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CURRENT LEGISLATION AND DECISIONS

NOTES

Administrative Law — Ashbacker Doctrine — Civil Aeronautics Board

On 8 August 1961, the Civil Aeronautics Board entered an order initiating an investigation of the United States-Caribbean-South American route situation.¹ The order expressed the Board's view that, due to the rapid growth of foreign air carriers on the route served by petitioners, Braniff Airways and Pan American-Grace Airways (Panagra), it appeared desirable to extend one of their routes to New York and to eliminate the other carrier. In response to the order, each of the petitioners filed an application in 1962 to extend its service to New York. Hearings on these applications were to be held in the *South American Route Case* proceedings which were not scheduled to commence before January 1965.² In 1964, pursuant to a bilateral executive agreement between the United States and Germany,³ Lufthansa Airways filed an application to have its foreign air carrier permit amended to authorize operations beyond New York to points in the Caribbean and South America.⁴ Lufthansa's application was set for hearing on 17 June 1964. The CAB granted petitioners leave to intervene. Braniff, supported by Panagra, filed a motion requesting that Lufthansa's application be consolidated with the pending route case or that proceedings on Lufthansa's application be deferred until a decision had been rendered in the case. Petitioners argued that Lufthansa, Braniff, and other United States carriers were competing applicants for the same route authorization, and that a prior grant of Lufthansa's application would preclude a grant of their applications because they were mutually exclusive as a matter of economics. The CAB denied the motion,⁵ and Braniff and Panagra filed a petition for review. *Held*: Petitioners were not entitled to a consolidated hearing, thus the order was interlocutory and non-reviewable. *Pan American-Grace Airways, Inc. v. CAB*, 342 F.2d 905 (D.C. Cir. 1964), *cert. denied*, 380 U.S. 934 (1965).

¹ United States-Caribbean-South American Investigation, CAB Docket No. 12895.

² *Ibid.*

³ Air Transport Agreement with the Federal Republic of Germany, 7 July 1955, 7 U.S.T. & O.I.A. 527, T.I.A.S. No. 3536. The agreement together with the agreed route schedule secured three reciprocal air routes for each party. The route in issue was granted to Germany and was via intermediate points to Boston, New York, and Philadelphia and beyond to points in the Caribbean and beyond to South America.

⁴ CAB Docket No. 15073 (10 Mar. 1964).

⁵ CAB Order No. E-20794 (6 May 1964).

Generally, the consolidation of proceedings is considered a matter for administrative rather than judicial judgment.⁶ When the courts interfere with administrative judgment on the consolidation question, they do so under the authority of *Ashbacker Radio Corp. v. FCC*.⁷ In *Ashbacker* the Fetzer Broadcasting Company had filed an application for authority to change its operating frequency to 1230 kilocycles and Ashbacker Radio Corporation had filed an application for authority to construct a broadcasting station which would operate on the same frequency. The Commission granted Fetzer's application and the same day set Ashbacker's application for hearing.⁸ Each applicant had a statutory right to a hearing before its application was denied.⁹ In reversing the FCC's action the Supreme Court stated:

Congress has granted applicants a right to a hearing on their applications for station licenses. Whether that is wise policy or whether the procedure adopted by the Commission in this case is preferable is not for us to decide. We only hold that where two *bona fide* applications are mutually exclusive the grant of one without a hearing to both deprives the loser of the opportunity which Congress chose to give him.¹⁰

It should be noted that the Commission had found that, due to the geographical locations of Fetzer's station and Ashbacker's proposed station, their simultaneous operation on the same frequency would result in "intolerable interference" to both.¹¹

Although originating in the communications field, the *Ashbacker* doctrine that parties filing mutually exclusive applications are entitled to comparative hearings has been applied to other federal agencies including the CAB.¹² The CAB may, upon an applicant's motion or its own initiative, consolidate two or more proceedings for hearing if such consolidation will be conducive to the proper dispatch of its business and to the ends of justice and will not unduly delay the proceedings.¹³ It appears that if a carrier wishes to assert a valid claim under the *Ashbacker* doctrine, it must establish: that the applications involve substantially the same or related issues; that consolidation will be conducive to the proper dispatch of the Board's business and to ends of justice; that consolidation will not unduly delay the proceedings; and, that the statutory guide, public con-

⁶ *FCC v. Pottsville Broadcasting Co.*, 309 U.S. 134 (1940); 1 DAVIS, ADMINISTRATIVE LAW TREATISE § 8.12 (1958). In *Pottsville*, the Court upheld a FCC order which set three rival applications for a comparative hearing.

⁷ 326 U.S. 327 (1945).

⁸ *Ashbacker Radio Corp. v. FCC*, 326 U.S. 327, 328 (1945).

⁹ FEDERAL COMMUNICATIONS ACT § 309(a), 48 Stat. 1085 (1934), 47 U.S.C. § 309(a) (1964). The FCC contended that Ashbacker had not been deprived of its right to a hearing because it would have ample opportunity to show that its proposed operation would serve the public interest better than Fetzer's operation. The Court met this argument by stating: "if the grant of one [application] effectively precludes the other, the statutory right to a hearing which Congress has accorded applicants before denial of their applications becomes an empty thing. We think that is the case here." 326 U.S. at 330.

¹⁰ *Ashbacker Radio Corp. v. FCC*, 326 U.S. 327, 333 (1945).

¹¹ *Id.* at 331. The FCC, in its notice of hearing on Ashbacker's application, referred to the hearing as though it was considered a hearing for the revocation of an established license.

¹² *Northwest Airlines, Inc. v. CAB*, 194 F.2d 339 (D.C. Cir. 1952). In its final order, the CAB stated that it was in the public interest to limit the number of carriers to operate on the route in issue.

¹³ 14 C.F.R. § 302.12(a) (1965).

venience and necessity, requires the CAB to limit the number of carriers on the route in question. If an applicant's motion to consolidate is denied by the Board, there is usually an appeal directly from the consolidation order. On appeal, in order to sustain their allegations of mutual exclusivity, the applicants have attempted to equate the economic factors which the CAB must consider before a certificate can be issued with the "intolerable interference" in *Ashbacker*. Generally, the courts have held that the Board's order was interlocutory and have dismissed the petitions for review for lack of jurisdiction.¹⁴ The courts have refused to review an order denying consolidation in the following instances: where the petitioner sought consolidation of an application for a certificate with a proceeding pending before the Board for approval of a merger;¹⁵ where it was possible for the Board to reach any one of three justifiable results;¹⁶ and, where consolidation would transform an area proceeding into one involving a trans-continental route pattern.¹⁷

In *Delta Air Lines, Inc. v. CAB*,¹⁸ the court established a choice of procedures which the CAB could follow when two applications are alleged to be mutually exclusive.¹⁹ However, *National Airlines, Inc. v. CAB*²⁰ limited the procedures established in *Delta* to the facts of that case. In the *National* case, the Board denied a motion to consolidate, but agreed to give National a full opportunity to establish the "mutually exclusive" issue on the record in the proceedings. The court held that the Board's action constituted a fair and substantial compliance with the *Ashbacker* doctrine.²¹

In the present case Lufthansa's application for a foreign air carrier permit was filed under section 402 of the Federal Aviation Act.²² Section 402 empowers the CAB to issue such a permit if it finds, *inter alia*, that it will be in the "public interest." However, the Board is not the final arbiter in such cases, because section 801²³ provides that the Board's decision with respect to an application filed under section 402 "shall be subject to the approval of the President." The petitioners' applications were filed pursuant to section 401²⁴ which authorizes the Board to issue a certificate

¹⁴ In dismissing for lack of jurisdiction to review, the courts consider the merits of a petitioner's contention. Once the courts decide that he is not entitled to an *Ashbacker* hearing, the order is considered interlocutory, because it is not dispositive of any rights.

¹⁵ *Western Air Lines, Inc. v. CAB*, 184 F.2d 545 (9th Cir. 1950); *Seaboard & W. Airlines, Inc. v. CAB*, 181 F.2d 777 (D.C. Cir. 1949).

¹⁶ *United Air Lines, Inc. v. CAB*, 228 F.2d 13 (D.C. Cir. 1955).

¹⁷ *Eastern Air Lines, Inc. v. CAB*, 247 F.2d 562 (D.C. Cir. 1957); *Eastern Air Lines, Inc. v. CAB*, 243 F.2d 607 (D.C. Cir. 1956).

¹⁸ 228 F.2d 17 (D.C. Cir. 1955).

¹⁹ The choice of procedures established was (1) set for hearing and thereupon decide the issue of exclusivity as a separate preliminary issue; (2) proceed to a comparative hearing upon the two applications without further ado; or (3) set for hearing and thereafter decide the merits of the two applications and also the issue of exclusivity.

²⁰ 249 F.2d 13 (D.C. Cir. 1957).

²¹ *Ashbacker Radio Corp. v. FCC*, *supra* note 7.

²² FEDERAL AVIATION ACT OF 1958, § 402, 72 Stat. 757 (1958), 49 U.S.C. § 1372 (1964).

²³ FEDERAL AVIATION ACT OF 1958, § 801, 72 Stat. 782 (1958), 49 U.S.C. § 1461 (1964). See also *Chicago & So. Air Lines, Inc. v. Waterman S.S. Corp.*, 333 U.S. 103 (1948); *Alaska Airlines, Inc. v. Pan Am. World Airways, Inc.*, 321 F.2d 394 (D.C. Cir. 1963); *British Overseas Airways Corp. v. CAB*, 304 F.2d 952 (D.C. Cir. 1962).

²⁴ FEDERAL AVIATION ACT OF 1958, § 401, 72 Stat. 754 (1958), 49 U.S.C. § 1371 (1964).

authorizing air transportation if it finds "that such transportation is required by the public convenience and necessity." Petitioners contended that they were entitled to an *Ashbacher* hearing, because the Board must consider the same factors in determining the "public interest" as it considers in determining "public convenience and necessity." In response to petitioners' contention, Judge Fahy stated:

We cannot carry the use of phraseology of similar character in the two sections to the point of overcoming the fact that the public interest involved in our obligations under the bilateral Agreement cannot be equated with the public convenience and necessity referred to in Section 401.²⁵

Recognizing that the factors which are considered in cases under section 401 are primarily economic, the court was of the opinion that a comparative consideration would have little effect on the Board's decision regarding Lufthansa's application.²⁶ The court considered the CAB as an agent of the United States because of the connection between sections 402 and 801 and felt that the Board's obligation with regard to Lufthansa's application involved "presidential consideration of our international relations with Germany as they arise with respect both to Lufthansa and American domestic carriers operating abroad."²⁷ The court reasoned that perhaps the most important public interest factor in Lufthansa's application was the policy and obligations of the United States as set forth in the bilateral agreements.²⁸ Without reaching the issue of mutual exclusivity, the court held petitioners were not entitled to an *Ashbacher* hearing because "quite different considerations bear upon Lufthansa's application and those of petitioners in the Route Case."²⁹

Although the courts have held that the *Ashbacher* doctrine applies to the CAB, they have failed to establish a set procedure for the Board to follow when two or more applications are alleged to be mutually exclusive.³⁰ In *Ashbacher*, the applications were mutually exclusive because it was physically impossible for both stations to operate on the same frequency and the FCC had made a finding to that effect. However, the CAB considers various economic factors in determining if a certification of public convenience and necessity should be issued³¹ and the fact of physical impossibility is not present. Also, the CAB may issue an order denying consolidation without making a finding on the issue of mutual exclusivity;³² and, if the courts rule that two or more applications are

²⁵ 343 F.2d at 909.

²⁶ *Id.*

²⁷ 342 F.2d at 908-09.

²⁸ 342 F.2d at 909.

²⁹ 342 F.2d at 908.

³⁰ See notes 19 & 20 and accompanying text.

³¹ FEDERAL AVIATION ACT OF 1958, § 102, 72 Stat. 740 (1958), 49 U.S.C. § 1302 (1964). The following are among the economic factors which the CAB considers:

(1) the sufficiency of traffic; (2) the requirements of the communities; (3) the need for a proper competitive balance among the various carriers; (4) the need for strong development forces in certain situations.

³² ADMINISTRATIVE PROCEDURE ACT § 6, 60 Stat. 240 (1946), 5 U.S.C. § 1005(d) (1964). The CAB may deny a motion to consolidate on grounds other than mutual exclusivity if the notice of denial is accompanied by a simple statement of the other grounds.

mutually exclusive before the CAB makes a finding on the issue, they are performing an administrative function. Perhaps the courts should follow the *National* case where the alleged "mutually exclusive" applications are both filed under section 401. If the Board denies a motion to consolidate, it should grant the party leave to intervene and provide a fair opportunity for the party to attempt to establish on the record that the applications are mutually exclusive. Assuming this procedure is followed and the Board finds that the applications are mutually exclusive, the applications must be given comparative consideration.³³ In the event the Board finds that the applications are not mutually exclusive and grants one of the applications but denies the other, the party may then appeal the Board's final order. If the Board's findings are not supported by substantial evidence, the court can remand and order comparative consideration. By following this procedure full advantage may be taken of the CAB's expertise, and there should be substantial compliance with the *Ashbacher* doctrine.

The question remains whether the *Ashbacher* doctrine should have been applicable in the present case. The issues in the petitioners' applications were economic, while the controlling issue in Lufthansa's application was the international commitment to Germany. The issues to be considered in the two applications were not interrelated; on the contrary, they were diverse. Further, section 1102 of the Federal Aviation Act³⁴ requires the Board to act consistently with any obligation assumed by the United States in a bilateral agreement. It is possible that a consolidation with the *South American Route Case* would have unduly broadened the scope of the proceeding on Lufthansa's application, and the CAB is to handle such applications in an expedient manner. However, assuming *Ashbacher* should have been applicable in the present case, it is doubtful that a consolidated hearing would have benefited the domestic carrier. In the event all the evidence supported a grant of the domestic carrier's application, the Board could have conceivably issued a permit to the foreign air carrier (the Board's action would have been consistent with the bilateral agreement), and the domestic carrier could not have obtained judicial review of the order because it would have been subject to presidential approval.³⁵ In cases such as the present one, perhaps a domestic carrier can adequately protect its interest through intervention. As an intervenor the carrier would become a party to the hearing on the foreign air carrier's application and could introduce evidence in support of its position. If the Board is of the

³³ The most effective means of comparing two applications is a consolidated hearing — a hearing embracing two or more applications. Such a hearing is certain to comply with *Ashbacher*. However, the *Ashbacher* decision suggests that a comparative hearing is also sufficient as long as final action has not been taken on one of the alleged mutually exclusive applications. In a comparative hearing the merits of one or more applications are compared with the merits of one or more applications considered in another hearing.

³⁴ FEDERAL AVIATION ACT OF 1958, § 1102, 72 Stat. 797 (1958), 49 U.S.C. § 1502 (1964). The CAB's construction of the section is that it is not required to recommend issuance of a foreign carrier's permit to the President merely because there is a bilateral agreement providing for such permit. In making its recommendation to the President, the CAB weighs the injurious affect on domestic carriers against the reciprocity benefits of the agreement.

