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Federal Jurisdiction—"Federal Common Law" vs. State Law.—United States v. Sommerville

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sessed. It can now do indirectly what it cannot do directly, *i.e.*, interfere with, and even defeat entirely, a federal lien.

Mr. Justice White began the conclusion of his dissent by writing: "Finally, the federal revenue deserves more protection than it receives today."[46] He viewed the majority's decision as an invitation for more taxpayers to invest in life insurance policies and to obtain bank loans by pledging them. The harm of such an invitation is, however, not so real as it may appear. It is to the advantage of the vast majority of married taxpayers to file joint tax returns. As a result of this practice, generally both the husband and the wife are individually liable for the full amount of any tax deficiency.

The majority opinion must be read as holding that the New York statute makes marshaling inequitable as to all those under its protection. As pointed out above,[47] New York extends its statutory shield to all third party beneficiaries regardless of their relationship to the insured. The Commissioner would receive comfort if *Meyer* could be viewed as illustrative that widows, as well as sureties, are the "darlings of the court." However, this solace is not available to him.

CHARLES BRADFORD ABBOTT

Federal Jurisdiction—"Federal Common Law" vs. State Law.—*United States v. Sommerville.*[1]—The Farmers Home Administration (FHA), an agency of the Department of Agriculture, made loans[2] over a four year period to Flickinger, which were secured in part by certain livestock. A security agreement, which stated that it was "intended by the parties to serve as both 'Financing Statement' and 'Security Agreement' under Pennsylvania law," was executed and the security interest perfected in accordance with the laws of that state.[3] Nine months after the security agreement was duly filed as a financing statement, Flickinger delivered three of his cows to the defendant for sale at the latter's auction. The plaintiff did not know of this delivery or consent to it, and the defendant-auctioneer did not have actual knowledge[4] of the Government's security interest in the livestock. The three cows were sold at the defendant's auction, and the purchase money, less commissions, was turned over to Flickinger. Upon learning of this sale, FHA urged Flickinger to liquidate all of his assets, which he did. The proceeds were then applied to the balance of the loans leaving a debt slightly in excess of five-hundred dollars. Plaintiff, on behalf of FHA,

46 Meyer v. United States, supra note 1, at 246.

47 See note 33, supra.

1 324 F.2d 712 (3d Cir. 1963).

2 The loans were made in compliance with the Bankhead-Jones Farm Tenant Act, 60 Stat. 1071, et seq. (1946), 7 U.S.C. 1007, et seq. (1958), now 75 Stat. 310, et seq. (1961), 7 U.S.C. 1941, et seq. (1963).

3 Pa. Stat. Ann. tit. 12A § 9-101 et seq. (Uniform Commercial Code).

4 An auctioneer is the agent of the owner of the property to be sold, and is guilty of conversion if the principal has no title to the property, even though the agent acts without knowledge of the title defect. Restatement (Second), Agency § 349 (1959).

brought an action in conversion against defendant to recover the value of the livestock sold by him at auction. The district court held that the action was governed by Pennsylvania law and determined that defendant was liable. On appeal the Third Circuit affirmed the decision but reversed the basis of the holding. HELD: An independant federal rule must be applied when a genuine federal interest would be subjected to disparate state laws. The majority found this federal interest to exist and concluded that because the loan program could otherwise be adversely affected, a necessity for uniformity was present.[5]

Whether or not federal common law should be applied to certain controversies requires an examination of the history of the specific problem.[6] The first important decision was *Swift v. Tyson*,[7] where the Supreme Court held that if the rights to be decided were general rather than local in nature, then "general law", rather than state law, could be used by the federal courts to guide their decision. Under this doctrine, if the state law was not beneficial to the party, he could move to another state and then commence an action in a federal court that would apply the "general law" which could be more beneficial.[8] This thwarted the purposes of the administration of state law.

In 1938, the *Swift-Tyson* doctrine was overruled by *Erie R.R. Co. v. Tompkins*,[9] where the Court stated that federal courts are bound on a state matter by state law. The Court also broadly stated that "there is no federal general common law."[10] This ruling declared that Congress has no power to declare substantive rules to be applicable in a state whether or not the issue is local or general in nature. Subsequently this decision was not interpreted to mean that there was no "federal common law" in all instances. In one case, involving a contract action against the United States, a federal district court held that *Erie* could not have meant that the Government's rights were to be undermined and henceforth determined by the individual state laws in cases where the circumstances show a need for uniformity.[11] The Court of Appeals for the First Circuit went even further in undermining the *Erie* decision by stating, "[T]here still exist certain fields—and this [interstate communications] is one where legal relations are governed by a 'federal common law', a body of decisional law developed by the federal courts."[12] In 1943, the Supreme Court in *Clearfield Trust Co. v. United States*[13] clarified under what circumstances, if any, *Erie* was to be

[5] It should be pointed out that although the U.C.C. is the Pennsylvania statute involved, the Court of Appeals decision is meant to apply to any state rule of law, and therefore, the decision here is not determined by the Code.

