forfeiture, lease, or in any other manner, is, in whole or in part, declared to be in excess of its needs by the Federal agency having control thereof, or by the President on recommendation of the Secretary of the Treasury, the Director of Procurement, with the approval of the Secretary of the Treasury, is authorized . . . to sell the same at public sale to the highest responsible bidder upon such terms and after such public advertisement as he may deem in the public interest."

sold the property to petitioner, the highest bidder. The terms of the contract provided that petitioner was to pay five per cent of the purchase price at the time of the bid, five per cent nine months thereafter, and the balance in nine equal yearly instalments and the remaining balance in the tenth year, which is 1949. On the final payment the Director of Procurement agreed to deliver a quitclaim deed conveying a marketable title free and clear of all encumbrances except those which "may have accrued against the purchaser's interest in the property subsequent to the acceptance" of the proposal. In the interim the purchaser was given possession of the property and the right to make leases, which leases were expressly subordinate to the Government's interest in the property. The risk of damage or loss was born by the purchaser after he took possession. The Government retained the right to terminate the contract of sale retaining any instalments of the purchase price already paid in the event the terms of the contract were not complied with.

When it took possession of the property under the contract in 1939, S.R.A. had the old building demolished and erected a new one containing stores which were leased to various tenants; the part of the premises not covered by the new building was leased as a parking lot. S.R.A. retained all the rents received. It had made the first several instalment payments to the United States at the time the present cases commenced.

On May 1, 1940, the County of Ramsey, Minnesota, assessed and

levied an ad valorem real estate tax against the premises "subject to the fee title remaining in the United States of $11,129.75 and on May 1, 1941, a tax amounting to $11,431.78. The assessments were based on the full and true value of the property; no deduction was ~~taken~~ made for the interest of the United States.

In order to have its property declared exempt from state taxation petitioner brought two separate suits in the state district court, one for each year in which the real estate tax was levied. The district court in the first case held the land immune from taxation. On appeal the Supreme Court of Minnesota reversed and remanded the first cause. 213 Minn. 487. In its first opinion the court below held that the State of Minnesota had the constitutional power to and did levy the tax only on the equitable interest of petitioner in the land; the court recognized that legal title retained by the United States as security for the payment of the purchase price could not be and was not taxed. On remand an amended petition was filed in the state district court which held the interest of petitioner in the land subject to the state tax ordering its sale to pay the amount of the tax, subject to the prior rights of the United States. That suit involving the 1941 tax was also started. On appeal final judgments of affirmance in the two cases was entered by the state supreme court. 219 Minn. 493; 219 Minn. 517.

Jurisdiction to tax. This question was not briefed or argued by the petitioner, nor raised below. The court below has held that the state real estate tax is one strictly in rem; no personal liability for the tax is created. The assessment of the tax is enforced by the sale of the interest in the land subject to the tax, in the present case whatever interest petitioner obtained by the contract. In order for the state to reach an interest in land otherwise properly subject to taxation, it must have territorial jurisdiction over the land. It is to this question that we turn. The site was purchased from private parties by the United States in 1867 under congressional authorization and appropriation. 14 Stat. 316; 15 Stat 114. As a post office and customs house, it is among the "other needful buildings" specified in Article 1, Section 8, Clause 17 of the Constitution which gives the United States exclusive jurisdiction over such buildings if the consent of the state is obtained and if the United States accepts such jurisdiction. Battle v. United States, 209 U. S. 36; Mason Co., Inc. v. Tax Comm., 302 U. S. 186.

The state has given its consent to the jurisdiction of the United States in a series of somewhat inconsistent acts. The act which most specifically deals with the kind of land and building involved here was passed in 1925. Sess. Laws 1925, Ch. 55-S.F. 366. The statute provides:

> "Section 1. United States may acquire sites.--The consent of the State of Minnesota is hereby given in accordance with seventeenth clause, eighth section, of the first article of the Constitution of the United States to the acquisition by the United States, by purchase, by condemnation, lease, or in any

> other manner whatsoever, of any land, or right or interest therein, in this State, required for sites for custom houses, . . . postoffices . . . .
>
> "Section 2. Exclusive jurisdiction in Federal Government.-- Exclusive jurisdiction in and over any lands, or buildings, any right or interest which has been so acquired by the United States, whether before or after the passage of this act, shall be and the same is hereby ceded to the United States for all purposes, herein provided except the service upon such sites of all civil or criminal process of the courts of this state, which right of service of said process within the bounds of said lands and sites is reserved to this State; but the jurisdiction so ceded shall continue no longer than the United States shall own or occupy such lands, or any right or interest therein; . . .
>
> "Section 3. Act effective, when.--The jurisdiction ceded shall not vest until the United States shall have acquired the title to, or possession of the said lands, or rights, or interest therein, by purchase . . . or otherwise; and so long as the said lands, or any rights or interest therein are held in fee simple by the United States, and no longer, such rights or interest, as the case may be, shall continue exempt and exonerated, from all States [sic] county, and Municipal taxation, assessment or other charges, which may be levied or imposed upon the authority of this State."

There was another statute in existence prior to the above which had the same general effect but reserves broader powers to the state. G. S. Minn., Ch. 1, §4. But the later statute, narrower in scope, is controlling. Bowen v. Johnson, 306 U. S. 19. It provides that jurisdiction is ceded to the United States over all places within the state heretofore acquired by it for national purposes, subject to the right of the state to cause civil and criminal process to be executed therein, and to punish offences against the laws of the state committed on the premises so acquired. The section gives future consent upon certain conditions, subject to the "concurrent jurisdiction aforesaid . . . ."

The acts with minor textual changes now appear in Minnesota Statutes, 1941, 1.04 to 1.09.

The question whether the state has surrendered its jurisdiction to tax to the United States is a federal question. Mason Co. v. Tax Comm.,

302 U. S. 186, 197. The court below did not deal with the issue since it was not there raised. We hold that in so far as the state can do so it has yielded its exclusive jurisdiction over the tract of land to the United States. Unlike the statutes in the Mason case, supra, and in James v. Dravo Contracting Co., 302 U. S. 134, as well as Wilson v. Cook, _____ U. S. _____, the statute in the present case has expressly given "exclusive jurisdiction" over postoffice and custom houses and other specified sites to the United States subject only to a reservation in the state of power to serve civil and criminal process therein. The residual powers of the state over the federally owned land has thus been ceded. Compare Pacific Coast Dairy Co. v. Dept., 318 U. S. 285; Bowen v. Johnson, 306 U. S. 19, where the state act was very similar to the one here involved. The conditions set forth in the state statute ceding exclusive jurisdiction have been met. By the terms of the contract of sale, the United States continues to own the land "in fee simple." The tax assessments in question expressly recognize that the fee is still in the United States.