³⁵ FEDERAL AVIATION ACT OF 1958, § 1006(a), 72 Stat. 795 (1958), 49 U.S.C. § 1486(a) 1964. See also Note, 32 J. AIR L. & COM. 127 (1966).

opinion that the domestic carrier's evidence compels a denial of the foreign air carrier's permit, it will make such a recommendation to the President.³⁶ Although the President might rely to a great extent on the CAB's recommendation, he must decide the ultimate issue, which is whether it is in the best interest of the United States to repudiate the bilateral agreement with Germany, and his decision is not subject to judicial review.

Rodney D. Moore

³⁶See note 34 *supra*.

Torts — Manufacturers' Liability — Continuing Duty

A Linea Aeropostal Venezolano Super Constellation left Idlewild (John F. Kennedy) Airport on 20 June 1956 for a scheduled non-stop flight to Maiquetia, Venezuela. Engine trouble developed and the pilot radioed the airport that he was returning with engine number two "off." Just off the coast of New Jersey the pilot asked for and obtained permission to dump fuel to lighten the load. Shortly thereafter the plane burst into flames and veered sharply into the sea, exploding upon impact. There were no survivors. The personal representatives of one of the passengers brought suit in admiralty under the Death on the High Seas Act,¹ alleging negligence by the manufacturer of the plane's propellers. *Held*: The evidence established that the malfunction of the propeller was the proximate cause of the crash, and there was a continuing duty upon the manufacturer to develop an improvement of its propeller systems which did not end with the delivery of the aircraft to the air carrier. *Noel v. United Aircraft Corp.*, 342 F.2d 232 (3d Cir. 1964).²

In determining the liability of a manufacturer, the principles of *MacPherson v. Buick*³ are applicable in admiralty as well as common law suits.⁴ Generally, a manufacturer is liable for bodily injury to those whom he should reasonably expect to use his product or be in the vicinity of its probable use, if he (1) knows or should have known that the object is likely to cause harm to them if it is used for the purposes for which it is manufactured, (2) has no reason to believe that they will realize its dangerous condition, and (3) fails to exercise reasonable care to inform them of its dangerous condition.⁵ The degree of care which the manufacturer must exercise is commensurate with the foreseeable risk of harm to others.⁶ The obligation to exercise reasonable care is imposed not only in the actual

¹ 41 Stat. 537 (1920), 46 U.S.C. § 761 (1964):

Whenever the death of a person shall be caused by wrongful act, neglect, or default occurring on the high seas beyond a marine league from the shore of any State, or the District of Columbia, or the Territories or dependencies of the United States, the personal representative of the decedent may maintain a suit for damages in the district courts of the United States, in admiralty, for the exclusive benefit of the decedent's wife, husband, parent, child, or dependent relative against the vessel, person, or corporation which would have been liable if death had not ensued.

² For related proceedings, see: *Noel v. United Aircraft Corp.*, 204 F. Supp. 929 (D. Del. 1962) (No action for breach of warranty under Death on the High Seas Act); 202 F. Supp. 556 (D. Del. 1962) (Action maintainable exclusively under the Death on the High Seas Act); 191 F. Supp. 557 (D. Del. 1961) (On implied breach of warranty, Venezuelan law held controlling).

³ 217 N.Y. 382, 111 N.E. 1050 (1916), *MacPherson* abolished the requirement of privity of contract in actions based on negligence of a manufacturer.

⁴ *Sieracki v. Seas Shipping Co.*, 149 F.2d 98 (3d Cir. 1945), *aff'd*, 328 U.S. 85 (1946).

⁵ RESTATEMENT, TORTS § 388 (1934).

⁶ See, e.g., *Hershey Chocolate Corp. v. The S.S. Robert Luckenbach*, 184 F. Supp. 134 (D. Ore. 1960); *Irelan-Yuba Gold Quartz Mining Co. v. Pacific Gas & Elec. Co.*, 18 Cal. 2d 577, 116 P.2d 611 (1941). As the district court stated, "the important considerations involve (1) the recognizable or foreseeable risk, (2) the degree of danger involved and (3) whether . . . [the plaintiff] was within the ambit of the protection of the duty imposed." *Noel v. United Aircraft Corp.*, 219 F. Supp. 556, 568 (D. Del. 1963).

manufacture of the product, but also in the subsequent "duty to warn" which has been imposed in numerous situations. The duty arises both where a defect is known to exist,⁷ and in certain cases in which there is insufficient or no evidence of any defective construction or improper design.⁸ Where some risk⁹ is involved in the reasonable, foreseeable use¹⁰ of the product, the duty is imposed upon the manufacturer to adequately warn¹¹ those whom he reasonably expects to use his product.¹² However, a manufacturer is not under a duty to warn of product dangers which are obvious or of which the user has or should have actual knowledge,¹³ nor is he required to warn of dangers which he could not have discovered by reasonable inspection.¹⁴ As part of his duty to warn, the manufacturer is now generally required to "keep reasonably abreast of scientific knowledge and discoveries concerning his field and is deemed to possess whatever knowledge is thereby imparted."¹⁵ He is required to conduct reasonable tests and inspections to discover latent dangers.¹⁶ This duty to test and to warn of danger does not terminate upon sale or distribution of the product, but the duty is a continuing one. This "continuing duty" is described in *Comstock v. General Motors Corp.*:¹⁷

The duty of the manufacturer to warn of a known danger in the product exists not only at the point of sale, but also exists where a latent defect hazardous to life becomes known to the manufacturer shortly after the product has been put on the market.¹⁸

This special duty, then, is generally limited to situations where a "latent defect hazardous to life" is discovered.¹⁹

⁷ See, e.g., *Vandermark v. Ford Motor Co.*, 61 Cal. 2d 256, 37 Cal. Rptr. 896, 391 P.2d 168 (1964); *Boeing Airplane Co. v. Brown*, 291 F.2d 310 (9th Cir. 1961), where the court, applying California law, held the manufacturer liable for failure to warn of a known defect, even though the defective component was supplied to it by another.

⁸ See, e.g., *Tamayo v. A. P. DeSanno & Son, Inc.*, 209 F.2d 544 (3d Cir. 1954), where the manufacturer was held liable for failure to warn that a grinding wheel would disintegrate when operated above a certain speed; *DeVito v. United Air Lines, Inc.*, 98 F. Supp. 88 (E.D.N.Y. 1951). See generally 1 FRUMER & FRIEDMAN, *PRODUCTS LIABILITY* 143-48.3 (1964).

⁹ The risk must be more than merely trivial. It is generally concluded that a reasonable probability of injury must exist. *Katz v. Arundel-Brooks Concrete Corp.*, 220 Md. 200, 151 A.2d 731 (1959).

¹⁰ *Martin v. Bengue, Inc.*, 25 N.J. 359, 136 A.2d 626, 632 (1957): "While the manufacturer of a product is not an insurer of its safety, he is under a duty of care to avoid all unreasonable risks of harm from its use. When such risks are foreseeable, he must take reasonable precautions to avoid them." See also *Comstock v. General Motors Corp.*, 358 Mich. 163, 99 N.W.2d 627 (1959), Annot., 78 A.L.R.2d 460 (1961).

¹¹ The warning must be appropriate and adequate to appraise the user of potential danger. *Tampa Drug Co. v. Wait*, 103 So.2d 603 (Fla. 1958), Annot., 75 A.L.R.2d 778 (1961). See generally 1 HURSH, *AMERICAN LAW OF PRODUCTS LIABILITY* §§ 2.40-44 (1961).

¹² *Tamayo v. A. P. DeSanno & Son, Inc.*, *supra* note 8; see generally 1 HURSH, *op. cit.*, *supra* note 11, at §§ 2.34-37.

¹³ *Id.* at §§ 2.37-39.

¹⁴ See, e.g., *Pabon v. Hackensack Auto Sales, Inc.*, 63 N.J. Super. 476, 164 A.2d 773 (App. Div. 1963); *Livesley v. Continental Motors Corp.*, 331 Mich. 434, 49 N.W.2d 365 (1951).

¹⁵ See, e.g., *Braun v. Roux Distrib. Co.*, 312 S.W.2d 758 (Mo. 1958).

¹⁶ See, e.g., *Pritchard v. Liggett & Myers Tobacco Co.*, 295 F.2d 292 (3d Cir. 1961), *Hopkins v. E.I. DuPont de Nemours & Co.*, 199 F.2d 930 (3d Cir. 1952); *Pan Am. World Airways, Inc. v. United Aircraft Corp.*, 192 A.2d 913 (Del. Super. Ct. 1963), *aff'd*, 199 A.2d 758 (Del. Sup. Ct. 1964).

¹⁷ 358 Mich. 163, 99 N.W.2d 627 (1959), Annot., 78 A.L.R.2d 460 (1961).

¹⁸ 99 N.W.2d 627, 628 (1959).

¹⁹ For a general discussion, see Noel, *Recent Trends in Manufacturers' Negligence as to Design, Instructions or Warnings*, 19 Sw. L.J. 43 (1965).

In the instant case the evidence available to the libellant²⁰ was primarily circumstantial.²¹ There were no survivors and the plane wreckage was mostly irrecoverable. It was agreed by the parties that an overspeed²² in the number two engine²³ had developed and that the pilot had decided to return to New York, since he could not correct it. The airliner was escorted on the return trip by a United States Coast Guard plane and an Eastern Air Lines plane. The evidence may be summarized as follows:

(1) Eye-witness reports of the pilots of the escorting aircraft were given. The Eastern pilot testified that he saw a "white puff" come out behind the Venezuelan airliner, while the Coast Guard crew testified that they saw a "blue flame" on the right side of the plane. Shortly thereafter the plane went down.²⁴

(2) Findings of bodies and airplane seats in the ocean were reported. Two bodies were found each with a leg severed, but there was conflicting testimony as to which leg. One of the plane's double seats was found severed diagonally with traces of orange paint on the seat, orange being the color of the paint banding on the propeller blades. The bodies and the seat were recovered three miles from the main scene of the wreckage. Although the location of the seat within the aircraft could not be ascertained, the bodies were identified as those of a Mrs. DeArmis and her son. According to the flight plan they were assigned to seat number four, which was just behind the number two propeller.

(3) Eugene L. Grindle, an expert witness, presented libellant's theory of the crash, and testified concerning the effect of overspeeds in relation to an aircraft in flight and the effect of inability to feather²⁵ an overspeeding propeller.

(4) Libellant presented exhibits of previously recorded overspeeds and their effect on airplanes in flight.

Relying on this evidence, libellant advanced a theory which was substantially adopted by the district court. The court found that the libellant had established by the preponderance of the evidence that the cause of

²⁰ Libellant was not suing the airline but the manufacturer of the propeller system used on the aircraft.

²¹ When direct evidence is unavailable, a plaintiff is free to present circumstantial evidence upon which reasonable inferences may be based. See, e.g., *Trowbridge v. Abrasive Co.*, 190 F.2d 825, 828 (3d Cir. 1951). If the inferences sought are reasonable, the circumstances need not negative every other possible conclusion. *Michalic v. Cleveland Tankers, Inc.*, 364 U.S. 325, 330 (1960); *Wood v. United States*, 125 F. Supp. 42 (S.D.N.Y. 1954). But see *Nash v. Raun*, 149 F.2d 885 (3d Cir. 1945), *cert. denied*, 326 U.S. 758 (1945). The principle limitation is that the findings should not be a matter of mere speculation or guesswork. *McCready v. United Iron & Steel Co.*, 272 F.2d 700 (10th Cir. 1959).

²² An overspeed occurs when the propeller turns at a rate beyond the maximum for which it was designed to rotate. *Noel v. United Aircraft Corp.*, *supra* note 6, at 557-58.

²³ The number two engine is the left-hand, inboard engine as one faces forward in the aircraft. *Id.* at 557 n.1.

²⁴ The district court resolved this conflict in testimony by concluding that the Coast Guard crew was mistaken. In view of the libellant's evidence and the fact that "there was no known, or strongly suspected, ignition source on the right side of the plane as compared with the number 2 engine on the left side," the court found that the bluish appearance which looked like fire was the result of some "trick of light." *Id.* at 565.

²⁵ "To feather means to cause the propeller blades to be turned to a position parallel to the air-stream so that they will cease to rotate due to pressure of air across the blades. Inability to feather permits the overspeeding propeller to rotate at an uncontrolled speed." *Id.* at 558 n.5.

the accident was a prolonged overspeed and inability to feather the propeller. This led to a decoupling,²⁶ fire and separation of the propeller. Upon separation, the propeller sliced through the fuselage dislodging the seat just behind the propeller²⁷ and ejecting the occupants.²⁸ It then gashed into the fuel tank located beneath the seats. The flames from the number two engine were swept back over the wing into the plumes of gasoline trailing from the dump chutes, igniting them.²⁹ The court concluded: "The flames from the explosion added to and increased the holocaust resulting in the total loss of the plane."³⁰ The United States Court of Appeals for the Third Circuit held that the district court's findings of fact were not "clearly erroneous,"³¹ but were substantiated by the record.³² Along with the trial court, the Third Circuit recognized that the duty to warn continued after the sale of the product; but both courts proceeded further, imposing a continuing duty to develop improvements to eliminate or minimize the danger. Such a duty, after the sale of the product, has been suggested³³ and impliedly rejected,³⁴ but both courts here met the issue directly, establishing the duty, with attendant conditions. This conclusion was based upon the following facts: (1) the manufacturer "was aware that, absent some type of control mechanism, continued use of its propeller systems on a particular aircraft endangered the public," and (2) despite this awareness, the manufacturer allowed the development of effective safety devices adaptable to these planes to fall behind similar programs for other aircraft.³⁵ The libellant, submitting records of previous instances of overspeeds followed by decoupling involving the same propeller system, and presenting the testimony of expert witnesses, established United's awareness of the urgent need for a safety device. Such a device, "pitch lock,"³⁶ was available, had been certified by the Civil Aeronautics Authority, and was manufactured and in actual use on Douglas aircraft as early as January 1956. No reason was shown for not using it on the Lockheed Constellation, and apparently both planes could have used it. The district court found that United's delay in developing pitch

²⁶ A decoupling occurs when the engine crankshaft is separated from the propeller shaft. The propeller is thereby left spinning free of the aircraft.

²⁷ This seat is the one found in the ocean some three miles from the wreckage.

²⁸ They were Mrs. DeArmis and her son. The libellant contended that this explained the location of the bodies three miles from the crash scene because they were ejected before the crash; and the relatively good state of preservation of the bodies because they were not subject to the added impact of the crash. The court agreed.

²⁹ Shortly before this sequence of events the pilot, after obtaining permission from the Idlewild tower, had begun to dump fuel in preparation for the landing in New York.

³⁰ *Noel v. United Aircraft Corp.*, 219 F. Supp. 556, 566 (D. Del. 1963).

