ANTITRUST—EXCHANGE OF PRICE INFORMATION IN VIOLATION OF SECTION 1 OF THE SHERMAN ACT—*United States v. Container Corporation of America, 393 U.S. 333 (1969)*—In 1963 the United States Department of Justice instituted a civil antitrust suit in the United States District Court for the Middle District of North Carolina against the Container Corporation of America and 17 other manufacturers of corrugated containers alleging a price fixing agreement in violation of section 1 of the Sherman Act.[1] The essence of the alleged violation was that the defendants, who controlled 90 percent of the corrugated container market in the Southeastern United States, had, since 1955, participated in an agreement to exchange price information as to the most recent prices charged or quoted to specific customers in particular transactions. The Justice Department charged that this agreement had the effect of restricting price competition in the southeastern sector of the corrugated container market.[2] The district court held that the requesting and furnishing of price information by the defendants did not have the effect of eliminating, reducing, minimizing or restricting price competition.[3] On direct appeal, the United States Supreme Court reversed, holding that the exchange of price information had resulted in a stabilization of prices and constituted a violation of section 1 of the Sherman Act.[4]

Section 1 of the Sherman Act states that "*(e)very* contract, combination or conspiracy in restraint of trade. . ." is prohibited. Early Supreme Court decisions construed this language as an absolute prohibition against activities that had the effect of restraining trade.[5] However, in *Standard Oil of New Jersey v. United States*,[6] the Supreme Court narrowed this seemingly peremptory ban by interpreting section 1 as declaring illegal only those agreements that effectuate an *unreasonable* restraint of trade. In the application of the "rule of reason"[7] the court determines in each case whether the alleged violative conduct produces an unreasonable restraint of trade under the given circumstances. While this rule of reason is the standard that has generally been applied in restraint of trade cases, the courts have recognized that ". . .certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use"[8]—i.e. illegal *per se*.[9] In 1940

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[1] Section 1 of the Sherman Act, 15 u.s.c. § 1 (1964), provides: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. . . ."

[2] The district court found that the price information was requested from a competitor infrequently, and only if it was not available from the defendants' records or customers. United States v. Container Corp. of America, 273 F. Supp. 18, 59 (M.D.N.C. 1967).

[3] United States v. Container Corp. of America, 273 F. Supp. 18, 67-68 (M.D.N.C. 1967). The court concluded that the evidence presented did not support the inference that there was either an agreement to exchange price information or that such agreement existed for the purpose of stabilizing or controlling prices.

[4] 393 U.S. 333, 336 (1969).

[5] United States v. Trans-Missouri Freight Association, 166 U.S. 290 (1897); Northern Securities Co. v. United States, 193 U.S. 197 (1904).

[6] 221 U.S. 1 (1911).

[7] In United States v. American Tobacco Co., 221 U.S. 106 (1911), the famous companion decision to the Standard Oil case, the Court succinctly articulated the rule of reason, stating that" . . . the words 'restraint of trade' . . . (embraced) acts which operated to the prejudice of public interests by unduly restricting competition . . . or which, either because of their inherent nature of effect, or because of the evident purpose of the acts, etc., injuriously restrain trade . . ." 221 U.S. at 179.

[8] Northern Pacific Railway Co. v. United States, 356 U.S. 1, 5 (1958).

the Supreme Court in *United States v. Socony-Vacuum Oil Co.*,[10] held that "a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*."[11] A violation, generically known as price fixing was thus established as a per se violation of section 1 of the Sherman Act.

Section 1 of the Sherman Act thus dictates that a "contract, combination. . .or conspiracy. . ." and, by judicial construction, an unreasonable restraint of trade are the prerequisites to a successful prosecution under that section. In *Container*, Justice Douglas looked to the reciprocal nature of the price information exchange[12] to find the conspiracy required by section 1 of the Sherman Act. Justice Fortas, concurring, also found a tacit agreement and Justice Marshall, dissenting, concurred in the finding that an agreement existed among the defendants.[13] However, the only support offered for the inference of the agreement in *Container* was a footnote comment by Justice Douglas in which he distinguished the activities in the instant case from the parallel business behavior condoned by the Supreme Court in *Theatre Enterprises, Inc. v. Paramount Film Distributing Corp.*[14] In that case the court held that the parallel behavior of the defendants, who were motion picture producers and distributors, in refusing to furnish the plaintiff with "first run" motion pictures in its suburban theatre was explainable on the basis of the independent self interest of each. The Court in *Theatre Enterprises* therefore concluded that the existence of an agreement was not a necessary inference from the fact that the defendants all acted in the same way. Justice Douglas did not articulate the distinction between the instant case and *Theatre Enterprises*, but he appears to have accepted the government's contention that the defendants' activity in *Container* was not independant, but the result of collaboration and that *Theatre Enterprises* was therefore inapplicable.[15]

The question which the court in *Container* thought more fundamental than that of the conspiracy, and to which it actively addressed itself, was whether the exchange of price information had resulted in an unreasonable restraint of trade. In this respect the Court considered several factors, including the oligopolistic nature of the corrugated container market, the fungibility of corrugated containers, the inelastic demand for such containers and the excess capacity existing in the corrugated container market. Although prices were falling,[16] the Court concluded that

[9] Among the activities that have been deemed unlawful per se are price fixing, United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 223 (1940); division of markets, United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899); group boycotts, Fashion Originators Guild v. FTC, 312 U.S. 457 (1941); tying arrangements, International Salt Co. v. United States, 332 U.S. 392 (1947); and certain sales commission systems for the marketing of tires, batteries, and accessories by service stations affiliated with major oil companies, FTC v. Texaco, Inc., 393 U.S. 223 (1968).

[10] 310 U.S. 150 (1940).

[11] *Id.* at 223.

[12] Justice Douglas reasoned that each defendant furnished data to his competitor with the expectation that he would be furnished with similar information upon his request. United States v. Container Corp. of America, 393 U.S. 333, 335 (1969). The district court, however, had held that, because of the infrequency and lack of uniformity of the information furnished, the government had failed to establish the existence of an agreement to exchange price information. United States v. Container Corp. of America, 273 F. Supp. 18, 58-59 (M.D.N.C. 1967).

[13] 393 U.S. 333, 340.

[14] 346 U.S. 537 (1954). The footnote comment appears at 393 U.S. at 335.

[15] Brief for Appellant at 19-20. United States v. Container Corp. of America, 393 U.S. 333 (1969).

[16] 393 U.S. 333, 336 (1969).

in this type of market the result of the reciprocal exchange of price information was the stabilization of prices at a downward level.[17] Apparently responding to the government's argument that the defendants' "concerted activity aimed at limiting price competition or tampering with price is unlawful *per se*,"[18] the Court held, relying on *United States v. Socony-Vacuum Oil*,[19] that "interference with the setting of price by free market forces is unlawful *per se*."[20] Thus, the Court implicitly brought the instant case within the ban of *Socony*. While the Court conceded that the exchange of price information in some markets may have no effect on a truly competitive price, it held that in *Container*, because of the market characteristics of the corrugated container industry, the information exchange had resulted in price uniformity. In concluding, the Court observed that "the inferences are irresistable that the exchange of price information has had an anticompetitive effect in the industry, chilling the vigor of price competition."[21]

The majority opinion in *Container* is somewhat ambiguous. A cursory reading of the opinion suggests that the per se rule has been extended to the practice of exchanging price information. Arguably, since nothing in the opinion expressly negates such a reading and since the Court appears to establish some sort of a relationship between *Socony* and the instant case, one might indeed conclude that a new *per se* rule has been announced. However, a reading of the opinion which is more consistent with the actual thrust of the majority's decision suggests that the rule of reason inquiry, rather than the *per se* approach, was applied. While the Court stated that "(t)he result of this reciprocal exchange of prices was to stabilize prices though at a downward level"[22] and that "(k)nowledge of a competitors price usually meant matching that price,"[23] it further stated that "(p)rice information exchanged in some markets may have no effect on a truly competitive price."[24] The Court appears to have rejected the idea that the exchange of price information will always lead to price stabilization—a necessary concomitant to the announcement of a *per se* rule. The above language would therefore indicate that the court was limiting its condemnation of the exchange of price information, in terms of its effect on price, to the factual context of the instant case—the traditional application of the rule of reason. Furthermore, the Court concentrated on the economic characteristics of the corrugated container industry in reaching its conclusion that "(t)he exchange of price data tends toward price uniformity."[25] It was within the economic setting of the corrugated container market that the Court thought "(p)rice (was) too critical, too sensitive a control to allow it to be used even in an informal manner to restrain competition."[26] If the Court had intended to announce a new *per se* rule, the economics of the situation would have been inconsequential since in *per se* analysis a practice ". . . (is) presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm (it has) caused. . . ."[27]

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[17] *Id.*

[18] Brief for Appellant at 13, United States v. Container Corp. of America, 393 U.S. 333 (1969), citing United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

[19] 310 U.S. 150 (1940).

