STATUTE

CONSUMER PARTICIPATION IN THE REGULATION OF PUBLIC UTILITIES: A MODEL ACT

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Mr. Leflar and Mr. Rogol submit that current administrative practice in public utility regulation fails adequately to protect the interests of the residential utility consumer. The authors argue that in many states there is no institution with expertise in the field of utility regulation which is devoted solely to the representation of residential consumer interests. Those institutions which are charged with consumer representation and which do attempt to perform it, as well as private litigants who take on the burden of such representation, are usually hampered by inadequate resources. Finally, neither the individuals nor the institutions that advocate consumer interests before regulatory agencies are sufficiently accountable to the people on whose behalf they appear.

The authors propose a Model State Act to Create a Residential Utility Consumer Action Group. The Model Act would accord to residential utility consumers systematic and continuing representation before regulatory agencies, legislatures, and other public bodies by advocates rendered accountable to their consumer constituency through a direct elective process. The organization is to be financed by voluntary contributions to be added to utility payments by the utility consumers themselves.

As of this date, consumer groups in at least fourteen states and the District of Columbia already have had legislation embodying the concept of the Model Act introduced or are planning to do so later in 1976.

Introduction

A prime characteristic of the American consumer movement over the past decade has been its concentration on the investi-

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gation and reform of administrative agencies lax in protecting citizens' interests.[1] Recently consumer attention has focused on the agencies charged with the regulation of public utilities. The convergence of the energy crisis with an inflationary economic situation has pushed utility costs up at a remarkable rate and heightened demands for increased energy production. Regulatory agency actions passing cost increases on to utility consumers and approving construction of new power production facilities have been met with sharp criticism from citizens feeling the pinch of recession or concerned with the preservation of the environment.[2]

Public dissatisfaction with regulatory agency performance[3] has been exacerbated by the inaccessibility of agency processes to the ordinary citizen. Lacking specialized expertise and financial resources to contest utility requests for rate increases or permission for power plant construction, baffled by agency procedures, and faced with utility commissioners often partial to utility interests,[4] residential utility consumers often have found the obstacles to effective public participation in the regulatory process overwhelming. Consequently, the focus of this discussion is on the interests of *residential* users of utility services, as opposed to the interests of large commercial and industrial users which possess resources adequate to mount presentations of their positions before public utility commissions.

This Note proposes a Model Act[5] designed to provide residential utility consumers with institutionalized representation before regulatory agencies, legislatures, and other public bodies by advocates directly responsible to a consumer electorate.[6] The Resi-

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1 *See, e.g.*, E. Cox, R. Fellmeth & J. Schultz, The Nader Report on the Federal Trade Commission (1969); R. Berkman & W. Viscusi, Damming the West (1973); R. Fellmeth, The Interstate Commerce Omission (1970); J. Turner, The Chemical Feast (1970).

2 *See generally* Joskow, *Inflation and Environmental Concern: Structural Change in the Process of Public Utility Rate Regulation*, 17 J.L. & Econ. 291 (1974).

3 *See* Section I, *infra*.

4 *See* text accompanying note 36, *infra*.

5 Consumer groups in at least fourteen states and the District of Columbia either have already had legislation embodying the RUCAG concept introduced at the time of this writing or are expected to do so later in 1976. The states are Arizona, California, Connecticut, the District of Columbia, Illinois, Indiana, Maine, Maryland, Massachusetts, Michigan, New York, Ohio, Oregon, Virginia, and Washington. As of this writing, the legislation has not been enacted in any jurisdiction.

6 See Residential Utility Consumer Action Group Act (hereinafter "Model Act"), Section 2, *infra*.

dential Utility Consumer Action Group (RUCAG) is to be a non-governmental body financed through voluntary contributions to be added to utility payments by the utility consumers themselves.[7] The proposed Act gives RUCAG the right to intervene in all proceedings before appropriate regulatory agencies, standing to challenge agency decisions in the courts on behalf of its consumer members,[8] and the authority to advocate their interests before legislative bodies.[9] RUCAG is, in essence, a vehicle to elicit widespread citizen participation in all government processes concerning utilities, and to provide the financial resources to render that participation effective.

At the core of the Model Act is a conception of the utility regulatory process as an adversarial proceeding: a contest between utility companies and affected classes of consumers,[10] presided over by the regulatory agencies with the courts as final arbiters. Inherent in this conception is the thesis that regulatory agencies do not and cannot carry out their statutory function of defining and protecting the interests of the various groups of utility consumers without the routine intervention of representative and knowledgeable residential consumers.

This Note describes as background the theory and practice of utility regulation, the ways in which that regulation has operated to the unnecessary detriment of the residential utility consumer, and the nature of some attempts to rectify the perceived imbalances in the regulatory scheme. It then presents a Model State Act to Create a Residential Utility Consumer Action Group with explanatory comments.

I. Defining the Problems

The thrust of the following discussion concerns rate setting proceedings of utility regulatory agencies. The primary concern

7 *Id.* Section 8.

8 *Id.* Section 6(b).

9 *Id.* Section 5(f).

10 Parties interested in the outcome of utility regulatory proceedings may include, in addition to residential consumers of utility services, large and small industrial and commercial consumers, environmentalists, and property owners, among others. The interests of these various groups may tend to converge on some issues of utility regulation but will differ on many others; the same holds true of the interests of residential consumers of different income levels. *See, e.g.*, the discussion of "declining block" rate structures, note 31 *infra*.

of most residential utility consumers is with the cost and reliability of their utility services. Thus it is anticipated that RUCAG, as the residential consumers' elected representative, will focus most of its attention, at least initially, on utility rate determinations and the considerations of reliability of service which accompany them.[11] However, RUCAG may also concern itself with issues such as utility service shut-offs, security deposit requirements (and allegations of racial and sexual discrimination in their imposition), late payment charges, estimated billings, and the like. Moreover, occasions will arise when RUCAG may venture into environmental and energy resource planning questions, which could involve representation of consumer interests before agencies other than the state utility commission and before the legislature.

The public utilities with which this discussion is concerned[12] are natural monopolies: their high fixed costs and economies of scale[13] make barriers to entry formidable.[14] A would-be competitor finds that an established firm of efficient size can completely satisfy existing market demands and can expand capacity to meet future demands at lower cost than can the potential entrant. Furthermore, competition in such industries could entail wasteful duplication of the heavy initial capital investments required and would tend to involve destructive price-cutting to marginal cost levels, discouraging investment and endangering the quality of service.[15]

11 A hotly debated issue is that of the utilities' proper "reserve margin," *i.e.*, the amount of generating capacity in excess of normal usage that is necessary to avoid disruption of service if a power plant breaks down. Many utility companies tend to construct capacity sufficient to maintain a very high reserve margin, since the cost of construction of this excess capacity is calculated into their rate bases to be passed on to consumers (*see generally* the materials cited at notes 18-21, *infra*), and since the utilities are subject to intense public criticisms following service breakdowns. The trade-off is between higher rates and an occasional brown-out or black-out.

12 Discussion of "public utilities" is confined in this Note to regulated suppliers of electricity, natural gas, water, and telephone service. Railroads, municipal transport systems, broadcasters, and the like are outside the scope of the Model Act.

13 By definition, such economies are assumed to be continuously present at least to the point at which aggregate industry demand is satisfied.

14 Certain activities in which some public utilities engage, however, lack the characteristics of a natural monopoly. The provision of accessory equipment by telephone companies is one example.

15 *See* C. KAYSEN & D. TURNER, ANTITRUST POLICY: AN ECONOMIC AND LEGAL ANALYSIS 191-93 (1959); 2 A. KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS 116-126 (1971).

Unregulated monopolies in these industries, however, would possess a stranglehold advantage over consumers to whom utility services are essential. Recognition of the potential for abuse by unregulated utility companies of their monopoly position provided a major rationale for outright government operation of utilities in some areas[16] and government regulation of utility rates and services elsewhere.[17]

Regulation generally imposes on public utilities a duty to render "adequate service" to consumers at "reasonable rates."[18] In exchange, utility investors are guaranteed a "fair rate of return" on their investments[19] and state protection of their monopoly position. The indefinite content of such conceptions as "reasonable rates" and "fair rate of return," and the calculations of the value of the utilities' property and permissible operating expenses, are subjects of continuing debate.[20] Thus there is considerable leeway for political and other nontechnical considerations to enter regulatory agency rate determinations.[21]

The proceedings[22] in which rate determinations are made are

16 Examples of publicly-owned and -operated utilities include the Tennessee Valley Authority and the Hoover Dam complex on the federal level, the Consumers Public Power District in Nebraska and power authorities in New York, South Carolina, Texas, and Oklahoma on the state level, and thousands of municipal water and electric authorities. *See generally* M. FARRIS & R. SAMPSON, PUBLIC UTILITIES: REGULATION, MANAGEMENT AND OWNERSHIP 263-279 (1973); M. GLAESER, PUBLIC UTILITIES IN AMERICAN CAPITALISM (1957).

17 *See* C. WILCOX, PUBLIC POLICIES TOWARD BUSINESS 284-87 (1966).

18 *See generally* Note, *The Duty of a Public Utility to Render Adequate Service: Its Scope and Enforcement,* 62 COLUM. L. REV. 312 (1962).

19 *FPC v. Hope Natural Gas Co.,* 320 U.S. 591 (1944). *See generally* M. FARRIS & R. SAMPSON, note 16 *supra,* at 79-83; GLAESER, note 16 *supra,* at 348-402.

20 *See* notes 18 and 19, *supra.*

21 *See* Cramton, *Some Modest Suggestions for Improving Public Utility Rate Proceedings,* 52 IOWA L. REV. 267, 270 (1966). In reality, ". . . to the extent that the statutes and courts require public utility commissions to look at the rate of return, it is far more a lower bound requirement (at least enough to attract capital) than it is an upper bound requirement, and is only one of the many legal and institutional constraints which define the operating set within which regulatory commissions can function." Joskow, note 2 *supra,* at 297.

22 There are four general types of administrative hearings: notice and comment rulemaking, rulemaking on the record, adjudications, and rate proceedings. Notice and comment rulemaking is a quasi-legislative proceeding in which an agency submits tentative rules for oral and written comment before issuing a final version. The primary characteristics of rulemaking on the record are that evidence and argument are received at an oral hearing and the agency's decision must be based on the record of the hearing. Formal administrative adjudications with trial-type hearings are employed for deciding disputed questions of fact and for ordering compliance by named parties with specific laws and regulations. *See* Gellhorn, *Public Participation in Administrative Proceedings,* 81 YALE L.J. 359, 369-71 (1972);

a mixture of the inquisitorial and adversarial paradigms of dispute resolution. The procedures for such determinations vary somewhat from state to state, but under typical practice,[23] the inquisitorial mode predominates. The regulatory agency theoretically performs the roles of both consumer advocate and arbiter of the public interest. The socially optimal result is to be ensured

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Administrative Procedure Act § 2, 5 U.S.C. § 551 (1967). While RUCAG in its dealings with various administrative agencies will participate on occasion in the first three, it is anticipated that its primary concern will be with rate proceedings.

23 A rate proceeding may be initiated in any of three ways. First, when a public utility files notice of a change in or commencement of rates for a utility service, consumers or competitors may file protests within a statutorily limited period. The utility commission must then (1) determine whether to suspend the effectiveness of the proposed rate pending a staff investigation of its reasonableness, and (2) commence a formal rate proceeding if the proposed rate is suspended. If the commission does not suspend the proposed rate, it becomes effective at the end of a statutory period. It may then be challenged as an unlawful "existing" rate by interested parties or by the commission itself. In some states, however, no rate increase may go into effect without a formal hearing. Cramton, note 21 *supra*, at 269.

Second, consumers, competitors, or public bodies may file complaints regarding the lawfulness of existing rates, in which case the utility commission may open a formal proceeding.

Finally, the commission may commence such a proceeding on its own motion.

After commencement of a proceeding initiated in any of these ways, the commission staff undertakes an investigation of the "reasonableness" of the controverted rate, calculating the ratio of the utility's projected earnings to its rate base (i.e., its investment in physical properties plus an allowance for working capital), and prepares an analysis and recommendations for the formal proceeding. (The considerations involved in making the determination of reasonableness of general rate levels and of rate design are summarized in Jones, *Judicial Determination of Public Utility Rates: A Critique*, 54 B.U.L. REV. 873, 876-94 (1974).)

The character of this proceeding varies from state to state and according to the nature of the case. A typical procedure divides the proceeding into two steps. The utility company, the agency staff, and any interveners first present evidence and arguments at an open hearing held before a hearing examiner, who analyzes the issues in the case and submits his recommendations to the commission. If exceptions are filed, the commission in a trial-type proceeding then receives testimony and exhibits from its staff and from the parties as a matter of first impression. Once the decision is rendered, parties aggrieved by it may, since all administrative remedies have been exhausted, seek judicial review. If the commission rules against its staff's recommendations, however, the staff may not appeal to the courts. *See* Comment, *Representation of the Public Interest in Michigan Utility Rate Proceedings*, 70 MICH. L. REV. 1367, 1384-86 (1972). The rationale for denying the staff access to judicial review despite its quasi-adversarial role in the proceedings is that it is merely a part of the commission which, by rendering its decision, has fulfilled its statutory duty.

For a comprehensive treatment of traditional rate-making procedures *see* J. BONBRIGHT, PRINCIPLES OF PUBLIC UTILITY RATES 147-283 (1961); 1 A. PRIEST, PRINCIPLES OF PUBLIC UTILITY REGULATION 45-226 (1969). The Federal Power Act, 41 STAT. 1063 (1920), *as amended*, 16 U.S.C. §§ 791a-825r (1964), is a federal analogue to the typical state public utility statute.

not so much by the clash of opposing interests as by the expertise of the agency.[24]

When representatives of consumer interests are unable to intervene or to present their case effectively,[25] the burden of consumer representation falls on the commission staff. The principal difficulty with this result lies not so often in the availability of the necessary information[26] as in the analysis of the vast amount of complex and highly technical data received from the utility companies. Utility commission staffs are traditionally undermanned and underfunded.[27] Consequently, staffs frequently exhibit a tendency to subject the carefully prepared analyses of the data submitted by the utility company to less than critical scrutiny, particularly if there is a lack of pressure from consumer interests to do so.

The capability of utility companies to make a decisive presentation is substantial. Since the costs of the utility's preparation of data and expert representation are passed through to the consumers,[28] the company has every incentive to commit considerable resources to rate proceedings. As a result of this disparity of means between the utilities and the commission staff, the arguments of the utilities frequently go unchallenged.[29]

Even when the commission staff is capable of presenting an effective rebuttal to a utility's position, the question of which

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24 Professor Stewart terms the analogous conception of the functioning of federal administrative agencies given broad discretionary powers by the Congress "the 'expertise' model of the New Deal period." Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1667, 1677-78, 1684 (1975).

25 *See* text accompanying note 41 *infra* for a discussion of the scope of the right of intervention and of the difficulties interveners without adequate resources face.

26 F. COOPER, STATE ADMINISTRATIVE LAW 294 (1965).

27 *See, e.g.*, Comment: *Representation of the Public Interest*, note 23 *supra*, at 1386. In some states, *e.g.*, Michigan, *id.*, the commission staff is funded by legislative appropriation; in the majority, however, part or all of the costs of investigations and presentation of cases before the commission, within certain statutory limits, are charged to the utilities, to be passed through to the consumers. FPC, FEDERAL AND STATE COMMISSION JURISDICTION AND REGULATION 45-46 (1967).

28 These costs are charged to operating expenses, which form a part of the calculation of a "fair rate of return."

29 Peter H. Schuck of Consumers Union has concluded that the consequences of this disparity of means is that ". . . there is no one to interpret the data in new ways, cross examine the company's witnesses, demonstrate the boundaries of expertise, and adduce new definitions of the public interest. . . ." Letter from Peter H. Schuck to Sen. Thomas Eagleton, S. REP. No. 93-1349, 93d Cong., 2d Sess. 16 (1974).

facets of the public interest the staff will choose to defend remains. A major criticism of commission staffs has been that they cannot give sufficient representation to each discrete interest, but are forced either to aggregate such interests or to ignore some of them.[30] Thus, large industrial or commercial users with the resources to make their arguments known have traditionally fared better than small residential users, a fact exemplified by the prevalence of the "declining block" nature of electric utility rate structures.[31]

The capacity of the utilities to outperform the commission staff in the open arena of a formal hearing is only one element of the tendency of regulated industries to dominate many of the regulatory agencies. Professor Davis has estimated that 80 to 90 percent of the administrative process takes place in informal hearings or meetings, "unaffected by either the procedural safeguards of formal hearings or the prospect of judicial review."[32] Utilities often have access to this informal decision-making process while consumer representatives do not.[33] Such informal, unrecorded proceedings constitute an opportunity for commissioners to formulate decisions based not so much on the record before them[34] as upon "attitudes . . . shaped by the rewards and feedbacks that our system provides."[35] The agency often responds less to the

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30 *See* Cramton, *The Where, Why, and How of Broadened Public Participation in the Administrative Process*, 60 GEO. L.J. 525, 527-28 (1972); Gellhorn, note 22 *supra*, at 360 n.7, 380-82; *cf.* Reich, *The Law of the Planned Society*, 75 YALE L.J. 1227, 1234-35 (1966).

31 In a "declining block" rate structure, the price of each additional KWH of energy declines as the quantity purchased increases, so that large consumers of energy pay a lower per-unit cost for it than small users. Environmentalists criticize the "declining block" structure as no longer cost-justified and therefore an encouragement to uneconomic expansion of consumption; the industries argue that the efficiencies of scale it produces result in lower average energy costs for all. *See* P. JOSKOW, APPLYING ECONOMIC PRINCIPLES TO PUBLIC UTILITY RATE STRUCTURES (1974).

32 K. DAVIS, ADMINISTRATIVE LAW TREATISE § 1.04-13, at 37 (1970 Supp.).

33 Kaufman, *Power for the People — And By the People: Utilities, the Environment, and the Public Interest*, 24 AD. L. REV. 3, 10 (1972).

34 Utility commissioners are quite often overburdened with cases and seldom have time to consult the record. *See* Cramton, *Some Modest Suggestions*, note 21 *supra*, at 278.

35 Cramton, *The Where, Why, and How*, note 30 *supra*, at 530. Professor Cramton quotes a parable recited by Lee C. White, former chairman of the FPC, regarding the "care and feeding" of regulators:

> A successful lawyer in Keokuk is appointed by the President to serve on an independent regulatory agency or as an assistant secretary of an executive

demonstrated needs of the parties before it than to its own "political necessities."[36]

The widespread ineffectiveness of commission staffs in providing adequate representation for residential utility consumers in conjunction with frequent partiality of utility commissioners to industry interests resulted in many states in the following situation described by the former Attorney General of North Carolina:

> . . . [W]ithout an adversary, counsel representing regulated

department that exercises regulatory functions. A round of parties and neighborly acclaim surround the new appointee's departure from Keokuk. After the goodbyes, he arrives in Washington and assumes his role as a regulator, believing that he is really a pretty important guy. After all, he almost got elected to Congress from Iowa. But after a few weeks in Washington, he realizes that nobody has ever heard of him or cares much what he does — except one group of very personable, reasonable, knowledgeable, delightful human beings who recognize his true worth. These friendly fellows — all lawyers and officials of the special interests that the agency deals with — provide him with information, views, and most important, love and affection. Except they bite hard when our regulator doesn't follow the light of their wisdom. The cumulative effect is to turn his head a bit.

Remarks of Lee C. White, Brookings Institute Conf. on Administrative Regulation, Apr. 8, 1971. *Id.*

36 J. SAX, DEFENDING THE ENVIRONMENT 61 (1970); *cf.* Joskow, note 2 *supra,* at 318; Pontz & Sheller, *The Consumer Interest: Is It Being Protected by the Public Utility Commission?* 45 TEMPLE L.Q. 315, 348 (1972).

The commission's own political necessities include the minimization of conflict and criticism from its economic, social, and legal environment. In the absence of broad public concern over a pending question, the concentrated persuasive efforts of the regulated industries will tend to predominate in commission considerations. Noll, *The Economics and Politics of Regulation,* 57 VA. L. REV. 1016, 1030 (1971). Normally public concern is aroused only in crisis situations, such as a regional power blackout, so that the commission will tend to err on the side of cautious policies aimed at the prevention of such catastrophes — which policies normally coincide to a large degree with industry interests. *See* note 11, *supra.* Thus even in periods in which efficiency gains or expansion of service may have pushed a utility's rate of return above the statutory limit, as long as rates remain constant and consumer complaints few, utility commissions have been disinclined to take independent action to lower rates. Joskow, *supra,* at 297-99. *See also Regulation Under Fire: Consumers, the Environment, the Economy, and the Impact of Change,* 8 COLUM. J.L. & SOC. PROB. 33, 52-53 (1971) (remarks of R. Schwartz).

Furthermore, the commission, by rulings acceptable to industry, has been able to minimize its chances of being embarrassed by reversal on appeal. Noll, *supra,* at 1030. The utilities have the resources and the interest at stake to take unfavorable decisions to the courts, while commission staffs lack the legal capacity to seek judicial review. Comment, *Representation of the Public Interest,* note 23 *supra,* at 1384-86.

Finally, the task of the regulatory commission is eased in the long run by a routinization of administration the realization of which depends on avoidance of conflict with the industries the commission regulates. This motivation too impels the commission to seek compromise with the industries. *See* Stewart, note 24 *supra,* at 1714.

> industries was formerly quite possibly the happiest man engaged in the practice of law. His witnesses and evidence went unchallenged. His victories were as regular as clockwork. The consumer was possibly the unhappiest man around — he paid the higher rates and had to pay, in addition, the legal fee of his adversary's counsel.[37]

The failure of the inquisitorial model of the utility regulatory process to protect the small consumer has become evident, and many states have begun to experiment with ways of restructuring agency proceedings to introduce a meaningful adversarial tension.

II. Attempts to Correct the Imbalance

In recent years, the character of utility rate proceedings has taken on a more adversarial quality. The need for agency staffs to accommodate conflicting interests of the public has led to a recognition that the diverse interests which together constitute the "public interest" can only be properly considered through an adversarial form of proceeding.[38] The argument for separate representation by a spectrum of interested parties is particularly strong in proceedings of a quasi-legislative nature, such as rate determinations, in which decisions of future effect concerning the public at large are reached.[39]

The recent movement toward realization of an adversarial framework for utility regulatory proceedings has taken three major directions: (1) liberalization of the standing requirements for public interest litigants to intervene in and to seek judicial review

37 Morgan, *The People's Advocate in the Marketplace — The Role of the North Carolina Attorney General in the Field of Consumer Protection*, 6 Wake Forest Intramural L. Rev. 1, 5 (1969).

38 *See* sources cited at note 30 *supra*. Thus the D.C. Court of Appeals observed approvingly that broadened public participation in agency proceedings "tends to cast governmental power, at least in the first instance, in the more detached role of arbiter rather than accuser." Office of Communication of United Church of Christ v. FCC, 359 F.2d 994, 1003 (D.C. 1966).

39 *See* Gellhorn, note 22 *supra*, at 369-72; Davis, *The Missouri Public Service Commission*, 42 U.M.K.C. L. Rev. 279, 280 (1974). The quasi-legislative nature of utility rate proceedings stems from the fact that virtually all consumers are affected by them. Indeed, an administrative decision to raise utility rates bears some resemblance to the imposition of a tax increase: since the demand of individual consumers for these quasi-governmental services is quite inelastic, in effect all consumers are obliged to pay. *Id.* One difference between a utility commission's rate decision and a legislature's tax measure is that the commission is required to act within the statutory and judicial bounds defining a "fair rate of return." *See* note 23 *supra*.

of agency adjudications; (2) intervention by state attorneys general in agency proceedings on behalf of consumers; and (3) creation of offices of "consumer counsel"[40] with the specific statutory duty of representation of consumer interests in utility regulatory proceedings.

A. *Representation by Public Interest Litigants*

A series of judicial decisions, legislative acts, and administrative rulings over the past decade has opened up the regulatory agencies to "private attorneys general," where previously they had been barred on doctrinal grounds that they lacked sufficient interest to participate.[41] Despite these liberalized standards for participation, however, citizen interveners face barriers to effective representation of consumer interests so high as to prevent in a great many cases even an approximation of the adversary ideal. The public is often given inadequate notice of upcoming pro-

40 This office is given different names in different states. "Consumer Counsel," "Public Counsel," "People's Counsel," and "Public Counselor" are the most common. Throughout the text, the office will be referred to as that of "consumer counsel."

41 Shapiro, *Some Thoughts on Intervention Before Courts, Agencies, and Arbitrators,* 81 HARV. L. REV. 721, 722 (1968); Association of Data Processing Service Organizations v. Camp, 397 U.S. 150 (1970); Barlow v. Collins, 397 U.S. 159 (1970). *See also* United States v. Students Challenging Regulatory Agency Procedures (SCRAP), 412 U.S. 669 (1973); Sierra Club v. Morton, 405 U.S. 727 (1972). Many state agencies in the past employed rather restrictive standards in ruling on the permissibility of intervention by private litigants. *See, e.g.,* Smith v. Public Serv. Comm'n, 336 S.W.2d 491 (Mo. 1960), M.W. Smith Lumber Co. v. Alabama Pub. Serv. Comm'n, 24 So.2d 409 (Ala. 1946), COOPER, note 26 *supra,* at 325-26. Recently, however, leave to intervene has been more freely given. State courts generally grant standing for *judicial review* to anyone who is in fact substantially injured by administrative action. 3 K. DAVIS, ADMINISTRATIVE LAW TREATISE 210 (1958 ed.), 722 (1970 Supp.). See Comment following Section 7 of the Model Act, *infra.* Such persons are also generally conceded a concomitant right of *intervention,* on the grounds that if they are sufficiently aggrieved to obtain judicial review of an administrative order, they have interests sufficient to participate in the agency proceedings leading up to the order, Shapiro, *supra,* at 722 & n.9, and that intervention may well be necessary in order to make the right to review effective, *see* American Communications Ass'n. v. United States, 298 F.2d 648 (2d Cir. 1962).

The major questions remaining concern the scope of the participation interveners are to be allowed. Scholarly opinion on this point is divided. Professor Shapiro, for instance, would "[t]ailor the litigation rights of an intervener . . . to match the reasons for allowing his intervention," for example by limiting participation to presentation of written statements, offering of evidence, and perhaps cross-examination of witnesses, Shapiro, *supra* at 752-56. Professor Gellhorn, on the other hand, holds that in most cases unlimited participation is appropriate, Gellhorn, note 22 *supra,* at 383-88. State procedures in this respect vary widely. 3 K. DAVIS, *supra,* §§ 24.01-.07 (state forms of proceedings).

ceedings; complex agency procedures often baffle the lay citizen seeking to oppose utility requests; private citizens have no means to monitor the day-to-day process of agency decision-making.[42] Moreover, it is difficult for citizen groups to develop the systematic expertise necessary for continuing and effective interventions.[43]

The most serious barrier to effective representation of consumer interests by private litigants, however, is that of financing the intervention. A full-fledged contest of a major rate increase request can cost as much as $100,000 for expert witnesses, attorneys' fees, transcript costs, and the like.[44] Not only can consumers seldom afford to make such financial commitments, but they would be acting in an economically irrational fashion if they did, since they could never hope to recoup their expenditures through benefits won by a favorable decision.[45] Proposed systems for reimbursement of attorneys' fees of public interest litigants by the agency or the utility[46] have not met with favor.[47]

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42 Consumers Union *et al.*, Petition for the Adoption of Model Rules of Citizen Participation in Administrative Agency Proceedings, 116 CONG. REC. 38891-93 (1970).

43 *But see* Comment, *Representation of the Public Interest,* note 23 *supra,* at 1378-79, for a favorable evaluation of the impact on Michigan utility regulation of intervention by groups without special expertise in the area, such as the City of Detroit, the UAW, and the Consumer Alliance of Michigan.

44 Letter from Fred Cowan, former Director, Arkansas Consumer Research, to the HARVARD JOURNAL ON LEGISLATION, Nov. 15, 1975, on file at the HARVARD JOURNAL ON LEGISLATION; *cf.* Cramton, *The Where, Why, and How,* note 30 *supra,* at 538-41. A spokesman for Consumers Union testified before a House committee, that the organization only had the resources to participate in an occasional ratemaking case before the Public Service Commission, saying that ". . . if Consumers Union, which is one of the largest consumer organizations in the nation, cannot fully participate in even a few proceedings, it is easy to understand why there are few or no consumer interveners in most state proceedings." *Hearings on H.R. 16782 Before the House Comm. on the District of Columbia,* 93d Cong., 2d Sess. 83 (1974) (testimony of Peter H. Schuck).

45 The transaction costs of assembling a group of consumers to shoulder the costs of intervention joint are normally high, particularly since the situation is one in which the nonparticipating consumer is in a position to take a "free ride" on the benefits won for him by the group contesting the rate increase request. Cramton, *The Where, Why, and How,* note 30 *supra,* at 529. *See generally,* M. OLSEN, THE LOGIC OF COLLECTIVE ACTION (1965).

46 *See, e.g.,* Comment, *Representation of the Public Interest,* note 23 *supra,* at 1391-92; *Regulation Under Fire,* note 36 *supra,* at 57 (remarks of R. Schwartz); BOASBERG, ET AL., REPORT TO THE NUCLEAR REGULATORY COMMISSION: POLICY ISSUES RAISED BY INTERVENOR REQUESTS FOR FINANCIAL ASSISTANCE IN NRC PROCEEDINGS (1975). *See generally,* Dawson, *Lawyers and Involuntary Clients in Public Interest Litigation,* 88 HARV. L. REV. 849 (1975).

47 *See* Stewart, note 24 *supra,* at 1767-69 and n.473. The authors are aware of no jurisdiction in which such a system is presently in effect.

A further difficulty with reliance on private litigants to uphold the interests of utility consumers is the potential diversity of such interests. Consumer views on such questions as rate design and construction of new power plants may vary.[48] Intervention by one public interest litigant, beneficial though it may be, provides no assurance that all unorganized classes of the public will be adequately represented.

Moreover, the public interest lawyer who represents the interests of large classes of people is seldom subject to mechanisms of formal accountability. Inherent in the public interest litigant's job is a broad discretion in the definition of those interests and the mode of their presentation. Such discretion can be a condition for creativity or a source of poor advocacy. Lawyers employed by public interest organizations may be subject to a variety of checks within the organization in their exercise of this discretion; even so, in the absence of mechanisms of formal accountability, the lawyer operates at several removes from the opinions of the class of citizens for whom the organization speaks. Lawyers staking out their own independent ideological claims in the public interest field, valuable though their work may be, may feel still less constrained by the desires of their adopted constituencies.[49] In sum, it is unlikely that adequate and faithful representation of all affected interests can be realized by private litigants alone.

B. *Representation by Attorneys General*

An increasingly accepted answer to the inability of citizen interests, acting independently, to present effectively the residential utility consumer's case before the utility commission is the assumption by state governments of the burden of intervention on

48 *See* notes 30 and 31 *supra* and accompanying text; *Regulation Under Fire*, note 36 *supra*, at 40-42 (remarks of W. Jones).

49 As Professor Stewart notes:

> In political representation we employ regular elections in the expectation that they will ensure that the representative is responsive to the interests of those whom he represents, but no analogous mechanism of accountability appears feasible in the case of the public interest lawyer. . . . [T]he efforts that would be involved in identifying the individual preferences of class members would reintroduce many of the crippling transaction costs which public interest representation is designed to circumvent (footnote omitted).

Stewart, note 24 *supra*, at 1766-67. *See also* Comment, *The New Public Interest Lawyers*, 79 YALE L.J. 1069, 1119-37 (1970), for a discussion of the problems of

behalf of its citizens. State attorneys general possess common law[50] and statutory[51] powers of intervention to protect the public interest. Usually acting through consumer protection divisions,[52] attorneys general have represented the public before state agencies in an increasing number of states.[53] Attorneys general have the legal expertise, the investigative capabilities,[54] and to some extent the financial resources to commit to regulatory proceedings which private litigants normally lack. Their willingness to enter the regulatory arena can serve to deter utilities from requesting unjustified rate hikes.[55]

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accountability of public interest lawyers in various contexts. The Comment outlines the attempts of certain lawyers to create informal mechanisms of accountability to community groups or to the broader constituencies whose interests they represent. Of interest is the assessment by Stephen Rosenfeld of the constraints operating on Ralph Nader:

> I think Nader's type of accountability is probably the most rigorous of all, a continuing one, since he has become the accepted spokesman for the consumer nationally. He is constantly being judged by a lot of people, and his ability to articulate their needs, littleness, powerlessness, and to translate that into some kind of action accurately reflecting their concern, will determine whether or not he will be retained as their spokesman. That is a very tenuous kind of retainer. Once Nader takes a wrong turn — as judged by consumer groups — the retainer is lost. . . .

Id. at 1130-31.

50 *See, e.g.*, Alexander v. New Jersey Power & Light Co., 21 N.J. 373, 376, 122 A.2d 339, 343 (1956); State *ex rel.* Olsen v. Public Serv. Comm'n, 129 Mont. 106, 283 P.2d 594 (1955). The common law powers of the attorney general are ill-defined and can be ascertained only by a thorough reading of the cases of the jurisdiction in question. *See generally* NATIONAL ASSOCIATION OF ATTORNEYS GENERAL, COMMITTEE ON THE OFFICE OF THE ATTORNEY GENERAL, REPORT ON THE OFFICE OF ATTORNEY GENERAL 32-61 (1971).

51 *See, e.g.*, KY. REV. STAT. ANN. § 367.150(8) (Supp. 1974); MICH. COMP. LAWS ANN. § 14.28 (1967).

52 In forty-three states the consumer protection agency is located in the attorney general's office. NATIONAL ASSOCIATION OF ATTORNEYS GENERAL, COMMITTEE ON THE OFFICE OF ATTORNEY GENERAL, STATE PROGRAMS FOR CONSUMER PROTECTION 1-3 (1973).

53 A 1973 survey by the Committee on the Office of Attorney General of the National Association of Attorneys General found that attorneys general in 17 of 40 states responding had assumed the responsibility of intervening on behalf of the public, an increase of four states since the previous year. *Id.* at 69.

54 Washington and several other states, for example, provide consumer protection enforcement agencies with an investigatory tool, called the Civil Investigative Demand, which "gives the attorney general, prior to the issuance of a complaint, and without any showing of probable cause, the right to inspect and copy any tangible business record that he believes may be relevant to the investigation of a possible violation of the Consumer Protection Act." Comment, *Washington's Civil Investigative Demand*, 10 GONZAGA L. REV. 651 (1975).

55 *See, e.g.*, Comment: *Representation of the Public Interest*, note 23 *supra*, at 1373-74.

The fact remains that in most states attorneys general have not adopted the practice of intervention on behalf of consumers in utility rate proceedings.[56] A survey of state attorneys general has found that the majority view their most important function as representation of state agencies, a function possibly inconsistent with representation of the public.[57] For example, on appeal from a utility commission decision to the courts, the attorney general may be required to represent both the consumer interests and the utility commission. At least one state court has upheld on conflict of interest grounds a denial of the attorney general's petition for intervention on appeal.[58]

A further limitation on the attorney general's capacity for effective consumer representation relates to his broad discretion in allocating the office's limited resources and structuring its efforts. Where the attorney general is elected,[59] political considerations often predominate in the officeholder's conception of the job. When consumer concern about utility rates is too diffuse to exert significant political pressure, the attorney general is unlikely to commit major resources to intervention in rate proceedings; and, in fact, finances allocated to consumer representation before utility commissions are generally insufficient to deal with the heavy load of rate cases.[60] Where the attorney general does intervene in a rate proceeding, he or she may find it impolitic to press for reform of rate structures favoring corporate consumers of utility

56 The 1973 survey by the National Association of Attorneys General (note 53 *supra*) found that of the 17 attorneys general who had intervened on behalf of the public before administrative agencies, only 12 had done so in rate proceedings. NATIONAL ASSOCIATION OF ATTORNEYS GENERAL, note 52 *supra*, at 69. A 1975 survey by Common Cause found that in 19 states the attorney general's office has intervened before public utility commissions, but that in the majority of these states representation has been "sporadic." Wortman, "State Provisions for Consumer Representation Before Public Utility Commissions" 6 (1975).