³¹ In reviewing a judgment of a federal district court sitting without a jury in admiralty, the reviewing court may not set the judgment aside unless it is "clearly erroneous." *McAllister v. United States*, 348 U.S. 19 (1954). "A finding is clearly erroneous when 'although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.'" *Id.* at 20; *United States v. Oregon State Medical Soc'y*, 343 U.S. 326, 339 (1952).

³² *Noel v. United Aircraft Corp.*, 342 F.2d 232 (3d Cir. 1964).

³³ *Ellis v. H. S. Finke, Inc.*, 278 F.2d 54 (6th Cir. 1960).

³⁴ *Shapiro v. Remington Arms Co.*, 259 F.2d 760 (7th Cir. 1958).

³⁵ 342 F.2d at 236.

³⁶ "Pitch lock" detects an overspeed and prevents the blade angle from going to a low pitch by locking oil in front of the piston. It does not prevent overspeed entirely, but limits it. *Noel v. United Aircraft Corp.*, *supra* note 30, at 570.

lock for use on the existing propeller driven planes was its concentration on the development of improved systems for the new Electra to come into service some two years later. Concluding, Judge Layton wrote:

I am forced to the conclusion that United was negligent in that it should and could have produced pitch lock for use on Constellation type planes prior to June 20, 1956, and had it done so, the ability of AMS [the call letters of the Venezuelan airliner] substantially to control overspeed would have been materially increased.³⁷

As three of the Third Circuit judges noted,³⁸ the continuing duty of the manufacturer to develop improvements in the safety of his product not found to have been negligently made is a new and far reaching one. The majority in *Noel* have taken an important step, yet they do not delineate the duty which they impose. As Judge Biggs stated, "[s]uch an extension of the law of liability requires . . . a full review and discussion and a hearing before this court en banc."³⁹ It is hoped that in the future the courts will carefully set out the limits within which the duty will be imposed. Certain guidelines, however, may be extracted from the *Noel* decision which will be helpful. It is clear, as the Third Circuit pointed out,⁴⁰ that a manufacturer need not develop safety devices to protect against every remotely possible danger.⁴¹ However, when a manufacturer is aware of a dangerous defect in his product, has the resources to develop an effective safety device, and has no reasonable explanation for not attempting to develop such a device, an immediate and continuing duty arises to "institute a vigorous safety program"⁴² for its development. Such a duty continues even after delivery and certification of the product. The imposition of the duty increases as the danger increases, so that a manufacturer of airplane parts would have a relatively high duty to develop safety improvements. Furthermore, when, as in the instant case, it appears that the manufacturer is the major supplier of that product, and the industry is particularly dependent upon it for the development of improved systems,⁴³ the duty is clear. Within these basic guidelines, the new duty will be a major advance in the field of tort law.

Leo M. Favrot III

³⁷ *Id.* at 572.

³⁸ On petition for rehearing, denied by the majority, Judge Hastie concurred in the opinion, while Judge Freedman and Judge Biggs dissented. *Noel v. United Aircraft Corp.*, 342 F.2d 240 (3d Cir. 1965).

³⁹ *Id.* at 244.

⁴⁰ *Noel v. United Aircraft Corp.*, 342 F.2d 232, 236 (3d Cir. 1964).

⁴¹ *Mitchell v. Machinery Center, Inc.*, 297 F.2d 883 (10th Cir. 1962); *Marker v. Universal Oil Prod. Co.*, 250 F.2d 603 (10th Cir. 1957); *Pontifex v. Sears, Roebuck & Co.*, 226 F.2d 909 (4th Cir. 1955).

⁴² Lambert & Joost, *Comments on Recent Important Aviation Cases*, 30 NACCA L.J. 380 (1964).

⁴³ *Pan Am. World Airways, Inc. v. United Aircraft Corp.*, *supra* note 16.

Estate Tax — Flight Accident Insurance — Section 2042

Prior to boarding a flight from New York to Venezuela, Marshal L. Noel signed applications for two round-trip flight accident insurance policies, aggregating \$125,000, and named his wife as beneficiary. The policies, dissimilar in minor respects but otherwise in the usual form, insured against loss of life or specified bodily injury¹ suffered by the insured as the result of an aircraft accident occurring during any part of the flight. The airplane crashed and the companies paid Mrs. Noel the face value of the policies. However, his executors did not include the proceeds in the estate tax return. The Tax Court found the insurance payments to be within the decedent's estate.² The Court of Appeals for the Third Circuit reversed the Tax Court,³ and the Supreme Court granted certiorari.⁴ *Held, reversed:* Flight accident insurance is insurance "on the life of the decedent." Mr. Noel possessed exercisable "incidents of ownership" in the policies at his death, and the proceeds are therefore includable in the gross estate. *Commissioner v. Estate of Noel*, 380 U. S. 678 (1965).

I. BACKGROUND

The right to transmit property at death is a right which has been enjoyed for generations and is an accepted incident of property ownership, rather than a privilege. However, the government can prescribe the conditions under which it will permit the transmission of property by devise or descent upon the owner's death⁵ because the right to take property by devise or by descent is a legal privilege and not a natural right.⁶ Death taxes are imposed either on the right of a decedent to transmit property or on the privilege of an heir or legatee to receive it, with the federal estate tax being an excise tax of the former type on the right to transmit property from the dead to the living⁷ while a state inheritance tax is of the latter type. The first federal estate tax statute in 1916⁸ did

¹ The policies provided for the payment of a specified amount for each of several enumerated injuries and for the payment of the principal sum in the event of accidental death.

Mrs. Noel testified that she paid the premiums on the policies, following which her husband instructed the sales clerk to give them to her.

² *Estate of Marshal L. Noel*, 39 T.C. 466 (1962).

³ *Estate of Noel v. Commissioner*, 332 F.2d 950 (3d Cir. 1964).

⁴ *Commissioner v. Estate of Noel*, 379 U.S. 927 (1964).

⁵ See generally 1 POLISHER, ESTATE PLANNING AND ESTATE TAX SAVING 52 (2d ed. 1948).

⁶ *Magoun v. Illinois Trust & Sav. Bank*, 170 U.S. 283 (1898).

⁷ *New York Trust Co. v. Eisner*, 256 U.S. 345 (1921), upheld the constitutionality of the federal estate tax which is imposed on the transfer or shifting of relationships to property at death.

⁸ Revenue Act of 1916, 39 Stat. 756. See also 1 POLISHER, *op. cit. supra* note 5, at 52. Prior to the federal estate tax statute of 1916, estate taxes were in the nature of emergency tax legislation during war periods which was repealed in postwar periods. In 1916, to provide funds for federal highway construction grants and for American preparedness for World War I, the estate tax, based on the net estate transmitted by a deceased, was passed. The present federal estate tax has its origin in this legislation.

not deal expressly with insurance, but insurance proceeds paid to the decedent's estate could be taxed as property owned by the decedent.⁹ In the Revenue Act of 1918,¹⁰ Congress added a specific provision to tax insurance receivable by the executor and, also, levied a tax on the proceeds of insurance policies "taken out by the decedent on his own life," even if the proceeds were payable to other named beneficiaries. The provision has been reenacted and exists in basically the same form as it did at its inception.¹¹ From 1918 to 1941, the test of inclusion shifted between ownership of policy and payment of premium with considerable uncertainty as to which represented the better reasoned approach. In late 1941, the Treasury issued a ruling, incorporated in 1942 into the code, providing for the taxation of the proceeds of all policies owned by the insured or paid for by him.¹² The premium payment test was discarded in the 1954 Code. Sections 2031-44 are the current statutory provisions for including property and interests in the gross estate of a decedent for federal estate tax purposes.¹³ The particular statute pertinent to life insurance is section 2042.¹⁴

Leopold Ackerman,¹⁵ a 1929 Board of Tax Appeals decision, is apparently the only prior case dealing with the includability of accident insurance death benefits in the gross estate. It was held in *Ackerman* that proceeds of double indemnity life insurance policies and payments under accidental death policies were amounts received "as insurance under policies taken out by the decedent upon his own life" within section 302(g) of the Revenue Act of 1924.¹⁶ According to *Ackerman*, accident insurance providing for unconditional payments in the case of accidental death is within the insurance concept of the present section 2042(2), which is almost identical to section 302(g) of the 1924 statute.¹⁷

Since *Ackerman*, it has been settled and consistent administrative practice to include insurance proceeds from accidental death policies in decedents' estates.¹⁸ The Treasury Regulations have remained unchanged

⁹ *Minnaugh v. United States*, 66 Ct. Cl. 411 (1928), *cert. denied*, 280 U.S. 563 (1929).

¹⁰ Revenue Act of 1918, § 402(f), 40 Stat. 1097, 1098. All property was included in the value of the gross estate "to the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over \$40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life."

¹¹ Revenue Act of 1918, § 402(f), 40 Stat. 1097, 1098; Revenue Act of 1921, § 402(f), 42 Stat. 227, 279; Revenue Act of 1924, § 302(g), 43 Stat. 253, 305; Revenue Act of 1926, § 302(g), 44 Stat. 9, 71; Int. Rev. Code of 1939, § 811(g), 53 Stat. 1, 122, as amended by Revenue Act of 1942, § 404, 56 Stat. 798, 944; INT. REV. CODE OF 1954, § 2042.

¹² Revenue Act of 1942, § 404, 56 Stat. 798.

¹³ INT. REV. CODE OF 1954, §§ 2031-44.

¹⁴ INT. REV. CODE OF 1954, § 2042. The pertinent provisions of this section are as follows:

The value of the gross estate shall include the value of all property—

(1) *Receivable by the executor*—to the extent of the amount receivable by the executor as insurance under policies on the life of the decedent.
(2) *Receivable by other beneficiaries*—to the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person.

¹⁵ 15 B.T.A. 635 (1929).

¹⁶ Revenue Act of 1924, § 302(g), 43 Stat. 253, 305.

¹⁷ See note 11 *supra*.

¹⁸ *Commissioner v. Estate of Noel*, 380 U.S. 678, 681 (1965).

from the time of the decision¹⁹ and Congress has never attempted to limit the scope of that decision or the established administrative construction of section 2042(2),²⁰ although it has reenacted the section and amended it in other respects a number of times. When a long-standing administrative interpretation continues without change and applies to substantially reenacted statutes, courts generally deem the interpretation to have received congressional approval and the effect of law.²¹

II. COMMISSIONER V. ESTATE OF NOEL

A. Policies On The Life Of Decedent

The Third Circuit's decision that flight accident insurance policies are not "policies on the life of the decedent" was based on the distinction between life and accident insurance. The fundamental distinctions between them are reflected not only in the various reasons for which each is purchased, but also in the inherent differences in the principles of coverage and underwriting requirements. The most significant difference perhaps, is the comparison between the measured, inevitable fact of death, and the highly speculative, evitable, uncertain occurrence of an accident. The likelihood of any individual's death can be statistically computed and measured in dollars and cents. Thus every ordinary life insurance policy has a discernable value from the moment it is issued. This value gives the insured an immediate and real asset over which he may exercise control. It is certainty of payment which gives ordinary life insurance its substance and provides the basis of taxability.²² In contrast, an accident policy represents a gamble without substantial economic value. These fundamental differences, it was argued, require different tax treatment.²³

Noel's estate contended that taxation would not further the purpose of the estate tax, *i.e.*, prevention of accumulated wealth from being passed on, undiminished, from generation to generation.²⁴ To justify includability in a decedent's taxable estate, property of economic value must have been owned or controlled by the decedent and transferred at his death.²⁵ The mere receipt of property by a beneficiary is not sufficient, because the tax is not upon the receipt of property, but is upon the transfer.²⁶ According to the Third Circuit's interpretation, the requisite valuable interest did not exist in the flight accident insurance policies held by Marshal Noel. Regardless of whether he had the right to change policy beneficiaries, he

¹⁹ 26 C.F.R. § 20.2042-1(a)(1) (1961); Treas. Reg. 105 (1939 Code), § 81.25; Treas. Reg. 80, art. 25 (1934 ed. & 1937 ed.); Treas. Reg. 70, art. 25 (1926 ed. & 1929 ed.); Treas. Reg. 68, art. 25 (1924 ed.); Treas. Reg. 63, art. 27 (1922 ed.); Treas. Reg. 37, art. 32 (1921 ed.).

²⁰ 380 U.S. at 681-82.

²¹ See, *e.g.*, *Boehm v. Commissioner*, 326 U.S. 287, 291-92 (1945); *Helvering v. Winwill*, 305 U.S. 79, 83 (1938); *United States v. Dakota-Montana Oil Co.*, 288 U.S. 459, 466 (1933); *National Lead Co. v. United States*, 252 U.S. 140, 146 (1920).

²² *Helvering v. Illinois Life Ins. Co.*, 299 U.S. 88, 91 (1936).

²³ Brief for Respondent, pp. 17-18, *Commissioner v. Estate of Noel*, 380 U.S. 678 (1965).

²⁴ *Id.* at 14.

²⁵ *Lewellyn v. Frick*, 268 U.S. 238 (1925).

²⁶ *Walker v. United States*, 83 F.2d 103, 110 (8th Cir. 1936).

retained nothing of value which was properly includable for estate taxation. The estate looked to the inherently speculative nature of the policies, the infinitesimal chance of an airplane accident, and the minimal premium charge to demonstrate the lack of value of decedent's interest in the policies.

A further aid to the Third Circuit's decision was an analysis of the legislative history of section 2042(2), and, more specifically, the phrase "insurance under policies on life of decedent." Section 2042(2) does not mention accident insurance policies, but such analysis sheds considerable light on congressional intent and interpretation of statutory phrases of doubtful meaning.²⁷ As earlier stated,²⁸ section 2042(2) is in essence the same as Section 402(f) of the Revenue Act of 1918, the original federal estate tax enactment concerning life insurance. The Committee on Ways and Means of the 65th Congress submitted a report stating that payments to specific beneficiaries "do not fall within the existing provision defining the gross estate . . . that wealthy persons have and now anticipate resorting to this method of defeating the estate tax . . . for the reason that such insurance would not be included in the gross estate."²⁹ On this basis the Court of Appeals stated that "the obvious intent of Congress and the purpose of the enactment was to foreclose the possibility of tax avoidance under the existing law."³⁰ The very uncertainty of accidental death precludes the use of accident insurance as an estate planning tool or instrument of tax avoidance.

