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Federal Courts--Application of Federal or State Law to Federal Agency Litigation

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despite the much higher level of punishment currently provided, is to avoid disproportion in penalties between this offense and such felonies as robbery, rape and burglary, especially where the removal or confinement is a relatively minor incident to the other offense. Note, *A Rationale of the Law of Kidnapping*, 53 COLUM. L. REV. 540 (1953).

The Model Penal Code justifies treating kidnapping as seriously as murder or rape on the likelihood of a victim disappearing permanently during a kidnapping, without the possibility of proving murder. Thus, to encourage the kidnapper to return the victim alive, first degree penalties apply only when the victim is not released alive in a safe place. Although the reasons for the inclusion of minimum penalties in the West Virginia statute are apparent, the failure to provide maximum penalties, coupled with the court's interpretation of the statute, have rendered them practically meaningless.

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Federal Courts—Application of Federal or State Law to Federal Agency Litigation

In an action by the United States on a note executed by husband and wife under a contract with the Small Business Loan Agency, judgment was rendered against both defendants, and the wife appealed asserting the common law defense of coverture. *Held*, reversed. The court of appeals found that the law of the state (Texas) where the contract was formed controlled. In Texas a married woman is protected by coverture from personal liability. The fact that the transaction was with the federal government did not nullify or abrogate the law of that state. The dissent contended that a loan from the federal government was a federal matter and should be governed by federal, rather than state, law as the use of state law would frustrate a multitude of federal programs and result in varied treatment to the residents of the various states. *United States v. Yazell*, 334 F.2d 454 (5th Cir. 1964).

The Small Business Act, 72 Stat. 384 (1958), 15 U.S.C. § 631 (1958), represents one of many federal programs undertaken within the last several decades that have led to frequent legal contact be-

tween federal agencies and private citizens. Adjudications in federal courts growing from such functions of these agencies frequently raise the problem of what law, state or federal, governs in such situations. Congress has expressly directed the use of state laws in some statutes, *e.g.* the Federal Torts Claim Act. But, Congress has more often left the choice of law to the federal courts. The latter situation created the problem of the principal case.

The historic development of this area of the law is ambivalent in its directions to courts hearing such litigation. The first doctrine adopted by the federal courts in this area was derived from *Swift v. Tyson*, 41 U.S. (16 Pet.) 1 (1842). The *Swift* decision involved federal proceedings by reason of diversity of citizenship. The Supreme Court decided that federal courts exercising jurisdiction in such cases need not, in matters of general law, apply the unwritten law of the state as declared by its highest court. Federal courts were thus freed to exercise their independent judgments as to what the common law of the state was—or should have been. This doctrine was the first to recognize the competence of federal courts to form their own general rules of decision. The *Swift* case was met with heavy criticism, 2 WARREN, THE SUPREME COURT IN UNITED STATES HISTORY 89 (rev. ed. 1953), and it was eventually overruled by the landmark decision of *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938). The *Erie* decision was based upon, among other things, 28 U.S.C. § 1652 (1958). This act provided that the laws of the several states were to be used as rules of decisions in trials where they applied, except where statute, treaty or the Constitution otherwise provided. The opinion stated several reasons why state law should be followed. The *Swift* case originally was intended as a unifying influence in providing a single set of principles for federal courts but it failed. Instead, this single set of rules had disrupted uniformity of law within the states and led to forum shopping by litigants whose state law was unfavorable to their cause. The *Erie* decision advanced the theory that federal courts had no common law of their own upon which to base their decisions. This theory required the federal courts to look to the state laws for a background of common law upon which to base their federal principles.

The relevancy of the *Erie* decision and the *Swift* decision to cases involving federal agencies is questionable, for the parties were in federal court only by reason of diversity of citizenship. However,

the courts appear to have applied these cases to situations much broader than diversity proceedings, *e.g.*, where the government rather than a private citizen was one of the parties to the litigation. Mishkin, *The Variousness of "Federal Law,"* 105 U. PA. L. REV. 802 (1957). Not until recently has any case given guidelines for determining the applicability of state or federal law in government agency proceedings. In *Clearfield Trust Co. v. United States,* 318 U.S. 363 (1943), the Supreme Court ushered in a new rule for areas where a going federal program or agency is involved in ligitation with an individual. The Court stated that where the act of Congress creating a federal agency provided no directions as to which law would apply the federal courts should fashion the governing rule of law according to their own discretion. The facts of the case involved commercial paper issued by the government in pursuance of the Federal Emergency Relief Act. The decision deemed federal law rather than state law to be governing under this statute. The court further stated that in choosing principles they had occasionally selected state law. But reasons which might make state law at times appropriate were missing in that case, *i.e.*, the control of currency and commercial paper exercised by the government has no state counterpart.

It is important to distinguish between the holdings of these three cases. The *Swift* doctrine found the federal courts competent to form their own principles. Conversely, the *Erie* case directed the application of state law. Finally, the *Clearfield* decision finds that where a Federal Agency is involved the federal courts can decide to apply either the state or federal rule depending upon the issues involved.

The contentions of counsels in related cases disclose the arguments on this question. In the principal case the *United States* asserted a binding precedent in *United States v. Helz,* 314 F.2d 301 (6th Cir. 1963). In the *Helz* case a wife's defense of coverture under Michigan law failed against the United States, which was suing under the National Housing Act for a balance due on F.H.A. notes executed by both the husband and wife. The only distinguishing characteristic between this case and the instant case is that different federal agencies were involved. The *Helz* case, however, only decided that federal principles were applicable to actions brought under the particular statute creating the F.H.A. It did not extend the decision to other statutes though they might be similar

in purpose and function. The *Helz* decision also did not rule out the application of a state law where it was found more appropriate. The court would not state what their decision might be if an execution were attempted on the real property of the wife. Generally, the courts seem more reluctant to ignore state law where land and immovables are involved.