57 NATIONAL ASSOCIATION OF ATTORNEYS GENERAL, COMMITTEE ON THE OFFICE OF ATTORNEY GENERAL, REPORT ON THE OFFICE OF ATTORNEY GENERAL 29 (1971), *cited in* Note, *The Role of the Michigan Attorney General in Consumer and Environmental Protection*, 72 MICH. L. REV. 1030, 1069 n.226 (1974).

58 City of York v. Pennsylvania P.U.C., 449 Pa. 136, 295 A.2d 825 (1975) (alternate holding). It appears that attorneys general are not barred from representing both sides of such cases in most jurisdictions. *See* Comment, *The Attorney General as Consumer Advocate*, 121 U. PA. L. REV. 1170, 1180 & n.72.

59 Attorneys general are elected in 42 states. Christenson, *The State Attorney General*, 1970 WISC. L. REV. 298, 298 n.5 (1970).

60 *See* Note, note 57 *supra*, at 1061.

services over residential consumers. The technicalities of rate design arguments are likely to be of serious political consequence only with regard to those with a large stake in the matter. Finally, the lawyers who are assigned to rate cases are often inexperienced and unacquainted with the economic intricacies and legal niceties of rate regulation.[61]

In sum, the attorney general is accountable for his performance in the utility regulation area only very indirectly. Voters are seldom made aware of the record of an attorney general who has been less than aggressive in utility cases. Even when they are made aware, that record is only one of a myriad of considerations involved in evaluating the attorney general's overall performance.

C. *Representation by Consumer Counsel*

In recognition of the inadequacy of consumer protection efforts through representation by regulatory agency staff and intervention by private litigants or the attorney general, nine states and the District of Columbia have created special offices for representation of consumer interests before state utility commissions.[62] Eight of these offices have been established within the past two years.[63] The offices have been given various titles, including Consumer Counsel,[64] Public Counsel,[65] and People's Counsel.[66] The typical office of consumer counsel is empowered to appear on behalf of consumers in utility commission proceedings, exercising all the rights of a party to the proceeding and employing experts to aid in its presentation.[67] The office is given investigatory powers and access to utility commission records.[68]

61 *See* Comment, note 23 *supra*, at 1379-80.

62 The office is involved primarily in utility proceedings in Connecticut, the District of Columbia, Florida, Georgia, Indiana, Maryland, Missouri, and Montana. It is a division of a larger consumer protection office in New Jersey and New York. Wortman, note 56 *supra*, at 36 *et seq.*

63 *Id.* at 38.

64 Connecticut, Georgia (Consumers' Utility Counsel), Montana.

65 Florida, Indiana (Public Counselor), Missouri.

66 District of Columbia, Maryland.

67 *See, e.g.*, MD. ANN. CODE art. 78 §§ 14, 15B (1975). The Maryland statute, enacted in 1922, is a prototype for the more recent statutes. *See* Leighton, *Consumer Protection Agency Proposals: The Origin of the Species*, 25 AD. L. REV. 269, 270-71 (1973). Consumer counsel are generally given the authority to intervene in federal as well as state proceedings. *See* Wortman, note 56 *supra*, at 39 *et seq.*

68 *See, e.g.*, MD. ANN. CODE art. 78 §§ 15(2), 15(3).

Most offices of consumer counsel are financed primarily by legislative appropriations.[69] In at least three jurisdictions,[70] however, the office is partially or wholly funded by an assessment on the utility companies, subject to statutory limits, on the theory that the cost will be passed through to the consumers who are the ultimate beneficiaries of the consumer counsel's work. Offices of both varieties generally operate under severe budgetary restraints.[71]

As in the case of public interest litigants and of attorneys general, consumer counsel are not formally accountable to the consumers they are to represent. The Missouri Public Counsel serves at the pleasure of the director of the state Department of Consumer Affairs; most other consumer counsel are appointed by their governors. In Montana and Florida consumer counsel are responsible to legislative committees.[72] In no state is the consumer counsel directly elected by the voters. It is perhaps too soon to measure what effect this lack of formal accountability has had on the work of the various offices. The concept of Consumer Counsel is still on trial.[73]

D. *Summary*

The regulatory process is fundamentally political, rather than technical and impartial. Decisions of utility commissions are based on considerations of the interests of the parties before it, not on mechanical formulas dictated by the data presented to it. Democratic theory suggests that all interests affected by regulatory

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69 *See* Wortman, note 56 *supra,* at 39 *et seq.*

70 The District of Columbia, Montana, and New Jersey. *Id.* at 57-64; Welch, "Analysis of the People's Counsel of the District of Columbia," 15-18 (1975 study for the D.C. Public Interest Research Group, on file at the HARVARD JOURNAL ON LEGISLATION).

71 In 1975, the Connecticut Consumer Counsel had only $35,000 at its disposal, the Missouri Public Counsel $30,000 (increased to $100,000 for fiscal year 1976), and the Montana Consumer Counsel $80,000 ($126,000 in fiscal 1976). Wortman, note 56 *supra,* 39-42, 53-60.

72 Welch, note 70 *supra,* at 19.

73 The major weaknesses in most consumer counsel offices, according to the 1975 Common Cause survey of the opinions of consumer leaders in the states where such offices exist, are: (1) greatly inadequate budget and staff; (2) staffs who neither seek input from consumer groups nor seek to inform and educate them; (3) lack of independence from the commissions and governor's office and the political process in general; (4) lack of meaningful qualifications and prohibited conduct restraints. Wortman, note 56 *supra,* at 89.

agency decisions be given the opportunity to present their views for consideration during the decision-making process. In practice, however, this opportunity generally has been denied to residential utility consumers.

Existing mechanisms for consumer representation before utility commissions fail in three major respects. First, in many states there is no institution with expertise in the field of utility regulation which is devoted solely to the representation of residential consumer interests. Second, those institutions which are charged with consumer representation and which do attempt to perform it, as well as private litigants who take on the burden of such representation, are usually hampered by inadequate resources. Finally, neither the individuals nor the institutions that advocate consumer interests before regulatory agencies are sufficiently accountable to the people on whose behalf they appear.

III. The Model Statute

A. *Summary of Provisions*

The Residential Utility Consumer Action Group (RUCAG) is to be in form a not-for-profit membership corporation.[74] It is given the authority and the statutory command to represent the interests of the class of residential utility consumers in proceedings before state regulatory agencies, legislative bodies, and other public authorities.[75] It is granted standing to initiate or to intervene in judicial proceedings for review or enforcement of agency actions.[76]

In addition, RUCAG is authorized to conduct and support research, investigations, and public information activities in the utility area,[77] and to participate in initiative and referendum campaigns.[78] RUCAG and its agents are specifically prohibited from

74 Model Act Section 4(a).

75 *Id.* Sections 5(a), 5(f), 6(b). The organization may also participate in federal agency proceedings touching the interests of the state's utility consumers, where federal law or agency rules allow, and appear before the U.S. Congress at hearings and the like. See Sections 5(f), 3(d). See also Comment following Section 6(b).

76 *Id.* Section 7. See Comment following Section 7.

77 *Id.* Section 5(d). See Comment following Section 5(d).

78 *Id.* Section 5(h). RUCAG may also contract for services which its employees are unable to perform, Section 5(e), and seek tax-exempt status, Section 5(c).

supporting or opposing political parties or candidates.[79] They are also prohibited from offering financial or other rewards to, or accepting them from, public officials or utility employees.[80] Violators of the latter provision are subject to both civil and criminal sanctions.[81]

RUCAG's finances will depend almost entirely on voluntary contributions.[82] Utility companies will be required to include in their monthly billings materials prepared by RUCAG and describing RUCAG's function, organization, and activities.[83] The utilities will also include on the bill itself or on a separate card a statement to the effect that utility consumers may contribute to RUCAG by adding any amount desired to their utility payments.

The Model Act provides three alternative methods by which a consumer may contribute. Proponents of the Act are to choose which method or combination of methods best fits the circumstances in their state.

(1) The consumer whose name appears on the utility bill may check a box signifying a contribution to RUCAG of a specified amount, such as twenty cents, to be determined in advance by the Board of Directors. The consumer adds this amount to his or her payment for the utility services. The utility turns the contribution over to RUCAG in the name of the consumer billed.[84]

(2) The consumer may check a box signifying a *pledge* to contribute a specified amount, such as twenty cents, to RUCAG on his or her next billing. The utility will then automatically add that pledge to the amount due for the next billing period. When the consumer makes the payment for the next billing period, the

79 *Id.* Section 5(g).

80 *Id.* Section 14(a). Public officials and utility employees are likewise prohibited from offering such rewards to RUCAG people. Section 14(c). RUCAG Directors, moreover, may not engage in private business with a utility either personally or through a partner or agent. Section 14(b).

81 *Id.* Section 14(d). A RUCAG Director violating Section 14 is also removed from office. Section 14(e).

82 See *Id.* Section 8. The only exceptions are the Section 5(d) provision permitting RUCAG to accept legislative appropriations to perform research, investigations, or public information activities, the prospect of RUCAG's being awarded attorney's fees after litigation, and the possibility that RUCAG could set up a (tax-exempt) institution which would receive contributions from foundations and private individuals (Section 5(c)).

83 *Id.* Sections 8(a)(1), 8(b).

84 *Id.* Sections 8(a)(2)(B-1), 8(d)(2)(A) and 8(d)(2)(C).

utility turns the pledged contribution over to RUCAG in the name of the consumer billed.[84a]

(3) The consumer billed may list in a space provided on the bill the names of those in the consumer's household, including himself or herself, who wish to contribute to RUCAG and the amount each person contributes. The consumer adds the amounts of these contributions to the payment. The utility turns each contribution over to RUCAG in the name of the person contributing.[85] Consumers sixteen or over who contribute a suggested minimal sum to RUCAG over the course of a year by any of the three alternative methods become members of the organization.[86]

RUCAG is to pay all costs incurred by the utilities in putting the system into operation above the utilities' normal billing costs, so that there is no question of placing a financial burden on the industry.[87] Disputes between RUCAG and utilities arising from the operation of this funding mechanism are to be resolved in state court.[88] Any persons interfering with the operation of this funding mechanism are subject to civil (and optional criminal) sanctions.[89]

RUCAG is to be governed by a Board of Directors responsible by direct election[90] to all residential utility consumers who contribute the minimum membership fee.[91] The Act provides for an interim Board of Directors appointed by various state officials[92] until such time as contributions and membership have reached a certain level,[93] after which the interim Board of Directors will

84a *Id.* Sections 8(a)(2)(B-2), 8(d)(2)(A) and 8(d)(2)(C).

85 *Id.* Sections 8(a)(2)(C) and 8(d)(2)(B) and (C).

86 *Id.* Section 4(b). See notes 107 and 114 *infra,* and Comment following Section 4(b).

87 *Id.* Section 8(e). Repayment of initial costs incurred by the utility during a "gearing-up period" before the first election of Directors may be postponed until one year after the elected Directors are installed in order to give the organization a chance to get started. See text accompanying notes 120, 121, and 122 *infra,* and Comment following Section 8(e).

88 *Id.* Section 8(f). See Comment following.

89 *Id.* Sections 8(g), (h) and (i).

90 *Id.* Sections 9(a), 9(g), and 10. During the initial gearing-up period, however, temporary appointed Directors are to be in charge of the organization. Sections 9(e) and (f).

91 *Id.* Sections 4(b), 10(g)(2).

92 See *Id.* Section 9(e) and Comment following.

93 See *Id.* Section 10(a)(1) and Comment following.

call an election for the first elected Directors. Each elected Director is to represent a geographical district of the state.[94] Candidates or Directorships must be members of RUCAG and residents of their respective districts.[95] To avoid personal conflicts of interest, candidacies of persons and their immediate families who are officers, employees, consultants, attorneys, accountants, real estate agents, shareholders, or bondholders of utility companies are barred.[96]

A candidate, to have his or her name placed on the ballot, must submit a nominating petition signed by a designated percentage of the RUCAG members in the candidate's district.[97] The candidate must also submit a short statement of his or her personal background and positions on issues concerning RUCAG and public utilities generally,[98] as well as a statement of financial interests disclosing the nature of the candidate's employment, directorships and trusteeships held, and recent personal or professional transactions with utility companies.[99] The candidates are subject to campaign contribution and spending limitations, and all candidates must submit a report after the election of all such expenditures and of contributions of five dollars and over.[100]

The election is to be conducted by the Board of Directors by mailing to each RUCAG member a ballot accompanied by the personal background statements of all the candidates.[101] A candidate receiving a plurality of the votes cast in his or her district is elected to the Board.[102] Directors serve three year terms staggered in such fashion that one-third of the board is up for election each year.[103]

The Board of Directors is to elect officers from among its members and to employ an Executive Director to supervise the hiring

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94 *Id.* Section 9(g). See Comment following.
95 *Id.* Sections 10(b)(1), (2).
96 *Id.* Sections 9(d), 10(b)(1).
97 *Id.* Section 10(c)(1). See Comment following.
98 *Id.* Section 10(e).
99 *Id.* Section 10(d).
100 *Id.* Section 10(f).
101 *Id.* Section 10(g)(1).
102 *Id.* Section 10(g)(5). See Comment following.
103 *Id.* Sections 9(b) and (c).

of the staff and the daily operations of the organization. The Executive Director is subject to the control of the Board.[104]

B. *Discussion*

The Residential Utility Consumer Action Group is designed to remedy the three principal defects in the utility regulatory process described above: (1) the absence of an institution possessing the necessary expertise to provide residential utility consumers with systematic and continuing representation; (2) the inadequacy of funding for consumer advocates; and (3) the absence of mechanisms to hold these advocates accountable to their consumer constituency.

1. Consumer Representation

It is RUCAG's statutory duty to devote its resources to consumer advocacy. RUCAG may perform this function in any forum in which the interests of residential utility consumers are at stake, including legislative bodies, although it is expected that RUCAG will initially concentrate its efforts in the administrative areas of rate regulation and utility power plant construction.

RUCAG will operate to fill at least part of the gap left in the developing adversary framework in utility regulation.[105] The organization could intervene: (1) to represent residential utility consumers in regulatory agency proceedings in those states where there is no consumer counsel and where the attorney general does not make a practice of intervening; (2) to defend consumer interests in those instances when the consumer counsel or attorney general is unable or unwilling to act for budgetary, political, or

104 *Id.* Sections 9(j)(8), 11, 12.

105 Even after RUCAG is established, there will still be interest groups unable to obtain adequate independent representation before utility commissions. Small commercial consumers of utility services might be one such group. (The interests of these consumers on many issues, such as rate design, however, may be similar to those of residential consumers — and owners of small commercial concerns may well wish to contribute to RUCAG in their individual capacities and seek places on the Board of Directors.) Interest groups within RUCAG which do not command a majority on the Board, however, may also lack adequate separate representation. See notes 134 to 138 *infra*, and accompanying text.

other reasons; and (3) to complement the presentation of the consumer counsel or attorney general by developing in depth particular issues or lines of argument covered superficially or not at all by the others, enabling the various consumer advocates to achieve an efficient division of function.

A considerable part of RUCAG's influence over the outcome of agency proceedings is likely to derive from deterrent effects associated with its presence at the proceedings and from informal bargaining power derived from the judicious exercise of its formal statutory powers. RUCAG will serve as a deterrent to unjustified rate increase requests and arbitrary agency action because of its formal powers of delay and exposure. Regulatory commissions will be compelled to consider carefully utility petitions when it is clear that there will be routine attendance at the proceedings by a party eager to challenge improper decisions. Utilities sensitive to bad publicity will need fear the power of RUCAG to reach out to its consumer constituency and mobilize protest. Moreover, RUCAG will have the resources to monitor and oversee on a daily basis the performance of the regulatory authority, ensuring thereby that all decisions reflect the residential consumer viewpoint.

The existence of RUCAG may lead to more protracted administrative proceedings and more frequent resort to the courts to challenge agency action than is now prevalent. These costs are the admitted price of public interest representation.[106] Indeed, if the residential consumer had been properly represented over the years, longer hearings would in fact be the norm. Such costs can be offset, however, by the benefits of public participation in the administrative process and the consequent legitimization of the process in the public consciousness. RUCAG will be exercising rights that are presently accorded to consumers but which go unused because of the great cost of participation in the regulatory process. RUCAG will be an effective vehicle to make these rights concrete. By so doing, RUCAG will be legitimizing the decisions of the utility commissions for consumers satisfied that their interests have seriously been considered.

RUCAG will also have a potentially beneficial effect on con-

106 *See* Stewart, note 24 *supra*, at 1770-76.

sumer awareness and organization generally by encouraging the involvement of its membership in RUCAG's "legislative watchdog" function. RUCAG will be permitted to appear before the state legislature and municipal governing bodies to express the views of its members on questions affecting their interests as utility consumers. It could engage in lobbying activities to the extent that any citizen can do so. It could participate in initiative and referendum campaigns. On legislation of substantial interest to residential utility consumers, citizens could exercise through RUCAG a significant influence on the eventual outcome. The decision of the allocation of RUCAG's resources between advocacy before regulatory agencies and advocacy before legislative bodies would be one for the Board of Directors and, ultimately, the general membership to make.

2. Funding

The funding mechanism is crucial to the RUCAG concept. RUCAG, as a citizens' organization free of dependence on the legislature or any other governmental authority, would impose no burden on the state's taxpayers; it would be supported almost entirely by voluntary contributions from its citizen constituency. RUCAG's system of appealing for and collecting these contributions is designed to minimize the transaction costs of assembling a large number of individual residential consumers into an entity with resources sufficient to represent the interests of all residential consumers.

The appeal for contributions and members would reach consumers at precisely the time when they are most receptive to it: the moment of confrontation with their utility bills. RUCAG statements on utility issues will be enclosed together with the pamphlets utility companies customarily insert into their billings. It is likely that consumers will thus become party to a lively debate on utility issues with every billing, and many will wish to become actively involved.

The method set out in the Model Act for contributing to

RUCAG[107] requires two affirmative acts by the consumer: (1) checking a box or entering the name of the contributor(s) in one's household and the amounts each contributes, and (2) adding the total contribution to one's payment for the utility services. This affirmative method of contribution to RUCAG may be contrasted with the more passive contribution methods employed in the presidential campaign fund check-off on the federal income tax form[108] and in the typical labor union dues check-off arrangement. When the taxpayer checks the box for a presidential campaign fund contribution, he or she makes no additional payment; the decision is a painless one requiring no real personal commitment. The union dues check-off requires somewhat more active engagement by the union member: he or she must provide a written authorization, which may be irrevocable for up to a year, for the employer to deduct union dues from the employee's wages and transmit the dues to the union.[109] However, as with the presidential campaign fund check-off, the union member sacrifices no personal economic interest by employing the dues check-off device, since the dues payment by one means or another is required for union membership. Unlike the RUCAG contribution mechanism, the dues check-off is designed to make the act of payment more automatic and less a repeated conscious choice of the person paying than the alternative of direct payment to the union.

The two affirmative acts necessary to contribute to RUCAG, however, require a positive personal commitment by the contributor. It is a major goal of RUCAG to stimulate a feeling of active participation in its members; the affirmative act of choosing to contribute money on a regular basis can be the starting point for an awakening of concern and activity.

The amount consumers are asked to contribute by checking the box is to remain at the discretion of the Board of Directors.[110]

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107 See Model Act Section 8(a) and Comment following, and text accompanying notes 84 to 86.

108 26 U.S.C. § 6103 (1967); *see also* Presidential Election Campaign Fund Act, 85 STAT. 562, 26 U.S.C. § 9001 *et seq.* (Supp. 1975).

109 Labor Management Relations Act § 302(c)(4), 29 U.S.C. § 186(c)(4) (1964).

110 Model Act Section 8(a)(2)(B). Note that the Board may also be given discretion over the total amount consumers must contribute over the course of a year in order to become members. Section 4(b) and Comment following.

It is anticipated that the cost to a utility of soliciting and processing each contribution will be quite low but perhaps not insignificant; the cost to RUCAG of recording the contributions in its own books may be higher. The requested amount of contribution will depend partially on what the per-transaction cost proves to be. Determination of the optimal appeal in terms of achieving both a broad membership and a high level of total contributions may require experimentation with various levels of requested contributions; on the other hand, a single sum fixed in consumers' minds[111] may be most effective. Another possibility is to encourage consumers to "round off" their bills, for example to the next highest dollar unit, and contribute the excess payment to RUCAG.[112] The model statute gives the Board the flexibility to make this determination in accordance with its own view of the situation.

The funding system minimizes the costs of soliciting and recording the contributions. The utilities already have developed efficient procedures, usually computerized, for printing and mailing the billings. These procedures could accommodate the requirements of the model statute with only minor modifications. The collection of contributions and incidental bookkeeping could likewise be accomplished through the utilities' computerized accounting systems. Minor changes in the computer programs would enable the utilities to send RUCAG each month lists of the names and addresses of all contributors, the amounts of their respective contributions, and the cumulative amount each has contributed during the period of time that determines whether an individual's contributions have met requirements for membership.[113]

The requirement of a monetary contribution for membership in RUCAG is a point of tension between the ideal of universal suffrage for utility consumers in selecting their representatives and

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111 Citizens' groups in Ohio conducting a campaign to legislate a RUCAG Act by initiative petition are as of this writing asking each signer of the petition for a twenty-cent contribution, to accustom consumers to the idea of a monthly twenty-cent check-off on their utility bills.

112 It is expected that many utility consumers will take advantage of the non-checkoff contribution alternative provided in Section 9(a)(2)(C) to contribute considerably more than the minimum required for membership. They may contribute either by large "one-shot" donations or by a cumulative practice of the "rounding off" of utility bills.

113 See Model Act Sections 4(b), 8(b).

the necessity for active citizen involvement and an effective fund-raising mechanism if RUCAG is to carry out its function of consumer representation. A substantial membership fee might operate in the same way as a poll tax to deter low income utility consumers from membership and consequently from voting. Any resulting bias of the Board of Directors in favor of middle class consumers could work to the detriment of poorer consumers on such issues as rate structures.

A minimal fee such as two dollars per year, as suggested in the Model Act,[114] would minimize the negative impact on low-income consumer membership, and, to the extent that the likely benefits in terms of lower utility bills are perceived as higher than the membership fee, would appeal to a broad range of consumers concerned with getting their "money's worth" from the organization. The total amount collected by RUCAG from the two-dollar membership fees alone, excluding other contributions in excess of that fee, could easily exceed the current budgets of many states for their Consumer Counsel.[115]

Three conditions must be met for the system to function properly: the utilities must cooperate in the operation of the system; individual contributors must feel secure from the threat of retaliation by the utilities; and contributors must be protected from invasions of their privacy. The Act provides sanctions to ensure the fulfillment of these conditions.

Interference with the printing or mailing of the RUCAG statements or of the check-off, or with the collection or transfer to RUCAG of contributions, would subject an individual or utility company to civil and possibly criminal sanctions.[116] Retribution

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114 *Id.* Section 4(b). The two alternative versions of Section 4(b) set the membership fee in the statute and give the Board of Directors discretion to set it.

115 See note 71 *supra.*

The idea that RUCAG should be paid for its successes — for example, that it should receive a percentage of the amounts it saves consumers through its representational efforts — was rejected as infeasible. The determination of what rates consumers would have been charged had RUCAG not intervened in a rate proceeding, for example, would require speculation as to the influence of hypothetical circumstances upon the minds of the utility commissioners. Moreover, such a system might distort the focus of RUCAG's efforts away from problems other than rates, such as service cut-offs, for instance, which many utility consumers might deem more pressing.

116 *Id.* Sections 8(h) and 8(i).

and threats of retribution for contribution to RUCAG or participation in RUCAG activities would subject an individual or utility to the same penalties.[117] If RUCAG makes these facts clear to consumers, any apprehensions about utility retaliation should be alleviated. Finally, disclosure of the RUCAG membership list to parties not involved either in the operation of the funding mechanism or in RUCAG elections or other business, or use of the list by such parties, would subject a violator to civil sanctions.[118] Contributors would thus be protected both from disclosure of the fact of their contributions and from the inconvenience of receiving appeals for donations from other organizations which might otherwise acquire the list.[119]

The requirement that RUCAG reimburse the utilities for the costs of operating the funding mechanism[120] is in keeping with the conception of the organization as completely voluntary. An alternative might have been to require the utilities to bear the additional billing and collection costs, since they can pass these costs on to the consumers, who will ultimately benefit from RUCAG's use of the contributions solicited. Indeed, the costs of consumer representation by consumer counsel in three jurisdictions are partially funded by assessments on the utilities.[121] However, such an assessment would presumably involve imposing a part of the burden on (1) industrial and commercial users of utility services which would not receive the benefits of RUCAG representation and (2) residential users who may not wish to support RUCAG. Thus the costs of operating the entire mechanism are to be placed on the contributors alone. That the organization is to pay its own way will also enhance its political attractiveness.

RUCAG is given twelve months after the installation of its first elected Directors to reimburse the utilities for the incremental costs the utilities incur pursuant to the Model Act *prior* to the first election.[122] This provision is designed to give the organiza-

117 *Id.* Sections 8(g) and 8(i).

118 *Id.* Section 8(j) and Comment following.

119 Protection of individual contributors' rights to privacy, it should be noted, is given priority here over RUCAG's interest in selling its membership list or loaning it to other groups with goals congenial to the RUCAG leadership.

120 Model Act Section 8(e).

121 See note 70 *supra.*

122 Model Act Sections 8(e)(2), 10(a)(1). Twelve months is suggested as a reason-

tion an initial "breathing space" in order to put itself on a sound financial footing for commencement of full-scale operations. It is anticipated that utilities will incur certain fixed costs, such as for the re-tooling of their billing systems, when the Act goes into effect. RUCAG might be stillborn if it were required to bear those initial fixed costs precisely at the point of its greatest financial weakness. It is desirable, however, that the organization be put on a completely self-sustaining basis as soon as is practicable. From the time the first elected Directors take office, all *current* utility costs must be promptly repaid, and no further financial burden, temporary or otherwise, could be imposed on the utility through the funding mechanism.

3. Accountability

The model statute is drafted so as to render the Directors and staff of RUCAG accountable to their constituency in multiple ways, through both formal and informal mechanisms. First, to become a Director one must go through both a selective and an elective process. Those with certain specified personal or professional connections with utility companies are disqualified from candidacy:[123] their conflict of interest would be so great as to override the other mechanisms of accountability in the Act. Candidates are required to disclose certain personal financial information[124] to the membership which would reveal connections to utilities insufficient to bar a person from candidacy but which voters could take into consideration. The provisions requiring candidates to obtain a substantial number of signatures on a nominating petition[125] and to explain their positions on utility issues and RUCAG organizational questions in a statement to be submitted to the entire membership in the district[126] will serve in rough fashion to "select out" those persons least likely to be responsive

able time period within which to require full reimbursement of utility costs initially unpaid. Section 8(e)(2).

123 Model Act Sections 10(b), 9(d).

124 *Id.* Section 10(d)(2).

125 *Id.* Section 10(c) and Comment following.

126 *Id.* Section 10(e).

to the views of their constituencies. It may be argued that these requirements are so stringent as to deter not only the frivolous but the capable from candidacy. It is anticipated, however, that "self-selection" induced by these campaign procedures will tend to encourage the candidacies of highly motivated and concerned citizens.

The formal accountability of the elected official to his constituency present in traditional democratic institutions is heightened by the statutory commands that the operations of RUCAG be conducted completely in the public eye. Books, records, reports, studies, and the like are all to be open to public scrutiny.[127] Reports of RUCAG activities and minutes of Board meetings are to be sent to each public library in the state,[128] and membership meetings and Board meetings are to be open to the public.[129] The accountability of the Directors is made more certain by the possibility of being recalled,[130] as well as by the prospect of defeat at the next election. A strict conflict of interests provision[131] ensures that Directors will remain clear of any financial entanglements with the utilities.

The Directors have the authority to exercise strong control over the activities of the Executive Director and the RUCAG staff.[132] The Executive Director serves at the pleasure of the Board.[133] The Executive Director's terms of employment and the allocation of policy-making responsibilities between the Executive Director and the Board are not specified. There is a trade-off between granting the Executive Director the independence and stability of employment necessary to attract a person of high competence, and preserving strict accountability to the consumers (at least indirectly through the Board) by setting detailed policies for the Executive Director to carry out. It is anticipated that persons elected Direc-

127 *Id.* Section 9(j)(2)-(5).
128 *Id.* Sections 9(j)(6), 9(k)(2).
129 *Id.* Sections 13(d), 9(k)(2).
130 *Id.* Section 9(h).
131 *Id.* Section 14.
132 *Id.* Sections 9(j)(8), 12(b).
133 *Id.* Section 12(c). It is suggested that a two-thirds vote of the Directors be required for dismissal of an Executive Director, as it is required for removal of officers of the Board, in order to give the Executive Director some assurance of security of tenure.

tor will tend to hold a relatively activist conception of their job, so that their exercise of the policy-making function will be rather extensive. If the formal and informal mechanisms of accountability set up in the model statute work on the Directors as planned, the actions of the Executive Director and staff of RUCAG should reflect the views of those consumers to whom a majority of the Board feels responsible.

The interests of all residential utility consumers, however, will not converge on some issues.[134] Even after RUCAG is established, it is likely that on some issues, interests of some classes of consumers will remain unrepresented.[135]

The Model Act provides that the existence of RUCAG shall not be taken to restrict the right of other citizens' groups to participate in agency or court proceedings.[136] Minorities within RUCAG and interest groups outside it would be as free to present their views to the commissions and courts as they are at present. They could also appeal to the attorney general or consumer counsel to protect their interests in states in which those officials intervene in utility cases.[137] Ultimately, the question is one of the allocation of RUCAG's limited resources between contending interests. Majority rule is a fair means of determining that allocation.[138]

The final measure of RUCAG's accountability to its state's residential utility consumers is its bank account. If citizens become dissatisfied with RUCAG's performance, or if RUCAG's activities

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134 Middle-class and low-income consumers may disagree on questions of rate design, for example, and environmentalists may oppose advocates of cheap electricity on the issue of nuclear power plants.

135 *See* note 105, *supra*. One possible solution to this dilemma would be that if two distinct interest groups clash within the organization, a RUCAG with sufficient resources could represent both, or could grant the minority funds to finance its own presentation. The possibilities of conflicts of interest and internal staff and organizational dissension, however, would be endemic to such a course of action. The Model Act is silent on this issue of multiple representation (as it is on most questions of RUCAG internal operations). Such a course of action would therefore be left to the discretion of the Board.

136 Model Act Section 15(b).

137 See notes 56 and 61 *supra*, and accompanying text.

138 In this respect membership in RUCAG would be somewhat analogous to membership in a labor union. In the National Labor Relations Act, 29 U.S.C. §§ 151-168 (1973), Congress made the general determination that working people joining organizations for their economic benefit are to be bound by the vote of the majority.

fail to capture or hold their interest and support, contributions will cease. It is this direct and telling feedback from the consumers themselves which most clearly distinguishes RUCAG from utility commission staffs, the offices of attorneys general, or consumer counsel. The organization's built-in insecurity will generate maximum responsiveness on the part of Directors and staff to consumer demands.

AN ACT TO CREATE A RESIDENTIAL UTILITY CONSUMER ACTION GROUP

TABLE OF CONTENTS

Section 1. *Short Title*

This Act may be cited as the [State] Residential Utility Consumer Action Group Act.

COMMENT: Proponents of the Model Act in some states have chosen to give the organization a different title.

Proponents of the statute may wish to introduce the substantive Comments following the provisions of the statute, as well as relevant parts of the discussion preceding the statute, into the legislative record. As part of the legislative history they will aid in subsequent judicial and administrative interpretation of the Act.

Section 2. *Statement of Legislative Intent*

The purpose of this Act is to ensure effective and democratic representation of residential utility consumers before regulatory agencies, legislatures, and other public bodies by:

(a) creation of a permanent nonprofit organization whose sole duty is the representation of the interests of residential utility consumers before such bodies;

(b) provision for democratic accountability of the Board of Directors of the organization to the will of its consumer constituency through open elections of Directors with thorough financial disclosure requirements and campaign spending limitations;

(c) encouragement of active citizen participation in the regulatory process through involvement in the activities of the organization; and

(d) creation of an efficient funding mechanism for the organization, involving no compulsory burden whatsoever on the taxpayers of this State, whereby residential utility consumers and others may voluntarily contribute to the organization by adding a sum to their utility payments.

Section 3. *Definitions*

(a) "Public utility" means a corporation or other entity engaged in the business of supplying utility services to persons within this State if rates or charges for such utility services have been established or are subject to approval by a local, state, or federal authority.

COMMENT: This definition may be keyed to the definitions in the state statutes providing for public utility regulation. Publicly owned utilities should be included in the definition, however, even if the state statutes do not include them.

(b) "Utility services" means electricity, water, natural gas, and telephone services supplied by a public utility.

COMMENT: Railroads, municipal transport systems, broadcasters, and the like are outside the scope of the Model Act.

(c) "Residential utility consumer" means any resident of this State whose residence is furnished with a utility service by a public utility.

COMMENT: The term "residence" is not confined to resident-owned dwellings, but includes any inhabited premises.

(d) "Regulatory agency" means any local, state, or federal commission or other public body with the legal authority:

(1) to establish or alter rates or charges for the provision or sale of utility services within this State;

(2) to plan or to approve, reject, or modify plans for the construction of facilities for the production or provision of utility services within this State;

(3) to formulate or review energy policies affecting this State; or

(4) otherwise to regulate the activities of public utilities doing business within this State; *provided* that local, state, and federal courts and legislative bodies shall not be deemed to be "regulatory agencies" for the purposes of this Act.

(e) "Proceeding" means any formal meeting of a regulatory agency or subdivision thereof, including a meeting conducted by a hearing examiner or other agent of the regulatory agency, regarding:

(1) the establishment or alteration of rates or charges for the provision or sale of utility services within this State;

(2) the establishment, abrogation, or amendment of rules or regulations concerning residential utility consumers, public utilities, or energy policies affecting this State, or concerning the conduct of regulatory agency proceedings themselves; or

(3) adjudication of the claims or petitions of residential utility consumers, public utilities, or other persons or groups of persons.

(f) "The Corporation" means the Residential Utility Consumer Action Group, Inc.

(g) "Member" means any person who meets the requirements for

membership in the Corporation set forth in Section 4(b) of this Act.

(h) "Director" means any person serving on the Board of Directors of the Corporation.

(i) "District" means any political subdivision from which one member is elected to the Upper House of this State.

(j) "Campaign expenditure"

(1) means a purchase, payment, distribution, loan, advance, deposit, or gift of money or anything of value, made for the purpose of electing a candidate to the Board of Directors of the Corporation; and

(2) means a contract, promise, or agreement, express or implied, whether or not legally enforceable, to make any campaign expenditure; but

(3) does not include the use of real or personal property and the cost of invitations, food, and beverages, voluntarily provided by an individual to a candidate in rendering voluntary personal services on the individual's residential premises for candidate-related activities if the cumulative value of such activities by such individual on behalf of any candidate does not exceed [$100.00] for any election.