As logical as the Third Circuit's analysis may appear,³¹ the more convincing interpretation of legislative intent supports the Supreme Court's decision. Sections 2033 through 2042 are all-encompassing, reaching every disposition which is testamentary and subject to a decedent's control. Section 2042 is only one of a number of provisions defining the gross estate of a decedent so as to make taxable the full value of any property controlled by a decedent and received by reason of his death. It performs an integral role in accomplishing the congressional purpose of taxing the full value of property transferred by reason of the death of a decedent who had the power to control the disposition of the property at the time of his death. As noted in *Ackerman*,³² Congress chose the broadest possible language in the coverage of insurance proceeds in the estate tax when it stated that "the gross estate shall include the value of all property . . . to the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent." Income tax provisions are not controlling for estate tax purposes, but an understanding of them

²⁷ See, e.g., *Harrison v. Northern Trust Co.*, 317 U.S. 476, 479-80 (1943); *United States v. American Trucking Ass'ns*, 310 U.S. 534-44 (1940); *Holy Trinity Church v. United States*, 143 U.S. 457 (1892); *J. C. Penney Co. v. Commissioner*, 312 F.2d 65, 68 (2d Cir. 1962); *City of Newark v. United States*, 254 F.2d 93, 97-98 (3d Cir. 1958).

²⁸ See text accompanying note 11 *supra*.

²⁹ H.R. REP. No. 767, 65th Cong., 2d Sess. 22 (1918).

³⁰ *Estate of Noel v. Commissioner*, *supra* note 3, at 953.

³¹ The House Report accompanying the Revenue Act of 1918, the only relevant item of legislative history, is inconclusive on the precise question of accidental death benefits, because there is no indication that Congress ever considered the question.

³² *Leopold Ackerman*, *supra* note 15, at 638.

can help in construing the insurance provisions of the estate tax.³³ Section 101 excludes from gross income death benefits paid "under a life insurance contract."³⁴ This section evolved from the first income tax act passed after the sixteenth amendment to the Constitution and is essentially the same today as when originally enacted.³⁵ Section 1.101-1(a) of the Treasury Regulations on Income Tax provides that "Death benefit payments having the characteristics of life insurance proceeds payable by reason of death under contracts, such as . . . accident and health insurance contracts, are covered by this provision."³⁶ It appears that Congress has intended a broad definition of the term "life insurance" in this strictly defined section, and quite possibly a more restricted interpretation was never intended by Congress when enacting section 2042.

The Supreme Court expressed³⁷ its awareness that the Board of Tax Appeals had recognized the distinction between life insurance and accident insurance when the Board held that they should be treated similarly. The broad language of section 2042 makes no such distinction and is not inconsistent with the decision in *Ackerman*.³⁸ Relying on the presumption that a long-standing administrative interpretation applicable to a substantially reenacted statute has received congressional approval and has the effect of law,³⁹ the Supreme Court felt itself bound to follow *Ackerman* and held that insurance policies, whether called "flight accident in-

³³ See, e.g., *United States v. Suplee-Biddle Hardware Co.*, 265 U.S. 189, 195-96 (1924). The Supreme Court compared income tax § 213 with estate tax § 402, both of which pertain to insurance. As life insurance was already subject to the estate tax, there would be double taxation if it were subject to the income tax. The Court held that Congress did not intend such a result.

³⁴ INT. REV. CODE OF 1954:

Section 101: CERTAIN DEATH BENEFITS .

(a) Proceeds of life Insurance Contracts Payable by Reason of Death.

(1) General Rule—Except as otherwise provided in paragraph (2) and in subsection (d), gross income does not include amounts received (whether in a single sum or otherwise) under a life insurance contract, if such amounts are paid by reason of the death of the insured.

³⁵ This original act provided that the proceeds of life insurance policies would not be included as income, 38 Stat. 167 (1913). Revenue Act of 1916, § 4, 39 Stat. 756, 758; Revenue Act of 1918, § 213(b)(1), 40 Stat. 1057, 1065; Revenue Act of 1921, § 213(b)(1), 42 Stat. 227, 238; Revenue Act of 1924, § 213(b)(1), 43 Stat. 253, 267; Revenue Act of 1926, § 213(b)(1), 44 Stat. 9, 24; Revenue Act of 1928, § 22(b)(1), 45 Stat. 791, 797; Revenue Act of 1932, § 22(b)(1), 47 Stat. 169, 178; Revenue Act of 1934, § 22(b)(1), 48 Stat. 680, 687; Revenue Act of 1936, § 22(b)(1), 49 Stat. 1648, 1657; Revenue Act of 1938, § 22(b)(1), 52 Stat. 447, 458; Int. Rev. Code of 1939, § 22(b)(1), 53 Stat. 1, 10.

³⁶ Treas. Reg. § 1.101-1 (1961).

³⁷ 380 U.S. at 681.

³⁸ *Leopold Ackerman*, *supra* note 15, at 637. This distinction did not affect the *Ackerman* decision because the Board of Tax Appeals stated "we fail to see why one [type of policy] is not taken out upon the life of the policyholder as much as the other. In each case the risk assumed by the insurer is the loss of the insured's life, and the payment of the insurance money is contingent upon the loss of life."

³⁹ See authority cited note 21 *supra*. It should be pointed out that attaching significance to congressional silence is normally an unrealistic canon of construction. It has been held that reenactment of a statute after interpretation by the Board of Tax Appeals is an unreliable indicium of congressional satisfaction with the interpretation, particularly in the absence of an affirmative indication that Congress was aware of the interpretation. See, e.g., *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955); *Helvering v. Wilshire Oil Co.*, 308 U.S. 90 (1939); *Hoshland v. Helvering*, 298 U.S. 441 (1936). It is difficult to argue that existing interpretations of tax statutes are incorporated by reenactment, because the numerous sources of interpretation in this field belie the theory that Congress was aware of them in passing a reenactment. See HART & SACKS, *THE LEGAL PROCESS* 1401-02 (tent. ed. 1958).

surance" or "life insurance," were in effect insurance taken out on the life of the decedent within the meaning of section 2042(2).⁴⁰

B. Incidents Of Ownership

The Tax Court found that the policy provision⁴¹ reserving to the insured the right to change beneficiary was an incident of ownership which brought the policies within the provisions of section 2042(2).⁴² The Court of Appeals agreed that the right amounted to an exercisable incident of ownership, but reversed the Tax Court because it did not believe flight accident insurance came within the meaning of the statute.⁴³ The Supreme Court agreed with both in holding that retention of the right to change beneficiary was sufficient to meet the statutory requirement.⁴⁴

There is considerable authority to the effect that retention of the right to change beneficiaries is an incident of ownership sufficient in itself to bring the policy proceeds into a decedent's gross estate.⁴⁵ To free proceeds from estate taxes, the insured must divest himself of all rights and powers in the insurance policies. The Supreme Court expressly stated that nothing they said should be taken to mean that a policyholder is without power to divest himself of all incidents of ownership by a valid gift or assignment,⁴⁶ so as to bar the inclusion of policy proceeds in his gross estate under section 2042.⁴⁷ Ordinarily, in the absence of statutory or contractual prohibition, an insurance policy can be assigned, and the usual rules of assignment as to the requisites, validity, operation, and effect of assignment, will apply.⁴⁸ An assignment is usually valid when the intention to pass an interest in the policy to the assignee is manifested in writing, and the writing need not be attached to, or written on, the policy.⁴⁹ However, the questions of whether an insured has the right to make an assignment and whether a valid and effective assignment has been made must be determined under local law.⁵⁰ Occasionally, the result may turn on which local law controls, and since insurance policies are contracts,

⁴⁰ 380 U.S. at 682.

⁴¹ In each policy there is a paragraph as follows: "CHANGE OF BENEFICIARY: The right to change of beneficiary is reserved to the insured and the consent of the beneficiary shall not be requisite to surrender or assignment of this policy or to any change of beneficiary or beneficiaries, or to any changes in this policy."

⁴² Estate of Marshal L. Noel, *supra* note 2, at 471.

⁴³ Estate of Noel v. Commissioner, *supra* note 3, at 954.

⁴⁴ 380 U.S. at 684.

⁴⁵ See, e.g., *Farwell v. United States*, in which the insured made proceeds payable to an irrevocable inter vivos trust. The court held that retention of right to change beneficiary was an incident of ownership. 243 F.2d 373 (7th Cir. 1957). Retention of the right to change a contingent beneficiary, despite the fact that the primary beneficiary was designated irrevocably with ownership rights, was considered an incident of ownership in *Broderick v. Keefe*, 112 F.2d 293 (1st Cir.), *appeal dismissed per stipulation*, 311 U.S. 721 (1940). Proceeds of life insurance were included in insured's gross estate, although insured's mother took out the policies, paid the premium, and retained possession, because insured retained the right to change beneficiary, an incident of ownership in *Michael Collino*, 25 T.C. 1026 (1956).

⁴⁶ Assignment forms are provided by flight insurance companies to allow an insured to transfer his right to change beneficiary.

⁴⁷ 380 U.S. at 684.

⁴⁸ See generally 45 C.J.S. *Insurance* § 410 (1946).

⁴⁹ *Id.* § 423.

⁵⁰ See, e.g., *Louis J. Dorson*, 4 T.C. 463 (1944); *Anna Rosenstock*, 41 B.T.A. 635 (1940).

the conflict of laws rules applicable to contracts will govern the choice of law.⁵¹

One question before the courts was whether Noel's practical inability to exercise his right to change beneficiary was sufficient to make the power illusory and not an appropriate incident of ownership to satisfy section 2042. Noel's estate argued that he possessed an empty power which could not be exercised once he entered the airplane. If Congress had intended to tax all incidents of ownership regardless of the practical substance, it would not have written section 2042(2) so as to condition taxability on whether the incident of ownership is exercisable.⁵² The term "incidents of ownership" is not limited in its meaning to ownership of the policy in the technical legal sense, but generally refers to the right of the insured to the economic benefits of the policy.⁵³ The estate contended that exercisable incidents of ownership within the meaning of the statute must be substantial and significant, and not empty, illusory, and valueless if the proceeds are to be includable for tax purposes.⁵⁴ A further argument was that the provision concerning change of beneficiary was merely "boiler plate," that decedent did not desire the right, and that he could not have obtained the policies without the provision. Courts have gone behind printed forms to determine if a decedent really had such rights.⁵⁵ The Tax Court⁵⁶ felt it was immaterial that the right to change the beneficiary was "boiler plate," because it was part of the contractual relationship with each insurance company, and defined a legal right of the decedent. The statute, accordingly, was applicable because the right to change beneficiaries is one of the recognized "incidents of ownership."⁵⁷ As the Tax Court's decision⁵⁸ was followed by the Supreme Court in *Noel*, it is now firmly established that the practical ability to exercise the right to change beneficiary at any moment is immaterial when determining if the insured had the particular incidents of ownership at the time of his death within the provisions of section 2042(2).⁵⁹

III. CONCLUSION

The treatment of life insurance proceeds payable to a named beneficiary

⁵¹ *Louise C. Moore*, 33 B.T.A. 108 (1935). The court held that the law of the state in which the contract was "made" should govern unless the contract specified otherwise. Here, the policies were issued in New York. "Made" seems to mean where the policy was sold.

⁵² The condition pertains to insurance "with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person." INT. REV. CODE OF 1954, § 2042(2).

⁵³ See *Commissioner v. Treganowan*, 183 F.2d 288 (2d Cir. 1950); S. REP. NO. 1631, 77th Cong., 2d Sess. 235 (1954); H.R. REP. NO. 2333, 77th Cong., 2d Sess. 163 (1954); 26 C.F.R. § 2042-1(c)(2).

⁵⁴ Brief for Respondent, p. 19, *Commissioner v. Estate of Noel*, 380 U.S. 678 (1965).

⁵⁵ See, e.g., *District of Columbia v. Wilson*, 216 F.2d 630 (D.C. Cir. 1954); *Schongalla v. Hickey*, 149 F.2d 687 (2d Cir. 1945); *National Metropolitan Bank v. United States*, 87 F. Supp. 773 (Ct. Cl. 1950); *Edward Doerken*, 46 B.T.A. 809 (1942).

⁵⁶ *Estate of Marshal L. Noel*, 39 T.C. 466, 471 (1962).

⁵⁷ 380 U.S. at 684.

⁵⁸ The *Noel* case followed the principle of Rev. Rul. 61-123, 1961-2 CUM. BULL. 151, which considered a similar situation in holding the insured's inability to exercise his right to change beneficiary at any particular time as immaterial, and that the insured possessed an incident of ownership.

⁵⁹ The Supreme Court stated that "it would stretch the imagination to think that Congress intended to measure estate tax liability by an individual's fluctuating, day-by-day, hour-by-hour capacity to dispose of property which he owns." 380 U.S. at 684.

other than the estate of the insured presents a major problem of tax policy. Two principal competing forces exist in this area. There is a congressional desire to encourage the use of insurance as a means of providing for surviving dependents. Insurance payments, being similar to testamentary dispositions, require the imposition of a tax. The testamentary nature of insurance arrangements at the present time is substantially ignored in favor of a broad exclusionary policy that often leaves insurance proceeds outside the gross estate.⁶⁰ The single test provided by section 2042(2) for determining whether amounts receivable by beneficiaries other than the estate are includable in the gross estate is whether the decedent possessed any of the incidents of ownership at the time of his death. *Noel* firmly establishes that section 2042 covers death payments under accident insurance policies "as insurance under policies on the life of the decedent."

The federal courts have determined what the term "insurance" encompasses as used in federal estate taxation.⁶¹ In a leading case,⁶² the Supreme Court stated that Congress identified the characteristics of life insurance as involving the essential elements of risk-shifting and risk-distributing. It can be assumed that Congress intended amounts received pursuant to a transaction having these features as within the meaning of insurance in the statute.⁶³ It can also be concluded that payments under contracts that are not insurance contracts, but having the same characteristics, are to be included in the decedent's gross estate under section 2042.⁶⁴ The courts will look to the substance of an insurance policy and will consider the title or description of the agreement as unimportant so long as life insurance elements are present.

It is apparent that ordinary life insurance, unlike limited purpose flight accident insurance, has a significant savings aspect, so that proceeds of such insurance may represent property accumulated by the insured during his lifetime. The possibilities of tax avoidance through investing accumulated property in ordinary life insurance are greater. The difference between the insured's contribution and the policy proceeds will be greater when the policy insures against death from only a limited number of causes or for only a limited time. Ordinary life insurance is at one extreme with accident insurance as in *Noel* at the other, and term insurance coming between them. The variance in degree of risk, in difference between premiums paid, and in benefits realized, is irrelevant for the purposes of the statute. Estate tax policy, as determined in *Noel*, considers these dis-

⁶⁰ STEPHENS & MARR, *THE FEDERAL ESTATE AND GIFT TAX* 153 (1959).

⁶¹ *Kernochan v. United States*, 29 F. Supp. 860 (Ct. Cl.), *cert. denied*, 309 U.S. 675 (1939).

⁶² *Helvering v. Le Gierse*, 312 U.S. 531, 539 (1941).

⁶³ See *Estate of Keller v. Commissioner*, 312 U.S. 543 (1941); *Helvering v. Le Gierse*, 312 U.S. 531 (1941); *Leopold Ackerman*, *supra* note 15.

