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ANTITRUST DIVISION

Assistant Attorney General Donald F. Turner

SUPREME COURT

CLAYTON ACT

SUPREME COURT REVERSES CIRCUIT COURT OF APPEALS IN CONGLOMERATE MERGER CASE.

Federal Trade Commission v. Procter & Gamble Co. (No. 342 - O. T. 1966; April 11, 1967; D. J. File 102-1292)

On October 7, 1957, the Federal Trade Commission issued a complaint charging that on August 1, 1957, the Procter & Gamble Company had acquired the assets of Clorox Chemical Company in violation of Section 7 of the Clayton Act. Following evidentiary hearings the hearing examiner ruled the acquisition unlawful and ordered divestiture. On appeal the Commission reversed holding the record inadequate as then constituted and remanded for additional evidentiary hearings. After taking further evidence the hearing examiner again ruled the acquisition illegal. Procter again appealed to the Commission which affirmed the examiner and entered a final order of divestiture.

The Court of Appeals for the Sixth Circuit reversed and directed the complaint be dismissed. The Court found nothing unhealthy about the liquid bleach industry simply because one producer controlled 50 percent and six producers 80 percent of the national market, and held that the advertising and marketing advantages which might accrue to Clorox as a result of the merger were economies. The Court also rejected the Commission's finding that the merger eliminated important potential competition of Procter with the observation that "[t]here was no reasonable probability that Procter would have entered the household liquid bleach market but for the merger."

The Supreme Court unanimously reversed, Justice Harlan concurring and Justices Stewart and Fortas not participating.

In an opinion by Justice Douglas the Court held that not only had the Court of Appeals misapprehended the standards for review of the Commission's proceeding, but also misapprehended the standards applicable in a Section 7 proceeding.

Among facts relied upon by the Commission which were not in dispute: At the time of the merger, Clorox was the leading manufacturer in the heavily concentrated liquid bleach industry. Clorox had approximately 50 percent

of the market and its next largest competitor had but 15.7 percent. Since all liquid bleach is chemically identical, advertising and sales promotion is vital. In 1957, Clorox spent almost $3,700,000 on advertising and an additional $1,700,000 for other promotional activities. Procter was a large, diversified manufacturer of low-price, high-turnover household products sold through grocery, drug and department stores, the same retail outlets for liquid bleach. In 1957, Procter was the nation's largest advertiser, spending more than $80 million on advertising and an additional $47 million on sales promotions. Due to its tremendous volume, Procter received substantial discounts from the media. As a multi-product firm Procter enjoys substantial advantages in advertising and sales promotion. Thus, it could feature several products in its promotions, reducing printing, mailing, and other costs for each product. Procter was also able to purchase network programs on behalf of several products, enabling it to give each product network exposure at a fraction of the cost per product that a firm with only a single product would incur. Prior to the acquisition, Procter was in the course of diversifying into product lines closely related to its basic detergent-soap-cleanser business.

In affirming the Commission and disapproving the standards applied by the Court of Appeals, the Court stated that Section 7 "can deal only with probabilities, not with certainties" and "there is certainly no requirement that the anticompetitive power manifest itself in anticompetitive action before § 7 can be called into play." Relying heavily on a structural analysis the Court found there was ample evidence to support the Commission's finding that: 1) the market behavior of the liquid bleach industry was influenced by each firm's predictions of the market behavior of its competitors, actual and potential; 2) the barriers to entry by a firm of Procter's size and with its advantages were not significant; 3) the number of potential entrants was not so large that the elimination of one would be insignificant; and that 4) Procter was the most likely entrant. The Court emphasized that the substitution of the powerful acquiring firm for the smaller, but already dominant, firm in the oligopolistic bleach industry may substantially reduce the competitive structure of the industry by raising entry barriers and by dissuading the smaller firms from aggressively competing, thus making the oligopoly more rigid. And looking to objective factors such as Procter's operations in related lines, serving the same customers by similar merchandising methods, it concluded that the acquisition eliminated the potential competition of the acquiring firm. The Court rejected the suggestion that possible economies may be used as a defense for an otherwise illegal merger.

Justice Harlan, concurring, expressed concern about the summary manner in which his brethren disposed of the case. After pointing out that the "Congress has not mandated the Commission or the courts to campaign against superconcentration in the absence of any harm to competition," he suggested that the Court failed "to make a convincing analysis of the difficult problems

presented." Justice Harlan recognized that Congress intended Section 7 to cover conglomerate mergers, but does not think that the rules of thumb developed in horizontal merger cases can be easily transferred to the conglomerates and that "when this Court does undertake to establish the standards for judging their legality, it should proceed with utmost circumspection." For example, in order to rely upon an elimination of the restraining influence which the acquiring firm may have on those firms in the market, he would require some evidence that the firms in the industry had some power over price which the presence of a potential competitor could restrain. If Procter had shown that the ceiling price in the industry was determined by the presence of small unadvertised brands and that this ceiling was below the level which would have invited entry by Procter, then Procters presence at the edge of the market made no contribution to competition. No such showing had been made, however. The case was argued by Solicitor General Marshall.

Staff: Richard A. Posner (Solicitor General's Office); Stephen G. Breyer and Robert K. Baker (Antitrust Division)

DISTRICT COURT

SHERMAN ACT

EIGHTEEN CHILDREN'S BOOK PUBLISHERS CHARGED WITH VIOLATION OF SECTION 1 OF ACT

United States v. Harper & Row, Publishers, Inc. (N.D. Ill., Civ. 67 C 612, April 18, 1967; DJ File 60-26-26).

On April 18, 1967, eighteen civil complaints (The Bobbs-Merrill Company, Inc.; Childrens Press, Inc.; Thomas Y. Crowell Company; Dodd, Mead & Company, Inc.; E. P. Dutton & Company, Inc.; Golden Press, Inc.; Grosset & Dunlap, Inc.; Holt, Rinehart and Winston, Inc.; Little, Brown & Company, Inc.; The Macmillan Company; William Morrow & Company, Inc.; G. P. Putnam's Sons; Random House, Inc.; Charles Scribner's Sons; The Viking Press, Inc.; Henry Z. Walck, Inc.; and Franklin Watts, Inc.) were filed against publishers of children's books, charging illegal resale price maintenance in the sale of library editions of children's books to schools, libraries, and governmental bodies. The cases were assigned to Judge Marovitz.

The complaints, which are substantially identical, allege that schools, libraries, and governmental bodies purchase over $100,000,000 worth of children's books per year of which books in library editions comprise approximately $40,000,000. This represents the major part of the total sales of children's books in the United States. The cases involve only children's library books, and not text books.

The complaints allege that schools, libraries, and governmental bodies purchase children's books from wholesalers and directly from publishers, and that wholesalers and publishers solicit many of the same customers in their efforts to sell children's books. The "fair trade" exemption to the antitrust laws therefore does not apply. United States v. McKesson & Robbins, Inc., 351 U.S. 305 (1956).

The complaint alleges that traditionally schools, libraries, and governmental bodies have benefited from competition among wholesalers and publishers of children's books, and that many such purchasers buy children's books by means of competitive bids. The complaints charge that in recent years, publishers and wholesalers have classified certain children's books as "library editions" and have sold such books without discount at uniform "net prices" to schools and libraries. Each complaint alleges (1) a combination and conspiracy among the publisher and co-conspirator wholesalers to fix, maintain, and stabilize prices on that publisher's books, and (2) a series of contracts between the publisher and each of the co-conspirator wholesalers to fix, maintain, and stabilize prices on that publisher's books.

The complaints ask that defendants be enjoined from using the terms "net" or "net price," suggesting resale prices, cutting off or discriminating against price cutters, or restricting the price at which its books are resold. The complaint further asks that defendants be enjoined from bidding list prices on large bids, and be required to furnish a certificate of noncollusion on bids.

This matter was the subject of a grand jury investigation in Chicago in the summer of 1966, and also of hearings by Senator Philip Hart's antitrust subcommittee in the spring of 1966. In June, 1966, a treble damage suit was filed in Philadelphia based on the same situation, on behalf of the Philadelphia schools and public library.

Staff: William T. Huyck, John Edward Burke and David Berman (Antitrust Division)

* * *

CIVIL DIVISION

Assistant Attorney General Barefoot Sanders

COURTS OF APPEALS

ADMINISTRATIVE SUBPOENAS

NATIONAL MEDIATION BOARD MAY INSPECT RECORDS OF ALABAMA STATE DOCKS DEPARTMENT; UNDER RAILWAY LABOR ACT, WHICH GIVES BOARD ACCESS TO RECORDS OF "CARRIERS" ONLY, BOARD DOES NOT HAVE TO PROVE "CARRIER" STATUS OF DOCKS DEPARTMENT TO OBTAIN SUCH RECORDS, BUT MERELY MUST SHOW THAT DEMAND FOR RECORDS IS NOT ARBITRARY OR WITHOUT FOUNDATION.

