

No. 93, Hercules Gasoline Co. v. Commissioner

Accepting Helvering v. Northwest Steel Mills, 311 U. S. 46, completely, I am unable to agree that this contract with preferred stockholders was other than a "routine contract dealing with ordinary debts." Certainly this is not an instance of a "statutory obligation" which are the words used in the Northwest case to describe the antithesis of the contract covered. "Routine" and "ordinary," as used in Northwest, do not imply to me anything more than an express contract, executed in accordance with Section 26(c)(1).

The exemption provisions of Section 26(c) make no exceptions because the debt of the corporation is owned by a stockholder. If such an exception is to be deduced from the purpose behind the words of the section, it should not be applied to such preferred stockholders as ~~these~~ ^{like} because their interest is that ^{of} a creditor. ~~As I~~ ^{1/} believe the statutory requirements are met, I should reverse.

See in accord,

1 This accords with the prevailing view of the courts. Lehigh Structural Steel Co. v. Commissioner, 127 F. 2d 67; Buda International Corp. v. Commissioner, 143 F. 2d 794; Philadelphia Record Co. v. Commissioner, 145 F. 2d 613; Rex-Hanover Mills Co. v. United States, 53 F. Supp. 235. See Eljer Co. v. Commissioner, 134 F. 2d 251, 255.

And trustee
for Gen'l
Mortgage
Bonds

E.W.

The petitioners in these five cases are the owners of claims against the debtor, Denver & Rio Grande Western Railroad Company, or against a secondary debtor, the Denver & Salt Lake Western Railroad Company. The respondents are the two debtors just named, hereinafter sometimes referred to as the Denver, and the Trustee of the Missouri Pacific Railroad Company, a large owner of common stock of the principal debtor.

The debtors sought reorganization in the District Court of the United States for the District of Colorado under Section 77 of the Bankruptcy Act, ^{1/} on November 1, 1935. The Interstate Commerce Commission approved the plan of reorganization under consideration in this review on June 14, 1943. ^{2/} The District Court approved the plan October 25, 1943. ^{3/} It was then submitted by the Commission to the creditors of the classes deemed entitled to vote for acceptance or rejection of the plan and a certificate of the result filed in the District Court on July 15, 1944. All classes of voting creditors approved the plan as required by Section 77 except the holders of the Denver's general mortgage bonds. ^{4/} On November 1, the District Court held the rejection of the plan by the holders of the general mortgage was not reasonably justified. ^{5/} and thereafter confirmed the plan on November 29, 1944. Section 77(e).

January 16, 1946.

In the second draft of the Kirby opinion, Nos. 56 and 197, October Term 1945, an attempted distinction between the Elbe case and the assumed case on p. 4 exists but has not been amplified or spelled out. It should be noted in considering any other "net profits" case which comes here.

The distinction is this. In the Elbe case, it was a sale of personalty, rights and privileges of extraction--leases. The court held that it was a sale and refused to allow depletion to the assignor recipient of the net profit. In the Kirby case and in the assumed case (p. 4 of the slip opinion, second draft) where the assumed annual rent was net profit, the documents were leases.

When the earlier cases referred to in the Kirby opinion said that the form of the ownership of the minerals was not material so long as the economic interest existed, they may have been thinking of whether or not a lease which grants the privilege of oil extraction transfers the title to the oil in place. In some states it does and in others it does not. I think that there is a different concept, however, as to the controlling effect of the character of ownership when we deal with sales and leases, apart from the idea of who gets title to the oil or mineral in place. In such cases, it is the documents themselves which determine whether there has been a sale or a lease. In the Elbe case there was a sale and therefore logically the net profit received as the purchase price could not be subject to depletion. In the Kirby case, which is assumed to be like a case where net profit was the only return for the privilege of exploitation, there was a lease and since by assumption it makes no difference whether the lease transfers the title to the oil in place or not, the lease with a net profit in payment for the right of exploitation reduces the economic interest of the lessor in the oil in place and therefore is subject to depletion.

In the West case, Nos. 667-70, 1945 Term, there was a deed which transferred the real estate and $\frac{5}{8}$ of the royalty but reserved to the grantors $\frac{3}{8}$ of the royalties and therefore there was clearly reserved to the grantors an economic interest to the oil in place. This West deed was a sale in every respect in so far as the land and $\frac{5}{8}$ of the royalties were concerned and a reservation of economic interest in the oil so far as $\frac{3}{8}$ is concerned.

If it be assumed that royalty and net profits stand always on the same basis, a net profit instead of a royalty in the West case would produce the same result--that is, the West deed with a reservation of a net profit only would leave the net profit subject to depletion. My distinction, however, is that where you have a deed with a royalty reservation, it is obviously an economic interest in the oil. While, when you have a deed with a reservation of a net profit derived from the oil, it is less distinctly an economic interest and really falls on the Elbe side of the line.

SR

Proceeding upon the principle accepted in the Western Pacific and Milwaukee cases,^{19/} that capitalization based upon earnings is a permissible method of valuation in reorganization, the Commission fixed \$155,173,127 as the sound capitalization. This capitalization under the terms of the issues, with provisions for a capital fund and a sinking fund for the first mortgages carries annual charges of \$6,211,250 before dividends on common. See note 6. The decision was unanimous except for one Commissioner who considered the valuation too high by ten per cent.

254 I.C.C. at 379.

There can be no doubt that as of June, 1943, there was ample evidence to justify the valuation made by the Commission.

Allocation of Securities. Within the framework of that valuation, the Commission allotted the available securities to the claimants. Securities, including the common stock, were given a face value. The aggregate was too small to allow anything to former stockholders. ^{20/} Thus they were eliminated from the reorganization. ^{21/}

For the holders of the general bonds, common stock was available to the amount of ten per cent only of their claim. ^{22/} A glance at the proposed distribution in note 6 will show that the claimants did not receive all the new senior securities in the strict order of their old priorities.

The value of a lien on a part of a railroad when the valuation is made from earnings cannot be fixed solely on a mileage basis. Nor is it practicable to issue new securities with a lien limited to the property that was covered by the old lien. There must be segregation of the system earnings to each existing lien and allocation of securities representing the system value to each class of claimants. This was done here as shown in the second table in note 6. ^{23/} Such a method is in full accord with the principle that senior creditors are to retain their relative priority of position in a reorganization. Group of Investors v. Milwaukee R. Co., 318 U. S. at 561-64. Furthermore, junior claims can

receive nothing until the senior claims receive securities of a worth or value equal to their indebtedness. 318 U. S. at 483; 318 U. S. at 569. The generals are definitely junior. 233 I.C.C. at 524.

The Commission did not make a finding that the cash value of the securities awarded the senior claimants as of the effective date of the plan equalled the face of the claims. It did, however, carefully state its reasons for concluding that the compensation "flowing under the plan to the various classes of bondholders for the rights surrendered by them" was adequate in the light of the absolute priority rule. 254 I.C.C. at 360. For those classes, other than the junior generals, that received common stock, the Commission said that the possibility of "unlimited dividends on common stock" was a factor in offsetting loss of position.^{24/} Thus it is clear that when the Commission made its allocations it had definitely in mind that one thing that gave the senior creditors compensation for the admission of junior claimants to participation in securities before the seniors obtained full cash payment was their chance to share in the unlimited dividends that might be earned and paid on the common stock. It should be noted that income applicable to dividends was at its highest in 1942 prior to the approval of the plan by the Commission in June, 1943. Therefore the abnormal earnings of 1942 were in the Commission's contemplation when it spoke of the opportunities for "unlimited dividends."

There is another important factor, corollary to stock ownership to be noted in the Commission's allocation of these securities.

This factor is that the creditors who received common stock to make them whole obtained with that common stock an interest in all cash

on hand or all cash that might be accumulated. Of course, the Commission thoroughly understood this. In fact, it referred to the ten

million plus of cash on hand as of January 1, 1943. 254 I.C.C. ____.

Cash, material and supplies, as well as all other assets of the debtor

were represented by the securities. If money was used to pay indebted-

ness, there would be a corresponding reduction in the capital structure.

Therefore the plan provided, 254 I.C.C. at 386:

"The new company shall be deemed to have come into possession of the properties as of the effective date of the plan.

" . . . The capitalization of the new company, as of January 1, 1943, after consummation of the plan . . . shall consist substantially of the following securities, excluding those to be pledged, the amounts stated being subject to reduction to the extent, if any, that matured interest proposed to be funded in the plan is paid, and as equipment obligations or other liabilities are paid or reduced"

Cash and War Earnings. The Circuit Court of Appeals was of the

view that

FOOTNOTES

1 11 U.S.C. §205.

2 The plan is printed in Denver & R. G. W. R. Co. Reorganization, 254 I. C. C. 349. See for former decisions of the Commission in this reorganization, 233 I. C. C. 515; 239 I.C.C. 583; 254 I. C. C. 5.

3 C.C. H. Bankruptcy Law Service ¶ 54,562.

4 The Denver & Rio Grande Western Railroad Company is referred to herein as the debtor or the Denver; The Denver & Salt Lake Western Railroad Company as Salt Lake Western; The Denver & Salt Lake Railway Company as the Salt Lake; The Rio Grande Junction Railway Company as the Junction.

5 In Re Denver & R. G. W. R. Co., 62 F. Supp. 384.

6 254 I.C.C. at 354 to 357.

Full details appear in the plan as well as explanation of certain items in the following tables. The tables are printed here to give the reader a convenient summary of the plan. 254 I.C.C. 382-83.

Capitalization and annual charges

	On basis of consoli- dation with Denver & Salt Lake		Denver & Rio Grande Western without Denver & Salt Lake	
	Principal	Annual charges	Principal	Annual charges
Equipment-trust obligations -----	\$5,758,000	\$139,989	\$5,758,000	\$139,989
Chase National Bank note -----	2,158,458	45,722	2,158,458	45,722
R. F. C. claim -----	-----	-----	13,900,605	556,024
Denver & Salt Lake first-mortgage bonds, 4 percent interest -----	1,500,000	60,000	-----	-----
Denver & Salt Lake income bonds, 3-1 percent interest -----	9,734,000	292,020	-----	-----
	19,150,458	537,731	21,817,063	741,735
New first-mortgage bonds, 3-1 percent interest -----	38,573,680	1,157,210	33,373,680	1,001,210
Total fixed interest -----	57,724,138	1,694,941	55,190,743	1,742,945
Capital fund, maximum payment ---	-----	750,000	-----	750,000
Prior contingent interest, 1 percent -----	-----	498,318	-----	348,978
Sinking fund for first-mortgage bonds, one-half of 1 percent --	-----	200,489	-----	182,323
		3,143,748		3,024,246
New income bonds, 4½ percent ----	29,750,184	1,364,133	21,049,579	972,606
Sinking fund for income bonds, one-fourth of 1 percent -----	-----	76,808	-----	58,527
Total debt, interest, payments to funds -----	87,474,322	4,584,689	76,240,322	4,055,379
New 5-percent preferred stock, par value \$100 -----	32,531,220	1,626,561	32,120,120	1,606,006
New common stock, par value \$100--	35,167,585	-----	35,167,585	-----
Total capitalization -----	155,173,127		143,528,027	

Distribution of new securities per \$1,000 of present bonds with accrued interest

	First- mortgage bonds	Income bonds	Preferred stock	Common stock
Rio Grande Western first trusts (\$15,190,000) -----	\$970.20	\$349.80	-----	-----
Rio Grande Western consolidated's (\$15,080,000) -----	-----	266.00	\$970.90	\$93.10
Junction firsts (\$2,000,000) -----	1,061.96	317.21	-----	-----
Denver & Rio Grande consolidated 4's (\$34,125,000) -----	318.92	217.08	321.60	482.40
Denver & Rio Grande consolidated 4½'s (\$6,382,000) -----	329.03	223.97	331.80	497.70
Refunding and improvement 5's (\$12,000,000) -----	250.01	159.61	310.75	692.13
Refunding and improvement 6's (\$2,000,000) -----	264.61	168.94	328.90	732.55
General 5's (\$29,808,000) -----	-----	-----	-----	146.10

Claims

	Claims as of Jan. 1, 1943	Undisturbed or extended
Equipment obligations -----	\$5,758,000	\$5,758,000
Rio Grande Western first-trust 4's -----	20,050,800	-----
Rio Grande Western consolidated 4's -----	20,056,400	-----
Rio Grande Junction first 5's -----	2,758,333	-----
Denver & Rio Grande consolidated 4's -----	45,727,500	-----
Denver & Rio Grande consolidated 4½'s -----	8,823,115	-----
Refunding and improvement 5's -----	16,950,000	-----
Refunding and improvement 6's -----	2,990,000	-----
General-mortgage 5's -----	43,548,155	-----
Chase National Bank note -----	2,158,458	2,158,458
R. R. Credit Corporation note; paid May 17, 1943 -	-----	-----
R. F. C. notes -----	13,900,605	-----
Unsecured claims, approximate -----	440,000	no equity
Total, Denver & Rio Grande Western -----	183,161,366	7,916,458

7 Ecker v. Western Pac. R. Co., 318 U. S. 448, 477-83; Group of Investors v. Milwaukee R. Co., 318 U. S. 523, 539-41.

8 See 318 U. S. at 543.

9 Applicable provisions of §77, 11 U.S.C. §205, are as follows:

"(b) A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; (2) may include provisions modifying or altering the rights of stockholders generally, or of any class of them, either through the issuance of new securities of any character, or otherwise; (3) may include, for the purpose of preserving such interests of creditors and stockholders as are not otherwise provided for, provisions for the issuance to any such creditor or stockholder of options or warrants to receive, or to subscribe for, securities of the reorganized company in such amounts and upon such terms and conditions as may be set forth in the plan; (4) shall provide for fixed charges (including fixed interest on funded debt, interest on unfunded debt, amortization of discount on funded debt, and rent for leased railroads) in such an amount that, after due consideration of the probable prospective earnings of the property in light of its earnings experience and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof; . . .

"(d) The debtor, after a petition is filed as provided in subsection (a) of this section, shall file a plan of reorganization within six months of the entry of the order by the judge approving the petition as properly filed, . . . After the filing of such a plan, the Commission, unless such plan shall be considered by it to be prima facie impracticable, shall, after due notice to all stockholders and creditors given in such manner as it shall determine, hold public hearings, at which opportunity shall be given to any interested party to be heard, and following which the Commission shall render a report and order in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet with the requirements of subsections (b) and (e) of this section, and will be compatible with the public interest; or it shall render a report and order in which it shall refuse to approve any plan. In such report the Commission shall state fully the reasons for its conclusions.

"(e) Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; . . .

". . . If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect, and shall send a certified copy of such opinion and order to the Commission. The plan shall then be submitted by the Commission to the creditors of each class whose claims have been filed and allowed in accordance with the requirements of subsection (c) of this section, and to the stockholders of each class, and/or to the committees or other representatives thereof, for acceptance or rejection, within such time as the Commission shall specify, together with the report or reports of the Commission thereon or such a summarization thereof as the Commission may approve, and the opinion and order of the judge: Provided, That submission to any class of stockholders shall not be necessary if the Commission shall

have found, and the judge shall have affirmed the finding, (a) that at the time of the finding the corporation is insolvent, or that at the time of the finding the equity of such class of stockholders has no value, or that the plan provides for the payment in cash to such class of stockholders of an amount not less than the value of their equity, if any, . . . Provided further, That submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, that the interests of such class of creditors will not be adversely and materially affected by the plan, or that at the time of the finding the interests of such class of creditors have no value, or that the plan provides for the payment in cash to such class of creditors of an amount not less than the value of their interests. . . . The Commission shall certify to the judge the results of such submission.

"Upon receipt of such certification, the judge shall confirm the plan if satisfied that it has been accepted by or on behalf of creditors of each class to which submission is required under this subsection holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan, and by or on behalf of stockholders of each class to which submission is required under this subsection holding more than two-thirds of the stock of such class which has been reported in said submission as voting on said plan; and that such acceptances have not been made or procured by any means forbidden by law: Provided, That, if the plan has not been so accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection (e): . . .

"If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."

10 318 U. S. at 472, 473, 477; concurring opinion at 512; 318 U. S. at 545.

11 318 U. S. at 475-76; 318 U. S. at 536-39.

Compagnie Industrielle de Navigation v. Union Central Ins. Co., 311 U. S. 273, 279;
12 47 Stat. 1474.

John Hancock Ins. Co. v. Bartels, 308 U. S. 180, 186.

13 49 Stat. 911. H. Rep. No. 1283, 74th Cong., 1st Sess., p. 1;

S. Rep. No. 1336, 74th Cong., 1st Sess., p. 1; *Crawford v. Miller, Amendments to R.R. Bankruptcy Law*, 49 Harv. L. Rev. 1254, See *Reese v. W. Pac. R.R.*, 318 U. S. at 470-471.

14 H. R. 5924, 79th Cong., 2d Sess.; Hearings on H. R. 4779, 79th Cong., 1st Sess., Serial No. 13; H. Rep. No. 1838, 79th Cong., 2d Sess., p. 3:

"Although all these laws were intended by Congress for the preservation of our railroads and their ownership, the theory has appeared to prevail that the capitalization of companies in section 77 proceedings should in all cases be drastically reduced. That is what has been done consistently and persistently. Under the past administration of section 77, as that statute was interpreted and applied by the Interstate Commerce Commission and affirmed by the Supreme Court, countless thousands of small stockholders already have been wiped out, and their investments, which would now be of great value, were uselessly destroyed. There are many more thousands upon thousands of such stockholders whose investments are imminently threatened with a like fate, unless Congress promptly enacts legislation to prevent such needless loss. And that loss--aggregating over

\$2,000,000,000—would be suffered largely by a widely scattered class of citizens (many thousands of whom are employees of these very railroads) who invested their legacies or their savings in one of America's greatest private enterprises, for education of their children, the purchase of homes, or security in old age. It literally may be said that these stocks were the favorite investments of widows and orphans and of trustees. "

S. Res. 192, 79th Cong., 1st Sess.; S. Rep. No. 925, 79th Cong., 2d Sess.; S. 1253, 79th Cong., 2d Sess.; Hearings on ~~S. 1253~~ ^{S. 1253}, 79th Cong., 1st Sess., Voluntary Modification of Railroad Financial Structures; Hearings on S. 1253, 79th Cong., 2d Sess., Modification of Railroad Financial Structures, Part 2; S. Rep. No. 1170, 79th Cong., 2d Sess.; pp.1-2:

"The bill (S. 1253) enables railroad companies to adjust their financial affairs quickly, economically, and on a business basis. The procedure it provides will reduce any disturbance of their affairs to a minimum, and will provide the maximum of protection for both the railroads and their investors.

"The existing law, section 77, was enacted in 1933, without hearings and without consideration by any subcommittee or committee of the Senate. It was enacted in the belief that it would help railroads to correct their financial affairs. It was found to do the opposite. It has placed in the hands of Government officials extraordinary power, which they had not requested, over 25 percent of the country's railroad mileage—a power which they have exercised:

- (1) to demolish every part of the financial and corporate structures of those railroads;
- (2) to plan in every respect the financial and corporate future of those railroads;
- (3) to pick men to control those railroads; and
- (4) to decree the forfeiture of \$2½ billion of investments.

"The present bill puts an end to every one of those powers and restores the operation of railroads to their managements and the adjustment of their finances to the companies themselves, with the assistance of their securityholders, where necessary."

See A Critical Analysis of Recent Reorganization Decisions of the Supreme Court of the United States, F. C. Nicodemus, Jr., Hearings on H. R. 4779, subsequently H. R. 5924, 79th Cong., 1st Sess., p. 181.

15 52 Stat. 1134; 56 Stat. 787. A bill to extend this act to 1950, H. R. 3429, was passed by the House of Representatives on November 1, 1945, 20 Cong. Rec. 10434; H. Rep. No. 1128, 79th Cong., 1st Sess.

16 Full details of the properties, the elements of rate making value, the corporate history, the capital structure at the beginning of the reorganization proceedings, the traffic and earnings appear throughout the various reports of the Commission, particularly the original report in 233 I.C.C. 515. The location and extent of its properties are succinctly described by the Commission at page 518, as follows:

"The Denver's principal eastern termini are Denver and Pueblo, Colo., at each of which points connection is made with the Atchison, Topeka & Santa Fe Railway and the Colorado & Southern Railway. At Denver connection is also made with the Chicago, Burlington & Quincy Railroad, the Chicago, Rock Island & Pacific Railway, and the Union Pacific Railroad; at Pueblo, also with the Missouri Pacific Railroad, which is the Denver's main outlet to the east.

"On the west the main line of the Denver passes through Salt Lake City and terminates at Ogden, Utah. Connection is made with the Union Pacific at each point; at Salt Lake City the Denver also connects with the Western Pacific Railroad and at Ogden with the Southern Pacific. The interchange with the Western Pacific is more important than that with any other western connection.

"The road owned by the Denver consists of 1,256.6 miles of main line and 1,094.9 miles of branch lines. Operated under lease are the Rio Grande Junction Railway . . . extending from Rifle to Grand Junction, Colo., 62.1 miles, the Goshen Valley Railroad, a branch line 8.8 miles in length, and the Salt Lake Western, extending from Dotsero, on the Denver, to Orestod on the Denver & Salt Lake Railway . . . 38.1 miles. Including these leased lines, the Denver operates approximately 1,357 miles of main lines and 1,104 miles of branch lines. Approximately 771 miles of narrow-gage lines are included in the operated mileage.

"In addition to the above-mentioned mileages, the Denver operates over the Salt Lake, between Denver and Orestod, 128.6 miles. This line, together with the Salt Lake Western, constitutes the Dotsero cut-off route. The Salt Lake's ownership embraces the line extending from Utah Junction, near Denver, to the western terminus at Craig, Colo., 220.2 miles. For its Denver terminal, the Salt Lake uses, under a lease, the facilities of the Northwestern Terminal Railroad Company. The Salt Lake derives no revenues from the through traffic moving over the cut-off, since all such traffic is handled by the Denver."

R. Co.

17 See Denver & Salt Lake Western/Construction, 154 I.C.C. 51; 175 I.C.C. 535; 233 I.C.C. at 520.

18 The reports show the income available for interest as follows:

1942 -	\$17,044,420.39
1943 -	11,573,667.94
1944 -	8,157,880.25

19 318 U. S. at 482 and 483; 318 U. S. at 539-541.

FOOTNOTES (contd.)

20 Ecker v. Western Pacific R. Corp., 318 U. S. at 475-76.

21 233 I.C.C. 578-81.

22 254 I.C.C. at 359.

23 See for discussion of the formulae 233 I.C.C. at 581 et seq;
254 I.C.C. at 16 and 359-76.

24 Rio Grande Western consolidated, 254 I.C.C. at 365: "Loss in earnings position and surrender of other rights, in our opinion, are offset by the possibility of increased return permitted by the 4½-percent income bonds, 5-percent convertible preferred stock, unlimited dividends on common stock, and the other features of the plan."

Denver & Rio Grande consolidated, id. at 364: "This apparent change in earnings position is offset by the new sinking fund and capital fund and by the increased rate of return obtainable from the new securities, i.e., slightly in excess of 4.5 percent for 64 percent of the claim and unlimited stock dividends for the remainder."

Denver & Rio Grande Western refunding and improvement, id. at 366: "They also will receive whatever dividends may be paid on 97,706 shares of common stock."

The improved physical condition of the road through expenditures of the trustees for previously deferred maintenance, improvements and new equipment was before the Commission and necessarily entered into their valuation of the property. 233 I. C. C. 531.

There is another important factor, corollary to stock ownership, to be noted in the Commission's allocation of these securities. This factor is that the creditors who received common stock to make them whole obtained with that common stock an interest in all cash on hand or all cash that might be accumulated. Of course, the Commission thoroughly understood this. In fact, it referred to the ten million plus of cash on hand as of January 1, 1943. 254 I. C. C. _____. Cash, material and supplies, as well as all other assets and all liabilities of the debtor were represented by the securities. If there is more cash on hand than needed, for taxes, expenses and proper improvements, it is at the disposal of the common stockholders. If money was used to pay indebtedness, there would be a corresponding reduction in the capital structure. Therefore, the plan provided, 254 I. C. C. at 386:

"The new company shall be deemed to have come into possession of the properties as of the effective date of the plan.