⁶⁴ *Commissioner v. Treganowan*, 183 F.2d 288 (2d Cir.), *cert. denied sub nom.*, *Estate of Strauss v. Commissioner*, 340 U.S. 853 (1950). Payments from a fund were made to the family of a deceased member of the New York Stock Exchange.

tinctions unimportant. The court will treat insurance policies in an economic rather than legal sense with death benefit payment provisions of accident insurance policies being treated as ordinary life insurance.⁶⁵ Accordingly, insurance on the life of a decedent will be interpreted broadly so as to include all death benefit payments in all varieties of insurance policies.

Though not mentioned by the courts in *Noel*, if the proceeds of life insurance are not includable in the gross estate under section 2042, they may be included under some other provision of the estate tax, depending upon the facts of the particular case. Where a decedent possessed incidents of ownership in an insurance policy on his life but gratuitously transferred all rights in the policy "in contemplation of death,"⁶⁶ section 2035 might apply.⁶⁷ The mere fact that the property involved in the transfer is life insurance does not of itself mean the transfer was in contemplation of death.⁶⁸ However, the regulations state that any transfer of an interest in property or relinquishment of a power within a period of three years ending with the date of death is presumed to have been made "in contemplation of death," unless the contrary is shown.⁶⁹ The Internal Revenue Service has indicated it will take the position that where the incidents of ownership in an air travel insurance policy are assigned by the insured to a related person, the insured has made a gift "in contemplation of death" and the proceeds will be included in the gross estate for federal estate tax purposes.⁷⁰ It is difficult to see how *Noel's* executors could successfully argue that the transfer was not made in contemplation of death.

In light of the past history of the estate tax provisions concerning the taxability of life insurance, it is quite possible the law is merely a temporary sanctuary for estate planners, and that other tests for determining the incidence of the estate tax may be established in the not too distant future. The "constitutional shadow" which once hung over the old pay-

⁶⁵ Respondent argued that amounts recoverable by beneficiaries from workmen's compensation death benefits, Rev. Rul. 56-637, 1956-2 CUM. BULL. 600; or under wrongful death statutes, Rev. Rul. 54-19, 1954-1 CUM. BULL. 179; or as social security death benefits, ET 18, 1940-2 CUM. BULL. 285; and Armed Forces Gratuity Pay, Rev. Rul. 55-581, 1955-2 CUM. BULL. 381, were not taxable and that the reasons for their exclusion should apply here.

⁶⁶ *United States v. Wells*, 283 U.S. 102 (1931), is the principal guide to the meaning of the phrase in connection with § 2035 of the 1954 Code. For the statute to apply, the Court said it is enough that contemplation of death was the inducing cause of the transfer, but it need not be the sole inducing cause of the transfer. It may be enough that thoughts of death played a substantial part inducing the transfer.

⁶⁷ 26 C.F.R. § 20.2042-1(a)(2) (1961).

⁶⁸ *Cronin's Estate v. Commissioner*, 164 F.2d 561 (6th Cir. 1947).

⁶⁹ 26 C.F.R. § 20.2035-1(d) (1961). An irrevocable assignment of a policy leaving no incident of ownership in the decedent but made in contemplation of death will not take the proceeds of the policy out of his estate. *Garrett's Estate v. Commissioner*, 180 F.2d 955 (2d Cir. 1950); *Liebman v. Hassett*, 148 F.2d 247 (1st Cir. 1945).

⁷⁰ Bulletin, ABA Section of Taxation, Point 7, p. 69 (Jan. 1962).

ment-of-premium test⁷¹ was recently removed when the Supreme Court sustained its constitutionality.⁷² Whether this will result in renewed efforts by the Treasury to again broaden the basis for the inclusion of life insurance proceeds only the future will tell. It is apparent the Government will continue to deem itself unrestricted by section 2042 when dealing with life insurance and will seek to treat some transfers of life insurance within other estate tax provisions such as "transactions in contemplation of death."

Edward S. Koppman

⁷¹ Kohl v. United States, 226 F.2d 381 (7th Cir. 1955).

⁷² United States v. Manufacturers Nat'l Bank, 363 U.S. 194 (1960).

Federal Aviation Act — Tariff Deviations — Setoff Arrangements

In 1962, Northeast Airlines and Sperry Rand Corporation entered into a forbearance agreement whereby Sperry agreed to accept payment of Northeast's obligation of \$8,554.04 in thirty-six equal monthly installments with interest. Under the agreement, Sperry had an option to utilize Northeast's transportation at published rates with the charges being offset against the balance.¹ The monthly installments were to continue without regard to the amount of transportation purchased by Sperry. This arrangement had the practical result of offsetting the monthly payments in reverse order beginning with the last installment and working backwards toward the first. The Civil Aeronautics Board reviewed the forbearance agreement, with the hearing centered on the setoff provision, which allegedly violated Section 403 of the Federal Aviation Act of 1958.² The Board found that the setoff was a tie-in arrangement giving Sperry advantageous terms in the purchase of transportation, and further, that it closely resembled a barter transaction since it gave Sperry a strong incentive to use Northeast to the exclusion of other carriers offering comparable service. The Court of Appeals essentially agreed with the Board's finding. *Held*: A setoff agreement which cancels the carrier's debts in exchange for transportation violates sections 403 and 404 of the act by giving the creditor more advantageous terms in the purchase of transportation than the terms available to the carrier's other customers. *Northeast Airlines, Inc. v. CAB*, 345 F.2d 662 (1st Cir. 1965).

Sections 403 and 404 of the Federal Aviation Act were intended to eliminate confusion concerning alleged discriminatory practices by providing that payment for air transportation be made in accordance with the tariff filed by each commercial air carrier. Section 403(a)³ permits a carrier to initially determine its rates and other terms and conditions upon

¹ The provision in no way obligated the forbearing creditor to utilize it, but gave the creditor the option of electing to use Northeast's services. To the extent Northeast's indebtedness was not discharged by offset, Sperry would be paid in cash with interest.

² 72 Stat. 758 (1958), 49 U.S.C. § 1373 (1964). The pertinent parts of § 403 are set out in footnotes 3, 5, and 8 *infra*.

³ FEDERAL AVIATION ACT OF 1958, § 403(a), 72 Stat. 758 (1958), 49 U.S.C. § 1373(a) (1964):

Every air carrier and every foreign air carrier shall file with the Board, and print, and keep open to public inspection, tariffs showing all rates, fares, and charges for air transportation . . . and showing to the extent required by regulations of the Board, all classifications, rules, regulations, practices, and services in connection with such air transportation. Tariffs shall be filed, posted, and published in such form and manner, and shall contain such information, as the Board shall by regulation prescribe; and the Board is empowered to reject any tariff so filed which is not consistent with this section and such regulations. Any tariff so rejected shall be void. The rates, fares, and charges shown in any tariff shall be stated in terms of lawful money of the United States, but such tariffs may also state rates, fares, and charges in terms of currencies other than lawful money of the United States. . . .

which it will offer services to the public, but they must be approved and embodied in a tariff filed with the Board. Rates filed and subsequently accepted by the Board as reasonable and non-discriminatory must be strictly adhered to.⁴ Section 403(b)⁵ provides that no carrier shall receive a "greater or less or different compensation" than the rates appearing in the tariff. The rate filed is controlling on both carrier and passenger and is the carrier's sole offer to serve the public.⁶ Although carriers are prevented from changing a tariff on their own initiative,⁷ any change which may become necessary can normally be accomplished by utilizing the method contained in section 430(c).⁸ Coupled with the provisions of section 403, section 404(b)⁹ prohibits any undue or unreasonable discrimination by an air carrier resulting from application of its tariff provisions, and publication of the tariff has proved to be an effective safeguard against such discrimination.¹⁰ Section 403 has not previously been the subject of judicial construction, but it was taken verbatim from the Interstate Commerce Act.¹¹ In reaching the present decision, the court followed the method the CAB generally uses in interpreting its statutes if a similar pre-existing statute of the Interstate Commerce Act is involved and looked to the decisions arising under the pertinent sections of the older statute and applied their reasoning to the present case.¹²

⁴ See *Texas & Pac. Ry. v. Mugg*, 202 U.S. 242 (1906); *Jones v. Northwest Airlines*, 157 P.2d 728, 22 Wash.2d 863 (1945). See also Orr, *The Law Affecting Aviation Liability*, 20 TEMP. L.Q. 64 (1946).

⁵ FEDERAL AVIATION ACT OF 1958, § 403(b), 72 Stat. 759 (1958), U.S.C. § 1373(b) 1964: No air carrier or foreign air carrier shall charge or demand or collect or receive a greater or less or different compensation for air transportation, or for any service in connection therewith, than the rates, fares, and charges specified in its currently effective tariffs; and no air carrier or foreign air carrier shall, in any manner or by any device, directly or indirectly, or through any agent or broker, or otherwise, refund or remit any portion of the rates, fares, or charges so specified, or extend to any person any privileges or facilities, with respect to matters required by the Board to be specified in such tariffs, except those specified therein. . . .

⁶ *Louisville & N.R.R. v. Maxwell*, 237 U.S. 94, 97 (1915).

⁷ *Chicago & A.R.R. v. Kirby*, 225 U.S. 155 (1912); see *Bills of Lading*, 29 I.C.C. 417, 419 (1914).

⁸ FEDERAL AVIATION ACT OF 1958, § 403(c), 72 Stat. 759 (1958), 49 U.S.C. § 1373(c) (1964):

No change shall be made in any rate, fare, or charge, or any classification, rule, regulation, or practice affecting such rate, fare, or charge . . . except after thirty days' notice of the proposed change filed, posted, and published in accordance with the subsection (a) of this section. Such notice shall plainly state the change proposed to be made and the time such change will take effect. The Board may in the public interest, by regulation or otherwise, allow such change upon notice less than that herein specified, or modify the requirements of this section with respect to filing and posting of tariffs, either in particular instances or by general order applicable to special or peculiar circumstances or conditions.

⁹ FEDERAL AVIATION ACT OF 1958, § 404(b), 72 Stat. 760 (1958), 49 U.S.C. § 1374(b) (1964).

¹⁰ In the Cullom Report, S. REP. NO. 46, 49th Cong., 1st Sess. 40 (1886), it was expressed that "the chief purpose of any legislation for the regulation of interstate commerce should be to secure the fullest publicity both as to charges made by common carriers and as to the manner in which their business is conducted." The Report went on to say that reasonableness and uniformity in rates could not be secured without publicity "which is the surest and most effective preventative of unjust discrimination." These principles were adopted by the Supreme Court when called upon to construe the effect of tariffs filed and published pursuant to the Interstate Commerce Act and have been applied without dissent as to the effect of tariffs on file with the CAB.

¹¹ INTERSTATE COMMERCE ACT, 34 Stat. 586 (1906), 49 U.S.C. § 6(7) (1964).

¹² *Markham & Blair, The Effect of Tariff Provisions Filed Under the Civil Aeronautics Act*, 15 J. AIR L. & COM. 251, 259 (1948).

The cases under the Interstate Commerce Act indicate the strength and the limitations the courts have placed on provisions identical to those in question. In *Louisville & N.R.R. v. Mottley*¹³ the Court declared that, "the statute manifestly means that the purchase of a transportation ticket by a passenger and its sale by the company shall be consummated only by the former paying cash and by the latter receiving cash of the amount specified in the published tariffs." The statement that transportation is payable only in cash, unless otherwise specified in the tariff, is the embodiment of the unyielding rule that a carrier cannot vary in any respect from its filed tariff.¹⁴ Gradually this strict rule acquired a degree of flexibility, allowing reason and good sense to take the place of blind application, although the basic purpose of eliminating discrimination involving carriers was rigidly maintained. The decision that payment by check satisfied the requirement for "cash" was indicative of this flexibility.¹⁵ Though a check is a promise (or order) to pay, the decision does not imply that any debt can be substituted by the shipper for his indebtedness to the carrier for the transportation already provided.¹⁶ Debts available for substitution are limited to obligations unconditionally payable on demand both as a matter of law and as a matter of practical expectation. As the Supreme Court pointed out,¹⁷ the statutes are not designed to hamper honest business practices, but to facilitate them. On occasion the courts have allowed the practice of extending "convenience credit." In *Gamble-Robinson Comm'n Co. v. Chicago & N.W. Ry.*,¹⁸ the court held that "convenience credit" was not a violation of the statute where the common practice was for the carrier to allow the transportation charges on credit to a consignee until the correct amount of indebtedness could be determined.¹⁹ Allowance of transportation on credit when it is not provided for in the tariff was narrowly limited by *United States v. Hocking Valley Ry.*²⁰ to credit given only in consideration of the nature of the commodity

¹³ 219 U.S. 467, 477 (1911).

¹⁴ *Id.* at 476:

These rates cannot be changed without notice and approval of the authorized agency. Otherwise, the published schedules would be of no value "if the published rates could be disregarded in special or particular cases by the acceptance of property of various kinds, and of such value as the parties immediately concerned chose to put upon it, in place of money for the services performed by the carrier."

¹⁵ *Fullerton Lumber Co. v. Chicago, M., St. P. & Pac. R.R.*, 282 U.S. 520, 522 (1931):

The Interstate Commerce Act does not in terms prescribe that the charges shall be paid in money; that is, in coin or currency. There is no reason for denying to the parties the convenience and safety incident to making payment, in accordance with the prevailing usage of business, by means of a check payable on demand drawn on a going bank in which the drawer has an ample deposit.

¹⁶ *Id.* at 521. See also *United States v. Hocking Valley Ry.*, 194 Fed. 234 (N.D. Ohio 1911).

¹⁷ See note 15 *supra*.

¹⁸ 168 Fed. 161 (8th Cir. 1909).

¹⁹ *But see United States v. Hocking Valley Ry.*, 194 Fed. 234 (N.D. Ohio 1911).

²⁰ *Id.* at 250-51.

The statute "cannot be employed to curtail any opportunity to secure to the carrier its full compensation, and no apparent discrimination which is effectual to accomplish that end is under the inhibition of that law." The Gamble-Robinson case loses authority "when we consider that here is not an effort to secure payment, as there, but a granting of a different credit . . . a credit which is not influenced by the character of the commodity but by a desire to extend a favor . . . a credit, too, which, the wider it goes, the more is weakened the authority of the law to compel defendant to treat all its shippers with equality."