United States v. Feaster (C.A. 5, No. 23,136, March 29, 1967; DJ File 124-3-1).

The Government sought an injunction barring the Alabama State Docks Department, an agency of the State, from denying the National Mediation Board access to its records in connection with a representation dispute among the Department's employees. The Railway Labor Act, 45 U.S.C. 152 Ninth, provides that the Mediation Board shall have access to the records of "carriers". In United States v. Feaster, 330 F. 2d 671 (C.A. 5), the Court of Appeals held that the Government's complaint stated a cause of action, and remanded the case to the district court for proof of the "carrier" status of the Docks Department. On remand, the district court received extensive affidavits on the question, and then held that, although the Department did run a railroad, its non-railroad activities predominated. For this reason, the district court denied the Government's motions for summary judgment and a preliminary injunction, and the Government appealed the denial of a preliminary injunction.

The Court of Appeals reversed and directed issuance of an order granting access to the records. The Court stated: "The 'proof' of carrier status referred to in the opinion on the first appeal is not 'proof' reaching the standard of burden of proof in trial of a civil case at issue, but 'proof' sufficient to show that the Board in asking for records, is not making a demand incompetent and irrelevant to its lawful purposes." This latter burden, the Court concluded, had been met. The Court noted: "In making a determination that the Board has submitted proof sufficient to show that its action was not incompetent or irrelevant to its purpose, and not arbitrary, capricious or without foundation, we do not determine nor indicate any opinion upon whether the State is or is not a carrier within the Act * * *."

Staff: Alan S. Rosenthal and Robert V. Zener (Civil Division)

ADMIRALTY--RIVERS AND HARBORS ACT

ACT DOES NOT REQUIRE SECRETARY OF ARMY TO REMOVE WRECK FROM NAVIGABLE CHANNEL; HE MAY EITHER REMOVE WRECK OR LIGHT IT AND MARK IT.

Buffalo Bayou Transportation Co. v. United States (C. A. 5, No. 23,308, April 17, 1967; DJ File 157-74-1946).

The Barge L-1, which sank in the Mississippi River, was abandoned by its owners a year later, at which time the Coast Guard undertook to light and mark the wreck. Libelants' barges later ran into the wreck. They sued the United States under the Suits in Admiralty Act, alleging that the wreck had been negligently marked and, alternatively, that the Secretary of the Army had a mandatory duty to remove the wreck. The district court dismissed the libel, finding that the Government had exercised due care in marking the wreck, and that the accidents were caused by libelants' carelessness. Libelants appealed solely on the ground that the Secretary had a mandatory duty to remove the wreck instead of merely marking it. The Court of Appeals rejected this contention, pointing out that the Rivers and Harbors Act of 1899, 33 U. S. C. 409 and 414, merely provides that abandonment of the wreck shall "subject" it to removal, and that no statute requires the Secretary to remove the wreck. The Fifth Circuit held that whether to remove a wreck or merely mark it was a matter of governmental discretion.

Staff: Martin Jacobs and Robert V. Zener (Civil Division)

FEDERAL RULES OF CIVIL PROCEDURE -- SUPPLEMENTARY PROCEEDINGS FOR COLLECTION OF JUDGMENTS

RULE 69(a), F. R. CIV. P., PERMITS USE OF WRITTEN INTERROGATORIES TO DISCOVER ASSETS OF JUDGMENT DEBTORS IN SUPPLEMENTARY PROCEEDINGS.

United States v. S. T. McWhirter (C. A. 5, No. 23,928, April 19, 1967; DJ File 77-75-318).

The Government filed a motion to compel its judgment debtors to answer interrogatories propounded under Rule 69(a), F. R. Civ. P., for the purpose of discovering the debtors' assets. The district court denied the motion, holding that Rule 69(a) only permitted the taking of depositions and did not include the right to propound written interrogatories. In reversing the district court, the Fifth Circuit held that the United States as a judgment creditor had the right to compel its judgment debtors to answer written interrogatories propounded in supplementary proceedings under Rule 69(a).

The Court of Appeals reasoned that written interrogatories afford a "direct, efficient, and accurate means by which the judgment creditor can obtain the desired information" and "for the holder of a small judgment they are the only practical means of discovering the assets of judgment debtors." This decision is significant to the Government, because of the more than 30,000 pending judgments which it holds with an outstanding balance of $281,980,642, approximately 60 percent are for amounts less than $1,000. Thus, in the future, United States Attorneys can utilize written interrogatories as a "simple and inexpensive" device to obtain information necessary for the collection of these small judgments.

The Court also held that the district court's order denying the Government's motion to compel answers to interrogatories was final and appealable since it determined substantial rights of the parties within the meaning of 28 U. S. C. 1291.

Staff: Jack H. Weiner (Civil Division)

MILITARY IMMUNITY

MEMBER OF ARMED FORCES MAY NOT SUE MILITARY DOCTOR FOR MALPRACTICE IN COURSE OF DUTY.

Bailey v. DeQuevedo (C. A. 3, No. 15,457, April 3, 1967; DJ File 145-4-1249).

Plaintiff, an Army sergeant, sued two Army surgeons, alleging that their malpractice resulted in the loss of a kidney. Under the decision in Feres v. United States, 340 U. S. 135, it was clear that plaintiff could not sue the United States under the Tort Claims Act, since his injuries were incurred "incident to service." Accordingly, he sued the two surgeons individually. A prior complaint against one surgeon in the Southern District of California was dismissed, and the Ninth Circuit affirmed that dismissal, stating: "We think the same policy considerations govern here as governed in the Jefferson and Griggs cases in the Feres group, Feres v. United States, 340 U. S. 135. This is not a tort claims case, but in principle we regard our result as a fortiori." Bailey v. Van Buskirk, 345 F. 2d 298 (C. A. 9), certiorari denied, 383 U. S. 948.

The present suit by Bailey against the second surgeon, brought in the Eastern District of Pennsylvania, was also dismissed, and the Third Circuit likewise affirmed. The Court agreed with the Ninth Circuit that the same policy considerations relating to military discipline, which govern in Tort Claims Act suits involving injuries arising out of military duty, also apply to suits between individual soldiers.

Staff: Robert V. Zener (Civil Division)

PUBLIC CONTRACTS

GOVERNMENT CONTRACTOR'S FAILURE TO PAY EMPLOYEES ANY WAGES ON ACCOUNT OF BANKRUPTCY HELD TO BE VIOLATION OF MINIMUM WAGE REQUIREMENTS OF WALSH-HEALEY ACT; CONTRACTOR HELD RESPONSIBLE FOR ITS SUPPLIER'S FAILURE TO PAY REQUIRED MINIMUM WAGES.

Jno. McCall Coal Co. v. United States (C.A. 4, No. 10,484, March 3, 1967; DJ File 78-35-60).

Jno. McCall Coal Company sued the United States to recover for coal sold and delivered. The Government did not dispute the debt but claimed a setoff under four prior coal contracts. The case was submitted to the district court on the administrative record which showed that McCall had agreed in those prior contracts to be liable for the observance of all Walsh-Healey labor standards in any mine supplying coal under the contracts; and that, because of financial difficulties leading to bankruptcy, one of its suppliers failed to pay its employees any wages for approximately one month. The Secretary of Labor had ruled that the supplier's nonpayment was a breach of the minimum wage stipulations contained in McCall's contracts. The district court sustained that ruling and the setoff made pursuant to it.

McCall appealed on the grounds that the failure to pay any wages did not violate the Act's minimum wage requirements (41 U.S.C. 35(b)), and that under 41 U.S.C. 36, it was not responsible for any such breach by its supplier. The Fourth Circuit rejected both contentions and affirmed. The Court ruled:

> It makes no difference whether employees go unpaid because of bankruptcy or from any other cause beyond the direct control of the contractor, or whether they go unpaid because of inadvertence or because of a willful act.
>
> The question to be determined is whether the employees were paid less than the minimum wage required by the statute. Total non-payment is clearly less than the minimum.

As to McCall's second contention, the Court observed that applicable regulations allowed a person not a "regular dealer" to become a Government contractor only if he assumed liability "for the observance in the mine of all labor standards provided in Section 1 of the Act," and that McCall had

not chosen to qualify as a "regular dealer" in coal. Thus, it was responsible for the payment of minimum wages due its supplier's employees.