Although the state may surrender to the United States exclusive jurisdiction over federal land, until the United States accepts such jurisdiction the power of the state remains as before. Mason Co. v. Tax Comm., supra, at 207. But that case points out at the same page that the presumption is that the United States has accepted the exclusive jurisdiction surrendered by the state. In the present case there is nothing to countervail this presumption. See Revised Statutes §355, and 86 Cong. Rec. 474.

By the Act of February 1, 1940, 54 Stat. 19, which amended R. S. §355, exclusive jurisdiction as to property acquired after that date is not to be presumed prior to written acceptance filed with the governor of the state by the head of an interested federal agency. See Adams v. United States, 319 U. S. 312. James Stewart & Co. v. Sadrakula, 309 U. S. 94, throws little light on this problem. There the question was whether a statute of New York dealing with the regulation of construction work applied to a post office site within the exclusive jurisdiction of the United States. The Court held that the statute, since it was in force at the time the site was acquired by the United States, continued as part of the laws of the ceded area, not by force of the continued territorial jurisdiction of the state, but because that statute became a part of the federal law of the enclave. But the same cannot be said of a state statute taxing federally owned realty. Congress must independently pass an ad valorem taxing act such as now prevails in the District of Columbia. In any event even if the state had the present tax act in 1867 the revenue received from petitioner thereunder would belong not to the state as is here claimed but to the Federal Government.

Sovereign Immunity: While we must accept the decision of the court below that the State of Minnesota has authorized the levy of an ad valorem real estate tax on the interest of the purchaser of land under a contract of sale since it is a question of purely local law (Compare Helvering v. Stuart,

317 U. S. 154, 161-62; Marsh v. Alabama, _____ U. S. _____, n. 2), the nature of the interest in the real estate created by a contract of sale to which the United States is a party and the question of whether it is immune from state taxation are matters of federal law on which this Court has the last word. United States v. County of Allegheny, 322 U. S. 174, 183, and cases there cited.

Ordinarily a contract for the sale and purchase of real estate upon its execution vests in the purchaser the complete beneficial interest or equitable title in the land while the vendor retains the legal fee title as security only. The vendor has been misleadingly called a trustee for the purchaser. See Scott on Trusts §13. As the court below has pointed out this is the law in Minnesota and in the federal courts as well. Lenman v. Jones, 222 U. S. 51, 54; Bissell v. Heywood, 96 U. S. 580, 586; Thompson, Real Property §4579. It is unnecessary to belabor this point with copious citations. But the question remains whether the contract in the present case gave the petitioner any interest in the land which the state might tax. The only rights which the petitioner received under the express terms of the contract were the right to possession and the right to make leases, subordinate to the government's interest in the property. The equitable interest of a purchaser of land under an executory contract is usually assignable. See Williston on Contracts (Rev. Ed.) §954-A; Thompson, Real Property §4568. The contract makes no mention of

its assignability except possibly in that section dealing with claims against the United States for defects in title, where it is stated that "neither the purchaser nor persons claiming under the purchaser" may recover damages for defects of title. Persons claiming under the purchaser might include assignees of its interest as well as lessees. But it is unlikely that the question of the contract's assignability was intended to be dealt with in so oblique a fashion. There is a federal statute, however, prohibiting the transfer of a contract with the United States to "any other party," the effect of such a transfer being to annul the contract "so far as the United States are concerned." 41 U.S.C.A. §15. However, claims may be assigned with the consent of the head of the department concerned. It might be that the state, thus could not enforce the tax against the land by public sale, since such sale would cause the forfeiture of petitioner's rights under the contract. It is unlikely, however, that such a result was intended by the statute. In the usual situation arising under the statute the contractor has attempted to delegate to others affirmative duties imposed upon him by the contract, other than the mere duty to make money payments to the United States. In the present case instead of a sale <u>to</u> the United States of goods or service, there is a sale <u>by</u> the United States of land, in which the only obligation of the purchaser is to pay money. Such a contract is not within the evil sought to be remedied by the statute. Compare <u>Freedman's Savings & Trust Co</u>. v. <u>Shepherd</u>, 127

U. S. 494. We need not discuss the matter further, since it too was not raised below nor on petition for certiorari.

We turn then to the questions which were raised below and are presented by the petition for certiorari. The main contention of petitioner is that the contract gave it no taxable interest whatever, and that it is entitled to obtain no such interest until all the payments provided for in the contract have been made, and the United States retains only the bare legal title. At that time only does petitioner concede that it receives an equitable interest subject to taxation by the state. Prior to that time, it is contended, the property belongs wholly to the United States and hence is immune from taxation. These propositions while they have some support in the language of earlier cases cannot be accepted. The tendency of this Court has been to limit the area of sovereign immunity from taxation. See Penn Dairies v. Milk Control Commn., 318 U. S. 261, 270-71. The principle itself continues to be recognized and nothing suggested by the respondent impinges on it. The court below has held as a matter of local law which is conclusive here that the taxing statutes may be applied to the separate equitable interest of a purchaser of land under an executory contract. As stated above, the federal rule is that such an interest arises upon the making of the contract. We see no reason why a different rule should be applied in the case of contracts to which the United States is a party. That the condition precedent to the conveyance of the legal title is that

the balance of the purchase price be paid does not change the fact that the Government has retained its fee interest solely for security purposes, and that the whole beneficial interest is in the purchaser. The fact, too, that the United States has not given its consent to be sued for the specific performance of the contract (United States v. Jones, 131 U. S. 1) is of no consequence, since in defining the substantive legal relations between the purchaser and the Government, as distinguished from the jurisdiction of the courts with respect to suits against the United States, the Federal Government must be treated as if it were a private person. Sinking Fund Cases, 99 U. S. 700, 719; Lynch v. United States, 292 U. S. 571.