". . . The capitalization of the new company, as of January 1, 1943, after consummation of the plan . . . shall consist substantially of the following securities, excluding those to be pledged, the amounts stated being subject to reduction to the extent, if any, that matured interest proposed to be funded in the plan is paid, and as equipment obligations or other liabilities are paid or reduced"

Cash and War Earnings. The Circuit Court of Appeals was of the view that war earnings were of "very little value in estimating the probable future earnings of this property in the peace economy which is to come" and that the Commission was well within its right in disregarding them. 150 F. 2d at 34. This was after the seventeen million earnings of the top year 1942. The appellate court agreed, too, that excess current assets should not be capitalized and that improvements made during the trusteeship for reorganization had been considered by the Commission and District Court in fixing their valuation by past and prospective earnings. 150 F. 2d at 35. The appellate court then made the following ruling:

"The Senior Bondholders were paid in full. They received all the new securities and most of the common stock. Ninety per cent of the General Bondholders' claims were wiped out. They received only a small amount of common stock, ten per cent of their total claim. Adequate operating funds are essential to the operation of a railroad. The Senior Bondholders were entitled to receive in addition to the full amount of their claims, working capital sufficient for proper and efficient operation of the railroad. But anything in excess of what was reasonably necessary for this purpose constituted assets of the insolvent corporation which belonged to the remaining creditors.

"We think it is apparent from the record that there were current assets on hand consisting of cash and securities in excess of what was needed for the efficient operation of the road. As pointed out, the working capital of the debtor had increased from a deficit of \$9,727,230 as of December 31, 1935, to a surplus of \$12,125,863.50 as of December 31, 1944. While these increased net earnings are due in large part to the war and will not continue after the end of the war, and may therefore be disregarded in setting up the capitalized structure based upon prospective earnings, we cannot disregard the fact that these huge surpluses actually exist. Their existence is an accomplished fact. It is also obvious that surpluses will continue to pile up for a reasonable time yet to come. We think any plan which fails to take this into account and which gives the Senior Bondholders their claims in full by substantially delivering the road to them, and gives them the surplus cash actually on hand and further enables them to receive in addition the excess war profits which are reasonably sure to come, is inherently inequitable and unfair, so long as there are classes of creditors, whose claims are not fully satisfied."

In our judgment this holding is erroneous.

The effective date of the plan was fixed by the Commission as January 1, 1943. This^{was} ^{25/}in its power. The allocation of the securities took into consideration the interest of the secured claims to that date. Any gain or any loss after that time was a benefit or an injury first to the common stockholders and then to security holders in positions senior to them. Assuming that this Court, as a court with equity powers in a bankruptcy matter, might set aside a plan, fair and equitable when adopted by the Commission, on account of subsequent changes in economic conditions, ^{26/}it should only be done when the changes are of the kind that were not envisaged by the Commission in its deliberations upon or explanations of the plan.

We have pointed out in the section of this opinion dealing with the allocations of the securities that a part of the compensation to senior claimants for their loss of position was the opportunity to participate in war earnings. This was understood by the District Court, ^{27/}and the Commission. ^{28/}Accumulations of cash beyond operating fund needs are in the same category. In dealing with the problem the Commission noted that a five percent dividend on the authorized common would require an income available for interest and dividends of \$7,969,629. Even before the transportation difficulties of 1946, it was obvious that the Commission's judgment was being confirmed by events. See note 18, ^{29/}supra.

The error of the Circuit Court in its holding set out above lies in its assumption that the senior bondholders were paid in full by the securities allotted to them without also accepting the determination of the Commission that the assets represented as of January 1, 1943, and all subsequent earnings were a part also of the common stock that was awarded the senior bondholders.

Decreases in Senior Debt. The plan provides for securities to take the place of the Rio Grande Junction's first 5's in the face amount of \$2,758,333 and for the assumption by the reorganized road of \$5,758,000 equipment obligations. All of these securities are senior to the generals. The Denver purchased the Junctions and paid \$1,218,000 on the equipments. This reduced the necessary capitalization by that aggregate sum. The Circuit Court of Appeals was of the opinion that "The value behind these securities in no wise belonged to the Senior Bondholders, because they had been paid in full." 150 F. 2d 39. This ruling, we conclude, was erroneous for the same basic reason that we held the cash and war earnings belong to the owners of the common stock.

We called attention, supra page _____, to the authority granted the District Court to reduce the capitalization of the new company as interest due on January 1, 1943, or equipment obligations or other liabilities were paid. The District Court acted on this authority and said of the Junctions, "They may be canceled or they may be utilized under the plan

in acquisition of new securities which will become an asset of the reorganized company. 62 F. Supp. at _____. The Junction bondholders did not vote on the plan. Under our determination that the creditors who received common stock were compensated partly by the assets and future earnings, it is obvious that the use of such assets to retire senior claims is a part of the normal and expected value from holdings of common stock. Of course, this section of the opinion is written and must be read on the assumption that the allocations of common stock are fair and equitable, a matter discussed later.

25 Ecker v. Western Pacific R. Corp., 318 U. S. at 509.

Interest accrues on the secured claims until the effective date of the plan. Group of Investors v. Milwaukee R. Co., 318 U. S. at 546.
XX Compare Ticonic Bank v. Sprague, 303 U. S. 406.

26 318 U. S. 506-509.

27 62 F. Supp. at 390:

"The \$25,000,000 or more the Trustees have expended in the Improvement Program inures to the benefit of the common stock. If the latter is worth anything it is as much due to these expenditures as to any other factor. This, with the increase in current assets and wartime earnings which counsel seem to believe are permanent, constitute the only equity behind the preferred and common stock."

28 254 I.C.C. at 356.

29 Mankind's foresight is limited. The uncertainties of future estimates are recognized. It is not without interest to note, however, that on April 15, 1946, the railroads of the United States petitioned the Interstate Commerce Commission for increased freight rates and charges. This was said:

"The situation of the railroads has now become critical and their need for a substantially higher level of freight rates has become imperative. This is the result of an extraordinary combination of war and postwar conditions with which the railroads are confronted, and more particularly the result of three factors of recent development: (1) the increase in wages of railroad employes of 16 cents per hour determined under the procedures of the Railway Labor Act in April, 1946, retroactive to January 1, 1946; (2) large increases, both present and prospective, in the prices of railway materials and supplies; and (3) a sharp decline in

FOOTNOTES (contd.)

volume of railway traffic and an even greater decline in railway revenue.

"The volume of freight and passenger traffic is falling continuously, and it is anticipated that the downward rate will accelerate in the months to come. The revenues will be reduced by reason both of the decline in volume and a return to a more nearly normal composition of traffic. It is estimated that the operating revenues of Class I railroads for 1946, on the basis of the present rates, fares and charges, would be approximately \$6,800,000,000, or 23.5 per cent less than they were in 1945.

"Freight and passenger traffic reached their peaks in 1944. But net railway operating income and net income began to diminish in 1943 on account of rising costs of operation. In the face of increasing traffic through 1944, both net railway operating income and net income moved steadily downward after reaching their peak in 1942. With the cessation of hostilities in 1945 there began to be a decline also in gross revenues which is expected to become more pronounced as the abnormal war conditions disappear, disabilities of highway carriers and other agencies of transportation are removed, and the prewar pattern of railway traffic is resumed."

The Denver apparently did not vary greatly from this overall picture. It's net revenue for 1945 from railway operations dropped from \$20,569,309 to \$14,246,504. It's gross operating revenue, however, increased four and a half million. The loss in net was due largely to increased amortization of defense projects.

The monthly report of revenues and expenses by the Denver for January and February of 1946 shows a decrease of operating revenues from \$10,856,764 to \$8,932,983.

INSERT, p. 12

Earnings during the trusteeship were used to improve the debtor railroad. When the vote was taken in 1944, the real estate and equipment account showed charges of \$43,291,513 during the trusteeship. An estimated ten million of it was between the Commission's approval of the plan, June, 1943, and the Commission's certification of its approval to the court by claimants on July 15, 1944. The retirements are said by the respondent trustee to have been about \$13,000,000, leaving a net addition to capital account of \$30,000,000. Respondents urge that since capitalization was not substantially increased by the Commission between 1938 and 1943, the junior creditors got little or nothing for this investment. The improvements may have been wise or unwise. That question is not before us. Railroads even in reorganizations must make additions to take care of public needs or to lower operating costs. See 62 F. Supp. 389. The senior bond interest continued to accumulate during this period. As the capitalization was not increased pari passu with the investments, the holders of junior securities received less participation. The Commission did not consider that the earning prospect justified a greater capitalization than the one given and we think its judgment controls the valuation. As was said, In Re Denver & R. G. W. R. Co., 150 F. 2d at 38:

"Neither was the Commission compelled to, nor would it be justified in adding the amount of these expenditures to the capitalized value if in the exercise of sound discretion it felt that the reasonable prospective earnings of the road, after the improvements did not justify it. However, in the face of all this, after satisfying in full the claims of the senior bondholders, the plan of reorganization should have made sure that all excess current assets, as well as all excess war profits yet to accrue, would go to the General Bondholders."

The last sentence, we think, has the vice of overlooking the reason^{why} the Commission gave common stock to the Seniors. See discussion under

INSERT, p. 12 contd.

TEL used
40% Allocation of Securities.

We note also the contention that the possibility of a national income much higher and interest rates much lower than before World War II should affect valuation based on prospective earnings. Those factors, we think were before the Commission when it made its earnings estimate.

of the junior creditors. See p. 18, supra. Respondents offer no other ground for their votes in rejection.

Congress with its purpose to stop the blockade of sound reorganization by classes of creditors with the veto power of the 1933 statute, note 35, supra, certainly did not intend to leave a class with the same power of interference because in its reasonable judgment that class thought the valuation was erroneous or the senior creditors were paid in full by the face value of securities. If a plan gives fair and equitable treatment to dissenters, the elements which make the plan fair and equitable cannot be the basis for a reasonably justified rejection. If only those elements are relied upon, as here the rejection is not reasonably justified.

Of course, this does not mean that if a plan is approved as fair and equitable by the Commission and court, there cannot be a reasonable justification for its rejection by a class of claimants on submission. Reasons to make their rejection reasonable may arise thereafter. For example, unanticipated, large earnings might develop. We see no reasonable justification here for the action of the General bondholders.

In conclusion, we shall add that the foregoing opinion has been written without reliance upon the duty of the Commission to plan reorganizations with an eye to the public interest as well as the private welfare

of creditors and stockholders.^{39/} This the Commission has done. Our failure to comment strongly upon that feature of the plan should not be interpreted as an intimation upon our part that it is not important. These respondents cannot be called upon to sacrifice their property unreasonably so that a depression-proof railroad system might be created. But they invested their capital in a public utility that does owe an obligation to the public. Both the Insurance Group Committee, with fiduciary responsibility to the myriad holders of policies, and the present stockholders with investment^{speculative} positions in the existing ~~stock~~ by their entry into a railroad enterprise assumed the risk that in any depression or any reorganization the interests of the public would be considered as well as theirs.

The judgment is affirmed in part and reversed in part and the case remanded to the District Court for further proceedings.

It is so ordered.

labor practice of refusing to bargain with an accredited union, merely
 to open the way for judicial review of the certification. * Consequently
 petitioner urges the cease and desist order should be no broader than
 the refusal to bargain which is covered by paragraph 1(a), note _____
 supra, with the addition of "or from any other acts in any manner inter-
 fering with the representative's efforts to negotiate." The suggested
 addition is taken from the Express Publishing Company case ~~at~~ 312 U. S.

at p. 438. Thus the breadth of paragraph 1(b) of the Board's order is sharply
 challenged as being beyond the power of the Board in view of the evi-
 dence and findings in this case.

In support of its objection to the breadth of the order, petitioner
 again relies upon Express Publishing Company case which decided, *Page 437,*
 that where the Labor Board found ^a ~~particularly~~ violation of subsection 8(5)
 of the statute, it could not on that finding ^{alone} ~~and~~ rightly enjoin viola-
 tions of all the other provisions:

"To justify an order restraining other violations it must
 appear that they bear some resemblance to that which the
 employer has committed or that danger of their commission
 in the future is to be anticipated from the course of his
 conduct in the past." *at*

The paragraph under attack in that case was substantially like the para-
 graph here attacked. *** # of this case* Under this ruling, it cannot be said that

* See American Federation of Labor v. National Labor Relations Board, 308 U. S. 401; Pittsburgh Plate Glass Co. v. National Labor Relations Board, 313 U. S. 146; Inland Empire Dist. Council etc. v. Millis, 325 U. S. _____ [65 S. Ct. 1316].

** The problem of the ^{administration} scope of injunction dealt with in National Labor Relations Board v. Express Publishing Co., 312 U. S. 426, has recently received careful consideration by judges and writers. 41 Columbia L. Rev. 911; 29 Georgetown L. J. 1026; 53 Harvard L. Rev. 472; 23 Boston University L. Rev. 447; 54 Yale L. J. 141. *W. E. Williams*

E

restraining orders of the breadth of 1(b), here in controversy, are always or are never justified when the Board properly determines that a single unfair labor practice has been committed by the employer.

Each case calls for the expert appraisal of the Board. To the Board

is given exclusive power to prevent unfair labor practices by ^{cease & desist} orders,

after determination that such unfair labor practice has been committed,

~~requiring such person to cease and desist from such unfair labor prac-~~

~~tices~~ Sections 10(a) and (c). The test of the validity of ^a ~~the~~ ^{broad}

~~the~~ cease and desist order is whether the Board might have reasonably

concluded from the evidence before it that ^{such} ~~an~~ an order was neces-

sary to prevent the ^{employer} ~~employer~~ (before it) "from engaging in any unfair

labor practice affecting commerce." Section 10 (a). * So long as there

is substantial evidence to justify the Board's conclusion as to the need

for a broad or general cease or desist order in the language of Section 7

or other proper definition of unfair practices, the courts of review should

not refuse enforcement of or modify the Board's order. If there is not

such evidence, the court must protect the person charged with the unfair

practice from the threat of contempt proceedings from future violations.

While contempt proceedings can be instituted only by the Board and in the

** public interest, the possibility of contempt penalties by the court for

* Ethyl Gasoline Corp. v. United States, 309 U. S. 436, 461; Union Pacific R. Co. v. United States, 313 U. S. 450, 470; United States v. Bausch & Lomb Co., 321 U. S. 707, 724.

** Amalgamated Workers v. Edison Co., 309 U. S. 261, 269.

future Labor Act violations adds sufficient additional sanctions to make material the difference between enjoined and non-enjoined employers in their relations with their employees.

occasionally to examine
 Courts are familiar with ~~weighting~~ evidence which is adduced before

the Board to determine whether it has substance enough to support a finding of an unfair labor practice. **** ~~While evidence sufficient to support a finding of a single unfair labor practice may not be sufficient to support a general order,~~ the determination of the ~~additional~~ evidence necessary to justify the broader order calls for the same type of judicial appraisal.

Equity has long been accustomed in other fields to reach conclusions as to the *scope* ~~breadth~~ of orders which *are* ~~is~~ necessary to prevent interferences

with the rights of those who seek the courts' protection. ***** By legislation the generality of this power has sometimes been curbed as in the

****** Clayton and Norris-LaGuardia Acts. Statutes of the United States

* See for business operations under contempt orders 41 Columbia L. Rev. at 913.

** See Labor Board v. Greyhound Lines, 303 U. S. 261, 270-71; Edison Co. v. Labor Board, 305 U. S. 197, 229.

*** Hecht Co. v. Bowles, 321 U. S. 321, 328; Wyoming v. Colorado, 286 U. S. 494, 508.

**** 38 Stat. 738, §19; 47 Stat. 70, §9.

which utilize this well-established power to effectuate the object
 which the particular legislation seeks to secure ^{has been} ~~and, of course,~~ enacted
 in the light of the existing equity power as it has been used by the
 courts. This is true as to the enforcement provisions of the National

*

Labor Relations Act.

Injunctions in broad terms are granted even in acts of the widest
 content, when the court deems them essential to accomplish the purposes

**

of the act. We think that the Board has the same power to determine

* S. Rep. No. 573, 74th Cong., 1st Sess., p. 14:

"Section 10. Procedure before the Board.—This is the most important procedural section. Despite the wide-spread charges that the bill invokes novel procedure and vests unusual powers in an administrative agency, the bill is modeled closely upon numerous Federal Statutes setting up administrative regulatory bodies of a quasi-judicial character. The common procedure is so well known that the committee deems it unnecessary in substantiation of this statement to refer to any analogous statutes save the Federal Trade Commission Act, section 5."

See also H. Rep. No. 1147, 74th Cong., 1st Sess., p. 23.

** Sherman Act—Standard Oil Co. v. United States, 221 U. S. 1, 77:

"It may be conceded that ordinarily where it was found that acts had been done in violation of the statute, adequate measure of relief would result from restraining the doing of such acts in the future. Swift v. United States, 196 U. S. 375. But in a case like this, where the condition which has been brought about in violation of the statute, in and of itself, is not only a continued attempt to monopolize, but also a monopolization, the duty to enforce the statute requires the application of broader and more controlling remedies."

"So far as the owners of the stock of the subsidiary corporations and the corporations themselves were concerned after the stock had been transferred, §6 of the decree enjoined them from in any way conspiring or combining to violate the act or to monopolize or attempt to monopolize in virtue of their ownership of the stock transferred to them, and prohibited all agreements between the subsidiary corporations or other stockholders in the future, tending to produce or bring about further violations of the act." P. 79.

"We so think, since we construe the sixth paragraph of the decree, not as depriving the stockholders or the corporations, after the dissolution of the combination, of the power to make normal and lawful contracts or agreements, but as restraining them from, by any device whatever, recreating directly or indirectly the illegal combination which the decree dissolved." P. 81

Local 167 v. United States, 291 U. S. 293, 299:

"Appellants seek elimination of the provision of the decree that enjoins them from using any of the offices or positions in Local 167 or the shoohim union 'for the purpose of coercing marketmen to buy poultry, poultry feed, or other commodities necessary to the poultry business from particular sellers thereof.' The United States is entitled to effective relief. To that end the decree should enjoin acts of the sort that are shown by the evidence to have been done or threatened in furtherance of the conspiracy. It should be broad enough to prevent evasion. In framing its provisions doubts should

the needed scope of cease and desist orders under the National Labor Relations Act that nisi prius courts have, ^{in other litigation.} subject to review of circuit

for abuse
of discretion

courts of appeal under Section 10 to keep the orders within the bounds

of the discretion which Congress has reposed in the Board. Compare

Labor Board v. Express Pub. Co., supra, at pages 435, 436 and 437.

There is no rigid scheme of remedies in the Wagner Act, any more than

there is a rigid delimitation of unfair labor practices. Compare Republic

Aviation Corporation v. National Labor Relations Board, 324 U. S. 793, 798.

When the Express Publishing Company case came to this Court, the Circuit

Court of Appeals for the Fifth Circuit had struck from the Board orders

all provisions for enforcement except that which directed the Publishing

Company to bargain collectively with the Guild. This eliminated the general

cease and desist paragraph, so similar to the one here in question. 312

U. S. at 430. It held violation of Section 8(5) refusal to bargain was

sufficiently proven. The Court of Appeals also held that the record, which

contained certain further statements which were charged to violate Section

8(1), did not justify the Board's further finding that Section 8(1) had

also been violated. 111 F. 2d 588. No review was sought by the Board

here of this latter ruling. Its petition for certiorari never mentioned

the ruling and its brief distinctly disclaimed any contention in regard

to it. The attack was focused on the refusal to enforce the general order

be resolved in favor of the Government and against the conspirators. Warner & Co. v. Lilly & Co., 265 U. S. 526, 532. . . . When regard is had to the evidence disclosing the numerous purposes of the conspiracy and the acts of coercion customarily employed by defendants, it is plain that the clause referred to cannot be condemned as unnecessary or without warrant." See Amer. Foundaries v. Tri-City Council, 257 U. S. 184, 194.

I

on the finding of a violation only of Section 8(5) by a refusal to

*
bargain. Therefore, this Court, as appears from the opinion, reached its conclusion that the paragraph in question was too broad, solely on consideration of the refusal to bargain. See 312 U. S. 429, 432, 433, 434.

In the present case a different situation presents itself. It is a narrow difference but significant when examined in the light of the statement in the Publishing Company case, pages 437-38, that persistent attempts by varying methods to interfere with the right of self-organization may justify the general type of cease and desist order. We think that it is not so important as to whether there is one or more instances of unfair labor practices but whether the situation as a whole is of such a character that the Board may fairly say--The broad type of order is necessary to attain the objects of the Labor Act. In this case there was evidence enough before the Board to justify it in reaching that conclusion. See discussion at page ~~athane~~ supra.

* In its brief the Board said: "While we think the court's holding that the statement did not violate the Act is erroneous, we do not seek review of its decision in that respect, since it turns on facts peculiar to this case and since, in the view we take, the refusal to bargain is sufficient alone to support the Board's order in its entirety."

FOOTNOTES

49 Stat. 452-53.

1 /"SEC. 7. Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in concerted activities, for the purpose of collective bargaining or other mutual aid or protection.

"SEC. 8. It shall be an unfair labor practice for an employer--

"(1) To interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7.

"(5) To refuse to bargain collectively with the representatives of his employees, subject to the provisions of Section 9(a)."

Opinion of the C.C.A., National Labor Relations Board v. May Dept. Stores Co., 146 F. 2d 66; determination of National Labor Relations Board, 53 N.L.R.B. 1366.

2. 49 Stat. 453, Sec. 9. "(b) The Board shall decide in each case whether, in order to insure to employees the full benefit of their right to self-organization and to collective bargaining, and otherwise to effectuate the policies of this Act, the unit appropriate for the purposes of collective bargaining shall be the employer unit, craft unit, plant unit, or subdivision thereof."

3. S. Rep. No. 573, 74th Cong., 1st Sess., p. 14.

4. In the matter of Houston Shipbuilding Corporation, 41 N.L.R.B. 638; In the matter of American Manufacturing Company, 41 N.L.R.B. 995.

FOOTNOTE

Illustrative of the decisions in the Circuit Courts are the following cases:

1. National Labor Relations Board

- (a) Upholding a general §8(1) order on the basis of a single unfair labor practice (the nature of the unfair practices is given in brackets):

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Labor Board v. Highland Park Mfg. Co., 110 F. 2d (C.C.A. 4) [§8(5)];
Art Metal Const. Co. v. Board, 110 F. 2d 148 (C.C.A. 2) [§8(5)];
Wilson & Co. v. Board, 124 F. 2d 845 (C.C.A. 7) [§8(3)]; Labor
Board v. Sunbeam El. Mfg. Co., 133 F. 2d 856 (C.C.A. 7) [§8(1)];
Labor Board v. Standard Oil Co., 138 F. 2d 885 (C.C.A. 2) [§8(2)].

- (b) Upholding a general §8(1) order where there was more than one unfair practice:

Labor Board v. Boss Mfg. Co., 107 F. 2d 574 (C.C.A. 7) [§§8(1),
8(3), 8(5)]; Labor Board v. Reed & Prince Mfg. Co., 118 F. 2d
874 (C.C.A. 1), cert. den. 313 U. S. 595 [§§8(1), 8(3), 8(5)];
F. W. Woolworth Co. v. Board, 121 F. 2d 658 (C.C.A. 2) [§§8(1),
8(3)]; Board v. Algoma Net Co., 124 F. 2d 730 (C.C.A. 7), cert.
den. 316 U. S. 706 [§§8(1), 8(3)]; Labor Board v. Baldwin Loco-
motive Works, 128 F. 2d 39 (C.C.A. 3) [§§8(1), 8(2), 8(3), 8(4)];
Labor Board v. Brezner Tanning Co., 141 F. 2d 62 (C.C.A. 1) [§§8(1),
8(3)]; Idaho Potato Growers v. Board, 144 F. 2d 295 (C.C.A. 9),
[§§8(3), 8(5)].

Cert. den. 323 U.S. 769

- (c) Limiting to acts specifically condemned a §8(1) order based on a single unfair labor practice:

Globe Cotton Mills v. Board, 103 F. 2d 91 (C.C.A. 5) [§8(5)];
Labor Board v. Swift & Co., 108 F. 2d 988 (C.C.A. 7) [§8(2)];
McQuay-Norris Mfg. Co. v. Board, 119 F. 2d 1009 (C.C.A. 7), cert.
den. 313 U. S. 565 [§8(5)]; Labor Board v. Newark Morning Ledger
Co., 120 F. 2d 262 (C.C.A. 3), cert. den. 314 U. S. 693 [§8(3)];
Labor Board v. Burry Biscuit Co., 123 F. 2d 540 (C.C.A. 7) [§8(2)];
Labor Board v. Stone et al., 125 F. 2d 752 (C.C.A. 7), cert. den.
317 U. S. 649 [§8(1)]; Commonwealth Edison Co. v. Board, 135 F. 2d
891 (C.C.A. 7) [§8(2)]; Consolidated Aircraft Co. v. Board, 141
F. 2d 785 (C.C.A. 9) [§8(1)]; Labor Board v. Lipshutz, 149 F. 2d
141 (C.C.A. 5) [§8(1)]; Labor Board v. Walt Disney Productions,
146 F. 2d 44 (C.C.A. 9), cert. den. 324 U. S. 877 [§8(3)].