Staff: Frederick Abramson and David L. Rose (Civil Division)

RECOVERY OF ERRONEOUS OVERPAYMENT

ERRONEOUS PAYMENT BY GOVERNMENT--BURDEN OF PROVING ENTITLEMENT AFTER GOVERNMENT MAKES PRIMA FACIE SHOWING OF MISTAKEN PAYMENT.

United States v. William Pedersen (C.A. 9, No. 20,929, April 5, 1967; DJ File 151-12-2209).

On being released from active duty with the Marine Corps and assigned to the Marine Corps Reserve, the defendant, an officer, was mistakenly paid severance pay although he was not discharged from the service. He was actually entitled to readjustment pay, a much lesser amount. When the erroneous payment was discovered and demand made by the Government for repayment, the officer refused to return the difference, claiming entitlement to severance pay on the basis of an alleged disability at the time of his release. In the ensuing litigation, the district court ruled that when the Government overpays a serviceman, it may recover the overpayment only if the error is patent on the face of the serviceman's pay records. Since the officer's pay record showed that the computation of severance pay was correct, the district court entered judgment for the defendant.

The Ninth Circuit reversed and directed the district court to enter judgment against the defendant for the difference between severance and readjustment pay. The appellate court rejected the district court's reasoning and ruled that since disability severance pay would only be available if the defendant were severed (discharged) for disability, he was not entitled to severance pay but only to the lesser readjustment pay. The Court also rejected the defendant's contention that the burden was on the Government not only to establish mistaken payment but the defendant's lack of entitlement to severance pay under any theory as well.

Staff: Harvey L. Zuckman (Civil Division)

RENEGOTIATION ACT

TAX COURT'S RULINGS ON QUESTIONS OF FACT AND LAW IN DETERMINATION OF EXCESSIVE PROFITS IN CONTRACT RENEGOTIATION CASES NOT REVIEWABLE.

Consolidated-Hammer Dry Plate & Film Co. v. The Renegotiation Board (C. A. 7, No. 15,806, April 11, 1967; DJ File 152-988).

This action was instituted by Consolidated-Hammer to review a determination of the Tax Court that it had accrued $75,000 in excessive profits in 1951 which could be recovered by the Government under the Renegotiation Act of 1951. After holding that the Tax Court properly found that petitioner was subject to the Act, the Seventh Circuit went on to hold that the "Act allows appellate review of the Tax Court's determination on constitutional and jurisdictional issues only." In response to petitioner's argument "that the holdings of the Tax Court were so arbitrary and capricious as to raise a constitutional issue," the Court stated that "the individual rulings to which the petitioner refers all present questions of fact and law entering into determination of the amount, if any, of excessive profits, which are not subject to review by this Court."

Staff: Robert C. McDiarmid (Civil Division)

TORT INDEMNITY

SETTLING INDEMNITEE WHO FAILS TO NOTIFY INDEMNITOR OF PENDENCY OF LITIGATION AND OF SETTLEMENT NEGOTIATIONS MAY RECOVER ONLY UPON SHOWING THAT HE WAS ACTUALLY LIABLE TO PERSON WITH WHOM HE SETTLED.

Jennings v. United States (C. A. 4, No. 10,635, March 2, 1967; DJ File 157-35-219).

An automobile driven by one Stewart Jennings collided with another vehicle on a roadway maintained by the United States. As a result of this collision, Jennings died and several others were injured. Those injured sued Jennings' estate in state court, and Jennings' insurance carrier eventually settled their claims. The Government was never notified either of the pendency of the actions or of the settlement negotiations. During the pendency of those actions, Jennings' administratrix and survivors instituted Federal Tort Claims actions, at the conclusion of which the United States was held liable for the accident as a result of the negligent construction and maintenance of the highway; Jennings was found not guilty of contributory negligence.

Jennings' insurance carrier brought this action for indemnity against the United States to recover the sum paid in settlement of the suits against Jennings' estate. In the district court, it was agreed (1) that the United States was negligent, (2) that the amount of the carrier's settlement was reasonable, and (3) that Jennings was not in fact negligent. The district

court held "that a settling indemnitee who fails to notify the indemnitor of the pendency of the litigation and of the settlement negotiations may recover only upon a showing that he was actually liable to the person with whom he settled," and entered judgment for the United States since the carrier had stipulated that Jennings was not in fact negligent.

The Fourth Circuit affirmed, rejecting the carrier's position that it need show no more than that there existed a substantial likelihood that it would have been held liable in the state court suits. The Court of Appeals reasoned:

> Lack of notice * * * entitles the indemnitor to be heard on the issue of the indemnitee's liability. The indemnitee's unilateral acts, albeit reasonable and undertaken in good faith, cannot bind the indemnitor; notice and an opportunity to defend are the indispensable due process satisfying elements.
>
> There is no more reason to dispense with the requirement of notice to the indemnitor where the suit against the indemnitee is terminated by settlement than where it is allowed to go to judgment. On the score of notice, the two cases stand alike. Indeed, if the reasonableness of the indemnitee's conduct be the touchstone, it should govern all indemnity actions, if the original suit went to judgment no less than if it was settled. Yet it would be repugnant to the sense of justice if an indemnitor could be bound by a judgment after trial in a proceeding to which he was not a party and of which he had no notice. There is no authority for binding him in such circumstances. * * *

Staff: John W. Bassett (Office of the Attorney General) and David L. Rose (Civil Division)

* * *

CIVIL RIGHTS DIVISION

Assistant Attorney General John Doar

COURT OF APPEALS

SCHOOL DESEGREGATION

COURT OF APPEALS FOR FIFTH CIRCUIT, SITTING EN BANC, HOLDS THAT SEGREGATED SCHOOL SYSTEMS MUST REORGANIZE INTO UNITARY, NONRACIAL, INTEGRATED SCHOOL SYSTEMS, AND DIRECTS ENTRY OF UNIFORM, SPECIFIC DECREE IN SEVEN CONSOLIDATED SCHOOL DESEGREGATION CASES.

United States v. Jefferson County Board of Education, (C. A. 5, No. 23345, March 29, 1967, and December 29, 1966, D. J. Files 169-1-5, 169-33-5, 169-33-11, 169-1-8, 169-33-8, 169-1-2, 169-33-1).

In seven school desegregation cases from Alabama and Louisiana in which the United States was appellant and plaintiff-intervenor, the Court of Appeals for the Fifth Circuit reversed district court orders approving freedom of choice desegregation plans which did not meet constitutional standards. The Court set out a specific decree for district courts to enter, which embodied a desegregation plan which gave great weight to the HEW Statement of Policies, or Guidelines, for the mechanics of the plan. The decision was entered by a three-judge panel by a 2 - 1 decision on December 29, 1966, and was reaffirmed on rehearing with clarification and minor changes by the Court en banc, by an 8 - 4 decision on March 29, 1967.

Four aspects of the decision are particularly significant: (1) the holding that de jure segregated school systems must reorganize into a unitary, nonracial school system, as well as assign students to schools on a nonracial basis; (2) the entry of a uniform decree for general circuit-wide application; (3) inclusion in the decree of specific mechanics designed to help assure the fair and effective operation of the freedom of choice method of pupil assignment; and (4) the principle that courts will give "great weight" to the Department of Health, Education and Welfare's school desegregation guidelines for formulating the mechanics of school desegregation plans.

(1) In reaffirming the decision of the original three-judge panel, the en banc Court held "that boards and officials administering public schools in this circuit have the affirmative duty under the Fourteenth Amendment to bring about an integrated, unitary school system in which there are no Negro schools and no white schools -- just schools." Insofar as prior rulings of the Court might imply a lesser obligation, they are overruled. This duty extends to all aspects of a school system, including faculty hiring and allocation,

school construction and planning, equalization of school facilities and provision for remedial programs, all school connected activities, transportation plans and bus routes, as well as assignment and transfer of students, and requires school boards to "take affirmative action to disestablish all school segregation and to eliminate the effects of the dual school system."

In order to effectuate this reorganization, the desegregation plan set forth in the uniform decree requires that services, facilities, activities, and programs must be conducted on a nondiscriminatory basis, and school facilities must be equalized, to the extent feasible, between formerly white and formerly Negro schools, including remedial programs to overcome the past inadequacies of segregated education. The location and expansion of schools must be done with the objective of eradicating the dual system, "to the extent consistent with the proper operation of the school system as a whole." Hiring, dismissing and allocation of faculty and staff must be done nonracially, except where racial assignments are necessary to correct the effects of past segregated assignments, and the school board must assign staff with the objective of preventing the identification of any school as a school tailored for a heavy concentration of either Negro or white pupils.

To facilitate monitoring of performance, the decree also requires the school district to report to the district court concerning the results of the choice period, the actual enrollment statistics after the beginning of school, and the action taken concerning faculty allocation and vacancies.