[6] The problem may be looked at as one in the field of conflicts of law, i.e., which law should be applied, state or federal? However, the problem will be treated here as one involving the scope and jurisdiction of "federal common law."

[7] 41 U.S. (16 Pet.) 1, 18 (1842).

[8] Black and White Taxicab and Transfer Co. v. Brown and Yellow Taxicab and Transfer Co., 276 U.S. 518 (1928).

[9] 304 U.S. 64 (1938).

[10] Id. at 78.

[11] Byron Jackson Co. v. United States, 35 F. Supp. 665 (S.D. Calif. 1940).

[12] O'Brien v. Western Union Tel. Co., 113 F.2d 539, 541 (1st Cir. 1940).

[13] 318 U.S. 363 (1943).

followed. Certiorari had been granted[14] because of a conflict in the decisions of the circuit courts.[15]

In *Clearfield*, a check was drawn on the Treasurer of the United States to the order of Barner for services rendered to the Works Progress Administration (WPA), an agency of the federal government. Barner did not receive the check, and an unknown person forged his endorsement. The check was cashed at J. C. Penny Company in Pennsylvania and turned over to the Clearfield Trust for collection. The United States honored the check, but when the forgery was subsequently discovered, the United States commenced action on Clearfield's express guaranty of prior endorsements. The Supreme Court held that the *Erie* rule did not apply to this action and that state law was inapplicable. Said the Court:

> We agree with the Circuit Court of Appeals that the rule of *Erie R. Co. v. Tompkins*, . . . does not apply to this action. The rights and duties of the United States on commercial paper which it issues are governed by federal rather than local law. When the United States disburses its funds or pays its debts, it is exercising a constitutional function or power. This check was issued for services performed under the Federal Emergency Relief Act of 1935. . . . The authority to issue the check had its origin in the Constitution and the statutes of the United States and was in no way dependent on the laws of Pennsylvania or of any other State. Cf. *Board of Commissioners v. United States*, 308 U.S. 343 [(1939)]; *Royal Indemnity Co. v. United States*, 313 U.S. 289 [(1941)]. The duties imposed upon the United States and the rights acquired by it as a result of the issuance find their roots in the same federal sources.[16]

The Court further stated that in certain instances[17] the applicable federal rule will be selected by state law. These instances depend on the circumstances of the case. In *United States v. Brosnan*,[18] the Court concluded that state law was appropriate to govern the divestiture of federal tax liens and adopted it as a proper expression of federal law. However, in *Clearfield* the application of disparate state laws would "subject the rights and duties of the United States to exceptional uncertainty [and] lead to great diversity in results by making identical transactions subject to the vagaries of the laws of the several states. The desirability of a uniform rule is plain."[19]

As a result of the *Clearfield* case, the *Swift-Tyson* doctrine has been revived to allow the federal courts to apply federal rules where there is a federal issue. However, the Court in *Clearfield* goes one step further by

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14 317 U.S. 619 (1942).

15 Security-First Nat. Bank v. United States, 103 F.2d 188 (9th Cir. 1939). This case presented a fact situation identical to the *Clearfield* case, but was decided contra to the later Third Circuit decision in *Clearfield*.

16 Supra note 13, at 366.

17 Royal Indem. Co. v. United States, 313 U.S. 289 (1941).

18 363 U.S. 237 (1960).

19 Supra note 13, at 367.

providing an exception to the general rule. Where the federal interest is not vital or necessary to the federal program involved, or where Congress has not indicated a desire to displace state laws, the federal common law will not be applicable. It would appear that *Clearfield* has started a new concept in the field of federal law besides renewing some old pre-*Erie* principles.[20] While attempting to clear up the muddle which the *Erie* decision created, the Supreme Court in *Clearfield* also created somewhat of an undecidable issue: What is a vital federal issue necessitating a uniform federal rule which displaces disparate state laws? However, this issue does not arise unless the authority of the Government is in no way dependent upon the laws of a state. In *Clearfield*, the Court noted that the authority to issue the check was in no way dependent on Pennsylvania laws.[21]

The Third Circuit in *United States v. Sommerville*[22] is the fourth circuit to decide on exactly the same factual situation. Two circuits now hold that the FHA loan program involves such a vital federal interest that federal common law should govern the rights of the parties, and two other circuits hold that there is no federal interest in this program that calls for a displacement of state law.[23] Until the *Sommerville* decision (3d Cir.) only *United States v. Matthews*[24] (9th Cir.) held that transactions under the Bankhead-Jones Act[25] were governed by "the federal common law."