But petitioner relies heavily on Irwin v. Wright, 258 U. S. 219, and the cases there cited at page 229. In that case the State of Arizona tried to assess a real property tax on land on which Irwin lived under the provisions of the Homestead Act. That Act provided that every person making a homestead entry must comply with certain specified conditions before he could become entitled to receive a patent from the United States entitling him to the land by nominal payment. The purpose of the Act plainly was to settle the then vast unoccupied territories of the West. Among those conditions was the requirement that the entryman establish a residence on the tract of land, maintain the residence and cultivate the land for a period of five years. In addition the entryman had to meet certain requirements imposed by the Reclamation Act and regulations issued

by the Secretary of the Interior thereunder. Irwin had not met the conditions imposed by the latter Ac t and was thus not yet entitled to a patent, conveying the legal title to the land. This Court, pointing out that the Government had framed its land policy to protect and encourage the homesteader, held that the homesteaders received no equitable interest subject to state taxation in the property until the government had issued the final certificate evidencing compliance with the requirements of the two acts, and all that remained was for the government to issue the patent conveying the legal title. It is obvious that the situation which prevailed in the Irwin case is considerably different from the present case where the Government in an ordinary commercial transaction sold sold surplus real property on the instalment plan. In the Irwin case the object of Congress was to encourage settlement and protect the entryman from burdensome state taxation on the land until he fully met the conditions entitling him to legal title. Until that time under the Acts which Congress adopted equitable interest arose which could be the subject of state taxation. What is true of the Irwin case is true of the other land grant cases cited by petitioner. Railway v. Prescott, 16 Wall. 603; Railway Company v. McShane, 22 Wall 444. In each of these cases the land was given by Congress in furtherance of national land settlemænt or transportation policies, and the taxes in each case would have imposed burdens prematurely, interfering with the congressiona intention that the United States retain the entire interest in the land until

the requirements of the grants were met.

The present case is like City of New Brunswick v. United States, 276 U. S. 47. There by statute the United States Housing Corporation was given authority to sell and convey all of its undisposed of property with the proviso that it should make no sale or conveyance without retaining a first lien on the property to secure the unpaid purchase money. The corporation entered into contracts for the sale of lots in New Brunswick, New Jersey, to various buyers. The contracts provided for instalment payments and that after the purchaser had paid ten per cent of the purchase price the corporation should execute and deliver a warranty deed, and the purchaser should execute and deliver notes together with a mortgage to secure the balance of the purchase price. The purchasers entered into possession of the lots and paid the requisite percentage of the purchase price so that they were entitled to a deed. Because the city had meanwhile assessed certain taxes on the properties the corporation refused to execute the deeds, and the purchasers the notes and mortgages. While the corporation thus continued to hold the legal title to the properties, the city assessed them for taxation to the purchasers. A suit to enjoin the taxes was brought. This Court held that the city, if New Jersey law permitted, might properly assess taxes against the purchasers for the entire value of the lots and enforce collection thereof by sale of their interests in the property, so long as the tax liens and the sale recognized and were subordinate to the security interest of the United States in the property. We can see no

difference between the security interest retained by the United States in the New Brunswick case, namely "the retention of legal title" or "a contract right to a mortgage," and the security interest retained by the United States in the present case which also consists in the retention of legal title until the balance of the purchase money is made. There should be no difference in result because in the one case the United States was to convey legal title and take back a purchase money mortgage and in the present case retain the legal title as security. 8 Thompson, supra, p. 461. In each case the state sought only to tax the interest of the purchaser in the property. See Rice, Intergovernmental Tax Immunities, 54 Yale L. J. 665, 681-85.

It is true, as petitioner points out, that there is some language in the New Brunswick case pointing to the fact that under the contracts the purchasers were immediately entitled to the conveyance of legal title and hence they had become equitable owners of the property, where as in the instant case the petitioner has only begun to make the payments which will eventually give it the right to demand conveyance of the legal title. But the language was unnecessary to the result in that case and accordingly it must be limited to that case.

In Baltimore Shipbuilding Co. v. Baltimore, 195 U. S. 375, the United States had conveyed certain lands to the company on condition that it build a dry dock and accord the United States the right to use the dry

dock forever for examination and repair of its ships. It was provided that if the dry dock was at any time unfit for use for a period of six months or longer, the property should revert to the United States. The city assessed and levied a tax on this land which was resisted on the basis of the interest retained by the Government. The court pointed out that a state may assert a tax lien against less than the entire interest in the land and had done so in that case. Accordingly, the tax assessment was sustained.

Petitioner cites United States v. Allegheny County, 322 U. S. 174, in support of its contentions. But in that case Pennsylvania made no effort to tax the separate property interest of the bailee in the machinery leased to it by the Government. This Court expressly did not pass on the question of the taxability of that interest. We do not do so here. In that case the Government retained a beneficial interest in as well as legal title to the machinery which was being used in furtherance of the war procurement program. Here the United States has retained the bare legal title to the realty for security purposes only, and the state has subjected to taxation only the interest of the purchaser, expressly recognizing the paramount interest of the United States.

The only other contention of petitioner which we need mention is that the state has included the interest of the Government in the valuation of the land, and has therefore subjected that interest to taxation. But no deduction need be made for the interest of the Government

since that interest is for security purposes only and is not beneficial in nature. Moreover, in equity it is personalty not realty. 8 Thompson, supra, p. 522. The whole equitable ownership is in the petitioner and the value of that ownership may be ascertained on the basis of the full value of the land. City of New Brunswick v. United States, supra, at 556. But cf. Ken Realty Co. v. Johnson, 138 F. 2d 809.

Affirmed.

February 5, 1946.

OCTOBER TERM, 1945.

Cases set for reargument--
presumably before full bench.

4--Freeman v. Hewitt

9-13--United Brotherhood of Carpenters, etc., et al. v. United States

16--Alma Motor Co. v. Timken-Detroit Axle Co.

40--Defense Plant Corp. v. County of Beaver, Penna.

Cases set for reargument--
specified before full bench.

23-30--Cleveland v. United States

34--United Federal Workers of Amer. v. Mitchell, et al.

75--Champlin Refining Co. v. United States

139--Levinson v. Spector Motor Service

609--Comet Carriers, Inc. v. Walling
[cert granted, to follow No. 139]

October 23, 1945.

MEMORANDUM TO THE CONFERENCE:

The following is submitted as to the mootness vel non of Collins v. Bowles, No. 393, and Utah Junk Co. v. Bowles, No. 400.

Section 203 of the Emergency Price Control Act, 56 Stat. 23, permits the filing of a protest against the validity of a price regulation with the Price Administrator and §204(a) an appeal to the Emergency Court of Appeals from the Administrator's decision.

In Thomas Paper Stock Co. v. Bowles, No. 67, the petitioners filed a protest with the administrator, Bowles, and sought a review in the Emergency Court of the validity of the regulation after the particular objection had been obviated by an amendment of the regulation.

The Emergency Court dismissed the attempted review and held it had no jurisdiction to consider that particular objection under §204(a) of the Act. It stated, however, that it could consider the same objection under §204(e)(1) of the Act, which authorizes determination of the validity of a regulation when enforcement proceedings are pending in the District Court for the violation of the same regulation, if a complaint were filed, pursuant to leave of the District Court, in the criminal case pending against petitioners.