The opinion of the en banc Court on rehearing emphasized that the freedom to attend any school in a system, embodied in many desegregation plans today, is not an end in itself, but merely a means available at this stage to achieve a unitary school system required by the Fourteenth Amendment. That "tool" for desegregation, as all other tools, must be evaluated by the criterion of whether it is reasonably related to accomplishing its task. Therefore the Court, like HEW, will look at the performance under the plan--the amount of desegregation--to help measure the effectiveness of freedom of choice as a useful tool for achieving a unitary, nonracial school system. If freedom of choice plans are not successful in achieving "a unitary system" then school boards must try other tools.

(2) The decree entered by the Court of Appeals in these cases is to be applied uniformly throughout the Fifth Circuit in school desegregation cases involving free choice plans, subject to modification for exceptional circumstances. In order to assure the constitutional adequacy of plans in cases which already have court approved plans, such cases may be reopened upon motion by the proper party.

(3) The Court's decree contains comprehensive and specific provisions for the mechanics of plans where the local school district undertakes

desegregation by allowing students a free choice of schools. Requirements to insure that the choice of schools is actually free and the assignment of students is nonracial are included in the Court's plan. Adequate notice of the plan's provisions must be given to the students and parents. Students are required to exercise a choice of school each year. In case a student's choice of schools is rejected because of overcrowding, he must be assigned on the basis of proximity to the school. The plan provides that transportation cannot be denied to students because of their race, and that busses should be routed to serve each student's choice of school to the maximum extent feasible. Desegregation plans for nonracial assignment of pupils must apply to all grades for the 1967-68 school year.

(4) The en banc Court reaffirmed that it would give "great weight" to HEW Guidelines for the mechanics of desegregation plans and held that they "establish minimum standards clearly applicable to disestablishing state-sanctioned segregation." The Court held that the Guidelines comply with the letter and spirit of the Civil Rights Act of 1964 and meet the requirements of the Constitution.

The Court expressly withheld its opinion of the applicability of the HEW Guidelines to racial imbalance arising from de facto segregation or whether state tolerance of de facto segregation in neighborhood schools constitutes state action. The en banc Court stated that school segregation is inherently unequal "by any name and wherever located," but pointed to the state action problem unique to a determination of constitutional duties in situations involving de facto school segregation arising from segregated residential patterns. In such situations, the Court thought that Shelley v. Kraemer, 334 U.S. 1 (1948) may be as important as Brown. "A broad-brush doctrinaire approach, therefore, that Brown's abolition of the dual school system solves all problems is conceptually and pragmatically inadequate for dealing with de facto-segregated neighborhood schools. We leave the problems of de facto segregation in a unitary system to solution in appropriate cases by the appropriate courts."

PUBLIC ACCOMMODATIONS

SMALL DRIVE-IN RESTAURANT WHICH SERVES ALL COMERS EXCEPT NEGROES, IS LOCATED THREE BLOCKS FROM FEDERAL HIGHWAY, AND SELLS MORE THAN MINIMAL OR INSIGNIFICANT AMOUNT OF FOOD THAT ORIGINATED OUT OF STATE, IS COVERED BY TITLE II OF CIVIL RIGHTS ACT OF 1964 BOTH BECAUSE IT OFFERS TO SERVE INTERSTATE TRAVELERS AND BECAUSE SUBSTANTIAL PORTION OF ITS FOOD HAS MOVED IN COMMERCE.

Gregory v. Meyer (C.A. 5, May 1, 1967, No. 23948, D.J. File 167-20-20)

Three Negroes who had been refused service (except at a side window or in the kitchen) at the Burger Boy Drive-In Restaurant in Savannah, Georgia, brought a class action for injunctive relief under Title II of the Civil Rights Act of 1964. The District Court for the Southern District of Georgia held that defendants did not offer to serve interstate travelers, that plaintiffs had not established "by the requisite burden of proof" that a substantial portion of the food sold had moved in interstate commerce, and that the discrimination (which was admitted by defendants) was not supported by state action. The district court therefore held that the restaurant was not within the coverage of Title II and granted summary judgment for defendants. The United States filed a brief on appeal as amicus curiae urging reversal. The Court of Appeals reversed and directed the district court to enter summary judgment for plaintiffs.

Pointing out that defendants served "all comers, except Negroes," the Court quoted approvingly from the Georgia Supreme Court's decision in Bolton v. State, 220 Ga. 632, 140 S.E. 2d 866 (1964), that:

> As a public eating place, this drive-in's offer to serve everybody, without qualification or limitation, who desires to purchase food from it, except Negroes, is unquestionably the holding out of an offer by it to serve white interstate travellers.

In the present case the restaurant was three blocks from a federal highway, on a street that was an extension of that highway, and so was "in such proximity to the highway as to make it probable that it will have interstate patrons." Furthermore, the proprietor did not make any distinction between tourists and local customers.

In finding that defendants' restaurant was also covered because a substantial portion of the food served had moved in interstate commerce, the Court of Appeals cited the "legislative history to the effect that the Act uses the term 'substantial' as meaning anything more than a minimal or insignificant amount." The record showed that the restaurant had annual sales of $70,856. The coffee and tea, amounting to $5,000 in annual sales, had moved in interstate commerce. Two-thirds of the total sales volume consisted of beef products, and the meat packer from whom defendants' beef supplier obtained his beef purchased twenty to thirty percent of its cattle from outside the state. In addition, numerous small items such as grits, cereal, vegetables, soups and pickles had moved in interstate commerce.

Staff: David L. Norman, Alan G. Marer, Merle W. Loper (Civil Rights Division)

DRIVE-IN EATING FACILITIES COVERED BY SECTION 201(b)(2), 42 U.S.C. 2000a(b)(2) OF CIVIL RIGHTS ACT AS "OTHER FACILITY PRINCIPALLY ENGAGED IN SELLING FOOD FOR CONSUMPTION ON THE PREMISES" AND THEREFORE CANNOT DISCRIMINATE IN SERVICE, REGARDLESS OF PERCENTAGE OF FOOD ACTUALLY CONSUMED ON PREMISES.

Newman, et al. v. Piggie Park Enterprises, Inc. (C.A. 4, April 24, 1967, No. 10,860)

The suit was commenced as a class action for injunctive relief under the public accommodations provisions of Title II of the 1964 Civil Rights Act. The Government participated as amicus curiae on appeal. The Fourth Circuit sitting en banc unanimously reversed a district court ruling that certain drive-in restaurants were not covered by the "other facility" provision of Section 201(b)(2) of the Act, 42 U.S.C. 2000a(b)(2), which forbids racial discrimination by "any restaurant, cafeteria, lunchroom, lunch counter, soda fountain, or other facility, principally engaged in selling food for consumption on the premises . . . ." (Emphasis added.)

The District Court for the District of South Carolina read the provision as covering a facility where food could conveniently be eaten on the premises only if more than 50 percent of the food is in fact eaten there. Under this interpretation the evidence showed that defendants' drive-ins were not public accommodations.

The Fourth Circuit rejected this interpretation. Relying on the legislative history and the overall purpose of the public accommodation provisions, the Court interpreted the "other facility" provision to mean that any establishment whose principal business is the sale of food "ready for consumption on the premises" (or "ready-to-eat food") is covered regardless of whether or not the customers actually eat it there or carry it out to be eaten elsewhere. Thus "for the consumption on the premises" describes the kind of food served and excludes "grocery type food stores" from coverage, and "principally" was included in the provision only "to exclude from coverage places where food service was incidental to some other business," such as certain bars and "Mrs. Murphy" tourist homes.

The Court of Appeals left the question of appellant's request for counsel fees pursuant to Section 204(b) of the Act, 42 U.S.C. 2000a-3(b), to the discretion of the district court. The test to be applied by the district court is a subjective one, taking into account whether defendants' defenses were presented for the purposes of delay and not in good faith.

Judge Winter, joined by Judge Sobeloff, concurred on the issue of attorney's fees. They would award fees to compensate plaintiffs for having to overcome patently frivolous defenses regardless of defendants' alleged good faith in interposing such defenses.

Staff: David L. Norman, Alan G. Marer, Michael R. Flicker, Alvin Hirshen (Civil Rights Division)

(NOTE: The staff on the case of U.S. v. Jefferson County Board of Education was:

Assistant Attorney General John Doar; St. John Barrett; David Norman; Owen Fiss; Brian Landsberg; Alexander Ross (Civil Rights Division)

* * *

CRIMINAL DIVISION

Assistant Attorney General Fred M. Vinson, Jr.

WITNESSES - PREJUDICIAL IDENTIFICATION

REPEATED REFERENCES BY WITNESSES TO "MUG SHOTS" OF DEFENDANT HELD PREJUDICIAL ERROR.