[20] 393 U.S. at 337.

[21] *Id.*

[22] *Id.* at 336.

[23] *Id.* at 336-337.

[24] *Id.* at 337.

[25] *Id.*

[26] *Id.* at 338.

[27] Northern Pacific Railway Co. v. United States, 356 U.S. 1, 5 (1958).

The validity of this "non *per se*" reading of the majority opinion in *Container* is further supported by the Court's treatment of previous exchange of price information cases. The Court factually distinguished the instant case from *Cement Manufacturers Protective Association v. United States*,[28] *Sugar Institute, Inc. v. United States*,[29] and *Maple Flooring Mfgs. Ass'n. v. United States*,[30] all decided under the rule of reason rationale. The necessary result of the adoption of a *per se* rule in *Container* would have been the overruling of these cases. Yet the Court chose not to do that. Similarly, the Court concluded that *American Column & Lumber Co. v. United States*[31] and *United States v. American Lindseed Oil*,[32] in which the court applied the rule of reason inquiry, were analogous to the instant case. Against this background there is little indication that the Court sought to establish a new *per se* rule.

Finally, Justices Fortas and Marshall, writing the concurring and dissenting opinions respectively, both rejected the application of a *per se* rule to the exchange of price information since such activity neither necessarily interferes with the "price mechanism of the market place"[33] nor "is so devoid of potential benefit or so inherently harmful. . ."[34] Justice Fortas in the opening remarks to his concurring opinion explicitly repudiates any contention that a new per se rule is announced by the majority, saying:

> I do not understand the Court's opinion to hold that the exchange of specific information among sellers as to prices charged to individual customers, pursuant to mutual arrangement, is a *per se* violation of the Sherman Act.[35]

Justice Marshall, filing a strong dissent, instructed the majority that "(t)his Court has refused to apply a *per se* rule to exchanges of price and market information in the past. . .(and) we should follow the same course in the present case."[36]

The rationale that will ultimately be applied to the practice of price information exchange is, of course, questionable. However, it is suggested that there appears to be no immediate need or justification to abandon the rule of reason inquiry traditionally applied in this type of case and create a new classification of per se violations. As Justice Marshall observed in his dissent, the application of a *per se* rule is only proper if "the potential competitive harm plus the administrative costs of determining in what particular situations the practice may be harmful. . .far outweigh the benefits that may result"[37] from not absolutely prohibiting the activity. The potential competitive harm of the exchange of price information is obviously not self-evident. This is clearly illustrated by the six to three split of the Court over the question of whether an unreasonable restraint of trade had, in fact, resulted and the Court's own admission that the exchange of price information in some markets may have no effect on competition. In addition, the Court has recognized in the past that there may be a legitimate business justification for the exchange of

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[28] 268 U.S. 588 (1925).

[29] 297 U.S. 553 (1936).

[30] 268 U.S. 563 (1925).

[31] 257 U.S. 377 (1921).

[32] 262 U.S. 371 (1923).

[33] United States v. Container Corp. of America, 393 U.S. 333, 339 (1969).

[34] *Id.* at 341.

[35] *Id.* at 338-339.

[36] *Id.* at 341.

[37] *Id.*

price information[38] and that such an exchange may have no appreciable effect on price in a competitive market.[39] The application of a *per se* rule would therefore produce harsh and inequitable results unwarranted by any consideration of the rights of the consuming public. The government should thus be required to prove an adverse effect on price from an exchange of price information in the usual rule of reason fashion. The lower federal courts should interpret the *Container* decision as applying the traditional rule of reason rather than a *per se* approach.

John S. Izzie

INCOME TAX—EXCLUDABILITY OF SCHOLARSHIP AND FELLOWSHIP GRANTS UNDER SECTION 117 OF THE INTERNAL REVENUE CODE OF 1954—*Bingler v. Johnson, 394 U. S. 741 (1969)*—Johnson, Wolfe and Pomerantz held engineering positions at the Bettis Atomic Power Laboratory in Pittsburgh, Pennsylvania, which is operated by Westinghouse Electric Corporation. They all participated in a program known as the Westinghouse Bettis Fellowship and Doctoral Program which involves a two-phase schedule of subsidized post-graduate studies in engineering, physics or mathematics. Under the second phase of the program they were granted an educational leave for the purpose of completing the dissertation requirement for their doctoral degrees. During this leave they were paid a certain percentage of their prior salaries and Federal Income Tax was withheld from these amounts. They filed claims for refunds, contending the payments they had received were "scholarships," and hence were excludable from gross income under Section 117 of the Internal Revenue Code of 1954, which provides in pertinent part:

> (a) *General Rule,*—In the case of an individual, gross income does not include—
> (1) any amount received—
> (A) as a scholarship at an educational institution (as defined in section 151 (e) (4)), or
> (B) as a fellowship grant. . . .[1]

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[38] Cement Mfgs. Protective Ass'n. v. United States, 268 U.S. 588 (1925).

[39] Maple Flooring Mfgs. Ass'n. v. United States, 268 U.S. 563 (1925); Tag Mfrs. Institute v. FTC, 174 F.2d 452 (1st Cir. 1949).

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[1] The entire section reads as follows:

Section 117. Scholarships and fellowship grants.

(a) General rule.

In the case of an individual, gross income does not include—

(1) any amount received—

(A) as a scholarship at an educational institution (as defined in section 151 (e)(4)), or

(B) as a fellowship grant, including the value of contributed services and accommodations; and

(2) any amount received to cover expenses for—

(A) travel,

(B) research,

(C) clerical help, or

(D) equipment,

which are incident to such a scholarship or to a fellowship grant, but only to the extent that the amount is so expended by the recipient.

(b) Limitations.

(1) Individuals who are candidates for degrees.

In the case of an individual who is a candidate for a degree at an education insti-

When those claims were rejected, the respondents instituted an action for a refund in the Federal District Court. After the basically undisputed evidence regarding the Bettis Program had been presented, the trial judge instructed the jury in accordance with Treasury Regulation Section 1.117-4(c), which provides that amounts representing "compensation for past, present, or future employment services," and amounts "paid . . . to . . . an individual to enable him to pursue studies or research primarily for the benefit of the grantor," are not excludable as scholarships.[2] The jury found the amounts received under the Bettis Program were tax-

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tution (as defined in section 151(e)(4)), subsection (a) shall not apply to that portion of any amount received which represents payment for teaching, research, or other services in the nature of part-time employment required as a condition to receiving the scholarship or the fellowship grant. If teaching, research, or other services are required of all candidates (whether or not recipients of scholarships or fellowship grants) for a particular degree as a condition to receiving such degree, such teaching, research, or other services shall not be regarded as part-time employment within the meaning of this paragraph.

(2) Individuals who are not candidates for degrees.

In the case of an individual who is not a candidate for a degree at an educational institution (as defined in section 151 (e)(4)), subsection (a) shall apply only if the condition in subparagraph (A) is satisfied and then only within the limitations provided in subparagraph (B).

(A) Conditions for exclusion.

The grantor of the scholarship or fellowship grant is—

(i) an organization described in section 501 (c)(3) which is exempt from tax under section 501(a),

(ii) a foreign government,

(iii) an international organization, or a binational or multinational education and cultural foundation or commission created or continued pursuant to the Mutual Educational and Cultural Exchange Act of 1961, or

(iv) The United States, or an instrumentality or agency thereof, or a State, a territory, or a possession of the United States, or any political subdivision thereof or the District of Columbia.

(B) Extent of exclusion.