COMMENT: The language of this definition is taken from the Federal Election Campaign Act[139] with certain modifications to adapt the provision to the local nature of RUCAG campaigns.

The provisions of (j) (3) exclude from the campaign expenditure limitations of Section 10(f)(1) certain types of activities common to grass-roots campaigns, particularly a candidate's use of a supporter's house, on a voluntary basis, as a local headquarters for canvassing, telephoning, etc. Underlying the provision are the policy of encouraging public participation in political campaigns at the grass roots level and the recognition that to require accounting of all such minor in-kind contributions would be an unduly burdensome imposition upon individual candidates. Lest a candidate seek to subvert the Section 10(f)(1) campaign spending limitation through excessive use of the 3(j)(3) exclusion, however, it is suggested that individual supporters be limited to $100.00 worth of such unrecorded in-kind donations.

The use of office space, equipment, and staff services, and the

139 2 U.S.C. § 431(f) (Supp. 1975).

provision of transportation, among other in-kind contributions, fall within the scope of "campaign expenditures."

(k) "Campaign contribution"

(1) means a gift, subscription, loan, advance, or deposit of money or anything of value, made for the purpose of electing a candidate to the Board of Directors of the Corporation; and

(2) means a contract, promise, or agreement, express or implied, whether or not legally enforceable, to make any campaign contribution; but

(3) does not include

(A) the value of services provided without compensation by individuals who volunteer a portion or all of their time on behalf of a candidate or political committee; or

(B) the use of real or personal property and the cost of invitations, food, and beverages, voluntarily provided by an individual to a candidate in rendering voluntary personal services on the individual's residential premises for candidate-related activities if the cumulative value of such activities by such individual on behalf of any candidate does not exceed $100.00 for any election.

COMMENT: The language of this provision is also taken from the Federal Election Campaign Act,[140] with certain modifications. The considerations underlying the provision are similar to those underlying subsection (j).

(*l*) "Political committee" means any committee, club, association, or other group of persons which makes campaign expenditures or receives campaign contributions during the year before an election of the Board of Directors.

COMMENT: This provision is adapted from the Federal Election Campaign Act.[141]

(m) "Periodic customer billing" means a demand for payment for utility services by a public utility to a residential utility consumer on a monthly or other regular basis.

(n) The "immediate family" of a person means the person and his or her spouse, and their parents, children, brothers and sisters.

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140 *Id.*, § 431(e). See also Model Act Section 10(f) and Comment following.

141 2 U.S.C. § 431(d). See Model Act Section 10(f)(1).

Section 4. *Creation of Corporation; Membership*

(a) There is hereby created a [not-for-profit] membership corporation to be known as the Residential Utility Consumer Action Group, Inc., hereinafter referred to as the Corporation.

COMMENT: Some jurisdictions use the term "not-for-profit corporation" to designate corporations not organized for business purposes; others use terms such as "membership corporation," "nonstock corporation," "nonprofit corporation," or "corporation not for pecuniary profit."[142] The legislature should choose the appropriate term.

(b) The membership of the Corporation shall consist of all residential utility consumers of sixteen years of age or older who have contributed to the Corporation at least [two dollars] [an amount to be set by the Board of Directors] in either its preceding or its current fiscal year; *provided,* that any person may resign from membership.

COMMENT: Sixteen years is set as the minimum age for membership in order to encourage young people of high school age to become acquainted with public issues and to give them an opportunity to participate in public affairs. Sixteen-year-olds in many states are given the responsibility of operating motor vehicles, and must pay taxes on their earnings. It is felt that they are likewise mature enough to participate in RUCAG activities, and that they would gain from such participation valuable experience in preparation for exercising the responsibilities of voting citizens.

The provision for membership for both the "preceding and current" fiscal years of RUCAG is (1) for administrative convenience in the keeping of membership rolls and (2) to ensure that persons who have qualified for membership in the past year, but whose contributions in the current fiscal year have not reached the requisite minimum for membership as of the election date (which might conceivably be set for early in the fiscal year), are not barred from voting. If the contribution records are computerized and turned over to RUCAG each month,[143] it would be

142 *See* 19 W. FLETCHER, CYCLOPEDIA OF LAWS OF PRIVATE CORPORATIONS § 9001 (1975 rev. vol.).

143 See Section 8(d)(3) *infra.*

feasible to change this provision to read "preceding twelve months" and to purge the membership rolls every month.

A person becomes a member of RUCAG as soon as his or her contributions, as recorded on the RUCAG books, reach the requisite minimum.[144] Proponents of the Act may wish to give the Board of Directors the discretion to set the membership fee at whatever level it determines would best serve the goals of obtaining a broad membership base and of maximizing total contributions. The Board would be democratically accountable to the membership for its decisions on this as on other policy questions.

A contribution to RUCAG is not to be considered refundable if the contributor resigns from membership.

Section 5. *Duties, Rights, and Powers*

(a) It shall be the duty of the Corporation effectively to represent and protect the interests of the residential utility consumers of this State. All actions which it undertakes under the provisions of this Act shall be directed toward that goal.

(b) The Corporation shall have all rights and powers accorded generally to, and shall be subject to all duties imposed generally upon, not-for-profit membership corporations under the laws of this State.

(c) The Corporation may seek tax-exempt status under state and federal law.

(d) The Corporation may conduct, support, and assist research, surveys, investigations, planning activities, conferences, demonstration projects, and public information activities concerning the interests of residential utility consumers. The Corporation may accept grants, contributions, and legislative appropriations for such activities.

COMMENT: This provision would permit RUCAG to investigate the books of utility companies to the extent permissible by law. It would also permit RUCAG to present its case to the public through the mass media, by paid or donated advertising or by other means.

144 See text accompanying note 115 *supra* for a discussion of the suggested two-dollar membership fee.

As RUCAG develops expertise in the field of utility issues and builds up a network of contacts with citizens' groups across the state in question, it is conceivable that the state legislature may wish to employ RUCAG to perform research or public information activities. This provision permits RUCAG to accept such work. It is the only exception to the general policy against the use by RUCAG of tax monies, legitimized by the fact that it would be a specific legislative authorization of payment for work done.

This provision in conjunction with subsection (c) also opens up the possibility that RUCAG could establish a tax-exempt subsidiary foundation to solicit foundation grants for its research or educational efforts.

(e) The Corporation may contract for services which cannot reasonably be performed by its employees.

COMMENT: This provision permits RUCAG to employ on a temporary basis accountants, engineers, lawyers, and others whose expert services are necessary in constructing an effective presentation at, for example, a rate proceeding.

Note that Section 9(l), *infra,* which limits compensation of Directors to "expenses necessarily incurred by them in the performance of their duties," would rule out the employment by RUCAG of its Directors to perform such expert services on a paid basis. A directorship in RUCAG is not to be a means of soliciting business for one's private occupation.

(f) The Corporation may represent the interests of residential utility consumers before regulatory agencies, legislative bodies, and other public authorities, except as this Act otherwise provides.

COMMENT: A discussion of consumer representation by RUCAG is set forth in the text.[145]

(g) The Corporation shall not sponsor, endorse, or otherwise support, nor shall it oppose, any political party or the candidacy of any person for public office.

145 See text accompanying note 105 *supra.*

(h) The Corporation may support or oppose initiatives or referenda concerning matters which it determines may affect the interests of residential utility consumers.

(i) The Corporation, upon receipt of any written complaint regarding a public utility, shall promptly transmit the complaint to the appropriate regulatory agency or other public authority. The agency or authority shall inform the Corporation of its response to the complaint.

(j) The Corporation shall have, in addition to the rights and powers enumerated in this Act, such other incidental rights and powers as are reasonably necessary for the effective representation and protection of the interests of residential utility consumers.

Section 6. *Representation of Utility Consumers in Regulatory Agency Proceedings*

(a) Notification of Impending Proceedings. Each regulatory agency of this State as defined in Section 3(d) shall notify the Corporation in advance of the time, place, subject, and names of parties of each proceeding of the agency, unless the agency reasonably determines that the proceeding will not affect the interests of the residential utility consumers of this State. The agency shall so notify the Corporation at least thirty days before the scheduled date of the proceeding or within five days after such date is fixed, whichever is later.

COMMENT: The purpose of this provision is to alert RUCAG to hearings in which residential utility consumers may have a stake in time to prepare adequately for participation in the hearings. The agency holding the proceeding is in the best position from an efficiency standpoint to make the determination of its relevance to residential utility consumer interests, and so is given the authority to do so within the bounds of "reasonableness." Thus local zoning commissions, which might be considered "regulatory agencies" for some purposes (e.g., when ruling on proposed power plants), could reasonably determine that the vast majority of their proceedings would not call for notification to RUCAG.

If, however, a regulatory agency fails to notify RUCAG of a proceeding affecting the interests of residential utility consumers, RUCAG may still intervene or otherwise participate in the pro-

ceeding under Section 6(b), *infra,* and may seek judicial review of the agency decision under Section 7, *infra.*

(b) Intervention and Participation in Proceedings.

(1) The Corporation may intervene as of right as a party or otherwise participate in any regulatory agency proceeding which the Corporation reasonably determines may affect the interests of residential utility consumers.

(2) The intervention or participation of the Corporation in any such proceeding shall not affect the obligation of the regulatory agency to operate in the public interest.

COMMENT: The statutory grant to RUCAG in Section 6(b)(1) would in practice differ little in content from liberal intervention standards now in effect in most state agency proceedings.[146] The agency would pass judgment on the reasonableness of RUCAG's determination that consumers' interests "may [be] affect[ed]." A decision against intervention would be a final judgment appealable to the courts.

(c) Conduct of the Proceeding. When the Corporation intervenes or participates in a regulatory agency proceeding, it shall be subject to all laws and rules of procedure of general applicability governing the conduct of the proceeding and the rights of interveners and participants. The Corporation shall have the same rights regarding representation by counsel, participation in pre-hearing conferences, discovery, requests for issuance of subpoenas by the agency, stipulation of facts, presentation and cross-examination of witnesses, oral and written argument, participation in settlement negotiations, and other aspects of the proceeding as are accorded to other interveners under the laws of this State, except as otherwise provided in this Act.

COMMENT: The Model Act essentially preserves agency procedures as they presently exist. Though in some jurisdictions reform of administrative procedures, particularly in the area of discovery powers, might well be a topic for citizen groups' reform agendas, it is not the purpose of the Model Act to legislate changes in how the utility commissions are to conduct their business other

146 See note 41 *supra.*

than those minimal changes necessary to allow RUCAG effective participation in agency proceedings.

Two other alternatives for reform might have been proposed in the Model Act. The first alternative would be to grant RUCAG all procedural rights deemed necessary to effectuate its statutory role as representative of residential consumers in agency proceedings. RUCAG would be given broad powers in each of the areas listed in Section 6(c). In the discovery area, for example, the agency would be obliged to issue subpoenas for relevant material at RUCAG's request. RUCAG would also be authorized to send interrogatories which the agency could compel a utility to answer, and to take depositions. Moreover, RUCAG would have access to the fruits of the utility commission's investigations and to the utility commission's experts. Such proposals, however, would be vulnerable to attack on fairness grounds, in that they would give RUCAG an undue advantage over other parties and interveners.

The second alternative would be to institute a thorough-going procedural reform granting the rights and powers mentioned above to all parties and interveners. It seems unwise to incorporate such a sweeping reform in the RUCAG proposal if it is to apply to all state regulatory agencies; RUCAG itself could get sidetracked in the ensuing debate. If the reform is to be confined to utility commission procedure, however, a stronger argument exists for inserting it in the RUCAG Act, although the fact that the procedural reform proposal would probably require an additional committee of the state legislature, the Judiciary Committee, to pass on the entire Model Act might raise a significant obstacle to the Act's adoption.

The principal problem in utility commission proceedings is not the rules of the proceedings themselves, however, but rather the inadequacy of effective and accountable residential consumer representation. In most proceedings, for example, once consumer representatives are granted leave to intervene, discovery is not a major difficulty: agencies generally issue subpoenas on request,[147]

147 Letter from Elliot Taubman, National Consumer Law Center, Boston, to the HARVARD JOURNAL ON LEGISLATION, Jan. 23, 1976, on file at the HARVARD JOURNAL ON LEGISLATION. There is little judicial precedent available, however, to define the rights of the parties regarding administrative subpoenas. F. COOPER, note 26 *supra*, at 294-95.

and in some states are required by statute to do so.[148] Only in those states in which consumer interveners have had significant problems in obtaining information from utilities or in which other agency procedures have been burdensome on consumer advocates in important respects should proponents of the Act add provisions to it to institute broad procedural reforms.

In any case, RUCAG, once established, may petition the agency or the legislature under the general authority accorded by Section 5(f) of the Act to undertake whatever procedural reforms RUCAG deems desirable.

Section 7. *Judicial Review of Regulatory Agency Decisions; Enforcement Actions*

The Corporation shall be deemed to have an interest sufficient to maintain, intervene as of right in, or otherwise participate in any civil action for the review or enforcement of any regulatory agency decision which the Corporation reasonably determines would adversely affect the interests of residential utility consumers.

COMMENT: The Section 7 grant of standing to RUCAG is within the mainstream of recent judicial decisions[149] on both the federal and state levels regarding standing to seek review of administrative actions. The decisions hold that a party sustaining an "injury in fact" from an agency action, where "the alleged injury was to an interest 'arguably within the zone of interests to be protected or regulated' by the statutes that the agencies were claimed to have violated," possesses standing to obtain judicial review of the agency action.[150] The federal decisions are grounded on Section 10(a) of the federal Administrative Procedure Act, granting judi-

148 Among these states are California (CAL. GOV'T CODE § 11510 (West, 1966)), Alaska (ALASKA STAT. § 44.62.430 (1967)), Massachusetts (MASS. GEN. LAWS ANN. ch. 30A § 12(3) (1966)), Missouri (MO. REV. STAT. § 536.077 (Supp. 1975)), North Dakota (N.D. CENT. CODE § 28-32-09 (1960)). Ohio (OHIO REV. CODE ANN. § 119.09 (Page, 1969)), Oregon (ORE. REV. STAT. § 183.440 (1974)), and Virginia (VA. CODE ANN. § 9-6.10(d) (1973)).

149 *See* cases cited in the Comment and in notes 150 to 153.

150 Sierra Club v. Morton, 405 U.S. 727, 733 (1972); Associated Data Processing Service Organizations v. Camp, 397 U.S. 150 (1970); Barlow v. Collins, 397 U.S. 159 (1970).

cial review to persons "*adversely affected* or aggrieved by agency action within the meaning of a relevant statute" (emphasis added).[151] This language corresponds to that of Section 7 of the Model Act. The degree of injury alleged need not be large; indeed, the Supreme Court has quoted approvingly Professor Davis's conclusion that ". . . an identifiable trifle is enough for standing to fight out a question of principle; the trifle is the basis for standing and the principle supplies the motivation."[152] State courts have moved to adopt the Supreme Court's standards in ruling on standing questions arising from state agency proceedings.[153]

In seeking review of agency decisions "adversely affecting" its members, RUCAG would be in essentially the same position as the public interest groups (whose members were alleged to be "injured in fact" by agency decisions) granted standing by the courts in *SCRAP*[154] and *Wisconsin Environmental Decade*.[155] The reasonableness of RUCAG's determination that its members would be "adversely affected" would presumably be judged by the court on the basis of a standard quite similar to, if not identical with, the "injury-in-fact" standard handed down by the Supreme Court in *SCRAP*.

Section 7 is also consistent with the "zone of interests" test in regard to the type of judicial review RUCAG is likely most often to seek: review of utility commission actions. It is clear that residential utility consumers' interests are within the "zone" regulated by the utility commission. The Model Act may be somewhat more liberal than the "zone of interests" test, however, in that it also grants RUCAG the right to obtain review of other regulatory agencies' actions which adversely affect its constituency, even if the statute the agency is interpreting or from which it derives its authority is not construed to "protect or regulate" the

151 5 U.S.C. § 702 (1970).

152 Davis, *Standing: Taxpayers and Others*, 35 U. CHI. L. REV. 601, 613 (1968), cited in United States v. SCRAP, 412 U.S. 669, 689 n.14 (1973).

153 Wagstaff v. Superior Ct., Family Ct. Div., 535 P.2d 1220 (Alas. 1975); De Vargas Savings & Loan Ass'n. of Santa Fe v. Campbell, 535 P.2d 1320 (N.M. 1975); Wisconsin Envir. Decade v. Public Serv. Comm'n of Wis., 230 N.W.2d 243 (Wis. 1975). See also note 41 *supra*.

154 United States v. Students Challenging Regulatory Agency Procedures (SCRAP), 412 U.S. 669 (1973).

155 Wisconsin Envir. Decade v. Public Service Comm'n of Wis., 230 N.W.2d 243 (Wis. 1975).

interests of residential utility consumers. In this respect the Model Act is consonant with the criticisms of judges and scholars that the "zone of interests" test is overly restrictive.[156]

Section 8. *Funding of the Corporation*

(a) The Corporation shall have the authority to prepare and furnish to each public utility in this State, not less than [fourteen] calendar days and not more than one year in advance of the date of each of the public utility's periodic customer billings, the following materials:

(1) a statement, not to exceed the folded size of [x] inches and [ ] ounces avoir., concerning the organization and activities of the Corporation and other matters which the Corporation determines may affect the interests of residential utility consumers; and

(2) a card, leaflet, or similar enclosure, not to exceed [x] inches and [ ] ounces avoir. or a statement to be printed upon the face of the billing in [ ] point or larger type,

(A) indicating that the utility consumer billed and others in his or her household may contribute money to the Corporation by a payment to the public utility in excess of his or her payment for utility services and that such excess payment will be transferred to the Corporation; and

(B-1) containing a box of dimensions [x] and a statement next to it indicating that if the utility consumer billed checks the box and adds [twenty cents or such amount as the Corporation may determine] to his or her payment, such excess payment will be transferred automatically to the Corporation as a contribution from the utility consumer billed; [and]/[or]

(B-2) containing a box of dimensions [x] and a statement next to it indicating that if the utility consumer billed checks the box, [twenty cents or such amount as the Corporation may determine] will be added automatically to his or her next periodic billing, and that such amount when paid will be transferred automatically to the Corporation as a contribution from the utility consumer billed; [and]/[or]

156 Barlow v. Collins, 397 U.S. 159, 167 (1970) (Brennan, J., concurring and dissenting); K. DAVIS, 3 ADMINISTRATIVE LAW TREATISE §§ 22.00-3 (1970 Supp.).

(C) containing a space no smaller than [x] inches in which the utility consumer may enter the names of contributors in his or her household sixteen years of age or older and the amount each contributes to the Corporation.

COMMENT: Proponents of the Act should choose which method among the alternatives (B-1), (B-2), and (C), or which combination of methods, would best serve the goals of encouraging contributions and reducing processing costs. Another possibility is to grant the Board of Directors of RUCAG the discretion to make the choice of method.

The Act's proponents must tailor these provisions to the specific billing practices of each utility in their respective states. Billing formats differ widely, as do the type and quantity of additional materials inserted by the utility companies into their billings.[157]

The weight limitation is of particular significance in view of the one-ounce allowance for first class mail. Although postal costs are to be borne by the utility under Section 8(e)(1), efforts should be made to keep the total weight of the bill, the return envelope, the RUCAG statement, and any informational or publicity material inserted by the utility within the one-ounce limit. Fairness dictates that the RUCAG statement and the utility's informational material be of approximately equal size and weight. The weight limitation should be set with these considerations in mind.

(b) Each public utility furnished with such statements or other enclosures in accordance with the provisions of subsection (a) of this Section shall print or otherwise include or enclose such statements or enclosures within, upon, or attached to each periodic customer billing which the public utility mails or delivers to any residential consumer.

COMMENT: How the utilities are to carry out this requirement is discussed in the text.[158]

(c) There is hereby created in each public utility's Uniform System

157 See text accompanying notes 84 to 86; see generally the section of the text entitled "Funding," accompanying notes 107 to 122, particularly the paragraph accompanying notes 110 to 112 and note 112.

158 See text accompanying note 113 *supra*.

of Accounts an account to be called the Residential Utility Consumer Action Group Account. All contributions to the Corporation received by the public utility and all other moneys due the Corporation under the control of the public utility shall be deposited in this Account immediately upon receipt of such contributions or when such moneys become due. Interest, calculated at [the current prime rate], shall be added daily to this Account.

COMMENT: When a residential utility customer in paying a monthly billing (1) makes a contribution to RUCAG and (2) has a dispute with the utility over the proper amount of the billing and withholds a part of the amount demanded by the utility, the utility may not apply the RUCAG contribution to the customer's balance due. It must place the contribution in the RUCAG Account to be forwarded to RUCAG under Section 8(d)(1). Disputes over billings must be resolved through normal procedures independent of the RUCAG funding mechanism.

(d) Each public utility which receives contributions to the Corporation shall transfer to the Corporation by the [fifteenth] day of each month

(1) the entire contents of the Residential Utility Consumer Action Group Account as of the date of transfer;

(2) the name and address of each contributor and the amount he or she contributed during the previous month, in the following manner:

(A) a contribution made by checking the box described in Section 8(a)(2)(B) shall be attributed to the consumer billed;

(B) each contribution made by entering the name of the contributor and the amount he or she contributes in the space described in Section 8(a)(2)(C) shall be attributed to such contributor; *provided,* that

(C) if the actual amount the consumer billed adds to his or her payment as a contribution to the Corporation is inconsistent with the amount the consumer states by the methods described in Sections 8(A)(2)(B) and (C) that the members of his or her household are contributing, the actual amount contributed shall be attributed entirely to the consumer billed; and *further provided,* that

(D) if a consumer neither checks the box described in Section

8(a)(2)(B) nor enters the name of any contributor in the space described in Section 8(a)(2)(C), any payment by the consumer in excess of the amount demanded in the periodic customer billing shall not be considered a contribution to the Corporation;

and

(3) if the public utility operates its billings and customer accounts on a computerized basis, a statement of the cumulative amount contributed by each contributor during the Corporation's current fiscal year.

COMMENT: The operation of this provision is explained in the text.[159] Section 8(d)(2)(C) covers the case in which the consumer billed errs in adding up the contributions of individual household members, or in adding the household's total contributions to the utility payment. So that the utility will not have to determine which part of the miscalculated amount contributed is attributable to each of the contributors in the household, the entire contribution is to be attributed to the consumer whose name appears on the periodic customer billing.

The final phrase of Section 8(d)(3) may be changed to "during the preceding twelve months," depending on the membership requirements.[160] See the Comment following Section 4(b), *supra*.

(e) The Corporation shall promptly reimburse each public utility for all reasonable costs incurred by the public utility, above the utility's normal billing costs, in complying with this Section; *provided,* that

(1) All postage costs of mailings pursuant to Section 8(a) shall be borne by the utility; and

(2) the Corporation may postpone reimbursement of the public utilities for costs incurred through the first election of Directors until [twelve months] after such Directors are installed.

COMMENT: The purpose of this provision is to avoid placing a financial burden on utilities in carrying out the requirements of this Act.[161]

159 See text accompanying notes 84, 85, and 110 to 113, and note 112.
160 See Comment following Section 4(b), *supra*.
161 See text accompanying notes 120 and 121, *supra*.

Proviso (e)(1) is made necessary by the possibility that a utility would force RUCAG to bear tremendous additional postal costs by including in the billings the utility's own publicity materials taking up the entire one-ounce first-class allowance, and then arguing that inclusion of the RUCAG material required additional postage. The proviso creates an incentive for the utility to keep the weight of its billing materials to a minimum.[162]

In states in which utility payments are made automatically from the consumer's bank account to the utility through a so-called Electronic Funds Transfer System, the procedures for solicitation and collection of contributions for RUCAG must be modified.

(f) Any disputes arising from the operation of this Section shall be resolved by negotiations between the Corporation and the public utility if possible, or by a civil proceeding in the courts of this State. Neither the public utility nor the Corporation may fail to comply with the provisions of this Act by reason of the existence of such a dispute.

COMMENT: Disputes over the costs of funding mechanism could be a life-or-death matter for RUCAG, especially in its early stages. Given that some state utility commissions are likely to be hostile to RUCAG at first, it seems wise to give jurisdiction of these disputes to the judicial system rather than to the agency.[163]

(g) No public utility or officer, employee, or agent of a public utility may interfere or threaten to interfere with or cause any interference with the utility service of, or penalize or threaten to penalize or cause to be penalized, any person who contributes to the Corporation or participates in any of its activities, in retribution for such contribution or participation.

(h) No public utility or officer, employee, or agent of a public utility may prevent, interfere with, or hinder the activities described in subsections (b), (c), and (d) of this Section.

(i) A person who violates subsections (g) or (h) of this Section shall be subject to a civil penalty of not more than [$5,000]. Each such violation shall constitute a separate and continuing violation of

162 See Comment following Section 8(a), *supra*. For an explanation of proviso (e)(2), see text accompanying note 122, *supra*. See also Section 10(a)(1).

163 See text accompanying notes 120-122 *supra*.

the Act. [A person who knowingly and willfully violates subsections (g) or (h) of this Section shall also be liable to imprisonment for a term not to exceed six months.]

(j) No person shall use any list of contributors to the Corporation, nor any part of such list, for purposes other than the conduct of the activities described in subsections (b), (c), and (d) of this Section, or the conduct of other business of the Corporation as prescribed in this Act. No person shall disclose any such list or part thereof to any other who the person has substantial reason to believe does not intend to use it for the lawful purposes described in this subsection. A person who violates this subsection shall be subject to a civil penalty of not more than [$5,000].

COMMENT: This provision is designed to protect the privacy interests of RUCAG members. The only persons outside of RUCAG with access to the membership lists will be the utility companies which compile the lists of contributors for RUCAG.[164] Use of the lists by these firms is strictly limited to the operation of the funding mechanism. Membership lists would be available to RUCAG members considering running for Director, since they would be essential to a petition campaign. Such members, however, would be prohibited from disclosing the lists to those not involved in RUCAG.

Section 9. *Board of Directors*

(a) Function. The affairs of the Corporation shall be managed by a Board of Directors.

(b) Term of Office. The term of office of elected Directors shall be three years, with the exception of Directors drawing shortened terms under the provisions of subsection (c) of this Section. The term of office of Directors appointed pursuant to subsection (e) of this Section shall end when the first elected Directors are installed in office. No Director shall serve more than two consecutive terms.

COMMENT: The prohibition against long, unbroken tenure in office is a safeguard against the establishment of personal fiefdoms within the organization. It will ensure a continual turnover of

164 See note 119 and accompanying text.

RUCAG leadership, which should combat tendencies toward bureaucratic stagnation.

(c) Staggering of Terms. One-third of the Directors first elected to the Board shall serve for a one year term, one-third of such Directors shall serve for a two year term, and one-third of such Directors shall serve for a full three year term. The Directors shall draw lots upon their installation in office to determine the length of their first terms.

(d) Qualifications. Directors shall be residents of this State who are members of the Corporation. No officer, employee, consultant, attorney, accountant, real estate agent, shareholder, bondholder, or member of the immediate family of an officer, employee, consultant, attorney, accountant, real estate agent, shareholder, or bondholder, of any public utility doing business in this State shall be eligible to become a Director.

COMMENT: The purpose of the second sentence of this provision is the elimination of conflicts of interests among Directors. Proponents of the Act may wish to consult their state law regarding conflicts of interest of public utility commissioners.[165]

(e) Appointed Directors. Within sixty days after this Act becomes effective, the Attorney General, the Speaker of the House, the President Pro Tempore of the Senate, the majority and minority leaders of the House, and the majority and minority leaders of the Senate of this State shall each appoint one Director of the Corporation to serve until the first elected Directors are installed in office. The appointed Directors shall be installed in office by the Governor.

COMMENT: Many states have set practices regarding appointment of commissions, agencies and the like. State practice may be followed in this respect.

(f) Special Duties of Appointed Directors. The appointed Directors shall:

(1) inform the residential utility consumers of this State, by the means provided for in Sections 5(d), 8, and elsewhere in this Act,

165 See also Section 14, *infra,* Corrupt Practices and Conflicts of Interest, and Comment following.

of the existence, nature, and purposes of the Corporation, and shall encourage residential utility consumers to participate in the Corporation's activities and contribute to its operating funds;

(2) elect officers as provided in Section 11;

(3) employ such staff as the Directors deem necessary to carry out the purposes of this Act;

(4) make all necessary preparations for the first election of Directors, oversee the election campaign, and tally the votes, as provided in Section 10; and

(5) carry out all other duties and exercise all other powers accorded to the Board of Directors in this Act.

COMMENT: Specification of the duties of the appointed Directors is necessary because (1) these Directors will not have been subjected to the rigorous formal and informal processes designed to assure that elected Directors have a sense of accountability to the consumers — and indeed may conceivably be hostile to the very conception of RUCAG; and (2) it is particularly essential that the appointed Directors carry out the initial publicizing of RUCAG, as required in Section 9(f)(1), in a whole-hearted fashion. Specification of duties should encourage the appointed Directors to perform their statutory obligations in an acceptable manner.

(g) Elected Directors. One Director shall be elected, pursuant to the procedures set down in Section 10, from each District in the State. Each Director shall represent the interests of the residential utility consumers of his or her District and of the State. Each Director shall have one vote in the Board of Directors. Elected Directors shall be installed in office by the President of the outgoing Board of Directors.

COMMENT: Election of Directors from geographical districts is desirable for several reasons. (1) The interests of residential consumers living in different areas of a state may be distinct. For instance, residents of an area where a power plant is to be built may have different views as to its desirability than residents of other areas which are to receive the power it generates. A scheme of statewide at-large representation, for example, would tend to increase the difficulty of geographically based interest groups obtaining adequate representation on the RUCAG Board. (2) Election by geographical district is the most practical form of selecting

Directors. Campaign expenses for gathering petition signatures and the like will be lower than if the elections were statewide. Candidates' mailings will need to go to fewer members. (3) Members will be better acquainted with a small number of candidates from their areas than with a large number from across the state, and will be able to make more intelligent choices among them.

It is suggested that, for administrative convenience, districts for the purpose of electing RUCAG Directors be coextensive with the state senatorial districts.[166]

(h) Recall of Directors. Upon receipt by the President of the Board of Directors of a petition to recall any Director with the valid signatures of at least forty percent of the members from such Director's District, the President shall call an election for the District, to be held not less than four months and not more than six months after his or her receipt of the petition, for the purpose of electing a Director to serve out the term of the recalled Director; *provided,* that no petition to recall a Director may be filed within six months of his or her election. An election following recall shall be conducted in accordance with the provisions of Section 10. A Director may become a candidate in an election following his or her own recall. The Director recalled shall continue to serve until the installment in office of his or her successor.

COMMENT: The four-to-six month delay in calling the election is to allow candidates for the recalled Director's position time to obtain signatures for nomination and to conduct the campaign as provided in Section 10. A newly elected Director is given six months' "immunity" from recall to establish a reviewable performance record.

(i) Vacancies. When a Director dies, resigns, is disqualified, or otherwise vacates his or her office, except as provided in subsection (h) of this Section, the Board of Directors shall select within three months a successor from the same District as such Director for the remainder of the Director's term of office. Any Director may nominate any qualified person as successor. The Board of Directors shall select the successor from among those nominated, by a [two-thirds] majority

166 See Section 3(i), *supra.*

of the remaining Directors present and voting. The successor shall be installed in office by the President of the Board of Directors.

(j) Duties of Board of Directors. The Board of Directors shall have the following duties:

(1) to maintain up-to-date membership rolls, and to keep them in confidence to the extent required by the provisions of Section 8(j);

(2) to keep minutes, books, and records which shall reflect all the acts and transactions of the Board of Directors and which shall be open to examination by any member during regular business hours;

(3) to make all reports, studies, and other information compiled by the Corporation pursuant to Section 6(d) of this Act, and all data pertaining to the finances of the Corporation, available for public inspection during regular business hours;

(4) to prepare quarterly statements of the financial and substantive operations of the Corporation, and to make copies of such statements available to the general public;

(5) to cause the Corporation's books to be audited by a certified public accountant at least once each fiscal year, and to make the audit available to the general public;

(6) to prepare and mail, as soon as practicable after the close of the Corporation's fiscal year, an annual report of the Corporation's financial and substantive operations to each member and to each public library in the State;

(7) to report to the membership at the annual membership meeting on the past and projected activities and policies of the Corporation;

(8) to employ an Executive Director and to direct and supervise his or her activities; and

(9) to carry out all other duties and responsibilities imposed upon the Corporation and the Board of Directors by this Act.

(k) Meetings of the Board of Directors.

(1) The Board of Directors shall hold regular meetings at least once every three months on such dates and at such places as it may determine. Special meetings may be called by the President or by any [ ] Directors upon at least five days' notice. [ ] of the Directors shall constitute a quorum.

(2) All meetings of the Board of Directors and of its committees and subdivisions shall be open to the public. Complete minutes of

the meetings shall be kept and distributed to all public libraries in the State.

(l) Expenses. The Treasurer shall reimburse Directors for actual expenses necessarily incurred by them in the performance of their duties, and for such expenses only.

COMMENT: Section 9(l) would rule out the employment by RUCAG of its Directors to perform services on a paid basis.[167]

(m) Bonding. Directors and employees eligible to disburse funds shall be bonded. The cost of such bonds shall be paid by the Corporation.

Section 10. *Election of Directors*

(a) Time of elections.

(1) When the membership of the Corporation has reached [1,000] persons and the Corporation has received [$10,000] in contributions, the appointed Directors shall promptly fix a date for the first election of Directors. The election shall be held not less than four months and not more than six months after the membership and contributions have both reached the prescribed levels.

COMMENT: This provision is designed to allow RUCAG to organize and commence its activities and to build up a fairly broadly based membership before its first election. RUCAG should initially accumulate sufficient funds to pay for the election and begin its consumer representation activities. The appropriate requirement regarding the number of members and amount of contributions received before the first election can be held will vary with the size of the state in question; the figures for New York or California, for example, would be much higher than those suggested in the text of the Act.

The four-to-six-month delay in the election is to give candidates an adequate period to obtain signatures for nomination and to conduct the campaign as provided in this Section.

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167 See Comment following Section 5(e), *supra*.

(2) Subsequent elections of Directors shall be held at approximately yearly intervals after the first election. The dates of such elections shall be fixed not less than four months in advance by the Board of Directors.

(b) Qualifications of Candidates. To be eligible for election to the Board of Directors, a candidate must:

(1) meet the qualifications for Directors prescribed in Section 9(d) of this Act;

(2) be a resident of the District which he or she seeks to represent;

(3) have his or her nomination certified by the Board of Directors pursuant to subsection (c) of this Section;

(4) submit to the Board of Directors a statement of financial interests in accordance with subsection (d) of this Section and a statement of personal background and positions in accordance with subsection (e) of this Section; and

(5) make the affirmation prescribed in subsection (f)(3) of this Section.

(c) Nomination of Candidates.

(1) A candidate for election to the Board of Directors shall submit to the Board, not later than [sixty] days prior to the election, a petition for nomination signed by at least [five percent] of the members residing in his or her District.

COMMENT: In larger states or where the five percent requirement might impose undue obstacles to candidacy, it may be desirable to reduce the required percentage. There is a trade-off between limiting the field to candidates who are dedicated enough to engage in what could be a difficult petition campaign on the one hand, and discouraging qualified people who lack the time or the resources to undertake such a project on the other. In small states in which the signature requirement could be so easily met that the field of candidates becomes crowded, a candidate might be elected with only a small percentage of the vote. (There is no provision for a runoff election because of the expense and loss of voter interest inevitably associated with it.) In such areas it may be desirable to raise the signature requirement to ten or even fifteen percent of the membership.