- (d) Limiting a §8(1) order where there was more than one unfair labor practice:

Press Co., Inc. v. Board, 118 F. 2d 937 (C.C.A. D.C.), cert. den.
313 U. S. 595 [§§8(1), 8(3)]; Labor Board v. Grower-Shipper
Vegetable Assn., 122 F. 2d 368 (C.C.A. 9) [§§8(1), 8(3)]; Wilson
& Co. v. Board, 123 F. 2d 411 (C.C.A. 8) [§§8(1), 8(2), 8(3)];
Labor Board v. Servel, Inc., 149 F. 2d 542 (C.C.A. 7) [§§8(1), 8(3)].

2. Office of Price Administration

A similar situation prevails with respect to the use of injunctions to restrain violations of regulations issued under the Emergency Price Control Act, 56 Stat. 23.

- (a) Granting or sustaining general injunctions on the basis of particular violations of a regulation:

Bowles v. Montgomery Ward & Co., 143 F. 2d 38 (C.C.A. 7) [preliminary injunction against violation of any price regulation granted for violation of several provisions of one regulation]. Cf. Bowles v. May Hardwood Co., 140 F. 2d 914 (C.C.A. 7).

- (b) Sustaining limited injunctions:

Bowles v. Town Hall Grill, 145 F. 2d 680 (C.C.A. 1) [violation of restaurant ceiling prices on poultry, lobster, gin items; injunction limited to such items sustained]; Bowles v. Sacker, 146 F. 2d 186 (C.C.A. 2) [sustaining injunction limited to particular type of violation proved].

3. Federal Trade Commission

(a) Enforcing or affirming order broader than specific acts complained of:

Ostler Cowdy Co. v. F.T.C., 106 F. 2d 962 (C.C.A. 10), cert. den. 309 U. S. 675; Hershey Chocolate Co. v. F.T.C., 121 F. 2d 968 (C.C.A. 3); E. B. Muller & Co. v. F.T.C., 142 F. 2d 511 (C.C.A. 6); Eugene Dietzgen Co. v. F.T.C., 142 F. 2d 321 (C.C.A. 7), cert den. 323 U. S. 730.

(b) Limiting orders to specific acts:

F.T.C. v. Beechnut Packing Co., 257 U. S. 441; F.T.C. v. A. McLean & Son, 84 F. 2d 910 (C.C.A. 7); Helen Ardelle, Inc. v. F.T.C., 101 F. 2d 718 (C.C.A. 9).

The plan provided for a reorganization as of January 1, 1943, by the Denver by adjustment of its assets to its liabilities with or without a consolidation with the Salt Lake and the Salt Lake Western to form a system. As no ruling that we are asked or required to make turns upon whether the reorganization is with or without the suggested consolidation, we need not give further consideration to possible differences. In either case, creditors with secured claims against the reorganized roads or against their property were left undisturbed or allocated new securities of the new company, consisting of first mortgage and income bonds, preferred and common stock in lots, in face amount of the secured claims except for the general mortgage issue, that the Commission and District Court determined in the plan were fair and equitable in the light of the respective priorities, liens and collateral of the various secured claims. All of the securities were given a par value. Interest partly fixed and interest partly contingent on earnings was used to gain play in annual charges. The plan eliminated unsecured claims and allocated common stock in face amount of ten per cent of their claim to general mortgage bonds of the debtor. It was determined that the aggregate of the securities in the plan represented the value of the properties for reorganization purposes and that through prospective earnings there was adequate coverage for the charges. ^{6/}

Respondents sought review in separate appeals from the order of approval or the order of confirmation or both to the Circuit Court of Appeals for the Tenth Circuit. That court reversed the District Court on all appeals

and remanded the reorganization proceedings to the Interstate Commerce Commission for further consideration with the statement, 150 F. 2d at 40,

"Nothing in the opinion shall prejudice or foreclose the rights of the parties to propose a new plan or reorganization or the power of the Commission to formulate, approve, and certify a new plan of reorganization in the light of any relevant facts presented to the Commission in any proceeding under 11 U.S.C. Sec. 205(d)."

By this remand, the Commission was empowered to proceed anew to consideration of the reorganization in all its phases, §77(e), including those steps previously taken and approved by the opinion of the Court of Appeals.

That Court approved the valuation of the debtor reached mainly by the use of present and prospective earnings. It held that the valuation adopted need not reflect necessarily the money spent for improvements during the trusteeship for reorganization. ^{15072d. 34,35} No argument is made against the soundness of these conclusions which are fully supported by the Western Pacific and Milwaukee cases. ^{1/} The circuit court further held that the Commission was justified in refusing to reopen the hearings just before the entry of its order of June 14, 1943, approving the plan, to hear evidence of the then existing economic conditions and the 1943 earnings of the debtor. ^{8/}

The reversal came from the circuit court's holding, contrary to the Commission ~~xxx~~ and the district court, that free cash in excess of operating capital needs and unexpectedly large earnings from war business after the date of the plan should be for the benefit of the General bondholders. 150 F. 2d 35-38. That court further held that

decreases in debt by cash payments, with the consequent reduction of securities that were required to be issued under the plan to cover such debt claims, should inure to the benefit of the same General bondholders. 150 F. 2d 38-39. The circuit court disagreed also with the treatment of certain collateral deposited behind the First Consolidated mortgage of the Rio Grande Western Railway Company and secondarily behind the Generals of the debtor. This is the Utah Fuel stock issue hereinafter discussed. These differences from the conclusions of the district court led the circuit court to hold that the general bondholders were "reasonably justified" in rejecting the plan and that the district court was without authority to confirm the plan over their veto. § 77(e).

The briefs of all the parties here restate the questions presented in the petition for certiorari according to the emphasis the particular party places upon points of controversy. After a general consideration of the background of the plan, we shall give attention to each of the just stated disagreements between the district and appellate court. This will cover the points under review.

The basic problems of railroad reorganization under Section 77 of the Bankruptcy Act have been so recently considered by this Court in the Western Pacific and Milwaukee cases that only a summary reference to the conclusions here pertinent need be made now. No new enactments have

changed the law since those decisions on March 15, 1943. The complexities of the reorganization of a railroad with responsibility to the public and obligations to its security holders was recognized. The impossibility without destruction of efficiency and values of reversing the process of integration to restore the parts that now make up the whole of a system to their original operational function was understood. The various bond issues with different and often overlapping liens, with competing claims for allocation of earnings pending reorganization, presented hard problems for legislative solution. A fair, administratively practical and lasting method was sought. By provisions for adjustment of creditors' claims, Congress intended to avoid the delays, costs and sacrifices of liquidation. ^{9/}

The agencies employed by Congress to accomplish reorganizations under Section 77 were the Interstate Commerce Commission and the courts. The answer reached by Congress was that the experience and judgment of the Commission must be relied upon for final determinations of value and of matters affecting the public interest, subject to judicial review to assure compliance with Constitutional and statutory requirements. This was the interpretation of all members of this Court from the language of the act and the evidence of Congressional purpose in the hearings, reports and discussion. ^{10/} To the courts, Congress confided the power to review the plan to determine whether the Commission has followed the statutory mandates of subsection (e), 318 U. S. at 477, and whether the Commission had material

evidence to support its conclusions. 318 U. S. at 477; concurring opinion at 512.

At this point, we restate our conclusion reached in the former cases that the Congressional authority to the Commission to eliminate valueless claims from participation in reorganization is a valid exercise of the federal bankruptcy power. Section 77 was directed at the relief of debtor railroads. Sec. 73, 47 Stat. 1467. Liquidation in depression periods meant that large portions of debts, as well as stock interests in the properties would be irretrievably lost to their holders while reorganization on a capitalization that estimated normal income would support meant the salvage of sound values. We see no more constitutional impediment to the elimination of claims against railroad debtors by the Interstate Commerce Commission's determination of values with judicial review as to the sufficiency of the evidence and compliance with statutory standards than we do to their elimination by an accepted bid in a depression market.^{11/} There is no occasion here to reexamine further these recent holdings of this Court in the Western Pacific and Milwaukee reorganizations.

In examining the contentions of petitioners as to the alleged errors of the Circuit Court of Appeals, we must approach the problems in accordance with our reviewing authority under Section 77. That section embodies the method that Congress selected in 1933^{12/} and improved in 1935^{13/}

to put the railroad transportation system of the country in order to meet its debts and perform its duties to the public after the hard years of the recent depression. Our constructions of the chief provisions of the section were handed down in March, 1943. Although the results of reorganizations under the section, as thus construed, have been criticized as unfortunate and changes have been suggested, no different legislation has been enacted.^{14/} Indeed a different method for reorganization, enacted in 1939 and designed to meet the requirements of railroads not in need of financial reorganization of the character provided by Section 77 but only of an opportunity for voluntary adjustments with their creditors, was allowed to lapse on November 1, 1945.^{15/} This situation leaves clear the duty of the agencies of the Government entrusted with the handling of reorganizations under Section 77, including this Court, to administer its provisions according to their best understanding of the purposes of Congress as expressed in the words of Section 77 read in the light of the contemporaneous discussion in Congress. Changes in economic conditions cannot effect the powers of the reorganization agencies even though they may require a reexamination into the present fairness of the former exercise of those powers.

The Denver and Rio Grande Western, the principal debtor, is an important link in transcontinental transportation.^{16/} The recent availability to the debtor of the Moffett Tunnel and the Dotsero Cut-off (1934) improve its strategic position in the competition for "overhead" or "bridge traffic," that is, traffic that is consigned from and destined to points beyond its lines. The traffic originating on its lines is mixed in character and varies with the general prosperity of the region.

The present Denver, the principal debtor, was organized in 1920. It succeeded the Denver & Rio Grande Railroad Company of 1908 which had in its turn acquired the property of the Rio Grande Western Railway Company, owning the western portion of the present debtor's lines, and of the Denver & Rio Grande Railroad Company of 1886, owning the eastern portion of the present debtor's lines. A connection between the two portions, Rio Grande Junction Railway, is under lease to the debtor who, as lessee and a stockholder, guarantees the Junction bonds. Substantially all of the capital stocks of the Salt Lake and Salt Lake Western, and various other branch lines are owned by the debtor.^{17/}

These corporate arrangements for the operations of the debtor have resulted in the assumption or creation by the debtor of the claims of the various issues, listed in note 6, supra.

Just after these reorganization proceedings began, December 31, 1935, the debtor's report showed that its long-term debt was \$120,541,000,

and its current liabilities \$24,990,901.63. It had current assets, including cash \$1,257,943.43, of \$5,966,666.93. At the time, the plan became effective, December 31, 1942, the report showed long-term debt of \$130,264,826.65 and current liabilities of \$14,172,575.50, and in addition deferred liabilities, chiefly matured interest in default of \$45,582,132.66. There were current assets, including cash \$10,850,149.96, of \$20,983,652.54. As of December 31, 1944, these items were: Long-term debt \$129,358, 337.79, current liabilities \$20,539,637.83, and deferred liabilities \$55,310,151.80. The current assets were \$32,665,501.33, including \$19,142,626.96 in cash.

The income of the system available for interest during the period was found by the Commission at its lowest in 1936-1938. After adjustment this was \$2,893,255. 233 I.C.C. at 552. In 1941 there was \$5,019,436. 254 I.C.C. at 10. When the present plan was approved by the Commission in June, 1943, the 1942 income available for interest was recognized but the continuance of such earning power was thought to be negatived by any sound forecast. ^{18/} 254 I.C.C. at 356.

The Commission reached its determination of a sound capital structure for the combined properties with these figures on earnings before it. In addition, of course, the Commission had complete statistical information to guide it from its Bureau of Valuation and its other sections dealing with traffic, rates, interest, et cetera. The discussion by the Commission will be found in its printed volumes listed in note 2.

This writ of certiorari brings here for review the decree of the Circuit Court of Appeals enforcing an order of the National Labor Relations Board which was entered after the Board found upon hearings that petitioner had violated Sections 8(1) and 8(5) of the National Labor Relations Act. ^{1/} On account of different treatments in circuit courts of appeal of Labor Board orders to cease and desist, which restrain other kinds of acts than those found by the Board to be unfair, a dispute over the proper scope of the cease and desist order made it important for us to grant the writ. See note _____ infra. The writ also presents issues (1) as to whether two small related departments with thirty to forty employees may be an appropriate bargaining unit when the department store of which they are a part has around three hundred and fifty departments and approximately five thousand employees; (2) as to whether the Board could properly place the name of a Joint Labor Council on the ballot for the employees' bargaining representative when none of the employees were members of the Council but only of a local union which was associated with others in the Council; and (3) as to whether seeking authority from the National War Labor Board to increase wages without taking up the increase with a certified bargaining agent may be an unfair labor practice under Section 8(1) of the Labor Act.

Appropriate Unit. After a hearing in which the employer, the petitioner here, the May Department Stores Company, doing business as

Famous-Barr Company, a St. Louis department store, took part, the Labor Board, on June 16, 1943, found that all non-supervisory employees of the Company, then 28 in number, working in the main and basement men's busheling rooms constituted an appropriate unit for collective bargaining within the meaning of Section 9(b) of the Labor Act. An election was ordered. It resulted in the choice and designation of the St. Louis Joint Council, United Retail, Wholesale & Department Store Employees of America, C.I.O., as the representative for collective bargaining of the employees of the unit.

The Company contended that a store-wide unit of its five thousand employees was the most appropriate and at any rate that employees in the women's alteration and the fur alteration departments belonged in the appropriate unit. As there is no provision for direct review of the determination and certification of the bargaining representative, the Company awaited this proceeding which sought a decree directing it to bargain collectively with the representative in order to secure judicial review of the finding as to the unit. See Inland Empire Dist. Council, etc. v. Millis, 325 U. S. ____.

A few months before this proceeding (to determine an appropriate unit for the men's busheling rooms) a determination that all employees of the Company were the appropriate unit for collective bargaining had been sought by the C.I.O. This was dismissed for failure of the

C.I.O. to make a substantial showing of membership in the ~~suggested~~ ^{store-wide}

unit. 46 N.L.R.B. 305. That prior application is not a bar to this.

It determined nothing. The Board was careful to note in this proceeding

that a larger unit might be fixed as appropriate if self-organization

developed. No labor organization claimed to represent the entire body

of employees. Therefore the Board determined to approve ~~this~~ this unit

as appropriate so that collective bargaining might start for these employees

without ~~requiring its postponement to a date when~~ ^{waiting until} more employees might

be organized into a larger unit. ~~Cf. Hearst Pab.~~

Under Section 9(b) ^{the} the Board is delegated the authority to deter-

mine the unit. The judicial review afforded is not to ~~weigh~~ ^{for the purpose of} the evi-

dence upon which the Board acted and perhaps ^{to} overrule the exercise

of its discretion but to "guarantee against arbitrary action by the

Board." ^{3/} The presence of members of one or another union throughout

the enterprise was a matter for consideration in deciding upon the

appropriate unit but was not decisive. Compare Pittsburgh Plate Glass

Co. v. Board, 313 U. S. 146, 156.

The Board had before it the business of the company, the numbers

of employees, the treatment of the employees as a unit by management

with reference to sick leave, hospitalization, employees privileges,

vacations, et cetera. Evidence was presented that a large proportion

of employees in the proposed unit were members of the same union. It

had testimony as to similarity and dissimilarity in tailoring and altering between the men's and women's alteration rooms. There was evidence that those who work on men's clothing, speaking generally, belong to a different union organization those those who work on women's clothes. The Board considered the interchange of workers between the two groups. We think that there was ample testimony to support the Board's conclusion that the employees of the two busheling rooms were an appropriate unit.

Form of Ballot. Petitioner objects to the certification because the ballot contained the name of the St. Louis Joint Council, United Retail, Wholesale & Department Store Employees, as a candidate for bargaining representative from the unit. This was the organization which was certified. It had filed the petition for determination of the representative. The Council claimed ^{that} more than 51% of the employees in the suggested unit had designated it as their collective bargaining representative. The Board directs what names go on the ballot. Unless there is a showing of a substantial number of employees in the proposed unit who have become members of and selected the petitioner as their bargaining representative, the Board does not ordinarily order an election. In this case on the Joint Council petition for certification, the Board found that the Council had a majority of the employees. As a matter of fact it was a local union which the employees had selected

and joined. The Board pointed out in its finding of facts on the

petition for an election that the Joint Council represented this ^{local} and

similar locals in other stores.
~~other locals of store employees.~~

The Company says that some employees may have been misled by the ballot into thinking that the Joint Council had a substantial number of the unit's employees as members because elections are not ordinarily called unless that situation exists. Even so, it is difficult to grasp what standing the employer has to object to placing a name on the ballot which has no members in the proposed unit. The name was that of the petitioner for the election. The local was represented by the Joint Council. Cf. National Labor Relations Board v. Frank Bros. Co., 137 F. 2d 989, 992, affirmed on other grounds Frank Bros. Co. v. Labor Board, 321 U. S. 702. The Joint Council was chosen by a majority of the employees of the unit and certified. In the circumstances of this election, we see no basis for the Company's objection to the certified representative on the ground of possible confusion of the employees. Cf. ~~National Labor Relations Board v. National Mineral Co.~~, 134 F. 2d 124, 426 r.c.

Action on Wages. The Board found that the Company interfered with, restrained and coerced its employees in the exercise of the rights guaranteed by Section 7 of the Act in seeking the approval on August 30, 1943, of the National War Labor Board for ~~a~~ wage adjustment upwards for a large proportion of its employees, including the employees of the unit here involved, without bargaining collectively on the subject of the wages with the certified union. A letter accompanied the request to the War Labor Board which explained that certain craft employees, not here involved, were excluded from the application for authority to increase wages because they were covered by collective bargaining agreements. The letter went on to say:

"The St. Louis Joint Council, United Retail, Wholesale and Department Store Employees of America, C.I.O., . . . has been certified by the National Labor Relations Board, but we do not regard this as an appropriate unit and have consistently taken that position and have so notified all parties concerned. It is our intention to submit that question to the Courts, if and when the occasion arises. We have not recognized this Union and have not bargained with it for the employees in Departments 280 or 281 and no negotiations with that Union are pending. It is intended, however, that the employees in Departments 280 and 291 shall be included in this application.

"We do not believe that any of the organizations named in the application, nor the organization named above, have any interest whatever in the enclosed application. However, if the organization named above should object to the inclusion of the employees of Departments 280 and 281 in the application, you are advised that said application may be considered as having been amended so as to exclude those employees from the application."

The next morning the employees were told over the store address system of the application for a wage increase for all employees, except higher paid executives and those "employees whose salaries have been fixed by closed shop agreements." A short time later another reference to the

application was made over the address system. A similar announcement appeared in the September 3 issue of the store paper. The conditional offer to exclude the employees of the unit was not referred to in the announcements. Upon these facts the Board found a violation of Section 8(1).

The Company urges that its request for authority without negotiation with the certified union was not an unfair practice under Section 8(1) but only a necessary result of its position ~~on non-recognition of the certified representative because the Company did not agree with the Board's determination of the appropriate unit for the selection of representatives.~~ To maintain this position, the Company says, it could give no recognition to the certified agent.

We have in preceding divisions of this opinion stated our conclusion that the Joint Council was a properly certified bargaining representative. Therefore at the time of the request to the War Labor Board for authority to increase wages, the Joint Council must be considered as a properly certified bargaining agent. Company action in regard to it must be judged in that light even though its attitude toward the certification made its choice difficult.

The Joint Council was certified on July 12, 1943. Meanwhile, after the election, the Council had requested a conference with the Company for negotiating a contract to cover wages, hours and working conditions. This request was declined on July 19th with the statement that the

Company did not agree with the decision of the Board and desired to preserve its full rights to question the result as it "may see fit." The application to the War Labor Board followed on August 30th.

It is settled law that the Wagner Act makes it an employer's duty to bargain collectively only with the duly recognized or accredited representative of the employees. Disregard of this duty violates Section 8(1) of the Act. Section 9(a) Medo Corp. v. Labor Board, 321 U. S. 678, 683-84. Any other conclusion would infringe an essential principle of collective bargaining. See J. I. Case v. Labor Board, 321 U. S. 332, 338. Employer action to bring about changes in wage scales without consultation and negotiation with the certified representative of its employees cannot, we think, logically or realistically, be distinguished from bargaining with individuals or minorities. In requiring signed and written agreements under the Labor Act, we said, "Contrasted with the unilateral statement by the employer of his labor policy, the signed agreement has been regarded as the effective instrument of stabilizing labor relations and preventing, through collective bargaining, strikes and industrial strife." H. J. Heinz Co. v. Labor Board, 311 U. S. 514, 524.

Two national labor groups had each separately sought for months ~~to~~ organize the Company. One effort to secure the designation of a unit had failed. The present designation was made over the protests

of the Company. It had urged:

"There are two competing labor organizations seeking to organize the employees in this store. By this decision one of them is granted an election in the unit composed of two departments. There are some 350 departments in this store and if this Employer is to be confronted with elections and separate bargaining for each one or two departments it will be an endless and intolerable interference with store operations, which should not be permitted."

By going ahead with wage adjustments without negotiation with the bargaining agent, it took a step which justified the conclusion of the Board as to the violation of Section 8(1). Such unilateral action, in the circumstances of this case, minimizes the influence of organized bargaining. It interferes with the right of self-organization by dramatizing for the employees the ^{there is no necessity for} ~~uselessness~~ of a collective bargaining agent. If successful in securing approval for the proposed increase of wages, it might well, as the Board points out, block the bargaining representative in securing further wage adjustments.

A
Book of Order

Petitioner complains here of the refusal of the Court to modify paragraph 1(b) of the Board's order to the extent which petitioner explicitly asked for below in its petition for rehearing.*

* Section 10(e) of the National Labor Relations Act, 49 Stat. 454, precludes the consideration by the Circuit Court of any objection not raised before the Board, unless such failure is excusable because of "extraordinary circumstances." We must therefore appraise the record to determine the power of the Circuit Court to review paragraph 1(b) of the Board's order.

In this proceeding the paragraph first appeared in the intermediate report of the Board's examiner (R. 55). The petitioner excepted specifically to paragraph 1(b) of the proposed order as "not supported or justified by the record" (R. 41). This was the only objection made to the paragraph in question in the proceedings before the Board. The examiner's recommendation was adopted by the Board in its order (R. 45). Unless this objection was sufficiently specific to apprise the Board of the question now presented, the Circuit Court had no power to consider it. *Marshall Field & Co. v. Board*, 318 U. S. 253. In the *Marshall Field* case we declined to consider an issue as to the power of the Board to grant a back pay order which was construed as barring the deduction of unemployment compensation from the award, although the question was raised by answer and decided by the Circuit Court of Appeals, *National Labor Relations Board v. Marshall Field & Co.*, 129 F. 2d 169. Our reason for refusing review was that the only objection to the Board's power was error by the examiner "in making each and every recommendation." The remedy recommended by the examiner was the usual back pay less earnings without any word in the report as to the unemployment compensation. This was too general to apprise the Board of an intention to bring up the question of the deductibility of the compensation and of the necessity for findings.

Although it falls short of desirable specificity, we think the objection was sufficient in the present case. *Further* No findings are needed. The

B

paragraph in issue is a standard form of order frequently used by the Board; the same question with respect to an almost identical order was considered by this Court in Labor Board v. Express Pub. Co., 312 U. S. 426, and has been a frequent subject of dispute in the Circuit Courts (see n. _____ ^{Post} ~~supra~~). These circumstances coupled with an objection that the order was "not supported or justified by the record" put the Board on notice of the issue now presented.

That paragraph, together with another which enjoins refusal to

*
bargain, is set out below. Petitioner's ~~only~~ ^{best} argument is that

the broad, blanket provisions of 1(b) are invalid. The language
of the prohibition covers interferences with all the rights of

**
employees which are covered by section 7 of the Labor Act, while
at the most, petitioner urges, the Board has found and the Circuit
Court sustained only two unfair labor practices by petitioner,

"(1) a refusal to bargain and (2) the storewide salary increase."