The amount of the scholarship or fellowship grant excluded under subsection (a)(1) in any taxable year shall be limited to an amount equal to $300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant during such taxable year, except that no exclusion shall be allowed under subsection (a) after the recipient has been entitled to exclude under this section for a period of 36 months (whether or not consecutive) amounts received as a scholarship or fellowship grant while not a candidate for a degree at an educational institution (as defined in section 151(e)(4)).

[2] Treas. Reg. § 1.117-4 (1956). Items not considered as scholarships or fellowships grants.

The following payments or allowances shall not be considered to be amounts received as a scholarship or a fellowship grant for the purpose of section 117:

. . . .

(c) Amounts paid as compensation for services or primarily for the benefit of the grantor.

(1) Except as provided in paragraph (a) of § 1.117-2, any amount paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research, if such amount represents either compensation for past, present, or future employment services or represents payment for services which are subject to the direction or supervision of the grantor.

(2) Any amount paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research primarily for the benefit of the grantor. However, amounts paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research are considered to be amounts received as a scholarship or fellowship grant for the purpose of section 117 if the primary purpose of the studies or research is to further the education and training of the recipient in his individual capacity and the amount provided by the grantor for such purpose does not represent

able income. The Court of Appeals for the Third Circuit reversed. It held that the Regulation referred to was invalid, that the jury instructions were therefore improper and that on the essentially undisputed facts it was clear as a matter of law that amounts received by the respondents were "scholarships" excludable under Section 117.[3] The Supreme Court granted *certiorari* and reversed.

Under the first phase of the Westinghouse Bettis Fellowship and Doctoral Program a participant holds a regular job with Westinghouse and is given up to eight hours per week "release" time for the purpose of attending classes. When an employee has completed all preliminary requirements for his doctorate, he may apply for an educational leave of absence which is the second phase of this program. His dissertation topic is required to have at least a general relevance to the work at Bettis Laboratory and is subject to approval by Westinghouse. If the topic is approved and leave is granted, the employee then spends the next several months in fulfilling his dissertation requirement while receiving a stipend from Westinghouse. The stipend is based on a specific percentage of the employee's prior salary. Johnson and Pomerantz took leaves of nine months and were paid $5,670 each, representing 80% of their prior salaries. Wolfe's leave lasted a year and he received $9,698.90 or 90% of his prior salary. Certain additional payments were made based on the size of the employee's family. Each of the men retained seniority status and all employee benefits, such as insurance and stock option privileges. In return they were required to submit periodic progress reports. At the end of their leave, Johnson and Pomerantz were obligated under a written contract they had signed to return to the employ of Westinghouse for a period of two years. Wolfe had been told before his leave that he was expected to return for a period of one year. Westinghouse under its own accounting system listed the amounts paid to these employees as "indirect labor" expenses and withheld Federal Income Tax.

In reversing the Third Circuit Court of Appeals the Supreme Court stressed five main points which contributed to the disqualification of these payments as scholarships:

(1) *The employer-employee relationship*—Not only were the recipients employees of the grantor prior to and during the educational leaves but in addition, they were required to return to work for a definite period of time after their leave.
(2) *Continuation of the employee benefits*—Insurance and stock option privileges were available to recipients during their leaves and they retained their seniority status.
(3) *Close relation of stipends to prior salaries*—The stipends were 80% to 90% of the recipients prior salaries (not including additional allowances for dependents).
(4) *Requirement that the topics relate to the work of the Bettis Laboratory*—Topics had to be submitted to Westinghouse for approval.
(5) *Periodic work reports*—Recipients were required to keep Westinghouse abreast of their progress.

After reviewing the above facts, Justice Stewart concluded:

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compensation or payment for the services described in subparagraph (1) of this paragraph. Neither the fact that the recipient is required to furnish reports of his progress to the grantor, nor the fact that the results of his studies or research may be of some incidental benefit to the grantor shall, of itself, be considered to destroy the essential character of such amount as a scholarship or fellowship grant.

[3] Johnson v. Bingler, 396 F.2d 258 (3d Cir. 1968).

> Under that provision,[4] as set out in the trial court's instructions, the jury here properly found that the amounts received by the respondents were taxable 'compensation' rather than excludable 'scholarships' . . . . Westinghouse unquestionably extracted a *quid pro quo* . . . . The thrust of the provision dealing with compensation is that bargained-for payments, given only as a *quo* in return for the *quid* of services rendered—whether past, present, or future—should not be excludable from income as 'scholarship' funds.[5]

This decision was the first by the Supreme Court involving Section 117 of the Internal Revenue Code of 1954, and Treasury Regulation 1.117-4(c)(1956). In upholding the validity of the Regulations the Supreme Court elected to follow the position taken by the Courts of Appeals[6] for the Fourth, Fifth, Sixth, and Tenth Circuits.

The Third Circuit in *Johnson v. Bingler*[7] rejected the approach of the other Courts of Appeal and substituted their own test of whether the subject grants were "reasonable" payments exhibiting the "normal characteristics" of scholarships. In the opinion Judge Weiner starts with the premise that the dominant legislative intent behind Section 117 of the Internal Revenue Code of 1954, is "that of encouraging financial aid to students . . . through the device of limited tax relief."[8] He points out that the amount of the exclusion is limited only for those students who are not candidates for a degree. Applying the canon of statutory construction *expressio unius est exclusio alterius* (expression of one thing is the exclusion of another), he concludes that Congress included the sole restructions it wished to place on the excludability of scholarships for degree candidates in the language of Section 117 (b) (1). In that section degree candidates are prevented from excluding any payments for services required as a condition for the grants. He takes issue with the Treasury Regulations which he believes purport to add two other restrictions on the excludability of payments. Here he is referring to the sections which would subject to taxation any amounts which "represent either compensation for past, present or future employment services" or which are "primarily for the benefit of the grantor."[9] Under this line of reasoning Judge Weiner concludes that:

> . . . any reasonable stipend which comes within the common understanding of what constitutes a scholarship, is paid to finance the schooling of a degree candidate, and does not fall within the limitation of Section 117 (b)(1) is excluded from gross income.[10]

Under this approach only two questions must be answered. The first is whether or not the payment is a scholarship or a fellowship grant. Judge Weiner admits that the characteristics of a scholarship or fellowship grant are "far from clear,"[11] but he is able to qualify the subject grants as such by pointing out some of the

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[4] Treas. Reg. § 1.117-4(c), cited note 2, *supra.*

[5] Bingler v. Johnson, 394 U.S. 741, 755-58 (1969).

[6] *See generally,* Ussery v. United States, 296 F.2d 582 (5th Cir. 1961); Reese v. Commissioner, 373 F.2d 742 (4th Cir. 1967); Stewart v. United States, 363 F.2d 355 (6th Cir. 1966); and Woddail v. Commissioner, 321 F.2d 721 (10th Cir. 1963); *See also,* Reiffen v. United States, 376 F.2d 883 (Ct. Cl. 1967).

[7] 396 F.2d 258 (3d Cir. 1968).

[8] *Id.* at 260.

[9] Treas. Reg. 1.117-4(c)(1)-(2) (1956).

[10] Johnson v. Bingler, 396 F.2d 258, 260-61 (3d Cir. 1968).

[11] *Id.* at 263.

salient "normal characteristics" of scholarships and fellowships exhibited by the grants in question:[12]

> Appellants' stipends were awarded as subsidies to full-time students in an amount bearing an appropriate relation to each recipient's needs. Their continuance was contingent upon the participant's maintenance of the academic standards required of a candidate for a graduate degree by the university which each appellant attended. While receiving these grants, appellants were on an academic leave of absence from their employment for the specific purpose of completing their doctoral dissertations.[13]

After it is determined that the payments being considered are scholarships or fellowships the question remaining is whether or not the payments are "reasonable." Because he views Section 117 as a Congressional attempt to encourage graduate study through the device of tax relief, Judge Weiner is willing to be very lenient in his requirement of reasonableness. He points out that if the payments were not based on a substantial percentage of prior income, employees, such as those in this case, would be hard pressed to leave work for a year to pursue an advanced degree. By first deciding that he is dealing with a scholarship or fellowship and then finding the amount to be reasonable, Judge Weiner is able to find the subject grants excludable from gross income under Section 117.