Petitioners, after this suggestion, obtained leave to file a complaint from the District Court in the criminal case, presenting the identical objection, and on October 5, 1945, the Emergency Court held that the regulation was valid as of the time the alleged violation of the regulation occurred.

The Thomas case is now moot since a decision by this Court that the Emergency Court had erred in declining jurisdiction would result in returning to it for determination a question which it had already decided in another proceeding involving the same parties. The case is still on the docket but has been postponed indefinitely and probably will be dismissed.

In Collins v. Bowles, No. 393, and Utah Junk Co. v. Bowles, No. 400, the situation is quite different. In No. 393 the complaint filed in the Emergency Court of Appeals under §204(a) was dismissed on the authority of the Thomas Stock case. The validity of a superseded liquor regulation was involved. Two enforcement actions are pending against petitioners in a District Court for violation of the superseded regulation. In one enforcement action, a later complaint under §204(e)(1) has already been filed in the Emergency Court. However, the respondent points out [Br. 2] that the questions presented under §204(a) to the Emergency Court in No. 393 and the later complaint under §204(e)(1) are not identical. Thus unless the petitioner prevails in No. 393, it may not obtain a hearing on certain of its objections to the validity of the regulation either under the review provisions of §204(a) or §204(e)(1) of the Act because the right to review under §204(e)(1) is discretionary with the District Court. We do not know what disposition the Emergency Court will make of the §204(e)(1) complaint. It may be dismissed for lack of jurisdiction [Reply 2]. The case, therefore, is not moot.

No. 400 is not moot because there is no enforcement proceeding pending against petitioner, and therefore it cannot now take advantage of §204(e)(1) of the Act. It cannot obtain review of the validity of the regulation as the proceeding now stands unless the Emergency Court has jurisdiction to consider objections to a superseded regulation under §204(a) of the Act.

STANLEY REED

§§203 and 204(a) of the Emergency Price Control Act permit the filing of a protest against the validity of a price regulation with the Price Administrator and an appeal to the Emergency Court of Appeals from the Administrator's decision.

In Thomas Paper Stock Co. v. Bowles, No. 67, the petitioners filed a protest with respondent and sought the Emergency Court to review the validity of a regulation as of a prior time; at the time the protest was filed the particular objection had been obviated by an amendment of the regulation.

The Emergency Court dismissed the complaint, holding it had no jurisdiction to consider that particular objection under §204(a) of the Act. It stated, however, that it could consider the same objection under §204(e)(1) of the Act if a complaint were filed, pur-
leave of the District Court
suant to, in the criminal case then pending against petitioners.

Petitioners obtained leave to file a complaint presenting the
from the District Court in the criminal case
identical objection and on October 5, 1945, the Emergency Court held that the regulation was valid as of the time the alleged violation of the regulation occurred.

The Thomas case is now moot since a decision by this Court that the Emergency Court had erred in declining jurisdiction would result in returning to it for determination a question which it had already decided in another proceeding involving the same parties.

In Collins et al v. Bowles, No. 393, this Term, and Utah Junk Co. v. Bowles, No. 400, this Term, the situation is quite different. In No. 393 the complaint filed in the Emergency Court of Appeals was dismissed on the authority of the Thomas Paper Stock case. The validity of a superseded liquor regulation was involved. Two Enforcement actions are pending against petitioners in a District Court for violation of the superseded regulation. In one enforcement action, a late complaint under §204(e)(1) has already been filed in the Emergency Court. However, the respondent points out [Br. 2] that the questions presented in No. 393 and the later complaint are not identical. Thus unless the petitioner prevails in No. 393, it may not obtain a hearing on certain of its objections to the validity of the regulation either under the review provisions of §204(a) or §204(e) of the act. The case, therefore, is not moot.

No. 400 is not moot because there is no enforcement proceeding pending against petitioner, and therefore it cannot take advantage of §204(e)(1) of the Act. It cannot now obtain review of the validity of the regulation unless the Emergency Court has jurisdiction to consider objections to a superseded regulation under §204(a) of the Act.

My conclusion is that Nos. 393 and 400 are not presently moot.

This writ of certiorari under Judicial Code §240 brings here for review certain problems relating to the just compensation for tenants in condemnation proceedings to take their entire leaseholds when the United States had already taken over the lessors' interest in the property which the tenants occupy. Certiorari was granted to consider the holding of the Circuit Court of Appeals, 147 F. 2d 912, affirming the judgments of the District Court, that evidence by a tenant of the costs of moving and reinstallation of equipment ~~and increased rents~~ was admissible to establish the value of his leasehold under the rule announced in United States v. General Motors Corporation, 323 U. S. 373. as this issue presents an important phase of the law of eminent domain, we granted certiorari 325 U.S. 848.[1] (See United States v. 10,620 Square Feet, Canadian Pacific Bg., 62 F. Supp. 115.)

These cases arise out of a petition for condemnation of the temporary use for public purposes of a building in Salt Lake City, Utah, filed November 9, 1942, which sought to take the use of the building for the Government through June 30, 1945, with the right of election upon the part of the United States to surrender the premises on June 30, 1943, or June 30, 1944, upon sixty days written notice to the owner.[2] The owner and tenants were parties defendant. An order for immediate possession was entered on November 11, 1942, subject to the right of the tenants to continue their occupation of their premises for short periods which varied from six to twenty days.

While the condemnation proceedings were pending the owner of the property made arrangements with the United States which resulted in the dismissal of the action against the owner. There is no claim by the United States that this arrangement released it from liability to the tenants for its taking of their leaseholds. As the total value of the use of the whole right of property, which was taken, thus lost all meaning, the Government accepts a separate responsibility to compensate the tenants for any legally recognized interest which they may have in the property. See Duckett & Co. v. United States, 266 U. S. 149.

The estate sought, although an earlier surrender might occur by the election of the United States, did not necessarily expire until June 30, 1945. Prompt possession was required from the tenants and all of them "were required by the order of possession to vacate" the premises which they occupied within various short periods of which twenty days was the longest. The judgments stated the issue was the amount due the tenants for the taking of their occupancy of their premises and found in dollars the just compensation for the rights taken. These facts, we conclude, resulted in the taking by the United States of the temporary use of the building until June 30, 1945. When the shortening of the term is wholly at the election of the lessor,

the term of the leasehold for the purpose of determing the extent of the taking must be considered to be its longest limit.[3] All rights of all the tenants, except the Pneumatic Tool Company, who are respondents here terminated before the end of the Government's lease by the lapse of time or in the case of the Tool Company by a "termination on condemnation" clause. With the exception of the Petty Motor Company and the Independent Pneumatic Tool Company, the tenants were tenants under oral contracts on a month to month basis. This entitled them only to notice of termination fifteen days prior to the end of a rental period. Utah Code Ann. (1943), T. 104-60-3(2). The Petty Motor Company held a lease which expired October 31, 1943, with an option for an additional year.