(2) The Board of Directors shall verify the validity of the sig-

natures. Upon determination that a sufficient number are valid, the Board shall certify the nomination of the candidate.

(d) Statement of Financial Interests.

(1) A candidate for election to the Board of Directors shall submit to the Board, not later than [sixty] days prior to the election, a statement of financial interests upon a form approved by the Board of Directors.

(2) The statement of financial interests shall include the following information:

(A) the occupation, employer, and position at place of employment of the candidate and of his or her immediate family members;

(B) a description of all significant personal or professional transactions by the candidate and by his or her immediate family members with any public utility during the previous three years;

(C) a list of all corporate and organizational directorships or other offices, and of all fiduciary relationships, held in the past three years by the candidate and by his or her immediate family members; and

(D) an affirmation, subject to penalty of perjury, that the information contained in the statement of financial interests is true and complete.

COMMENT: The rationale underlying the financial disclosure requirements is discussed in the text.[168]

(e) Statement of Personal Background and Positions. A candidate for election to the Board of Directors shall submit to the Board, not later than [sixty] days prior to the election, a [two] page statement concerning his or her personal background and positions on issues relating to public utilities or the operations of the Corporation. The statement shall contain an affirmation, subject to penalty of perjury, that the candidate meets the qualifications prescribed for Directors in Section 9(d) of this Act and is a resident of the District which he or she seeks to represent.

COMMENT: The purpose of the Statement of Personal Background and Positions is described in the text.[169]

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168 See text accompanying notes 123 and 124, *supra*.

169 See text accompanying note 126, *supra*.

(f) Restrictions on and Reporting of Campaign Contributions and Expenditures.

(1) Each candidate may accept no more than [$50.00] in campaign contributions, as defined in Section 3(k) of this Act, from any person or political committee from one year before the date of an election through the date of the election.

(2) Each candidate shall keep complete records of all contributions to his or her campaign of five dollars or more made from one year before the date of an election through the date of the election.

(3) Each candidate may incur no more than [$_____] [_____] per member of the Corporation residing in the candidate's District as of sixty days prior to the election] in campaign expenditures, as defined in Section 3(j) of this Act, from the time he or she commences circulation of petitions for nomination or from four months prior to the election, whichever is earlier, through the date of the election.

(4) Each candidate shall keep complete records of his or her campaign expenditures, and shall make such records available for inspection during normal business hours to any member or employee of the Corporation.

(5) Each candidate, within twenty-one days after the election, shall submit an accurate statement of his or her campaign contributions accepted and campaign expenditures incurred to the Board of Directors, and shall affirm to the Board, subject to penalty of perjury, that he or she has fully complied with the requirements of subsections (f)(1) through (f)(4) of this Section.

COMMENT: The Supreme Court's decision in Buckley v. Valeo,[169a] which was handed down just before this article went to press, casts some doubt upon the constitutional validity of Section 10(f)(3) of the Model Act. The decision struck down the Federal Election Campaign Act's restrictions on expenditures in campaigns for federal offices[169b] as an impermissible burden on the freedom of expression protected by the First Amendment.[169c]

The restrictions on campaign contributions and expenditures are designed to preclude candidates with access to substantial fi-

169a 44 U.S.L.W. 4127 (U.S. Jan. 30, 1976).

169b Federal Election Campaign Act of 1971 § 608(c), Pub. L. No. 92-225, 86 Stat. 3, *as amended,* Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, 83 Stat. 1263.

169c 44 U.S.L.W. at 4143-44.

nancial resources from overwhelming those without. The amount of permitted campaign expenditures will vary with the size of the state and the number of RUCAG members. Proponents of the Act should consider the kinds of campaign they are willing to permit and estimate the likely cost of such a campaign. One possible measure would be the estimated cost of one mailing to each RUCAG member in the candidate's District, plus an allowance for costs of campaign organization. Addition of an index to compensate for inflation may also be appropriate.[170]

The maximum permissible amount for a campaign contribution may vary somewhat with the campaign expenditure limit and the type of campaign that proponents of the Act would find acceptable.[171]

(g) Election Procedures.

(1) The Board of Directors shall send or have sent by first class mail to each member, not sooner than [twenty-one] and not later than [fourteen] days before the date fixed for the election:

(A) an official ballot listing all candidates for Director from the member's District whose nominations the Board has certified and who have complied with the requirements of subsections (d) and (e) of this Section;

(B) each such candidate's statement of financial interests; and

(C) each such candidate's statement of personal background and positions.

(2) Each member may cast a vote in the election by returning his or her official ballot, properly marked, to the head office of the Corporation by [8 p.m. of] the date fixed for the election.

(3) Voting shall be by secret ballot.

(4) The Board of Directors shall tally votes with all reasonable speed and shall inform the membership promptly of the names of the candidates elected.

(5) In each District, the candidate with the most votes shall be declared elected.

COMMENT: A plurality-vote provision was decided upon because of the expense and loss of popular interest involved in the run-

170 See also the Comment following Section 3(j), *supra*.
171 See Section 3(k) and Comment following.

offs which would be required by a provision for election by majority vote.

(h) Installation of Elected Candidates. The President of the Board of Directors shall install in office within [thirty] days after the election all elected candidates who meet the qualifications prescribed in subsection (b) of this Section.

(i) Election Rules. The Board of Directors may prescribe rules for the conduct of elections and election campaigns not inconsistent with this Act.

Section 11. *Officers*

(a) Election of Officers. At the first regular meeting of the Board of Directors, at which a quorum is present, subsequent to the initial appointments of Directors and at the first regular meeting of the Board, at which a quorum is present, subsequent to the installation of new Directors following each annual election, the Board shall elect by majority vote of members present and voting from among the Directors a President, a Vice-President, a Secretary, and a Treasurer. The Board shall also have the power to elect a Comptroller and such other officers as it deems necessary.

(b) Term of Office; Removal from Office.

(1) Officers shall be installed by the President immediately upon their election. The term of office of officers shall be one year; *provided* that an officer may resign, or may be removed from office by a [two-thirds] vote of all the Directors. After an officer's term of office has expired, the officer shall continue to serve until his or her successor is installed.

(2) When an officer dies, resigns, is removed, or otherwise vacates his or her office, the Board of Directors shall elect a successor to serve out such officer's term of office.

(c) Duties and Powers of Officers. The officers shall exercise such powers and perform such duties as are prescribed by this Act or are delegated to them by the Board of Directors.

Section 12. *Executive Director*

(a) The Board of Directors shall employ an Executive Director.

(b) The Executive Director shall have the following powers and

duties, subject at all times to the directions and supervision of the Board of Directors:

(1) to decide upon the course of action of the Corporation regarding appearances before regulatory agencies, legislative bodies, and other public authorities, and regarding other activities which the Corporation has the authority to perform under Sections 5, 6, 7, and 8 of this Act;

(2) to employ and discharge employees of the Corporation;

(3) to supervise the offices, the facilities, and the work of the employees of the Corporation;

(4) to have custody of and to maintain the books, records, and membership rolls of the Corporation, in accordance with the provisions of this Act;

(5) to prepare and submit to the Board of Directors annual and quarterly statements of the financial and substantive operations of the Corporation, and financial estimates for the future operations of the Corporation;

(6) to attend and participate in meetings of the Board of Directors as a non-voting Director; and

(7) to exercise such other powers and perform such other duties as the Board of Directors delegates to him or her.

(c) The Executive Director may be discharged by [two-thirds] vote of all the Directors.

COMMENT: The relationship between the Board of Directors and the Executive Director is discussed in the text.[172]

Section 13. *Annual Membership Meeting*

(a) An annual meeting of the membership shall be held in the month of _____ on a date and at a place within the State to be determined by the Board of Directors.

(b) All members shall be eligible to attend, participate in, and vote in the annual membership meeting.

(c) The form of the annual membership meeting shall be as provided in the law of this State regarding not-for-profit membership corporations.

(d) The annual membership meeting shall be open to the public.

172 See text accompanying notes 132 and 133, *supra*, for comment.

COMMENT: The Board of Directors may find it desirable to rotate the annual membership meeting among different areas of the state, in fairness to the entire membership.

Section 14. *Corrupt Practices and Conflicts of Interest*

(a) Neither the Corporation nor its Directors, employees, or agents shall offer anything of monetary value to, or accept anything of monetary value from, any public official or official or employee of any public utility or agent thereof, except as otherwise provided in this Act.

(b) No Director shall personally or through any partner or agent render any professional service or make or perform any business contract with or for any public utility.

(c) No public official or official or employee of any public utility or agent thereof shall offer anything of monetary value to, or accept anything of monetary value from, the Corporation or its Directors, employees, or agents, except as otherwise provided in this Act.

(d) Any person who violates subsection (a), (b), or (c) of this Section shall be subject to a civil penalty of not more than [$5000], or imprisonment for a term not to exceed [five years], or both.

(c) The office of a Director found in violation of subsection (a) or (b) shall be declared vacant.

COMMENT: Proponents of the Act may wish to consult their state law regarding conflicts of interest of public utility commissioners and bring this Section into accord with its language.

A member of a law firm or accounting firm, for example, which numbers among its clients a public utility would be ineligible to become a Director under Section 9(d). Note that under subsection 14(b), such a person would also become subject to civil liability. He or she would be required to cease activity with the firm before becoming Director.

Section 15. *Construction of the Act*

(a) The provisions of this Act shall be construed in such a manner as best to enable the Corporation effectively to represent and protect

the interests of the residential utility consumers of this State.

(b) Nothing in this Act shall be construed to limit the right of any person to initiate, intervene in, or otherwise participate in any regulatory agency proceeding or court action, nor to require any petition or notification to the Corporation as a condition precedent to the exercise of such right, nor to relieve any regulatory agency or court of any obligation, or to affect its discretion, to permit intervention or participation by any person in any proceeding or action.

COMMENT: This subsection is designed to protect minorities within RUCAG as well as interests outside it.[173]

Section 16. *Severability*

If any provision of this Act shall be declared unconstitutional or invalid, the other provisions shall remain in effect notwithstanding.

Section 17. *Effective Date*

This Act shall become effective on the date of its enactment.

173 See text accompanying note 136, *supra*.

STATUTE

THE TENANT TAX ACT: EXTENDING THE FEDERAL REAL ESTATE TAX DEDUCTION TO RESIDENTIAL TENANTS

BRIAN M. FREEMAN*

In this article, Mr. Freeman notes that the issue of equal treatment for tenants and homeowners has long been a controversial one in American tax law. The author points out that one step toward that end is to permit tenants to deduct the real property taxes borne by them as undisclosed elements of their rent. This can be accomplished by state legislation, although the most recent rulings by the Internal Revenue Service eliminate the possibility of a simple solution. The Model Act proposed herein is a state statute imposing a tenant tax in place of the hidden rent charges for property taxes. Based upon an extensive analysis of the authorities, Mr. Freeman argues that this tax will qualify as a real property tax and entitle the tenant to a deduction under the federal tax code.

Introduction

The present structure of the federal income tax favors homeowners over residential tenants. The Internal Revenue Code allows an owner-occupier to deduct real estate taxes[1] and mortgage interest[2] and to exclude imputed rental income derived from his or her home in determining taxable income.[3] Tenants, on the

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1 INT. REV. CODE OF 1954, § 164.

2 INT. REV. CODE OF 1954, § 163.

3 Goode, *Imputed Rent of Owner-Occupied Dwellings Under the Income Tax*, J. FINANCE 504, 505-507 (1960).

other hand, are not allowed to deduct any of their housing costs, which typically include a share of the landlord's property tax and interest expense as part of the rent.[4] Moreover, tenants are taxed on the income from investments made in lieu of investment in homeownership.

The Model Act presented in this article is an attempt to deal with one aspect of the problem, the deduction for real estate taxes, through state legislation. The proposal calls for direct imposition of real estate taxes on tenants in a manner which will permit tax payments to be deducted under § 164(a)(1) of the Code.

I. THE POLICY DEBATE

The fundamental criticism of present law in the real estate tax deduction area is premised on the principle of horizontal income tax equity — the view that taxpayers in identical situations should be treated equally under the income tax laws.[5] At present owner-occupiers pay substantially less federal income tax than tenants whose housing consumption expenses are identical in amount.[6]

4 *See* note 7, *infra*. Commercial tenants are not similarly disadvantaged since their entire rent payment may be deducted as an ordinary business expense. INT. REV. CODE OF 1954, § 162(a)(3).

5 *See* G. BREAK & J. PECHMAN, FEDERAL TAX REFORM 4-5 (1975).

6 The following table, based upon the 1970 tax law, assumes real housing costs are 25 percent for both renter and owner and that the renter claims the standard deduction while the owner-occupier itemizes. This is intended to be an illustrative, rather than a typical, example.

	Renter	Owner
Earnings	$10,000	$10,000
Income from assets at 4%		
Assets valued at $25,000	1,000	
Assets valued at $15,000		600
Equity of $10,000 in house		400
Money income	11,000	10,600
Rent payments	2,500	
Housing expenses		2,100
Residual money income	8,500	8,500
Tax Liability	1,304	962

Aaron, *Income Taxes and Housing*, 60 AM. ECON. REV. 789, 790 (1970). A more

Recent studies tend to indicate that the bulk of the burden of real estate taxes levied on residential rental property is shifted forward to the property's tenants.[7] The impact of this shift on each tenant is substantial. Twenty to twenty-five percent of each rental payment is generally attributable to property taxes; the proportion is even higher in some jurisdictions.[8] While the real estate taxes borne by homeowners and tenants are approximately equivalent,[9] only the former are allowed to deduct them. The result, according to one analysis, is that middle income homeowners pay between 4.5 and 5 percent less of their total income in taxes than tenants in the same income class.[10]

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recent, parallel analysis computes the federal income tax liability of renter and owner at $1770.50 and $1512.00 respectively. Kee & Moan, *The Property Tax and Tenant Equality,* 89 HARV. L. REV. 531, 535 n.22 (1976).

7 The traditional view was that the landowner bore that part of the property tax allocable to the land, and the part allocable to the improvements was passed on to the tenants. *See, e.g.,* H. AARON, WHO PAYS THE PROPERTY TAX? 20-25 (1975); Musgrave, Carroll, Cook & Frane, *Distribution of Tax Payments by Income Groups: A Case Study for 1948,* 4 NAT'L TAX J. 1, 22-3 (1951); D. NETZER, ECONOMICS OF THE PROPERTY TAX 32-9 (1966).

The current view is that, while much more empirical data is needed to draw a definite conclusion, it seems that the landlords do bear more of the property tax than was previously thought. This additional burden includes a large segment of interjurisdiction tax differentials and a smaller portion of the base tax improvements. *See* Break, *The Incidence and Economic Effects of Taxation* in THE ECONOMICS OF PUBLIC FINANCE 119, 164-8 (1974); Orr, *The Incidence of Differential Property Taxes on Urban Housing,* 21 NAT'L TAX J. 253 (1968); Orr, *The Incidence of Differential Property Taxes: A Response* 23 NAT'L TAX J. 99 (1970); Richman, *The Incidence of Urban Real Estate Taxes Under Conditions of Static and Dynamic Equilibrium,* 43 LAND ECON. 172 (1967). *See also* H. AARON, WHO PAYS THE PROPERTY TAX? 38-45 (1975); Aaron, *The Property Tax: Progressive or Regressive? A New View of Incidence,* 64 AM. ECON. REV. 212 (1974); Harriss, *Property Tax in Government Finance,* TAX FOUNDATION INC. RESEARCH BULLETIN NO. 31, 33-34 (1974); Musgrave, *Is a Property Tax on Housing Regressive?* 64 AM. ECON. REV. 222, 224 (1974); Netzer, *The Incidence of the Property Tax Revisited,* 26 NAT'L TAX J. 515 (1973).

8 *See* J. KEE & T. MOAN, REPORT ON TENANT EQUALITY ACT, PREPARED FOR THE NEW YORK TEMPORARY STATE COMMISSION ON LIVING COSTS AND THE ECONOMY 3 (December 10, 1973) (a copy of this report is filed with the *Harvard Journal on Legislation*); D. NETZER, ECONOMICS AND URBAN PROBLEMS 130-1 (1970); D. NETZER, IMPACT OF THE PROPERTY TAX: ITS ECONOMIC IMPLICATIONS FOR URBAN PROBLEMS, supplied by the Nat'l Comm. on Urban Problems to the Joint Economic Comm., [hereinafter cited as NETZER, IMPACT OF THE PROPERTY TAX]. 90th Cong., 2d Sess. 16-18 (1968). *See also Hearings on Tax Reform Before the House Comm. on Ways and Means,* 93d Cong., 1st Sess. 3245, 3258 (1973) (Statement of R. Ross indicating that 18-25% of rental income goes to pay property taxes).

9 *See* NETZER, IMPACT OF THE PROPERTY TAX 17, *supra* note 8.

10 Total income equals adjusted gross income plus excluded dividends, excluded sick pay, and imputed rent. Aaron's 1966 data indicate that homeowners in the

This differential treatment has broad social implications. It tends to discriminate against central city residents,[11] who are more likely to be members of low-income and minority groups.[12] It favors suburban and rural residents, who tend to be older, to have more stable employment, and to be more financially secure.[13]

Defenders of the status quo contend that the differential tax treatment is justified by the capital risk taken by the homeowner in investing in his or her dwelling. But similarly favorable treatment is not accorded to taxpayers in general who take capital risks on other investments. And the extent of the risk taken is substantially limited by insurance and by the catastrophic loss provisions of the Code[14] as well as by the generally prevalent appreciation in housing values.[15]

Perhaps the most significant factor distinguishing the owner-occupier from the tenant is that it is the homeowner and not the tenant who formally pays the property tax and incurs other deductible housing expenses. For reasons of administrative convenience as well as of policy, the tax law seldom imputes income or expenses. It may be argued that any resultant horizontal inequity is a reasonable price to pay for avoiding the practical problems of imputation. Any general taxing statute which must deal with a wide variety of individual situations will produce inequities which should be tolerated at reasonable levels. But the argument of administrative convenience is not totally convincing.

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three classes between $7,000 and $25,000 annual total income paid 8.2, 9.9 and 12.2 percent of their total income in federal taxes, respectively. Disallowing the deductions for mortgage interest and property taxes increases the average tax per family for these classes 0.8, 0.9, and 1.1 percent, a change of 9.8, 9, and 9 percent, respectively. Aaron, *Income Taxes and Housing*, 60 AM. ECON. REV. 789, 792-3 (1970). the Whites indicate that the impacts of the mortgage interest deduction and the property tax deduction are approximately equal; hence the above figures are divided in half. White & White, *Horizontal Inequality in the Federal Income Tax Treatment of Homeowners and Tenants*, 18 NAT'L TAX J. 225, 232-35 (1965).

11 *See generally* D. NETZER, ECONOMICS OF THE PROPERTY TAX (1966). *See also* STATISTICAL ABSTRACT OF THE U.S. 1975 at 720, Table 1229.

12 *Cf.* Kain & Quigley, *Housing Market Discrimination, Home Ownership, and Savings Behavior*, 62 AM. ECON. REV. 263, 273 (1972); KEE & MOAN, *supra* note 8 at 5.

13 *Cf.* Goode, *Imputed Rent of Owner-Occupied Dwelling Under the Income Tax*, 15 J. FINANCE 504, 507 (1960).

14 INT. REV. CODE OF 1954 § 165(c)(3).

15 *See* STATISTICAL ABSTRACT OF THE U.S. 1975 at 720 (Table 1230 indicates that the median value of an owner-occupied unit rose from $11,900 in 1960 to $24,600 in 1974).

The discrimination here is significant enough to justify an attempt at greater equality.[16]

Supporters of the existing favorable treatment for owner-occupiers see it as an encouragement to homeownership. Such a policy is thought to promote greater social stability, a heightened interest in community life among residents, and a stronger economy.[17] Critics respond that these attributes do not derive from homeownership in itself so much as from other factors such as adequate income levels.[18]

Moreover, even if these results were conceded to stem from homeownership, the current tax treatment is a poor tool for its encouragement. The degree to which it tilts the own-or-rent decision toward ownership is uncertain and perhaps incapable of empirical demonstration. Except in the cooperative-condominium market the effect is likely to be marginal.[19] The decision is probably more significantly affected by many non-tax factors such as the availability of mortgage financing, mortgage interest rates, inflation and appreciation, length of anticipated residence, tolerance of risk, and living style preference.[20] A national purpose to encourage ownership would be better served by other means, *e.g.* a direct subsidy to the lower income classes who need larger inducements to ownership and are more likely to react to them.[21] The income tax itself could be redesigned to provide greater tax incentives for homeownership to lower income taxpayers through the grant of credits or diminishing deductions.[22]

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16 In 1970, 67 percent of all housing in the U.S. was owner-occupied and 37 percent was renter-occupied. STATISTICAL ABSTRACT OF THE U.S. 1974 at 700.

17 *Compare* Aaron, *Income Taxes and Housing*, 60 AM. ECON. REV. 789, 803 n.33 (1970) *with* J. ROTHENBERG, ECONOMIC EVALUATION OF URBAN RENEWAL (1967) *and* A. SCHORR, SLUMS AND SOCIAL INSECURITY (1963).

18 *Cf.* Aaron, *Income Taxes and Housing*, 60 AM. ECON. REV. 789, 803 n.33 (1970).

19 *See* NETZER, ECONOMICS AND URBAN PROBLEMS 142 (2d ed. 1974).

20 Goode, *Imputed Rent of Owner-Occupied Dwellings Under the Income Tax*, 5 J. FINANCE 504, 515-18 (1960); McDonald, *Housing Market Discrimination, Homeownership and Savings Behavior: Comment*, 64 AM. ECON. REV. 225 (1974).

21 *Cf.* A COMPENDIUM OF PAPERS SUBMITTED TO THE JOINT ECON. COMM. 92d Cong., 2d Sess., THE ECONOMICS OF FEDERAL SUBSIDY PROGRAMS, pt. 5 — Housing Subsidies (1972).

22 Under the progressive rate structure, a $100 deduction is worth $70 to a taxpayer in the 70 percent bracket but only $30 to one in the 30 percent bracket. In contrast, a tax credit reduces the tax bill of each an equal amount. *Cf.* H.R. 1040, 93d Cong., 1st Sess. § 302 (1973); Emory, *The Corman and Mills-Mansfield Bills: A Look at Some Major Tax Reform Issues*, 29 TAX L. REV. 3, 35-37 (1973). *See gen-*

Finally, the basic assumption of the present policy deserves closer scrutiny. Even if the benefits of encouraging homeownership were once clear, they may no longer be so. The national concerns of suburban sprawl, urban decay and environmental deterioration as well as the crises in energy and transportation may demand a policy more attuned to the needs of central city inhabitants: a policy favoring residential tenants.

II. The Alternatives

Either Congress or the states can act to change the status quo. Federal action to equalize the tax treatment of tenants and homeowners could follow any of three avenues: (1) imputation of rent to owner-occupiers; (2) elimination of deductions for mortgage interest and property tax payments; or (3) a deduction pass-through, *i.e.* an allowance to tenants of a deduction for all rent or for that portion deemed attributable to housing expenses deducted by landlords. Each of these is subject to a number of practical and policy-based objections which, in the existing political environment, make congressional enactment unlikely in the foreseeable future.

Imputation of gross rental income to owner-occupiers poses severe problems of administration. Uniformity and fairness between jurisdictions would be almost impossible to attain short of a complete federal takeover of local real estate assessment. Moreover, the principle of imputation has never found favor in the American tax system. On several early occasions, Congress considered and rejected proposals to tax the rental value of owner-occupied housing,[23] and a body of case law has developed impos-

erally R. Freeman, *Tax Relief for the Homeowner?* 26 Nat'l Tax J. 485, 488 (1973); Maxwell, *Income Tax Discrimination Against the Renter,* 26 Nat'l Tax J. 491, 496-497 (1973).

23 The Commissioner of Internal Revenue claimed that the law would be fairer if owner-occupiers were taxed on the rental values of their homes. Report of the Commissioner of Internal Revenue for the Year Ending June 30, 1864, H.R. Exec. Doc. vol. 7, No. 3, 38th Cong., 2d Sess. 66 (1864); E. Seligman, The Income Tax 439, 448-9 (2d ed. 1914); H. Smith, The United States Federal Internal Tax History, 1861-1871 at 58 (1914). The administrative practice of not imputing rental value to owners began before 1865. C. Emerson, Internal Revenue Guide 50 (1865). The practice was continued after the Income Tax Law of 1894. E. Seligman, The Income Tax 511-12 (2d ed. 1914).

ing a strong presumption against imputation in the absence of a business transaction.[24] Finally, the political cost of imposing an estimated additional $4.02 billion in taxes on homeowners[25] is, doubtless, obvious to every member of Congress.

Congressional action to end the owner-occupier deductions would add an estimated $6.75 billion to the tax liability of homeowners.[26] The political unpopularity of such action would be accompanied by serious policy objections as well. The traditional view in this country has been that income tax should be assessed only on net income.[27] The deduction for real estate taxes reflects the belief that amounts paid in taxes are not appropriately included in income, and it appeals to an intuitive sense of fairness by not taxing a homeowner on income which is not available to pay the tax.[28] Termination of the real estate tax deduction for homeowners would itself seem unfair if the deduction were retained for business property and all other taxes remained deductible.

The deduction for mortgage interest is likewise viewed as

In 1864 a proposal to tax imputed rental value was debated in the Senate but not enacted. One reason for rejection was that such a measure would discriminate against city dwellers and in favor of farm owners, because rental value was much higher in the city. *Cong. Globe,* 38th Cong., 1st Sess. 2517 (1864). *See* H. SMITH, THE UNITED STATES FEDERAL INTERNAL TAX HISTORY, 1861-1871 at 62 (1914).

24 Brushaber v. Union Pac. R.R., 240 U.S. 1 (1916) (argument that there was a bias between ownership and rental termed "minute and hypercritical" by the Court); Helvering v. Independent Life Insurance Co., 292 U.S. 371 (1934); Crystal Lake Cemetery Ass'n v. United States, 413 F.2d 617 (8th Cir. 1969); Neil F. McCabe, 54 T.C. 1745, 1748 (1970); Penn Mutual Indemnity Co., 32 T.C. 653, 702 (1959); Harper v. Granger, 99 F. Supp. 216 (W.D. Pa. 1951).

25 Aaron, *Income Taxes and Housing,* 60 AM. ECON. REV. 789, 794 (1970).

26 In 1972, the federal revenue loss from property tax deductions for homeowners came to $3.25 billion; the loss from mortgage interest deductions came to $3.5 billion. STAFFS OF THE TREASURY DEPT. AND JOINT COMM. ON INTERNAL REVENUE TAXATION, 93D CONG., 1ST SESS., ESTIMATES OF FEDERAL TAX EXPENDITURES 4 (Comm. Print 1973).

27 C. ELDRIDGE, THE UNITED STATES INTERNAL REVENUE TAX SYSTEM (1895); R. PAUL, TAXATION IN THE UNITED STATES (1954); E. SELIGMAN, THE INCOME TAX (2d ed. 1914); H. SMITH, THE UNITED STATES FEDERAL INTERNAL REVENUE TAX HISTORY, 1861-1871 (1914).

28 *See generally* Andrews, *Personal Deductions in an Ideal Income Tax,* 86 HARV. L. REV. 309 (1972). In arguing that the personal income tax should relate the tax burdens to a taxpayer's aggregate personal consumption and accumulation, Professor Andrews urges that both the interest and state and local real estate and other tax deductions are justifiable because funds so spent are not available for consumption. *Id.* at 376. Thus, he concludes that they are no different when related to personal endeavors than when related to business endeavors. *Id.* at 382.

necessary if a tax on only net income is to result.[29] Additionally, it has been urged that the deduction reflects a real difference in income between the owner-occupier with a mortgage and one without.[30]

Although certain practical problems exist, extension of homeowner deductions to tenants appears to generate the fewest principled objections of the three reform schemes. The potential federal revenue loss from allowing tenants to deduct real estate taxes has been estimated to be between $1.6 and $2.2 billion, although the actual figure is likely to be at the lower end of this range.[31] From a policy standpoint, allowing tenants an interest deduction is questionable because of its potential to skew the rental market. Unless a standard portion of the tenant's rent were made deductible without regard to the interest actually paid by the landlord, tenants would prefer to rent more highly mortgaged buildings to take advantage of larger interest deductions. The largest administrative problem would be that of determining the portion of the tenant's rent which is properly deductible. Allowing a total rent deduction would generate its own inequity,[32] but a simple formula or arbitrary percentage could be adopted which would operate fairly in the majority of cases.[33]

Enactment of any of these alternatives is unlikely because they run squarely against the prevailing political winds in Congress. A proposal to reduce tenant taxes will be opposed for its effect in

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29 C. ELDRIDGE, THE UNITED STATES INTERNAL REVENUE TAX SYSTEM (1895); R. PAUL, TAXATION IN THE UNITED STATES (1954); E. SELIGMAN, THE INCOME TAX (2d ed. 1914); H. SMITH, THE UNITED STATES FEDERAL INTERNAL REVENUE TAX HISTORY, 1861-1871 (1914).

30 Andrews, *Personal Deductions in an Ideal Income Tax,* 86 HARV. L. REV. 309, 376 n.116 (1972).

31 The high figure assumes full itemization of deductions by all tenants. The lower figure results from the more realistic assumption that lower income tenants will use the standard deduction. P. Gabel, Untitled, unpublished paper (1975) (on file with the *Harvard Journal on Legislation).* (The figures are derived from the 1970 Census of Housing). *See also* KEE & MOAN, *supra* note 8, at 3.

32 A total rent deduction would permit tenants to deduct changes for obsolescence, repairs, insurance, and other expenses passed on to them in rent but for which owner-occupiers are allowed no deductions.

33 Proposed legislation has adopted this approach. H.R. 19024, 90th Cong., 2d Sess. (1968). The formula or percentage could serve in the absence of proof of higher actual amounts. This may now be done on tax returns, for sales and gasoline tax deduction. Instructions for Schedule A, Form 1040, 1975; INT. REV. CODE OF 1954 § 164(a).

decreasing federal revenues. Generally speaking, any measure to increase homeowners' taxes will meet the opposition of the building industry, construction trades unions, and homeowners themselves. Tenants, however, are unlikely to be capable of mobilizing effective political pressure, because of their transient nature.[34]

Evidence of a pro-homeowner bias in Congress is abundant. Recent federal legislation which encourages owner-occupancy while also stimulating or subsidizing the politically powerful housing industry include: the 1975 income tax credit on the purchase of new homes;[35] extension of owner-occupier benefits to condominium and cooperative owners;[36] nonrecognition of gain on the sale of a home if the proceeds are reinvested in a new residence and capital gains treatment when not so invested;[37] and exclusion of the home mortgage interest deduction from computations of minimum tax and maximum interest limitations.[38] This bias has effectively blocked all efforts to equalize the tax treatment of tenants and homeowners. No major tax reform measure has squarely addressed this issue although its existence has been acknowledged in several important discussions.[39] Many minor bills have been introduced by congressmen from New York and other urban areas seeking to rectify the situation, but all have died in committee.[40] Barring the emergence of a powerful pro-tenant lobby, a federal solution is unlikely in the extreme.

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34 In 1970, 9,882,680 heads of households who rented their residences moved to a different residence. BUREAU OF THE CENSUS, U.S. DEPT. OF COMMERCE, 1970 CENSUS OF POPULATION: MOBILITY FOR STATES AND THE NATION PC (2)-2B 181 (Table 20) (1973).

35 INT. REV. CODE OF 1954 § 44.

36 *Id.* § 216.

37 *Id.* § 1034.

38 *Id.* §§ 57, 163(d).

39 PANEL DISCUSSION ON GENERAL TAX REFORM BEFORE THE HOUSE COMM. ON WAYS AND MEANS, 93d Cong., 1st Sess. Part I (1973); H. AARON, WHO PAYS THE PROPERTY TAX? (1975); Goode, *Imputed Rent of Owner-Occupied Dwellings Under the Income Tax,* 15 J. OF FINANCE 504 (1960); Orr, *The Incidence of Differential Property Taxes on Urban Housing,* 21 NAT'L. TAX J. 253 (1968); Kee & Moan, *The Property Tax and Tenant Equality,* 89 HARV. L. REV. 531 (1976).

40 The first effort was made by Rep. D. Rostenkowski (D.-Ill.) in H.R. 19024. He proposed granting a deduction of 30% of rent paid by tenants for their principle residence up to a maximum deduction of $1,000.

Several minor bills were introduced in 1969 in the 91st Congress, by congressmen from New York. H.R. 8318, proposed by Rep. Rostenkowski, and H.R. 9959 by Rep. C. Pepper (D.-Fla.) would allow the tenant to deduct a fixed percentage of his rent. H.R. 10815, introduced by Rep. S. Halpern (R.-N.Y.), would have passed

While only a change in the federal tax law can impute rental income to homeowners or end the homeowners' deductions, state legislation can be designed to extend those deductions to tenants for that portion of their landlords' deductible housing costs which the tenants bear.[41] The alternative of state legislative action seems promising. In some states, and especially in some local jurisdictions, tenants constitute a large and politically significant class which may possess the power to obtain remedial legislation. In addition, a state may find that it increases its tax revenue by adopting an equalization measure which increases the after-tax income of its citizens since additional consumption augments the

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through to tenants a deduction for their proportionate shares of amounts actually expended by their landlords for real estate taxes and mortgage interest, with allocations made pursuant to regulation.

Five minor proposals were introduced in 1971 during the first session of the 92nd Congress. All appear to have had much broader sponsorship than prior or subsequent individual proposals. All would have allowed residential tenants a deduction for a proportionate share of real estate taxes and interest paid by their landlords, pursuant to regulations to be given by the taxing authorities. H.R. 842; H.R. 10990; H.R. 7484; H.R. 6388; H.R. 4983, 92d Cong., 1st Sess. (1971).

Twelve bills were introduced in the House during the second session of the 92nd Congress which would have produced equity by granting the tenant a deduction or credit. Three other bills would have eliminated the mortgage interest deduction. H.R. 14162; H.R. 14351; H.R. 14375. H.R. 15378 and H.R. 16401 suggested the deduction of a specified portion of rent paid.

Rep. E. Celler (D.-N.Y.) introduced a new proposal that would provide a $750 additional exemption for those who rent their principal residence. H.R. 14887. He also introduced a separate proposal allowing such an exemption for renters, and a tax credit to owners for real estate taxes and mortgage interest paid. H.R. 15351.

Rep. J. Addabbo (D.-N.Y.) suggested a tax credit, not in excess of $300, to all taxpayers of that portion of rent attributable to taxes paid by owner-occupiers. H.R. 15189. A refundable credit concept was also suggested by Rep. C. Thone (R.-Neb.). H.R. 16917.

In 1973, during the first session of the 93rd Congress, sixteen minor proposals were offered. Fifteen repeated prior proposals. These included: H.R. 702; H.R. 5186; H.R. 6082; H.R. 6198; H.R. 6403; H.R. 6598; H.R. 6970; H.R. 2082; H.R. 2750; H.R. 2498; H.R. 3526; H.R. 6737. These all proposed deductions for tenants. Rep. Addabbo reintroduced his bill proposing a tax credit for a portion of rental payments. He revised it, however, to provide a credit to residential tenants in an amount equal to the lesser of $300 or 25% of rent paid, less charges for utilities, furnishings, and appliances. H.R. 2642, 93d Cong., 1st Sess. (1973).