The above result could not have been reached, however, without first rejecting the definitions of scholarships and fellowships contained in the Treasury Regulations.[14] It is here that the Supreme Court finds fault with the Third Circuit's opinion. Judge Weiner invalidated Treasury Regulation 117.4(c) (1)-(2)(1956) and replaced it with his own concept of the "normal characteristics" of scholarships and fellowships. Justice Stewart points out that the Commissioner, not the courts, was given the power by Congress to implement the provisions of the Internal Revenue Code. This power includes prescribing all necessary rules for enforcing the Code. Since Congress did not define the terms "scholarship" and "fellowship" as used in Section 117 it was perfectly proper for the Commissioner to define the scope of these terms in the Regulations. Having done so these Regulations "must be sustained unless unreasonable and plainly inconsistent with the revenue statutes," and "should not be overruled except for weighty reasons."[15] Justice Stewart did not believe that the legislative history "precludes, as 'plainly inconsistent' with the statute, a definition of 'scholarship' that excludes from the reach of that term amounts received as compensation for services performed."[16] Thus the Supreme Court endorsed the "compensation" test of the Treasury Regulations and rejected the Third Circuit's test of "reasonable" payments exhibiting the "normal characteristics" of scholarships. Previous to the Supreme Court's opinion in *Johnson* a lower court had said in regard to the Third Circuit's view:

> This court believes the weight of authority is the sounder view and is contrary to *Johnson*. To follow the view of *Johnson* would permit nearly any payment labeled 'scholarship' or 'fellowship' and not expressly within the restrictions of Section 117 (b)(1) to be excluded from gross income. The court does not believe that the legislative history of this section leads to that conclusion.[17]

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[12] *Id.* at 259.

[13] *Id.*

[14] Treas. Reg. 1.117-4(c)(1)-(2) (1956).

[15] Commissioner of Internal Revenue v. South Texas Lumber Co., 333 U.S. 496, 501 (1948).

[16] Bingler v. Johnson, 394 U.S. 741, 752 (1969).

[17] Quast v. U.S., 293 F. Supp. 56, 61 (1968).

This statement adequately summarizes the Supreme Court's view of this case.

In order to fully understand the importance of the Supreme Court's decision in *Bingler v. Johnson* it is necessary to examine the way problems under Section 117 had been handled in prior cases. Under the 1939 Code scholarships and fellowships had not been given separate treatment. In order to be excludable they had to meet the requirements of gifts and so the courts applied a test of "gift" versus "compensation."[18] This made a case by case determination necessary and it was this which Congress was seeking to end by its passage of Section 117 of the Internal Revenue Code of 1954. Congress desired to eliminate "the existing confusion as to whether such payments are to be treated as income or as gifts."[19] Congress recognized that "scholarships and fellowships" were "sufficiently unique" to warrant tax treatment "separate from that accorded gifts."[20] But, as the Supreme Court in *Bingler v. Johnson* points out, the "delineation of the precise contours" of the categories of scholarships and fellowships was left to the determination of the Commissioner.[21] The result of this determination was Treasury Regulation Section 1.117 which, unfortunately, did not accomplish the Congressional purpose of ending case by case determinations. In fact, the old "gift" versus "compensation" test was revived under the heading of Treasury Regulation 1.117-4(c)[22] which required an inquiry as to the motive of the grantor (primary purpose) and a determination as to whether the grant constituted "compensation."[23] In actual operation this section of the Regulations fostered three basic approaches; the "primary purpose" test, the "indicia of compensation" test and a third which is merely a combination of the first two.

The "primary purpose" test arose from the language of Treasury Regulation 1.117-4(c) (2) which exempts from the definition of scholarships and fellowships any amount paid to an individual to enable him to pursue "studies or research *primarily for the benefit of the grantor.*"[24] (emphasis added). In *Ussery v. United States*[25] a state public welfare department employee received compensation while on educational leave. The leave was granted under a formal agreement outlining his obligation to return to duties with the department and stating that the purpose of the grant was to improve the efficiency of the department. The court found that under these facts the primary purpose of the grant was to benefit the grantor. In *Reiffen v. United States*[26] the Court of Claims held a research laboratory's payments to a taxpayer, to enable him to pursue studies and research at a university with which the laboratory was connected, were not a scholarship or fellowship grant and were not excludable from gross income. The court said the payments "were made [to plaintiff] to enable him to pursue studies and research primarily for the benefit of" the grantor.[27] Thus it can be seen that the "primary purpose" test

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18 *See* Stone v. Commissioner, 23 T.C. 254 (1954).

19 H.R. REP. NO. 1337, 83rd Cong., 2d Sess. (1954).

20 Gordon, *Scholarship and Fellowship Grants as Income: A Search for Treasury Policy*, 1960 WASH. U.L.Q. 144, 151. For a somewhat different apprach see, Chommie, *Services Rendered, Not Donative Intent, Governs Exemption of Study Grants*, 4 JOURNAL OF TAXATION 375 (1956).

21 Bingler v. Johnson, 394 U.S. 741, 753 (1969).

22 Cited note 2, *supra.*

23 Gordon, *supra* note 20, at 157.

24 Cited note 2, *supra.*

25 296 F.2d 582 (5th Cir. 1961).

26 376 F.2d 883 (1967).

27 *Id.* at 890.

involves a determination of whether the grant was made in order to benefit the grantor or grantee. This necessitates an investigation into the grantor's motives.

Under the second test, i.e., "indicia of compensation," the courts merely look to see if the grant has the characteristics usually associated with compensation. In *Stewart v. United States*[28] a Tennessee Department of Public Welfare employee received monthly stipends and other benefits during an educational leave of absence and was required to return to her previous position. In finding the stipends taxable the court rejected the "primary purpose" test. They stated that "consideration of the facts as indicia of compensation for services is a more meaningful test than that of whether the stipend was primarily for the benefit of the grantor."[29] The reasoning behind this rejection of the "primary purpose" test was that in any employment relationship, past or future, there is at least some mutuality of benefit. This makes it difficult in many cases to determine whether or not the grant was primarily for the benefit of the grantor. The court in *Stewart* thought it was easier to look for "indicia of compensation."

The third test is actually a combination of "primary purpose" and "indicia of compensation." In *Woddail v. Commissioner*[30] a physician was employed full-time by a Veteran's Administration hospital where he received residence training in psychiatry and neurology in addition to his regular duties. The court found the amount paid to Woddail was "an amount paid for services and was primarily for the benefit of the grantor."[31] Thus they employed both tests in finding the payments taxable. Another case employing both tests was *Evans v. Commissioner*[32] where the "primary purpose" of the payments was to train the recipient and they were not compensation for services.

Against this backdrop of conflicting approaches the Supreme Court decided *Bingler v. Johnson.* The court relied heavily on the "indicia of compensation" test and did not even mention the "primary purpose" test in the main body of its opinion. In footnote 32[33] the court states that it views the "primarily for the benefit of the grantor" paragraph as merely an adjunct to the initial "compensation" provision. The court believes this paragraph was added to impose income tax on bargained-for arrangements which do not create an employer-employee relationship. This would indicate that the court would not even look to the "primary purpose" of a grant except in cases where there was no employer-employee relationship of any kind. In applying the "indicia of compensation" test the Supreme Court stressed the "bargained-for" aspects of the grant and stated that the most important fact was that Westinghouse "extracted a *quid pro quo* for its grants."[34] Thus, it should be clear that in future cases if the grant is bargained-for and services are rendered (whether past, present or future) in exchange for the payment, then it will not be found to be a "scholarship" or "fellowship" under Section 117.

Harry D. Cornett, Jr.

[28] 363 F.2d 355 (6th Cir. 1966).

[29] *Id.* at 357.

[30] 321 F.2d 721 (10th Cir. 1963).

[31] *Id.* at 724.

[32] 34 T.C. 720 (1960).

[33] Bingler v. Johnson, 394 U.S. 741, 758 (1969).

[34] *Id.* at 757.