Both of these, it is asserted, are but incidents in petitioner's
effort to obtain judicial review of the Board's certification. As
the Board's selection of an appropriate unit to choose the employees'
bargaining representative and the Board's subsequent certification
of the representative chosen, section 9, is not judicially reviewable
directly, petitioner takes the position that it committed the unfair

* Decreed that May Department Stores Company, etc., shall cease and desist from 1. (a) "Refusing to bargain collectively with St. Louis Joint Council, United Retail & Department Store Employees of America, affiliated with the Congress of Industrial Organizations, as the exclusive representative of all its employees at its St. Louis store engaged in the busheling room, second floor, department 280, and in the busheling room, basement, department 281, including regular extra employees in these departments, but excluding the two foremen and all other employees of the respondent;

"(b) In any other manner interfering with, restraining, or coercing its employees who are referred to in paragraph 1(a) in the exercise of their right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in concerted activities, for the purpose of collective bargaining or other mutual aid or protection, as guaranteed in Section 7 of the National Labor Relations Act."

** The guarantees of section 7 are coextensive with the prohibitions of paragraph 1(b) of the order. 49 Stat. 452.

These writs of certiorari were granted to examine the deductibility as interest of certain payments which the taxpayer corporations made to holders of their corporate obligations. Although the obligations of the two taxpayers had only one striking difference, the non-cumulative in one and the cumulative quality in the other of the payments reserved under the characterization of interest, the Tax Court ^{formerly the Board of Tax Appeals} held that the payments under the former, the Kelley Company case, were interest and under the Talbot Mills were dividends. The Circuit Court of Appeals reversed the Tax Court in the Kelley case and another circuit affirmed the Talbot Mills decision. ^{1/} One circuit court treated the issue in the Kelley case as a clear question of law for its plenary review and the other circuit court cited Dobson v. Commissioner, 320 U. S. 489, in support of its concurrence with the Tax Court's conclusions. Deeming further examination of the principle of the Dobson case needed in the administration of the laws relating to internal revenue, we granted certiorari.

In the Kelley case, a corporation, all of whose common and preferred stock was owned directly or as trustee by members of a family group, was reorganized by authorizing the issue of \$250,000 income debenture bearer bonds, issued under a trust indenture, calling for 8% interest, non-cumulative. They were offered only to shareholders of the taxpayer but were assignable. The debentures were payable in twenty years,

December 31, 1956, with payment of general interest conditioned upon the sufficiency of the net income to meet the obligation. The debenture holders had priority of payment over stockholders but were subordinated to all other creditors. The debentures were redeemable at the taxpayer's option, carried the usual acceleration provisions for specified defaults and were transferable. The debenture holders had no right to participate in management. Other changes not material here were made in the corporate structure. Debentures were issued to the amount of \$150,000 face value. The greater part, \$114,648, was in exchange for the original preferred, with six per cent cumulative guaranteed dividends, at its retirement price and the balance at par, which was eventually paid with sums obtained by the purchasers from common stock dividends. Common stock was owned in the same proportions by the same stockholders before and after the reorganization.

In the Talbot Mills case the taxpayer was a corporation which, prior to its recapitalization, had a capital stock of five thousand shares of the par value of \$100 or \$500,000. All of the stock with the exception of some qualifying shares was held by members, through blood or marriage, of the Talbot family. In an effort to adjust the capital structure to the advantage of the taxpayer, the company was recapitalized just prior to the beginning of the fiscal year in question.

by each stockholder surrendering four-fifths of his stock and taking in lieu thereof registered notes in aggregate face value equal to the aggregate par value of the stock retired. This amounted to an issue of \$400,000 in notes to the then stockholders. These notes were dated October 2, 1939 and were payable to a specific payee or his assignees on December 1, 1964. They brought annual interest at a rate not to exceed 10% nor less than 2%, subject to a computation that took into consideration the net earnings of the corporation for the fiscal year ended last previous to the annual interest paying date. There was, therefore, a minimum amount of 2% and a maximum of 10% due annually and between these limits the interest payable varied in accordance with company earnings. The notes were transferable only by the owner's endorsement and the notation of the transfer by the company. The interest was cumulative and payment might be deferred until the note's maturity when "necessary by reason of the condition of the corporation." Dividends could not be paid until all then due interest on the notes was satisfied. The notes limited the corporation's right to mortgage its real assets. The notes could be subordinated by action of the Board of Directors to any obligation maturing not later than the maturity of the notes. For the fiscal year in question the maximum payment of 10% was made on the notes.

In holding that the recapitalization in the Kelley case made its reserved payments "interest," the Tax Court said that the exchange of the preferred stock for the debentures in question showed that for personal reasons the holders preferred the debtor-creditor status to that of stockholders. An accrued interest account was set up on the corporation's books sufficient to meet the obligations. Payment to the debenture holders was authorized as "interest." The holders had no voice in management. There was an unconditional promise to pay the principal at a fixed maturity date. The Tax Court considered the effect of payment of interest only out of net income and of the subordination of the bonds to other indebtedness. It does not appear that the Tax Court considered the effect of the transferability feature of the debentures. Because of that feature the debenture holders might have been different from the stockholders. Nor does it appear in the opinion that the effect of the ^{unusual} non-cumulative provision was weighed.

In the Talbot Mills decision, the Tax Court found that tax advantage was one of the motivating facts in the recapitalization. It appraised the assignability feature; recognized the presence of the cumulative interest requirement and of the deferability provision; distinguished the Kelley decision because interest there was to be paid out of income without fluctuation and sales of the bonds were made. Its conclusion

was made from the totality of primary facts, not from examination of individual elements.

The payments in question on corporate obligations were for the years in the Kelley case, 1937, 1938 and 1939; in the Talbot Mills case for the year 1940. Both corporations deducted the payments as interest from their reports of gross income under statutory sections and regulations set out in the footnote.^{2/} The applicable statutes and regulations were identical for all periods. The Commissioner asserted deficiencies because the payments were considered dividends and not interest.

From the statements of facts which were found by the Tax Court, it appears that the characteristics of all the obligations in question and the surrounding circumstances were of such a nature that it is reasonably possible for determiners to reach a conclusion that the secured annual payments were interest to creditors or dividends to stockholders. There is not present in either situation the wholly useless temporary compliance with statutory literalness which this Court condemned as futile, as a matter of law, in Gregory v. Helvering, 293 U. S. 465. The demonstrated possibility of sales by the holders of the obligations to persons other than stockholders alone proves the differentiation. As material amounts of capital were invested in stock, we need not consider the effect of extreme situations such as nominal stock investments and an obviously excessive debt structure.

For reasons which will presently appear, we do not believe that the statutory court review of Tax Court decisions empowers the Circuit Courts of Appeals or this Court to draw inferences as to whether the conclusion of the Tax Court as to the character, as interest or dividends, of the reserved annual payments on the corporate obligations. Such inferences are solely for the Tax Court. However, in the Kelley Company case, we think that as a matter of law the opinion of the Tax Court fails to give evidence of the appraisal of certain relevant factors in the situation. We express no opinion as to the weight which the Tax Court should give to the additional evidence to which we refer.

Check
2

The obligation to render carefully considered judgments on the applicable facts accompanies the legislative delegation to agencies of finality in their factual determinations. In the case of the Tax Court this requirement is directed by the statutory mandates for open hearings and written findings of facts and opinions. Internal Revenue Code §§1116, 1117 and 1118. This duty is more definite than an agency's responsibility for clarity of decision to which we called attention in Phelps Dodge Corporation v. Labor Board.^{3/} The Tax Court sits to hear issues between the Government and the taxpayer. Its function partakes of the judicial. Its decision must be drawn from legally admitted evidence and it may not exclude from consideration legally relevant facts. Compare Morgan v. United States, 298 U.S. 468, 479. As we read

the Tax Court decision in the Kelley Company case, it evidences no appraisal of effect on its conclusion of the transferability of the bonds or the non-cumulative feature of the interest payments. Perhaps implicitly but certainly not explicitly, it fails to weigh the impact on the issue of the aggregate factors either for or against its conclusion on deductibility of the payments. We think the issue should be reconsidered by the Tax Court. We cannot say ^{as a matter of law} ~~that these bonds are stock or debt~~ ^{since there is material evidence to support either contention.}

for us and the Circuit Courts of Appeals
The lack of power/to draw such inferences lies in the limitations

of the statutory sections relating to court review of Tax Court decisions.

The Internal Revenue Code, Section 1141, authorizes the review. Subsection (c) which controls that action reads as follows:

"§1141. Courts of Review. . . . (c) Powers
(1) To affirm, modify or reverse. Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require."

Our question here is whether the inferences which the Tax Court has drawn from the uncontroverted facts of these records are subject to judicial reexamination in the reviewing courts. We think that they are not.

Anyone accustomed to examine the results of agency determinations, where questions of law have been reserved for judicial review, has been frequently confronted with the difficulty of drawing the line

cf Dobson

between issues of law which the courts may pass upon and issues of fact which are for the exclusive decision of the administrative body. Perhaps no definite or convincing solution lies in any generalization.^{4/} Sometimes the answer is so elusive that the reviewing court is attracted to the view that matters for an administrative body's final determination should be all those matters in which that agency has the competence of experience and specialization. This would result practically in limiting judicial review to procedure. That is, for examples to an examination into whether the administrative body followed the statutory requisites of notice, hearing and adjudging or whether the charge was leveled at a person within the coverage of the act or whether the sanction was within the agency's power. It is sometimes suggested, too, that an administrative body should act finally in those instances where the body's decision settles a case but lays down no principle of general application. Without undertaking to say whether such tests would promote clarity of administration, courts are not at liberty to choose for themselves either an easier way for their disposing of cases or a method of decision by agencies which might be thought to promote administrative efficiency.

Judicial review is a well understood concept. The difficulties of discrimination between law and fact must have been known to the Congress in 1926 when it created the Tax Court and endowed it with administrative

finality in matters of fact by allowing review only when the decision of the Court was not in accordance with law. Since the power to review the Tax Court exists only when its decisions are not in accordance with law, federal appellate courts must begin consideration of every appeal from the Tax Court with an inquiry into their power of review under the statute.

When Congress in 1926 passed the present sections which provide for judicial review of Tax Court decisions, it was legislating upon a subject, the collection of the revenue, in which federal administrative finality has been given wide scope.^{5/} This Court has recently fully reviewed the legal history of the enactment. Dobson v. Commissioner, 320 U. S. 489, 496. The Tax Court was originally established to "secure an impartial and disinterested determination of the issues involved, so that the taxpayer and the Government would have an independent review of the position of either on tax demands before payment of the tax or foreclosure of an asserted deficiency. Two years later its success was recognized by committee commendation and the enlargement of the finality of its decisions from "prima facie evidence of the facts therein stated" to reviewability only "if the decision of the Board is not in accordance with law."^{6/} As to the mischief which the limitation of the scope of judicial review was to cure, we find only the words of the committee reports.^{7/}

In 1926 it must be admitted there existed the same uncertainty in legal thought which exists today as to the precise demarcation between law and fact.^{8/}

From the reports of the House and Senate Committees, note 7, supra, we know that the mechanics of procedure on review from the decision of the experts was to be like "an original action in a Federal district court." That is, that the review was to be before an appellate court in accordance with the procedure for review, ~~(as distinguished from the finality of the Tax Court's decision)~~ of the Federal Trade Commission and the Packers and Stockyards Act. ^{The method of ~~whenever~~} ~~Judicial review for these two~~ ^{differed.} agencies were of different kinds. The Federal Trade Commission's orders were subject to review in a circuit court of appeals. It was then the Commission's duty to file a transcript of the record in the court. 38 Stat. 720:

"Upon the filing of the transcript the court shall have the same jurisdiction to affirm, set aside, or modify the order of the commission as in the case of an application by the commission for the enforcement of its order, and the findings of the commission as to the facts, if supported by testimony, shall in like manner be conclusive."

The Packers and Stockyards Act, 42 Stat. 159, had two methods of review, one for Title II, Packers, by which the packer aggrieved could secure a plenary review of the law and facts, ^{10/} and the other for Title III, Stockyards, the familiar injunction proceedings under the Urgent Deficiencies Act of 1913 for Interstate Commerce orders, 38 Stat. 220. For tax appeals a direct court review was adopted rather than the procedure of injunction. So far as the finality of Tax Court action is concerned, the Tax Act now under consideration did not embody specifically the language

or implied effect of any of the provisions to which reference has just been made. Instead the limitation on review power of the Code §1141, set out on page ____ was enacted.

Courts

~~Judicial review~~ under the Interstate Commerce Act procedure had, in 1926, recognized the finality of that commission's determinations not only in primary or evidential facts but also in the inferences or conclusions to be drawn from those facts. This Court had definitely ruled that determinations by the Commission of what was an "undue preference" or a discrimination were beyond judicial reviewing power.

United States v. Louisville and Nashville R. Co., 235 U. S. 314, 320: "in substituting its judgment as to the existence of preference for that of the Commission on the ground that where there was no dispute as to the facts it had a right to do so, obviously exerted an authority not conferred upon it by the statute."

This position was emphatically repeated in Pennsylvania Co. v. United States, 236 U. S. 351, 361, thus:

"This section forbids any undue or unreasonable preference or advantage in favor of any person, company, firm, corporation or locality; what is such undue or unreasonable preference or advantage is a question not of law, but of fact. Texas & Pacific Ry. v. Interstate Commerce Commission, 162 U. S. 197, 219; Interstate Commerce Commission v. Alabama Midland Railway, 168 U. S. 144, 170."

See also Manufacturers Railway v. United States, 246 U. S. 457, 481; Atchison, Topeka & Santa Fe R. Co. v. United States, 232 U. S. 199, 221. So with the reasonableness of rates. Interstate Commerce Commission v.

Union Pacific R. Co., 222 U. S. 541, 550; Illinois Cent. &c. R. R. v.

Interstate Commerce Commission, 206 U. S. 428, 459. Under the Federal Trade Commission Act, this Court had held that an inference of that Commission on "unfair method of competition" was subject to judicial review so as "ultimately to determine as matter of law what they include."

Federal Trade Comm. v. Gratz, 253 U. S. 421, 427. Perhaps the Court felt there was a difference between direct review, though limited as above indicated, and the review by injunction. See Fed. Trade Comm. v. Curtis Co., 260 U. S. 568, 580. If so, that view has given way to a different conception of the court's powers of review over the orders of the Federal Trade Commission. In Fed. Trade Comm'n v. Algoma Co., 291 U. S. 67, 73, 81-2, it was said as to an "unfair" finding:

"The findings of the Commission as to facts, if supported by testimony, shall be conclusive." 15 U.S.C. §45. The Court of Appeals, though professing adherence to this mandate, honored it, we think, with lip service only. In form the court determined that the finding of unfair competition had no support whatever. In fact what the court did was to make its own appraisal of the testimony, picking and choosing for itself among uncertain and conflicting inferences. Statute and decision (Federal Trade Comm'n v. Pacific States Paper Trade Assn., 273 U. S. 52, 61, 63) forbid that exercise of power."

See also Fed. Trade Comm'n v. Education Society, 302 U. S. 112, 113, 117.

"The finding of unfair competition being supported by the testimony, the Commission did not abuse its discretion in reaching the conclusion that no change of the name short of the excision of the word 'white' would give adequate protection."

administrative finality of agency inferences from primary facts.

For example, in Swayne & Hoyt v. United States, 300 U. S. 297, also

review by injunction, it was held on a review of a rate as unduly

prejudicial to certain shippers that:

"Whether a discrimination in rates or services of a carrier is undue or unreasonable has always been regarded as peculiarly a question committed to the judgment of the administrative body, based upon an appreciation of all the facts and circumstances affecting the traffic." Page 304.

"Even though, as appellants seem to argue, the evidence may lend itself to support a different inference, we are without authority to substitute our judgment for that of the Secretary that the discrimination was unreasonable." Page 307.

And in Security Adm'r v. Quaker Oats Co., 318 U. S. 218, ~~227~~, 233, in passing upon a regulation defining a food product, we said:

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See also Trade Comm'n v. Education Society, 302 U. S. 112, 113, 117.

In other fields, this Court has been prompt to recognize the administrative finality of agency inferences from primary facts. For example, in Swayne & Hoyt v. United States, 300 U. S. 297, also review by injunction, it was held on a review of a rate as unduly prejudicial to certain shippers that:

"Whether a discrimination in rates or services of a carrier is undue or unreasonable has always been regarded as peculiarly a question committed to the judgment of the administrative body, based upon an appreciation of all the facts and circumstances affecting the traffic." Page 304.

"Even though, as appellants seem to argue, the evidence may lend itself to support a different inference, we are without authority to substitute our judgment for that of the Secretary that the discrimination was unreasonable." Page 307.

And in Security Adm'r v. Quaker Oats Co., 318 U. S. 218, ~~227~~, 233, in passing upon a regulation defining a food product, we said:

"The Act does not contemplate that courts should thus substitute their own judgment for that of the Administrator. As passed by the House it appears to have provided for a judicial review in which the court could take additional evidence, weigh the evidence, and direct the Administrator 'to take such further action as justice may require.' . . . But before enactment, the Conference Committee substituted for these provisions those which became §701(f) of the Act. While under that section the Administrator's regulations must be supported by findings based upon 'substantial evidence' adduced at the hearing, the Administrator's findings as to the facts if based on substantial evidence are conclusive."

"Since the definition of identity of a vitamin-treated food, marketed under its common or usual name, involves the inclusion of some vitamin ingredients and the exclusion of others, the Administrator necessarily has a large range of choice in determining what may be included and what excluded. It is not necessarily a valid objection to his choice that another could reasonably have been made. The judicial is not to be substituted for the legislative judgment. It is enough that the Administrator has acted within the statutory bounds of his authority, and that his choice among possible alternative standards adapted to the statutory end is one which a rational person could have made."

11/

In the Quaker Oats case, the review was direct, not by injunction.

For further light on the purpose of Congress, we return to the words of the report which will be found in note 7, supra. The illustrations in the report are legal questions without doubt, except the possibility that the words "application of the statute or any regulation having the force of law" may be thought to give a reviewing court power to pass upon the Tax Court's conclusion from the primary or evidential facts. So that in the present cases, it might be said to be a question of law as to whether the primary facts adduced made the payments under consideration dividends or interest. But we think such an argument misconceives the purpose of the Tax Court. The finality of the Tax Court's rulings was being enlarged by the 1926 Act. The then Board was spoken of as an impartial and independent tribunal of experts "for the determination of tax liabilities as between the Government and the

taxpayer." Report No. 1, supra, page 17. There would hardly need
to be experts in tax affairs to decide questions of dates or amounts
or to calculate rates. ^{Their usefulness} ~~Its value~~ lies in the ability to draw inferences.

? Adequate reason for the use of the word "application" of course exists
in situations where true legal questions ^{arise} ~~exist~~, as in whether an act
applies to transfers antecedent to its enactment or to income or estate
taxes from trusts or to situations which involve conflicts of law.

Following the passage of the 1926 Act limiting the judicial review of the Tax Court's decisions to those instances where the reviewing court could hold that the tax Court's decision was not in accordance with law, ^{courts} ~~the court's review~~ undertook examination of Tax Court inferences from primary facts as ^{legal questions} ~~a matter of law~~. ^{12/} This approach was continued with small variation ^{through} ~~until~~ Tex-Penn Oil Co. v. Helvering, 300 U. S. 481, 490, and Bogardus v. Commissioner, 302 U. S. 34, 38. The concurrence and the dissent in those two cases indicated a developing conviction that the courts of review were barred from reexamining Tax Court inferences from evidentiary findings of fact. See also Colorado Bank v. Commissioner, 305 U. S. 23, 27.

With the extension of adjudicatory powers to agencies for the purpose of carrying on the involved routine of government, judicial acceptance of the constitutionality of the part these administrative bodies were expected by Congress to play in the federal legal system ^{13/} has led this Court gradually to readjust its conception of the statutory limitation on review of Tax Court inferences. ^{14/}

Of course, the construction of a tax statute is a legal question. When the statutory language needs definition to make its meaning or its application known, that definition must be given by the courts, just as a judge instructs a jury on the meaning of negligence or of self-defense. When, however, construction or definition has been made

by courts or when the statutory language needs neither, the Tax Court's inference from the primary facts of the particular case under review has finality. Its decision is "untouchable" unless beyond reason.^{15/}

Perhaps courts would not have reached the same conclusions on the facts of the cases we are considering. The words "interest" and "dividend," as used in the tax statutes, are well understood, however.

Equitable Life Assurance Society v. Commissioner, 321 U. S. 560;

Deputy v. DuPont, 308 U. S. 488, 498. We are brought to the conclusion the determination of that ~~xxxxxxxxxxxx~~ whether the circumstances of the recapitalizations brought the disbursements under one category or the other was for the Tax Court.

Since we think the Tax Court in the Kelley decision failed to give consideration to certain factors which require appraisal, we reverse that judgment and direct that it be returned to the Tax Court for rehearing. We affirm the Talbot Mills decree.

It is so ordered.

- 1 1 T.C. 457; 146 F. 2d 466; cert granted, U. S. ; Judicial Code §240(a).
3 T.C. 95; 146 F. 2d 809; cert granted, U. S. ; Judicial Code §240(a).

2 Internal Revenue Code:

"SEC. 23. Deductions from Gross Income. In computing net income there shall be allowed as deductions:

(b) Interest.--All interest paid or accrued within the taxable year on indebtedness, . . . "

"SEC. 115. Distributions by Corporations. (a) Definition of Dividend.-- The term 'dividend' when used in this chapter (except in section 203(a)(3) and section 207(c)(1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year"

Treasury Regulations 103.

"SEC. 19.23 (b)-1. Interest.--Interest paid or accrued within the year on indebtedness may be deducted from gross income, . . .

So-called interest on preferred stock, which is in reality a dividend thereon, cannot be deducted in computing net income. . . ."

See Revenue Acts of 1936 and 1938, 49 Stat. 1648, 52 Stat. 447, and Treasury Regulations 94, Art. 23(b)-1 and 101 Art. 23(b)-1.

3. 313 U. S. 177, 189-197.

4 Jurisconsults, authors and judges have grappled with the problem over the years. Compare Thayer, A Preliminary Treatise on Evidence at the Common Law, CV, with Holmes, The Common Law, pp. 123-129. Holdsworth, History of English Law, Vol. 1, pp. 298, 312. Report, Committee on Minister's Powers (English)(1932), sec. 111, subsection 12, p. 98. King v. Board of Education, 2 K.B. (1910) 165, 174, 179; Minister of Health v. The King (on prosecution of Yaffe)(1931) A.C. 494, 503, 532; Errington v. Minister of Health, 1 K.B. (1935) 249, 265; White and Collins v. Minister of Health, 2 K.B. (1939) 838; Final Report, Attorney General's (U.S.) Committee on Administrative Procedure (1941) CVI; Dickinson, Administrative Justice, c. III; Brown, Fact and Law in Judicial Review, 56 Harv. L. R. 899; Jaffe, Administrative Procedure, 56 Harv. L. R. 726; Paul, Dobson v. Commissioner; The Strange Ways of Law and Fact, 57 Harv. L. R. 753.

FOOTNOTES (contd.)

5 R. S. §224; U. S. C. §653; *Heiner v. Diamond Alkali Co.*, 288 U. S. 502; *Cary v. Curtis*, 3 How. 236.

6 H. Rep. No. 179, 68th Cong., 1st Sess., p. ; S. Rep. No. 398, 68th Cong., 1st Sess., p. ; 44 Stat. 110, sec. 1003(b); H. Rep. No. 1, 69th Cong., 1st Sess., p. 17; S. Rep. No. 52, 69th Cong., 1st Sess., p. 34.

While establishing a complete system of review, it has all along been recognized that the taxpayer could secure a jury trial of fact issues, if he chose to pay and sue for recovery. S. Rep. No. 52, 69th Cong., 1st Sess., p. 37. *Dobson v. Commissioner*, 320 U. S. 489, 495; *Bingham v. Commissioner*, No. 932, decided June 4, 1945, dissent, note 1.

7 H. Rep. No. 1, 69th Cong., 1st Sess., p. 19:

"Court review--Questions of fact and law.--The procedure is made to conform as nearly as may be to the procedure in the case of an original action in a Federal district court. Inasmuch as the complicated and technical facts governing tax liability require a determination by a body of experts, the review is taken directly to an appellate court, just as, for instance, in the case of orders of the Federal Trade Commission, and orders of the Secretary of Agriculture under the packers and stockyards act. In view of the grant of exclusive power to the board finally to determine the facts upon which tax liability is based, subdivision (b) of section 914 limits the review on appeal to what are commonly known as questions of law. The court upon review may consider, for example, questions as to the constitutionality of the substantive law applied, the constitutionality of the procedure used, failure to observe the procedure required by law, the proper interpretation and application of the statute or any regulation having the force of law, the existence of at least some evidence to support the findings of fact, and the validity of any ruling upon the admissibility of evidence (see subdivision (a) of section 907 and subdivision (b) of section 914). The court, therefore, may adequately control the action of the administrative officer or agency, but will not be burdened with the duty of substituting its opinion for that of the board upon the evidence."