The lease of the Pneumatic Tool Company included a clause for its termination on the Federal Government's entry into possession of the leased property for public use.[4] The events connected with the Government's entry just set out appear to meet the requirements for termination. This does not seem to be controverted. The contention of the Tool Company, as we understand it, is that the tenant is barred from claiming "any of the award of the landlord" but that the condemnor is not relieved of liability to the lessee. This position seems inconsistent. If the Tool Company was the only tenant and condemnation of all interests in the property was decreed, the landlord

would take the entire compensation because the lessee would have no rights against the fund. There would appear to be no greater right where the landlord has been otherwise satisfied. Condemnation proceedings are in rem, Duckett & Co. v. United States, 266 U. S. 149; United States v. Dunnington, 146 U. S. 338, 350-54. and compensation is made for the value of the rights which are taken. United States v. General Motors Corporation, 323 U. S. 373, 379. The Pneumatic Tool Company had contracted away any rights that it might otherwise have had. We are dealing here with a clause for automatic termination of the lease on a taking of property for public use by governmental authority. With this type of clause, the tenant has no right which persists beyond the taking and can be entitled to nothing.5/

In order to inform the jury as to the value of the tenants' interests where there was a right to continue the occupation of their respective premises, the trial court permitted the introduction of evidence, over the Government's objections, not only as to the value on the market of the use and occupancy, over and above the agreed rent, for any remainder of a term which may have existed in the respective tenants after they were dispossessed, but also allowed evidence of the expenses incurred in moving and the reinstallation of equipment. The trial court's instructions made clear that the

evidence was submitted to the jury not for a finding on the cost to the tenants of relocating their businesses but as an element in determining the "value" of their tenancies for that portion of their term which was left upon the termination of the lease. The admission of the evidence and its submission to the jury was approved by the Circuit Court of Appeals on the theory that consideration of such elements of cost was compelled by the General Motors case. 323 U. S. 373. The Court of Appeals recognized that here the Government took the entire term of all the lessees except the Tool Company and possibly the Petty Motor Company but was of the opinion that the principles of the General Motors case applied when any leasehold was taken. 147 F. 2d 912, 914. In so holding, the Court of Appeals was in error.

The Constitution and the statutes do not define the meaning of just compensation. But it has come to be recognized that just compensation is the value of the interest taken. This is not the value to the owner for his particular purposes or to the condemnor for some special use, ~~for~~ but a so-called "market value." It is recognized that an owner often receives less than the value of the property to him but experience has shown that the rule is reasonably satisfactory.

Since "market value" does not fluctuate with the needs of condemnor or condemnee but with general demand for the property, evidence of loss of profits, damage to good will, the expense of relocation and other such consequential losses is refused in federal condemnation proceedings. Mitchell v. United States, 267 U. S. 341, 344; United States ex rel. T.V.A. v. Powellson, 319 U. S. 266, 281; Orgel, Valuation under Eminent Domain, chap. V; Potomac Electric Power Co. v. United States, 85 F. 2d 243. For the purposes of these cases, it is immaterial whether the Government actually took the leaseholds of the tenants in addition to taking the temporary use of the fee or only destroyed the tenants' right of occupancy. At any rate, there was a sufficient taking to require compensation. Cf. United States v. Welch, 217 U. S. 333.

There was a complete taking of the entire interest of the tenants in the property. It has been urged that to measure just compensation for the taking of a leasehold by its value on the market or by the difference between a fair rental as of the time of taking and the agreed rent, is unfair. It is said the unfairness comes from the fact that there is really no market for leaseholds; that their value is something peculiarly personal to the lessee.[6] The same thing is true as to incidental and consequential damages

to the owner of a fee. We think the sounder rule under the federal statutes is to treat the condemnation of all interests in a leasehold like the condemnation of all interests in the fee. In neither situation should evidence of the cost of removal or relocation be admitted. Such costs are apart from the value of the thing taken. They are personal to the lessee.[7] The lessee would have to move at the end of his term. The compensation for the value of his leasehold covers the loss from the premature termination except in the unusual situation where there is a higher cost for present relocation than for a future. See Emery v. Boston Terminal Co., 178 Mass. 172, 185.

This conclusion is entirely consistent with the General Motors case. We there said, p. 382:

> "When it takes the property, that is, the fee, the lease, whatever he may own, terminating altogether his interest, under the established law it must pay him for what is taken, not more; and he must stand whatever indirect or remote injuries are properly comprehended within the meaning of 'consequential damage' as that conception has been defined in such cases. Even so the consequences often are harsh. For these whatever remedy may exist lies with Congress."

There is a fundamental difference between the taking of a part of a lease and the taking of the whole lease. That difference is that the lessee must return to the leasehold at the end of the Government's use or at least the responsibility for the period of the lease, which is not taken, rests upon the lessee. This was brought out in the General Motors decision.[9] Because of that continuing obligation

in all takings of temporary occupancy of leaseholds, the value of the rights of the lessees, which are taken may be affected by evidence of the cost of removal.

Upon a new trial, each tenant, other than the Independent Pneumatic Tool Company, should be permitted to prove damages for the condemnation of its rights for any remainder of its term which existed after its ouster by the order of possession but not costs of moving or relocation. The measure of damages is the difference between the value of the use and occupancy of the leasehold for the remainder of the tenant's term less the agreed rent which the tenant would pay for such use and occupancy.

<u>Reversed</u>.

FOOTNOTES

2 There is no question as to the authority of the United States to condemn this temporary interest. Second War Powers Act, 56 Stat. 177, sec. 201. United States v. General Motors Corporation, 323 U. S. 373.

3 In United States v. General Motors Corporation, 323 U. S. 373, note 3, a different situation existed. While the estate there sought did not necessarily expire during the existing national emergency, the order for possession, the verdict and the judgment was for that part of the leasehold interest in the property extending from June 19, 1942, to June 30, 1943.

We said: "The case now presented involves only the original taking for one year. If, on remand, the case be treated as involving the Government's option of renewal, the additional value of that interest must be included in the compensation awarded."

4 The clause reads as follows:

"If the whole or any part of the demised premises shall be taken by Federal, State, county, city, or other authority for public use, or under any statute, or by right of eminent domain, then when possession shall be taken thereunder of said premises, or any part thereof, the term hereby granted and all rights of the Lessee hereunder shall immediately cease and terminate, and the Lessee shall not be entitled to any part of any award that may be made for such taking, nor to any damages therefor except that the rent shall be adjusted as of the date of such termination of the Lease."