LIMITATION OF ACTIONS—THE OHIO SAVING STATUTE AND THE RIGHT TO VOLUNTARILY DISMISS—*Beckner v. Stover, 18 Ohio St. 2d 36, 247 N.E.2d 300 (1969)*—Plaintiff commenced an action in May, 1964, in the Common Pleas Court of Franklin County to recover damages that she suffered in an automobile collision on September 12, 1963 due to the alleged negligence of the defendant. On the second day of the trial, after the defense had rested, the plaintiff's attorney attempted to recall a medical witness who had been excused in the morning and was not present at the courthouse. The trial judge denied the plaintiff's request. The plaintiff then offered to introduce into evidence an article concerning whiplash injuries. The court sustained an objection to this. As a result of the court's rulings the plaintiff moved to dismiss the action without prejudice under the voluntary dismissal statute.[1] The court granted the motion. The plaintiff, on November 10, 1966, the same day as the dismissal, commenced a new action. The defendant, however, moved to dismiss on the grounds that it was barred by the two-year statute of limitations.[2] The court sustained the defendant's motion to dismiss, and the plaintiff appealed.

The Court of Appeals for Franklin County reversed the judgment of the trial court, holding that ". . . any voluntary nonsuit or dismissal of a case . . . . qualifies as a case which 'fails otherwise than upon the merits' within the special savings [sic] statute, section 2305.19, [Ohio] Revised Code"[3] which provides that:

> In an action commenced, or attempted to be commenced, if in due time a judgment for plaintiff is reversed, or if the plantiff fails otherwise than upon the merits, and the time limited for the commencement of such action at the date of a reversal or failure has expired, the plaintiff . . . may commence a new action within one year after such date. . . .[4]

The Ohio Supreme Court reversed the Court of Appeals. It held that where a plaintiff voluntarily dismisses an action without prejudice there is no "failure otherwise than upon the merits" under the saving statute when his dismissal is " . . . in response to adverse rulings of the trial court, unless those rulings will prevent a trial of the cause upon its merits."[5]

The meaning of "failure otherwise than upon the merits" was first construed by the Supreme Court in *Siegfried v. Railroad Co.*[6] in 1893. The court reasoned that a failure, within the purview of the saving statute, implied an effort or purpose to succeed. A plaintiff who voluntarily dismissed, thereby abandoning his action, did not evidence a purpose or effort to succeed. He therefore did not fail and could not gain an extra year in which to commence a new action. The failure had to be a result of " . . . some action by the court, by which the plaintiff is defeated without a trial upon the merits."[7]

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[1] OHIO REV. CODE ANN. § 2323.05 (Page 1953), provides that:

> An action may be dismissed without prejudice to a future action:
>
> (A) By the plaintiff, before its final submission to the jury, or to the court, when the trial is by the court;
>
> . . . .

[2] OHIO REV. CODE ANN. § 2305.10 (Page 1953).

[3] Beckner v. Stover, 42 Ohio Op. 2d 382, 13 Ohio App. 2d 222 (1968).

[4] OHIO REV. CODE ANN. § 2305.19 (Page 1953).

[5] Beckner v. Stover, 18 Ohio St. 2d 36, 37, 247 N.E.2d 300, 301 (1969).

[6] 50 Ohio St. 294, 34 N.E. 331 (1893); for a discussion of § 2305.19 of the Ohio Revised Code and judicial interpretation of "an action commenced or attempted to be commenced" as used in the statute *see* 28 OHIO ST. L. J. 558 (1967).

[7] *Id.* at 296, 34 N.E. at 332.

The *Siegfried* interpretation of the voluntary dismissal and the saving statute was closely adhered to by Ohio courts[8] until 1960 when the Supreme Court distinguished it in *Cero Realty Corp. v. American Manufacturers Mutual Insurance Co.*[9] In that case the plaintiff had suffered the sustaining of two demurrers by the court for misjoinder of parties and could not proceed further. The plaintiff voluntarily dismissed without prejudice and refiled the action. Since the statute of limitations had run, the plaintiff invoked the saving statute in support of his recommencement. The court noted that section 2305.19 of the Ohio Revised Code was remedial in nature and entitled to a liberal construction and stated that excluding all voluntary dismissals from the operation of the statute was an unduly narrow interpretation. Here the plaintiff's dismissal was voluntary but was attributable to adverse rulings by the trial court and such a dismissal was a "failure" under the meaning and terms of the statute.[10]

After *Cero* was decided it was suggested that the Ohio rule, as set forth in *Siegfried*, might be narrowed to the extent that only a plaintiff who dismissed for no apparent reason would be prohibited from invoking the saving statute. But where an adverse ruling by the court impelled the plaintiff to follow a course of dismissal, he would be permitted to gain an extra year in which to refile.[11]

Cero seemingly placed Ohio law in an equivocal or transitional stage. It could easily have led to a rule bringing all voluntary dismissals within the purview of the saving statute — a rule which prevails in many states.[12] However the Supreme Court in *Beckner* dispelled such notions and relied on *Siegfried* to reject the idea that any adverse ruling by the court would be sufficient to allow the plaintiff to withdraw his suit voluntarily and reinstitute it under the saving statute. The court pointed out that the plaintiff's alernative to dismissal in *Cero* was to suffer an adverse judgment or curtail critical elements of his complaint, and to term such a dismissal as voluntary would be an incorrect designation.[13] The court said that only a voluntary dismissal due to an adverse ruling which would " . . . prevent a trial of the cause upon its merits"[14] would constitute a "failure otherwise than upon the merits." This is quite similar to the language employed in *Siegfried*.[15]

The opinion in the principal case clearly recognizes that the trial court has the authority to conduct the trial as it sees fit and stresses that alleged errors made by the court are to be settled by recourse to the appellate courts of the state after the cause has been tried on its merits. The saving statute is not to be used as an alternative or substitute for the appellate process.[16] It seems apparent that, when the statute of limitations has run, a plaintiff may safely exercise his right to voluntarily dismiss without prejudice only when he is confronted with a ruling by the court which would force him to suffer an adverse judgment without the merits being reached.

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8 Buehrer v. Provident Mutual Life Ins. Co., 123 Ohio St. 264, 175 N.E. 25 (1931); see also Annot., 79 A.L.R.2d 1300 (1961) for a listing of other relevant Ohio cases after *Siegfried*.

9 171 Ohio St. 82, 167 N.E.2d 774 (1960).

10 *Id.* at 86, 167 N.E.2d at 777.

11 Annot., 79 A.L.R.2d 1301 (1961).

12 *See* Annot., 79 A.L.R.2d 1290 (1961) for a discussion on allowing and disallowing a voluntary dismissal or nonsuit to come under the saving or extension statutes of states and for a partial listing of states that follow each rule.

13 18 Ohio St. 2d 36, 39, 247 N.E.2d 300, 302.

14 *Id.* at 37, 247 N.E.2d at 301.

15 50 Ohio St. 294, 296, 34 N.E. 331, 332.

16 18 Ohio St. 2d 36, 39, 40, 247 N.E.2d 300, 302.

In reinstating the *Siegfried* rule, the court in *Beckner* was concerned with the possibility of abuse by plaintiff. The court's concern with allowing a plaintiff to dismiss on his own and refile under the saving statute was not only that this would permit a plaintiff to avoid the appellate process to determine claimed errors but that it would also authorize ". . . a practice [by which] parties could try and retry their cases indefinitely until the most favorable circumstances for submission were finally achieved."[17] The defendant-appellant argued that under the ruling of the court of appeals a plaintiff could try a case up until the time it is to be submitted to the jury and then dismiss and refile. "He can continue to do this time after time, and there is no limitation upon how frequently he can do this."[18] The court agreed that this possibility of abuse was too great, stating that the saving statute ". . . neither provides nor permits such a practice."[19]

However, the question of whether the saving statute would permit such a practice was answered in the negative years ago in *Bush v. Cole*.[20] The opinion was affirmed *per curiam* by the Supreme Court.[21] In that case the court of appeals stated that the saving statute did not "authorize repeated new actions within one year after the discontinuance of the preceding action . . . [nor could] a cause of action be kept alive and litigation prolonged indefinitely by plaintiff."[22] The court there reasoned that the action commenced, as referred to in the saving statute, must be an action brought within the statute of limitations and that if the plaintiff "failed otherwise than upon the merits" after the original period had run, he then was granted but one year to commence a new action.[23]

This decision, though not relied on by the court in *Beckner*, appears to solve the problem of potential abuse posed by the defendant and the court. It is also in line with numerous courts across the country which have considered this question.[24] It is generally held that the privilege can be exercised but one time.[25] Therefore,

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[17] *Id.* at 40, 247 N.E.2d at 303.