No broad reform proposals, and none relevant to the tenant-owner equity issue, were introduced during the second session of the 93rd Congress. Remarks were made, however, regarding tax credit for a portion of residential rental payments. 119 *Cong. Rec.* H 3077 (daily ed. Apr. 23, 1974).

Seven bills were introduced during the first session of the 94th Congress. H.R. 578; H.R. 856; H.R. 2487; H.R. 3069; H.R. 2013; H.R. 4116; H.R. 4411.

41 See Tenant Tax Act *infra*.

yield of sales and excise taxes, and this may more than offset any decline in state income tax revenues. The more favorable climate for tenant-oriented legislation at the state level is evidenced by recent state and local tax law reforms allowing deductions or credits for rent and property taxes actually or effectively paid.[42] Two states, California and Hawaii, have enacted legislation which has been held to permit certain tenants to deduct real estate taxes borne by them in computing their federal income tax.[43]

State legislation in this area may have undesirable consequences. The likely effects of such efforts include a decrease in value for owner-occupied real estate as rental alternatives become more attractive; revenue losses under state and local income tax laws which "piggyback" the federal;[44] and potentially large administrative burdens. A more fundamental issue is the propriety of state action which significantly affects the federal purse. A pass-through of the real estate tax deduction could cut federal income tax revenues by between $1.6 and $2.2 billion.[45] Although this amounts to less than two percent of 1974 federal tax revenues,[46] the impact may not be ignored. In the past, Congress has reacted in various ways to state attempts to lighten citizens' federal income tax burdens by, for example, legislation on community property laws, industrial revenue bonds, and local benefit property taxes.[47]

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42 *See* CAL. ANN. CODE § 17053.5 (1975 Pocket Part) (rent credit from $25 to $45 varying with adjusted gross income, enacted 1972); Col. Sess. Laws § 138-1-20 (1974) (tax credit for 20% of rent paid); MICH. COMP. LAWS ANN. § 206.520 (1975 Pocket Part) (credit for real estate taxes, amounting to 17% of gross rent paid, enacted 1973); MINN. STAT. ANN. § 290.981-83 (1975 Pocket Part) (credit of 10% of rent, with a maximum of $120, enacted 1973).

43 California law specifies that "owner" includes members or shareholders in a cooperative housing corporation, whose share or membership includes the right to exclusive occupancy. The exemption amounts to $1750 at the assessed value at the building for fiscal year 1973-74 and thereafter. The exemption is deducted from the total assessed value at the cooperative housing corporation, and apportioned among members. ANN. CAL. CODES, REVENUE AND TAXATION, § 218 (West 1975).

Hawaii law provides that $8,000 of the value of a cooperative apartment housing unit shall be tax exempt. HAWAII REV. STAT. § 246-27 (1975). See discussion in text at note 140 *infra*.

44 Some states use net federal taxable income as the basis for their own income tax thereby incorporating all federal tax deductions.

45 *See* note 31 *supra*.

46 NEWSPAPER ENTERPRISE ASSOC., INC., THE WORLD ALMANAC AND BOOK OF FACTS 84-5 (1975). Net federal budget receipts for 1974 were $264,847,484,000.

47 INT. REV. CODE OF 1954, §§ 6013, 103(c), 164(c)(1).

Finally, the ultimate impact of a deduction pass-through must be evaluated. Although it would be enacted on behalf of all tenants, the common use of the standard deduction by lower income taxpayers means that the pass-through will most benefit those tenants who have relatively more income.[48]

For a state which wishes to enact a deduction pass-through, three possibilities exist. The first is an interest deduction; its difficulties have already been discussed in the federal context.[49] A further disadvantage of this alternative is that interest is deductible only if it is on indebtedness of the taxpayer.[50] It may be very difficult for a tenant to deduct interest actually paid by the landlord. It would be theoretically possible to design legislation and standard lease and loan provisions which would make tenants parties to the mortgage loans and would obligate them to pay an allocable portion of the interest due. However, such a radical departure from existing mortgage loan procedures seems certain to be expensively and badly administered.

The second possibility, a deduction for personal property taxes,[51] is likewise restricted in application. The basic difficulty is that, to be deductible, the tax must be based on the value of personal property.[52] Some personal property related to the tenancy would have to be designated as the taxed object, such as the leasehold itself or the tenant's occupancy rights. Determination of the value of such property poses difficult problems. As a result of rent control, favorable or unfavorable lease terms or the like, the market value would not always be a proportionate share of the value of the landlords' entire property and would not, therefore, relate directly to the tax burden borne by the tenant through the rent. Accordingly, direct valuation of each leasehold would be required and the basic property tax assessment could not be resorted to as a reference point. While these problems might be avoided by a valuation scheme like that put forward in the Model Act,[53] others

48 *See* McKINSEY & Co., SHARING THE BENEFITS FROM TAXING THE REAL PROPERTY TAX PORTION OF RENT DEDUCTIBLE BY TENANTS, REPORT TO THE CITY OF NEW YORK (1973) (copy on file with the *Harvard Journal on Legislation*).

49 See text following note 31 *supra*.

50 *See* Treas. Reg. § 1.163-1(a) (1957).

51 INT. REV. CODE OF 1954 § 164(a)(2).

52 Treas. Reg. § 1.164-3(c) (1957).

53 See Tenant Tax Act § 201 *infra*.

remain. Coordination with the property tax and with other areas of state law could not be assured in any meaningful way. The conceptual confusions of such a system and the size of the bureaucracy necessary to implement it would far surpass in cost and inefficiency the moderate gains to be expected.

The final alternative, a real estate tax deduction, promises to be both effective and efficient. Its potential benefits to tenants are substantial. It would be both simple and inexpensive to administer. It is this scheme which is embodied in the Model Act presented herein.

III. Code Requirements for a Real Estate Tax Deduction

A. *In General*

Section 164 of the Internal Revenue Code of 1954 allows a deduction for real property taxes paid at the state and local levels.[54] Any state or local legislation which purports to create a real estate tax subject to deduction by residential tenants must be harmonized with the statutory and case-law requirements of this provision.

Construction of the statutory language has proved to be problematic because there is no definition of the key term "real property taxes" in § 164(b). The only clue to the proper interpretation of this language found in the text itself must be drawn by implication from the exclusion of "[t]axes assessed against local benefits. . . ." in § 164(c)(1).[55] The clear intent here is to prevent deduc-

54 Int. Rev. Code of 1954, § 164(a) General Rule. — Except as otherwise provided in this section, the following shall be allowed as a deduction for the taxable year within which paid or accrued:
(1) state and local, and foreign, real property taxes.

55 *Id.* § 164(c) provides:

> Deduction Denied in Case of Certain Taxes. — No deduction shall be allowed for the following taxes:
> (1) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not prevent the deduction of so much of such taxes as is properly allocable to maintenance or interest charges.
> . . .

Formerly, an exception was made for local improvement taxes levied by a special taxing district covering at least one county which encompasses 1,000 persons or more and levied annually at a uniform rate on the same assessed value used for

tion of local assessments for capital expenditures which directly benefit the taxpayer's property. Beyond this, however, there is no indication of the scope of the deduction or of the necessary relationship between the taxpayer and the assessed property.

The legislative history also fails to shed light on the proper statutory interpretation. The specific deduction allowed in § 164 (a)(1) for real estate taxes was added to the Internal Revenue Code by a 1964 amendment.[56] Previously, deductions were permitted for all taxes with only specified exceptions.[57] The House Committee which considered the amendment added little substance to the Code language "real property taxes." In its report, the Committee simply defined the phrase as "taxes imposed on interests in real property," and expressed the intent that taxes deductible under prior law as real property taxes remain deductible and that taxes not thus deductible not be made so.[58]

Accordingly, it is necessary to turn to the Regulations, Revenue Rulings, and the case law to determine the scope of allowable deductions under § 164. From these sources, four requirements for deductibility are discernible: (1) the levy must be a tax; (2) the tax must be on an interest in real property; (3) the tax must be imposed on the taxpayer; and (4) payment must be made to the taxing jurisdiction.

1. The Levy Must Be a Tax

For an exaction to be a real property tax, rather than an assessment or fee for a particular privilege or benefits accruing to the property, the levy must be intended as a means of raising revenue for carrying on general governmental functions, "with the distinction frequently rest[ing] upon nuances of local law."[59]

the real property tax. Act of Aug. 16, 1954, 68A Stat. 47 (now INT. REV. CODE OF 1954, § 164(c)(1)). The exception was eliminated in 1964 (Act of Feb. 26, 1964, Pub. L. No. 88-272, § 207(a), 78 Stat. 40) because it was of "quite limited application" and "no longer desirable." H.R. REP. No. 749, 88th Cong., 1st Sess. (1963) in INTERNAL REVENUE ACTS BEGINNING 1961, at 1321; S. REP. No. 830, 88th Cong., 2d Sess. (1964), *id.* at 1691.

56 Act of Feb. 26, 1964, Pub. L. No. 88-272, § 207(a), 78 Stat. 40.

57 Act of Aug. 16, 1954, 68A Stat. 47 now INT. REV. CODE OF 1954, § 164(a) *(e.g.* federal income and social security taxes, estate and gift taxes).

58 H.R. Rep. No. 749, 88th Cong., 1st Sess. (1963) in INTERNAL REVENUE ACTS BEGINNING 1961, at 1319.

59 Aaron Dubitsky, 60 T.C. 29, 34 (1973); *see also* United Gas Improvement Co., 25 B.T.A. 1382 (1932) and Holeproof Hosiery Co., 11 B.T.A. 547, 554 (1928).

Clearly, not every charge levied by a sovereign government constitutes a property tax, even if levied directly on real estate. Some, such as special assessments, are fees for services provided to the property.[60] The Regulations carry this distinction one step further by expressly limiting deductions to taxes "levied for the general welfare" and excluding those "assessed against local benefits."[61] The limitations developed in the Regulations therefore lead to the following rules of thumb: a levy is deductible as a "real property tax" if it is (a) assessed against real property, (b) levied for the general public welfare, (c) levied by the proper taxing authorities, and (d) imposed at a like rate against all property within the relevant jurisdiction.[62]

2. The Tax Must Be on an Interest in Real Property

A property tax is an ad valorem assessment on the basis of the value of the thing or article to be taxed. It must be distinguished from an excise or user tax which is any charge on the performance of an act, enjoyment of a privilege, or engagement in an occupation, which is not also a poll or property tax. A major difference between the two is that one is a direct assessment while the other is an indirect levy. A further distinction concerns the methods adopted for levying the two types of taxes and fixing their amounts:

> If a tax is imposed directly by the Legislature without assessment, and its sum is measured by the amount of business done, income previously received, or by the extent to which a taxable privilege may have been enjoyed or exercised by the taxpayer, irrespective of the nature or value of such taxpayer's assets or his investments in business, it is to be regarded as an excise tax. But, if the tax is computed upon the valuation of the property, and assessed by assessors, either where it is situated or at the owner's domicile, although priv-

60 Special assessments are levies against real property to defray all or part of the costs of special public improvements which are assumed to increase property values. Common examples are street paving, sidewalk, or sewer placement. See generally TAX FOUNDATION, INC., SPECIAL ASSESSMENTS AND SERVICE CHARGES IN MUNICIPAL FINANCE 6-17, 19-20 (1970).

61 Treas. Reg. § 1.164-4(a) (1964).

62 Treas. Reg. § 1.164-4(a) (1964). Certain other payments, in lieu of taxes, are also deductible if the funds generated are used for governmental purposes. Rev. Rul. 71-49, 1971-1 CUM. BULL. 103 ("tax equivalency payments" made by cooperative housing projects to the New York City Education Construction Fund).

> ileges may be included in the valuation, it is considered a property tax. . . .[63]

The meager and relatively recent authorities in this area indicate that, for a property tax to be deductible under § 164(a)(1), it must be an ad valorem assessment directed against the *underlying property and based upon the value of all interests in it.* The subject of the tax may be either the underlying land or the buildings on it, or both. If the land and buildings are separately owned, taxes attributable to each may be deducted by the relevant owner.[64] Taxes determined by reference to leasehold values and leases, or as personal charges against tenants, however, are considered excise taxes and so are not deductible.[65] Thus, a tenant's leasehold interest does not by itself provide him or her with the required interest in real property upon which he can claim a deduction, even if under the prevailing local law it gives him *an interest* in property.

While it may make little sense in economic terms to separate the use value from the property value of residential property,[66] this distinction has proved to be determinative in practice. For example, in Revenue Ruling 73-600,[67] the IRS in 1973 disallowed a tax deduction to a U.S. taxpayer temporarily residing in England and subject to a "rates" tax. The English "rates" tax is imposed

63 City of Deland v. Florida Public Service Co., 161 So. 735, 738 (Fla. 1935). *Accord,* Callaway v. City of Overland Park, 508 P.2d 902, 907 (Kan. 1973).

64 *Cf.* Rev. Rul. 62-178, 1962-2 CUM. BULL. 91, which held that a cooperative housing corporation which leased land and built an apartment building thereon at its own expense may deduct real estate taxes it pays or incurs with respect to the building pursuant to the terms of the ground lease, even though legal title to the building is vested in the lessor of the land. The tenant-stockholders of the cooperative may deduct amounts which they pay to the corporation representing their proportionate shares of such taxes, provided they do not elect to use the standard deduction or the optional tax table.

65 Rev. Rul. 75-558, 1975 INT. REV. BULL. No. 52, at 17 (no deduction for county "renters tax" imposed as two percent surcharge on rent paid). Since most state laws assess the tax against the landlord, tenants do not qualify for property tax deductions even where the incidence of the property tax falls by contract on the tenant. *See, e.g.,* Caroline T. Kissel, 15 B.T.A. 1270, 1273-74 (1929).

66 The distinction for leasehold taxes is, arguably, forced and unrealistic. The value of real property is in its use. Where rented, that use is best evidenced by the rental value or other fair market value of the leasehold. Leasehold values are the principal basis upon which local assessments of rental property are usually made. This is especially true for long-term leases. *See* Treas. Reg. § 1.1031(a)-1(c) (1967); Estate of Margaret Thaw Carnegie De Perigny, 9 T.C. 782, 784-86 (1947), *non-acquiescence in,* 1948-2, CUM. BULL. 5, *petition for rev. dismissed,* 3d Cir., 1949. *See also,* McClaughry, *A Model State Land Trust Act,* 12 HARV. J. LEGIS. 563 (1975).

67 1973-2 CUM. BULL. 47.

on the "occupier" of lands, houses, and certain other property or against the owner if the property is temporarily unoccupied and the property has been held for such use. Unlike the American property tax, the "rates" tax is not imposed upon or assessed against the property itself.

While somewhat cryptic and capable of conflicting interpretations, the Commissioner's analysis correctly concluded against deductibility. After discussing the tax itself and finding the presence of mere personal liability and the absence of direct liability and foreclosability of the property, the Commissioner held that:

> [T]he "rates" tax is not a tax on or against real property or on interests in real property within the scope of Section 164 (a)(1) of the Code or the regulations thereunder, but rather a tax on the occupation or use of real property, computed on the basis of the presumed rental value thereof, and for which there is only personal liability.
>
> Accordingly, the taxpayer . . . may not deduct the United Kingdom "rates" tax as a foreign real property tax under Section 164(a)(1) of the Code.[68]

The Tax Court in a recent and analogous opinion, *Maynard Waxenberg*,[69] came to a similar result under § 164(a)(1) on the issue of the English "rates" tax. Noting that the litigants could cite no relevant authorities and that none were found on the identical question in the Revenue Ruling, the court stated that "[t]here is no legislative history to shed any light on what Congress intended by the term real property tax."[70] For further guidance, the court directed its inquiry to the case law which evolved in determining whether taxes were direct taxes or excises under the Constitution.[71] It found the key factor to be whether the tax was on the property or on only *some* incidents of ownership:

> The distinction drawn between a tax imposed upon the

68 *Id.* at 48-49. The ruling distinguishes previous rulings which permitted tenants to deduct real property taxes:

> Rev. Rul. 64-327, 1964-2 C.B. 56, and Rev. Rul. 68-84, 1968-1 C.B. 71, . . . , are distinguishable from the instant case in that they involve the question of on *whom* the real property taxes therein are imposed for purposes of determining *who* may deduct such taxes . . . , while the instant case involves *whether* the United Kingdom "rates" tax is a real property tax under section 164(a)(1). *Id.* at 49.

69 62 T.C. 594 (1974), *cert. for appeal to 9th Cir.*

70 *Id.* at 601.

71 U.S. CONST. art. I, § 8.

> property (a property tax) and a tax imposed upon some, but not all, of the incidents of ownership of property (an excise) leads us to the conclusion that a tax imposed upon the occupancy of real property is an excise rather than a property tax because occupancy is only one of the incidents of ownership and full ownership is required for the tax to be classified as a property tax. This conforms to the reasoning of the Supreme Court . . . that the privilege of transferring property by gift is but one of the incidents of ownership and a tax on such privilege is an excise not a property tax.[72]

In emphasizing that the English "rates" tax looked to rental value rather than property value, the Tax Court turned to state law decisions distinguishing the assessment of property and excise taxes.[73] The court determined that the states were following in substance the Supreme Court decision upon which it relied.[74]

The Tax Court in *Waxenberg* disposed of the suggestion that the absence of an economic difference between an excise and

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72 Maynard Waxenberg, 62 T.C. 594, 602-3 (1974), *cert. for appeal to 9th Cir.* The Supreme Court opinion cited by the Tax Court is Bromley v. McCaughn, 280 U.S. 124 (1929). The Tax Court's references to property, as opposed to excise taxes, are best understood by reference to the following excerpt from *Bromley:*

> . . . While taxes levied upon or collected from persons because of their general ownership of property may be taken to be direct, . . . this Court has consistently held . . . that a tax imposed upon a particular use of property or the exercise of a single power over property incidental to ownership, is an excise which need not be apportioned, and it is enough for present purposes that this tax is of the latter class [citations omitted]. . . .
>
> [An excise] is a tax laid only upon the exercise of a single one of those powers incident to ownership, the power to give the property owned to another. Under this statute all other rights and powers which collectively constitute property or ownership may be fully enjoyed free of the tax [citations omitted]. . . .
>
> It is true that in each of these cases the tax [an excise] was imposed upon the exercise of one of the numerous rights of property, but each is clearly distinguishable from a tax which falls upon the owner merely because he is owner, regardless of the use or disposition made of his property [citations omitted]. . . . The persistence of this distinction and the justification for it rest upon the historic fact that taxes of this type were not understood to be direct taxes when the Constitution was adopted and, as well, upon the reluctance of this Court to enlarge by construction, limitations upon the sovereign power of taxation by Article I, § 8, so vital to the maintenance of the National Government. . . . *Id.* at 136-37.

73 *See* Lonbard v. Illinois Bell Telephone Co., 405 Ill. 209, 90 N.E.2d 105 (1950); Continental Motors Corp. v. Township of Muskegon, 376 Mich. 170, 135 N.W.2d 908 (1965); Callaway v. City of Overland Park, 508 P.2d 902 (Kan. 1973); City of Deland v. Florida Public Service Co., 161 So. 735 (Fla. 1935); Ampco Printing-Adv. Off. Corp. v. City of New York, 14 N.Y.2d 11, 247 N.Y.S.2d 865, 197 N.E.2d 285 (1964).

74 Bromley v. McCaughn, 280 U.S. 124 (1929).

ad valorem property tax might be a determinative factor, by reference to a New York Court of Appeals decision[75] upholding the constitutionality of a city-imposed tax on commercial businesses occupying real estate. The Court of Appeals had commented that:

> We are not persuaded by the plaintiff's contention that the economic impact of the tax is equivalent to a tax on real estate and that, therefore, it should be treated as coming within the constitutional limitation. After observing that ownership of real property includes the right to use it and to lease it for use by others, the plaintiffs conclude that a tax on the use of real estate is a tax on the real estate itself. Such reasoning has been repeatedly rejected. . . .[76]

It thus appears that for a tax to qualify as a § 164 real property tax — on interests in real property — it must be based upon the value of the interests in the underlying property, and not merely upon one interest such as a leasehold. Unfortunately, neither the Regulations nor the case law describes the required quantum of interests in the underlying property, nor do they state whether a specific type of valuation is necessary where the sum of the interests is divided horizontally or vertically. Suppose, for example, that a piece of property is subject to division into mineral leases, ground leases, improvement leases, and separate life and residuary interests. Common sense would suggest that the various property interests be taxed separately. The sum of these separate taxes would equal the exact amount presently raised by taxing the party holding the fee simple and having him shift this added cost on to the other interest holders. Support for this proposal can be found in a ruling under the condominium provisions which held that a cooperative renting property under a ground lease may deduct real estate taxes levied with respect to its building, where the building's useful life is less than the leasehold and although title to the property is vested in the lessor under the lease.[77]

At this point, the question of whether or not the tax is imposed

75 Ampco Printing-Adv. Off. Corp. v. City of New York, 14 N.Y.2d 11, 247 N.Y.S.2d 865, 197 N.E.2d 285 (1964).

76 *Id.* at 21, 247 N.Y.S.2d at 869, 197 N.E.2d at 288.

77 Rev. Rul. 71-49, 1971-1 CUM. BULL. 103.

on a real property interest becomes an examination of the particular taxpayer's interest in the property and shifts into the third category of limitations.

3. The Tax Must Be Imposed On the Taxpayer

The regulations under § 164 establish the general rule that "taxes are deductible only by the person upon whom they are imposed."[78] The precise application of this rule in the real estate tax area is somewhat uncertain but the basic command seems clear: before such a tax may be deducted, there must be a direct relationship between the taxpayer and the taxing authority. This necessary relationship apparently exists in either of two circumstances: (1) where the taxpayer is directly and personally liable for the tax payment, and (2) where the taxpayer owns some interest in the underlying property which may be lost, forfeited, or foreclosed for failure to satisfy the tax liability.

The emphasis on personal liability seemingly derives from nothing more than a literal reading of the "imposed upon" requirement. A clear understanding of this emphasis can be gained by contrasting it with voluntary and contractually assumed burdens, two instances in which imposition is typically found wanting. In dealing with this issue, courts first turn to the tax statute itself to identify the intended taxpayer.[79] This was the approach of the Supreme Court in *Magruder v. Supplee*[80] where the imposition rule was termed the "guiding principle" for deductibility.[81] In *Magruder,* a purchaser of real property was not allowed to deduct real estate taxes because, as of the pre-closing tax due date, state law imposed both a lien against the property and personal liability against the seller.[82] In disallowing the de-

78 Treas. Reg. § 1.164-1(a) (1964).

79 *Cf.* Helvering v. Fuller, 310 U.S. 69, 74-75 (1940); Walsh-McGuire Co. v. Comm'r, 97 F.2d 983 (6th Cir. 1938); R. PAUL, SELECTED STUDIES IN FEDERAL TAXATION, SECOND SERIES 23-27 (1938).

80 316 U.S. 394 (1942).

81 *Id.* at 396. Subsequent decisions have viewed *Magruder* as having approved the regulations. *See* J. Raymond Batcheller, 1946 P-H Tax Ct. Mem, 711, 712.

82 Magruder v. Supplee, 316 U.S. 394 (1942). As support, the Court indicated that an action in assumpsit could have been brought any time after the due date; personal liability would persist on a sale after the assessment date; and on seller's bankruptcy, the tax claim would have been a provable claim against the seller. *Id.* at 397.

duction, the Court relegated the purchaser's payment to the category of contractually assumed burdens of which the tax law takes no notice.[83] The purchaser was held to be discharging an encumbrance upon the land, no different from other encumbrances or liens.[84]

In denying a deduction for a contractually incurred liability, the *Magruder* court followed a well established line of precedent. Under the 1921 and 1924 Acts,[85] it was held that a tenant could not deduct taxes paid pursuant to a lease covenant which required payment as part of the rent for residential realty since the obligation was not to the taxing authority but to the lessor.[86] This precedent has been correctly interpreted by one commentator as requiring lessee liability solely to the taxing jurisdiction for tenant deduction.[87] Others have stated this proposition differently: "It is settled beyond doubt that when a tenant pays his landlord's real estate taxes, the taxes are treated as additional rent."[88] Moreover, a recent Revenue Ruling has confirmed this concept in cases where increased real estate taxes on a landlord were passed on to his tenant as a tax surcharge pursuant to a city rent control ordinance.[89]

Similarly, a taxpayer cannot deduct real estate taxes of another which he pays as a *mere volunteer*. This rule has been applied in a variety of situations including cases in which the assessed property is the family home and the legal owner is the taxpayer's spouse.[90] The cases make it clear that neither a *moral obligation* nor a *contractual duty* is sufficient to shift the liability for the

83 *Id.* at 398.

84 *Id.*

85 42 Stat. 227-71; 43 Stat. 254-303.

86 Caroline T. Kissel, 15 B.T.A. 1270 (1929). *See also* The Falk Corp., 23 B.T.A. 883 (1931).

87 R. Hanson, *The Internal Revenue Service v. Residential Leases in Orange County*, 8 J. ORANGE COUNTY B. ASS'N 21, 23 (1965).

88 *Timing is Problem When Agreeing to Pay Landlord's Real Estate Taxes*, CCH 1975 STAND. FED. TAX REP. ¶ 8280. *See also* Treas. Reg. § 1.162-11(a) (1956) (business property).

89 Rev. Rul. 75-301, 1975 INT. REV. BUL. No. 30, at 8.

90 Teitelbaum v. Comm'r, 346 F.2d 266, 270 (7th Cir. 1965) *aff'g* 1964 P-H Tax Ct. Mem. 932; *accord*, Estate of Gordon W. Bonnette, 1950 P-H Tax Ct. Mem. 137; Eugene W. Small, 27 B.T.A. 1219 (1933); William Ainslie Colston, 21 B.T.A. 396 (1930), *aff'g*, 59 F.2d 867 (D.C. Cir. 1932); Mrs. Charles F. Dean, 1 B.T.A. 27 (1924); Bank of Commerce, 3 B.T.A. 950 (1926) (tax levied on shareholders, but paid by corporation, may not be deducted by corporation).

tax. A taxpayer is not allowed to deduct the tax "unless he is legally liable to the authority imposing the tax."[91]

In contrast to Revenue Ruling 73-600,[92] the Tax Court in the *Waxenburg* case, discussed above,[93] did not consider or establish a requirement beyond personal liability for the property tax. This would appear to weaken a prior Tax Court decision in the case of *Lena L. Steinert*[94] in which the court held that because the taxpayer's life tenant's interest could be foreclosed and terminated for nonpayment of property taxes, she could deduct all taxes actually paid even though she was neither record nor actual owner of the fee simple.[95] Accordingly, foreclosability of the underlying property for non-payment of the property tax may not be a condition precedent to deductibility under § 164.

Where legal liability exists in virtually any form, the deduction will be allowed. This is true in the case of multiple, primary liability which some states impose upon registered legal, or beneficial owners.[96] Likewise, secondary liability under state law is sufficient where title rests in a third party, at least if the taxpayer had an interest in the underlying property at the time the tax accrued.[97] Under this rubric, deduction would be allowed the original owner of foreclosed property for taxes paid on redemption if, under state law, he or she remains personally liable until

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91 J. Raymond Batcheller, 1946 P-H Tax Ct. Mem. 711, 712; *accord,* John Patrick Feeney, 1966 P-H Tax Ct. Mem. 43; Solomon N. Seale, 1950 P-H Tax Ct. Mem. 32.

92 See note 67 *supra* and accompanying text.

93 See note 69 *supra* and accompanying text.

94 33 T.C. 447 (1959).

95 In *Steinert,* the Tax Court held that the "imposed on" requirement in § 164 (b)(1) (regarding "personal property taxes" rather than "real property taxes" under § 164(a)(1)) was satisfied in that the widowed tenant had a duty to pay the property tax for the party holding legal title under a testamentary trust because she had been allowed under Massachusetts law to waive her dower and homestead rights and take a life interest in the estate real property.

96 Robert C. Ligget, 1945 P-H Tax Ct. Mem. 656 (trust beneficiary allowed deduction for real estate taxes paid where real or beneficial owner is liable for the taxes under Pennsylvania law).

97 Hord v. Comm'r, 95 F.2d 179 (6th Cir. 1938) (trust beneficiary had secondary obligation under state law to satisfy taxes accruing while property was held in trust, and such obligation was sufficient to allow deduction for the taxes paid); Estate of John E. Morrell, 43 B.T.A. 651 (1941) (following *Hord, nonacquiescence in,* 1941-1 CUM. BULL. 17; Martin Thomas O'Brien, 47 B.T.A. 561 (1942) (followed and extended *Hord,* holding that personal liability is a nonessential consideration when a forfeitable beneficial interest is present).

redemption or foreclosure of his or her right to redeem.[98] Such personal liability renders inapplicable the usual rule with respect to mortgages which considers payment of back taxes part of the cost of acquisition. However, taxes paid out of the proceeds of a foreclosure by the prior owner are not deductible because of lack of ownership, if personal liability ends upon the foreclosure.[99]

Where the taxpayer has no direct liability for the tax assessment, a real estate tax deduction might still be allowed if the taxpayer holds a beneficial interest in some portion of the property which is subject to forfeiture for nonpayment. The rationale is that since the beneficial owner will lose his interest if the property is foreclosed for tax deficiencies, his payment of the assessment is essentially not as a pure volunteer. This interpretation has been accepted by the Board of Tax Appeals in the case of *Martin Thomas O'Brien*.[100] The Tax Court further suggested that the requirement of imposition on the taxpayer would be satisfied because a portion of the property subject to the tax actually belonged to the trust beneficiary who held equitable title:

> [C]ertainly a personal liability to pay the taxes is not a prerequisite to a deduction. It is sufficient if they are assessed as taxes against property which the taxpayer then owns, and could be collected out of it. . . .
>
> [Since] personal liability for taxes is in any event a nonessential consideration and since in all trust cases the beneficiary must "pay or suffer the sale of the property," this hardly seems a satisfactory test or distinction. . . . Once we can satisfy ourselves that this property actually belonged to this petitioner, we think it follows by hypothesis that taxes levied upon the property were [the beneficiary's] taxes.[101]

Therefore, in light of the developed case law, it appears that the forfeitable interest requirement constitutes a secondary basis for deduction where the imposition rule would not be satisfied by strict construction and application of the governing tax statute.

The extent of the interest required in the taxed property has

98 John Randolph Hopkins, 15 T.C. 160, 179-80 (1950); Clarence E. Baldwin, 1955 P-H Tax Ct. Mem. 666, 676.

99 George Mogg, 15 T.C. 133 (1950); Charles H. McGlue, 45 B.T.A. 761, 771 (1941).

100 47 B.T.A. 561, 563 (1942).

101 *Id.* at 563, 564.

never been definitively settled. Indeed, one decision of the Board of Tax Appeals, representing an extreme point of view, appears to adopt absolute legal ownership as the sole criterion for deductibility without considering the issue of personal liability.[102] In deciding *W.H. Sheffield* the Board concluded that a taxpayer is not entitled to a deduction for taxes paid on "property which does not belong to himself. . . ."[103]

A better reasoned and supportable approach would be a rule taking into account both ownership and personal liability and allowing a deduction where either exists. There is case law recognizing the importance of liability while abandoning exclusive reliance on ownership. Such an analysis can be found in *Albion D. T. Libby*,[104] where the Board of Tax Appeals, in denying a deduction to a mortgagee for tax payments made prior to foreclosure, stated that "[i]n order to be deductible, payments for taxes . . . must be made by the person liable therefor upon property which he owns."[105] The Tax Court adopted a similar rule in denying a deduction to a taxpayer for taxes paid on property owned by his mother:

> It is well settled that in order to be entitled to deduction of taxes one must be the owner of the property taxed. Deduction of taxes is based upon the liability therefor and everything before us indicates that petitioner was not liable for such taxes.[106]

The ownership requirements stated in these cases primarily rest on three decisions, none of which is true authority for the ownership and liability rule it supposedly supports. Decided first was *Colston v. Burnet*,[107] a decision which disallowed a deduction for taxes on a home held in the name of the taxpayer's wife despite the taxpayer's claims that he held an equitable interest in the premises and that payment satisfied his support obligation. The Commissioner had disallowed the deduction on the grounds

102 W. H. Sheffield, 1941 P-H B.T.A. Mem. 962.

103 *Id.* at 963 (taxes paid on a brother's property held to be a loan despite fact that the brother, already in debt to the taxpayer, had devised the property to him in his will).

104 1942 P-H B.T.A. Tax Ct. Mem. 626.

105 *Id.* at 627.

106 Solomon Seale, 1950 P-H Tax Ct. Mem. 32, 34.

107 59 F.2d 867 (D.C. Cir. 1932) *aff'g* 21 B.T.A. 396 (1930).

"that the property was owned by [the] petitioner's wife, and that consequently the payments were not made by petitioner on his own obligation but merely for the voluntary discharge of the obligation of another."[108] The court found both equitable and legal title absent and said that "it is not necessary to cite authority to the effect that the voluntary payment by him of her taxes . . . should not entitle him to a deduction therefor under the revenue laws."[109] Thus *Colston* merely indicates that no deduction is allowable where there is neither liability nor ownership of some interest in the property.

Second, in *Eugene W. Small,*[110] a husband had transferred property to his wife under a verbal understanding that she would maintain the premises as the family home. Under the separation decree, the husband was personally obligated to pay the taxes under a mortgage on the property. The court found that the contractual liability of the mortgage did not satisfy the imposition requirement since under New York law, petitioner's wife "being the owner of the property" would be personally liable for all taxes assessed.[111]

And lastly, *Edward C. Kohlsaat*[112] involved a husband's payment, pursuant to a separation agreement, of the taxes on property which had been owned by him and transferred to his wife under the terms of the agreement. It allowed the taxpayer a deduction for taxes accrued prior to the transfer, since he was primarily and personally liable for them prior to conveyance, but not thereafter since there was an absolute transfer to the wife under state law. Although the court's opinion implied that both liability and ownership are necessary for deductibility,[113] it is clear that the facts here cannot be carried beyond the actual holding in *Colston, i.e.,* that the taxpayer could establish neither personal liability nor ownership of some interest in the property under state law.

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108 *Id.* at 869.
109 *Id.* at 870.
110 27 B.T.A. 1219 (1933).
111 *Id.* at 1223.
112 40 B.T.A. 528 (1939).
113 "[T]he deduction for the taxes is allowable to the petitioner to the extent that . . . they were paid by the petitioner in discharge of his own liability as owner of the property." *Id.* at 535.

The *Kohlsaat* court cited as authority for its rule the *Colston* and *Small* decisions.[114] It found secondary authority in *Walsh-Maguire Co. v. Commissioner*,[115] which considered the deductibility of taxes accrued as a lien on property prior to its purchase by the taxpayer. The court found the tax payment to be a capital expense undertaken to clear title. Under state law, the taxpayer was not legally bound to make the payment in question. Nor did he assert an interest in the property that would be forfeited if the tax were not paid since his ownership was not established until the taxes were paid. The court's concluding paragraph does appear to emphasize required ownership of some interest in the taxed property,[116] but only to distinguish that line of cases involving allowance of the deduction when there was no liability.

Thus, none of the decisions cited by successive courts in articulating the rule actually stands for the proposition that the quantum of interest required for deductibility includes both an ownership element and a personal liability element. *Colston, Small, Kohlsaat* and *Walsh-Maguire* all merely restate the rule that where there is neither personal liability nor some ownership interest, there is no deduction allowed under § 164. While a rule demanding absolute ownership overstates the case law, it appears both sensible and supportable from the cases to require either ownership *or* liability.