United States v. Orrin Scott Reed (C. A. 7, February 9, 1967, DJ File 29-100-3581)

Reed was convicted, together with an accomplice, of bank robbery and placing the life of a bank employee in jeopardy by using a dangerous weapon in violation of 18 U.S.C. 2113 (d). On appeal, the principal issue was whether defendant was prejudiced by the implied references to his prior criminal record.

At the trial, a state trooper testified that during the investigation he went to the home of a bank employee to show him two "mug shots". The trooper stated, in response to a question, that mug shots are photographs of former inmates of the state prison. During cross-examination several minutes later, the trooper again stated the source of the photographs to be the state prison. Shortly after this testimony, another Government witness identified Government exhibit 10 as "a mug shot of Orrin Scott Reed". On cross-examination, the witness testified that he showed pictures of Reed to the bank employee and his family along with eight or ten "other" photographs from the state prison.

In reversing the conviction, the Seventh Circuit held that Reed's right not to take the stand in his own defense was substantially destroyed by the testimony relating to the "mug shots". The Court felt that, even though repeated objections to this testimony were sustained, the testimony remained with the jury. It also noted that the characterization of photographs as "mug shots" had the same effect as the testimony relating to penitentiary notations on photographs held to be prejudicial in United States v. Harman, 349 F. 2d 316 (C. A. 5, 1965).

The United States Attorneys and their staffs should make every effort to avoid problems similar to those in the Reed case and take steps to prevent their recurrence. This can sometimes be done by interviewing all Government witnesses before trial and advising them to be careful about such remarks.

MAIL FRAUD

CHAIN REFERRAL PLAN; GOOD FAITH DEFENSE.

Steiger v. United States, 373 F. 2d 133 (C. A. 10, 1967, DJ File 36-60-70)

The three defendants were convicted on charges of mail fraud (18 U.S.C. 1341) in connection with the operation of Superior Products, Inc., selling household appliances at grossly inflated prices on a chain referral plan. Purchasers were led to believe that the merchandise could be paid for, and additional money earned, from commissions paid as a result of referrals of new customers. On appeal, it was contended that the evidence was insufficient to sustain the convictions and that the trial court erred in failing to instruct the jury on good faith as a defense.

While the Court of Appeals reversed the convictions for failure of the trial court to give the requested instructions on good faith, it found that there was substantial evidence to support the verdicts of guilty, thus making it clear that these chain referral schemes may be successfully prosecuted under the mail fraud statute. On retrial, the principal defendant was convicted.

Staff: United States Attorney B. Andrew Potter; Assistant United States Attorney John W. Raley, Jr. (W. D. Okla.)

* * *

EXECUTIVE OFFICE FOR UNITED STATES ATTORNEYS
Assistant to the Deputy Attorney General John W. Kern, III

ASSISTANTS APPOINTED

California, Southern - JOSEPH MILCHEN, ESQ.; University of Michigan, J. D., and formerly in private practice.

District of Columbia - ALBERT OVERBY, ESQ.; New York University, LL.B., and formerly attorney with AEC, and in private practice.

District of Columbia - JAMES TREANOR, ESQ.; Fordham University, LL.B., and formerly a law clerk in U.S. District Court and in private practice.

Kentucky, Eastern - PATRICK MOLLOY, ESQ.; University of Kentucky, J.D., and formerly law clerk, United States Attorney's Office, Kentucky Eastern.

New York, Eastern - DAVID STEINMANN, ESQ.; Columbia University, LL.B., and formerly a Legal Intern at Georgetown University, and in private practice.

New York, Southern - BRIAN GALLAGHER, ESQ.; Fordham University, LL.B., and formerly in private practice.

Texas, Eastern - WILLIAM WHITE, ESQ.; South Texas College of Law, LL.B., and formerly Assistant District Attorney.

LAND AND NATURAL RESOURCES DIVISION

Assistant Attorney General Edwin L. Weisl, Jr.

PUBLIC LANDS

DESERT LAND ENTRIES; RES JUDICATA.

Robert E. McCarthy v. Leonard E. Noren, et al., 370 F. 2d 845 (C. A. 9, 1966, pet. for cert. has been filed, DJ File 90-1-4-92.)

This case arose seeking the reversal of the Secretary of the Interior's rejection of appellees' desert land entry applications. Appellees first filed a complaint seeking to obtain a de novo trial on the rejection of their desert land entries. The district court ruled that appellees were not entitled to a de novo trial. See 199 F. Supp. 708. No appeal was taken from this decision. Thereafter, appellees filed a second complaint involving the same desert land applications, the same property and parties, seeking the same relief.

The trial court refused to dismiss this second complaint, ruling that the first action was not res judicata. The only difference urged by appellees, in the second of the two actions, was the legal theory. It was argued that the first was an action brought under the provisions of the Administrative Procedure Act, while the second presented a question of denial of procedural due process under the Fifth Amendment.

The Court of Appeals, in reversing the district court, held that the due process grounds urged in the second action could have been raised in the first case and did come within the allegation of the first complaint that the Secretary's action was arbitrary and capricious. The Court held that the assertion of a different legal theory in the second complaint was not the same as the urging of a separate and distinct cause of action. The first decision of the district court was held to be res judicata.

Staff: George R. Hyde (Land and Natural Resources Division).

CONDEMNATION

OWNERS' TESTIMONY MUST HAVE FOUNDATION; MARKET VALUE IS STANDARD EVEN WHEN THERE ARE NO COMPARABLE SALES; ADMISSIBILITY OF EVIDENCE; COMPARABLE SALES ADMISSIBLE EITHER AS DIRECT PROOF OF VALUE OR IN SUPPORT OF OPINION TESTIMONY; MULTIPLICATION OF TONNAGE BY PRICE FOR MINERAL VALUATION GENERALLY IMPROPER; ADAPTABILITY TO USE DOES NOT ESTABLISH

MARKET; BURDEN OF PROOF ON OWNER; OPINION EVIDENCE MUST HAVE RATIONAL FOUNDATION; OWNERS' TESTIMONY BASED ON SPECULATION HAS NO PROBATIVE VALUE.

United States v. Sowards, 370 F. 2d 87 (C.A. 10, 1966, DJ File 33-46-257-65)

This condemnation action was instituted to acquire the coal, coal mines and workings in 18.18 acres of land, in Utah, the interest retained by the property owners from whom the surface interests had been purchased in a negotiated transaction. The first trial of this case resulted in an excessive verdict and the United States obtained a reversal due in large measure to the prejudicial conduct of the trial judge. See 339 F. 2d 401. The second trial was held before a different judge but was in most respects a repeat of the first trial.

There were no comparable sales of coal properties in the area due to the fact that the coal interests were usually sold with the surface rights. The only evidence which could be said to support the verdict was the property owners' "value to me." The United States again was prevented from making its full case by the trial judge in the same manner as was done in the first trial. The trial court's prejudice was due to the position of the United States' witness that the interests taken had only nominal value. The trial judge considered the United States' testimony to be ridiculous due to his feeling that we would not be taking this mineral interest if it did not have a value.

The Court of Appeals, in reversing, took occasion to state in some detail many of the principles which are constantly recurring in condemnation cases. The Court held, citing numerous authorities, that:

> The sovereign must place the owner in as good a position pecuniarily as he would have been had his property not been taken. The constitutional requirement extends only to the property taken, and not to the opportunities which the owner may lose. * * * Just compensation is measured by the market value of the property at the time of taking. * * *The federal concept of market value is intimately related to selling price on the market, and it generally recognized that the best evidence of market value is found in sales of comparable property within a reasonable time before taking; but the determination is not limited to that method. * * *

But, whatever method is employed, the evidence offered must have a bearing upon what a willing buyer would pay a willing seller for the property on the date of the taking. Considerations that may not reasonably be held to affect market value are excluded. * * * The lack of comparable sales does not change the measure of compensation; * * *. * * * The law of evidence in federal courts favors a broad rule of admissibility and is designed to permit the admission of all evidence which is relevant and material to the issues in controversy, unless there is a sound and practical reason for excluding it. * * * [E]vidence of comparable sales is admissible either as direct proof of value or in support of the opinion of an expert, * * *.

* * * courts have generally held that the tonnage multiplied by unit price is a deviation from the proper standard of valuation at the time of taking, because the result is based upon speculation as to the continuing existence of a theoretical future market. * * *

The mere adaptability of the coal deposit to a use does not establish a market.