[18] Brief for Appellant at 2, Beckner v. Stover, 18 Ohio St. 2d 36, 247 N.E.2d 300 (1969).

[19] 18 Ohio St. 2d 36, 40, 247 N.E.2d 300, 303.

[20] 1 Ohio App. 269 (1913).

[21] 91 Ohio St. 369, 110 N.E. 1056 (1914).

[22] Bush v. Cole, 1 Ohio App. 269, 271 (1913).

[23] *Id.* at 271.

[24] Annot., 54 A.L.R.2d 1230 (1957).

[25] Annot., 83 A.L.R. 487 (1933); An early Ohio case has been cited as having held that two successive actions may be brought within the "saving" year, Schock v. J.A. Frazier & Co., 6 Ohio Dec. Reprint 1078, 10 Am. L. Rec. 305 (1881), see Annot., *supra* at 488. The plaintiff in that case filed his first action on Sept. 15, 1878, one day before the statute of limitations was to expire. The case was dismissed without prejudice, and a second action was filed on Sept. 16, 1878. This action was dismissed on Sept. 20, 1878, and a third action was filed on Sept. 24, 1878. The defendant contended that this third action was barred by the statute of limitations, but the court said that it was saved by the Ohio saving statute. If the second action was brought before the statute of limitations expired, being filed on the last day, and dismissed after the statute had run, then the case can only be cited as having allowed one action brought within the "saving" year. Section 1.14 of the Ohio Revised Code would seem to authorize this interpretation. The opinion of the court in *Schock* is unclear, but the court does state that the third action was commenced after the statute of limitations had run and refers only to the second action as having been filed on the day the statute expired.

The case, having been decided by the Hamilton County District Court, before both *Siegfried* and *Bush*, is of dubious value as precedent to authorize successive suits to be filed within the extension year allowed by the saving statute. The ambiguity of the holding was noted in United States Fire Ins. Co. v. Swyden, 175 Okla. 475, 477, 53 P.2d 284, 287 (1935).

In Shircliff v. Elliott, 384 F.2d 947 (6th Cir. 1967), plaintiff was allowed to file two actions within Kentucky's ninety day extension period. The court noted that only one extension without either suggesting that this would change the *Beckner* holding—nor advocating that it should—it seems proper to recognize that to have held as the Court of Appeals did in *Beckner* would have allowed the plaintiff to refile the action but once.

As a result of the relationship between sections 2323.05 and 2305.19 of the Ohio Revised Code, as interpreted by *Beckner*, a trap awaits an unsuspecting attorney. For, on the face of statutes, it would seem that a plaintiff who voluntarily dismisses should be able to refile successfully under the saving statute. If the dismissal is granted "without prejudice," an attorney might well assume that the prior dismissal will not affect recommencement of his suit. One might also interpret "failure otherwise than upon the merits" as including a dismissal "without prejudice"[26] which is, by definition, not on the merits. The holding of the court of appeals in the principal case, by liberalizing the interpretation of the statutes, would seemingly conform to the apparent meaning of the statutes by making a dismissal without prejudice actually mean that the commencement of another action would not be barred.

The right of the plaintiff to dismiss without prejudice exists by statute, but often it may not exist in fact. In *Beckner* the cause came to trial almost two years and six months after the petition was filed. This was more than one year after the statute of limitations had run. Therefore, long before the trial was commenced, the plaintiff could not have dismissed without prejudice since the statute of limitations had run and the saving statute was, as resulted, not applicable. The right to so dismiss was unexercisable for this plaintiff as it might be for many others. Suspending for a moment the question as to whether the right to dismiss voluntarily without prejudice should exist, the fact that it is written in the code means, one would think, that it should be capable of being exercised.

The major cause for the impossibility of exercising this right in *Beckner v. Stover* and many other cases, especially personal injury suits which constitute many of the cases presented in courts today, is the congestion in the court system. If the object is to curb the right of voluntary dismissal of the plaintiff, which has been criticized as being both inequitable to the defendant and antiquated,[27] it is questionable whether the proper way to suspend the right, because of the possibility of its being abused, is by the unplanned and unwanted backlog in the courts.

Since Ohio is now in the process of revising its procedural rules, assessment of the current rule in Ohio on voluntary dismissal as compared to Rule 41 (a)(1) of the Federal Rules is pertinent. Rule 41 (a)(1) allows a plaintiff to voluntarily dismiss an action at any time before service by the defendant of an answer or of a motion for summary judgment. The dismissal is without prejudice to the commencement of another action.[28] The purpose of this rule, which limits the plaintiff's right much more than Ohio's current rule, ". . . is to facilitate the voluntary dismissal of an action, but safeguard abuse of the right by limiting its application to an

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period was allowed plaintiff. But to avoid a defeat on technicalities of venue to a plaintiff acting in good faith and not harassing defendant, the court allowed plaintiff to refile a second time within the extension period. The court cited the *Schock* case as authority for this principle of successive actions in the extension period and, as noted above, that case seems to be a rather questionable authority. However, the Court of Appeals stressed the good faith of the plaintiff and the lack of harrassment to the defendant.

26 For cases that follow this reasoning see Annot., 79 A.L.R.2d 1290 (1961).

27 5 J. MOORE, FEDERAL PRACTICE ¶ 41.02 [1], at 1019 (2d ed. 1969); 7 WM. & MARY L. REV. 357 (1966).

28 FED. R. CIV. P. 41 (a)(1).

early stage of the proceedings."[29] Any dismissal after this stage may be made only by order of the court when such a course is deemed to be proper.

Any change in Ohio's rule should take into account the above purpose of the Federal Rule as well as other factors referred to previously. The new Ohio rule on dismissal of actions could simply not allow voluntary dismissal by the plaintiff. As long as the plaintiff has freedom to amend his complaint the right to dismiss without prejudice is unnecessary if the concern, in the first place, is to avoid the adjudication of one's rights on procedural technicalities rather than upon the merits. The right has been criticized for several reasons,[30] and it has been suggested, for the Federal Rules, to curb the right even further in order to lessen the waste of the court's time.[31]

The tentative proposal for the new Ohio rule will permit the plaintiff to voluntarily dismiss without prejudice at any time before commencement of the trial. This would be at the point where the judge asks the counsel if they are ready to proceed. This rule would grant the plaintiff much more time to exercise his right than exists under the current Federal Rule due to the generally long time lapse between the service of the answer and the commencement of the trial. The proposed rule would also define as "failures other than on the merits" dismissals for improper venue, for lack of jurisdiction over the person or the subject matter, or of failure to join a party under Rule 19 (persons needed for a just adjudication). Rulings such as these would seemingly come within the *Beckner* definition of a "failure otherwise than upon the merits" preventing a trial on the merits. If such a rule is adopted, *Beckner* would then be applicable to the period between the filing of the complaint and the commencement of the trial. After the latter point is reached any dismissal would have to come by order of the court.

The right to voluntarily dismiss without prejudice under this proposal would still be illusory in many cases. Due to the various factors causing the congestion in the courts, the time lag between the commencement of an action and commencement of trial is often great.[32] The statute of limitations might run as it did in *Beckner*, long before the trial is commenced. After it runs the plaintiff will often not be able to dismiss without prejudice due to *Beckner*. The right, in reality, will exist only in the period between filing the complaint and before the statute of limitations runs.

However, at present, the current case law, coupled with the backlog in the administration of the courts, greatly curtails the right to voluntarily dismiss without prejudice by restricting the use of the saving statute. The interpretation of the statutes is narrow and effectively renders the phrase "without prejudice" meaning-

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[29] 5 J. MOORE, FEDERAL PRACTICE ¶ 41.02 [1], at 1019 (2d ed. 1968).

[30] Authorities cited *supra* note 27; when plaintiff dismissed in the *Beckner* trial the trial judge remarked: "The motion will be sustained. I want to make this one statement, and I want to make it for the record. I think this is an abuse of the time of the court, the jury, the parties and the counsel, but since the statute provides that the plaintiff has a right to do so, the Court has no alternative. . . . It will be dismissed without prejudice. . . ." *Additional Record* at 7.

[31] 5 J. MOORE, FEDERAL PRACTICE ¶ 41.02 [3], at 1031 (2d ed. 1969).