Assuming at this point that ownership is not the only basis for deductibility, but that it can be one of several, then the question becomes: should ownership be limited to taxpayers with a legal title to the entire property, or will divided legal and beneficial interests support a deduction? The latter proposition was upheld in the case of a tenant in common who paid property taxes for all the co-interests in the property.[117] The Tax Court reasoned that:

> [A]ny owner of real property, regardless of the fact or possibility of personal liability, has a legal right to protect his property interest by paying taxes justly due thereon. We see

114 *Id.*

115 97 F.2d 983 (6th Cir. 1938).

116 *Id.* at 985. The court cites and distinguishes Hord v. Commissioner, 95 F.2d 179 (6th Cir. 1937), considered *supra*, note 68, on the ground that in *Hord*, the taxpayer was the beneficial owner of the property at the time of the incidence of the tax.

117 Lulu L. Powell, 1967 P-H Tax Ct. Mem. 175.

> no reason why such a person should have any less right to the deduction of such taxes he pays.
>
> It seems to us that the proper test of whether or not a real property tax is deductible by the person who paid such tax is whether the person satisfied some personal liability *or protected some personal right or beneficial interest in property.* . . . Even if we assume that petitioner was not jointly and severally liable under Texas law for all of the taxes accruing to the jointly held property, all of the property would still be subject to sale for the remaining five-sixths of the real property taxes due and her undivided interest in the real property could be destroyed. . . .[118]

The court ultimately determined that the taxpayer be allowed to deduct all taxes paid by her from her separate funds.[119]

This interpretation is consistent with earlier cases involving beneficial interests. In *Estate of Mary Rumsey Movius*[120] a deduction was allowed to certain beneficiaries of an estate who had authorized the executor to withhold required distributions to them in order to create a fund from which to pay the property taxes on all the estate holdings. The Internal Revenue Service disallowed the deduction on the ground that legal title to the assessed property lay not with the beneficiaries but with the trustees. The Tax Court reversed the disallowance: "The rule appears to be clear that one owning a beneficial interest in property who pays taxes thereon to protect such interest may deduct the payment so made, even though the legal title to the property is in another against whom the tax is assessed [citations omitted]."[121] On this reasoning, other decisions have allowed deductions to estate and trust beneficiaries for taxes burdening property.[122]

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118 *Id.* at 182 (emphasis added).

119 *Id.* at 183. (The taxpayer was actually only allowed a deduction for half of the taxes paid because she was married, residing in a community property state, filed a separate return, and failed to prove that she had paid the taxes from her own separate funds.) This holding apparently overturns the rule of earlier decisions that such a taxpayer may deduct only that proportional part of the total taxes equal to his proportionate interest in the property. A subsequent decision has confirmed the authority of this rule. Donald G. Peters, 1970 P-H Tax Ct. Mem. 1575, 1576 (deductibility of part of tax denied on other grounds).

120 22 T.C. 391 (1954).

121 *Id.* at 394.

122 *See* cases cited in note 97 *supra.*

Similar analyses have been applied in other areas. For example, deductions under § 164(a)(1) have been given to life tenants[123] and to owners of a reserved term of years.[124] This mode of analysis has also been applied to beneficial owners of interests in property under venture agreements by which parties acting together as a syndicate or otherwise buy partial interests in property; here, the deduction is limited to a portion of the tax represented by the taxpayer's proportionate beneficial interest.[125]

Interestingly, not all property interests are viewed as falling within the *Powell-Movius* rule. Inchoate curtesy and dower rights have been expressly excluded.[126] Some decisions have involved the exclusion of mortgagees' proprietary interests, even in foreclosures. In this latter situation, additional payments, whether paid before or after foreclosure or at foreclosure sales, are viewed as additional loans, to be recouped in determining gain or loss on subsequent foreclosure sales.[127] Mortgagee payments after foreclosure are viewed simply as part of the purchase price.[128] However, there is some indication that a foreclosing mortgagee can deduct taxes becoming liens after the foreclosure date.[129] Similar rules apply to repossessing vendors under conditional sales contracts.[130]

Under the current construction of § 164(a)(1), discussed above, state property taxes are assessed against landlords, and therefore lessees may not deduct real estate taxes required to be paid by them on the leased premises because their obligation is merely contractual as rent.[131] Most of the limited number of cases allow-

123 Cornelia C. F. Horsford, 2 T.C. 826 (1943); Frances E. Cummings, 1949 P-H Tax Ct. Mem. 545 (following *Horsford);* Lena L. Steinert, 33 T.C. 447 (1959) (life tenant allowed deduction although title was in name of bank and taxes were assessed on bank). *But see* Rev. Rul. 73-531, 1973-2 CUM. BULL. 45 (terminable life tenant allowed to deduct real estate taxes *imposed* directly on him).

124 Rev. Rul. 67-21, 1967-1 CUM. BULL. 45.

125 *See, e.g.,* Sidney Gorman, 1947 P-H Tax Ct. Mem. 35.

126 Colston v. Comm'r, 59 F.2d 867 (D.C. Cir. 1932).

127 I.T. 1611, II-1 CUM. BULL. 87 (1923); Harry S. Brown, 1941 P-H B.T.A. Mem. 483; *see* Estate of Lucy S. Schlieffelin, 44 B.T.A. 137 (1941); Hadley Falls Trust Co. v. United States, 110 F.2d 887, 893 (1st Cir. 1940).

128 I.T. 1611, II-1 CUM. BULL. 87 (1923); John Hancock Mutual Life Ins. Co., 10 B.T.A. 736 (1928); Lifson v. Comm'r., 98 F.2d 508 (8th Cir. 1938).

129 *See* Charles H. McGlue, 45 B.T.A. 761, 771 (1941) (by implication).

130 *E.g.,* Pacific Southwest Realty Co., 45 B.T.A. 426 (1941); Thomas L. Townley, 1942 P-H B.T.A. Mem. 483.

131 *See, e.g.,* Caroline T. Kissel, 15 B.T.A. 1270, 1273-74 (1929).

ing the deduction to lessees have involved long-term leaseholds and leaseholds substantially longer than the estimated useful life of the building leased.[132] In one case, a tenant under a ground lease was allowed to deduct taxes assessed with respect to the building erected by the tenant even though title passed to the landlord under the lease, because the estimated useful life of the structure was substantially less than the lease term.[133] But this case involved an unusual tenant cooperative which the IRS viewed as enjoying the entire net worth of the building, while the landlord was seen as receiving no income attributable to it.

It is at least arguable that some long-term lessees should fall within the rubric of the *Powell* and *Movius* decisions discussed above, but no decisions have so held. Particularly, no case has involved a tenant under a long-term lease who rendered payment in the absence of a contractual obligation to do so. Payment by such a tenant could be viewed as made by a mere volunteer, especially since foreclosure would usually be subject to existing leaseholds and the tenant's leasehold interest would not be forfeited. However, a persuasive argument could be made that a tenant under a very long lease has substantial enjoyment of the property of a nature sufficient to be viewed as an actual beneficial interest.[134] Support may be derived from the like-kind exchange regulations which provide that the exchange of a leasehold of 30 years or more for a fee simple interest in real estate is allowed special non-recognition status.[135] And a 99-year lease with an option to renew for 999 years was treated as a fee simple estate for inclusion in the gross estate under § 2031(a) for years prior to October 16, 1962.[136] If such a lease can be viewed as substantially equivalent to a real estate interest for these provisions, then arguably it can also be so viewed for § 164(a)(1) purposes.[137]

132 Rev. Rul. 62-177, 1962-2 CUM. BULL. 89.

133 Rev. Rul. 62-178, 1962-2 CUM. BULL. 91.

134 See text accompanying notes 117 to 125 *supra.*

135 Treas. Reg. § 1.1031(a)-1(c) (1967).

136 Estate of M. T. C. De Perigny, 9 T.C. 782 (1947), *nonacquiescence in,* 1948-2 CUM. BULL. 5.

137 It may not require too difficult or long a logical jump to conclude that even a contractually agreed tax payment would be acceptable for the deduction if the lease term gave the tenant a beneficial interest in the property under section 164(a). That result is precluded, however, under the present authorities. Rev. Rul. 62-177, 1962-2 CUM. BULL. 89.

4. Payment Must Be Made to the Taxing Judisdiction

A cash basis taxpayer may not deduct a payment until it is actually or constructively received by the taxing authority. Payment to an intermediary not acting on behalf of the taxing power is insufficient. Accordingly, deductions have been disallowed for payments to third parties, real estate and mortgage companies, and banks, whether made pursuant to a contractual obligation or otherwise, even where a fiduciary relationship existed.[138] The deduction is allowed to cash basis taxpayers only *for taxes when paid.*[139]

B. *Existing State Legislation*

Two states, Hawaii and California, have enacted legislation dealing with tax deductions for tenants. An examination of the rulings on these statutes sheds further light on the Code requirements for a proper real estate tax deduction.

The Hawaii statute explicitly imposes the real estate tax on the tenant and his or her successors, instead of on the owner, where the property is leased for a term of 15 years or more; the statute deems such lessee or successor to be the owner for tax purposes.[140] Under this statute, a taxpayer who was the lessee under a 15-year lease was allowed to deduct payments made to set off his tax liability. In a Revenue Ruling construing the application of this statute, the Commissioner allowed the deduction to the lessee on the ground that he was personally liable because the statute causes the tax to be imposed upon the lessee.[141]

The California statute does not automatically impose the property tax on a tenant, but instead permits any tenant to have himself or herself assessed for property taxes on premises he or her occupies. The terms of the law require assessment of property to be made "to the persons owning, claiming, possessing, or controlling it on the lien date," and permit any person claiming or desiring to be assessed to have his or her name inserted with

138 Frank J. Hradesky, P-H TAX CT. REP. & MEM. DEC. ¶ 65.7 (1975); Arthur T. Galt, 31 B.T.A. 930 (1934).

139 INT. REV. CODE OF 1954 § 164(a).

140 HAWAII REV. STAT. § 246-4 (1968).

141 Rev. Rul. 64-327, 1964-2 CUM. BULL. 56.

that of the owner on the county assessment roll.[142] As a result, the tenant voluntarily assumes the tax burden as an incident to his or her lease contract with the landlord.

In a 1968 ruling on the Califoria statute the IRS held that payments made under it were deductible as § 164 real estate taxes. A tenant, pursuant to his 75-year lease, placed his name on the county assessment roll and paid the local taxes. The Commissioner permitted deduction under § 164(a)(2), emphasizing that the tenant was "obligated to pay" the tax and had been "personally assessed" and "assessed directly," and that the "significant feature" of the statute was the incidence of the tax on the lessee.[143] Apparently, however, IRS auditors have not allowed deduction of the California tax by a tenant not actually listed on the assessment rolls. [144]

Since California imposes no personal liability for its real property tax,[145] the ruling's reliance on personal liability is misplaced. However, the lessee would still be *the* or *an* assessed party, the incidence of the tax would be on the lessee, and he would have the legal responsibility to pay part of the tax, even if payment in full were not enforceable against the lessee directly. From this reading of the case, one might argue that assessment without either liability or ownership is sufficient to satisfy § 164.

It might be urged that one should not generalize from the Hawaii statute, applicable only to leases of 15 years or more, or the ruling involving a 75 year California lease to relatively short term leases. However, in neither case was the lease term length invoked as a requirement, except to bring into operation the Hawaii statute.

It might also be contended that both rulings involved tenants whose lease of the *entire* property made them responsible for payment of the total taxes assessed on the premises. Although neither statute has been applied to a lease of only a portion of taxed premises, a "whole premises" limitation is not logically a

142 CAL. REV. & TAX CODE §§ 405, 610 (West 1970).

143 *See* Rev. Rul. 68-84, 1968-1 CUM. BULL. 71.

144 Hanson, *The Internal Revenue Service v. Residential Leases in Orange County,* 8 ORANGE CO. BAR BULL. 23 (1965).

145 *Id.* at 23, citing CALIFORNIA SENATE, INTERIM COMMITTEE ON STATE AND LOCAL TAXATION, REPORT, Pt. 3, Div. IV, at 263-65.

condition precedent to deduction. The limitation is to taxes imposed on a taxpayer, and it does not follow that one must assess all the property taxes on a single taxpayer. The liability for a single assessment could be divided into separate liabilities.[146]

One might argue that restructuring liabilities between owner and tenant, with one primarily and the other secondarily liable or with both jointly and severally liable, is not contemplated by the rulings on the tenant laws. While both Revenue Ruling 64-327 (construing the Hawaii statute) and Revenue Ruling 68-84 (construing the California statute) apparently assume that the statute involved makes the tenant primarily liable, neither expressly considers this factor. Indeed, although Hawaii's statute seems to impose no liability on the owner where a lessee is assessed, California's appears to involve no personal liability for either party.

The essential requirement to be satisfied before a tenant will be allowed to deduct a real estate tax under § 164(a)(1) can be summed up in a single word: imposition. While this word can be defined in terms of personal liability or direct assessment, a distinction between these two terms is meaningless in practice. The condition precedent is and should be only that of responsibility to the taxing authority, whether by liability or assessment.

The tenant rulings, although using language emphasizing personal assessment, also look to incidence and obligation to pay. Indeed, in considering and distinguishing the facts of both tenant rulings on the nature of the tax involved, a recent decision describes their sole concern as the question of imposition.[147] Perhaps most significantly, no decision holds mere personal liability to be an inadequate basis or attempts a distinction between personal liability under the governing property tax law and assessment.

Perhaps Revenue Ruling 68-84 authorizes a deduction based solely on assessment. This seems proper since, in paying the tax, the taxpayer meets a responsibility imposed by the sovereign and is in no sense a mere volunteer. Nevertheless, prudence advises

146 *But cf.* text accompanying notes 117-125 *supra.*
147 Rev. Rul. 73-600, 1973-2 CUM. BULL. 47.

that state legislation intended to pass through the real estate tax deduction meet the imposition requirement by creating explicit personal liability in the tenant.

IV. Structuring a Workable Tenant Tax

Several technical difficulties arise in the restructuring of state real property tax law to create a federal tenant deduction, and in coordinating the basic statutory provisions with state and local law. A means of determining the size of the tenant's tax liability must be devised; a new collection mechanism must be implemented; and the proper relationship with other areas of the law such as rent control must be worked out. Properly structured legislation will accomplish all of this.

The essence of the tenant tax act is direct liability of the tenant for that portion of the real estate taxes on the landlord's property determined to be borne by the tenant. To meet the basic liability requirement of § 164(a)(1), the Model Act explicitly imposes on the tenant personal liability for the tax.[148] Beyond the creation of this new liability, however, there is no need to eliminate the existing personal or in rem liability of the landlord since the Code permits deduction for any personal tax liability whether it be joint and several, primary or secondary.[149] The landlord continues to receive the full rent amount, including reimbursement for that portion of his of her own tax liability allocable to the tenant.

A separate liability is imposed on the tenant because it would be insufficient merely to recharacterize the rent payment. Under the Code, statutorily redescribing payment of a private contractural obligation does not necessarily result in a deductible payment in satisfaction of a liability imposed by legislation. Instead, the Model Act divides the existing rent into two separate legal elements: an apportioned tax to be paid to the taxing jurisdiction, and a basic rent to be retained by the landlord.[150]

At this point, two options are open: (1) a separately negotiated

148 Tenant Tax Act § 201(a).

149 See text at notes 96 and 97 *supra*. *Cf.* Rev. Rul. 71-590, 1971-2 Cum. Bull. 124 (purchaser of real estate allowed to deduct real estate transfer tax where tax paid under statute providing for joint and several liability of purchaser and seller).

150 Tenant Tax Act §§ 103(f)-(h).

basic rent element can be fixed leaving the tax element to vary, thereby passing through to the tenants any changes in the property's tax burden; or (2) the sum of the rent and the apportioned tax can be fixed, with the tax component varying with changes in the property's tax burden.

A complete pass-through immediately subjects the tenant to the cost of assessment changes with respect to his or her unit. However, it eliminates the landlord's need to include a risk factor for possible tax increases in fixing rents. It may inject confusion into the renting process since the tenant's total leasehold obligation would be uncertain; the tax portion will vary although the base rent portion remains constant. Moreover, although the tenant may benefit from tax decreases, real estate tax levels generally rise, and tenants may be less able than landlords to contest erroneous or unfair tax increases. The converse results generally follow from fixing the total leasehold obligation. While this alternative basically maintains the status quo, it entails the additional administrative burden of frequently redetermining the proper split between the tax and rent components.[151]

The interrelationship of the tenant tax with other areas of state law should significantly affect the pass-through choice. Most importantly, a structure which passes through the full economic impact of property tax changes will produce some tension with rent control laws.[152] The total leasehold burden for even rent controlled apartments will increase as the total tax burden on the premises increases. The allocation of taxes among tenants will reflect the reduced rent on a controlled unit, but tenant tax increases may be forthcoming more rapidly if fully passed through unless tenants are as politically effective as landlord groups. This may be undesirable for several reasons. Rent-controlled tenants would find it objectionable. It would run against the policy of rent control legislation and limit the intended ability to control rent levels since that portion attributed to the tenant tax would effectively become uncontrolled. Moreover, the ability to pass through changes may produce larger assessments

151 The pass-through choice also affects the tax allocation system. See text at note 167 *infra*.

152 For the effect of rent control on the allocation system see text at note 165 *infra*.

for controlled properties, since their value to landlords will be greater than where rent levels are fully controlled. On the other hand, more rapid pass-through would be more equitable to the landlord, would reduce those situations in which non-rent controlled tenants effectively subsidize the real estate taxes attributable to the controlled units and would limit other economic distortions produced by rent control.

The choice between the two alternatives of the tax pass-through and the fixed total leasehold obligation is left to the legislature.[153] While the selection could be an item in individual lease negotiations, this is believed inappropriate given the normally weak bargaining position of tenants in such negotiations.

The statute does not affect the quantum of rights and obligations created under existing contracts. It avoids a possible constitutional problem[154] by providing for the continuation of existing contractual rights and does not attempt to reconstitute directly the required contractual payments. Instead, it merely imposes the obligations on landlord and tenant and allows the tenant to meet his or her responsibility simply by satisfying the leasehold obligation to pay the total agreed rent. The tenant remains obligated to the landlord for the entire leasehold liability.[155]

Although the Model Act is not so designed, a tenant tax could be made to operate on a local option basis. Leaving the option with individual tenants would produce a complicated and confusing system and may not create a meaningful statutory liability;[156] but local option provisions would allow municipalities to retain control over what is, for many, their principal revenue source.[157]

The tenant's personal liability may be enforced through summary suit either by the taxing jurisdiction or by the landlord for nonpayment of the tenant tax obligation.[158] The Model Act also

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153 Tenant Tax Act § 203.

154 U.S. Const. art. I, § 10.

155 Tenant Tax Act §§ 205, 206.

156 *Cf.* COMM. ON STATE LEGISLATION, ASS'N OF THE BAR OF THE CITY OF NEW YORK, REPORT 237 (1973).

157 C. HARRISS, PROPERTY TAXATION IN GOVERNMENT FINANCE 9, 11-14 (1974).

158 Tenant Tax Act §§ 301, 302. It has been suggested that a valid tenant tax requires forfeitability of some tenant interest in the underlying property. COMM. ON

specifies the valid defenses to such an action including: payment of the liability to the landlord, taxing jurisdiction or court; non-occupancy; and defenses against the landlord for all or part of the leasehold obligation.[159]

The tenant's liability is no more burdensome than his or her current rental obligation. The only change brought about by the statute is that the tenant is now obligated to the taxing jurisdiction for the tax portion of the leasehold obligation. The tenant remains obligated to the landlord for both portions of that obligation. The landlord is usually the party holding the tenant to his or her obligation; and the taxing jurisdiction will continue to look to the landlord for payments and advances on the tenant's behalf. The tenant's tax liability will be satisfied by payment to the landlord with the base rent, even if the landlord fails to remit it to the taxing jurisdiction. If the landlord is in default and the tenant fails to pay the landlord, the taxing jurisdiction can proceed directly against the tenant for the tax payment with interest at the rate applicable to landlord delays.

A fundamental problem in determining each tenant's liability, and hence deduction, is designing a method of computing the size of that liability for individual tenants of multi-unit or multi-use premises. As an initial step the legislature must select a figure which it believes best represents the fraction of the property tax shifted to tenants. Next, the tenant portion of the tax must be allocated among the individual units. It would be possible to compute the tax either directly by reference to each separate rental unit, or indirectly by a formula which relates and compares the separate unit's value with the value of the entire premises.

Direct valuation of individual rental units appears inadvisable largely for administrative reasons. The assessment of each unit which would become necessary in addition to the basic property tax assessment would involve considerable expense. Moreover, the value of multiple dwellings may be lower than the aggregate

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STATE LEGISLATION, ASS'N OF THE BAR OF THE CITY OF NEW YORK, REPORT 233 (1973). This, however, appears to be an overly strict reading of several confusing court decisions. *See* text at notes 102-16 *supra*.

159 Tenant Tax Act § 303.

value of the individual apartments.[160] Finally, direct reference to each rental unit might raise the issue of whether the specific tenant tax satisfies § 164(a)(1) since a tax on individual units is more likely to be viewed as a tax on a leasehold, and the property laws of many states categorize leaseholds as personalty.[161]

An indirect computation scheme seems preferable especially for premises with many tenants and this approach has been adopted in the Model Act.[162] It requires neither changes in the property assessment process, nor assessment of residential rental property differently from other property. Rather, the premises are assessed in the normal manner and the total taxes are then apportioned among the rental units. Three apportionment methods are conceivable: (1) actual unit rent (or comparable market rents for owner-occupants) relative to total premise rents; (2) unit physical area relative to total premise rental area; or (3) unit market rental value relative to total premise market rental value. The first alternative is employed by the Model Act. This method most directly relates the tenant's liability to the tax burden related to his or her unit because the total assessment is generally close to the aggregate rental value of all units.[163] By this measure, each tenant's share of the tax is equal to his or her share of the total rent bill of the building. This approach, though simple and understandable, involves two potential problem areas: full disclosure of each tenant's rent to all tenants and frequent recomputation of individual tenant tax allocations. Full disclosure may be necessary to prevent erroneous or fraudulent tax allocations by the landlord, but may be offensive to tenants for reasons of privacy, and to landlords for fear of reaction to disclosed landlord puffing, discrepancies, errors, or misrepresentations. The legitimate considerations of tenant privacy rights, however, may be balanced by the

160 *See* Joint Comm. on Housing & Urban Development, Memorandum on the Condominium Act, 1964 NEW YORK LEGISLATURE ANNUAL 350.

161 1 AMERICAN LAW OF PROPERTY § 205 (A. J. Casner ed. 1952). Assuming away the assessment problems, the payment would probably be deductible as a personal property tax. INT. REV. CODE OF 1954 § 164(a)(2). See text following note 51 *supra*.

162 Tenant Tax Act § 201(b).

163 *See, e.g.*, Pepsi-Cola Co. v. Tax Comm'r, 19 A.D.2d 56, 240 N.Y.S.2d 770 (1st Dept. 1963). Even if rent levels are not reflected in the tax level, it seems clear that the landlord's economic burden is actually shared by the tenants in proportion to arm's length rents.

stimulation of a competitive rental market resulting from full disclosure. Moreover, tenants are often aware of the relative nature of their rent, and they may view the availability of additional information with favor.

An actual rent formula also has potential administrative problems. The landlord is required to make several computations, but the necessary figures are readily available to him or her and the actual calculation should pose no problem. Somewhat more burdensome, however, is the required recalculation of the relevant allocation, for example, whenever a unit's rent is changed. Recalculation may be frequent, especially for premises with many units and frequent turnover, but can be avoided or rendered manageable by statutorily limiting it to annual or semiannual frequency.[164]

An allocation formula based upon a physical characteristic such as rental unit area or number of rooms would be the simplest measure. The entire property's total tax burden would be apportioned to each unit in accordance with some measure of the unit's size relative to the entire premises; hallways, driveways, and other common areas would be excluded from the total. Of these two physical measures, actual area would be better, because the number of rooms may relate to physical area only very indirectly. A physical area allocation has the advantage of administrative simplicity. Because the size of the premises does not normally change, only an initial allocation percentage need be determined. Changes required due to subdivision or enlargement of individual units or building extensions will usually be infrequent and cause only limited and acceptable recomputation burdens. A physical measure is readily available and would not require consideration of comparable rents and the like.

Distortions and inequity in a physical area allocation, however, would result in several ways. First, rent levels do not vary directly with apartment size. Second, rent variations or distortions occur for units in the same premises, due to differences in rentability over time, occupancy concessions, varying lease terms,

164 Tenant Tax Act § 201(b). An exception could permit more frequent recalculation whenever tenant turnover exceeds a specified percentage of total units, or total rent roll or individual unit rent charge exceeds a specified percentage of the same item as of the immediately prior recalculation.

and the like. Third, distortions and inequity may result from rent control. Because the total tax burden of residential rental premises usually reflects the size of the rental stream, rent controlled leases produce a smaller total tax burden for the premises and should bear a relatively smaller apportioned burden. A physical area allocation would, however, produce situations in which tenants who pay less than market rents are charged with, and allowed to deduct, disproportionately larger portions of their rent than neighbors living in otherwise identical apartments, paying higher rents. Particularly if the total leasehold tax obligation were fixed, when the total tax burden on the premises is raised, a rent controlled tenant would obtain a disproportionately higher deduction without additional cost.[165]

A formula based upon relative unit market rental value would be similar to one based upon relative actual rents, except that it would be more difficult to apply. In addition to the administrative problems of the latter measure, a relative market value formula would require appraisal of individual unit values.

Any allocation formula raises several additional computational problems. The proper treatment of vacancies is a useful example. Vacancies may be of two basic types: minor and temporary as during tenant turnover; or significant and long-term, perhaps due to a lack of demand. As to temporary vacancies, the Model Act requires inclusion of the vacant unit's last rental value in the formula's total rent base, with the landlord bearing the tax burden of the vacant unit. Alternatively, the vacant unit could be excluded with the remaining tenants charged on a pro rata basis. This method would require allocation adjustments whenever a vacancy arises or terminates, and is rejected for that reason. Additionally, the total tax assessment, and hence the burden, usually imputes such vacancies.[166] Furthermore, the landlord himself imputes such a factor in determining rent levels.

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165 The rent controlled tenant would bear the actual economic burden of tax increases under a full tax pass-through.

166 Common assessment practice with commercial property is to employ the capitalization of earnings method. Typically in determining the income production potential of residential property the assessor will include a factor for normal turnover. *See generally* O. OLDMAN & F. SCHEOTTLE, STATE AND LOCAL TAXES AND FINANCE, 143-44 (1974); Comment, *Real Property-Application of Taxes as an Expense in Determining Assessed Value by the Capitalization of Income Approach*, 9 SUFFOLK U.L. REV. 903, 904 n.4 (1975).

The Model Act also includes long-term vacancies in the formula base and attributes their apportioned liability to the landlord. This approach is adopted because total vacancies may exceed those which the taxing authorities impute in making their assessments. The assessor may allow no reduction for these types of vacancies, viewing the vacant units as rentable and available and the property's true value as reflected by imputing rent to them. Including all units in the formula ensures that the tenant is charged only with those taxes attributable to his unit. However, where long-term vacancies are recognized by assessment changes, problems arise.[167] Under a tax pass-through system, the assessment reduction unduly benefits tenants under this formula because the remaining total tax burden is apportioned to all units and each remaining tenant's liability is reduced below that attributable to his unit. Where the total rental obligation is fixed, however, the system operates to the detriment of the tenant since the deductible amount is reduced but the tenant's payments remain the same. No formula can effectively and equitably respond to both these situations. Perhaps what is needed is an administrative regulation which would require remaining real estate taxes produced by reassessments to be allocated only to remaining tenants.

The problems are similar for concessions, *i.e.,* reductions or discounts from agreed rent made to facilitate leasing. This device is employed either to allow maintenance of nominal rent levels for rental or sale purposes, to avoid pressures from current tenants who may react adversely to lower rents made available to newer tenants because of market conditions, or to create a higher nominal base to protect against rent control and similar measures. The Model Act definition of rent[168] leads to an allocation of total tax burden by reference to actual rent paid because the burden itself may result from an assessment made by reference to actual rent received or the tenant may be viewed as bearing a share of total taxes in proportion to his actual rent. Upon termination of the concession, reallocation is required.

"Common area" allocation must reflect the differences between areas which are fully common to the residential tenants and those

167 *See* text following note 150 *supra* for full discussion of pass-through.
168 Tenant Tax Act § 103(f).

which are proprietary or attributable to other uses. While this allocation may be difficult because of functional overlap between areas, the Model Act solution attributes to the landlord all areas not completely common.[169] Common portions of the premises fully available to and shared equally by all tenants include hallways, corridors and the like, open for use by all tenants without additional fees. Similarly, premises resided in at less than market rents and other areas occupied by in-house staff, such as superintendant and janitorial personnel, are attributable to the tenant population. Tenant rents effectively bear the economic cost and tax burden of these areas.

The treatment of other areas, such as parking spaces, health clubs and the like, is conceptually more difficult even where such areas are common in nature. The difficulty arises from the fact that their economic cost is sometimes included in each tenant's rent, and in other cases use of the facilities is made optional to the tenant or available to the public at a fee. For these, a simple test is set forth: where such areas and services are completely common and available without limitation and without optional fee, they are properly related to the leasehold, even if an extra charge for them is separately stated; taxes related thereto should be apportioned to the residential tenants.[170] But where the services or use of the areas are completely optional or open to the public, they are not sufficiently related to the residential leaseholds to justify allocation. Instead, they partake of the nature of a separate landlord proprietary business.

The same analysis is applied to multi-use premises, such as those constructed partially for residential rental and partially for commercial or office purposes. The taxes levied on the entire premises are allocated between such uses, then the portion attributable to residential areas is distributed among tenants. The allocation to non-residential areas should be on a basis consistent with the allocation among residential tenants. The relevant types of factors have already been considered.[171] A formula based upon relative actual rents seems especially desirable where multi-

169 *Id.* § 201(b).
170 *Id.*
171 See text accompanying notes 160-168 *supra.*

use premises are involved. A physical measure could produce massive allocation distortions where one use is commercial. Commercial property generally rents for a much higher rate than residential and is taxed at a higher rate than residential property of comparable size.[172] Only a relative rent or relative value formula would properly apportion the tax burden in such instances. Again, the relative rent system is to be preferred for ease of administration.

The necessity of reconciling the tenant tax with existing real estate tax procedures gives rise to a variety of conceptual and technical questions. Under the status quo, real estate taxes are usually assessed annually with liability to be satisfied by prepayments for quarterly or longer periods. The tenant, however, usually satisfies his or her rental obligation by monthly payments. The Model Act retains the status quo to a large degree by requiring landlord prepayments[173] and tenant monthly tax payments to the landlord.[174] The landlord transfers the tax portion of tenant payments to the taxing authorities, receiving a credit against his or her assessed liability for amounts remitted. Because of the prepayment arrangement, a landlord under the Model Act collects tenant taxes during one year periods which are applied against his or her tax bill for the following period. Due to this lag, the landlord is always out of pocket the first prepayment and any subsequent tax increase. Although this represents no departure from existing practice, it remains true that only when the landlord disposes of the property for consideration will he or she be reimbursed for the net amount outstanding.[175]

By utilizing the landlord as an intermediary, the Model Act scheme avoids the severe administrative problems inherent in dealing with each tenant individually. The landlord, however, ap-

172 *See* H. AARON, WHO PAYS THE PROPERTY TAX (1975); Oldman & Aaron, *Assessment-Sales Ratios Under the Boston Property Tax,* 18 NAT. TAX J. 36, 41, 44 (1965); Comment, *Real Property Tax Assessment: A Look at Its Administration, Practices and Procedures,* 38 ALBANY L. REV. 498, 506-08 (1974).

173 Tenant Tax Act § 206.

174 *Id.* § 205.

175 This somewhat minor burden on the landlord could be eliminated and the tenant tax directly related to the year in which it is collected either by ending the prepayment system or by crediting the amount remitted by the landlord against his prior payment. The bookkeeping and refund procedures necessitated by the latter alternative would make it an administrative nightmare.

pears to run a greater risk of economic loss if, for instance, tenant tax payments remain outstanding and in default at the end of a year. The loss could arise if the landlord's right of reimbursement precluded his or her deduction of the unpaid amounts. The Code, however, specifically allows the deduction of all real property taxes "paid." A taxpayer may deduct actual tax payments even where he or she has a right to refund or reimbursement, so long as he or she was personally liable to the taxing authorities for the amount paid or has an economic interest in the underlying property.[176]

Although, as has been noted, the cost to the taxing authority is high, two alternatives exist which would not impose upon the landlord the costs and responsibilities of intermediary status. One possibility is to require tenant payment of the tax element of the leasehold obligation in advance in the same manner that property owners are required to make prepayments under the status quo. In addition to the problems of dealing with tenants individually, this method requires that a system be set up to handle the adjustments necessary where tenancies end before the end of a prepayment period or begin during the period.[177] Alternatively, the tax could be collected by the taxing jurisdiction on a monthly basis. While this would obviate the need for an adjustment system,[178] the cost would be a tripling of the already high number of returns to be processed and checked.

A second pair of possible alternatives to the Model Act retains the landlord as an intermediary, but is designed to correct what may be seen as weaknesses in the proposed scheme. In the first system, tenant tax receipts would be viewed as direct reimbursements of landlord advances. This approach would avoid the problems in crediting the payments to a proper period, but since

176 *See* INTERNAL REVENUE SERVICE, YOUR FEDERAL INCOME TAX 89 (1975).

177 In criticizing one bill intended to produce a tenant tax, the Committee on Taxation of the New York City Bar Association appears to have suggested longer than monthly payment periods while acknowledging the difficulties resulting thereby. COMM. ON STATE LEGISLATION, ASS'N OF THE BAR OF THE CITY OF NEW YORK, REPORT 234 (1973).

178 Requiring a tenant to pay the full monthly tax bill for the dwelling he occupies on the first day of the month will be inequitable in cases where the tenant moves out of the jurisdiction or ceases to be a tenant during the month. It will likewise be unfair to a landlord when a unit which has been empty is occupied after the first of the month. In any event, the additional tax cost will be small and mitigated by its deductibility.

no fund is turned over to the government it has the unwanted appearance of a mere payment from tenant to landlord rather than to the taxing authority. The most radical alternative to the Model Act would be to alter the existing property tax law so that the landlord would not be liable for taxes attributable to the tenant units. The landlord could be required merely to collect the tenant taxes and pay them to the taxing authorities. This would be a major change in the law and would place the jurisdiction at additional risk where the tenant does not pay his or her tenant taxes.

The Tenant Tax Act as herein proposed is designed to extend the benefits of property tax deductions to residential tenants. It is believed that the particular form chosen is the most effective and efficient means of achieving that goal. Nevertheless, it must be remembered that whatever its purpose, the actual effect of the Act is merely to create a new form of tax. Deductibility of the tax depends entirely on the retention in the federal tax law of the concept presently embodied in §164(a)(1).

AN ACT

To amend the real property tax law and the landlord-tenant law, to impose on tenants the real property and school taxes levied against rented residential property in order to permit tenants to claim a deduction for real property taxes under federal tax law.

The People of the State ————————, represented in Senate and Assembly, do enact as follows:

§ 1. The real property tax law of Chapter ——— of the Laws of this State is hereby amended by adding thereto at its end a new Article, to be Article ———, to read as follows:

ARTICLE _____

TENANT TAX ACT

TABLE OF CONTENTS

TITLE I: SHORT TITLE, PURPOSE, AND DEFINITIONS

§ 101. *Short Title*

This Act may be cited as the Tenant Tax Act.