The court in the *Sommerville* case uses the *Clearfield* decision as its authority for holding that "an independent federal rule of decision must be applied when a genuine federal interest would be subjected to uncertainty by application of disparate state rules."[26] It devises a test consisting of two major premises: (1) If there is a federal interest present, then formulate a federal rule. (2) If there is a necessity for uniformity, then state law should not be used in formulating that federal rule. It is in the formulation of this test that the present court misinterprets the *Clearfield* case. *Clearfield* established the rule that where a federal interest was present the federal common law governs the situation, but only if there was necessity for uniformity, and if the Government's authority was not dependent on the state law.

Because the Government is a party to the action or because a federal program is involved is not enough to set aside state laws. There must be some basis rooted in federal law. In *United States v. Matthews*[27] (9th Cir.) an identical fact situation brought about the same decision. However, the

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[20] See 45 Calif. L. Rev. 212 (1957).

[21] Supra note 13, at 366.

[22] Supra note 1.

[23] Application for certiorari is now pending in the Supreme Court. In the accompanying memorandum for respondent, the United States, the following is written: "Although we believe that the decision below is correct, we do not oppose the petition. The decision is in conflict with decisions of the Court of Appeals for the Fourth and Eighth Circuits and the issue presented is a recurrent one." The Ninth and Third Circuits hold the other way.

[24] 244 F.2d 626 (9th Cir. 1957).

[25] Supra note 2.

[26] Supra note 1, at 714-15.

[27] Supra note 24.

court stated it was not necessary to discuss why the federal rule should be applied, because the parties had agreed in the litigation that it did apply.[28] Another more recent decision[29] from the same circuit held that the rights under a government contract affecting national security must be decided uniformly by federal law.[30] It is significant to note that although the principal decision agrees with the result of the *Matthews* case, that case was not cited as authority for its decision. This suggests that the court recognized that *Matthews* could be distinguished in that there was no issue as to which law should be applied.

Therefore, *Sommerville* is the first case which actually holds that rights under the Bankhead-Jones Act should be decided by federal rules regardless of the appropriate state law. The court did not point out where the statute indicated an intent to formulate such a uniform federal rule in these cases. In *Clearfield*, the authority to apply the federal rules was based on the basic right of the Government to issue checks or drafts on the United States Treasury. However, in *Sommerville*, there is no federally based right of the Government to determine where the legal possession of personal property belongs. This right of possession arises by state law, and should be determined by such unless changed by federal legislation.

In accord with this view are the Fourth and Eighth Circuits which have held that the rights of the parties to a security agreement under the Bankhead-Jones Act should be governed by the laws of the state where the transaction occurs. *United States v. Kramel*[31] held that the *Erie* doctrine, declaring that there is no "federal common law," does not apply except in instances where federal jurisdiction is based on diversity of citizenship. Although in *Sommerville* federal jurisdiction is not based on diversity[32] as was *Kramel*, federal law should not be applied except where necessary or except in those cases where the federal court is concededly enunciating a federal rule, but in doing so is free to select from the laws of the states. The court in *Kramel* went on to state that there must be a clear legislative intent to displace state law in such a broad fashion.[33] It appears that this court does not want to go so far as to say that there is no federal common law, thus concluding that the federal rule to be applied must be taken from the state law.

The most recent case involving secured property under the Bankhead-Jones Act,[34] which holds *state law* as applicable, is *United States v. Union*

[28] Id. at 633. Circuit Judge Pope, concurring, specially states that this decision need not be in conflict with United States v. Kramel, 234 F.2d 577 (8th Cir. 1956) because here the decision is the same under state and federal laws, and the court need not decide which is applicable.

[29] American Pipe & Steel Corp. v. Firestone Tire & Rubber Co., 292 F.2d 640 (9th Cir. 1961).

[30] This case involved two private parties, but the court held that the Government was affected by the outcome.

[31] Supra note 28.

[32] Jurisdiction in the *Sommerville* case is based on 62 Stat. 933 (1948), 28 U.S.C. § 1345 (1958) which authorizes the United States to sue in the District Court.

[33] United States v. Kramel, supra note 28, at 581.