[32] A recent study of personal injury suits tried by jury reports that the average time between the service of the answer and the time of trial in 101 jurisdictions across the country was 22.1 months. This was based on cases coming to trial in a one-year period ending April 30, 1969. For the Common Pleas Court of Franklin County the average delay was 20.0 months in such suits. In 1968 it was 18.5 months. Cuyahoga County reported an average delay of 35.4 months in 1968. For 1969 the figure dropped to 10.5 months (this was an estimate not based on the formula recommended by the committee). Hamilton County failed to furnish data. The Institute of Judicial Administration, Calendar Status Study—1969, State Trial Courts of General Jurisdiction—Personal Injury Cases, August 1, 1969.

less. For clarification it would seem advantageous to enact the tentative proposal as discussed above or the current Federal Rule thereby directly limiting the right while providing the plaintiff greater liberty to amend and giving the court the power to dismiss or not when just or equitable considerations so demand. The saving statute would then exist to assist a plaintiff faced with procedural problems to gain an extra year when he cannot, in the court's opinion, try his case on the merits.

Limiting the present and rather broad right to voluntarily dismiss without prejudice, which is often non-existent in fact, will more adequately protect the parties. The statutes now purport to grant a right which practice denies. The complete cure of this situation would be abolition of the right. Though neither the current Federal Rule nor the tentative Ohio rule go this far, the former is more satisfactory than the latter since the restriction is greater. It should be noted again that the congestion in the courts, apparently increasing rather than decreasing, does adversely affect the exercise of rights. The right to voluntarily dismiss without prejudice, if it were capable of being exercised, would constitute one factor delaying the adjudication of cases. However, it is not the only factor. A solution of this problem is necessary in the interest of the efficient and equitable administration of justice.

Thomas E. Roberts

UNFAIR TRADE—PERMISSIBLE USE OF ANOTHER'S TRADEMARK—*Geisel v. Poynter Products, Inc., 295 F. Supp. 331 (S.D.N.Y. 1968)*—In 1932, Theodor Seuss Geisel, plaintiff, under the pen name "Dr. Seuss," prepared a series of twenty-three "cartoon essays" for *Liberty* Magazine. Each cartoon contained several "animal creations." Geisel himself retained no copyrights on the cartoons, but simply sold them, with all rights,[1] to *Liberty* Magazine. *Liberty* obtained a copyright, which embraced the entire issue, on each issue of the publication. Through a series of assignments, the rights in the cartoons became, in 1964, the property of the defendant Liberty Library Corporation, *Liberty* Magazine having ceased publication. In order to exploit these rights, Liberty Library Corporation granted to the defendant Poynter Products, Inc., a license to manufacture dolls based on the Dr. Seuss cartoons. Donald Poynter of Poynter Products designed and produced the three-dimensional toy dolls, imitating as closely as possible the cartoon drawings created by Dr. Seuss. On the bottoms of the dolls, on hang tags, on display cartons, and on advertising handbills were the following expressions:

From Original Illustrations of Dr. Seuss
From the Wonderful World of Dr. Seuss
from Dr. Seuss' Merry Menagerie

The format of the name "Dr. Seuss" was copied exactly as the plaintiff used it in all of his works. On February 16, 1968, the dolls were offered for sale.

On March 12, 1968, the plaintiff sought and obtained a temporary restraining order which restrained the defendants from using the name "Dr. Seuss" in any way connected with the dolls. The defendants ceased selling the dolls. On April 9,

[1] This was a factual determination by the Court based upon extensive testimony as to the transaction and as to trade customs of the 1930's. The magazine was held to have been granted the common-law copyright and the right to secure a statutory copyright. Geisel v. Poyner Productions, Inc., 295 F. Supp. 331, 335-44. (S.D.N.Y. 1968).

1968, the Court issued a temporary injunction[2] *pendente lite* which restrained the defendants from using the plaintiff's name in any misleading or deceiving way.[3]

After April 9, 1968, the defendants began to sell the dolls again, but changed the printed advertisements and slogans to read as follows in an effort to comply with the injunction:

> TOYS CREATED, DESIGNED & PRODUCED EXCLUSIVELY BY DON POYNTER
> MERRY MENAGERIE BASED ON LIBERTY MAGAZINE ILLUSTRATIONS
> BY DR. SEUSS

The names "Dr. Seuss" and "Don Poynter" were in the same size and style of type.

In this litigation, the plaintiff sought to permanently enjoin the defendants from using the name "Dr. Seuss" in any way without his consent. The plaintiff also sought compensatory and punitive damages, alleging[4] that the defendants had violated Section 43(a) of the Lanham Trademark Act,[5] which generally forbids false designations of the origin of a product.

After determining that the plaintiff's sale of the cartoons to *Liberty* Magazine in 1932 without reservation constituted a grant of all the rights in the cartoons, the court held[6] that the defendant Liberty Library, as owner of the copyright, had the right to copy three-dimensional figures, or license others to do so, from the two-dimensional cartoons created by Dr. Seuss. To arrive at this decision the Court first noted it to be a settled rule that the owner of a copyright on work in one me-

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[2] The Court decided that there was "a reasonable probability of plaintiff's success" on the trial of the Lanham Act (use of trade name) cause of action, 295 F. Supp. at 333.

[3] The temporary injunction restrained defendants from:

A. Representing that defendants' doll, toy, or other similar product has been created, designed, produced, approved, or authorized by plaintiff;

B. Describing defendants' doll, toy, or other similar product as having been created, designed, produced, approved, or authorized by plaintiff; or

C. Representing, describing, or designating plaintiff as the originator, creator, designer, or producer of defendants' doll, toy or other similar products, 295 F. Supp. at 334.

[4] Plaintiff had four other claims which were rather quickly set aside by the Court and are not important to this discussion:

a. Unfair competition under Section 368-d of the New York General Business Law, N.Y. GEN. BUS. LAW § 368-d (McKinney 1968). This statute did not apply because the contractual relation existed between parties, and because there was no showing of a "liklihood of injury to business reputation," 295 F. Supp. at 355;

b. Violation of plaintiff's right of privacy under the New York Civil Rights Law. Jaccard v. R. H. Macy & Co., 265 App. Div. 15, 37 N.Y.S.2d 570 (1942) held that the Civil Rights Law does not protect an assumed or trade name such as "Dr. Seuss," 295 F. Supp. at 356;

c. Defamation, and

d. Conspiracy to injure, which were little more than frivolous claims, 295 F. Supp. at 357, 358.

[5] Lanham Act § 43(a), 15 U.S.C. § 1125(a) (1964) provides:

§1125 *False designations of origin and false descriptions forbidden*

(a) Any person who shall affix, apply, or annex, or use in connection with any goods or services, or any container or containers for goods, a false designation of origin, or any false description or representation, including words or other symbols tending falsely to describe or represent the same, and shall cause such goods or services to enter into commerce, . . . shall be liable to a civil action . . . by any person who believes that he is or is likely to be damaged by the use of any such false description or representation.

[6] This reaffirmed the temporary injunction decision.

dium is protected against infringement of that copyright in a different medium.[7] This rule was established by *King Features Syndicate v. Fleischer*,[8] in which the plaintiff held a copyright on a book of cartoons which pictured "Barney Google and Spark Plug" (a horse). The defendant manufactured a toy horse named "Sparky," in exact imitation of the cartoon picture of "Spark Plug." This was held to infringe the plaintiff's copyright, since a three-dimensional toy figure *can* be a copy of a two-dimensional cartoon. *Fleischer Studios, Inc. v. Ralph A. Freundlich, Inc.*[9] reaffirmed the holding of *King Features*, and added that the three-dimensional copy need not be an exact copy of the two-dimensional to constitute an infringement. In *Fleischer* the defendant had produced a doll extremely similar to the plaintiff's "Betty Boop" cartoon drawings, except for the way in which the doll's hair was arranged.