5 See United States v. 8286 Sq. Ft. of Space, etc., 61 F. Supp. 737, 740-43; United States v. Improved Premises, etc., 54 F. Supp. 469, 471; United States v. 3.5 Acres, 57 F. Supp. 548; Goodyear Shoe Machinery Co. v. Boston Terminal Co., 176 Mass. 115; United States v. 21,815 Square Feet etc., 59 F. Supp. 219; United States v. 10,620 Sq. Ft., Canadian Building, etc., 62 F. Supp. 115. Cf. United States v. Entire Fifth Floor in Butterick Bldg., 54 F. Supp. 258.

6 See West Side Elevated R. R. Co. v. Siegel, 161 Ill. 638; McMillin Printing Co. v. Railroad Co., 216 Pa. 504.

7 Compare United States v. Improved Premises etc., 54 F. Supp. 469, 472; United States v. Entire Fifth Floor in Butterick Bldg, idem, 261; United States v. Certain Parcels of Land, etc., idem, 562; Wm. Wrigley, Jr. Co. v. United States, 75 Ct. Cl. 569; Thormal Syndicate v. United States, 81 Ct. Cl. 446, 454.

FOOTNOTES (contd.)

8 323 U. S. 373, 380, 383:

"The question posed in this case then is, shall a different measure of compensation apply where that which is taken is a right of temporary occupancy of a building equipped for the condemnee's business, filled with his commodities, and presumably to be reoccupied and used, as before, to the end of the lease term on the termination of the Government's use?"

"Some of the elements which would certainly and directly affect the market price agreed upon by a tenant and a sublessee in such an extraordinary and unusual transaction would be the reasonable cost of moving out the property stored and preparing the space for occupancy by the subtenant. That cost would include labor, materials, and transportation. And it might also include the storage of goods against their sale or the cost of their return to the leased premises. Such items may be proved, not as independent items of damage but to aid in the determination of what would be the usual--the market--price which would be asked and paid for such temporary occupancy of the building then in use under a long-term lease."

No. 517, Schulte, Inc. v. Gangi, et al.

Respondents were employed by petitioner as building service and maintenance employees in its 23 story loft building in the garment district of New York City. During the period here involved, October 24, 1938, to February 5, 1942, the building had numerous tenants whose business it was to serve the dress manufacturing industry. In so far as they relate to the issue of settlement the facts indicate that until February 5, 1942, respondents were not paid the overtime compensation required by section 7 of the Fair Labor Standards Act. After this Court decided Kirschbaum Co. v. Walling, 316 U. S. 517, on June 1, 1942, respondent through their union representative asked for the statutory overtime pay and liquidated damages due them from the inception of the Act. Petitioner's District Manager indicated that he felt that the building did not come under the Act because the tenants were largely contractors who performed labor for New York manufacturers. Most of the tenants were engaged by dress manufacturers to perform certain operations necessary to the completion of the dress, such as sewing or pleating or making accessories. Respondents requested the District Manager to take the matter up with the office. The "office" took the same view as the District Manager.

In August, 1942, respondents threatened suit unless they were paid overtime and liquidated damages. To avoid suit petitioners paid

the overtime compensation and obtained a release signed by the several respondents. It is set out below.[1] Petitioner computed the amount of overtime and respondents raised no question as to its accuracy. Respondents then brought this suit in the district court to recover liquidated damages due them under Section 16(b) of the Act. Respondent set up the releases as a defense and contended that there had been a bona fide dispute as to coverage.

The district court found as a fact that there was a "genuine dispute between the parties pertaining to a claim for compensation" and that there was a good accord and satisfaction and release of all respondent's rights under the Act. (R. 312). Accordingly the complaint was dismissed on the merits.

The Circuit Court held that the release did not bar the suit and reversed.

The Circuit Court on the settlement phase of the case proceeded on the theory that under §16(b) the employer's liability for unpaid overtime compensation and liquidated damages is "a single and entire liability" which "is not discharged in toto by paying half of it." The court felt that only such a view would be consistent with the holding

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1 "The undersigned, an employee of D. A. Schulte, Inc., in premises 575 Eighth Avenue, New York City, does hereby acknowledge receipt of the sum of $_______ as payment in full of all sums, if any, which may be due to the undersigned by said D. A. Schulte, Inc. by reason of the Federal Wage & Hour Act, and the undersigned does hereby release said D. A. Schulte, Inc. from any other further obligations in connection therewith." R. 317-18.

and implications of Brooklyn Savings Bank v. O'Neal, 324 U. S. 697. It pointed out that there was very little factual difference between the present case and the O'Neal case. In fact the only difference appears to be that in the latter case no question was expressly raised at or before the time of settlement as to whether the building was covered under the Act, whereas here the petitioner's agent did express some doubts as to coverage. It is difficult to see how a difference of opinion as to the legal consequences of existing facts can make a significant alteration in substantive rights in view of the opinion in the O'Neal case. All the arguments there expressed so forcefully seem to apply whether or not there is a bona fide dispute as to coverage. The deterrent effect of §16(b) would be equally interfered with; violation of the law would be encourage; the employer who vociferously maintained his legal position even though in good faith would be enabled to obtain a competitive advantage by settling for less than other employers who were sued. Section 16(b) itself provides no inference that the unitary liability it establishes may be broken up into two parts, the compensation not being subject to settlement, and the damages subject to compromise if there is a bona fide dispute as to coverage. Moreover, what was said with respect to settlements of workmen's compensation applies equally here:

> "As a basis for such trading, the insurance adjuster can in all cases present issues of controversy by alleging that no liability exists and that if it does, the liability is less than that claimed by the injured worker; and, in the trading, the claimant is at a material disadvantage." Dodd, Administration of Workmen's Compensation, p. 192.

The court below did suggest, however, that a settlement based on good consideration might be effected where there was a genuine dispute as to the facts themselves, as distinguished from their legal consequences, such as the amount of work actually performed. Such a view would be consistent with the court below's "unitary" theory of the liability imposed by §16(b). Thus if time records were not clear or were not kept, the parties after negotiation might agree on the number of hours worked in excess of the maximum and make an agreement on the basis of it. See Strand v. Garden Valley Telephone Co., 51 F. Supp. 898, 904-905. Once agreed, I would think that an equal amount of damages would also be owed and could not be waived. But such an agreement would at least preclude the parties there from litigating the amount of time worked. But this question need not be and should not be decided in this case, since that issue is not presented. It should be left open until a case presenting it comes before this Court. Such a case may be Williams-Bauer Corp. v. de Pasquale, No. 644 this term, presently held for the instant case. There the only dispute claimed related to hours worked, not coverage. But the Second Circuit held the defense insufficiently pleases, even if otherwise it might be good.