[§ 1003(b)]

8 In 1926, it was written:

"In truth, the distinction between 'questions of law' and 'questions of fact' really gives little help in determining how far the courts will review; and for the good reason that there is no fixed distinction. They are not two mutually exclusive kinds of questions, based upon a difference of subject-matter. Matters of law grow downward into roots of fact, and matters of fact reach upward, without a break, into matters of law. The knife of policy alone effects an artificial cleavage at the point where the court chooses to draw the line between public interest and private right." Dickinson, *Administrative Justice and the Supremacy of Law*, p. 55.

In 1941 the Final Report of the Attorney General's Committee on Administrative Procedure declared, p. 90: "What one judge regards as a question of fact, another thinks is a question of law."

FOOTNOTES (contd.)

9 On application by the commission for enforcement, the statute provides as follows, 38 Stat. 720: " . . . thereupon shall have jurisdiction of the proceeding and of the question determined therein, and shall have power to make and enter upon the pleadings, testimony, and proceedings set forth in such transcript a decree affirming, modifying, or setting aside the order of the commission. The findings of the commission as to the facts, if supported by testimony, shall be conclusive."

10 42 Stat. 162:

"(d) The evidence so taken or admitted, duly certified and filed as aforesaid as a part of the record, shall be considered by the court as the evidence in the case. The proceedings in such cases in the circuit court of appeals shall be made a preferred cause and shall be expedited in every way.

"(e) The court may affirm, modify, or set aside the order of the Secretary."

11 52 Stat. 1056:

"(3) The court shall have jurisdiction to affirm the order, or to set it aside in whole or in part, temporarily or permanently. If the order of the Secretary refuses to issue, amend, or repeal a regulation and such order is not in accordance with law the court shall by its judgment order the Secretary to take action, with respect to such regulation, in accordance with law. The findings of the Secretary as to the facts, if supported by substantial evidence, shall be conclusive."

12 Phillips v. Commissioner, 283 U. S. 589, 599; Old Colony Tr. Co. v. Comm'r Int. Rev., 279 U. S. 716, 729; Mertens, Federal Income Taxation, 405; 2 Paul, Federal Estate and Gift Taxation, 869. (9)

13 Brown, Administrative Commissions and the Judicial Power, XIX Minnesota L. Rev. 261.

14 Helvering v. F. & R. Lazarus Co., 308 U. S. 252, 255 (inference that lease was a mortgage); Wilmington v. Helvering, 316 U. S. 164, 167 (inference that sales of stock were ordinary sales, not short sales); Helvering v. Stock Yards Co., 318 U. S. 693, 700, 702 (corporation availed of for tax avoidance); Dobson v. Commissioner, 320 U. S. 489, 502, 506 (proper tax accounting); Equitable Society v. Comm'r, 321 U. S. 560, 563 (inference whether payments were interest); Comm'r v. Scottish American Co., 323 U. S. 119 (inference that office or place of business was maintained).

15 See note 4, supra, Dickinson, p. 312; Paul, 826, 832, 840; Brown, 904.

FOOTNOTE

Of the decisions rendered by this Court since the Dobson case, in the following cases the conclusions depended on:

1. Questions of law: Comm'r v. Lane-Well, Co., 321 U. S. 219 (whether separate personal holding company tax return must be filed to start statute of limitation running); Douglas v. Comm'r, 322 U. S. 275 (whether validity of treasury regulation relating to ~~treatment of~~ depletion deductions from advance royalties where no minerals are extracted); Comm'r v. Harmon, 323 U. S. 44 (effect of Okla. optional community property statute on income tax liability); McDonald v. Comm'r, 323 U. S. 57 (deductibility of campaign expenses); Claridge Apartments Co. v. Comm'r, 323 U. S. 141 (interpretation and application of provisions of bankruptcy act relating to basis); Fondren v. Comm'r, 324 U. S. 18 (whether certain transfers to minor children constituted "gifts of future interests in property"); Comm'r v. Estate of Field, 324 U. S. 113 (method of valuation of part of corpus of inter vivos trust under estate tax); Webre-Steib Co. v. Comm'r, 324 U. S. 164 (interpretation of meaning and effect of certain statutory presumptions, determination of whether there was sufficient evidence to justify remand to Tax Court for finding of fact); Comm'r v. Smith, 324 U. S. 177, (whether difference between option price and market price of shares of stock is income to employee in the years in which the option is exercised although option was valueless when given); Comm'r v. Wheeler, 324 U. S. 542 (method of determining for purposes of "earnings or profits" under whether §112(b)(7)(E) of the Revenue Act of 1938 the basis of assets distributed in liquidation, which shares were acquired in a tax free reorganization, was the transferor's basis or the fair market value at the time of distribution); Comm'r v. Estate of Bedford, 325 U. S. 283 (whether distribution of cash in a recapitalization had the effect of a distribution of a taxable dividend or was taxable as a capital gain); Angelus Milling Co. v. Comm'r, 325 U. S. 293 (procedure with respect to claim for refund of processing tax); ~~XXXXXXXXXXXXXXXXXXXX~~ Trust of Bingham v. Comm'r 325 U. S. 365 (whether legal expenses were deductible by trust as "non-trade" or "non-business" expenses); Comm'r v. Diston, 325 U. S. 442 (whether certain gifts to minors were "gifts of future interest in property"); Boehm v. Comm'r, U. S. (standard for determining when stock becomes worthless).

FOOTNOTE - cont'd

2. Question based on inferences from primary facts: Equitable Life Assurance Soc. v. Comm'r, 321 U. S. 560 (deductibility as interest of "excess interest dividends" paid under life insurance policies); Comm'r v. Scottish American Co., 323 U. S. 119 (whether an "office" or "place of business" was maintained in the United States); Boehm v. Comm'r, U. S. (year in which certain stock became worthless). *Kalley*

3. Questions of fact (including accounting): Dixie Pine Products Co. v. Comm'r., 320 U. S. 516 (time for accruing deduction of contested state tax); Security Flour Mills v. Comm'r., 321 U. S. 281 (time for accruing as deduction refunds of processing tax to customers); Choate v. Comm'r, 324 U. S. 1 (whether transfer of oil lease together with oil wells and equipment constituted sub-lease or sale); Comm'r v. Wemyss, 324 U. S. 303 (whether ante-nuptial transfer was taxable as gift); Comm'r v. Court Holding Co., 324 U. S. 331 (whether sale effected by corporation or shareholders); Estate of Putnam v. Comm'r, 324 U. S. 393 (time for accruing dividends paid shareholders).

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tax); *Weber Steib Co. v. Comm'r*, 324 U.S. 164 (interpretation of meaning & effect of certain statutory presumptions; determination of whether there was sufficient evidence to justify remand to Tax Court for finding of fact); *Comm'r v. Smith*, 324 U.S. 177, 69-1 (whether difference between option price + market price of shares of stock is income to employee in the the years in which the option is exercised although option was valueless when given); *Comm'r v. Wheeler*, 324 U.S. 542 (Method of determining for purposes of "earnings or profits" under § 112(b)(7)(E) of the Rev Act of 1938 the basis of shares ^{to} distributed distributed in liquidation, which ^{shares} were acquired in a tax free reorganization); *Comm'r v. Estate of Bedford* 325 U.S. 383 (whether distribution of cash in a recapitalization had the effect of a distribution of a taxable dividend or was taxable as a capital gain); *Angelo, Milling Co. v. Comm'r* 325 U.S. 293 (procedure with respect to claim for refund of processing tax);

Comm'r v. Disston, 320 U.S. 472 (whether certain gifts to minors were "gifts of future interest in property");

Trust of Biapham v. Comm'r, 325 U.S. 365 (whether legal expenses were deductible by trust as "non trade" or "non-business" expenses);

Boehm v. Comm'r - U.S. - (Standard for determining when stock becomes worthless)

2. ^{question based on} Inference from primary facts:

Equitable Life Assurance Soc. v. Comm'r, 321 U.S. 560 (deductibility as interest of "excess interest-dividends" paid under life insurance policies);

Comm'r v. Scottish American Co., 323 U.S. 119 (whether an "office" or "place of business" was maintained in the United State); ~~Comm'r v.~~

~~Boehm~~ Boehm v. Comm'r - U.S. - (year in which certain stock became worthless)

3 Questions of Fact (including accounting)

Dixie Pine Products Co. v. Comm., 320 U.S. 816 (Time for accruing deduction of contested state tax);

Security Flour Mills v. Comm'r, 321 U.S. ²⁸¹ ~~228~~ (Time for accruing as deduction refunds of processing tax to customers); Choate v.

Comm'r (324 U.S. 1) (whether

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transfer of oil lease together with
oil wells & equipment constituted sub-
lease or sale),

Comm'r v. Wemyss, 324 U.S. 303,
(whether anticipated transfer was
taxable as gift); Comm'r v.
Court Holding Co., 324 U.S. 331
(whether sale effected by corporation
or shareholders); Estate of
Putnam v. Comm'r 324 U.S. 593
(Time for accruing dividends
paid shareholder).

1

Of the ~~following~~ decisions rendered by this Court since the Dobson case in the following cases the conclusions depended on:

1. Statutory Interpretation ^{Questions} ~~Matter~~ of law:

Comm'r v. Lane-Well Co., 321 U.S.

219 (Whether separate personal holding company tax return must be filed to start statute of limitation running);

Douglas v. Comm'r, 322 U.S. 220-

(Validity of treasury regulation relating to treatment of depletion deduction from advance royalties where no minerals are extracted); Comm'r

v. Harmon, 323 U.S. 44 (Effect of Okla. optional community property ~~law~~ statute on income tax liability);

McDonald v. Comm'r, 323 U.S. 57 (Deductibility of campaign expenses);

Clavidge Apartments Co. v. Comm'r, 323 U.S. 141 (Interpretation & application of

provision of Bankruptcy Act ^{relating to} ~~tax~~ basis); Faudren v. Comm'r, 324

U.S. 18 (Whether certain gifts to minor children constituted "gifts of future interests in property"); Comm'r v. ^{Estate of} Field, 324 U.S.

113 (Method of ~~valuing~~ valuation of corpus of inter vivos trust sub estate

TALBOT MILLS

THE JOHN KELLEY CO.

Nature of Corporation

Small Family

Small Family

Manner of Distribution

Exchange for part of common shares
plus sale to existing stockholders.
No change in corporate control.

In exchange for preferred shares.
No change in corporate control.

Motive

Tax avoidance

Tax avoidance

Name of Security

Registered note

Income debenture *bonds*

Characteristics of Security

Fixed maturity date

Fixed maturity date

Fixed minimum rate of 2% whether
or not there are earnings; rate
between 2% and 10%, variable de-
pending on earnings. Payment
deferable till maturity. Cumulative.

Fixed interest (8%) out of income
only. Non-cumulative.

May be subordinated by directors
to any debt maturing not later
than maturity date of note.
Not presently subordinated.

Debenture expressly subordinate
to all other debts

Transferable

Transferable

Right to principal and interest
accelerated on bankruptcy,
receivership, dissolution or
liquidation.

Right to accelerate payment of
principal if interest due and
unpaid for two successive years.

No trust agreement

Trustees under indenture are
principal stockholders and
officers of the corporation;
they are vested with rights of
enforcement.

No voice in management

No voice in management.

3/5 of noteholders may alter terms
except they may not extend maturity
date, alter interest rate, diminish
principal, vacate effect of any
existing subordination.

The grounds of my dissent from the conclusion which the Court reaches in Estep's writ of certiorari may be simply stated. As the Court's decision involves at the least important principles of statutory interpretation, a disagreement with them justifies a succinct statement of the reasons which lead me to a contrary result.

As I understand the Court's opinion, it holds that the orders of the Selective Service System with respect to inclusion for or exemption from service under the Selective Training and Service Act of 1940 are final. That is that no one affected by such orders may question their validity in any judicial proceeding until after induction into the armed forces. Assuming that Congress might thus withdraw every judicial remedy ~~defense~~ from the citizen except habeas corpus, based upon violations or statutory? of constitutional rights, after induction, I do not read the statutory provisions of the Selective Service Act as so providing. Section 11 of the Act prescribes the punishment for knowingly failing to perform duties required by the Selective Service System in this case, failing to report and submit to induction. It directs that civilians, not "actually inducted" in the services shall be tried by the usual courts. Nothing is said in the Act as to any limitation upon the kind of defense a person may make. But the Court now holds, in reliance upon the words of finality in Section 10(a)(2), that although trial of

violators of orders is restricted to civil courts, defenses based upon violations of due process of law cannot be made. Specifically this means that, notwithstanding exercises of arbitrary power by the Selective Service agencies, even those dependent upon fraud or personal animosities or racial or religious bias, as is charged in this case, the victim must submit to induction into the armed forces or face trial without means of defense against the charge of violating a Selective Service order. The deferment of duly ordained ministers of religion is bracketed in classification under the Act with Governors of the states and territories and members of national or state legislative bodies. There is no need to detail further the specific violations of constitutional rights by the local board of the Selective Service System which the defendant offered to prove and which evidence the trial court refused to accept. No one questions that if the classification of the petitioner was handled as he intends, he was denied due process of law. To deny petitioner the right to prove his contentions draws all meaning out of the statutory provision for civilian trials under the Selective Service Act. It writes into the Act complete administrative finality for the orders of the Selective Service System for which I see no warrant in the words or legislative history of the enactment.

In *Falbo v. United States*, 320 U. S. 549, the administrative

process was incomplete. Pages 553, 554. In *Billings v. Truesdell*, 321 U. S. 542, we marked the line which finishes the administrative process. Pages 558, 559. Up to that point there is to be no interruption of the selective process by court review of its action.

Finality to the determinations of the local boards is given by

Section 10(a)(2) on "all questions or claims with respect to inclusion for, or exemption or deferment from, training and service under this

Act." The Court is compelled to admit that judicial relief from unconstitutional ^{or unlawful} restraint of liberty exists through habeas corpus. A complete

denial of such protection would destroy the system of checks and balances inherent in the Constitutional plan for the separation of powers.

If the orders of the local boards do not possess the finality which forbids that judicial review, I cannot believe that Congress, which forbade a court-martial for refusal to submit to induction, intended to deny a defendant the right to prove at his civil trial that the order which he refused to obey was a nullity because it was entered in

defiance of his constitutional rights. Only unambiguous legislation

to that effect would convince me that Congress intended to deny ^{the right to raise the} ~~the~~ defense of

^{deprivation} ~~protection~~ of procedural due process of law to any person in our courts.

See *Bridges v. Wixon*, No. 788, 1944 Term; *Chambers v. Florida*, 309 U. S.

227; *Stark v. Wickard*, 321 U. S. 288, 309. Compare *Yackus*

U. S., 321 U. S. 414.

adequate to require creditors to acquiesce in a fair adjustment of their claims, so long as the creditor gets all the value of his lien and his share of any free assets. ^{36/}

The grounds accepted by us in former sections of this opinion as sustaining, as of January 1, 1943, the valuation of the road, the allocation of the securities, and the treatment of cash, war earnings and capital reductions establish that for the act of confirmation over the objection of the General bondholders, the finding of the judge that the plan then made "adequate provision for fair and equitable treatment" of the dissenters was justified. 62 F. Supp. at 390. There is no doubt that the plan conforms to subsection (b), note 9 supra, and the other requirements of the first paragraph of subsection (e). Note 9 supra.

This leaves for consideration the question of whether, the plan being fair and equitable as of June, 1943, effective January 1, 1943, the Generals were reasonably justified in rejecting the plan by ballots cast between April 26 and July 15, 1944.

As we have pointed out under Allocation of Securities, supra, the Commission's plan was adopted after 1942, the year of greatest profit and with anticipation on the part of the Commission that there might be other "big" years but with realization that the war profits were not a sound basis for higher valuation. Current reports of earnings were a part of the record. Nothing that respondents have called to our attention

Reasonableness of Rejection. As the conclusions of the Circuit Court of Appeals as to the allocation of securities, the treatment by the Commission of cash, war earnings, and decrease in debt with priority over the Generals differed from those made by this Court in this opinion, that court's conclusion followed naturally that the General bondholders were reasonably justified in rejecting the plan. 150 F. 2d 40. Section (e) gives power to a class, here the General bondholders to reject the plan subject to the power of the District Court, after certification of the result of the submission, to "confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection (e)." 11 U.S.C. §205; see note 9, supra. ^{34/} The plan was confirmed after appropriate findings. 62 F. Supp. at 390.

This provision for confirmation of a plan despite rejection by a class appeared in the draft for the 1935 amendments. Apparently it caused no particular comment. ^{35/} We think that the provisions for confirmation by the courts over the creditors' objection are within the bankruptcy powers of Congress. Those powers are adequate to eliminate claims by administrative valuations with judicial review and they are

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FOOTNOTES (contd.)

34 Clauses (2) to (3) are not involved. They relate to expenses, fees and costs.

35 H. Rep. No. 1283, 74th Cong., 1st Sess., p. 18; S. Rep. No. 1336, 74th Cong., 1st Sess., p. 3, contains the following statement: "Further, the consent of two-thirds of each class of stockholders must be acquired, unless, by an elaborate valuation proceeding, it is proved that the value of the property is so low that the stock has no interest. This is an effective obstruction. . . ."

"In order to remedy these defects, S. 1634, as amended, provides that two-thirds of those of each class who vote upon a plan will bind the dissenters or those failing to vote. But it also provides that the court may make effective a fair plan where the parties do not agree. . . . If two-thirds of each class consent, the plan will bind the remainder of each class. But the judge may make the plan effective, even if not so accepted, if he finds that it conforms to the requirements just stated, provides fair and equitable treatment for the interests of those rejecting it, and that their rejection is not reasonably justified in the light of the respective rights and interests. These provisions give complete due process of law from a procedural standpoint, there being provision for full hearings both before the commission and the court. Within the broad powers of Congress under the bankruptcy clause as recently declared by the Supreme Court in Continental Illinois Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co. (55 Sup. Ct. Rep. 595), the provisions also afford due process of law in fully protecting the property rights which are involved."

See also Hearings, House Judiciary Committee, 74th Cong., 1st Sess., on H. R. 6249, Serial 3, pp. 16 and 22.

36 Wright v. Union Central Ins. Co., 311 U. S. at 278, and discussion at pp 8 and 9, supra.

37 Cf. I.C.C. v. Jersey City, 322 U. S. 503, 515.

38 In Re Denver & R. G. W. R. Co., 150 F. 2d at 38:

"Neither was the Commission compelled to, nor would it be justified in adding the amount of these expenditures to the capitalized value if in the exercise of sound discretion it felt that the reasonable prospective earnings of the road, after the improvements did not justify it. However, in the face of all this, after satisfying in full the claims of the senior bondholders, the plan of reorganization should have made sure that all excess current assets, as well as all excess war profits yet to accrue, would go to the General Bondholders."

Section 10 (a) and (e). The Express Publishing Company case

declared:

"To justify an order restraining other violations it must appear that they bear some resemblance to that which the employer has committed or that danger of their commission in the future is to be anticipated from the course of his conduct in the past." P. 497.

We think that here, although there is a violation of Section 8(1) as well as 8(5), the violation of 8(1) is so intertwined with the refusal to bargain that the decree should not enjoin Company actions which are not motivated by its position on the appropriateness of the unit.

This conclusion requires a modification of the decree. There should be added to paragraph I(a) of the decree, note 6 supra, the following clause, "or from any other acts in any manner interfering with the representative's efforts to negotiate for or represent the above named employees as bargaining agent." Paragraph 1(b) should be stricken. Textual corrections should be made to conform to these changes. As thus modified, the decree is

Affirmed.

C.W.
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UTAH FUEL COMPANY STOCK

The Rio Grande Western Railroad Co. in 1899 executed its First Consolidated Mortgage, an indenture to secure its issue of First Consolidated Bonds, maturing April 1, 1949. Rio Grande Western reserved the right to issue additional bonds under the indenture.

The Utah Fuel Company was organized in 1900, with a capitalization of 100,000 shares. In 1901 an agreement was entered into by Rio Grande Western, the trustee under the First Consolidated Mortgage, and the owner of the Utah Fuel stock. The contract provided that the stock would be held by the trustee to secure bonds issued under the First Consolidated Mortgage and that Rio Grande Western would have the right at any time on paying the trustee \$6,000,000 in cash or delivering an equal face amount in First Consolidated bonds to receive the Utah Fuel stock, free of the mortgage lien. Subject to the lien, the stock was transferred to Rio Grande Western. \$6,000,000 in additional First Consolidateds were issued to the owner of the stock.

In 1908, Denver & Rio Grande Railroad Company was organized and acquired the property of Rio Grande Western, assuming the obligation of its first consolidated mortgage bonds of 1899. The equity of redemption of Denver & Rio Grande Railroad Co. in the Utah Fuel stock was sold in 1918 under execution and transferred to the Western Pacific Railroad Corporation.

In 1924 under an agreement among the Denver & Rio Grande Western Railroad Company, the Western Pacific Railroad Corp., Missouri Pacific Railroad Co. and T. S. Alexander, who by the agreement became trustee of the equity of redemption in the Utah Fuel stock, Western Pacific transferred to T. S. Alexander, Trustee, subject to the pledge under the Consolidated Mortgage its Utah Fuel stock and the debtor transferred to said trustee whatever interest it had in the stock, through certain releases, not here important.

The agreement first provided that the ultimate beneficial interest in the Utah Fuel stock so held was vested one-half in Missouri Pacific and one-half in Western Pacific [R. 1084]. Except for certain contingencies not here important, it was provided that the trustee under the 1924 agreement would pay all dividends received by him from the trustee under the Consolidated Mortgage on Utah Fuel stock to the debtor so long as any of the General or Refunding bonds were outstanding.

The agreement further provided that if the General Mortgage or the Refunding or other mortgage of the debtor were foreclosed, the trustee would sell their interest in the Utah Fuel stock [R. 1090, top] subject to the Consolidated Mortgage, if outstanding, and apply the proceeds to the payment of the bonds secured by the equity of redemption in the stock dividing any surplus between Western Pacific and Missouri Pacific [R. 1090].

The general mortgage and refunding bonds created in the 1924 reorganization were thus given a lien on the Utah Fuel stock, junior to the lien of the Denver & Rio Grande First Consolidated Mortgage.

Under the plan approved by the Commission and the District Court, the First Consolidated bonds were allotted 20% of their claim in new income bonds, 73% in preferred stock, and 7% in common stock. The plan further provided that [R. 20-21]:

"The trustee under the Rio Grande Western Railway Company consolidated mortgage shall be permitted to obtain the release of the equities in the stock of the Utah Fuel Company and distribute the stock among the holders of the aforesaid bonds in any manner agreeable to them, or to enforce its rights as pledgee of the stock of the Utah Fuel Company, the proceeds recovered to be distributed to the holders of the bonds."

See n. 24
The Commission took the position that this and the other features of the treatment of the First Consolidated bonds were justified as compensation for "loss of earnings position and surrender of their rights" ~~*~~ under the plan.

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The Commission made no definite finding with respect to the value of the Fuel Company stock. The Commission had before it evidence through 1936 with respect to the value of the stock [R. 713, 765-69, 798-815] as well as an appraisal of the value of the Fuel Company made for the trustee of the First Consolidated Mortgage, which indicated a value of \$4,653,720. The only dividend paid to the debtor by Utah Fuel under the 1924 agreement was in 1934 and amounted to \$250,000; the debtor in applying its formula for allocation of earnings by mortgage districts credited the ^{consolidated} mortgage with an income of \$83,333 per annum based on that dividend payment allocated over the three-year period, 1932 to 1934. The status of the stock was considered by the Commission in its original report and its several supplemental reports, and its proposals with respect to the stock remained unchanged.

In proceedings before the District Court in 1943 on objections to the plan, it was revealed that the Fuel Company's net income for 1942 was \$415,000 and for the first seven months of 1943, \$535,869.* The company has no funded debt.

Before the Circuit Court the respondents contended that the holders of the First Consolidated bonds should be compelled either to foreclose this collateral, applying the proceeds to their claim, or credit their claim with the value of the collateral and be allowed new securities only for the balance. The Circuit Court disapproved the treatment of the

* According to Moody's Manual [Resp. br. 29, note] the net income of the Fuel Company for 1943 was \$865,140, 1944 \$653,901, and earned surplus at the end of the latter year \$4,862,980.