§ 102. *Statement of Legislative Intent*

The purposes of this Act are:

(a) to assess and impose against individual residential tenants the liability for the real property taxes attributable to their dwelling;

(b) to make explicit and separate the legal incidence of the real property tax burden economically borne by individual residential tenants in the rent attributable to their dwelling in order to entitle them to real estate tax deduction under existing federal tax law; [and]

[(c) to pass to individual residential tenants the complete risk of changes in the real property taxes attributable to dwelling; and]

(c) [or (d)] to coordinate achievement of the foregoing purposes with related areas of the laws.

COMMENT: The first subsection (c) is optional. It should be used where the legistature chooses to change the status quo by passing through tax rate and assessment changes to the tenant, rather than maintaining a fixed leasehold obligation on the tenant.

§ 103. *Definitions*

Notwithstanding the provisions of any federal, state or local law, rule, or regulation to the contrary, when used in this Article the following words and phrases have the following meanings:

(a) A "dwelling" is any building or structure or portion thereof which is resided in, rented, leased, let or hired out to be occupied, or is resided in or occupied, in whole or in part as the home, residence or sleeping place of one or more persons.

(b) A "multiple dwelling" is a dwelling which is either rented, leased, let or hired out, to be resided in or occupied, or is resided in or occupied, as the home, residence, or sleeping place of two or more tenants living independently of each other. A "multiple dwelling" shall be deemed not to include a hospital, convent, monastery, asylum, public institution, cooperative apartment corporation, condominium or any building exempt from taxes; except that, it shall be deemed to include that portion of a cooperative apartment corporation or condominium which is rented, leased, let or hired out, to be resided in or occupied or is resided in or occupied, as the home, residence or sleeping place of two or more persons living independently of each other.

(c) An "apartment" is that dwelling which is rented, leased, let or hired out, to be occupied, or is occupied, on a non-transient basis, by a tenant; and is that portion of a multiple dwelling which is rented, leased, let or hired out, to be occupied or is occupied by a tenant, which is separated and set apart from all other parts of the multiple dwelling.

(d) "Landlord" means the lessor to the tenant, and may include the owner of a dwelling or a multiple dwelling, its lessor, sublessor, or their successors, assigns, heirs, or legal representatives, other than the tenant *qua* tenant.

(e) "Tenant" means a person, family, or group of persons that rents, leases, lets, hires out, occupies, resides in, or otherwise pays rent to a landlord on behalf of himself or itself in exchange for the right to reside in or otherwise occupy an apartment.

(f) "Rent" means that consideration paid for the use, residence, or other occupancy of an apartment, exclusive of any amount separately stated for some or all tenants of a multiple dwelling which represents fuel and utility charges or the realistic value for the use of personal property, such as furniture and furnishings, and personal services rendered to the tenant. It is the sum of the "basic rent" and "tenant tax" elements of the leasehold obligation. For purposes of all provisions of the law except this Article unless otherwise provided, the term "rent" shall mean the sum of those elements combined. Where the actual monthly rent is indirectly reduced by concessions, the term "rent" shall mean the net amount actually to be received allocated on a monthly basis over the entire lease term.

(g) "Tenant tax" means that element of an individual tenant's rent which represents that portion of the real estate taxes assessed against the multiple dwelling which is attributable to the individual tenant's apartment, pursuant to §§ 201 *et seq.* hereof.

(h) "Basic rent" means that part or element of an individual tenant's rent not attributable to the tenant tax element.

(i) "Income" means the total funds that would be derived from a multiple dwelling if it were fully occupied before deduction of depreciation and expenses, calculated by adding the annual rent payable by tenants of occupied apartments, imputed rent for an owner-occupied apartment equal to the annual rent of the most comparable apartment in the dwelling, and three times the rent charged for a vacant apartment for the last four calendar months it was occupied.

(j) "Assessing unit" means the governing political subdivision and any agency or agent thereof designated and with legal authority to assess, levy, and collect real property taxes and, for school district taxes, the school district or other similar agency.

(k) "Real property tax" means any ad valorem tax imposed on or assessed against real property under the basic real property tax laws, and includes taxes of that nature imposed by school districts.

(l) "Basic property tax law" means the state, local and municipal

laws, regulations and rules applicable to taxes imposed on or assessed against real property, as if this Article were not enacted, and without regard to the provisions of this Article, and includes provisions related to taxes of that nature imposed by school districts.

COMMENT: Subsection (f) defines "rent" to exclude consideration for other than the mere usage of the apartment to avoid distortions in allocation which might arise from the varying relative usages of utilities, other services, and personal property. However, exclusion is applied only where breakdowns are available for at least some of the units of a multiple dwelling. Where no breakdown for any unit is available, it may be impractical to seek a breakdown; moreover, it is less likely that varying usage impacts the relative unit rent levels. The relative, not the absolute, rent levels have the operational impact under the formula for allocating the real estate tax burden under § 201 hereof.

Subsection (i) defines "income" to include as imputed rent from an owner-occupied apartment an amount equal to the rent of a comparable apartment. This ensures that the formula in § 201(b) will allocate to each tenant only the taxes attributable to his or her unit.

TITLE II: IMPOSITION OF TAX AND RELATED PROCEDURES

§ 201. *Imposition and Computation of Tax Burden*

(a) A tenant shall be personally liable, and is hereby assessed, for one-twelfth of the tenant taxes allocated pursuant to subsection (b) hereof to his apartment for each calendar month, the first day of which he rents, leases, lets, resides in or occupies the apartment and for any calendar month for which a judgment for rent due is obtained against him by the landlord.

(b) A tenant's liability and assessment under subsection (a) shall be ____% of the total assessment on the dwelling or multiple dwelling and the land appurtenant thereto multiplied by a fraction, the numerator of which is the rent payable per annum by such tenant and the demoninator of which is the total income of the dwelling or

multiple dwelling, numerator and denominator to be calculated as of the last day of the assessing unit's fiscal year next preceding the day on which the tax period commences; except that for a dwelling or multiple dwelling which includes vacant land and premises used for commercial or other non-residential purposes, the total assessment on the dwelling or multiple dwelling shall be viewed as excluding that portion, if any, of the total assessment for the premises which is attributable to non-residential uses to the extent not directly incidental to the multiple dwelling utilization. The determination of the portion excluded shall be made pursuant to regulations promulgated by the assessing unit.

COMMENT: Subsection (a) assesses and imposes a liability only on the residential tenant in order to provide the simplest statutory scheme and best retain the status quo. Landlord assessment and liability remain under the basic real estate tax law, except insofar as landlord allocation, collection and notice responsibilities are imposed regarding the tenant tax. The tenant's liability is for ratable amounts of the total apportioned taxes regardless of whether he begins his tenancy subsequent to the real estate tax assessment or terminates it between assessment dates. There is no requirement that the tenant's name be added to the assessment rolls. This feature may be required to qualify as a real estate tax under the law of some states, but it does not affect the substance of the tenant's liability.

Subsection (b) leaves to the legislature the decision on the extent to which the property tax burden is shifted to the tenant. While the exact proportion is indeterminate, most is clearly borne by the tenant.[179] Most jurisdictions will find it advantageous to view the entire burden as shifted since this will provide the largest deduction thereby increasing the disposable income of their residents and in turn augment the jurisdiction's tax revenues. This also avoids one set of computations. The adverse effect on federal revenues can be justified by the failure of Congress to act in this area. However, this subsection assumes that the legislature will adopt the more technically correct position of allocating some portion of the tax burden to the landlord. The allocation is made before apportioning the tax among the tenants, making the computation simple and easy to understand.

179 *See* text at note 7 *supra.*

An allocation and apportionment formula based upon relative rents and rental value is provided. This approach avoids the distortions possible from a physical measure and is most reasonable since rents are usually the main factor affecting the property tax burden on leased residential premises.

The tenant tax burden is limited to residential and incidental uses. Non-arm's length transactions could be accounted for generally only by eliminating that property from the formula, but that would introduce undesirable confusion. This problem may often be taken account of in the tax level under assessment practices which relate to capitalized earnings.

The section leaves to the municipality the determination of allocation by regulation, since the municipality would be most aware of its assessment practices.

§ 202. *Exemptions and Abatements*

(a) A tenant who is liable for tenant taxes allocated to his apartment pursuant to this Article shall not be deemed to own that apartment for the purpose of determining the applicability of any total or partial exemption or abatement from any real estate taxes under any provision of federal, state or local law.

(b) Where the apartment has been leased to the tenant under the provisions of any federal, state or local law which provides for a total or partial exemption or abatement of the tax assessed against the underlying dwelling, multiple dwelling or real property, the provisions of such tax exemption or abatement law shall control in determining the amount of tenant taxes due; provided, however, that if said tax exemption or abatement law permits the owner to increase rent by only a fraction of the total assessed taxes upon the expiration of the tax exemption or abatement, the assessment attributable to an apartment as tenant taxes shall be similarly determined under § 201 hereof.

§ 203. *Contractual and Regulated Rent Levels*

(a) The landlord, in the creation of any residential tenancy, by written or other lease or otherwise, after the effective dates of this Act, shall separately charge basic rent and tenant tax.

(b) The landlord's right and obligation shall be to collect the total rent, including both the basic rent and tenant tax elements; except that the landlord shall receive the tenant tax element pursuant to the provisions of this Article. For leases entered into prior to the effective date of this Act, the landlord's receipt of that portion of the total rent, otherwise attributable to the tenant tax shall be treated as received under this Article for all purposes of this Article.

(c) [1] The total of the basic rent and tenant tax elements shall not exceed the maximum amount provided by the lease permitted by any federal, state or local law, regulation or rule.

[2] A landlord may not charge a tenant under any written or other lease or by reason of a tenancy created by a state or local law relating to the regulation and control of residential rents, an amount in any rent period in excess of the rent reserved in such lease or the maximum rent permitted under such provisions for the regulation and control of apartment rents, reduced by that portion of the real estate taxes payable by such tenant as the rent period bears to the full tax year.

[3] If any statute or regulation of any jurisdiction or if the governing lease allows a landlord to increase the rent charged for an apartment by an amount equivalent to a percentage of the rent previously charged for said apartment then the amount of the permitted increase shall be determined as if this Article were never enacted, but if the basic rent that may be charged after such increase plus the tenant taxes allocated to the apartment exceeds the rent that would have been charged for said apartment if this Article were never enacted, then the rent that may be charged for the apartment shall be reduced by the amount of the excess.

(d) Subsection (c) shall not apply with respect to an apartment leased pursuant to a written lease expressly referring to and exempting itself from the provisions of subsection (c), provided that and to the extent that such provision in such lease is otherwise permitted by law.

[(c) Except for leases entered into prior to or on the effective date of this Act and except for leases entered into subsequent to that date which refer to this Act and expressly provide otherwise, the total of the basic rent and tenant tax elements shall vary with changes in the tenant tax element. That is, the tenant shall bear the burdens and benefits of changes in the level of real estate taxes assessed against the dwelling or multiple dwelling in which his apartment is located.]

COMMENT: Subsection (c) provides a structure which retains the status quo and facilitates rent control. It fixes the total rent level for the lease term and does not immediately pass through to the tenant the impact of real estate tax increases or reductions. A pass-through can, however, be simply achieved by dropping subsections (c) and (d) and adding the bracketed subsection (c) in place thereof.

§ 204. *Landlord Notification to Tenant of Taxes Due and Paid*

(a) Within 30 days of the landlord's or the owner's, if other than the landlord, receipt from the assessing unit of the real property tax assessment against the premises for the next fiscal year or his receipt of notification of change in such assessment the landlord shall send a notice to each tenant stating:

[1] the amount of tenant taxes allocated to the tenant's apartment;

[2] that the tenant should pay one-twelfth of the tenant taxes due to his landlord by the first day of each calendar month of the assessing unit's fiscal year he continues to pay rent for the apartment;

[3] the amount of tenant taxes due on the first day of each calendar month;

[4] that the landlord shall upon receipt of the tenant's payment send the tenant a receipt which shall be conclusive proof that the tenant made the payment; and

[5] that failure to pay tenant taxes may subject the tenant's property to sale by the assessing unit.

(b) The landlord shall send a notice containing the information required by subdivision two of this section to any person who becomes a tenant after the fiscal year's original notice is delivered to other tenants.

(c) Failure by the landlord to mail the notice shall not affect any tenant's liability for tenant taxes.

(d) Between the first day and the thirty-first day of January in each year, the landlord shall send a notice stating the amount of taxes paid by the tenant in the preceding calendar year.

COMMENT: The intermediary status imposed on the landlord by

the Model Act carries with it certain administrative duties but his legal liability is the same as under the existing property tax. While imposing additional liability might hasten the collection of tax revenues, it may be practically impossible to pass more burdensome legislation. The administrative costs to landlords should be fairly small and may well be more than offset by savings from reduced tenant turnover and vacancy rates resulting from the reduced incentive to purchase homes or to quibble over minor rental cost changes. Even if the cost is significant, it can easily be covered by a slight rise in base rents. Although not true in every case, increases in the tenants' burden generally should be more than offset by the benefits of deductibility.

§ 205. *Tenant Payment and Landlord Collection of Taxes*

(a) By the first day of every calendar month, each tenant shall pay his landlord one-twelfth of the tenant taxes allocated to his apartment. Such payment shall discharge the tenant's liability for tenant taxes so paid, regardless of any subsequent disposition of the funds paid.

(b) In the event a notice of intent to abandon is accepted by the assessing unit pursuant to § 206(b) hereof, payment of tenant taxes by the tenant to the landlord, to his agent or directly to the assessing unit, shall discharge the tenant's obligation to pay the tenant tax regardless of any subsequent disposition of the funds paid.

(c) In the event the tenant renders a partial and/or late payment of basic rent plus tenant taxes, or a timely payment where earlier liabilities are outstanding, no amount collected by the landlord shall be viewed as in satisfaction of tenant taxes until the tenant's outstanding liability to the landlord for basic rent payments with respect to the tenant's apartment is discharged.

COMMENT: The landlord is the statutorily designated agent for collecting taxes. Unlike the cases where the intermediary relationship is merely contractual,[180] payment to the landlord will entitle the tenant to a tax deduction regardless of the ultimate disposition of the funds.

180 *See* text following note 90 *supra*.

To eliminate any incentive for tenants to satisfy only part of this leasehold obligation while obtaining the federal income tax benefits, to avoid requiring landlords to make prorata allocations of payments received in such instances, and to continue the rights of both the assessing unit and the landlord against the tenant, subsection (c) attributes payments as first in satisfaction of the liability for basic rent.

§ 206. *Landlord Collection and Liability*

(a) The landlord, as agent for the assessing unit, shall collect tenant tax payments from tenants. A landlord required to collect the tenant tax shall be liable to pay to the assessing jurisdiction tenant tax payments collected from tenants, but only to the extent he is liable for real property tax payments under the basic real property tax law. Any landlord's personal liability shall be discharged *pro tanto* by prepayment of real estate taxes levied under the basic real property tax law.

(b) The landlord, if owner, may be relieved of his obligations to collect the tenant taxes assessed by filing a notice of intent to abandon the dwelling or multiple dwelling and appurtenant incidental property with the assessing unit or other designated agency of the governing body of the governmental unit or jurisdiction in which the dwelling or multiple dwelling is located. Such notice shall constitute an offer of a contract between the governmental unit or jurisdiction and the landlord providing for the transfer of the dwelling or multiple dwelling to the governmental unit or jurisdiction at no consideration upon such terms and conditions as may be agreed upon by the governmental unit and the landlord. Except as otherwise provided by law, the assessing unit or other designated agency may accept or reject or otherwise modify the notice, at its option. The notice shall be effective upon acceptance by the assessing unit or other designated agency, and the landlord shall be relieved from the collection of all future tenant taxes on the dwelling or multiple dwelling. This subsection shall not be construed as relieving the landlord of the obligation to pay real property taxes under any other provision of the basic real property tax law.

COMMENT: The purpose of this provision is twofold: to provide

the landlord with a means by which to terminate the procedural responsibilities imposed on him under this Act; and to notify the municipality so that it may act more expeditiously to minimize the deterioration of premises, inequity to tenants, and administrative and legal burdens which inevitably accompany landlord abandonment of multifamily premises under the more usual procedures which require appointment of a receiver for a failure to provide services, or foreclosure for unpaid real estate taxes. In its absence, the landlord would have to prove abandonment to be relieved of the responsibilities imposed by this Act. Although the assessing jurisdiction need not accept the offer under this provision, it is clear evidence in support of a landlord's claim of abandonment. The landlord would also benefit from this evidence in jurisdictions which impose personal liability on real estate owners for the real estate taxes. The benefit to the community and its tenants from more expeditious procedures on abandonment is obvious. In recent years some states have enacted new procedures to rescue property which appears about to be abandoned or where services, taxes, and the like have not been provided for what, under traditional standards, would be a relatively short time.[181]

§ 207. *Tax Statement Filing with Assessing Jurisdiction*

(a) No later than sixty days after the beginning of an assessing unit's fiscal year, every landlord who owns a dwelling or a multiple dwelling located wholly or partially in the assessing unit shall deliver to the assessing unit or other designated agency the following information for the year ending _____ days prior to the first day of the assessing unit's fiscal year:

[1] the dwelling or multiple dwelling's income and other funds derived from it, separately stated;

[2] a list of each apartment and its tenant, if any;

[3] the apartment's rent if it is occupied, and an explanation for other than fair market rents;

181 *See, e.g.*, N.Y. REAL PROPERTY ACTIONS & PROCEEDINGS LAW § 1971 (McKinney Supp. 1975).

[4] three times the monthly rent charged during and the last four calendar months the apartment was occupied, if it was vacant;

[5] the multiple dwelling's real estate tax assessment for that fiscal year; and

[6] a statement of tenant taxes attributable to each apartment pursuant to this Article.

(b) Any school district may by resolution of its governing body direct its assessing unit to use the information provided by a landlord to a city, county, town or village assessing unit, in which case a landlord shall not file the statement required by subsection one of this section with the school district's assessing unit.

(c) A landlord shall upon the request of any tenant allow the tenant to inspect the landlord's statement of tax allocation filed with the assessing unit under this Section.

§ 208. *Erroneous Tenant Tax Computations*

(a) The landlord shall be liable to the tenant for a civil penalty of treble damages for any intentional or grossly negligent miscalculation of the tenant tax assessed to the tenant; that is, in an amount equal to three times any amount by which the tenant's correct tenant tax assessment exceeds the amount actually assessed. The landlord shall also be liable to the tenant in an amount equal to the tenant taxes attributable to the tenant's apartment if the landlord fails to separately charge the tenant for the tenant tax.

[(b) A class action under § of the civil practice law and rules may be maintained by one or more tenants or by one or more tenants and the owner or other landlord to review the assessment of a dwelling, multiple or other real property under the basic real property tax law where the tenant's apartment is part of such premises, on land appurtenant thereto, or such real property is usable at no fee by all the members of the class because they are tenants.

In the event a class action is brought by one or more tenants, or by one or more tenants and the owner or other landlord to review an assessment under the basic real property tax law the tenant, landlord, or owner bringing the action shall give notice of such action to the other tenants and the owner or other landlord of the dwelling, multiple dwelling, or other real property.

The tenant may recoup from any recovery lawyer's fees and costs of suit in reasonable amounts to be determined by the court.]

(b) [or (c)] If a tenant tax has been erroneously charged by the landlord and collected from any tenant, such tenant shall be entitled to recover the amount or to withhold and retain the same from any tenant tax or basic rent due or accruing from him to the landlord for the apartment on which the tenant tax was paid.

COMMENT: Bracketed subsection (c) granting tenants some of the historical rights of assessees is necessary only if the status quo is changed by adopting the immediate pass-through to tenants of real property tax changes. With a fixed leasehold obligation, such rights are no more necessary than they would be under the status quo. The right to appeal or otherwise challenge the assessment size is desirable under the full pass-through because the landlord has little incentive to reduce the tax burden on his property since he bears so little of it. Although there is a competitive incentive to keep the taxes low, this limitation is likely to be somewhat less effective than the status quo where, prior to new or renewed leases, the landlord has the incentive to act because he reaps the full benefit of tax dollars saved and bears the full cost of those lost.

Granting such rights to tenants may lead to excessive litigation and administrative costs, but the time consumption, inconvenience, and expense involved is likely to restrain their exercise. Only where the net benefits for an individual tenant are sufficient or where a group of tenants act together and share costs will it be worthwhile to pursue such rights.[182]

No reason appears for granting tenants rights in foreclosure. Here they are not uniquely prejudiced or damaged by property forfeiture under a taxing system which includes a tenant tax. It is the landlord who is most directly burdened by foreclosure since the interests and rights of a transferee following foreclosure are subject to existing leaseholds. In fact, where foreclosure occurs, the tenant may be in a more advantageous position than under the status quo. Investors may be more willing both to purchase rental property at foreclosure and to provide better services where they need not be fully concerned about real estate tax rate changes.

182 Class actions here, as in other areas of the law, are the subject of much criticism, but the courts generally appear capable of fashioning rules to limit abuses.

Although not a part of the Model Act, there may be some feeling that tenants should be granted rights such as redemption after foreclosure and satisfaction of outstanding liabilities. Perhaps, to avoid the possible dislocation and governmental burdens from foreclosure and government management, tenants should be provided secondary rights to satisfy outstanding tax liabilities and to obtain ownership prior to foreclosure and public sale, or during the redemption period, after or during an interval of landlord inaction. The landlord's basic rights would persist; during inaction, an individual tenant or tenant group could intervene and take title subject to the landlord's primary rights. However, despite the anticipated benefits it seems unlikely that many tenants or tenant groups would be financially capable of exercising these rights.

§ 209. *Hearing of Tenant Claims Against Landlords or Owners*

A tenant may bring an action in the [local housing court, landlord-tenant court, district court] to enforce the provisions of this Act or to remedy violations of it by the landlord, the owner, or his agent or representative. The rules of procedure, evidence, and appeal which govern that court shall govern actions brought hereunder.

COMMENT: This section is designed to insure that disputes under this Act can be resolved quickly at the lowest level of the judicial system. An administrative hearing system has been rejected as too cumbersome.

TITLE III. COLLECTION OF TENANT DELINQUENCIES

§ 301. *Landlord Collection of Tenant Delinquencies*

The landlord may bring any and all actions or suits against the tenant in any court of competent jurisdiction, to collect either or both elements of the rent due or to evict a tenant delinquent in paying the basic rent and/or tenant tax elements, as the landlord might have brought for the total leasehold obligation prior to, or in the absence

of this Article. If, however, the landlord should bring action or suit for outstanding basic rent, it shall be coupled with claim for any tenant tax outstanding from the tenant with respect to every apartment for which basic rent is being sought in the action or suit. Partial recovery or settlement shall be apportioned to the outstanding basic rent and tenant tax in proportion to the relative outstanding amounts thereof.

§ 302. *Assessing Unit Collection of Tenant Delinquencies*

(a) Within two months after the due date of tenant tax payments to the landlord, each landlord shall file a notice with the assessing unit to inform it of tenant tax payment delinquencies. Such notice shall state the name and address of each delinquent tenant, and list each tenant tax payment due from such tenant by date and amount.

(b) Any tenant may, up to _____ days following each period established for landlords to prepay real property taxes to the assessing unit under the basic real property tax law, pay the assessing unit any unpaid tenant taxes for the preceding period for which the tenant is liable plus an interest of _____% of the amount outstanding on an annualized basis.

(c) [1] Within _____ months after the period established for tenants to pay tenant taxes directly to the assessing unit, the assessing unit shall serve a demand for unpaid tenant taxes upon any tenant whose taxes remain unpaid.

[2] Service of the demand shall be made by personally delivering to the respondent; or by delivering to and leaving personally with a person of suitable age and discretion who resides or is employed in the building where the tenant actually resides, a copy of the demand, if upon reasonable application admittance can be obtained and such person found; or, if the tenant's actual residence cannot be found, by affixing a copy of the demand upon a conspicuous part of the apartment for which tenant taxes are due, and, if known, the building where the tenant actually resides; and, in addition, within one day after such delivery to such suitable person or such affixing, by mailing a copy of the demand to the respondent at his last known address by registered or certified mail.

[3] The demand shall state:

1. the amount of and the period for which tenant taxes are due;

2. how they may be paid; and

3. that within ten days the tenant must either pay the taxes or file an answer with the assessing unit asserting any of the defenses established by § 303 of this Article.

§ 303. *Tenant Defenses to Delinquency Claims*

(a) Valid defenses to landlord suit under § 301 hereof means any and all defenses which would be valid without regard to this Article.

(b) [1] The tenant must within ten days of the service of a demand for tenant taxes under § 302 hereof either pay the tenant taxes or file an answer with the assessing unit.

[2] Valid defenses to a demand under § 302 hereof unpaid tenant taxes are that:

a. the tenant paid the tenant taxes to the landlord or to the assessing unit;

b. the tenant did not reside in, occupy, rent, lease, let, or hire out to reside in or occupy the apartment for any portion of the period for which tenant taxes are demanded; and

c. that the landlord must pay the tenant taxes for any of the reasons established by § 306 of this Article; except that, unless otherwise directly or indirectly provided therein, the tenant shall remain liable for tenant taxes attributable to his apartment even if building code violations exist with respect to the apartment.

§ 304. *Adjudication of Disputes with Assessing Unit*

(a) If tenant files an answer to a demand under § 302 hereof asserting any of the defenses established by § 303 of this Article, the assessing unit shall designate and inform the tenant and his landlord of the time and place where the assessing unit shall hear evidence concerning the tenant's defense. The assessing unit shall inform the landlord of the defenses asserted by the tenant.

(b) If the assessing unit determines that the tenant was not required to pay any portion of the tenant taxes demanded he shall so order.

(c) [1] If the tenant fails to file an answer within ten days to a demand for unpaid tenant taxes under § 302 hereof or upon an

assessing unit's determination that the tenant is liable for any portion of the tenant taxes demanded, the tenant shall pay, and the assessing unit shall so order by demand served in the manner provided in § 302 (c)[2] hereof, within five days of notification those tenant taxes demanded or liability determined, plus one-half of one percent interest monthly on the amount of such liability from the date or dates the tenant taxes should have been paid by the tenant, and may order an additional one percent of the amount of such liability monthly from the date or dates to which the liability relates as a penalty for unreasonable nonpayment.

[2] The demand shall state:

a. the amount of and the period for which the tenant taxes are due;

b. the amount of and the period for which interest and penalty are due, separately stated; and

c. that within five days the tenant must either pay the taxes, interest, and penalties or suffer levy upon and sale of his assets pursuant to § 305 hereof.

§ 305. *Method of Collection by Assessing Unit*

(a) Five days after a tenant is notified under § 304 (c) hereof by the assessing unit, if any such tenant refuses or fails to pay the tenant taxes demanded, the assessing unit may levy upon any personal property in the state belonging to or in the possession of such tenant or any real property in the state belonging to such tenant and, unless the tenant taxes are paid prior thereto, cause the same to be sold at public auction for the purpose of paying the tenant taxes due and the expenses of levy and sale.

(b) Public notice of the time and place of such auction shall be posted in at least three public places in the city or town where the sale is to take place and be published in the assessing unit's or jurisdiction's official newspaper, if one exists.

(c) Any surplus from the proceeds of the sale after payment of the tenant taxes due and the expenses of levy and sale shall be paid to the person liable for the tenant taxes unless a claim therefore is made by some other person on the ground that the property sold belonged to him. If the person liable for the tenant taxes admits the validity of such claim, the surplus shall be paid to the person making the claim, otherwise it shall be paid to the chief fiscal officer

of the assessing unit or jurisdiction who shall retain the same until the rights of the parties have been determined in accordance with law or by agreement of the parties. Either party may bring an action against the other to recover such surplus and, for the purposes of the action, the defendant shall be deemed to be in possession thereof. The successful party shall, in addition to such surplus, be entitled to the costs of the action, including reasonable legal fees. In an action brought pursuant to this subsection, no other cause of action shall be joined, nor shall any setoff or counterclaim be allowed.

§ 306. *Tenant Payment of Taxes during Certain Proceedings*

(a) [1] If a stay of proceedings to dispossess a tenant for nonpayment of rent or any action for rent or rental value upon failure to make repairs is ordered pursuant to § _____ of the landlord-tenant law, then the tenant shall deposit the tenant taxes due, with any basic rent due, with the clerk of the court for any period for which rent is deposited with the clerk of the court. References in the landlord-tenant law to "rent" shall be viewed hereunder as referring to the total of the tenant tax and basic rent elements. Upon the entry of an order vacating the stay, the tenant taxes, as well as any basic rent deposited shall be paid to the plaintiff or landlord or his duly authorized agent.

[2] If a stay of proceedings pursuant to § _____ of the landlord-tenant law is in effect, the landlord shall remain responsible to pay, from his own funds, the real property taxes due on the premises allocated to the apartments of the tenants who are the respondents or defendants in the stayed proceedings under the basic real property tax law, but only to the extent, and in the manner, they would be due.

(b) [1] If a stay or proceeding to dispossess a tenant for nonpayment of rent or any action for rent or rental value is stayed pursuant to § _____ of the landlord-tenant law because of the failure of the landlord or other person having control of said multiple dwelling to pay for utilities for which he may have contracted, the landlord shall, if the stay is in effect at the times when he is required to pay the assessing unit tenant taxes allocated to apartments, remain responsible to pay, from his own funds, the real property taxes due on the premises allocated to the apartments of the tenants who are the respondents or defendants in the stayed

proceedings, but only to the extent, and in the manner, they would be due under the basic real property tax law.

[2] When the stay is discontinued the landlord may recover as tenant taxes the real estate taxes he paid pursuant to this subsection in the same action or proceeding.

(c) [1] If the court in a special proceeding pursuant to § _____ of the landlord-tenant law orders the tenants to deposit tenant taxes due with the clerk of the court, the landlord shall remain responsible under the basic real property tax law to pay, from his own funds, the real property taxes on the premises allocated to apartments in the multiple dwelling, when due, until the completion of the work ordered in accordance with the judgment in the proceeding, but only to the extent, and in the manner, they would be due under the basic real property tax law.

[2] Any tenant taxes deposited with the court pursuant to this subsection shall be used in the same manner as rents deposited pursuant to the judgment in the proceedings.

(d) [1] If a tenant raises the defense established by § _____ of the landlord-tenant law in any action to recover rent or in any special proceeding for the recovery of possession because of nonpayment of rent, the tenant shall deposit any unpaid tenant taxes and tenant taxes that come due with the clerk of the court. If the landlord prevails, the tenant taxes shall be paid to him. If the tenant prevails, the tenant taxes shall be returned to him.

[2] If pursuant to § _____ of the landlord-tenant law any tenant taxes are returned to the defendants or respondents or are on deposit with the clerk of the court at the time landlords pay real property taxes allocable to apartments, the landlord shall remain responsible under the basic real property tax law to pay, from his own funds, any real property taxes due on the premises allocated to the defendant's or respondent's apartment, but only to the extent, and in the manner, required by the basic real property tax law.

(e) Payment of tenant taxes to the clerk of the court under subsection (a), (c), or (d) of this section shall discharge the tenant's liability for the tenant taxes so paid.

COMMENT: This section is intended to coordinate the tenant tax with landlord-tenant law. Where the tenant exercises a defense in an action for the tax he will be denied a deduction for those amounts withheld or subject to total abatement unless and until they are paid.

TITLE IV. MISCELLANEOUS PROVISIONS

§ 401. *Unimpairment of Assessing Unit's Rights Under the Basic Property Tax Laws*

Nothing contained in this Article shall be construed to affect, alter, or in any way impair the rights of the appropriate assessing unit and governmental jurisdiction to collect taxes levied against the landlord pursuant to the basic real property tax law without regard to this Article and as if this Article was never enacted and was not in effect.

§ 402 *Regulations*

The assessing unit or other designated agency shall promulgate regulations interpreting and implementing the requirements and provisions of this Article to best effectuate its apparent intent..

Section 2. Article _____, Section _____ of the Landlord Tenants Law of Chapter _____ is hereby amended to read as follows:

(a) The person who asserts the defenses established by this Article shall deposit unpaid tenant taxes and any such tenant taxes that come due during the proceeding with the court. If the landlord prevails, the tenant taxes shall be paid to him; if the tenant prevails, the tenant taxes shall be returned to him.

(b) If pursuant to this section, any tenant taxes are returned to a tenant or tenants or are on deposit with the clerk of the court, at the time the landlord pays real property taxes allocable to apartments, the landlord shall remain responsible to pay, from his own funds, the real property taxes due on the premises allocated to the apartments of the tenants who are the defendants or respondents, but only to the extent, and in the manner, they would be due under the basic real property tax law.

Section 3. Article _____, Section _____, of the Civil Court of Chapter _____ is hereby amended by adding a new Section _____ to read as follows:

The [local housing court, landlord-tenant court, district court] shall have jurisdiction to hear actions brought under the provisions of the Tenant Tax Act of Article _____, Chapter _____.

Section 4. *Effective date*

This Act shall take effect immediately. However, no real property or school taxes shall be allocated to apartments in any governmental jurisdiction during the fiscal year of the assessing unit of that jurisdiction in which this Act goes into effect.

STATUTE

SECTOR BY SECTOR ANTI-INFLATION LEGISLATION: PROPOSED AMENDMENTS TO THE COUNCIL ON WAGE AND PRICE STABILITY ACT

THOMAS J. DOUGHERTY*

One of the important lessons of our experience with high inflation in the 1970's is that inflation in various sectors of the economy proceeds at different rates with different causes and symptoms. Although the general rate of inflation has been declining in recent months, in many sectors it has not slowed, and in some it has accelerated. The existing Council on Wage and Price Stability is a watchdog of inflation nationwide, but lacks the authority to concentrate its attention on inflation-prone sectors of the economy and to implement a graduated program of anti-inflationary measures.

Mr. Dougherty surveys recent attempts to check inflation to suggest the need for a sector by sector approach. He then proposes that the Council on Wage and Price Stability be given permanent status and establishes procedures for implementing a sector by sector approach. His amendments would authorize a graduated program of anti-inflation measures tailored to each inflationary sector's needs. That program would include disclosure of cost, price, profit and other information by product line in order to increase pressure for competitive pricing; government refusals to purchase goods at inflationary prices; review of inflationary government regulatory policies; and direct wage and price restraints.

Food sector policy is singled out for special attention in the note because food price increases are a bellwether of inflation and because past anti-inflation programs have handled the sector unsuccessfully. The special problems of wage restraint are also analyzed.

Finally, Mr. Dougherty recommends the establishment of a Cost of Living Court of Appeals to review the Council's orders, drawing upon the experience with the Emergency Court of Appeals which existed during the World War II Price Controls Program.

Introduction

The United States economy is projected to improve from very bad to not so bad this year. Real output, measured by the gross national product, is predicted to rise this year for the first year in three.[1] Inflation, measured by all the major price indices may subside to seven percent annually, down from the eight to nine percent inflation of 1975 and considerably below 1974's wholesale

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* Member of the Class of 1976 at Harvard Law School.

1 Golden, *Economists See Little Improvement, That's All,* N.Y. Times, January 4, 1975, § 3, at 46.

price increases of 18 percent. But success in the fight against inflation, if success it is, has been achieved at serious cost. The price paid has been America's sixth and worst recession since World War II.[2] Factories are operating at roughly 71 percent of capacity,[3] and unemployment is now at 8.3 percent across the nation, with considerably higher levels in certain industries and among certain groups of workers.[4] Such high rates of inflation lead to adverse economic effects on allocation and on distribution. First, inflation is undesirable because it causes serious dislocations and imbalances in the flow of economic activity.[5] Furthermore, persistent and widespread price increases over an extended period generate an inflationary psychology that hampers the effectiveness of monetary and fiscal policies.[6] A second effect of inflation is that, as a whole, it tends to redistribute income away from fixed income groups, including those whose return on savings is fixed, and from workers whose economic power is weak towards large powerful corporations, workers with significant bargaining strength and, given the progressive income tax, toward the federal government.[7] In short, it is precisely because the allocative and redistributive effects of inflation are predictable and have been judged socially undesirable that inflation is considered an important public policy problem.