But see Passenger Credit Plans Investigation, CAB Order No. E-19197 (16 Jan. 1963), where the

in order to secure the carrier's full compensation. The Supreme Court further expanded the area of permissible deviation from a tariff in *Chicago & N.W. Ry. v. Lindell*.²¹ Having due regard for the perishable nature of the commodity shipped and the resulting difficulty in ascertaining the correct transportation charges, the Court held that payment by setting off a debt fixed by court judgment against the transportation charges was not "different compensation" prohibited by statute.²² The Court reasoned that when the debts of both parties had been reduced to judgments, a court may offset them against each other in order to avoid a multiplicity of suits. However the parties themselves cannot, by agreement, offset liquidated debts in order to reduce the indebtedness incurred through the use of the carrier's services.²³

In discussing practices that the courts have allowed, it should be noted that the Interstate Commerce Act does not prohibit the giving of all preferences and advantages, or the production of all prejudices and disadvantages, but only those that are undue and unreasonable.²⁴ A carrier is free to exercise practices ordinarily used by other individuals provided that any resulting discrimination is not unreasonable.²⁵ In line with this, it appears that in the area of "group rates" the courts will allow a lower rate to be charged. Although this may be discrimination in respect to a single passenger, it is not considered unreasonable, because he is not similarly circumstanced with the group.²⁶ Illustrative of the courts' approach to situations involving not only an alleged violation of the statute but also the question of unreasonable discrimination is *United States v. Union Pac. R.R.*²⁷ There the granting of delayed service to give the shippers additional time to locate markets for their products was found to constitute the furnishing of additional "privileges or facilities" within the

Board declared that "convenience credit" plans that are included in the tariff are frequently utilized by surface and air carriers alike and, while they constitute a discrimination, such arrangements are not unreasonable discriminations as prohibited by statute.

²¹ 281 U.S. 14 (1930).

²² *Id.* at 17.

²³ See *Illinois Cent. R.R. v. Hoopes & Sons*, 233 Fed. 135 (S.D. Iowa 1916).

²⁴ *ICC v. Baltimore & O.R.R.*, 43 Fed. 37 (S.D. Ohio 1890), *aff'd*, 145 U.S. 263 (1892).

Subject to the two leading prohibitions that their charges shall not be unjust or unreasonable, and that they shall not unjustly discriminate, so as to give undue preference or disadvantage to persons or traffic similarly circumstanced, the act to regulate commerce leaves common carriers as they were at common law, free to make special contracts looking to the increase of their business, to classify their traffic, to adjust and apportion their rates so as to meet the necessities of commerce, and generally to manage their important interests upon the same principles which are regarded as sound, and adopted in other trades and pursuits. 43 Fed. at 50-51.

Accord, *Gamble-Robinson Comm'n Co. v. Chicago & N.W. Ry.*, *supra* note 18.

²⁵ In the dicta of *United States v. Wells-Fargo Express*, 161 Fed. 606, 610 (N.D. Ill. 1908), it is suggested that since only unreasonable discrimination violates the statute, the statute is void for indefiniteness because one cannot know in advance if he is violating the law, and one jury may find an offense and another nothing reprehensible in their determination of "unreasonable." However, this view overlooks the fact that it is for the court to first pass on the application of the law to the facts which the prosecution offers against the defendant. The proper performance of this duty leaves to the jury no latitude for speculation on the question which is the court's alone. The court in dealing with the descriptive term "unreasonable" is dealing with a familiar word. Any contention that carriers will become involved in a maze of complaints stemming from the ambiguous word "unreasonable" from those who feel as though they are not receiving the same consideration as a competitor is not well-founded.

²⁶ *ICC v. Baltimore & O.R.R.*, *supra* note 24.

²⁷ 173 F. Supp. 397 (S.D. Iowa 1959), *aff'd*, 362 U.S. 327 (1960).

meaning of the Interstate Commerce Act. While the court held such delays cost the carrier money and consequently must be in the tariff, it reserved for later consideration whether such a practice was unreasonable. In *Armour Packing Co. v. United States*,²⁸ the Court emphasized that neither the shipper nor the carrier need be guilty of moral turpitude for a practice to be illegal. The fact that criminal statutes are to be strictly construed as requiring a criminal intent has no application when the general purpose of the legislature is manifest and is subserved by giving the words used in the statute their ordinary meaning, and thus, covering the acts charged.²⁹ Several courts have discussed at length the general purpose of the statute in question.³⁰ They found that the aim of the statute is disassociated from any criminal intent, but instead is concerned with reaching all methods by which a carrier may engage in unlawful discriminations in violation of its tariff.

In the present case, the setoff provision between Northeast and Sperry must be considered as of the day Sperry accepted the forbearance agreement because it replaced the overdue debt. Since the setoff portion provided for the cancellation of the indebtedness in reverse order, Sperry's utilization of Northeast's transportation became a present use of transportation for cancellation of a debt due in the future. Such an arrangement has a two-fold basis of illegality. In his concurring opinion Chief Judge Aldrich recognized that the cases arising under the Interstate Commerce Act involving payment for transportation provide that the cancellation of a debt by offsetting another debt is limited to the use of "valid checks, drafts, and money orders."³¹ Noting that the practice is further limited to the cancellation of two presently-due debts, and not debts due in the future, he pointed out that, "a time note is not the equivalent of cash."³² Judge Aldrich also reasoned that an attempt to offset the transportation against a future debt was an extension of credit not included in Northeast's tariff and, therefore, a violation of section 403.³³ The opinion of the court implied that an even stronger basis for holding the present set-off violative of section 403 may be found in public policy. If the court had assumed that Northeast's indebtedness was independently acquired, thus making the setoff other than an exchange or compensation so that the "greater or less or different" prohibition would be inapplicable, the door

²⁸ 209 U.S. 56 (1908). The carrier changed its rates but allowed a long-time shipper to continue under a former contract at the previous rate. The shipper contended there was no intended violation of the statute but it was held:

While intent is in a certain sense essential to the commission of a crime, and in some classes of cases it is necessary to show moral turpitude in order to make out a crime, there is a class of cases within which we think the one under consideration falls, where purposely doing a thing prohibited by statute may amount to an offense, although the act does not involve turpitude or moral wrong. In this case the statutes provide it shall be penal to receive transportation of goods at less than the published rate. *Id.* at 85.

²⁹ *United States v. P. Koenig Coal Co.*, 270 U.S. 512, 520 (1926).

³⁰ See, e.g., *Armour Packing Co. v. United States*, 209 U.S. 56, 85 (1908); *United States v. Hocking Valley Ry.*, *supra* note 19, at 249.

³¹ *Fullerton Lumber Co. v. Chicago, M., St. P. & Pac. R.R.*, *supra* note 15, at 521.

³² *Northeast Airlines, Inc. v. CAB*, 345 F.2d 662, 668 (1st Cir., 1965).

³³ *Ibid. Accord*, *United States v. Hocking Valley Ry.*, *supra* note 19, at 244.

for the perpetration of fraud would be opened. A "true barter transaction" that clearly violates section 403 could easily be camouflaged by "arranging" to have the carrier become indebted to the shipper before the parties entered into such a setoff agreement.³⁴ No barter or exchange would ever be prohibited by section 403 and its purpose would be defeated. Even if the court had found nothing illegal in the particular arrangement between Northeast and Sperry, it would have been necessary, as a policy matter, to rule against it in order to safeguard the purpose of section 403 from the dangers of fraud.³⁵ Had the court in *Northeast* undertaken the evaluation of the evidence in order to determine whether a tie-in arrangement was actually involved, the result would be that each similar setoff agreement would have to come under court scrutiny before it could be said that the agreement was not a violation of section 403. Such a procedure would be too lengthy and costly to justify its use. The court's heavy reliance on *Louisville & N.R.R. v. Mottley*³⁶ is not particularly suited to this case, although the expressions of statutory purpose found within the decision form a strong policy basis for the present holding. In *Mottley*, the attempted setoff involved the exchange of transportation passes for an unliquidated damage claim. The basis of any valid setoff arrangement is the counter-balancing of two or more liquidated claims and can in no matter involve the setoff of an unliquidated claim.³⁷ This was pointed out in *Lindell*, where, prior to litigation, the shipper's unliquidated claim could not lawfully be used as a setoff. Furthermore, the Court in *Union Pac. Ry v. Goodridge*,³⁸ looking at an unliquidated claim merely as contractual consideration rather than as a part of a setoff declared,

There is no doubt of the general proposition that the release of an unliquidated claim for damages is a good consideration for a promise, as between the parties, and if no one else were interested in the transaction, that rule might apply here; but the legislature, upon grounds of public policy, and for the protection of third parties, has made certain requirements with

³⁴ While this would certainly be true where the carrier offered only transportation, here Northeast gave Sperry an option to receive only money or a combination of money and transportation in satisfaction. Although this type of arrangement is further removed from a barter where only transportation is offered, still it is a barter and could easily lend itself to fraud by merely giving "lip service" to a provision giving the shipper an option.

³⁵ See *United States v. Louisville Bridge Co.*, 233 Fed. 270, 276 (W.D. Ky. 1916), where the court stated:

While in many instances Congress, had it seen fit to do so, might have ameliorated and softened some apparently harsh results . . . many instances of the ruthless results of legislation under the commerce clause of the Constitution have appeared where the courts, and especially the Supreme Court, have found no power to avoid them. The case of *Louisville & Nashville R.R. Co. v. Mottley* . . . is one of the most striking of these.

³⁶ *Supra* note 13.

³⁷ WATERMAN, SETOFFS AND COUNTERCLAIMS 334 (1872):

The reason why a setoff is only permitted to be exercised where the demands are fixed and ascertained by the admission of the parties, by judgment, or something equivalent, rendering equally certain the right and the amount, is obvious. "Were the exercise more general, as the proceeding is of a summary nature, the parties would be deprived of the ordinary modes for the trial of controverted claims, and of the established methods of review and redress for error."

³⁸ 149 U.S. 680 (1893).

regard to equality of rates which, in their practical application would be rendered nugatory, if this rule were given full effect.³⁹

Public policy occupied a similarly important position in *Mottley* and for this reason the case is a particularly apt precedent for the present case. The basis for the *Mottley* decision was the presumption of the opportunity for fraud, and this same presumption prevents *Chicago, I. & L. Ry. v. United States*⁴⁰ from being distinguished away. There the carrier had induced the shipper to occupy the position of the carrier's creditor by offering the exchange of its transportation for advertising. Sperry quite possibly already occupied the position of a Northeast creditor before any mention of the setoff was made. In such a situation the inducement would be lacking and hence no barter. Had the court upheld the setoff, the danger of fraud in similar subsequent transactions by covering up an actual inducement situation is so apparent that public policy behind the statute "forced" the court to recognize this factor.

In *Northeast*, the court indicates disapproval of any arrangement between air carrier and shipper providing for the use of setoffs of liquidated debts in exchange for transportation. And while the basis for the decision is a violation of section 403, underlying is the court's fear of fraud being perpetrated against the purpose of the statute. The court wishes to remain steadfast to the "purpose of Congress . . . to cut up by the roots every form of discrimination, favoritism and inequality."⁴¹ Actually the court is prohibiting formalized arrangements that evade, or make available avenues to evade, the purpose of section 403. The writer believes, however, that as a practical matter, the practice of bartering goes on between air carriers and their customers under an unwritten mutual reciprocity agreement. Suppliers to the air carrier will find that the carrier's need for their particular product will decrease markedly should the supplier choose to utilize the transportation of the carrier's competitor. Such informal "understandings" or quasi-barters are, however, outside the scope of the CAB's authority. Therefore, while the CAB can control formalized bartering originating from either the carrier or the shipper, reciprocal business considerations will prevent a form of barter by means of a setoff arrangement from being completely extinguished.

Charles J. McGuire

³⁹ *Id.* at 691.

⁴⁰ 219 U.S. 486 (1911). Decided the same day as *Mottley*, it combines with *Mottley* to form the basis of the court's decision in *Northeast*.

⁴¹ *Louisville & N.R.R. v. Mottley*, 219 U.S. 467, 478 (1911). In *Northeast* the court states that:

An interpretation of the statute which adopts, in effect, a rule of *per se* illegality . . . is defensible on the basis that it is essential to the statutory scheme of comprehensive regulation to preclude any possibility of integrated transactions being accomplished by being broken into ostensibly independent steps and, furthermore, to preclude saddling the Board with the necessity of policing or examining such business dealings between carriers and customers in order to ascertain whether a disguised step-transaction is or is not being effectuated by a carrier in any case in which an outright cash or check payment is not used. 345 F.2d at 667.

Administrative Law — Judicial Review — *Waterman* Doctrine

Petitioners, American Airlines, Trans World Airlines, and Pan American World Airways, challenged the Civil Aeronautics Board's issuance of certificates of public convenience and necessity¹ authorizing Saturn Airways and Capitol Airways to institute international "split charter" flights.² The certificates had been approved by the President pursuant to Federal Aviation Act provisions requiring presidential approval of certificates of public convenience and necessity dealing with overseas or foreign air transportation.³ The CAB action was contested by petitioners, first, as transgressing statutory authority and, second, as being invalid for lack of findings. The CAB contended that it had acted within its statutory authority in approving the "split charter" flights, and that the court was precluded from any further review by the *Waterman* doctrine.⁴ The Supreme Court held in *Chicago & So. Air Lines, Inc. v. Waterman S.S. Corp.*⁵ that orders issued by the Board which are subject to presidential approval embody an element of political decision, and a review by the courts would amount to an infringement of exclusive presidential authority in dealing with foreign affairs. *Held*: The courts may review a CAB order which has been approved by the President where the challenge is that the order exceeds statutory authority. Further, the Federal Aviation Act of 1958⁶ authorized the CAB to evolve a definition of the term "charter trips" to conform with the changing needs of the aircraft industry, and the Board did not transgress the perimeter of its statutory authority by promulgating a definition which includes "split charter" flights. *American Airlines, Inc. v. CAB*, 348 F.2d 349 (D.C. Cir. 1965).

In the *Waterman* case, the petitioner alleged that a CAB order denying him a certificate of public convenience and necessity was issued without the support of substantial evidence. The majority⁷ admittedly held, con-

¹ Transatlantic Charter Investigation, CAB Order Nos. E-20530 & 20531 (24 Feb. 1964).

² A "split charter" occurs when two eligible groups each charter half of a plane's capacity.

³ FEDERAL AVIATION ACT OF 1958, § 801, 72 Stat. 782 (1958), 49 U.S.C. § 1461 (1964): The issuance, denial, transfer, amendment, cancellation, suspension, or revocation of, and the terms, conditions, and limitations contained in, any certificate authorizing air carrier to engage in overseas or foreign air transportation, or air transportation between places in the same Territory or possession, or any permit issuable to any foreign air carrier under section 1372 of this title, shall be subject to the approval of the President.

⁴ *Chicago & So. Air Lines, Inc. v. Waterman S.S. Corp.*, 333 U.S. 103 (1948).

⁵ *Ibid.* For an interesting discussion of the system of presidential approval of CAB orders, see generally Calkins, *Acquisition of Operating Authority by Foreign Air Carriers: The Role of the CAB, White House, and Department of State*, 31 J. AIR L. & COM. 65 (1965).

⁶ FEDERAL AVIATION ACT OF 1958, § 101, 72 Stat. 737 (1958), 49 U.S.C. § 1301 (1964).

⁷ *Chicago & So. Air Lines v. Waterman S.S. Corp.*, *supra* note 4, at 110: "It may be conceded that a literal reading of § 1006 subjects this order to re-examination by the courts."

trary to the literal language of the Civil Aeronautics Act of 1938,⁸ that section 1006 of the act exempted from judicial review all orders granting or denying applications of citizen airlines to engage in overseas and foreign air transportation. The decision that such orders are not amenable to review followed from their being subject to presidential approval under the Civil Aeronautics Act.⁹ As a consequence, such orders are not reviewable prior to presidential approval because they are not final and, after presidential action, they are beyond judicial inquiry since they embody presidential discretion as to international affairs.