General bondholders with respect to the Fuel Company stock pointing to the fact that the Commission had permitted "doubts and uncertainties" to remain with respect to the value of the collateral, and that there was a danger that if the collateral had substantial value, the First Consolidated bondholders might receive more than full payment. *Consol. Rock etc? § 77 (e) last para.*

The facts set out above fully support the conclusion of the Commission that the "title to the stock is vested in the Missouri Pacific and Western Pacific." [R. 77]. Whatever rights the debtor may have retained after the sale of the stock on execution in 1918 were released to the trustee and the two railroads in 1924. We have then a situation in which the holders of the ultimate beneficial interest in stock which had been pledged previously under a mortgage have permitted that interest to be encumbered by a third person, namely the debtor, as security for its General and Refunding bonds. The rule is settled in bankruptcy proceedings that a creditor secured by the property of others need not deduct the value of that collateral or its proceeds in proving his debt. Ivanhoe Bldg. & Loan Asso. v. Orr, 295 U. S. 243. We see no reason why the same should not be true under § 77. See New York Trust Co. v. Palmer, 101 F. 2d 1, 3. Therefore the First Consolidated Mortgage bonds were properly permitted to prove the full amount of their debt.

Respondents, however, object that the plan gives the First Consolidated bondholders all the Utah Fuel stock or its proceeds in addition to securities the face value of which amounts to one hundred per cent of their claims. It is thus contended that the plan deprives them of their junior interest in the stock without a determination of the value of that stock, or a finding of the extent to which the Consolidated bondholders have been paid by the new securities to be given them. We do not so read the plan. The plan provides merely that the trustee of the Consolidated Mortgage "shall be permitted to obtain the release of the equities in the stock of the Utah Fuel Company" and distribute the stock or its proceeds to the holders of the bonds. This statement ^{contains} ~~implies~~ at least two requirements ^{to be met} before the Consolidated bonds obtain anything from

the collateral. The first is that the trustee of the First Consolidated Mortgage be in existence. Even after the plan goes into operation and the old securities are surrendered for cancellation there is no requirement that the trusts terminate since ^{it} ~~they~~ will continue to hold property other than that of the debtor. §77(f) does not so require. Hence whatever action the trustees take, may be commenced prior to or after the execution of the plan. This will ^{also} permit the respondent, trustee under the General Mortgage, which would continue in existence for the purpose, to take the necessary steps to safeguard its rights in the collateral on behalf of the Generals.*

The second requirement, which is explicit in the plan, is that the trustee obtain the release of the equities in the stock. The predominant, if not the only existing equity ^{trustee of the General also} in the stock is that of respondents. They have an absolute right under the terms of the 1901 pledge and the 1924 agreement to all the proceeds of the stock over \$6,000,000 and a right also to any part of the proceeds not needed to make the First Consolidated bonds whole. Petitioners concede in their brief here that enforcement of the pledge "can be brought only through judicial proceedings." They correctly point out that in such proceedings full protection can be given to all those who have any junior interest in the stock. Respondents' fear that the General bondholders and the mortgage trustee will not be in existence and so unable to protect themselves has been above demonstrated to be without foundation in fact.

The result is that this aspect of the plan did not in any way change or affect existing rights in the collateral. The respondents may show in the judicial proceedings which ^{must} ~~will necessarily~~ be brought by the trustee of the First Consolidated Mortgage that the First Consolidated bonds have been fully paid by the securities awarded them under the plan, if such be the fact, or ^{the respondents themselves bring a proceeding to} ~~they may obtain a judicial valuation or a sale~~ of the collateral together with an adjudication of the extent to which the several claimants are entitled to the collateral or its proceeds.

* Obviously, the Fuel stock or its proceeds could be distributed to record holders of the old securities as of the date or dates of distribution of the new securities.

Petitioners concede, as they must, that they are not entitled to more than full payment and that they are under a duty to account to the respondents for any surplus remaining after they have been made whole.*

The treatment of the Utah Fuel stock in the plan is fully consistent with the Commission's disposition of certain collateral pledged with the Reconstruction Finance Corporation and the Railroad Credit Corporation by parties other than the debtor to secure notes of the debtor in the Western Pacific case. Western Pac. R. Co. Reorganization, 233 I.C.C. 409, 432.

No 4 The Commission permitted the pledgees to retain the collateral and this Court approved that action saying "This collateral, other than the refunding bonds, was therefore left with the pledgees with its position unaffected by any direct action of the Commission." Ecker v. Western Pacific R. Corp., supra, at 506. This conclusion is reinforced by the fact that Section 77 deals only with the "debtor and its property." Since the Utah Fuel stock is not the property of the debtor, neither the Commission nor the court could effectively conclude the rights of any claimants in it.

~~So construed, we hold that the plan is fair and equitable in its treatment of the respondents with respect to the Utah Fuel stock.~~

* There is a certain illogic in the position of First Consolidated bonds in asserting any rights in the collateral at all. If, as they concede and we now hold, they are entitled to be paid in full in new securities without regard to the collateral, it must be assumed that they have been fully paid by the new securities given them since they do not complain of their treatment under the plan. Since they are entitled only to full payment it would seem to follow that they have no rights against the collateral. We should not be taken as deciding this question, however, since we leave it to an independent suit in which there is jurisdiction over the proper parties.

Petitioner complains here of the refusal of the Court to modify paragraph 1(b) of the Board's order to the extent which petitioner explicitly asked for below in its petition for rehearing.

* The statutory direction to the Circuit Court in section 10(e) of the National Labor Relations Act, 49 Stat. 454, to refuse consideration to any objection which was not urged before the Board compels appraisal of the record to determine the power of the Circuit Court to review paragraph 1(b) of the Board's order. *Labor Board v. Bradford Dyeing Assn.*, 310 U. S. 318, 341. To obtain the advantages in the handling of the multitudinous proceedings under the Labor Act which are offered by administrative hearings with judicial review, courts must be satisfied when the proceedings comply substantially with the requirements of the Act and procedural due process even though the utmost nicety has not been observed in the pleadings. Compare *National Labor Relations Board v. Biles Coleman L. Co.*, 98 F. 2d 18,20; *National Labor Relations Board v. Lund*, 103 F. 2d 815, 820.

In this proceeding the paragraph of the Board's order in controversy first appeared in the intermediate report of the Board's examiner (R. 55). The petitioner excepted to the recommendation as "not supported or justified by the record" (R. 41). The examiner's recommendation was adopted by the Board in its order (R. 45). In answer to the Board's petition for enforcement, it was averred that this paragraph of the order was "not supported by any valid finding or by any evidence" that the petitioner here interfered with, restrained or coerced its employees in the exercise of their rights of self-organization (R. 61). The Circuit Court, in the light of *National Labor Relations Board v. Express Publishing Co.*, 312 U. S. 426, first approved the order as passed by the Board on the theory that as the interference by unilaterally seeking approval of wage increases by the National War Labor Board in the circumstances of this case violated section 7 of the National Labor Relations Act, the cease and desist order might properly forbid all interferences by petitioner with the rights of

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employees under that section. National Labor Relations Board v. May Dept. Stores Co., 146 F. 2d 66, 69. On a petition for rehearing, petitioner here sought a modification of ~~xxx~~ paragraph 1(b) so that it would "relate only to the acts of which complaint was made and not to all conceivable acts" which would be violative of section 7. The Court modified its approval of the Board's order so as to limit its restraint to the employees of the approved bargaining unit instead of all employees but left the scope of the paragraph otherwise unchanged.

As the petition for rehearing and the action of the Circuit Court presented the issue of the extent of the prohibited acts to that court, the problem of whether the objection is properly made so as to permit consideration by the Circuit Court of Appeals and by us is narrowed to the question of whether the objection was urged before the Board so as to give a power to review under the provision of section 10(e), referred to above.

The requirement that the Board be afforded an opportunity to consider questions to be urged upon review of its order is a policy of Congress. Undoubtedly, as we have said, it is "salutary." Marshall Field & Co. v. Board, 318 U. S. 253. It avoids the ransacking of the Board's record by a defeated party to find ^a possible point for contest which had not emerged as important enough to make before the Board. Surprise is guarded against by the power of the reviewing court to permit objection where the failure to urge the same objection before the Board was excusable "because of extraordinary circumstances." Section 10(e). In the Marshall Field case we declined to consider an issue as to the power of the Board to grant a back pay order which was construed as barring the deduction of unemployment compensation from the award, although the question was raised by answer and decided by the Circuit Court of Appeals, National Labor Relations Board v. Marshall Field & Co., 129 F. 2d 169. Our reason for refusing that review was/the only objection was error "in making each and every recommendation." This was too general to apprise the Board of an intention

to press this objection and of the necessity for findings.

In the present case, however, while the objection falls short of desirable clarity, we think it was sufficiently urged before the Board. No findings were called for. The petitioner objected to the proposed paragraph as not "supported or justified" by the evidence. In view of *Labor Board v. Express Pub. Co.*, 312 U. S. 426, previously decided, we think that this informed the Board of the issue as to the scope of the order. That is enough.

and the fact that the ~~order~~ ^{form} of the order is ^a standard one frequently used by ~~the~~ ^{it} Board

This Court in considering whether a reshipping privilege was an "undue preference" under the Interstate Commerce Act had declared such inference from the facts was for the Commission, saying:

"in substituting its judgment as to the existence of preference for that of the Commission on the ground that where there was no dispute as to the facts it had a right to do so, obviously exerted an authority not conferred upon it by the statute."
United States v. Louisville & N. R. Co., 235 U. S. 314, 320.

This position was emphatically repeated in Pennsylvania Co. v. United States, 236 U. S. 351, 361, thus:

"This section forbids any undue or unreasonable preference or advantage in favor of any person, company, firm, corporation or locality; what is such undue or unreasonable preference or advantage is a question not of law, but of fact. Texas & Pacific Ry. v. Interstate Commerce Commission, 162 U. S. 197, 219; Interstate Commerce Commission v. Alabama Midland Railway, 168 U. S. 144, 170."

See also Manufacturers Railway v. United States, 246 U. S. 457, 481;

Atchison, Topeka & Santa Fe R. Co. v. United States, 232 U. S. 199, 221.

A different conclusion was reached upon a ruling upon "unfair method of competition" in Federal Trade Comm. v. Gratz, 253 U. S. 421, 427.^{9/} But

the subsequent tendency has been toward administrative finality for the Trade Commission's inferences.^{10/}

In other fields, this Court has been prompt to recognize the administrative finality of agency inferences from primary facts. For example, in Swayne & Hoyt v. United States, 300 U. S. 297, 304, it was held on a review of a rate as unduly prejudicial to certain shippers that:

"Whether a discrimination in rates or services of a carrier is undue or unreasonable has always been regarded as peculiarly a question committed to the judgment of the administrative body, based upon an appreciation of all the facts and circumstances affecting the traffic." Page 304.

"Even though, as appellants seem to argue, the evidence may lend itself to support a different inference, we are without authority to substitute our judgment for that of the Secretary that the discrimination was unreasonable." Page 307.

Also in Security Adm'r v. Quaker Oats Co., 318 U. S. 218 at 227, in

passing upon a regulation defining a food product, we said:

"The Act does not contemplate that courts should thus substitute their own judgment for that of the Administrator. As passed by the House it appears to have provided for a judicial review in which the court could take additional evidence, weigh the evidence, and direct the Administrator 'to take such further action as justice may require.' . . . But before enactment, the Conference Committee substituted for these provisions those which became §701(f) of the Act. While under that section the Administrator's regulations must be supported by findings based upon 'substantial evidence' adduced at the hearing, the Administrator's findings as to the facts if based on substantial evidence are conclusive."

From the reports of the House and Senate Committees, note 7, supra, we know that the mechanics of procedure on review from the decision of the experts was to be like "an original action in a Federal district court." That is, that the review was to be before an appellate court in accordance with the procedure for review of the Federal Trade Commission and the Packers and Stockyards Act. The illustrations are legal questions without doubt, except the possibility that the words "application of the statute or any regulation having the force of law" may be thought to give a reviewing court power to pass upon the Tax Court's conclusion from the primary or evidential facts. So that in the present cases, it might be said to be a question of law as to whether the primary facts adduced made the payments under consideration dividends or interest.

But we think such an argument misconceives the purpose of the Tax Court. The finality of the Tax Court's rulings was being enlarged by the 1926 Act. The then Board was spoken of as an impartial and independent tribunal of experts "for the determination of tax liabilities as between the Government and the taxpayer." Report No. 1, supra, page 17. There would hardly need to be experts in tax affairs to decide questions of dates or amounts or to calculate rates. Its value lies in the ability to draw inferences. Adequate reason for the use of the word "application" of course exists in situations where true legal questions exist, as in whether an act applies to transfers antecedent to its enactment or to income or estate taxes from trusts or to situations which involve conflicts of law.

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This writ of certiorari brings before us the judgment of the Supreme Court of Nebraska which affirmed a judgment of a district court which dismissed the petition for habeas corpus for want of merit and failure to state a cause of action. 14 S.C.J. 24 (Nebr.); Hawk v. Olson, 16 N. W. 2d 181.^{1/} The writ was granted because a substantial federal question as to the denial of a constitutional right seemed to be presented by the petition for certiorari and the response.

_____ U. S. _____.

As no evidence was received in the district court, we accept as true all well pleaded allegations of the petition and, in the exercise of the duty which lies on us as well as the Nebraska courts to safeguard the federal constitutional rights of petitioner, examine for ourselves whether under the facts stated the petitioner is entitled to a hearing on the claimed violations of the due process clause of the Fourteenth Amendment in his conviction for murder in the first degree.

Lisenba v. California, 314 U. S. 219, 237; Williams v. Kaiser, 323

U. S. 471.

1 The opinion of the Supreme Court of Nebraska does not deal with an alternate ground of the district court judgment. This was that previous petitions for habeas corpus had "fully and finally adjudicated" the present issues. Compare Salinger v. Loisel, 265 U. S. 224, 230; Ex parte Hawk 321 U. S. 114, 118. We do not consider this issue.

The following reported cases show the efforts of petitioner to secure release. There are other proceedings not reported. Hawk v. O'Grady, 137 Nebr. 639 (appeal from denial of writ in state District Court), cert. den. 311 U. S. 645; Hawk v. Olson, 130 F. 2d 910 (appeal from denial of writ in District Court), cert. den. 317 U. S. 697; 318 U. S. 746 (original); 321 U. S. 114 (original).

In its opinion the Supreme Court of Nebraska carefully considers a number of claims of denial of due process. It is said that some of the grounds for release are pleaded in the form of conclusions and that Nebraska procedure requires in habeas corpus proceedings that the applicant must set forth the facts from which it must appear that he will be entitled to discharge. Hawk v. Olson, 16 N. W. 2d 181, 183, 1.c. We assume since this allegation appears that one of these pretermitted grounds is that "conviction was obtained by the use of perjured testimony knowingly used by the prosecuting officials and the trial court." See Ex parte Hawk, 321 U. S. 114, 116. Whatever Nebraska may require in the way of further specification may be furnished, if available, and permissible under the law of Nebraska (see Hawk v. Olson, supra, 183, r.c.), by petitioner on a new hearing. Cf. Tomkins v. Missouri, 323 U. S. 485, 487. On the issues of the sufficiency of the evidence and the interference with the right of appeal, we accept the decision of Nebraska that the first cannot be raised by habeas corpus and that the second is not supported by the facts stated by petitioner. Other objections (not discussed herein) to the judgment have been made which we have looked into and which we do not consider merit further attention.

Petitioner contends that his conviction violates the Fourteenth Amendment because of denial at his trial of an opportunity to examine the charge, subpoena witnesses, consult counsel and prepare a defense. Denial of

effective assistance of counsel does violate due process. Powell v. Alabama, 287 U. S. 45, 58; House v. Mayo, 324 U. S. 42, 45; compare White v. Ragen, 324 U. S. 760, 764.

FOOTNOTE 2 *count. p. A.*

The section had its origin in a bill [No. 605] reported by the Judiciary Committee of the House in response to a resolution directing that committee to inquire and report to the House by bill or otherwise "what legislation is necessary to enable the courts of the United States . . . to enforce the liberty of all persons under the operation of the constitutional amendment abolishing slavery." See Cong. Globe, 39th Cong., 1st Sess., 87, 3501, 4151. The debates on the bill in the House and Senate, while mostly concerned with incidental matters, indicated that jurisdiction to issue the writ of habeas corpus was not intended to be limited merely to violations of the Thirteenth Amendment. See Cong. Globe, 39th Cong., 1st Sess., 4150, 4151, 4229; Cong. Globe, 39th Cong., 2d Sess., 730, 790.

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Since Frank V. Mangum, 237 U. S. 309, 329, this Court has recognized that habeas corpus in the federal courts by one convicted of a criminal offense is a proper procedure "to safeguard the liberty of all persons within the jurisdiction of the United States against infringement through any violation of the Constitution," even though the events which were alleged to infringe did not appear upon the face of the record of his conviction. This opportunity for an examination into the "very truth and substance of the causes of his detention" was said in the Frank case to have come from the adoption in 1867 of a statute which empowered federal courts to examine into restraints of liberty in violation of the Constitution of the United States. 14 Stat. 385, Chap. XXVIII. ^{*} The legislation enlarged ^{for the federal courts} the "bare legal review"

✓ * This statute was reenacted as R. S. §§752-761. See 28 U.S.C. §453: "The writ of habeas corpus shall in no case extend to a prisoner in jail unless where he is in custody under or by color of the authority of the United States, or is committed for trial before some court thereof; or is in custody for an act done or omitted in pursuance of a law of the United States, or of an order, process, or decree of a court or judge thereof; or is in custody in violation of the Constitution or of a law or treaty of the United States; or, being a subject or citizen of a foreign State, and domiciled therein, is in custody for an act done or omitted under any alleged right, title, authority, privilege, protection, or exemption claimed under the commission, or order, or sanction of any foreign State, or under color thereof, the validity and effect whereof depend upon the law of nations; or unless it is necessary to bring the prisoner into court to testify."

previously afforded by habeas corpus.* Johnson v. Zerbst, 304 U. S. 458, 465-67. See also In re Neagle, 135 U. S. 1, 69-76; McNally v. Hill, Warden, 293 U. S. 131.

This liberalization of habeas corpus permitted federal courts to examine whether a conviction was by a state court which had lost jurisdiction of the defendant in the course of a trial by domination of a mob. Frank v. Mangum, supra, 327, 331, 335, dissent 347. The rule was applied to examine a state conviction under alleged community coercion a few years later when this Court said that if the facts set out were true, the trial was "absolutely void." In Mooney v. Holohan, 294 U. S. 103, 113, it was declared that the knowing use of material perjured testimony by a state prosecutor would make the trial a pretense and in Johnson v. Zerbst, supra, 467, 468, that a federal court would lose jurisdiction to convict if it failed to provide counsel for an accused who has not intelligently waived this constitutional guaranty. Walker v. Johnston, 312 U. S. 275, 286, reiterated that a denial of the same constitutional right would justify the release of a prisoner from the discharge of a commitment on a sentence which was obtained after such denial. In House v. Mayo, _____ U. S. _____, this rule as to denial of a constitutional right was extended to a situation where the prisoner had been forced to plead without the aid and advice of counsel whose presence he requested. Loss of jurisdiction is used as

* See Ex parte Watkins, 3 Pet. 193, 202, cited in the Frank case and 4 Bacon's Abridgement 563, et seq., Johnson Edition 1856; Viner's Abridgement, (2d Ed.), 212 (d) and (f)(2).

a means of saying the judgment is void. Waley v. Johnston, 316 U. S. 101, 104. It will be noted that in all of the cases in this paragraph the writ was sought in the federal courts and that therefore the extent of their power in habeas corpus was the traditional power of courts plus the extension of that power to those in custody in violation of the Constitution and other situations which are covered by 28 U. S. C. §452.

In Smith v. O'Grady, 312 U. S. 329, the writ was filed in a state court and came here by certiorari. It raised the question whether a person held in a state prison "pursuant to a court judgment rendered in violation of rights guaranteed him by the federal Constitution" must be released. The change was that the prisoner, an ignorant layman not represented by counsel, was tricked into pleading guilty to a serious offense. The federal question was raised in the state court but the application was dismissed without a hearing. We held that, "These allegations, if true, undermine and invalidate the judgment upon which petitioner's imprisonment rests." They "are wholly irreconcilable with the constitutional safeguards of due process."

Page 334.

In Williams v. Kaiser, 323 U. S. 472, a person pleaded guilty to robbery by means of a deadly weapon. In his habeas corpus petition in a state court, reviewed here on certiorari, he alleged he requested

counsel which was not furnished and was compelled to plead guilty, since he was incapable adequately of making his own defense, although he did not waive his right to counsel. We reversed the state court's dismissal of the petition for failure to state a cause of action, on the ground that "the right to counsel in cases of this type is a right protected by the Fourteenth Amendment of the federal Constitution." Page 473.

See also Tompkins v. Missouri, 323 U. S. 485; Cochran v. Kansas, 316 U. S.

255. Thus the federal public policy against restraint of persons convicted in violation of the federal Constitution, made effective by 28 U. S. C.

§453 finds application through the due process clause of the Fourteenth Amendment to wholly state proceedings, when persons similarly convicted are denied corrective judicial process. Acts violative of the federal Constitution when done by federal officers may or may not be violative of the due process clause of the Fourteenth Amendment when done under state authority. Betts v. Brady, 316 U. S. 455, 461, and cases cited.

It is a violation of a constitutional right to restrain convicted persons who have been forced to trial in such a way as to deprive them of the effective assistance of counsel (Ex parte Hawk, 321 U. S. 114; House v. Mayo, 324 U. S. 42) and, we think, it is a denial of the due process of the Fourteenth Amendment. Powell v. Alabama, supra, 52, 58.

Petitioner set out the following facts in his petition which we think are not inconsistent with the record of his trial. On March 16,

1936, at 4:15 p.m., the petitioner, who had previously had a preliminary hearing, was brought to Omaha from the federal penitentiary at Leavenworth, Kansas. He was held incommunicado in the Omaha jail except for a visit of fifteen minutes that evening, 11 to 11:15 p.m., by the Public Defender and his assistant. These officials tried to intimidate the petitioner to plead guilty. This petitioner refused to do, ". . . at which time the two Public Officials left your Petitioner and at the time said they would have nothing to do with Petitioner's trial scheduled for trial the following morning." The next day petitioner was arraigned ^{was} and read an information charging the murder to which he pleaded "not guilty," ^{4/} and "forthwith moved the Trial Court orally for a continuance of twenty-four (24) hours for the purpose of consulting counsel, examine the charge, subpoena witnesses and prepare a defense, and forthwith the Trial Court overruled the motion for a continuance and ordered the trial to proceed at which time the Clerk of the Court began to impanel the trial jury and had called two or three jurymen, when Joseph M. Lovely, a Public Official (Public Defender) and John N. Baldwin, his assistant stepped forward and entered the case, without ever having consulted your Petitioner, and

4 Petitioner does not allege whether or not he had previously received a copy of the indictment in conformity with the requirement of Revised Statutes of Nebraska §29-1802 which provides: "that within 24 hours after the filing of the indictment for a felony, the clerk shall deliver to the sheriff, the defendant or his counsel a copy of the indictment and the sheriff on receiving the copy shall serve the same on the defendant. No one may be arraigned or called on to answer an indictment until one day shall have elapsed after receiving it in person or by counsel."

without ever having been assigned by the Trial Court to represent your Petitioner.

"Your Petitioner had no consultation whatsoever with either of the aforesaid Public Officials regarding his defense, they picked the jury and testimony was adduced and a continuance or recess taken until the following morning March 18 (wednesday), 1936." Petitioner claimed the protection of the Fourteenth Amendment.

These facts, if true, we think, set out a violation of the Fourteenth Amendment. They are not too vague and entitle the petitioner to a hearing. The charge upon which petitioner was convicted was murder in the first degree. He had no advice of counsel prior to the beginning of the trial. Homicide has degrees in Nebraska. Comp. Stat. Neb. 1921, §§28, 401, 403. There are difficulties in the application of the rules. In re App. of Cole, 103 Neb. 802, 805; Bourne v. State, 116 Neb. 141. The defendant needs counsel and counsel needs time. Cf. Tomkins v. Missouri, 323 U. S. 485, 488.

Petitioner carries the burden in a collateral attack on a judgment. Regularity of the proceedings is presumed, if the record does not show the contrary. He must prove his allegations but he is entitled to a hearing. Johnson v. Zerbst, supra, 468; Walker v. Johnson, supra, 286; Williams v. Kaiser, supra, 474.