The burden rests upon the owner to establish by competent evidence his right to substantial compensation. * * * Qualified and knowledgeable witnesses may give their opinion or estimate of the value of the property taken, but to have probative value, that opinion or estimate must be founded upon substantial data, not mere conjecture, speculation or unwarranted assumption. It must have a rational foundation. * * *

It is the general rule that an owner, because of his ownership, is presumed to have special knowledge of the property and may testify as to its value. * * * But the owner's qualification to testify does not change the "market value" concept and permit him to substitute a "value to me" standard for the accepted rule, or to establish a value based entirely upon speculation. * * * [H]ere, the presumption of the owner's special knowledge is negated by

his own testimony, his opinion has no probative value and is insufficient to sustain the award.

This case will not be retried, due to the fact that the property owners' reasonable settlement offer has been accepted.

Staff: George R. Hyde (Land and Natural Resources Division)

RULE 71A(h) COMMISSION PROCEDURE; LACK OF INSTRUCTIONS NOT REVERSIBLE ERROR WHERE COMMISSION FOLLOWED CORRECT STANDARD; ADEQUACY OF REPORT; CONSTRUCTION OF DECLARATION OF TAKING; PURCHASE AGREEMENTS ENTERED INTO BY UNITED STATES AND ALL EXISTING PARTIES POSSESSING PRESENT AND FUTURE INTERESTS ARE EVIDENCE OF VALUE.

Chandler v. United States, 372 F.2d 276 (C.A. 10, 1967, D.J. File 33-17-199-32)

The United States entered into purchase agreements with all persons having present and future interests in certain lands in Kansas. However, transfer by conveyance was not feasible due to possible outstanding remainder and reversionary interests. Thus, it was necessary to condemn to acquire clear title. The original declaration of taking described the estate taken as one in fee simple, reserving mineral interests (including oil and gas) in the defendants for a period of years, but reserving to the United States a percentage of royalties from oil and gas production. With the court's permission, the original declaration of taking was amended to eliminate the retention of royalties by the United States. Without any instructions, the case was assigned to a commission to determine fair market value. The commission heard evidence, made its determination and filed a report which was accepted by the district court.

On appeal, the defendants argued for reversal of the judgment for several reasons: the amendment of the declaration of taking was improper; the commission acted without instructions; the report was inadequate; and the commission considered the purchase agreements as evidence of value, even though possible future remainder and reversionary interests, not parties to the agreements, could be affected.

The Court of Appeals affirmed the judgment. It reasoned that the United States cannot unilaterally divest itself of title taken. However, that presumes a lawful taking at the inception. The amendment here merely eliminated an illegal reservation to the Government of a percentage of royalty. As to the lack of instructions, the Court said that the hearing met all the requirements of Merz, the report was adequate, and the correct legal standard was

followed--in essence no prejudicial error occurred. The Court further stated that the purchase agreements were relevant and admissible in evidence. They were "admitted as evidence of value and are in the same evidentiary category as evidence of recent sales."

Staff: William M. Cohen (Land and Natural Resources Division).

TUCKER ACT

FEDERAL RULES OF CIVIL PROCEDURE; ADEQUACY OF PLEADINGS TO STATE CLAIM; NOTICE.

United States v. Hardy, 368 F.2d 191 (C.A. 10, 1966, D.J. File 90-2-2-115)

This action was instituted to collect delinquent irrigation project water charges. At the trial, defendants claimed that the United States cut off water from a second tract of land in the irrigation project on which they were not delinquent. They thus raised a counterclaim for the loss of cattle and inability to grow hay on the second tract; several of the years for which they claimed such damages were more than six years before this action was commenced. The Government trial attorney claimed surprise and requested a continuance. This was denied by the court on the ground that the counterclaim was properly raised by the pretrial order question: "Are defendants entitled to any set-off?" A judgment was entered, stating that defendants owe the Government on their delinquent water charges, but that they can set-off from their delinquency the amount of their counterclaim (an amount greater than the arrearages). Accordingly, the result was an affirmative award for defendants.

Appeal was taken only from that portion of the judgment allowing the counterclaim. It was argued by the Government that: (1) judgment cannot be based on a counterclaim not pleaded and of which no notice was given prior to trial, and (2) the district court lacked jurisdiction to make an affirmative award based on a counterclaim under the Tucker Act after the jurisdictional time period for bringing that action had run.

The Court of Appeals ruled that the burden is upon the party stating a claim to state it clearly enough to give the other side notice. "[N]o plain statement appeared either in the pleadings or the pretrial order to show that the Hardys were claiming such damages (loss of cattle and inability to grow hay), as required by Rule 8(a), F.R.Civ.P. Nowhere was the government given notice of such a claim or the grounds upon which it rested; consequently

it was deprived of the opportunity effectively to defend thereon." That portion of the judgment allowing the set-off by means of the counterclaim was reversed.

Staff: William M. Cohen (Land and Natural Resources Division).

INDIANS

ADMINISTRATIVE LAW; VALIDITY OF SECRETARY OF INTERIOR'S WITHDRAWALS AND RESTORATION OF CEDED TRIBAL LANDS UNDER INDIAN REORGANIZATION ACT; INDISPENSABLE PARTY.

Rundle v. Udall (C. A. D. C. No. 19797, April 21, 1967, D. J. File 90-2-18-99).

This is a companion case to Bowman v. Udall, 243 F. Supp. 672 (D. D. C. 1965), affirmed sub nom. Hinton v. Udall, 364 F. 2d 676 (C. A. D. C. 1966). There, pursuant to Sections 3 and 7 of the Indian Reorganization Act of June 18, 1934 (also known as the Wheeler-Howard Act), 48 Stat. 984, 25 U. S. C. 463 and 467, the Secretary of the Interior, in 1963, ordered restoration to the San Carlos Tribe of Indians of subsurface interests in certain ceded lands in Arizona, known as the Mineral Strip, "subject to any valid existing rights." The lands had been temporarily withdrawn from all forms of entry in 1931 and 1934. The State of Arizona, patentees, and grazing lessees sought to enjoin restoration. The district court dismissed the action, concluding that plaintiffs lacked standing and presented no case or controversy on which to base jurisdiction. On the merits, it also ruled that the Secretary's restoration order was authorized. The Court of Appeals affirmed on grounds of justiciability and ripeness, with no ruling on the merits.

Here, the district court upheld the Secretary's invalidation of appellants' mining claims because the claims had been located on lands withdrawn from mineral entry.

The Court of Appeals affirmed, per curiam, adopting the Bowman district court discussion of the historical, statutory and administrative background and the Bowman ruling on the merits that "the Secretary had authority under Section 3 of the Indian Reorganization Act to withdraw and to restore" the lands. The Court did not comment on the Government's contention that the Tribe was an indispensable party.

Staff: Raymond N. Zagone (Land and Natural Resources Division).

GOVERNMENT EMPLOYEES AND CONTRACTORS; CRIMINAL LIABILITY FOR VIOLATIONS OF STATE STATUTES REQUIRING PERMIT OR

LICENSE TO CONDUCT PLUMBING OR WELL-DRILLING ACTIVITIES WITHIN STATE; REMOVAL OF CRIMINAL PROCEEDINGS TO FEDERAL COURT; GOVERNMENT EMPLOYEES AND CONTRACTORS NOT BOUND TO COMPLY WITH STATE LICENSE REQUIREMENTS WHERE ENGAGED IN IMPROVEMENTS TO SANITATION ON INDIAN RESERVATION FOR PUBLIC HEALTH SERVICE; APPLICABILITY OF SUPREMACY CLAUSE (ART. VI OF CONSTITUTION).

State of Wisconsin v. Budreau, No. CR-65-81; State of Wisconsin v. Christensen Supply Company, No. 66-CR-20. (W. D. Wis., Feb. 7, 1967, D. J. Files 90-2-4-89 and 90-2-4-90).

The District Attorney of Burnett County, Wisconsin, caused a summons to be issued against Budreau, charging him with engaging in plumbing activities within the State, without being licensed by the Wisconsin State Board of Health, in violation of Section 145.06 of the Wisconsin Statutes. At the time of the alleged offense, Budreau was a Sanitarian Aide of the Division of Indian Health, United States Public Health Service, Department of Health, Education and Welfare, was serving as a local Project Assistant at the St. Croix Indian Reservation and was engaged in the installation of plumbing on the reservation for sanitation purposes.

The District Attorney of Burnett County, Wisconsin, also caused a summons to be issued against the Christensen Supply Company, charging it with engaging in the industry of well-drilling without first having registered with the State Board of Health and without first having obtained a permit from the Board, in violation of Section 162.04 of the Wisconsin Statutes. The Christensen Supply Company is owned by one Holger Christensen, a resident of Minnesota. The company had been awarded a contract by the Public Health Service for drilling and developing 31 wells on the St. Croix Indian Reservation.

A timely removal of these criminal proceedings to the federal court was effected pursuant to 28 U.S.C. 1442(a)(1).