Four justices¹⁰ in *Waterman* joined in a vigorous dissent, protesting that the majority decision left no remedy for "lawless" action by the CAB, that is, even for action whereby the CAB violated the Civil Aeronautics Act itself.¹¹ They reasoned that presidentially approved CAB action authorizing domestic carriers to engage in foreign air transportation should be subject to review as long as the matter to be reviewed could be divorced from any substantial element of presidential discretion. It seems that the dissenting view is not dissimilar to that expressed in a much-cited case, *Banco De Espana v. Federal Reserve Bank*.¹² In *Banco* the court held that although the State Department has the power to make final determinations in foreign policy matters, the courts retain power to determine property questions provided they do not affect the international or diplomatic relations of the Government. At present, the Federal Aviation Act, which was enacted subsequent to *Banco* and *Waterman*, expressly excludes certificates of public convenience and necessity from the domain of property rights,¹³ a practice not uncommon in federal licensing.¹⁴ It appears that the *Banco* decision, which was concerned exclusively with the deprivation of property rights, would not be considered controlling in cases involving such certificates. *Banco* indicated, however, that there are instances in the field of foreign affairs in which discretionary elements can be validly separated from personal rights so that a judicial determination can be made

⁸ The provisions of § 1006 originally appeared in the Civil Aeronautics Act of 1938, 52 Stat. 1024 (1938), (now FEDERAL AVIATION ACT OF 1958, 72 Stat. 795 (1958), 49 U.S.C. § 1486 (1964)):

Any order, affirmative or negative, issued by the Board under this Act, except any order in respect of any *foreign* air carrier subject to the approval of the President as provided in section 801 of this Act, shall be subject to review by the circuit courts of appeals of the United States or the United States Court of Appeals for the District of Columbia upon petition . . . (Emphasis added.)

⁹ Civil Aeronautics Act of 1938, § 801, 52 Stat. 1014 (now FEDERAL AVIATION ACT OF 1958, § 801, 72 Stat. 782 (1958), 49 U.S.C. § 1461 (1964), *supra* note 3).

¹⁰ Justices Douglas, Black, Reed, and Rutledge.

¹¹ 333 U.S. at 118:

[N]o matter how extreme the action of the Board, the courts are powerless to correct it under today's decision . . .

Judicial review would assure the President, the litigants and the public that the Board had acted within the limits of its authority. It would carry out the aim of Congress to guard against administrative action which *exceeds statutory bounds*. (Emphasis added.)

¹² 114 F.2d 438 (2d Cir. 1940).

¹³ FEDERAL AVIATION ACT OF 1958, § 401(i), 72 Stat. 754 (1958), 49 U.S.C. § 1371(i) (1964): "No certificate shall confer any proprietary, property, or exclusive right in the use of any air space, civil airway, landing area, or air-navigation facility."

¹⁴ See, e.g., COMMUNICATIONS ACTS, 48 Stat. 1085 (1934), 47 U.S.C. § 309(h) (1964).

as to whether there has been an unconstitutional deprivation. Yet, the Court in *Waterman* did not consider the constitutional question in arriving at its decision. Perhaps the reasoning is that the right to engage in overseas and foreign air transportation, being within the President's authority in dealing with foreign affairs, is not so fundamental a right as to be protected by the Constitution.¹⁵

The majority view in *Waterman* has remained essentially unquestioned where the action of the CAB has been challenged for arbitrariness or lack of substantial evidence.¹⁶ However, no reported case has held *Waterman* controlling where the action of the Board was challenged for lack of statutory power. In addition to the instant decision, one recent case adds force to the proposition that the courts should not and will not abdicate their judicial responsibility to review Board action which transgresses statutory authority. In *Alaska Airlines, Inc. v. Pan Am. World Airways, Inc.*¹⁷ the court was faced with a situation in which the CAB might have been acting in contravention of the Federal Aviation Act. The Board was in the process of terminating a certificate of public convenience and necessity previously granted to Pan American. The act provides that such certificates can be revoked only for failure to comply with an order, rule, regulation, term, condition, or limitation issued by the Board.¹⁸ Pan American had not so failed, and the district court¹⁹ handed down a declaratory judgment in favor of Pan American limiting the CAB to action within the terms of the Federal Aviation Act. The Court of Appeals for the District of Columbia Circuit²⁰ vacated the district court decision, the basis of the ruling being that the CAB order was not final and, therefore, not reviewable, since it was still subject to presidential approval. Nevertheless, the court suggested²¹ that the order would be reviewable once issued by the Board and approved by the President.

In the present case, petitioner contended that the Federal Aviation Act did not authorize the CAB to issue certificates of public convenience and necessity for "split charter" flights. The court held that *Waterman* should be restricted to situations where the order is challenged for lack of substantial evidence or procedural due process. Hence, even though the judiciary cannot transgress the bounds of presidential authority by reviewing a particular CAB order which may or may not have been supported by

¹⁵ 4 DAVIS, ADMINISTRATIVE LAW TREATISE, § 28.19 (1958).

¹⁶ See, e.g., *Great Lakes Airlines, Inc. v. CAB*, 229 F.2d 437 (9th Cir. 1956); *United States Overseas Airlines, Inc. v. CAB*, 222 F.2d 303 (D.C. Cir. 1955).

¹⁷ 321 F.2d 394 (D.C. Cir. 1963).

¹⁸ FEDERAL AVIATION ACT OF 1958, § 401(g), 72 Stat. 754 (1958), 49 U.S.C. § 1371(g) (1964).

¹⁹ *Alaska Airlines, Inc. v. Pan Am. World Airways, Inc.*, 207 F. Supp. 152 (D.D.C. 1962).

²⁰ *Alaska Airlines, Inc. v. Pan Am. World Airways, Inc.*, 321 F.2d 394 (D.C. Cir. 1963).

²¹ *Id.* at 396:

Whether the President has statutory or constitutional authority to terminate Pan American's route authorization for reasons of public convenience and necessity is quite a different question from the one . . . [raised] in *Waterman*. That case neither settles nor illuminates more than faintly the issues which would face a court reviewing the authority of the Board or the President in this case to terminate Pan American's route authorization.

sufficient evidence, the judiciary can still validly review an order allegedly issued without statutory "power." The court interpreted *Waterman* as "clearly presupposing" lawful and congressionally authorized Board action "as an indispensable predicate, without which there is nothing Presidential action can approve."²² Judge Burger distinguished *United States Overseas Airlines, Inc. v. CAB*,²³ in which petitioner had unsuccessfully sought review of CAB action on the basis of an alleged violation of procedural due process. He reasoned that a decision to review an order challenged for lack of statutory "power" was not inconsistent with a refusal to review for lack of procedural due process.²⁴ The basis for the distinction was that allegations of denial of procedural due process go to the correctness of an award to a particular party rather than to the statutory "power" to issue the order. Pursuant to section 801,²⁵ CAB orders involving overseas and foreign air transportation are subject to approval by the President, and he must be free to consider all evidentiary matters, including a denial of procedural due process, and must be free to exercise unreviewable discretion concerning the relative weight to be given each evidentiary factor.

The *Waterman* decision is still very much in force, although its effect is certainly not as broad in scope as the dissenting opinion therein seems to surmise. It seems that as the law presently stands there is no judicial remedy for action by the CAB in respect to foreign air carriers or citizen air carriers engaging in overseas or foreign air transportation so long as the Board does not violate the provisions of the Federal Aviation Act. However, if the CAB acts in contravention of the statute and the order is approved by the President, the judiciary may hold the order void since it is a nullity when it reaches the President, and there is, in effect, nothing for him to approve. Although the court in *American Airlines* clearly stated that the President could not by his approval validate invalid orders issued by the Board,²⁶ it seems to contradict itself by hinting²⁷ that there might be situations in which a CAB order issued without statutory power could be validated through presidential approval. The implication is that if the President should approve a particular CAB order on the basis of foreign policy considerations, the court may refuse to determine whether the CAB acted outside the perimeter of statutory authority. With all due respect for the broad discretion which is properly accorded the President in dealing with foreign affairs, it is still difficult to visualize circumstances

²² *American Airlines, Inc. v. CAB*, 348 F.2d 349, 352 (D.C. Cir. 1965).

²³ 222 F.2d 303 (D.C. Cir. 1955).

²⁴ The orders in dispute in *USOA* had not been approved by the President so the holding of the case could have been restricted to the proposition that they were not reviewable since they were not final. This was the basis in *Waterman* for holding that orders still subject to presidential action were unreviewable. However, the court in *USOA* clearly indicated that even had the orders already been approved, the court would still have refused review, the reasoning being that the President should be free to exercise unreviewable discretion in dealing with procedural due process. In somewhat the same vein, the statement in *British Overseas Airways Corp. v. CAB*, 304 F.2d 952 (1962), in regard to unavailability of review "now or later" can be considered dictum. The *American Airlines* court restricts *BOAC* to the holding that the orders were not reviewable because they had not been acted upon by the President and thus, were not final.

²⁵ FEDERAL AVIATION ACT OF 1958, § 801, 72 Stat. 782 (1958), 49 U.S.C. § 1461 (1964).

²⁶ 348 F.2d at 352.

²⁷ *Id.* n.2.

which would authorize the courts to refuse to review CAB action which allegedly violates the terms of the Federal Aviation Act. It is one thing for a court to refuse to review an act of discretion exercised under the statute, for such discretionary act is by its nature a political action; however, it is quite another thing, and perhaps an abdication of the judicial process, to refuse to review not the action but the scope of the statute itself. As of now this question has not been directly encountered by the courts. Consequently, it remains to be decided whether the President can, by his approval of an invalid CAB order, change the black to white.

Michael M. Wade

Chattel Mortgages — Federal Aviation Act — Federal Recordation

Plaintiff, Texas National Bank of Houston, loaned a retail aircraft dealer, Cummings and Groves (Cummings), ninety per cent of the purchase price of all aircraft which it purchased. In exchange, the bank obtained a personal sixty-day note and a floor plan chattel mortgage on each aircraft. The mortgages were filed for record with the county clerk of Harris County, Texas, and recorded with the Federal Aviation Agency in Oklahoma City pursuant to the provisions of Section 503 of the Federal Aviation Act of 1958.¹ Subsequently, Cummings sold one of the aircraft to the defendants, Calvin Aufderheide and John McCauley, and allowed them to take possession and remove it to their residence in Arkansas. Cummings deposited the defendants' check with the plaintiff bank, but did not direct payment of its obligation out of the proceeds. Unable to collect on the note, the bank brought suit to regain possession of the aircraft. *Held*: The mortgage was inoperative under the general rule that mortgages on chattels exposed to daily retail sale are void, and recordation with the FAA will not validate a mortgage inherently invalid. *Texas Nat'l Bank v. Aufderheide*, 235 F. Supp. 599 (D. Ark. 1964).

The complexity involved in determining the validity of aircraft conveyances has long been recognized by Congress. In 1938 it enacted title V of the Civil Aeronautics Act² establishing a national recording system for all instruments affecting title to or interest in domestic civil aircraft. In so doing, Congress clearly preempted the field of conveyancing of interest in aircraft to facilitate the control and promotion of air commerce.³ Congress felt that the recordation provisions of the Civil Aeronautics Act were definitely within the proper application of federal law in a field of federal competence.⁴ These provisions were substantially re-enacted in the Federal Aviation Act of 1958,⁵ plus the addition of a new

¹ 72 Stat. 772 (1958), as amended, 49 U.S.C. § 1403 (1964).

² Civil Aeronautics Act of 1938, §§ 501-05, 52 Stat. 973 (1938).

³ *Pacific Fin. Corp. v. Central Bank & Trust Co.*, 296 F.2d 68, 71 (5th Cir. 1961); *United States v. United Aircraft Corp.*, 80 F. Supp. 52 (D. Conn. 1948).

⁴ *Continental Radio Co. v. Continental Bank & Trust Co.*, 369 S.W.2d 359, 362 (Tex. Civ. App. 1963) *error ref. n.r.e.*

⁵ FEDERAL AVIATION ACT OF 1958, § 503 (a)-(d), 72 Stat. 772 (1958), 49 U.S.C. § 1403 (a)-(d) (1964). The following are the pertinent sections of the act:

(a) The Administrator shall establish and maintain a system for the recording of each and all of the following:

(1) Any conveyance which affects the title to or an interest in any civil aircraft of the United States. . . .

(b) The Administrator shall also record under the system provided for in Section (a) of this section any release, cancellation, discharge or satisfaction relating to any conveyance or other instrument recorded under said system.

(c) No conveyance or instrument, the recording of which is provided for by Section 503 (a) shall be valid in respect to such aircraft, aircraft engine or engines, propellers, appliances or spare parts against any person other than the person by whom the con-

section concerning the issuance of dealers' aircraft registration certificates by the Administrator.⁶ The reenacted provisions provide that no conveyance or instrument affecting aircraft will be valid unless filed for recordation in accordance with the specific procedure enumerated in the act, except as to parties to the instrument or persons with actual knowledge of its existence. Consequently, to determine whether there is a valid encumbrance on any aircraft, it is only necessary to check the central file in Oklahoma City. This federal registration requirement is applicable to all civil aircraft including those operating intrastate as well as interstate.⁷ When an instrument is filed for recordation under section 503 of the act, all persons are deemed to have notice of its existence and its effect on the title to the property concerned.

Although the existing law had assisted materially in facilitating the recordation of security instruments, it did not determine their substantive validity; to determine this, one still had to look to the state statutes. The courts, in attempting to apply the proper state law, were faced with determining which state law should be applied. Apparently some courts chose to apply the law of the state in which the property was located. Other courts chose the state in which the parties resided, or in which the instrument was executed and delivered. In order to alleviate the problem, Congress amended the Federal Aviation Act.⁸ The new provision, section 506, provides a uniform federal rule that the validity of instruments affecting title to or interest in aircraft is to be governed by the law of the state in which the documents are delivered, irrespective of the location, or the place of delivery, of the property covered. If a place of delivery is designated in the instrument, there is a presumption that the instrument was delivered at the place so specified. As a result of section 506, the courts are now able to apply a uniform rule in determining the substantive validity of such instruments.

In *Aufderbeide* the court did not base its holding on the common or statutory law of Texas, but on a general and, the court thought, salutary

veyance or other instrument is made or given, his heir or devisee, or any person having actual notice thereof, until such conveyance or other instrument is filed for recordation in the office of the Administrator. . . .