Reversed and remanded.

indicates any improvement in economic conditions or prospects in July, 1944, or any date since, over June, 1943, which would justify a treatment different from that accorded the claimants in 1943.^{37/} The question

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p 27
of the reasonableness or the unreasonableness of the rejection of the plan does not vary by virtue of any change of conditions since its approval by the District Court October 23, 1943. Under subsection (e), note 9 supra, the judge automatically confirms a plan after a vote of classes of creditors if satisfied that two-thirds of each class have accepted. If there is a rejection then there is a reexamination of the plan to assure that those who dissent have had fair and equitable treatment. Apparently the reexamination for this treatment does not differ from that for the original court approval under the first paragraph of subsection (e). It does, however, center upon the rights of those who rejected the plan.

A rejection would not be reasonably justified unless the dissenters had a valid reason for their vote. As is shown by Judge Symes' discussion of their objections,^{38/} their reasons were the payment of the Junction bonds with consequent release of capitalization for junior securities and the inadequate valuation, particularly in view of the large additions to plants from earnings. We think that we have demonstrated that there was an adequate basis for the valuation, see page 12 et seq., and that the decreases in senior debt were not for the account

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Frank Bloom, Chief Trial Examiner
William Ringer)
George Bokar) Associate Chief
Sam Jaffe) Trial Examiners

September 7, 1945

Ivar Petersen
Louis Libbin

Contents of Intermediate Reports

In the interest of having Intermediate Reports as complete as possible, your attention is called to the following matters which are now included in Board decisions, as well as those matters which most frequently require "doctoring" in Board decisions.

1. Rationale for a broad cease-and-desist order. In view of the fact that the courts have recently been modifying our broad cease-and-desist orders even where there are independent 8(1) findings, the decisions now contain rationale to support such orders in the following situations:

(a) Where the only unfair labor practices found are 8(3) and derivative 8(1). See, e.g., Southern United Ice d/b/a Bluff City Delivery, 15-C-975, 62 N.L.R.B., No. 112;

(b) Where the only unfair labor practices found are 8(3) plus independent 8(1). See, e.g., Union Mfg. Co., 16-C-1103, 63 N.L.R.B., No. 39; Firestone Tire & Rubber Co., 18-C-1039, 62 N.L.R.B., No. 180.

(c) Where the only unfair labor practices found are 8(2) and derivative 8(1). See, e.g., Standard Oil of California, 21-C-2167, 61 N.L.R.B. 1251;

(d) Where the only unfair labor practices found are 8(2) plus independent 8(1). See, for example, Hortex Mfg. Co., 16-C-1136, 63 N.L.R.B., No. 44; Keystone Steel & Wire Corp., 13-C-2069, 62 N.L.R.B., No. 91;

(e) It is also desirable to include such rationale, if possible, where the only unfair labor practice found is 8(1).

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FOOTNOTES (contd.)

"It rests upon the idea that there is a grade of insanity not sufficient to acquit the party of the crime of manslaughter and yet sufficient to acquit him of the crime of murder.

"The law does not recognize any such distinction as that in the forms of insanity. The rule of law is very plain that in order that the plea of insanity shall prevail, there must have been that mental condition of the party which disabled him from distinguishing between right and wrong in respect of the act committed.

"Now if the prisoner was so far capable of distinguishing between right and wrong as to be guilty of the crime of manslaughter, he surely was capable of distinguishing between right and wrong in respect of the crime of murder of the identical party. There can be no recognition of the doctrine that a man is incapable of distinguishing between right and wrong so as to determine that the case is not a case of murder, and yet capable of distinguishing between right and wrong so as to be guilty of manslaughter. There is no such doctrine, and nothing in the books that favors any such idea. The prayer therefore is unsound in all respects, and even if it had been sound, not being supported by evidence, the court below was entirely justified in rejecting it."

8 Compare *Owens v. United States*, 85 F. 2d 270, 273, *l.c.*

9 The reference to the establishment of degrees of murder in *Hopt v. People*, 103 U. S. 631, 634, may indicate a different point of view. The Court was there considering intoxication under a statutory requirement that the intoxication should be taken into consideration by the jury in determining the degree of the offense.

10 We are indebted to the respondent's brief for the collection of cases. Those accepting the petitioner's theory are: *State v. Saxon*, 87 Conn. 5, 14-15 (1913); *Andersen v. State*, 43 Conn. 514, 526 (1876); *State v. Johnson*, 40 Conn. 136, 143-44 (1873); *Fisher v. People*, 23 Ill. 283, 295 (.860); *Donahue v. State*, 165 Ind. 148, 156 (1905); *Aszman v. State*, 123 Ind. 347, 356 (1889); *Maulding v. Commonwealth*, 172 Ky. 370, 380 (1916); *Rogers v. Commonwealth*, 96 Ky. 24, 28 (1894); *Mangrum v. Commonwealth*, 19 Ky. Law Rep. 94 (1897); *Commonwealth v. Clark*, 292 Mass. 409, 414 (1935); *Commonwealth v. Trippi*, 268 Mass. 227, 231 (1929); *State v. Close*, 106 N.J. L. 321, 324 (1930); *State v. Schilling*, 95 N.J.L. 145, 148 (1920); *People v. Moran*, 249 N.Y. 179, 180 (1928); *Jones v. Commonwealth*, 75 Pa. 403, 408 (1874); *State v. Fenik*, 45 R. I. 309, 315 (1923); *State v. Green*, 78 Utah 580, 602 (1931); *State v. Anselmo*, 46 Utah 137, 145, 157 (1915); *Dejarnette v. Commonwealth*, 75 Va. 867, 880-81 (1881); *Oborn v. State*, 143 Wis. 249, 272 (1910); *Hempton v. State*, 111 Wis. 127, 135 (1901).

Those rejecting it are: *United States v. Lee*, 15 D. C. (4 Mackey) 489, 495-96 (1886); *Foster v. State*, 37 Ariz. 281, 289-90 (1930); *Bell v. State*, 120 Ark. 530, 557-58 (1915); *People v. French*, 12 Cal. 2d 720, 738 (1939); *People v. Cordova*, 14 Cal. 2d 308, 312-13 (1939); *People v. Troche*, 206 Cal. 35, 47 (1928); *State v. Van Vlack*, 57 Idaho 316, 360-67 (1937); *Sage v. State*, 91 Ind. 141, 144-45 (1883); *Perciful v. Commonwealth*, 212 Ky. 673, 678 (1926); *Spencer v. State*, 69 Md. 28, 41-43 (1888); *Commonwealth v. Cooper*, 219 Mass. 1, 5 (1914); *State v. Paulsgrove*, 203 Mo. 193, 206 (1907); *State v. Holloway*, 156 Mo. 222, 231 (1900); *State v. Rodia*, 132 N.J.L. 199 (1944); *State v. Noel*, 102 N.J.L. 659, 676-77 (1926); *State v. Martin*, 102 N.J.L. 388, 402-404 (1926); *State v. James*, 96 N.J.L. 132 (1921); *State v. Maioni*, 78 N.J.L. 339 (1909); *Sindram v. People*, 88 N.Y. 196, 200-201 (1882); *Commonwealth v. Barner*, 199 Pa. 335, 342 (1901); *Commonwealth v. Hollinger*, 190 Pa. 155, 160 (1899); *Commonwealth v. Wireback*, 190 Pa. 138, 151-52 (1899); *Jacobs v. Commonwealth*, 121 Pa. 586, 592-93 (1888); *Commonwealth v. Scott*, 14 Penna. District & County Rep. 191 (1930); *Witty v. State*, 75 Tex. Cr. Rep. ~~440, 457 (1914)~~; *Hogue v. State*, 65 Tex. Cr. Rep. 539, 542 (1912); *State v. Schneider*, 158 Wash. 504, 510-11 (1930).

FOOTNOTES (contd.)

11 104 U. S. at 634: "But when a statute establishing different degrees of murder requires deliberate premeditation in order to constitute murder in the first degree, the question whether the accused is in such a condition of mind, by reason of drunkenness or otherwise, as to be capable of deliberate premeditation, necessarily becomes a material subject of consideration by the jury."

See Edwin R. Keedy, *Insanity and Criminal Responsibility*, 30 Harv. L. Rev. at 552.

The cases cited by this Court to support this statement are all instances of intoxication.

12 See 104 U. S. 631 at 634.

13 Wharton, *Criminal Law* (12th ed.), vol. 1, sec. 64; Weinhofen, *Insanity as a Defense in Criminal Law* (1933), pp. 200-103; Weinhofen, *Partial Insanity and Criminal Intent*, 24 Ill. Law Rev. 505 (1930); Keedy, *Insanity and Criminal Responsibility*, 30 Harv. Law Rev. 535, 552-554 (1917); Note, 79 U. of Pa. Law Rev. 209 (1930); *Mental Abnormality and Crime*, *English Studies in Criminal Science* (1944), pp. 61-63; Glueck, *Mental Disorder and the Criminal Law* (1925), pp. 199-208.

14 Such a conclusion is, at the least, doubtful. See *Mental Disease and Criminal Responsibility*, 45 Col. L. Rev. 677 (September 1945).

15 It has been said that reduction of the degree of crime through provocation depends upon the reaction of the ordinary man to the insult. *McHargue v. Commonwealth*, 231 Ky. 82.

16 Zilborg, *Legal Aspects of Psychiatry in One Hundred Years of American Psychiatry* 513; Glueck, *supra*, 203.

A question as to the power of the State of Minnesota to tax realty within the boundaries of that state, when the legal title remains in the United States under a state act of cession in accordance with the exclusive legislation clause of the United States Constitution, Article 1, Section 8, Clause 17, is presented by this writ of certiorari. ^{1/}

The realty in question was conveyed to the United States in 1867 as a site for a building to house a post office, a custom's office and offices for various departments and agencies of the United States. The building was eventually vacated and the property sold in 1939 by the Director of Procurement of the Department of the Treasury under the authority of an act for the disposal of surplus federal real estate. 49 Stat. 885.

It was purchased on public ^{sale} ~~land~~ and improved by petitioner who was in full possession with right of user at the time of the levy of the tax under an executory contract of sale between it and the United States. That contract provided for a cash payment and annual instalments, possession by petitioner so long as it met the terms of the contract, and for repossession by the United States upon ^{the purchaser's} failure to comply with any term or condition of the contract with retention of prior instalments of the purchase price. Upon repossession, the United States was authorized to resell the realty and recover any resulting deficiency from the petitioner. All obligations due under

the contract had been met by petitioner. The major portion of the contract price had not fallen due and was unpaid. The contract permitted leases to others by the petitioner in subordination to the rights of the United States. The contract required the United States to execute and deliver a quit claim deed for the realty to the petitioner upon its completion with the requirements of the contract.

With the ownership of the property in the situation just described, taxes for general and special purposes were levied on the property for 1940 under the usual Minnesota procedure. The tax was on the realty "subject to fee title remaining in the United States of America." Petitioner duly filed its objections in the proper state district court, pursuant to statute. 1 Minn. Stat. (1941) Ch. 278. So far as concerns this review, the objection to the tax was based on a claimed exemption of the realty from state taxation because title to all of the premises was in the United States. The exemption was sustained by the trial court. The Supreme Court of Minnesota reversed its judgment and denied exemption. In re Petition of S.R.A., Inc., 213 Minn. 487. On retrial, the lower court held the realty liable for the tax and declared a lien "upon such parcel of land as against the estate, right, title, interest, claim or lien, in law or equity, of every person, company or corporation, subject however to the prior rights, liens and interests of the United States

of America." This second judgment was affirmed on appeal. In re
Petition of S. R. A., Inc., 219 Minn. 493.

Certiorari was sought under Section 237(b) of the Judicial
Code. It was granted because of the importance and uncertainty of
the subject of the right of a state to tax realty of the United States
in possession of a buyer from the Government under a contract of sale
with uncompleted conditions for execution and delivery of the muniments
of title. _____ U.S. _____^{2/}

The Supremacy of the Federal Government in our Union forbids
the acknowledgment of the power of any state to tax property of the
United States against its will. Its property and operations must be
exempt from state control in tax, as in other matters. Van Brocklin
v. Tennessee, 117 U. S. 151, 177; M'Culloch v. Maryland, 4 Wheat. 316,
425, et seq.; United States v. Allegheny County, 322 U. S. 174, 176-77.
This postulate, as a matter of federal law, forces final decision of
the validity of claimed exemptions under this immunity upon this Court.
United States v. Allegheny County, supra, 183, and cases cited. The
impact of state taxation on federal operations may be so close and
threatening as to compel judicial intervention to declare the state
tax invalid, as in the M'Culloch case, or so remote and incidental as
to justify a federal court in refusing to relieve a taxpayer from a
state tax. Alabama v. King & Boozer, 314 U. S. 1. The line of

taxability is somewhat irregular and has varied through the years. Where
does
the tax ~~is~~ not bear directly on the United States, the trend is to recog-
nize a broader scope to the state taxing power than in earlier years. ^{3/}

The right of a state to tax realty directly depends primarily upon
its territorial jurisdiction over the area. The realty of petitioner had
been conveyed to and used by the United States for the essential govern-
mental activities which authorized the exercise of its exclusive legislative
jurisdiction. ^{4/} Exclusive legislative power is in essence complete

sovereignty. ^{5/} That is, not only is the federal property immune from
taxation because of the supremacy of the Federal Government but state laws,
not adopted directly or impliedly by the United States, are ineffective to
tax or regulate other property or persons upon that ^{6/} enclave. It would
seem that the United States obtained this property in compliance with
cession by Minnesota of exclusive sovereignty. Act of February 9, 1867,

Minn. Laws 1867 Jan., p. 125. The acceptance by the United States at that
time of the power ceded is presumed. ^{7/} So far as we are aware, this Court
has never directly passed upon the effect on Federal sovereignty of the
property's transfer by the United States to ^{private} other hands.

In this instance there were no specific words in the contract
which were intended to retain sovereignty in the United States. There was
no express retrocession by Congress to Minnesota, such as sometimes occurs. ^{8/}
There was no requirement in the act of cession for return of sovereignty

to the state when the ceded territory was no longer used for federal

purposes.^{9/} In the absence of some such provisions, a transfer of property held by the United States under state cessions pursuant to Article 1, Section 8, Clause 17, of the Constitution would leave numerous isolated islands of federal jurisdiction, unless the unrestricted transfer of the property to private hands is held without more to revest sovereignty in the states. As the purpose of Clause 17 was to give control over the sites of governmental operations to the United States, when such control was deemed essential for federal activities, we are of the opinion that the sovereignty of the United States would end with the reason for its existence. The Government's unrestricted transfer of property to non-federal hands is a relinquishment of the exclusive legislative power.^{10/}

Recognition has been given to this result as a rule of necessity.^{11/}

IF such

Minnesota showed its acceptance of a supposed retrocession by its levy of a tax on the property. Whether or not exclusive legislative power continues in the United States over this property so as to forbid state taxation depends upon whether there was a transfer of the property by the contract of sale.

Turning to the contract, we find in it no characteristics which differentiate it from the normal executory contract for the sale of land with partial payments.

Under federal law such a contract transfers to the purchaser the equity in the land. That equity is realty. It was owned by the vendee. The United States retains only a legal title as security. In substance it is in the position of a mortgagee.^{12/} Minnesota has the same rule. In re Petition of S.R.A., Inc., 219 Minn. 493, 507; 213 Minn. 487, 495, 499. Therefore when petitioner entered into possession of this real estate under its contract of purchase, the taxed property by the transfer became subject to the territorial jurisdiction of Minnesota.^{13/}

Territorial jurisdiction in Minnesota does not dispose of this tax problem. The nub of this case, that is the exemption from state taxation of property to which the United States holds legal title, remains. Minnesota took care to leave unassessed whatever interest the United States holds. The levy and judgment was "subject to fee title remaining in the United States of America." 219 Minn. at 496. Although Minnesota real estate taxes are assessed on the parcel of land as a "unitary item" including "all rights and privileges," the state does not claim that a tax sale will divest the fee title of the United States. 213 Minn. at 493, 499. Apparently the state is of the view that the equitable interest alone may be sold under its laws, leaving the fee of the United States in its position of priority over any interests which may be transferred by the tax sale. 213 Minn. at 497; 219 Minn. at 513. Such a construction of the state tax law is binding upon this Court. It

does not impinge upon federal rights. So long as that situation exists, the determination of the state cannot be challenged here. The possibility of repossession by the United States is not enough to block a tax sale in which the paramount rights of the United States are protected.

Baltimore Shipbuilding & Dry Dock Co. v. Baltimore, 195 U. S. 381-82;

New Brunswick v. United States, 276 U. S. 547, 556. ¹⁴

Petitioner's argument goes beyond the question of the enforcement of the assessed tax. It is bottomed on the implied constitutional immunity from state taxation of property for which the United States holds title. In Van Brocklin v. Tennessee, 117 U. S. 151, that state sought to tax realty of the United States which was not held for the purposes or under the authority of the Cession Clause. Certain lots had been purchased by and conveyed to the United States pursuant to a federal tax sale. 12 Stat. 423, §7. These lots were later transferred by deed or certificate of release to private owners. 17 Stat. 331, 18 Stat. 313. Tennessee assessed its own taxes upon the property for the years during which title to the lots was in the United States and attempted to collect them from the private owners after the transfer. Tennessee's claim was founded on the absence of state cession. This Court refused to permit the state's action, saying at page 179:

"While the United States owned the land struck off to them for the amount of the taxes because no one would pay more for it, and until it was sold by the United States for a greater price, or was redeemed by the former owner, the United States held the entire title as security for the payment of the taxes; and it could not be known how much, if anything beyond the amount of the taxes the land was worth. To allow land, lawfully held by the United States as security for the payment of taxes assessed by and due to them, to be assessed and sold for State taxes, would tend to create a conflict between the officers of the two governments, to deprive the United States of a title lawfully acquired under express acts of Congress, and to defeat the exercise of the constitutional power to lay and collect taxes, to pay the debts and provide for the common defence and general welfare of the United States."

The posture of the land sought to be taxed in the Van Brocklin case differentiates it from one presently under consideration. The United States there held complete title as a purchaser at a tax sale. The right to redeem was a matter of grace. The United States, here, as we have demonstrated above has transferred equitable ownership to the purchaser and has only a legal title as security.

Petitioner presses various land grant cases upon us as announcing the controlling rule.^{15/} The principle which petitioner extracts from these cases is that alienation of United States' property does not pass an interest to the vendee taxable by a state until all conditions precedent for the delivery of the deed have been complied with. In the present case, the full amount of the purchase price must be paid.

Such a rule can be extracted by the literal reading of certain phrases in the land grant cases. ^{16/} The reason for the rule was said, in the

earlier cases, to be that a state tax sale would defeat the government lien for surveying or other costs because the state sale would pass a

title free from the United States' lien. ^{17/} As heretofore shown,

page 6 supra, this ground for refusing power to Minnesota to tax is not present in this case, since Minnesota holds that the lien of the United States will remain paramount.

~~W~~ Irwin v. Wright, ~~which~~ involved the taxability by a state of property occupied by an entryman under the Reclamation and Homestead Acts who had not received his required final certificate of land clearance, pages 227, 228, 232. ^The reason for the rule against state taxation until the equitable title passes from the United States to the entryman, was ^{there} placed ~~upon~~ upon the policy of the government to require those who sought government land to perform the required conditions of residence or improvement before beneficial title, subject to state taxation, passes from the United States to the locator. This transfer was said not to take place until the certificate was issued. Page 231. After compliance with the condition and before patent, ^{18/} the state could tax.

We think the public policy of national development and federal tax collection justify the limitation on state taxing power announced by the foregoing decisions. We do not, however, conclude that their

rationale leads to an exemption from state taxation of all lands in which the United States holds legal title as security for the purchase price. To say that the payment of the purchase price is a necessary condition precedent to the loss of federal immunity is to make the rule too mechanical. It should be sufficiently flexible to subject real private rights, disentangled from federal policies to state taxation. This has been the holding in mining claims.^{19/} Where beneficial interest has passed to a vendee, the retention of legal title does not give a significant difference from the situation of a deed with a lien retained or a mortgage back to secure the purchase money.

That was the interpretation given the facts in New Brunswick v. United States, 276 U. S. 547. The City of New Brunswick under authority of New Jersey sought to tax lots in the possession of purchasers from the Housing Corporation, a corporation wholly owned by the United States and therefore treated as the United States. These purchasers had paid enough of the purchase price--ten per cent--to entitle them to deeds under their contracts but had not paid the entire purchase price. The deeds had not been delivered nor the mortgages executed for the balance as required by the purchase agreement. This Court said: "In equity the situation was then the same as if the Corporation had conveyed title to the purchasers, as owners,

and they had mortgaged the lots to the Corporation to secure the unpaid purchase money." Page 555. The Court sustained the tax subject to the paramount lien of the United States. We think the petitioner's Minnesota property is in a similar position. Ownership of the beneficial interest has passed to the petitioner with legal title retained by the United States for security purposes. This should not put this private property in an exempt class.

There is a suggestion that to hold United States property subject to state taxation pending the completion of payment will injuriously affect its salability and therefore interfere with the Government's handling of its affairs. Our recent cases have disposed of this economic argument in a way which is contrary to petitioner's contention. Alabama v. King & Boozer, 314 U. S. 1, and cases cited.

The only other contention of petitioner ^{affirmed} which we need mention is that the state has included the interest of the United States in the valuation of the land, and has therefore subjected that interest to taxation. But no deduction need be made for the interest of the Government since that interest is for security purposes only and is not beneficial in nature. ~~Moreover, in equity it is personality not realty.~~

~~3 Thompson, supra, p. 522.~~ The whole equitable ownership is in the petitioner and the value of that ownership may be ascertained on the basis of the full value of the land. ~~See~~ New Brunswick v. United States, supra, at 556. But cf. Ken Realty Co. v. Johnson, 138 F. 2d 809. Affirmed.

FOOTNOTES

1 No. 255, S. R. A., Inc. v. State of Minnesota, is in all respects like No. 254, except that the state tax was laid for the year 1941. This opinion in No. 254 governs the result and the same judgment of affirmance is directed. See 219 Minn. 517; _____ U. S. _____

2 Varying results have been reached by other courts in similar situations. Lincoln Co. v. Pacific Spruce Corp., 26 F. 2d 435; Ken Realty Co. v. Johnson, 138 F. 2d 809; Mint Realty Co. v. Philadelphia, 218 Pa. 104; Copp v. State, 69 W. Va. 439; A. B. R. Corp. v. City of Newark, 133 N.J.L. 34. See also Bancroft Investment Corp. v. City of Jacksonville, _____ Fla. _____, decided January 15, 1946.

3 Compare Mayo v. United States, 319 U. S. 441, with Alabama v. King & Boozer, supra, and United States v. Allegheny County, supra, p. 176, notes 1 and 2, and cases cited.

4 Art. 1, Sec. 8, Cl. 17:

"The Congress shall have Power . . .

"To exercise exclusive Legislation in all Cases whatsoever, over such District (not exceeding ten Miles square) as may, by Cession of particular States, and the acceptance of Congress, become the Seat of the Government of the United States, and to exercise like Authority over all Places purchased by the Consent of the Legislature of the State in which the Same shall be, for the Erection of Forts, Magazines, Arsenals, dock-Yards, and other needful Buildings; . . .

5 Fort Leavenworth R. R. Co. v. Lowe, 114 U. S. 525, 532-33; United States v. Unzeuta, 281 U. S. 138; Surplus Trading Co. v. Cook, 281 U. S. 647, 652-56; Bowen v. Johnston, 306 U. S. 19.

6 Stewart v. Sadrakula, 309 U. S. 94; Surplus Trading Co. v. Cook, supra, note 5.

7 Fort Leavenworth v. Lowe, supra, p. 528; Benson v. United States, 146 U. S. 325, 330; Mason Co. v. Tax Comm'n., 302 U. S. 186, 207.

At the time of the purchase, R. S. §355 was in force. As public money it required consent of the state of the situs before acquisition by the United States of locations for needful buildings, it is to be presumed the requirement was satisfied. R. S. §355 has been consistently construed to require full sovereignty in the United States. 8 Op. A. G. 102; 10 Op. A. G. 34; ~~39 Op. A. G. 285~~; 20 Op. A. G. 611; 31 Op. A. G. 265; 38 Op. A. G. 341; 39 Op. A. G. 285. R. S. §355 has been superseded. 40 U.S. C. 255; Adams v. United States, 319 U. S. 312.

8 30 Stat. 668; 9 Stat. 35.

9 Palmer v. Barrett, 162 U. S. 399; James v. Dravo Contracting Co., supra, 144; Surplus Trading Co. v. Cook, supra, 656.

10 Compare Palmer v. Barrett, supra, with Arlington Hotel Co. v. Fant, 278 U. S. 439.

FOOTNOTES (contd.)