In 1954, the Congress transferred to the Surgeon General all functions, responsibilities and duties of the Department of the Interior relating to health facilities for Indians and the conservation of the health of Indians. 42 U.S.C. 2001. In carrying out his functions, the Surgeon General was charged by the Congress with the responsibility for constructing, improving and maintaining, by contract or otherwise, essential sanitation facilities, including water supply, drainage, sewage and waste disposal for Indian homes, communities and lands. 48 U.S.C. 2004(a).

Separate motions to dismiss these proceedings were filed on behalf of each of the defendants, upon the ground that each of them was immune from the Wisconsin plumbing and well-drilling statutes. The court granted the motions to dismiss on February 7, 1967.

In an opinion rendered in the Budreau case on the same date, the Court stated:

> I conclude that for a federal employee to engage in plumbing without a Wisconsin plumbing license does not necessarily mean that he has departed from the Congressional purpose declared in 42 U.S.C. sec. 2004(a)(1). Thus, the defendant, acting under color of his federal office, is entitled to the shield from state regulation provided by Article VI of the Constitution of the United States. [Supremacy Clause]

In an opinion rendered in the Christensen Supply Co. case on February 7, 1967, the Court said:

> The only distinction in the two situations appears to be that Budreau performed his plumbing services as an employee of the United States, whereas Christensen Supply Co. performed its well-drilling services as a contractor with the United States. I do not consider this distinction significant.

Staff: United States Attorney Edmund A. Nix; Assistant United States Attorney John E. Clarke (W.D. Wis.), and David D. Hochstein (Land and Natural Resources Division).

* * *

TAX DIVISION

Assistant Attorney General Mitchell Rogovin

COURTS OF APPEALS - CRIMINAL CASES

EVASION

TAX ATTORNEY'S COLLECTION OF TAX MONIES FROM CLIENTS FOLLOWED BY DIVERSION TO HIS PERSONAL USE AND FAILURE TO FILE RETURNS HELD, UNDER CIRCUMSTANCES OF THIS CASE, NOT TO AMOUNT TO ATTEMPTS TO EVADE CLIENTS' TAXES

Charles L. O. Edwards v. United States (C.A. 9, No. 19,782, April 4, 1967, DJ File 5-61-1486).

Appellant, a tax attorney, was convicted on a total of 25 counts. Three counts charged failure to file his own returns, five counts charged that he had wilfully assisted in the preparation and filing of false returns for clients, and seventeen counts charged that he had wilfully attempted to evade income taxes owing by certain clients. The Court of Appeals affirmed the judgment on the first eight counts, finding no merit in the argument that wilfulness had not been shown, but reversed the judgment on the last seventeen counts. It appeared that appellant would secure from his clients checks payable to him covering the tax due plus his fee, which he would deposit into a special "trust account". On this account he would sometimes draw checks payable to the Director of Internal Revenue which would be transmitted with the returns to the Director. At other times, of which these seventeen instances were examples, appellant would fall behind and fail to file returns, simply keeping the money paid to him by his clients. He argued on appeal that (1) this conduct does not constitute an affirmative "attempt" under Spies v. United States, 317 U.S. 492; and (2) that even if it does the attempt was not wilful in the sense that that word is used in Section 7201. The Court of Appeals disagreed with appellant on (1), holding that there were affirmative acts of evasion (contra, United States v. Mesheski, 286 F. 2d 345 (C.A. 7)), but agreed with appellant on (2), holding that under all the circumstances shown by this record appellant's conduct was not wilful. Some shortages in the trust account were traceable to appellant's practice of advancing money to some of his clients--"embezzling from Peter to pay Paul's taxes"--but he also drew on the account for personal purposes, gradually falling behind in filing returns and remitting payments. In some cases he applied for time extensions for filing. The Court concluded, on all the facts, that appellant was merely taking advantage of the time lag in investigation of delinquent returns to tide him over during a period of hardship, and did not intend the "permanent evasion of any of his clients' taxes." As we understand the opinion, the Court holds

that, contrary to Mesheski, there can be attempts to evade clients' taxes in cases of this kind, but that here, on all the evidence, appellant's conduct was not wilful.

Staff: United States Attorney Sidney I. Lezak; Assistant United States Attorney Charles H. Habernigg (D. Ore.)

COURTS OF APPEALS - CIVIL CASES

STATE TAX LIEN HELD NOT TO HAVE STATUS OF JUDGMENT CREDITOR FOR PURPOSES OF SECTION 6323 OF I.R. CODE OF 1954 AND FEDERAL TAX LIEN HELD TO BE EFFECTIVE AGAINST COMPETING LIENS AS OF DATE OF RECORDING OF NOTICE OF LIEN, ALTHOUGH NOTICE AND DEMAND WAS ISSUED TO TAXPAYER AT LATER DATE.

North Gate Corp., et al. v. North Gate Bowl, Inc., (No. 217 Wisconsin Supreme Court, April 14, 1967; DJ File 5-86-548) (67-1 U.S.T.C., ¶9384).

The United States and the Wisconsin State Industrial Commission intervened in this action to assert their respective liens for federal withholding taxes and state unemployment taxes against defendant. The United States, contending that its liens had priority by virtue of the filing of a Notice of Lien on June 4, 1965, moved for and was granted summary judgment. The Commission appealed on the ground that the federal tax lien did not become effective until June 24, 1965, the date notice and demand was made upon defendant by the United States, and the Commission's lien, which had been filed June 17, 1965, was therefore entitled to priority.

On appeal, the Court noted that the Commission was claiming status as a judgment creditor pursuant to Section 108.22(2) of the Wisconsin Statutes. This statute raises the administrative assessment of the Commission to the status of a judgment lien when notice of the state assessment is filed. On the basis of United States v. Gilbert Associates, 345 U.S. 361, the Court held that the Commission was not a judgment creditor in the traditional sense, and was not, therefore, within the class of creditors entitled to the protection afforded by Section 6323 of the Internal Revenue Code.

Moreover, the Court held that even if the Commission qualified as a creditor entitled to record notice under Section 6323 of the Code, the recording of a Notice of Lien is not impaired by the fact that notice and demand has not yet been issued to the taxpayer. The requirement of notice to the taxpayer was held to be for the taxpayer's benefit rather than the creditor's. A concurring opinion was filed expressing disagreement with this alternative holding.

Staff: United States Attorney Edmund A. Nix and Assistant United States Attorney John E. Clarke (W.D. Wis.); Thomas Boerschinger and Howard J. Feldmann (Tax Division).

BANKRUPTCY

FEDERAL TAX CLAIMS: PRIORITY: TORT CLAIMS AGAINST RECEIVER IN BANKRUPTCY, GROUNDED UPON NEGLIGENCE OF RECEIVER'S AGENTS IN ATTEMPTING TO PRESERVE ESTATE AND ARISING AFTER CHAPTER 11 PETITION WAS FILED, DO NOT HAVE PRIORITY AS COSTS OF ADMINISTRATION OVER UNSECURED FEDERAL TAX CLAIMS.

In re I. J. Knight Realty Co., Bankrupt, Reading Co., Claimant, 370 F. 2d 624 (C.A. 3d, 1967) (CCH 67-1 U.S.T.C., ¶9263)

On November 6, 1962, the I. J. Knight Realty Company filed a petition for arrangement under Chapter 11 of the Bankruptcy Act. On that day a receiver was appointed and authorized to operate the debtor's business, namely, the leasing of space to commercial tenants in the debtor's eight-story industrial building in Philadelphia. On January 1, 1963, this building was destroyed by a fire which spread to adjoining premises and caused damage to the property of the Reading Company, appellant, and others. On April 3, 1963, appellant filed a claim for damages for $560,000, alleging that the receiver's agents were negligent in permitting the fire to start and to spread. A total of 146 claims for more than $3,500,000 were filed on the same ground. For the purposes of the case, it was admitted that the unusually disastrous fire was caused by the negligence of the receiver's agents when, in attempting to repair certain frozen and burst water pipes serving the building's sprinkler system, they turned off the water and made certain defective electrical connections for the purpose of providing heat and light in the building which circuits were left operating and became intensely overheated. Appellant contended that the tort claims were entitled to a first priority as an expense of administration pursuant to Section 64a(1) of the Bankruptcy Act over inter alia, the fourth priority claims (Section 64a(4) of the Act) of the Government for approximately $228,500 in taxes (not secured by liens on realty) and over the claims of general unsecured creditors. Subsequently, the debtor was voluntarily adjudicated a bankrupt. A trustee was elected and he moved to expunge the appellant's claim on the ground that it was not an administrative expense. The Referee expunged the claim and the district court upheld the Referee's decision. The Court of Appeals, after rehearing the case en banc sua sponte, affirmed the district court by a four to three decision.