As might be antifipated there is some diversity in the cases as to whether a settlement is effective on the question of liquidated damages where there was a bona fide dispute as to coverage. Most of

the courts have adopted what I call the "unitary" theory of liability imposed by §16(b), namely that the duty to pay the compensation and an additional equal amount as damages is a single duty and may not be arbitrarily divided up. There is language in the *O'Neal* case (p. 711) supporting this position. The Second Circuit has consistently been of this view. *Rigopoulos* v. *Kervan*, 140 F. 2d 506 (dicta); *Fleming* v. *Post*, 146 F. 2d 441 (dicta). I have excluded here cases not in some manner dealing with the question of a settlement, release etc. where there was claimed to be a bona fide dispute as to hours worked or coverage.

The opposing point of view is presented by *Guess* v. *Montague*, 140 F. 2d 500 (C.C.A. 5). In that case as to some of the plaintiffs the defendant paid the full amount of their minimum wages, though doubtful about coverage. They accepted the payments and executed written releases of all claims under the Act. Later as in the present case suit was brought to recover the liquidated damages. The court held that no recovery could be had because there had been a valid accord and satisfaction. The court distinguished between the situation (also involved in the case) where the statutory minimum wages had not been paid, yet a release had been obtained, and the case where the minimum had been paid and a release given. As to the former the court permitted the plaintiffs to obtain not only the balance of the minimum wages, but also the liquidated damages. As to the latter, it was held that the

minimum wage part of the liability created by §16(b) and the liquidated damage part where separable; that the former could not be settled and the latter could be. The differentiation in treating the minimum wages and the liquidated damages was premised on the fact that §§ 6 and 7 specifically require the observance of the hours and wage provisions of the Act and they are enforced with criminal penalties, whereas this is not true of the liquidated damages. The only remedy for that is a civil action by the employee. But the section creating the liability, §16(b), makes no such differentiation. It creates a single duty, namely to pay the minimum wages and the liquidated damages. What the court in the Guess case does is to rewrite the statute extensively. It creates several rights and exceptions to them. For example, it says that where the minimum wages have been paid the liquidated damages may be settled; but where they have not been paid, neither the minimum wage claims nor the liquidated damages may be released. The reason for this anomolous situation is that the settlement was a "single transaction and was void in contravention of the statute." But that is merely the statement of a conclusion. Legal and illegal provisions may be separable and on the court's theory there is no compelling reason why they may not be separated here. Furthermore, in justification of the result the court points out that the defendant had a "doubt" in his mind as to coverage when the minimum wages were paid and the release obtained. This doubt,

apparently purely subjective at that time, is held to make a significant difference with respect to statutory rights created by Congress. I think such a view is unsupportable. However, this view has been accepted in Atlantic Co. v. Broughton, 146 F. 2d 480(C.C.A. 5).

The O'Neal case apparently was discussed only in one law review note, 45 Col. L. Rev. 798. The write-up approves the decision of the Court, relying on the "unitary" theory of the liability created by §16(b). It suggests that the right to liquidated damages is mandatory regardless of the employer's good faith or bona fide intentions.

14 George Washington L. Rev. 385 which discusses the Gangi case, itself, takes the view that the implications and the logic of the O'Neal case, as well as the "unitary" theory of liability, require a holding that there can be no settlement where coverage is disputed. It is also pointed out that the payment of overtime wages would not be good consideration to support a release of all claims, since there must be a dispute as to facts, not the legal consequences of the facts. Otherwise, payment is merely made pursuant to a preexisting legal duty. "Legislative policy and the public interest should not be forfeited either because of the employees' relinquishing a right or employers' intransigent denial of liability. Liability under the Act when in doubt must be determined by the courts." (P. 389.)

The last law review discussion dealing with the specific problem of the settlement of the bona fide dispute is in 57 Harv. L. Rev. 257. This article, too, relies on the single right to compensation and damages created by §16(b). It is there pointed out that §6 which establishes the minimum wages rates gives the employee as such no rights and should have no effect on the interpretation of §16(b).

A proper conclusion then would seem to be at least with respect to a bona fide dispute over coverage that the rationale of the O'Neal case applies with equal force, and it would be an unwarranted construction of the Act to artifically bifurcate the liquidated damages from the right to recover minimum wages.

3 4a Chesapeake & O. R. Co v. Kentucky, 179 US 388, ~~Held valid~~ Statute requiring segregation of intrastate passengers, after construing the statute to apply to them only. The act apparantly applies to require segregation of local passengers on an interstate train, however.

5 4a S. Covington & C. St. R. Co v. Kentucky, 252 US 399 ~~Held valid~~ Statute requirig interstate interurban railroad to segregate its intrastate passengers. See dissent at 407.

4 4a McCabe v. Atchison, T. & S. F. R. Co., 235 US 151 ~~held valid~~ state segregation law ~~xx~~ applied to intrastate transportation.

5b Edwards v. Cal., 314 US 160, ~~held invalid~~ Statute making it a crime/ knowingly to bring into the state any indigent person who is a nonresident.

5 1a Kansas City S. R. Co v. Kaw Valley Drainage Dist., 233 US 75, ~~Held invalid~~ 9 - Holmes Order requiring railroad to remove its bridges over river for flood control purposes.

8 2b St. Louis, & S. F. R. Co. v. Pub. Service Comm., 254 US 535, ~~Held invalid~~ Order requiring though trains to detour its trains thourgh a small town.

4a Plessy v. Ferguson, 163 US 537 Segregation upheld under 14th amendment, but some discussion of commerce point.

7 2b Missouri, K. & T. R. Co. v. Texas, 245 US 484 ** Order fixing time allowed train to stop given length or points of junction for stops of interst te train,

4 2b St. Louis S. W. R. Co. v. Arkansas, 217 US 136, Statute and order requiring delivery of freight cars to local shippers.

11 1a S. C. Highway Dept. v. Barnwell Bros. 303 US 184. Statute restricting weight and size of motor carriers.

10 1a Kelley v. Washington, 302 US 1, statute imposing safety and inspection requirements on tug boat used in interstate commerce.

Chicago, R. I. & P. R. Co v. Arkansas, 219 US 453

St. Louis I. M. & S. R. Co. v. Arkansas, 240 US 518 Held state full crew law valid on interstate trains.