[34] This Act authorized operating loans for farmers through the FHA. The purpose

Livestock Sales Co.[35] There the court reasoned that state law governs "where transfers of private property are made by the owners in accordance with state law in the course of business transactions."[36] Here *Clearfield* was used for the proposition that state law governs where the Government places itself in a position where its rights necessarily are determinable by state law. In speaking of the Bankhead-Jones Act, they say: "These provisions seem to us to carry the unmistakable import that the nature and effect of the Government's security interest under a chattel mortgage is to be subject to the applicable recording laws, and the fair inference is that the Government's rights with respect to third persons are to be determined in accordance with the local law."[37]

It seems that from the *Kramel* and *Union Livestock* cases, the determinative factors are: under what law did the rights of the parties arise, and what necessity has been shown which justifies displacement of state law for "federal common law." The court in *Sommerville* overlooks the first factor, and finds necessity while ignoring an obvious contrary intent of the legislature.[38] The ramification of these decisions is far-reaching in that any of the millions of citizens doing business under one of these federal programs may be subject to a "foreign" rule, or even worse may not know what rule, state or federal, will be applied to the transaction. For example, under the majority decision in *Sommerville,* with the security interest arising from the federal statute, there would be no need to file in order to perfect the security interest even in a Uniform Commercial Code state. What would then happen to a subsequent creditor, who without knowledge of the Government's security interest, perfects his interest in the same property in accordance with state law? In cases where the vital federal interest is apparent or uniformity is obviously needed,[39] the courts have no trouble. The difficulties arise when the courts are not sure whether a federal interest is present, and whether that interest is vital enough to displace state law.[40]

In the *Sommerville* case, there is evidence of a legislative policy as revealed in the Bankhead-Jones Farm Act,[41] that state law should govern

of it is to allow farmers to operate their farms with the greatest efficiency by borrowing money at low interest rates. The Act calls for security in all equipment and livestock.

[35] 298 F.2d 755 (4th Cir. 1962).

[36] Id. at 758.

[37] Id. at 759. The regulations of the Department of Agriculture governing the administration of the Bankhead-Jones Farm Tenant Act, 6 C.F.R. 342.3(g) (Supp. 1958) provides in part:

> Form *FHA-31*, "Promissory Note." The applicant's spouse will be required to execute Form FHA-31 when legally required by State Law, or the loan approval official determines that the signature is needed because of the spouse's interest in the farm being operated or in property offered as security or it is determined by the State Director, on a state basis, that the spouse's signature will be required.

[38] Supra note 1, at 716.

[39] Howard v. Lyons, 360 U.S. 593 (1959); United States v. Standard Oil Co., 332 U.S. 301 (1947); United States v. County of Allegheny, 322 U.S. 174 (1944); Clearfield Trust Co. v. United States, 318 U.S. 363 (1943).

[40] United States v. Ferguson, 158 F. Supp. 814 (E.D. Ark. 1958). See also cases cited supra notes 24, 31 and 35.

[41] See supra note 37.

the rights and liabilities of the parties. Courts have held that even where no policy is stated, considered with all the other circumstances, congressional silence should indicate the desire to keep state law as the determinative body of rules.[42] The perfected security interest held by the United States was created under the laws of Pennsylvania. Because the rights and interests of the parties are created by state law, that same law should also decide the liabilities and obligations. If Congress felt that the loan program under the Bankhead-Jones Act would be hampered, then it could have provided for a security interest based on a federal right. The court in *Sommerville* saw a federal interest and twisted the *Clearfield* doctrine to fit their decision. It disregarded two well reasoned opinions,[43] and relied heavily on a decision for which no reason was given,[44] because whether federal or state law should be applied was not there in issue. Even though the result would be the same whether federal or state law was applied in the main case, the importance of this decision is not lessened. The next case involving a security agreement or chattel mortgage held by the United States under the FHA Loan Program might call for a different result under the appropriate state law.

ROBERT I. DEUTSCH

Insurance—Pre-Existing Disease—Insurer's Contractual Liability in Accident Policies.—*Miles v. Continental Cas. Co.*[1]—Plaintiff-beneficiary brought an action for recovery under a Health and Accident Policy which provided for the payment of $5,000 for death from "bodily injury caused by accident" and "resulting directly and independently of all other causes."[2] Decedent-insured had accidentally sustained a fracture of his left femur, and subsequent X-rays revealed the presence of cancerous growth in the immediate area of the injury. Medical testimony disclosed that: (1) the cancer was malignant, metastatic, and present in the area prior to the fracture rather than trauma induced; (2) the cancer was active and not dormant, and would have caused the insured's death irrespective of the fracture; (3) although the fracture itself could not directly and independ-

[42] United States v. Kramel, supra note 28, at 581.

[43] Supra notes 31 and 35.

[44] Supra note 28.

[1] —— Wyo. ——, 386 P.2d 720 (1963).

[2] Although the court characterized it as an "Accident and Health Policy," Continental Casualty Company classified the contract as a "Business and Professional Disability Policy." The two relevant clauses are as follows:

(1) Definition of injury

> "Injury" wherever used in this policy means bodily injury caused by accident occurring while this policy is in force and resulting directly and independently of all other causes in loss covered by this policy.

(2) Death provision

> When injury results in loss of life of the Insured within 100 days after the date of the accident the Company will pay the Loss of Life Accident Indemnity stated in the Schedule.

It should be noted that the company had previously paid claims under the policy for hospitalization, medical treatment, and per diem expenses.