Section 64a(1) of the Bankruptcy Act grants a first priority to "(1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; * * *." The majority opinion of the Court of Appeals held that appellant's tort claim was not "within the restrictive language" of Section 64a(1) because it was not "an expense so related to the development, preservation or distribution of estate assets as to be deemed to have incurred in connection

therewith." Cf. In the Matter of Connecticut Motor Lines, Inc., 336 F. 2d 96, 101-102 (C.A. 3, 1964). In so holding, the Court pointed out that: (1) The right to priority in a Chapter XI proceeding is controlled exclusively by Section 64; (2) Only those post-petition expenses which are actually "related to the development, preservation, or distribution of the bankrupt's assets" (Connecticut Motor Lines, Inc., supra, p. 102) can be considered to be within Section 64a(1); and (3) Contrary to appellant's principal argument, the priorities established in equity receivership proceedings (where most tort claims do have a first priority--even over secured creditors) are not determinative in interpretating Section 64a(1), a "purposeful statutory restriction."

The dissent would have held for appellant primarily on the grounds that: (1) the general equity receivership priority principles are carried over into Section 64a(1); (2) the activities giving rise to the fire were clearly acts to preserve the estate (i.e., the shutting off of the water to repair the pipes, etc.); and (3) the general trend of the law is that "tort immunity has little justification." These points by the dissent were premised in part on the assumption that "The fundamental purpose of a Chapter XI proceeding, unlike a straight bankruptcy, is the ultimate rehabilitation of the debtor," similar to a Chapter X reorganization proceeding, where tort claims arising out of the operation of the bankrupt's business have a first priority under general equity receivership rules.

Appellant's petition for rehearing was denied on February 13, 1967, without opinion.

Staff: Joseph Kovner and Edward Lee Rogers (Tax Division)

RECEIVERSHIP

SUIT TO RESTRAIN COLLECTION OF DEFICIENCIES IN FEDERAL INCOME TAX ASSESSED PURSUANT TO SECTION 6871 OF 1954 CODE HELD BARRED BY SECTION 7421 OF THAT CODE; DISTRICT COURT HAD NO DUTY UNDER SECTION 6871(b) TO ADJUDICATE CLAIM FOR TAXES AND ANSWER AND COUNTERCLAIM FILED IN RESPONSE THERETO WHEN NOT TIMELY PRESENTED IN RECEIVERSHIP PROCEEDINGS; 1954 CODE DOES NOT PROVIDE FOR DECLARATORY JUDGMENT BY COURT AS TO VALIDITY OF ASSESSMENT ONCE MADE.

Rutas Aereas Nacionales, S.A. (Ransa) v. United States (C.A. 5, No. 23085 and No. 23219; DJ Files 5-18-4578 and 5-18-6892).

Taxpayer, a Venezuelan air carrier, appealed in cause No. 23219 from the dismissal by the United States District Court for the Southern District of Florida of its complaint for an injunction. Taxpayer had sought to enjoin the United States from collecting deficiencies in federal income tax assessed

against it pursuant to the provisions of Section 6871 of the 1954 Code on the ground that the assessments were illegal and void because taxpayer was not issued a statutory 90-day deficiency notice affording it an opportunity to test its liability for the taxes in the Tax Court as provided by Section 6213(a) of the 1954 Code. The District Court held that the remedy of injunction was barred to taxpayer by virtue of the provisions of Section 7421(a) of the 1954 Code and that the exceptions embodied therein pertaining to Section 6212(a) and (c) and Section 6213(a) were not applicable in this case because the assessments were made during a receivership proceeding entitled Cauley and Martin v. Rutas Aereas Nacionales, S.A. in accordance with the provisions of Section 6871. Section 6871(a) provides that upon the appointment of a receiver for any taxpayer in any receivership proceeding, a deficiency may be immediately assessed against the receiver and that the normal procedures for, and restrictions upon, the assessment and collection of income tax deficiencies are superseded; thus negating the requirement that a notice of deficiency be sent to taxpayer.

The gravamen of taxpayer's appeal was that no receivership proceedings authorizing an assessment without the giving of statutory notice, pursuant to Section 6871, ever existed in the Cauley and Martin proceeding. The Fifth Circuit, finding a receivership to have existed, affirmed the dismisal of taxpayer's complaint for injunction. In answer to taxpayer's further argument that, inasmuch as no receivership was now in existence and there was thus no forum in which taxpayer could have a pre-payment trial of the correctness of the assessment, the Fifth Circuit held that just such a forum had existed in the receivership proceeding in that taxpayer there had a right to attack the proof of claim filed by the United States and that its failure to do so during the existence of the receivership proceeding amounted to as valid a waiver of its right to a pre-collection determination as the running of the 90-day period would in the case where a notice of deficiency had been sent to a taxpayer.

The Fifth Circuit additionally held that the assessment was made strictly in accordance with the provisions of the statute and that the Internal Revenue Code does not provide for a declaratory judgment by a Court as to the validity of an assessment once made. This was in response to the argument raised by the United States that to have granted taxpayer's complaint for injunction, the District Court would have had to have made the determination that the assessment against taxpayer under Section 6871 was invalid in that no receivership proceeding existed and that such determination would be tantamount to a declaratory judgment; relief which is prohibited by 28 U.S.C. 2201.

In cause No. 23085, taxpayer appealed from the sua sponte dismissal by the United States District Court for the Southern District of Florida of the claim filed by the United States and the answer, set-off recoupment and counter-claim for certain excise taxes which it had filed. The district court stated that it was "of the opinion that it is without jurisdiction to entertain the

claim of the United States heretofore filed in this cause as well as the answer and counter-claim filed in response thereto". Taxpayer argued on appeal that assuming there was a receivership proc eeding, the district court had the duty to adjudicate the claim for taxes filed by the United States.

The Fifth Circuit, in affirming the order of the lower court, held that it was within the power of the district court, which had the receivership matter before it, to determine that it had no further jurisdiction over the matter of the claim for federal income taxes "which had never been 'attached', or brought into controversy by taxpayer for nearly four years after the assets had all been transferred back to the debtors". It further held that there could be no receivership without a receiver and that there was none at the time taxpayer belatedly sought to require the Government to submit its assessment for income tax to the district court for approval or rejection before proceeding to levy on the assessments or otherwise collect the amount covered by the assessments.

Staff: United States Attorney William A. Meadows, Jr.; Assistant United States Attorneys Alfred E. Sapp and Lavinia L. Redd (S.D. Fla.); Stephen H. Paley (Tax Division)

DISTRICT COURTS - CIVIL CASES

LEVY

LEVIES ARE UNENFORCEABLE AGAINST EMPLOYERS IF SERVED AT TIME WHEN THEY IN FACT OWED TAXPAYER-EMPLOYEE NOTHING, ABSENT SHOWING OF AN ARRANGEMENT TO FRUSTRATE TAX COLLECTION EFFORTS BY ADVANCING WAGES.

United States v. Harry Penn and Louis Zunin (D. Ariz., Civil No. 2190-Tucson; March 31, 1967, DJ File 5-8-1727) (67-1 U.S.T.C. ¶9402).

Taxpayer, one Boucher, was indebted for unpaid federal taxes in the amount of $3,547.69 for the third quarter of 1961 as a result of a certain business venture. In December, 1961, he started working for the defendants, one of whom was his father-in-law. In 1964, the Internal Revenue Service made a series of levies on defendants to attach Boucher's weekly salary. Defendants refused to honor such on the theory that the current payment they were about to make to him was an advance, in return for which Boucher owed them a week's work. This "advance" was then paid to Boucher despite the levies. Suit was brought to obtain a personal judgment against defendants in the amount of the salary paid on the various dates the levies were served. Defendants answered, relying on the same theory that they were not indebted to Boucher on the dates of the levies, that from time to time they would pay Boucher in advance, and that on the dates the levies

were served, they had paid him in advance. After defendants' depositions were taken, the court granted their motion for summary judgment, on the basis that none of the pleadings, depositions or affidavits disputed the fact that when the levies were made the defendants did not owe Boucher anything. Further, since levies do not affect future earnings (United States v. Long Island Drug Co., 115 F. 2d 983 (C.A. 2, 1940); United States v. Newhard, 128 F. Supp. 805 (W.D. Pa., 1955)), there was no property held by defendants which was subject to the levies. The court pointed out that neither the complaint nor the record showed that the advance salary arrangement was made by defendants for the purpose of frustrating the efforts of the United States to collect the taxes. An appeal is under consideration.

Staff: United States Attorney Edward E. Davis and Assistant United States Attorneys Richard C. Gormley and Jo Ann D. Diamos (D. Ariz.).

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