3 3a Missouri P. R. Co v. Norwood, 283 US 249 Arkansas full crew laws applied to freight and switching crews.

12 1a Maurer v. Hamilton 309 US 598, Penna. statute forbidding the use of its highways to any vehicle carrying any other vehicle over the head of the operator of the vehicle.

9 1a Sproles v. Binford, 286 US 374 Size and weight restrictions on trucks imposed by Texas statute.

8 1a Morris v. Duby, 274 US 143 Weight restrictions on motor carriers imposed by order of Oregon highway commission.

1 2a Gladson v. Minnesota, 166 US 427 State statute requiring intrastate train to stop at county seat to take on and discharge passengers.

1 5b Hennington v. Georgia, 163 US 299 Statute forbidding the running of freight trains on Sunday as applied to interstate train.

2(a) 2a Lake Shore & M. S. R. Co v. Ohio, 173 US 285 Statute requiring three trains daily, if so many are run, to stop at each city containing over 3,000 inhabitants as applied to interstate trains.

3 2b Atlantic Coast Line R. Co. v. Wharton, 207 US 328, S. C. statute and railroad commission order requiring interstate train to stop at small towns.

6 2b Chicago, B. & Q. R. Co. v. Comm., 237 US 220, Wisconsin statute requring interstate train to stop at villages containing 200 or more inhabitants.

3 2a Atlantic Coast Line v. N. C. Corp. Comm. 206 US 1, Order regulating train service, particularly requiring train to permit connection at junction point. 31

4 2a Missouri P. R. Co v. Kansas, 216 US 262, Order directing the operation of intrastate passenger train service over given route.

1b S. Pac. R. Co. v. Arizaona, US , statute limiting number of cars in freight train to 70 and passenger cars to 14.

3 4a Chiles v. Chesapeake & O. R. Co. 218 US 71, regulations of carrier requiring segregation of colored interstate passengers. [The case came up from a state ct so that the commerce question must have been raised].

1 4a Louisville N. O. & T. R. Co. v. Mississippi, 133 US 587 State statute requiring segregation on intrastate trains, + passengers. ???? for intrastate passengers.

The following ~~xxxxxx~~ are illustrative cases in this court dealing with alleged state interferences with the operations of carriers. The cases to a large degree turn on their own facts since the validity of the interference must be based on the extent of the burden it imposes on interstate commerce.

1. Statutes or orders dealing with safety of operations:

   a) Held valid:

   b) Held invalid

2. Statutes or orders requiring local train service

   a) Held valid

   b) Held invalid

3. Statutes dealing with employment of labor -full crew laws etc.

   a) Held valid

   ~~b) Held invalid~~

4. Statutes or carrier rules requiring segregation or non-segragation

   a) Held valid

   b) Held invalid

5. Miscellaneous statutes

   a) ~~Held valid~~

   b) Held invalid

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3 1a New York, N. H. & H. R. Co v. New York, 165 U. S. 628 -- ~~Held~~ N. Y. Sta tute ~~xequxingxthxtx~~ forbiding the use ~~inxpx~~ of furnaces or stoves in passenger cars to heat them ~~was valid even~~ on interstate trains.

6 1a A tlantic Coast Line v. Ga., 234 US 2 80-- ~~Held~~ Ga. statute requiring electric headlights on locomotives ~~was valid despite possible inconveniences from conflicting state statutes~~.

1 3a Chicago, R. I. & P. R. Co. v. Arkansas, 219 US 453- ~~Held~~ Arkansas full crew law ~~is valid~~ as applied to on interstate trains.

1 1a Smith v. A la., 124 US 465 -~~Held that~~ A labama statute requiring an examination + license of train engineers before operating in the state ~~was valid~~ as applied to an egginfer operating an interstate train.

2 1a Nashville, C & St. L. R. Co. v. Ala., 128 US 96- ~~Held~~ Statute requiring examination of ra ilroad employees as to vision and color blindness before they could operate in the state, ~~was valid~~.

2 3a St. Louis, I. M. & S. R. Co. v. Arkansas, 240 US 518-- ~~Held~~ Arka sas full crews ~~xxxxxvalid~~ laws ~~valid as~~ applied to switching yards and terminals.

13 1a Terminal R. Asso. v. Brotherhood, 318 US 1, ~~Held~~ Illinois statute requiring cabooses ~~held valid~~. on freight trains.

1 1b Seaboard A ir Line R. Co. v. Blackwell, 2 44 US 310 ~~Held~~ Ga. Blow Post Law requiring train to blow whistle and slow down at each grade crossing ~~was invalid~~, where numerous grade crossings were involved. Cf. Southern Ry v. King, 217 US 524, where plea held insufficient to permit proof of burden of ~~xxxxxxxxxxxxxxxxxxKingxxx17xUSx524~~ the statute on interstate commerce.

4 1a Erb v. Morasch, 177 US 584- ~~Held valid~~ Municipal ordinance limiting spped of trains in city to 6 miles an hour.

2(b) ~~3~~2b Cleveland, C. C. & St. L. R. Co. v. Illinois, 177 US 514 ~~Held~~ Ill. statute requiring interstate train to stop at each station. ~~held invalid~~.

7 1a+b (repeat) S, Covington & C. Street R. Co v. Covington, 235 US 5~~xx~~37 ~~Held~~ ordinaces regulating the number of passengers to be carried in and the ~~xxxxxxxx~~ temperature of an interurban street railway car invalid; those ~~dealing~~ requiring ~~with~~ ra ils on front and rear platforms, ~~and~~ ventilation and cleaning ~~held~~ valid.

1 4b Hall v. DeCuir, 95 US 488 ~~Held~~ state statute requiring non-segregation of passengers on interstate steamboat ~~invalid~~.

1 2b Illinois C. R. Co. v. Illinois, 163 US 142, ~~Held~~, Statute applied to require fast mail train to ~~stop at~~ detour from main line in order to stop at county seat for the taking on and discharge of passengers ~~is invalid~~.

2 2b Mississippi R. Comm. v. Ill nois C. R. Co., 203 US 335: Order of Commission requiring interstate tra in to stop at small town held. ~~invalid~~.

5 2b Herndon v. Chicago, R. I. & P. R. Co., 218 US 135 ~~Held~~ sta tute requiring interstate train to stop at junction point. ~~is inva lid~~.

9 2b St. Louis San Francisco R. Co v. Comm., 261 US 369 ~~Held invalid~~ Order requring that interstate trains be stopped at smmall town.

~~226 US~~; 216-262 ~~219-518~~

✓235 US 151

✓183 - 567

179 - 343

✓179 - 388