In *Bumb v. United States,* 276 F.2d 729 (9th Cir. 1960), the court applied the rule that state law should govern. The *Bumb* decision involved the question of whether the Small Business Agency as a creditor was subject to the California Bulk Sales Statute in regard to third party creditors. This court indicated that the government should be afforded no preferential treatment merely because it, rather than a private lending agency, had loaned the defendant money. The court further found no Congressional intent in the Small Business Act which should exempt security interests from the requirements of local law. Another case, *United States v. View Crest Garden Apartments,* 268 F.2d 380 (9th Cir. 1959), stated that where it was commercially expedient to adopt state law as the federal rule, and where it impaired no federal policy, the local rules could be effectively utilized.

The dissenting argument of the principal case and the holding of the *Clearfield* decision are quite similar to those cases in which it was contended that a federal rule should be adopted regarding their respective statutes because of the extensive nationwide scale upon which those agencies operated. The United States argued in both cases that a federal rule would give more uniformity to decisions in this area. The *Clearfield* decision stated that the adoption of the state law would lead to great diversity in results under identical situations. The court in the *Bumb* case found that the government was under no duty to risk the credit of the United States, and the fact that the Small Business Agency operated on such a large scale throughout the United States raised no presumption in favor of a federal rule. The court further felt that the United States maintained competent legal personnel in the different legal programs. These lawyers necessarily should be familiar with the laws in the various states where those programs are in operation to sufficiently protect the interests of the federal government.

In the principal case it is difficult to determine on what grounds the court made their decision in favor of applying the Texas law.

The court did not indicate that, as a matter of discretion, they were incorporating Texas law. The court merely held that Texas law was applicable. This holding leads to speculation as to whether the court thought it had competence to promulgate a federal rule if it so desired. The holding would have been stronger and clearer if the court had given reasons for its decision.

In an action by the United States in the fourth circuit against a West Virginia auctioneer, state law was applied. The court recognized that it could have used a federal rule but found the state law more applicable. The facts disclose that the mortgagor of a chattel mortgage on two cattle sold them to an auctioneer in West Virginia. The mortgage was authorized by the act creating the Farmers Home Administration and was recorded in the mortgagor's home state of Ohio. The court found that neither federal nor Ohio law applied and that the auctioneer was liable by West Virginia law. The court further stated that state law should control where transfers of personal property are made by owners in accordance with state laws in business transactions. *United States v. Union Livestock Sales Co.*, 298 F.2d 755, 758 (4th Cir. 1962).

The simplest answer to the federal courts' problem in situations like the principal case might be for Congress to provide in each particular statute directions as to what law is to be followed in litigations arising under that particular act. However, this answer is not the most practical. The great volumes of acts which Congress must pass upon each year require the legislative branch to leave some problems to the judiciary to resolve. Accordingly, the answers that the federal courts provide have not been the most symmetrical or the simplest. It does appear that where the courts have decided to incorporate a federal rule they have usually restricted it to the particular statute involved. This result requires a determination under each statute in order that a precedent be established. Where a federal agency is involved in a number of different functions, it seems possible that state law would be more applicable on some questions and federal laws more apposite on others. The only guides for lawyers trying these cases apparently stems from the "localness" of a particular function. In areas where real property, recording acts, and other local functions unique to states are involved, the courts are more reluctant to interfere with local law. Also, where the state law does not interfere with the "spirit" and functions of a congressional statute there is less reason to ignore the

laws of the states. This line of argument might even depend somewhat on whether the function the agency was involved in was more proprietary than governmental. As an example, it seems that the Federal Emergency Relief Act would be a much more centralized governmental function than the Small Business Act. The law in this area is far from settled although some guidelines are gradually appearing. This area of law is comparatively recent in origin, and all that is certain is that this problem can only be resolved by a creative federal judiciary.

Larry Lynn Skeen

Income Tax—Depreciation In Year Of Sale

The taxpayer acquired a depreciable asset and began using a straight line depreciation method based on its estimated useful life and salvage value. He sold the asset before the end of its estimated useful life for more than its undepreciated cost. The Commissioner disallowed the usual depreciation deduction for the year of sale, asserting that in the year of retirement, the usual depreciation deduction is limited to the amount by which the undepreciated cost at the beginning of that year exceeded the amount received from the retirement. *Held,* reversed. The figure below which usual depreciation may not be taken is salvage value, an estimate made when an asset is acquired. The Commissioner may redetermine the estimated salvage value when he can show it was incorrect, but the mere event of a sale does not automatically give him the right to substitute a figure equal to the sales price as the amount below which no further depreciation may be taken. *Macabe Co.*, 42 T.C. No. 87 (1964).

An understanding of the nature and function of depreciation accounting is necessary to appreciate the problem involved in the principal case. According to generally accepted accounting principles, depreciation aims to allocate the cost or other basic value of an asset, less its estimated salvage value, over its estimated useful life. Depreciation is sharply distinguished from the concept of a decline in value. American Institute of Accountants, *Accounting Terminology Bulletin* No. 1, ¶ 56 (1953). This same principle is recognized by economists. Depreciation is not concerned with changing market values, because it is merely an allocation of so