(d) Each conveyance or other instrument recorded by means of or under the system provided for in sub-sections (a) or (b) of this section shall from the time of its filing for recordation be valid as to all persons without further or other recordation, except that an instrument pursuant to Section 503(a)(3) shall be effective only with respect to those of such items which may from time to time be situated at the designated location or locations and only while so situated; provided, that an instrument recorded under Section 503(a)(2) shall not be affected as to the engine or engines, or propeller or propellers, specifically identified therein, by any instrument theretofore or thereafter recorded, pursuant to Section 503(a)(3). . . .

⁶ FEDERAL AVIATION ACT OF 1958, § 505, 72 Stat. 744, 49 U.S.C. § 1405 (1958).

⁷ *Blalock v. Brown*, 78 Ga. App. 537, 51 S.E.2d 610 (1949). See Annot., 9 A.L.R. 2d 476 (1949) for a discussion of this area.

⁸ FEDERAL AVIATION ACT OF 1958, § 506, 78 Stat. 236, 49 U.S.C. § 1406 (1964):

The validity of any instrument the recording of which is provided for by Section 503 of this act shall be governed by the laws of the State, District of Columbia, or territory or possession of the United States in which such instrument is delivered, irrespective of the location of place of delivery of the property which is subject to such instrument. Where the place of intended delivery of such instrument is specified therein, it shall constitute presumptive evidence that such instrument was delivered at the place so specified.

principle of law which it felt should be given recognition in applying section 503.⁹ The court felt that where there is no agreement to the contrary, consent to sell mortgaged property consisting of a stock of goods is implied when the mortgagor is permitted to remain in possession of the property and such property is daily exposed and offered for sale by the mortgagor in the ordinary course of business.¹⁰ In support of this proposition, the court cited Section 9-307 of the Uniform Commercial Code,¹¹ although Texas did not adopt the Code until after the *Aufderheide* decision.¹² The court further reasoned that a purchaser should be able to rely on a dealer's right to sell an aircraft and should not be required to make a search of the records before purchasing the aircraft. Further, the court pointed out that a purchaser need not determine whether a merchant has obtained a valid release of the item from a bank floor plan before accepting delivery. The requirement of consent is waived if the mortgagee knowingly permits the violation of the floor plan chattel mortgage provision prohibiting removal of mortgaged aircraft by authorized dealers without the mortgagee's written consent.¹³ In *Aufderheide*, the plaintiff bank had allowed the mortgagor to retain possession of the aircraft which the bank knew would be daily exposed for sale in the course of the mortgagor's business. Monies received by the mortgagor upon sale of the aircraft were deposited to its own account, to be applied later in settlement with the bank. Under such circumstances the court found that the mortgagor had at least the implied consent of the bank to sell the aircraft notwithstanding the prohibition contained in the mortgage. When the defendants purchased the aircraft, the bank was estopped to assert any rights which it had under the mortgage.

Although Congress preempted the recordation of aircraft conveyances, it provided that state law should be controlling as to the substantive validity of any security instrument. Under section 503, the court should have applied Texas law. It would have arrived at virtually the same decision, because Texas has a statutory provision similar to the general principle of property law cited in support of the court's position.¹⁴ The mortgage existing between the plaintiff and Cummings was inoperative and considered to be fraudulent in law.¹⁵ When the defendant purchased in

⁹ *Sechrist-Hall Co. v. Harlingen Nat'l Bank*, 368 S.W.2d 155 (Tex. Civ. App. 1963) *error ref. n.r.e.* *Donohue Inv. Co. v. H. E. McMasters Co.*, 301 S.W.2d 330 (Tex. Civ. App. 1957).

¹⁰ See generally 14 C.J.S. *Chattel Mortgages* § 262(6) (1939).

¹¹ It can be seen from § 9-104 of the Uniform Commercial Code that the Code does not apply to any transaction which is subject to any statute of the United States, to the extent that such statute governs the rights of parties affected by transactions in particular types of property. Filing under 49 U.S.C. §§ 1401-05 (calling for the registration of the title to, and liens upon, aircraft with the Federal Aviation Agency) is recognized as the equivalent to filing under § 9-302 of the Code.

¹² The Code will become effective 1 July 1966. Vernon's Tex. Sess. Law Serv. Ch. 721 (1965).

¹³ *Texas Nat'l Bank v. Aufderheide*, 235 F. Supp. 599 (D. Ark. 1964). See generally 15 Am. Jur. 2d *Chattel Mortgages* § 155 (1964).

¹⁴ TEX. REV. CIV. STAT. ANN. art. 4000 (1949): "Every mortgage . . . daily exposed to sale . . . in the regular course of business of such merchandise, and contemplating a continuance of the possession of said goods by said owner, shall be deemed fraudulent and void. . . ."

¹⁵ *A. Peiser & Co. v. Peticolas*, 50 Tex. 638 (1879):

Fraud in Law is defined to be such acts or contracts as, although not originating in any actual evil design or contrivance to perpetrate a positive fraud upon other per-

good faith and for a valuable consideration, he took title to the aircraft and cut off the bank's lien. The mere fact that the plaintiff had registered the mortgage agreement under federal requirements did not make it valid.¹⁶

Aufderheide demonstrates two significant points in connection with the federal preemption of the recordation of aircraft security documents. First, state statutes are to govern the original validity of mortgages and various other instruments pertaining to aircraft. Second, the federal act apparently does not attempt to affect the validity of these instruments, but was intended to furnish a central location where claims of liens could be filed. Therefore, filing with the FAA in compliance with section 503(c) of the act is essential if a valid instrument is to constitute notice to subsequent purchasers and creditors. However, filing will accord no validity to an instrument invalid under state law. As long as the state law controls the substantive validity of mortgage instruments, recordation of these instruments, although federally controlled, will afford mortgagees little security. In order to protect banks and other financial institutions concerned with the financing of aircraft from future losses which might be sustained in light of this court's ruling, further legislation is required. Amendment of the Federal Aviation Act to provide for a uniform federal rule controlling the substantive validity of security instruments should be made. Upon default of a merchant, banks and other financing institutions should be able to look to the retail purchaser for repossession of the chattel. Any purchaser who wished to afford himself protection against this repossession could do so by merely placing a call to the central office in Oklahoma City prior to the purchase thereby ascertaining any encumbrances outstanding on the chattel.

Ben J. Kerr III

sons, or to violate private or public competence, or to impair or injure the public interests, deemed equally reprehensible with positive fraud, and therefore are prohibited by law as within reasons as acts done mala animo.

¹⁶ See *Aircraft Inv. Corp. v. Pezzoni & Reid Equip. Co.*, 205 F. Supp. 80, 82 (E.D. Mich. 1962) where the court stated:

In providing for the recordation of various instruments pertaining to transactions affecting title or interest in aircraft, Congress has not impaired the existence and effectiveness of state laws creating and defining such instruments. . . . Thus if the purported chattel mortgage is void as to defendant under the appropriate state law, federal recording will not save it. Even if defendant had notice of plaintiff's mortgage, it may still be able to show reliance on conduct by the plaintiff amounting to a waiver of the mortgage lien. . . .

Accord, *Production Credit Ass'n v. Mahan*, 168 S.W.2d 903 (Tex. Civ. App. 1943). See generally 12 Tex. Jur. 2d *Chattel Mortgages* § 37 (1960).

RECENT DECISIONS

LABOR LAW—FREEDOM OF SPEECH—
INFORMATIONAL PICKETING

In October 1965, mechanics represented by Air Transport Local 512, a labor organization within the Railway Labor Act, began an economic strike against their employer, Chicago Helicopter Airways. The company leases space from the City of Chicago in the terminal building at O'Hare International Airport where it maintains a passenger service counter. Seeking to inform the public of the labor dispute, the union placed one picket in the vicinity of Helicopter's counter, utilizing a body "sandwich type" sign rather than a placard. The city has the policy of not authorizing pickets, solicitors, peddlers or hawkers, and others not having business at the airport, within the confines of the terminal building. The union picket was escorted from the building by Chicago police, but he would have been permitted to picket on the sidewalk outside the entrances to the building. Contending that they were exercising a constitutional privilege of free speech, the union sought to enjoin the interference by the City. *Held*: The terminal is an extremely important public facility. The interest of the public in efficient transportation outweighs the picket's exercise of his right to free speech within the confines of the building. *Nelson ex rel. Air Transport Local 512, TWU v. City of Chicago*, 9 AV. L. REP. 17,878 (N.D. Ill. 21 Oct. 1965).

In reaching its decision, the court merely weighed the respective rights and interests, that of the labor union to engage in informational picketing and of the city to manage the airport. Although the union argued that picketing outside the terminal would be ineffective because Helicopter's passengers might never go outside the building, the court found this to be outweighed by the "rights of others to have unimpeded access to transportation and other airport facilities." Although informational picketing is often permitted at a "common situs" such as the exterior of stores in a shopping center, the decision shows the inapplicability of that doctrine to ticket counters in a congested airport terminal building.

J.E.M.

WARSAW CONVENTION—LIMITATION ON LIABILITY—
NOTICE TO PASSENGERS

During 1961 Flying Tiger Lines entered into a "call contract" with the United States Military Air Transport Service (MATS) to provide transportation for government personnel. In early 1962, MATS issued a service order to Flying Tiger requesting air transportation for ninety-nine persons from Travis Air Force Base, California, to Saigon, Vietnam. The passengers were selected by MATS and each was given a MATS boarding pass and claim check. At the foot of the boarding ramp the passengers were given

a boarding ticket by a Flying Tiger stewardess, and were instructed to write their boarding ticket numbers on their claim checks. The front of this boarding ticket stated that the transportation was subject to the liability limitations of the Warsaw Convention, and other conditions of the Convention were printed on the back of the ticket in very fine print. The MATS boarding pass, however, contained no mention of the Convention or the liability limitation. After the boarding tickets were issued, the servicemen were required to board the plane immediately and were not given an opportunity to read the ticket and return to the terminal to purchase flight insurance. The plane vanished enroute to Vietnam and the personal representatives of the passengers sought recovery under the Death on the High Seas Act. The lower court held that the Warsaw Convention was applicable and that sufficient notice of the liability limitation had been given to the passengers.¹ *Held, reversed and remanded*: delivery of the passenger ticket was not made sufficiently in advance of the flight to allow passengers adequate time to purchase additional insurance. *Warren v. Flying Tiger Line, Inc.*, 352 F.2d 494 (9th Cir. 1965).

Article 3 of the Warsaw Convention requires delivery of a ticket and provides that failure to deliver a ticket results in a waiver of liability limitation by the carrier. In holding that Flying Tiger did not give adequate notice, the Ninth Circuit relied primarily on *Mertens v. Flying Tiger Line, Inc.*² where the passenger ticket was delivered to Mertens after he had boarded the plane. The Second Circuit held that delivery of the ticket under these circumstances was insufficient and the damages limitation of the Warsaw Convention was inapplicable. The holding by the Ninth Circuit in *Warren* appears to be a logical extension of *Mertens* and that airlines must now give notice of the Convention's applicability in the form of a passenger or boarding ticket sufficiently in advance of the flight to allow passengers to make allowances for the liability limitation. It would seem that further extension of the notice requirements established in *Warren* would not be in line with Article 3 of the Convention, which merely requires "delivery." However, situations where *Mertens* and *Warren* will be applied will depend largely upon the facts in each case.

E.A.P.

FEDERAL AVIATION ACT—CAB AUTHORITY OVER HAWAII— INTERISLAND FLIGHTS

In August 1961, Island Airlines, Inc. (Island) secured an order from the Public Utilities Commission of Hawaii fixing its rates for flights between the major islands of Hawaii. Without securing a certificate of convenience and necessity from the Civil Aeronautics Board authorizing it to engage in air transportation, and without attempting to comply with Section 401(a) of the Federal Aviation Act of 1958, Island began carrying pas-

¹ *Warren v. Flying Tiger Line, Inc.*, 234 F. Supp. 223 (S.D. Cal. 1964).

² 341 F.2d 851 (2d Cir. 1965).

sengers between the major islands. When Island persisted in its flights after notification by the CAB that it was operating in violation of section 401(a), the CAB filed a complaint, seeking a declaratory judgment and permanent injunction. *Held*: Injunction granted; the flights were in interstate commerce subject to the authority of the CAB. Island was required to get a federal certificate of convenience and necessity. *Island Airlines, Inc. v. CAB*, 352 F.2d 735 (9th Cir. 1965).

The boundaries of a state are determined by Congress, and not by international law. Of course, Congress is not precluded, in creating the boundaries, from following and adopting international law. Where Congress has failed to delineate the boundaries with certainty, the courts must define them and in doing so they may apply international law. Since Congress had not established the channels between the islands of Hawaii as being within the boundaries of the state, it remained for the court to determine whether Hawaii had acquired these channels as historic waters acquired by prescription. In determining whether a state has acquired an historic title to a maritime area under international law, at least three factors are considered: (1) the exercise of authority over the area by the state claiming the historic right, (2) a continuity of this exercise of authority, and (3) the attitude of foreign states. The nation of Hawaii had not exercised such continuing sovereignty and, therefore, had not established a prescriptive historical right to the interisland channels. When the islands were ceded to the United States, no right to the waters beyond the traditional three-mile limit was transferred, nor has the United States claimed such rights. It follows that when Island flew over the channels it was compelled to fly outside the state's boundaries and over the high seas, thereby engaging in "interstate air commerce" within the meaning of the Federal Aviation Act. This case provides a definitive ruling on the question of sovereignty over the interisland channels of Hawaii and the regulation of flights over them.

L.M.F.

CONFLICT OF LAWS—*LEX LOCI* THEORY— DAMAGES LIMITATION

Plaintiff's decedent was a passenger aboard defendant's aircraft which crashed in Missouri during a flight from Oklahoma to Indiana. The evidence indicated that the proximate cause of the accident was the result of negligence occurring solely in Missouri. Missouri has a statutory limitation of \$25,000 in wrongful death actions; however, the Oklahoma district court in which the action was brought entered judgment for \$250,000. Defendant's argument on appeal was that the Missouri statute limiting liability was controlling. *Held*: Judgment affirmed, on condition that plaintiff enter a remittitur of \$225,000. The substantive law of the place where the injury occurred (*lex loci*) governs the amount of damages awarded in

a suit instituted in a "foreign" jurisdiction. *Cherokee Laboratories, Inc. v. Rogers*, 398 P.2d 520 (Okla. 1965).

The substantive rights of parties in a tort action have normally been governed by the law of the place where the injury occurred or where the wrong causing that injury was committed. This traditional rule, or *lex loci* theory, is the result of an extended parade of cases from many jurisdictions. Substantive rights have always been distinguished from procedural matters which are controlled by the law of the forum in which the action is instituted (*lex fori*). According to adherents to the *lex loci* theory, damages are considered to be a substantive "right," and thus subject to the *lex loci*. This case is among the majority when one considers the sheer number of opinions in this field, but does not reflect the significant trend toward "avoiding" or overruling the *lex loci* rule in favor of a yet unresolved replacement.

For a discussion of the new trend, see Note, 31 J. AIR L. & COM. 275 (1965), discussing *Griffith v. United Air Lines, Inc.*

J.T.L.