Taking this well-established rule, the *Geisel* court reasoned that since the owner of a copyright may protect his property from infringement in other media, it follows that the owner himself may, as part of his right under the copyright, copy or transform the work into a different medium. Thus, the owner of copyrighted two-dimensional cartoons has the right to produce three-dimensional figures from those cartoons.[10]

The plaintiff's primary contention was that the defendants' use of the trade name "Dr. Seuss," both before and after the temporary injunction and revision of the labels, was wrongful. The Court agreed that *before* March 12, 1968, the defendants had violated Section 43(a) of the Lanham Act by their use of the name "Dr. Seuss," since the manner of use[11] created the false impression that the dolls were authorized by the plaintiff. However, the plaintiff made no showing of measurable damages for this period, and therefore was entitled to no recovery. The Court went on to hold that the defendants' use of the plaintiff's trade name *after* April 9, 1968, was a permissible use and did not violate Section 43(a)[12] of the Lanham Act.

A trade name[13] such as "Dr. Seuss" may be established by adoption and use[14]

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[7] Geisel v. Poynter Products, Inc., 295 F. Supp. at 350.

[8] 299 F. 533 (2d Cir. 1924).

[9] 5 F. Supp. 808 (S.D.N.Y. 1934).

[10] 17 U.S.C. § 1 (1964) seems to support this result, by giving the owner of a copyright the exclusive right to "copy" the copyrighted work. It would seem that production of three-dimensional figures based on two-dimensional cartoons should be considered "copying" such cartoons, so 17 U.S.C. § 1 should apply here.

[11] *See* text accompanying note 3 *supra*.

[12] *See* note 5 *supra*.

[13] "Dr. Seuss" is an assumed name taken from plaintiff's name, Theodor Seuss Geisel. The Geisel Court designated "Dr. Seuss" a trade name, 295 F. Supp. at 352, but it cited as precedent cases dealing with both trade name and trademark. The RESTATEMENT OF TORTS §§ 715, 716 (1938), gives very similar but different definitions to "trademark" and "trade name," but "trademark" is defined to exclude personal names. "Dr. Seuss" is a personal name, even though it is a pseudonym. Section 716 of the Restatement defines "trade name":

> A trade name is any designation which
> (a) is adopted and used by a person to denominate goods which he markets or services which he renders or a business which he conducts, or has come to be so used by others, and
> (b) through its association with such goods, services or business, has acquired a special significance as the name thereof, and
> (c) the use of which for the purpose stated in Clause (a) is prohibited neither by a legislative enactment nor by an otherwise defined public policy.

RESTATEMENT (SECOND) OF TORTS, §§ 715, 716 (Tent. Draft No. 8, 1963) would somewhat alter the above definition.

but it must acquire a "secondary meaning" as identifying particular goods or services before it is entitled to full protection. It belongs to the person who first uses it and gives it value in a particular field.[15] An exclusive, firmly established trade name such as "Dr. Seuss" which has acquired a secondary meaning is protected very much on the same principles and scope as are trademarks, under both the Lanham Act and the common law.[16]

Even though a person has a valid trademark or trade name, it does not follow that all other persons are prohibited from making any uses of that mark or name. The controlling rule on the permissible use of another's mark was first expounded by Mr. Justice Holmes in *Prestonettes, Inc. v. Coty*.[17] In *Coty*, the owner of a trademark was not permitted to enjoin another from rebottling and selling Coty's products with labels that truthfully disclosed that Coty was the source of the product. Justice Holmes explained,

> [w]hen the mark is used in a way that does not deceive the public we see no such sanctity in the word as to prevent its being used to tell the truth.[18]

In *Champion Spark Plug Co. v. Sanders*,[19] the defendant was reconditioning and reselling used Champion Spark Plugs, using the name "Champion" on the plugs and boxes for resale. The Court, citing *Prestonettes* with approval, held that the defendant had the right to use Champion's name, because a trademark may always be used by another, provided there is full and "meticulously truthful" disclosure of the origin and nature of the product. Justice Douglas stated that the second-hand dealer under this rule obviously gets some advantage from use of the trademark,

> [b]ut under the rule of *Prestonettes*, . . . that is wholly permissible so long as the manufacturer is not identified with the inferior qualitiies of the product . . . .[20]

Thus, under the common law rule, the owner of a trademark or trade name may only prohibit the use of the mark so far as is necessary to protect the owner's good will.[21] A manufacturer or owner is entitled to full disclosure by one using his trade name, but no more.

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[14] RESTATEMENT OF TORTS § 716 (1938); S. C. OPPENHEIM, UNFAIR TRADE PRACTICES 43, 44 (2d ed. 1965).

[15] Western Auto Supply Co. v. Western Auto Supply Co., 13 F. Supp. 525 (D.C.N.H. 1936).

[16] OPPENHEIM, *supra* note 14, at 44, 45; Eastern Columbia, Inc. v. Waldman, 30 Cal. 2d 268, 181 P.2d 865 (1947); Stork Restaurant v. Sahati, 166 F.2d 348 (9th Cir. 1948).

[17] 264 U.S. 359 (1924).

[18] *Id.* at 368.

[19] 331 U.S. 125 (1947).

[20] *Id.* at 130.

[21] RESTATEMENT OF TORTS § 717 (1938) provides:

(1) One infringes another's trade name, if

(a) without a privilege to do so, he uses in his business, in the manner of a trademark or trade name, a designation which is identical with or confusingly similar to the other's trade name, though he does not use the designation for the purpose of deception, and

(b) the other's interest in his trade name is protected with reference to

(i) the goods, services or business in connection with which the actor uses his designation, and

(ii) the markets in which the actor uses his designation.

RESTATEMENT (SECOND) OF TORTS, § 717 (Tent. Draft No. 8, 1963) would make minor alterations to the above definition.

A recent case interpreted Section 43(a) of the Lanham Act to give a trade name or trademark owner the same rights he had under the common law rule. In *Societe Comptoir De L'Industrie Cotonniere Establissements Boussac v. Alexander's Department Stores, Inc.*[22] a fashion designer sued a department store for supposedly wrongful use of the designer's trademark in defendant's sales of copies of the designer's dresses. The Court, citing Justice Holmes in *Prestonettes*, held that the Lanham Act created no enforceable claim in favor of a trademark owner in the absence of *deception of the public* as to the origin of the product identified by the mark.

In the *Geisel* case, the defendants stood in at least as good a position as the defendants in the above cases. In *Geisel*, there was the additional factor of a contractual relation between the parties through which the defendants owned all rights in the Dr. Seuss cartoons. That ownership, reasoned the *Geisel* Court, "must include some right to use the name 'Dr. Seuss' because that name appeared on each of the pages of cartoons in *Liberty* Magazine."[23] The defendants' explanations on the dolls that they were "based on" original drawings by Dr. Seuss satisfied the requirement of full disclosure and certainly had no tendency to deceive the public. Moreover, even without the contractual relation, the defendants would appear to have been properly using the plaintiff's name, under the guidelines established by the previous cases and under the Lanham Act.

Geisel extends the rule of *Prestonettes* and *Champion* to artistic creations. *Geisel* allows a defendant to exploit to a limited extent the goodwill of a plaintiff's mark. But this is not a necessarily undersirable result; it does not undermine the policy behind trademark protection. Various arguments are often asserted to justify the protection of trademarks and trade names. One such argument is that consumers rely upon a "brand-name" as an indication of quality. Many writers urge that trademark protection encourages freely competitive economic development. Historically, courts have emphasized that a trademark is a type of property entitled to protection, against three impositions: diversion of sales; discrediting of a mark by association with inferior products; and dilution of the significance of a mark as to a particular origin. Another argument for protection is that fair-dealing marketing policy disallows one to get a "free ride on the coat tails" of another's good will.[24]

But the *Geisel* Court applied the *Prestonettes* doctrine properly in this case. None of the arguments justifying protection of trademarks indicates that an owner need be protected against the *Geisel* type of use. Moreover, it may be economically undesirable to prohibit such a use. As Justice Douglas noted in *Champion*,[25] it would be absurd to require a reconditioner of used cars to remove the name "Ford" or "Chevrolet" from the cars for resale. To require the defendants in *Geisel* to abstain from any mention of the plaintiff's name would suggest the same type overprotectiveness.

Thomas Freiburger

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[22] 299 F.2d 33 (2d Cir. 1962).

[23] Geisel v. Poynter Products, Inc., 295 F. Supp. 331, 354 (S.D.N.Y. 1968).

[24] OPPENHEIM, *supra* note 14, at 38, 39.

[25] Champion Spark Plug Co. v. Sanders, 331 U.S. 125, 129 (1947).