11 Fort Leavenworth R. R. Co. v. Lowe, 114 U. S. 525, 542: "It is necessarily temporary, to be exercised only so long as the places continue to be used for the public purposes for which the property was acquired or reserved from sale. When they cease to be thus used, the jurisdiction reverts to the State."

The Federal Cession Clause was not applicable to the place under consideration, Fort Leavenworth, Kansas. Page 528. The reference to federal control of "reserved" land probably relates to the supremacy of the United States for the management of governmental affairs in the absence of exclusive legislative power. See page 539. As the Fort Leavenworth case itself demonstrates, the United States does not have power of exclusive legislation on reserved public lands without state consent. See *Wilson v. Cook*, No. 328, 1945 Term, slip opinion, p. 9.

12 *Lenman v. Jones*, 222 U. S. 51; *Gunton v. Carroll*, 101 U. S. 426, 430-31; *Bissell v. Heyward*, 96 U. S. 580; *Secombe v. Steele*, 20 How. 90, 103-104. Compare 8 *Thompson, Real Property*, Secs. 4579, 4582; 2 *Sugden, Vendors* (14th Ed.), 375. See *Lowery v. Peterson*, 75 Ala. 109. Compare *Restatement, Conflict of Laws* §209.

13 We reserve, without expression of opinion, the question as to the legislative status of this property, if it is repossessed by the United States. See the cases cited in note 10, *supra*.

14 As the case was tried below on the theory of direct or implied immunity because the fee was in the United States, we neither consider nor decide the effect of a tax sale of petitioner's rights on its contract with the United States. See *Wilson v. Cook*, No. 328, 1945 Term, p. 5, slip opinion. Compare 41 U.S.C. §15 with *Freedmen's Saving Co. v. Shepherd*, 127 U. S. 494.

15 *Railway v. Prescott*, 16 Wall. 603; *Railway Co. v. McShane*, 22 Wall. 444; *Northern Pacific Railway Co. v. Rockne*, 115 U. S. 600; *Irwin v. Wright*, 258 U. S. 219.

xxxxxx

FOOTNOTES (contd.)

16 Irwin v. Wright, supra, 228, 229, 232, 233; Northern Pacific R. R. Co. v. Rockne, supra, at 609; Railway Co. v. McShane, supra, at 462.

17 16 Wall. at 608; 22 Wall. at 462; 115 U. S. at 610. In the McShane case, itself, which clearly set out the above reason for non-taxability, it was recognized that the federal right of pre-emption for the benefit of settlers would not be affected by a state tax sale. This Court therefore reversed its former judgment in the Prescott case that land held by the railroads subject to this pre-emption could not be taxed by a state. 22 Wall. at 461. Congress promptly terminated the land tax exemption after the Traill County (~~Prescott~~) decision by subjecting railroad land grants to state taxation before payment of conveyancing costs. 43 U.S.C. §882.

18 Bethwell v. Bingham County, 237 U. S. 642, 647.

19 Elder v. Wood, 208 U. S. 226.

SUPREME COURT OF THE UNITED STATES

No. 122--October Term, 1945.

Julius Fisher, Petitioner,	)	
	)	On Writ of Certiorari to the
vs.	)	United States Court of Appeals
	)	for the District of Columbia.
The United States of America.	)	

[]

This writ of certiorari brings here for review the sentence of death imposed upon petitioner by the District Court of the United States for the District of Columbia after a verdict of guilty on the first count of an indictment which charged petitioner with killing by choking and strangling Catherine Cooper Reardon, with deliberate and premeditated malice. The United States Court of Appeals for the District of Columbia affirmed the judgment and sentence of the District Court. 149 F. 2d 28.

The errors presented by the petition for certiorari and urged at our bar were, in substance, that the trial court refused to instruct the jurors that they should consider the evidence of the accused's psychopathic aggressive tendencies, low emotional response and borderline mental deficiency to determine whether he was guilty of murder in the first or second degree. The aggregate of these factors admittedly was not enough to support a finding of not guilty by reason of insanity.^{1/} Deliberation and premeditation are necessary elements of first degree murder.

Consideration for a proper administration of justice in view of the issue presented induced us to grant the writ. Judicial Code, Section 240(a).

The homicide took place in the Library building on the grounds of the Cathedral of Saint^{James} Peter and Paul, Washington, D. C., on March 1, 1944. The victim was the librarian. The petitioner was the janitor. The record shows Miss Reardon was killed by the petitioner immediately following sharp words between them over his care of the premises. After slapping her impulsively, petitioner ran up a flight of steps to reach an exit on a higher level but turned back down, after seizing a convenient stick of firewood, to stop her screaming. He struck her with the stick and when it broke choked her to silence and death. These facts are undisputed.

The effort of the defense is to show that the murder was not deliberate and premeditated; that it was not first but second degree murder. The evidence, it is agreed, would be sufficient to support a verdict of murder in the first degree, if petitioner was a normal man in his mental and emotional characteristic. Cf. Bostic v. United States, 94 F. 2d 636, 638. But the defense takes the position that the petitioner is fairly entitled to be judged as to deliberation and premeditation, not by a theoretical normality but by his own personal traits. It is the contention of the defense that the mental and emotional qualities of

petitioner were of such a level at the time of the crime that he was incapable of deliberation and premeditation although he was then sane in the usual legal sense. He knew right from wrong. See The M'Naghten Rules, 10 Co. and F. 200, 210. His will was capable of controlling his impulses. Smith v. United States, 36 F. 2d 548. Testimony of psychiatrists to support this contention was introduced. An instruction charging the jury to consider the personality of the petitioner in determining intent, premeditation and deliberation was sought and refused.

From the evidence of the psychiatrists for the defense, the jury might have concluded the petitioner was mentally somewhat below the average with minor stigmata of mental subnormalcy. An expert testified that he was a psychopathic personality ^{2/} of a predominantly aggressive type. There was evidence that petitioner was unable by reason of a deranged mental condition to resist the impulse to kill Miss Beardon. All evidence offered by the defense was accepted by the trial court. The claimed error is limited to the refusal of the one instruction. Of course, in view of the status of the defense of partial responsibility in the District and the nation no contention is or could be made of the denial of due process. The prosecution had competent evidence that petitioner was capable of understanding the nature and quality of his acts. Instructions in the usual form were given by the court, which are unchallenged, submitting to the jury the issues of insanity, irresistible

impulse, malice, deliberation and premeditation. Under the instructions the jury could have determined from the evidence that the homicide was not the result of premeditation and deliberation.

However, such a result could not have been reached on the theory of partial responsibility ^{3/} for his acts which the petitioner urges. Petitioner sought an instruction from the trial court which would permit the jury to weigh the evidence of his mental deficiencies, which were short of insanity in the legal sense, in determining the fact of and the accused's capacity for premeditation and deliberation. ^{4/} The appellate court approved the refusal upon the alternate ground that an accused is not entitled to an instruction upon petitioner's theory. ^{5/} This has long been the law of the District of Columbia. ^{6/} This is made abundantly clear by United States v. Lee, 4 Mackey 489, 495. This also was a murder case in which there was evidence of mental defects which did not amount to insanity. An instruction was asked and denied in the language copied in the margin. ^{7/}

It is suggested that the Lee case was decided when murder under the District law was not divided into degrees and that therefore it was not proper to instruct as to capacity to premeditate and deliberate while now it would be. We do not agree. The separation of the crime of murder into the present two degrees by the code of law for the District of Columbia, March 3, 1901, 37 Stat. 1189, 1321, is not significant in

analyzing the necessity for the proposed submission of the evidence concerning petitioner's mental and emotional characteristics to the jury by specific instruction. The reason for the change, doubtless, lay in the wide range of atrocity with which the crime of murder might be committed so that Congress deemed it desirable to establish grades of punishment. Cf. Davis v. Utah Territory, 151 U. S. 262, 267, 270. Homicide, at common law, the rules of which were applicable in the District of Columbia had degrees. Murder was "with malice aforethought, either express or implied." Hill v. United States, 22 App. D. C. 395, 401; Hamilton v. United States, 26 App. D. C. 382, 386-91; Burge v. United States, 26 App. D. C. 524, 527-30. Manslaughter was unlawful homicide without malice. Blackstone, Book IV, p. 191. As capacity of a defendant to have malice would depend upon the same kind of evidence and instruction which is urged here,^{8/} it cannot properly be said that the separation of murder into degrees introduced a new situation into the law of the District of Columbia.^{9/} As shown by the action of the District of Columbia courts in this case and the others just referred to, we think it is the established law in the District that an accused in a criminal trial is not entitled to an instruction based upon evidence of mental weakness, short of legal insanity which would reduce his crime from first to second degree murder.

Petitioner urges forcefully that mental deficiency should be declared to be a relevant factor in determining whether an accused is guilty of murder

in the first or second degree, upon which an instruction should be given, as requested. It is pointed out that the courts of certain states have adopted this theory.^{10/} It is urged, also, that since evidence of intoxication to a state where one guilty of the crime of murder may not be capable of deliberate premeditation requires an instruction to that effect, courts from this must deduce that disease and congenital defects, for which the accused may not be responsible, may also reduce the crime of murder from first to second degree. In the District, intoxication may reduce the degree of murder. McAffee v. United States, 111 F. 2d 199, 205 r.c. This Court reversed the Supreme Court of the Territory of Utah for failure to give a partial responsibility charge upon evidence of drunkenness in language which has been said to be broad enough to cover mental deficiency. Hopt v. People, 104 U. S. 631, 634.^{11/} It should be noted, however, that the Territory of Utah had a statute specifically establishing such a rule.^{12/}

No one doubts that there are more possible classifications of mentality than the sane and the insane. White, Insanity and the Criminal Law 89. Those charged with the administration of the criminal law have felt impelled to draw such a line as a practical method of protecting society against the irresponsible. Criminologists and psychologists have weighed the advantages and disadvantages of the adoption of the ~~xxxx~~ theory of partial responsibility as a basis of

the jury's determination of the degree of crime of which/^amentally
deficient defendant may be guilty.^{13/} Its use in criminal trials
in the District by virtue of judicial declaration might in some
instances protect the subnormal from harsh punishment for acts for
which they are not so much to blame as would be the normal individual.
It was to attain such a merciful administration of justice that the
lines of responsibility now controlling in the District of Columbia
have been drawn. It may be that psychiatry has now reached a position
of certainty in its diagnosis and prognosis which would justify the
change in the rule of responsibility for crime for which petitioner
contends.^{14/}

Further differentiations of responsibility will introduce new
standards of psychotherapy which are difficult to apply. They would
not be apparent except to those learned in that field. Thus they would
differ from the present exceptions of drunkenness and provocation.^{15/}
~~It has been said that reduction of the degree of crime through provocation~~
~~depends upon the reaction of the ordinary man to the insult. McHargue v.~~
~~Commonwealth, 231 Ky. 82.~~ ^{No FF} As was pointed out below, society would have
less protection since the subnormal are more likely to act without the
full inhibitions of the normal man. No logical reason is perceived why
such a theory of partial responsibility should not apply to intent or
malice, as well as to premeditation and deliberation or to crimes other

than homicide which involve intent or malice. For this Court to require the District of Columbia to adopt such a requirement ~~for~~ criminal trials would involve a fundamental change in the common law theory of responsibility.

We think such a radical departure from common law concepts is more properly a subject for the exercise of legislative power or at least for the discretion of the courts of the District of Columbia. It is a matter peculiarly of local concern. Such a practice might well require separate preliminary proceedings for examination of the accused by psychiatrists. Perhaps it is illogical to entrust such determinations to layman without ~~xxx~~ neutral expert advice.^{16/} This Court has in a less important matter undertaken to adjust by decision the outmoded rule of the common law to modern conditions. But when that step was taken, it was declared that "experience has clearly demonstrated the fallacy or unwisdom of the old rule." Funk v. United States, 290 U. S. 371, 381; Weiler v. United States, 323 U. S. 606, 609. Where the choice of the Court of Appeals of the District of Columbia in local matters between conflicting legal conclusions seems nicely balanced, we do not interfere. District of Columbia v. Pace, 320 U. S. 698, 702. We shall not do so here.

Affirmed.

FOOTNOTES

(1940 Ed.)

- 1 The Code of Law for the District of Columbia/provides as follows:

Title 22, section 2401, "Whoever, being of sound memory and discretion, kills another purposely, either of deliberate and premeditated malice or by means of poison, or in perpetrating or attempting to perpetrate any offense punishable by imprisonment in the penitentiary, or without purpose so to do kills another in perpetrating or in attempting to perpetrate any arson, as defined in section 22-401 or 22-402 of this Code, rape, mayhem, robbery, or kidnapping, or in perpetrating or in attempting to perpetrate any housebreaking while armed with or using a dangerous weapon, is guilty of murder in the first degree."

Title 22, section 2404, "The punishment of murder in the first degree shall be death by electrocution. The punishment of murder in the second degree shall be imprisonment for life, or for not less than twenty years."

- 2 "The only conclusion that seems warrantable is that, at some time or other and by some reputable authority, the term psychopathic personality has been used to designate every conceivable type of abnormal character." Curran and Mallinson, *Psychopathic Personality* (1944) 90 J. Ment. Sci. 278.

- 3 The phrase is used herein to indicate responsibility for a lesser grade of offense. See Gluck, *Mental Disorders and the Criminal Law* (1925) 310, n. 1.

- 4 The instruction requested reads as follows:

"The jury is instructed that in considering the question of intent or lack of intent to kill on the part of the defendant, the question of premeditation or no premeditation, deliberation or no deliberation, whether or not the defendant at the time of the fatal acts was of sound memory and discretion, it should consider the entire personality of the defendant, his mental, nervous, emotional and physical characteristics as developed by the evidence in the case."

Our conclusion does not require that we pass upon whether the instruction was correct, if petitioner's theory is sound, or whether if incorrect, the judge should have recast the instruction in proper form. See the case below, 149 F. 2d 28, 29 r.c. Compare *Freihage v. United States*, 56 F. 2d 127, 133, with *George v. United States*, 125 F. 2d 559, 563.

- 5 *Fisher v. United States*, 140 F. 2d 28, 29 l.c.

The Court of Appeals spoke of an acquittal under the proposed instruction. The other language of the opinion and the refusal of the petition for rehearing, which pointed out the misuse of the word, shows clearly that a reduction in degree was meant, not an acquittal.

- 6 Cf. *Guiteau's Case*, 10 Fed. 161, 168, 182; *Bolden v. United States*, 69 F. 2d 121.

- 7 4 Mackey 295-96:

"... the defendant, at the time he committed the act, was so mentally unsound as to render him incapable of judging between right and wrong; yet if the jury find from the evidence that there was such a degree of mental unsoundness existing at the time of the homicide as to render the defendant incapable of premeditation and of forming such an intent as the jury believe the circumstances of this case would reasonably impute to a man of sound mind, they may consider such degree of mental unsoundness in determining the question whether the act was murder or manslaughter."

SUPREME COURT OF THE UNITED STATES
Nos. 56 and 197.--October Term, 1945.

Kirby Petroleum Company, Petitioner,	)	
No. 56	vs.	)
Commissioner of Internal Revenue	)	On Writ of Certiorari to the
	)	United States Circuit
	)	Court of Appeals for the
	)	Fifth Circuit.
Commissioner of Internal Revenue,	)	
Petitioner,	)	
No. 197	vs.	)
Anna Vickers Crawford.	)	On Writ of Certiorari to the
	)	United States Circuit
	)	Court of Appeals for the
	)	Ninth Circuit.

[]

Mr. Justice REED delivered the opinion of the Court.

The writ of certiorari in Kirby Petroleum Co. v. Commissioner brings here for review the judgment of the Circuit Court of Appeals for the Fifth Circuit, 148 F. 2d 80, reversing the decision of the Tax Court, 2 T. C. 1258, which had sustained the taxpayer's position. The narrow issue is the deductibility under Sections 23(m) and 114(b)(3)^{1/} of the Internal Revenue Code of the depletion allowance of 27½ per centum of gross income from property, permitted by those sections, from the taxpayer's gross income for 1940 from certain oil leases.

The taxpayer owned the fee simple title to certain Texas lands, except for a minor mineral interest which is not here involved. It leased the lands to two companies for the production of oil, gas and other minerals for a cash bonus, a royalty in the usual form and an agreement, executed contemporaneously with the lease and as part consideration therefor, that the taxpayer should receive twenty per cent of the net money profits realized by the lessees from their

operations under the lease.

The same narrow issue is in Commissioner v. Crawford.

In this latter case, the taxpayer owned an interest in fee in certain real estate in California. She, together with her co-owners, entered into several leases for portions of the property for the production of oil, gas and other minerals. For an understanding of the issues here presented, it is unnecessary to analyze the leases further than to say that they were given in consideration of bonuses, royalties in the usual form and additional payments from the net profits of the operation.^{2/} The Commissioner assessed a deficiency because of the denial of a claimed depletion allowance for 1938, 1939 and 1940. The Tax Court supported the taxpayer's position. ____ T.C. _____. The Circuit Court of Appeals affirmed. ____ F. 2d ____.

In both cases, the Commissioner concedes that the depletion allowance of Sections 23(m) and 114(b)(3) is applicable to the bonuses and royalties.^{2/} The provisions are identical for all years. The 27½ per cent of Section 114(b)(3) was therefore properly deducted from these receipts by the taxpayers. In each of these years there was also income to these taxpayers from the lease provisions for the lessors to share in the net profits from the oil extracted from the leased lands. The taxpayers

claim the right to deduct the $27\frac{1}{2}$ per cent depletion from these receipts also. These are the deductions which the Commissioner disallowed. On account of the conflicting decisions of the Circuits in these cases on the point, certiorari was granted by us. _____

U. S. _____; _____ U. S. _____.

The present provisions for depletion allowances have been worked out so as to give the holder of an economic interest in the oil or other natural resource an allowance for depletion. ^{4/} In theory the aggregate sum allowed for depletion would equal the value of the natural resource at the time of its acquisition by the taxpayer, so that at the exhaustion of the resource the taxpayer would have recovered exactly his investment. The administrative difficulties in oil and gas production in view of the uncertainties of quantities and time of acquisition, that is at the instant of purchase of the property or discovery of oil or gas, finally have brought us to the arbitrary allowance of $27\frac{1}{2}$ per cent now embodied in Section 114(b)(3). ^{5/}

✓ Thus the taxpayers capital is returned to him by the depletion allowance and the rest of the proceeds of the natural asset becomes gross income. Anderson v. Helvering, 310 U. S. 404, 407-8. It follows from this theory that only a taxpayer with an economic interest in the asset, here the oil, are entitled to the depletion. Palmer v. Bender, 287 U. S. 551, 557; Thomas v. Perkins, 301 U. S. 655, 659.

Congress

Actual
Technical
The ownership of the oil in place is not important. Title in case of a lease may depend upon the law of the state in which the deposit lies. Burnet v. Harmel, supra, 109-10. The test of the right to depletion is whether the taxpayer has a capital investment in the oil in place which is necessarily reduced as the oil is extracted. See Anderson v. Helvering, 310 U. S. 404, 407.

The taxpayers here involved were lessors. Under the leases and our previous decisions, these taxpayers had an economic interest, a capital investment, in so much of the extracted oil as was used by the lessee to pay to the taxpayers the royalties and bonuses. See note 3, supra. The taxpayer lessors were entitled to the depletion allowance on these royalties and bonuses whether they were paid to them in oil or cash, the proceeds of the oil. Helvering v. Twin Bell Oil Syndicate, 293 U. S. 312, 321. The depletion allowance, in the aggregate, is always the same amount, $27\frac{1}{2}$ per cent of the "gross income from the property."^{6/} "In the case of leases the deductions shall be equitably apportioned between the lessor and lessee." Section 23(m). An equitable apportionment is obtained by excluding from the lessee's gross income "an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property." Section 114(b)(3).^{7/} We think these taxpayers had an economic interest, sufficient to support depletion, in the extracted oil, which the lessees

sold to earn that portion of "net profit" allocated to the taxpayer lessors by the contracts.

This economic interest remains in the taxpayers rather than passing to the lessees because there was not a divestment by the taxpayers of all their interest in the oil but merely the grant of the privilege of extraction to the lessees upon their agreement to pay to the taxpayer lessors a part of the profits from the sale of the extracted oil. If we assume that the only payment for the privilege of oil extraction made to the taxpayer lessors by the lessees was the portion of "net income" paid under the leases, it would be clear that such payment of "net income" would be rent or royalty paid by the lessees for the privilege of extraction. Since Section 114(b)(3) ^{begs question} would require the lessee to deduct this rent or royalty from their gross incomes from the sale of oil from the property before taking the lessees' depletion, a gross receipt from oil sold equal to the amount of the "net income" paid to the taxpayer lessors would not be subject to depletion, unless the taxpayer lessors are permitted to apply depletion to this payment. This would be contrary to the purpose of the depletion statute, which is to allow to the lessor and lessee together a depletion of $27\frac{1}{2}$ per cent of the gross sale price of the oil. On the other hand if depletion on the "net income" payments is allowed to the lessors, the lessees are allowed depletion

But if
tax ex.

Why not
deductible
if not rent
or royalty.
at all?

on the gross income from oil sales less the net payment and the entire allowable depletion is allocated between the lessors and lessees.

Reference is made to a sentence in Anderson v. Helvering, 310 U. S. 404, 409, as indicating that this Court had determined that "net profit" payments were not subject to depletion. It reads as follows :

"A share in the net profits derived from development and operation, on the contrary, does not entitle the holder of such interest to a depletion allowance even though continued production is essential to the realization of such profits."

This was said in setting out the series of cases dealing with depletion. No net income was involved in the Anderson case. The statement was supported by the citation of Helvering v. O'Donnell, 303 U. S. 370, and Helvering v. Elbe Oil Land Development Co., 303 U. S. 372. In the O'Donnell case, the taxpayer, who received the "net income" from an oil operation was a stranger to the lease, who had contracted for a share of its net profits as consideration for his stock in a corporation which was the owner of the lease. "The question is whether respondent had an interest, that is, a capital investment in the oil and gas in place As a mere owner of shares in the San Gabriel Company, respondent had no such interest." Page 371. In the Elbe Oil Land case, there was a specific provision that consideration other than the "net profit" payment should result in "full ownership" to the buyer. The transaction which included the clause

Tax case

for "net profit" was a sale of all the right, title and interest in the property. This Court said this specific provision made the transaction an "absolute sale" which deprived the owner of any investment in the oil. Thus the Anderson case correctly stated that ^{mere contractual} a share in "net profits" does not entitle the holder to a depletion allowance. But when the holder of such share, as here, continues his economic interest in the oil ^{in place} and receives the "net profit" in whole or partial payment for the privilege of extraction, such a lessor is entitled to his depletion allowance.

In our view, the "net profit" payments in these cases flow directly from the taxpayers' economic interest in the oil and partake of the quality of rent for the privilege of extraction rather than of a sale price. Therefore, the capital investment of the lessors is reduced by the extraction of the oil and the lessors should have depletion.

No. 56 is reversed.

No. 197 is affirmed.

FOOTNOTES

1 Internal Revenue Code:

"SEC. 23. Deductions from Gross Income.

"In computing net income there shall be allowed as deductions:

"(m) Depletion.-- In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. . . . In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. . . ."

"SEC. 114. Basis for Depreciation and Depletion.

"(b) Basis for Depletion.--

"(3) Percentage depletion for oil and gas wells.--In the case of oil and gas wells the allowance for depletion under section 23(m) shall be $27\frac{1}{2}$ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property"

2 The following clause of one lease will illustrate the type of arrangement which produced the additional payments:

"When, and as soon as the 'Income Credits' of said account shall exceed the 'Operating Charges' of the Lessee, the Lessor shall be entitled to a secondary and additional royalty, the amount thereof to be one-half of such difference between the 'Operating Charges' and 'Income Credits' of said account."
The leases defined methods of computation.

✓ 3 Burnet v. Warmel, 287 U. S. 103, 111; Palmer v. Bender, 287 U. S. 551, 557. See Anderson v. Helvering, 310 U. S. 404, 409.

4 Treasury Regulation 103, Sec. 19.23(m)-1, as amended by T. D. 5413, 1944 Cum. Bull. 124, 129:

"Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest."

5 For the background of the present provisions, see Helvering v. Twin Bell Oil Syndicate, 293 U. S. 312.

FOOTNOTES

6 Sec. 114(b)(3). The gross income refers only to oil and gas. Helvering v. Twin Bell Oil Syndicate, 293 U. S. 312, 320-21; Anderson v. Helvering, 310 U. S. 404, 408.

7 See Helvering v. Twin Bell/^{Oil}Syndicate, 293 U. S. 312, 322.