Although it has considered this problem at some length,[8] the 94th Congress has not enacted anti-inflation legislation of any substance.[9] Perhaps Congress has been lulled into complacency by one good Consumer Price Index result. More probably, its

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2 *See* Defina, *Labor and the economy during 1975,* MONTHLY LABOR REVIEW, Jan. 1976, at 3; *Business Outlook,* BUSINESS WEEK, January 26, 1976 at 19.

3 The Wall Street Journal, January 20, 1976, at 2.

4 *See* Defina, *supra* note 2.

5 Bronfenbrenner and Holzman, *Survey of Inflation Theory,* 53 AM. ECON. REV. 646-652 (1963); *Economic Report of the President 1962,* at 167; F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 288 (1971).

6 EXHORTATION AND CONTROLS, THE SEARCH FOR A WAGE-PRICE POLICY 1945-1971 304-08 (C. Goodwin ed. 1975).

7 *See, e.g.,* Aaron, *Taxation and Inflation* (unpublished essay prepared for Brookings Inst. Conference, Oct. 30, 1975) in REPORT ON BROOKINGS CONFERENCE ON TAXATION AND INFLATION (forthcoming).

8 *See, e.g., Hearings on S. 409 before the Senate Committee on Banking, Housing and Urban Affairs,* 94th Cong., 1st Sess. (Feb. 5-6 and March 6-7, 1975).

9 The legislation that it has so far enacted is discussed and criticized below. *See* text at note 93 *infra.*

inaction stems from a fundamental failure to understand the nature of inflation of the 1970's and what can be done to counter it.

The choice that Congress now faces is not between *do nothing* and *do too much*. The alternatives are not limited to a hands-off policy or mandatory across-the-board wage and price controls. Such a dichotomization is, all too familiarly, far more effective as a political campaign weapon than as a guide for setting economic policy. If all Congress does is curse the deficit and cut the budget, its anti-inflation policy will fail again. It will condemn the economy to future rounds of inflationary policy used to end recessions followed by recessionary policy to dampen the resulting inflation. Alternatively, the danger of doing nothing is obvious — at the first breath of new inflation, the administration and the Federal Reserve are likely to abandon the fight against recession or stretch out the recovery, with the result that the country will be put through a lengthy and unnecessary period of slow recovery and chronic unemployment and slack capacity.

The present economic situation offers a valuable opportunity to seek the middle ground. What is needed is a recognition of the special nature of the current inflation, and a shift in the way we conceptualize our responses to it. Such a basic reordering of our approach to the problem of inflation will not be easy, but recent experience suggests its necessity.

The severity and persistence of the current inflation have shaken economists' faith in traditional theories of inflation's causes and cures. This notes does not present a new theory; it presents a practical plan of action that translates a centrist view of the political economy of inflation into a legislative framework.[10] Part I sketches and criticizes anti-inflation policies of 1960-1975. Part II analyzes the causes and characteristics of the present inflation and suggests what can be done to stop it. Part III

10 An earlier version of this bill was drafted last spring in response to a request from the staff of Senator Edward Kennedy. *See* 121 CONG. REC. E1805-06 (daily ed. April 16, 1975). (Congressman James A. Burke D-Mass., Extension of Remarks). Based in part on analysis supporting that early draft, Senator Kennedy offered some modest amendments to S-409. 121 CONG. REC. 6792 (daily ed. April 25, 1975) 121 CONG. REC. 7545-50 (daily ed. May 6, 1975) (Sen. Kennedy). Failure of the Congress to strengthen the Council on Wage and Price Stability prompted this note.

sets out the Council on Wage and Price Stability Act and proposed amendments, together with comments to each.

I. Historical Perspective: Anti-Inflation Policy 1960-75[11]

A. *The Kennedy Wage-Price Guidelines*

From 1960 to 1964, the Consumer Price Index was reasonably stable, averaging a 1.2 percent annual increase. Unemployment, however, averaged 5.8 percent from 1954 to 1963.[12] The Kennedy Administration felt that six percent unemployment was too high for an equilibrium value, so it set about to use fiscal and monetary policy to reduce that figure. However, uneasy about the possibility of inflation, the Administration instituted wage-price guidelines.[13]

The guidelines were based on an estimation that the average annual rate of productivity increase during 1957-62 had been 3.2 percent. If wages rose 3.2 percent annually, unit labor costs would remain stable and, *ex hypothesi,* so would prices. In industries where productivity gains were less than 3.2 percent, prices could rise to pay a higher real wage bill; in industries where productivity gains exceeded 3.2 percent, prices should fall. Regardless of theory, the guidelines were largely ignored in practice. By mid-1966, they had gradually collapsed as many union leaders began boasting to their members and to the public that the latest settlements were exceeding the guidelines.[14]

Also, faulty projections about the relative labor costs and price levels doomed the program to failure. Implicit in the goal that unit labor costs and prices remain constant was the assumption that labor's share in national income would also remain constant (i.e., its slice of the national income pie would not increase or decrease relative to that of investors). However, profits rose at

11 For a discussion of anti-inflation policy from 1945 to 1961 *see* Exhortation and Controls: The Search for a Wage-Price Policy 1945-71 9-134 (C. Goodwin ed., 1975).

12 M. Evans, Macroeconomic Activity, Theory, Forecasting, and Control 540 (1969).

13 *See* Exhortation and Controls: The Search for a Wage-Price Policy 1945-1971 149-54, 190-91. (C. Goodwin, ed. 1975).

14 M. Evans, *supra* note 12, at 540.

an annual rate of 11 percent during 1961-65, whereas total wages rose only five percent.[15]

Profits rose faster than wages for two reasons. First, the national guidelines were set too low. Productivity in the manufacturing sector grew at approximately four percent per year, but almost no industries cut prices. Therefore, unit labor costs fell while prices stayed the same, and profit margins increased.[16] Second, in 1965 non-farm wholesale prices rose 1.3 percent, whereas they should have been falling with falling unit labor costs. Consequently, the spread between price and unit labor costs widened even further.[17]

In 1966, food prices rose about ten percent. Labor leaders called for six percent pay increases in upcoming negotiations, and many industries raised prices further in anticipation of large wage settlements. The guidelines had failed.[18]

B. *The Nixon Economic Stabilization Program*

In the late 1960's, inflation in the United States reached what was then considered a severe level. The Consumer Price Index accelerated from an increase of 2.8 percent in 1966-67 to roughly 6.0 percent in 1970-71.[19]

Upon his election in 1968, President Nixon declared he would not seek nor use authority to control inflation directly.[20] In August of 1970, however, such authority was provided when the Democratic Congress passed the Economic Stabilization Act in the face of strong Administration opposition.[21] This legislation was grounded, at least in part, in the realities of partisan politics. "The President's opponents apparently sought to place him in

15 *Id.* at 541.
16 *Id.*
17 *Id.*
18 *Id.*
19 U.S. BUREAU OF LABOR STATISTICS, DEPT. OF LABOR, HANDBOOK OF LABOR STATISTICS 276 (1972).
20 EXHORTATION AND CONTROLS: THE SEARCH FOR A WAGE-PRICE POLICY 1945-1971 295 (C. GOODWIN ed. 1975).
21 The Economic Stabilization Act of 1970, Pub. L. No. 91-379, 84 Stat. 799 (1970) was originally enacted as part of an amendment to the Defense Production Act of 1950, which President Nixon did not want to veto. The Act was then expanded and extended to April 30, 1972, Pub. L. No. 92-15, 85 Stat. 38 (1971). Subsequent revisions for two one year periods finally expired on April 30, 1974. Pub. L. No. 92-210, 85 Stat. 743 (1971), Pub. L. No. 93-28, 87 Stat. 27 (1973).

the position that they could criticize him if he failed to use [wage and price controls], or if he used them to criticize him for not having his heart in the exercise or for their ineffectual administration."[22] Responding to a deteriorating economic situation, the President first applied controls on March 29, 1971,[23] to the construction industry where first-year collective bargaining settlements were averaging 17 percent.[24]

The imposition of a comprehensive wage-price freeze, which followed on August 15, 1971, was the first general application of direct inflation controls in the peacetime history of the United States.[25] That such action was taken by a Republican Administration, whose economic rhetoric up until that time had been primarily *revanchist,* suggests the political uncertainty and tension which surrounded Nixon's new economic policy. Phase I marked the beginning of a series of phases and freezes that became known as the Nixon Administration's Economic Stabilization Program.

The "new economic policy" primarily sought to strengthen the dollar against other currencies, especially the yen and the mark, and to encourage economic expansion through investment credits to business.[26] The dollar had been overvalued for some time both

22 J. Dunlop, Inflation and Income Policies: The Political Economy of Recent U.S. Experience, 5, Oct. 17, 1974 (unpublished Harvard Economics Seminar Memorandum) (on file at the Harvard Journal on Legislation).

23 Exec. Order No. 11588, 36 Fed. Reg. 6339 (1971).

24 Dunlop, *supra* note 22, at 6.

25 A. WEBER, IN PURSUIT OF PRICE STABILITY: THE WAGE-PRICE FREEZE OF 1971 1 (1973).

26 *See* OFFICE OF ECONOMIC STABILIZATION OF THE DEPARTMENT OF THE TREASURY, HISTORICAL WORKING PAPERS ON THE ECONOMIC STABILIZATION PROGRAM, AUGUST 15, 1971 TO APRIL 30, 1974, at 9-10 (1974) [hereinafter cited as HISTORICAL WORKING PAPERS].

The HISTORICAL WORKING PAPERS comprise 2348 pages of published description and analysis of most aspects of the administration of the Economic Stabilization Program. Importantly, however, food price policy and behavior is not included in the published study. It is suggested that food was too "controversial" an area to be treated in an official report. HISTORICAL WORKING PAPERS 1425. More likely, the omission is due to the Nixon Administration's understandable reticence to publicize the failure of its food inflation policies. The HISTORICAL WORKING PAPERS make reference to two unpublished studies prepared for the Office of Economic Stabilization and filed in the National Archives: G. Nelson, Food and Agricultural Policy in 1971-74, Reflections on Controls and their Impact, December 1974 [National Archives Record Group No. 432, Box 956, 197 pages], and R. Brown, Regulatory Food Prices During the Economic Stabilization Program 1971-74, December 1974 [National Archives Record Group No. 432, Box 956, 76 pages]. The latter

against gold and against other major currencies; and the economy's general sluggishness had been widely noted.[27] The stimulus to investors, to exporters, and to industries subject to foreign competition was aimed at raising output and lowering unemployment from its then current level of 6.1 percent.[28] Wage and price controls were merely an adjunct to the expansionist program. They were intended as moderating checks "to reduce inflationary consequences of the unprecedented devaluation rather than as a significant end in themselves."[29]

The Phase I freeze took effect immediately upon its promulgation by President Nixon on August 15, 1971.[30] The freeze order provided for the stabilization of prices, rents, wages, and salaries, for a period of 90 days. It also established the Cost of Living Council,[31] which was charged with the primary responsibility for administering the stabilization program and for recommending to the President additional policies and mechanisms to permit an orderly transition from the 90-day general price, rent, wage and salary freeze to a more flexible and selective system of economic restraints.[32]

There is little disagreement that the comprehensive freeze did restrain wage and price increases in the short run. The major price indices showed a marked deceleration during the freeze period. The Consumer Price Index rose at an annual rate of 1.6 percent from August to November 1971, as compared with 4.0

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is a thoughtful and sharply critical essay on the Economic Stabilization Program's approach to control of food price inflation. It is curiously marked "Not Published — Only Copy. SEQUESTERED." Perhaps it was thought too critical for general distribution. *See also* A. WEBER, *supra* note 5, which evaluates Phase I.

27 *See* HISTORICAL WORKING PAPERS, at 9-10.

28 *Id.*

29 Dunlop, *supra* note 22, at 6.

30 Exec. Order No. 11615, 36 Fed. Reg. 15727 (1971), 12 U.S.C. § 1904 (Supp. III, 1973), issued under authority of the Economic Stabilization Act of 1970, Pub. L. No. 91-379, § 203, 84 Stat. 799 (1970).

31 The Council comprised the Secretaries of the Treasury, Agriculture, Commerce, Labor, and Housing and Urban Development (the latter was not named in Exec. Order No. 11615, but was included in the amending Exec. Order No. 11617, 36 Fed. Reg. 17813 (1971)); the Director of the Office of Management and Budget, the Chairman of the Council of Economic Advisors; the Director of the Office of Emergency Preparedness; the Special Assistant to the President for Consumer Affairs; and, as advisor, the chairman of the Federal Reserve Board.

32 For a survey of the policy planning of Phase I, *see* HISTORICAL WORKING PAPERS, *supra* note 26, at 8-20.

percent in the six months preceding the freeze.[33] The decline in the rate of increase in the Wholesale Price Index was even more dramatic: the index declined at an annual rate of almost 0.4 percent during the freeze, as compared with an annual rate of increase of 4.9 percent prior to the freeze.[34] The largest price increases occurred in the prices of foods, nondurable goods, services and rent. The freeze did not cover most food prices, and some of the increase in the price of services and rent had occurred before the freeze.[35] This short-run success was "facilitated by the fact that the freeze was imposed on a cool economy marked by considerable slack in the labor force and industrial capacity."[36] Moreover, the freeze had little or no effect on food prices, and the stability of food prices during August to November 1971 should not be attributed to the freeze.[37] However, much of the popular perception of the short-term success of the freeze was probably attributable to the stability of food prices.[38] That people thought the freeze was a successful device for checking food price inflation proved to be unfortunate in retrospect. In the longer run, the "toughness" of the freeze "clearly contributed to the magnitude of the post-freeze 'bubble' that distorted wage and price movements in the first few months of Phase II and made it extremely difficult to maintain the credibility of the stabilization program."[39] From November 1971 through February 1972, the Consumer Price Index rose at an annual rate of 4.8 percent, the Wholesale Price Index by 6.9 percent, and the index of hourly earnings for private non-farm production workers by 9.4 percent.[40]

Phase II was announced on October 15, 1971,[41] and implemented on November 13, 1971.[42] The freeze on wages and prices was discontinued, and a system of flexible wage, price and rent

33 A. WEBER, *supra* note 25, at 100.
34 *Id.*
35 *Id.* at 101.
36 *Id.* at 122.
37 G. Nelson, *supra* note 26, at 33.
38 *Id.;* R. Brown, *supra* note 26, at 4.
39 A. WEBER, *supra* note 25, at 126-27.
40 ECONOMIC REPORT OF THE PRESIDENT 57,228 (January 1973).
41 Exec. Order No. 11627, 36 Fed. Reg. 20139 (1971).
42 R. LANZILLOTTI, M. HAMILTON & R. ROBERTS, PHASE II IN REVIEW: THE PRICE COMMISSION EXPERIENCE 1 (1975).

controls was authorized. Price and rent controls were administered by a Price Commission, composed of seven public members, and wage restraints were managed by a tripartite Pay Board, comprised of five representatives of business, five representatives of labor and five public members.[43] These two groups were independent of the Cost of Living Council, but were required to act in concert with it.[44]

Overall goals of Phase II included a halving of the rate of price inflation from five or 5.5 percent down to two or three percent and a growth in productivity of three percent. Combining these objectives with a ceiling on wage increases of 5.5 percent and an additional 0.7 percent for pensions and health and welfare benefits, the Administration sought to tie wage guideposts to aggregate productivity gains, and prices to unit labor costs on an industry by industry basis so that an overall target of 2.5 percent inflation might be achieved.[45]

Price and wage increases above these norms could be approved by the Pay Board or the Price Commission. The general price standard specified that prices could be increased over August 1971 levels no more than would be proportional to increases in costs. If prices *were* increased, however, a firm's profit margin in relation to sales could not exceed the average of the best two of the three fiscal years preceding August 1971.[46] Both the Pay Board and the Price Commission operated regionally from the offices of the Internal Revenue Service. The Construction Industry Stabilization Committee in the meantime continued functioning as a semi-autonomous body subject only to the condition that its wage norms were to be consistent with those of the Pay Board. The Cost of Living Council continued as the coordinating and policy-making body.[47]

43 *See* HISTORICAL WORKING PAPERS, *supra* note 26, at 116, 118.

44 HISTORICAL WORKING PAPERS, *supra* note 26, at 22-26, 116. *See also,* R. LANZILLOTTI, *supra* note 42, at 9-26. Presidential authority underpinning Phase II was strengthened by the Economic Stabilization Act Amendments of 1972, Pub. L. No. 92-210, 85 Stat. 743 (1971).

45 ECONOMIC REPORT OF THE PRESIDENT 96-100 (January 1972). *See generally,* GUIDELINES, INFORMED CONTROLS, AND THE MARKET PLACE: POLICY CHOICES IN A FULL EMPLOYMENT ECONOMY (G. Shultz, R. Aliber ed. 1966). *See also,* J. SHEAHAN, THE WAGE PRICE GUIDEPOSTS (1967).

46 R. LANZILLOTTI, *supra* note 42, at 34-35.

47 J. Dunlop, *supra* note 22, at 7.

As in Phase I, raw agricultural products were not controlled at all. Thus, "Phase II price and wage controls had little or no direct effect on price increases originating at the farm level."[48] The Phase II control scheme for food manufacturers was identical to that employed for the rest of the economy.[49] That is, food manufacturers' price increases were allowed if related to cost increases, subject to a further constraint that firm-wide historical profit margins not be exceeded.[50] Firms with over $100 million in annual sales volume were required to notify the Price Commission 30 days in advance of proposed price increases.[51]

During the implementation of Phase II, the fluctuation of food raw material prices interfered with the smooth administration of a prenotified price control scheme, in which price increases had to be justified by cost. Firms subject to large and unforseeable fluctuation in raw material costs were unable to make the nearly instantaneous adjustments necessary to avoid cost absorption. Such firms were exempted from prenotification, under a "volatile price authority" rule.[52]

The upward pressure on raw agricultural prices was soon aggravated by events on the other side of the globe. The U.S.S.R.'s production of total grains in 1972-3 was only 156 million tons, 13 million tons less than in 1971-2, which was in turn 5 million tons less than 1970-71 production.[53] Nearly all of the decline took place in wheat. Such variation was not uncommon; nor was it uncommon for the Soviet Union to make large purchases in world markets to offset substandard production.[54]

On July 8, 1972, the White House triumphantly announced the Soviet-American grain deal.[55] The U.S.S.R. agreed to pur-

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48 G. Nelson, *supra* note 26, at 38.

49 R. Brown, *supra* note 26, at 5.

50 *Id.*

51 36 Fed. Reg. 21790 (1971).

52 R. Brown, *supra* note 26, at 7.

53 G. Nelson, *supra* note 26, at 51-52.

54 *Id.* at 51, 53. Soviet net imports in similar poor harvest years were as follows: 1963-64, 5.8 million metric tons imported; 1965-66, 3.7 million metric tons imported; 1971-72, 2.2 million metric tons imported.

55 Albright, *Some Deal,* N.Y. Times, Nov. 26, 1973 (Magazine), at 95, Col. 2, *see also,* D. HATHAWAY, FOOD PRICES AND INFLATION, BROOKINGS PAPERS ON ECONOMIC ACTIVITY, 63, 85-90 (1974); J. SCHNITTKER, THE 1972-73 FOOD PRICE SPIRAL, BROOKINGS PAPERS ON ECONOMIC ACTIVITY, 498-506 (1973).

chase $750 million of grain during a three-year period beginning August 1, 1972, at least $200 million of which would be purchased in the first year.[56] The Soviet Union was granted a credit up to $500 million in a manner similar to other purchasers of agricultural products.[57]

Beginning in early July and continuing through early August the Soviet Union purchased an unprecedented 20 million tons of wheat and feed grains fully offsetting their short-fall in production.[58] Three-fourths of the purchases were of wheat, and the bulk of these purchases were made from private American export companies. From 1971-72 to 1972-73, Soviet grain consumption actually rose 2.7 percent, rather than decreasing as expected following substandard production.[59]

The Department of Agriculture had been pursuing a policy of subsidizing wheat exports and continued it throughout the period of the Russian purchases. The export subsidy was designed to maintain the U.S. competitive position in world trade while domestic producers were receiving higher prices. Exporters received a payment for the difference between the domestic price and the lower fixed world price of $60 per ton. In the third quarter of 1972, a total of about $300 million of U.S. taxpayers' money was expended to subsidize Soviet and other foreign wheat consumers.[60] The farm price of wheat reached $2.38 per bushel by December, but since many wheat growers had sold in June and July for $1.38 per bushel or less, speculators and exporters reaped windfalls of $1 per bushel or more.[61]

The U.S. Department of Agriculture announced a very restrictive wheat program for 1973 on July 17, 1972, despite the announcement of the Soviet grain deal a few days earlier.[62] The Department's goals included a reduction of government stockpiles of grain and an improvement of farm incomes. Payments to farmers to set aside acreage — not to produce — were the maximum

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56 U.S. DEPT. OF AGRICULTURE, WHEAT SITUATION, WS-221, August 1972 at 3.
57 Albright, *supra* note 55, at 95, col. 3.
58 G. Nelson, *supra* note 26, at 54.
59 *Id.*
60 G. NELSON, *supra* note 26, at 55.
61 *Id.* at 55.
62 U.S. DEPT. OF AGRICULTURE, *supra* note 56, at 9-10.

allowed by law.[63] This combination of inept policy decisions by Secretary Earl Butz and his department contributed to a new upswing in prices in 1973-74. Furthermore, it resulted in needless costs to American taxpayers, as already mentioned, and in a loss of foreign exchange earnings due to the artificially depressed world grain prices.

The effectiveness of Phase II controls on prices of nonagricultural goods at the aggregate level has been summarized as follows:

> Comparisons of actual changes in prices at the aggregate level, and estimates of what would have occurred under historical conditions without price and wage controls, indicate first, a significant reduction in the rate of inflation for consumer prices (around 2.0 percentage points) and, second, a much smaller impact on wholesale prices (no more than 0.5 percentage points). These conclusions seem to follow from a variety of different approaches using aggregate, private nonfarm data.[64]

Phase III was established on January 11, 1973.[65] It involved a shift from the Phase II system of specific rules requiring cost justification and prior approval to a system of loose, self-administered standards. Rent was decontrolled entirely. The functions of the Price Commission and the Pay Board were merged into a reorganized Cost of Living Council.[66] The looseness of the standards in Phase III is exemplified by one regulation allowing price increases above those attributable to cost increases whenever "necessary for efficient allocation of resources or to maintain adequate levels of supply."[67]

A number of reasons have been given for the drastic shift from Phase II to Phase III: (1) the Administration had always been opposed to controls and eagerly sought an alternative; (2) price controls were not working well in several industries such as

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63 *Id.*

64 R. LANZILLOTTI, *supra* note 42, at 114.

65 Exec. Order No. 11695, 6 C.F.R. 605 (1974) 12 U.S.C. § 1904 (Supp. III, 1973).

66 The new Council was headed by Harvard economics professor John T. Dunlop, who had previously been the chairman of the Construction Industry Stabilization Committee, *see* text at note 148 *infra*. HISTORICAL WORKING PAPERS, *supra* note 26, at 138.

67 6 C.F.R. § 130.13 (1974).

lumber and textiles;[68] (3) the economy was approaching capacity utilization in many sectors, creating the need for more flexibility in general price regulations; (4) a general belief on the part of Secretary of the Treasury George P. Shultz, that even the best controls became ineffective or unmanageable over time.[69]

While the remainder of the economy was placed under a voluntary controls program, food manufacturing prices continued to remain under mandatory controls. The cost pass-through system that comprised Phase II was continued during Phase III with minor modifications.[70] But, as in Phases I and II, "Phase III food price policy did not attempt systematically to restrain large increases in raw product prices."[71] The shortages induced by the inept action of the Department of Agriculture in 1972 were, therefore, free to work their effects on prices in the food sector.[72]

The easing of restraint in Phase III was followed by a price explosion. Wholesale prices increased at a rate of 12.5 percent annually over the first year of Phase III.[73] A sector-by-sector breakdown of the price advance reveals that 90 percent of the increase in the Wholesale Price Index during January to June 1973 was concentrated in four sectors: food, petroleum products, textiles and lumber.[74] Food prices, for example, increased at the following seasonally adjusted annual rates:[75]

November 1972	8.4
December 1972	— 1.2
January 1973	25.2
February 1973	22.8

68 R. LANZILLOTTI, *supra* note 42, at 139.
69 J. Dunlop, *supra* note 22, at 9.
70 R. Brown, *supra* note 26, at 9.
71 *Id.* at 9.
72 G. Nelson, *supra* note 26, at 57-60, describes other inflationary decisions of the Department of Agriculture. For example, throughout 1972, the Department recommended a reduction in egg production in order to gain "improvement" in egg prices. These rose sharply from 55 cents per dozen at retail in November 1972 to 74 cents in January 1973. To make matters worse, in January the Department recommended a cutback in broiler production—at the very time when the prices of poultry and meat (which are forms of processed grain) were skyrocketing in reaction to the Russian grain deal and other stimuli.
73 R. LANZILLOTTI, *supra* note 42, at 198.
74 HISTORICAL WORKING PAPERS, *supra* note 26, at 51.
75 *Id.* at 43.

March 1973	28.8
April 1973	16.8
June 1973	10.8

On March 29th, the Nixon Administration imposed a ceiling on the prices of red meat at processing, wholesale and retail levels.[76] Again, the raw agricultural product, cattle feed, was exempt.[77] On May 2, the Phase II requirement that major businesses prenotify the Cost of Living Council of price increases was reinstituted.[78] On June 13, 1973, a second general freeze, of 60 days' duration, was imposed,[79] but again, raw agricultural products were not frozen.[80] Despite these measures, the Administration's efforts were soon overwhelmed by another foreign development with extensive domestic inflationary impact.

Between October 1973 and January 1974, the export price of Saudi Arabian light crude oil increased three and one-half fold. By the end of 1974, it was four times the level it had been prior to the Arab-Israeli war of 1973.[81] This was the single most inflationary event since World War II.[82] The Brookings Institution study of the immediate effects of OPEC price hikes and governmental response to them has been summarized as follows:

> *In sum,* the price-raising effect of the oil crisis, following hard on an already accelerating inflation, attracted far more attention from the makers of economic policy in the industrial nations than did its depressing effects on aggregate demand. Monetary policies, far from being relaxed to offset the demand-reducing effects of the oil "excise tax," were tightened in an effort to moderate its inflationary impact. The tightening was particularly evident in the United States and Japan, but it was also observable to a lesser extent in most Western European countries. The forces leading to recession were strengthened further. By the end of 1974 the sharp fall in aggregate demand was clearly acting to decel-

76 *Id.* at 51-52. On April 30, 1973, the Economic Stabilization Act was extended until April 30, 1974. Pub. L. No. 93-28, 87 Stat. 27 (1973).

77 Brown, *supra* note 26, at 11.

78 HISTORICAL WORKING PAPERS, *supra* note 26, at 52-53.

79 Exec. Order No. 11723, 6 C.F.R. 612 (1974), 12 U.S.C. § 1904 (Supp. III, 1973).

80 HISTORICAL WORKING PAPERS, *supra* note 26, at 161.

81 HIGHER OIL PRICES AND THE WORLD ECONOMY, THE ADJUSTMENT PROBLEM 1-2 (E. FRIED and C. SCHULTZE eds. 1975).

82 *Id.*

> erate inflation in every country except the United Kingdom. But the cost, in most countries, was the worst recession in thirty years.[83]

By 1975, the OPEC price increases had reduced the United States' real GNP by about $35 billion and had directly increased unemployment by about one percentage point.[84] "Higher oil prices had directly added 3.5 percent to the consumption price deflator and were projected to add roughly that much again through wage-price spiral effects."[85]

Phase IV was established on July 18, 1973.[86] It aimed at minimizing the secondary effects of the enormous increases in the prices of raw materials that had occurred during Phase III. Just as Phase II was designed to permit a gradual withdrawal from controls, Phase IV was designed to permit gradual elimination of the meat ceiling and the second freeze. Unlike Phase III's across the board approach, Phase IV decontrol strategy called for a sector by sector approach.[87]

The separate treatment of different sectors was designed in recognition of the enormous differential cost pressures working their way through the economic system due to price increases of primary materials and imports. The regulations were intended to spread the expected consumer goods price increases over a longer period of time and generally to dampen price rises without disrupting supply.

John T. Dunlop, who oversaw Phase IV as head of the Cost of Living Council, described the Phase IV purpose and methodology as follows:

> Phase IV was also designed as a way out of controls, a purpose which the self-administration of Phase III had not achieved. The elimination of controls was to be achieved by lifting wage and price controls simultaneously on a sector by sector basis. Starting with the fertilizer industry in October and the cement industry in November decontrol was granted in exchange for various commitments made by companies to limit

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83 *Id.* at 27.
84 *Id.* at 103.
85. *Id.*
86 Exec. Ord. No. 11730, July 18, 1973, 38 Fed. Reg. 19345.
87 HISTORICAL WORKING PAPERS, *supra* note 26, at 63.

> price increases even beyond the expected expiration of control authority on April 30, 1974, to limit exports, to increase productive capacity, start up shut-down facilities, provide additional statistical data, and take various industrial relations steps in a few cases in cooperation with the collective bargaining agent. In general, decontrol prior to April 30, 1974 was to be achieved by a sector in exchange for commitments to restrain price and to increase supply.[88]

Presidential authority to impose a system of mandatory wage and price controls contained in the Economic Stabilization Act of 1970 expired at midnight on April 30, 1974.[89] By mid-June, the Cost of Living Council, left with only its monitoring function, had closed up shop.[90]

In the months that followed, double digit inflation continued unchecked. The Consumer Price Index increased at an annual rate of 12.6 percent over those months.[91] The annual rate of increase in the Wholesale Price Index was an astounding 44 percent in July 1974, and more than 55 percent at a compound annual rate.[92]

C. *The Ford Council on Wage and Price Stability*

Government attention to the economy, as with other policy matters, was minimal during the summer of 1974 preceding the resignation of President Nixon. In his first speech to Congress, President Ford endorsed a bill establishing an executive group to monitor inflationary developments.[93] The bill was enacted within a matter of days.[94] It established the Council on Wage and Price Stability (COWPS), an eight-member board appointed by the President and charged with the task of monitoring the economy. The Council, however, was a body with severely limited

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88 J. Dunlop, *supra* note 22, at 12.

89 Pub. L. No. 91-379, 84 Stat. 799 (1970) (codified at 12 U.S.C. § 1904 (Supp. III, 1973)).

90 Exec. Order No. 11781, 39 Fed. Reg. 15749 (1974) provided for an "orderly transition" from mandatory controls. Exec. Order No. 11788, 39 Fed. Reg. 22113 (1974), abruptly killed the Council.

91 121 CONG. REC. 7545 (daily ed. May 6, 1975) (remarks of Senator Muskie).

92 *Id.*

93 121 CONG. REC. 8160 (daily ed. August 12, 1975).

94 Council on Wage and Price Stability Act of 1974, 12 U.S.C.A. § 1904 (Supp. 1975).

powers: it was expressly not authorized to impose mandatory economic controls;[95] it had no power to compel the production of cost, wage, price, or other information from the businesses which it was charged with monitoring; it could not compel production of profit or expense information from the IRS or other federal agencies;[96] it could not disclose cost information that it did receive from business or government agencies;[97] it was not given authority to use government purchasing power to resist inflationary price increases; it had a minimal budget and staff;[98] and its authorization lasted for only a year.[99]

Inflation continued unabated from March 1974 to March 1975. The Wholesale Price Index increased 12.5 percent (down from 18.8 percent for April 1973 to April 1974). The Consumer Price Index increased 10.3 percent from March 1974 to March 1975 (slightly higher than the figure for March 1973 to March 1974 of 10.2 percent).[100]

COWPS efforts, consistent with its limited authority, were hortatory. For example, on November 25, 1974, it held public hearings to discuss the sharp increase in the price of sugar that had taken place. COWPS worked with food processors and the press to encourage sugar conservation and the promotion of sugar-free products.[101] The price of sugar fell, but COWPS actions probably contributed little if anything to the decline. In December 1974, COWPS investigated price increases announced by three major steel producers. Albert Rees, Chairman of COWPS, has stated that he was successful in achieving a 20 percent rollback in these prices, but it is unclear whether these companies initially asked for 125 percent (or more) of the price increases they wanted, anticipating the 20 percent "rollbacks."[102]

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95 *Id.* § 3(b).

96 *Id.* § 4(e).

97 *Id.* § 4(b),(c),(d).

98 *Id.*, §§ 2(b),(d), 6. The Council staff numbered about 35. *Hearings on S. 409, supra* note 8, at 13 (Statement by Albert Rees, Director of the Council on Wage and Price Stability).

99 *Id.*, § 7.

100 121 CONG. REC. 7545 (daily ed. May 6, 1975) (remarks of Sen. Kennedy).

101 *Hearings on S. 409, supra* note 8, at 13.

102 *Id.* Without power to subpoena cost information, COWPS would not be certain that the allowed price increase was justified by cost increases, but Mr. Rees stated that this "appeared" to be so.

D. *S. 409 — The Senate Banking Committee's COWPS Amendments of 1975*

Dissatisfaction with the continuing high levels of inflation led to movement within the Senate Banking Committee to amend the 1974 Anti-Inflation Act to give COWPS some "teeth,"[103] that is, power to limit or delay price and wage increases. Senate Bill 409, as originally proposed by Senators Proxmire and Stevenson, gave COWPS power "to require periodic reports" and to subpoena "books, papers and other documents relating to wages, prices, costs, profits and productivity by product line . . . ."[104] COWPS was required to make available to the public any information collected from private firms unless the Council determined that public disclosure of such information would "impose an undue competitive disadvantage" on the firms submitting the information.[105] The bill authorized COWPS to require prenotification of wage and price increases by major companies and employee groups,[106] and also to delay inflationary price increases for up to sixty days.[107] Its budget was to be increased from $1,000,000 to $4,000,000,[108] and its life was to be extended by two years to September 30, 1977.[109]

As enacted, S. 409 gave COWPS slightly sharper eyes but no "teeth." It authorized COWPS, for any purpose related to the Act, to:

> (1) require periodic reports for the submission of information maintained in the ordinary course of business; and (2) issue subpoenas signed by the Chairman or the Director for the attendance and testimony of witnesses and the production of relevant books, papers, and other documents, only to entities whose annual gross revenues are in excess of $5,000,000; relating to wages, costs, productivity, prices, sales, profits, imports and exports by product line or by such other categories as the Council may prescribe.[110]

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103 *Id.* at 1-3.
104 *Id.* at 6.
105 *Id.* at 7.
106 *Id.*
107 *Id.* at 8.
108 *Id.* at 9.
109 *Id.* at 10.
110 Pub. L. No. 94-78 § 3 (Aug. 9, 1975).

It gave the Council authority to intervene in rule making and other proceedings before federal agencies to express its views as to the inflationary impact that might result from such proceedings.[111] It extended the life of the Council to September 30, 1977, as had been originally proposed,[112] and increased its budget from $1,000,000 to $1,700,000.[113]

It is worth noting the differences between the informational burdens placed on businesses by the Proxmire-Stevenson bill and by the law as enacted.

First, although both drafts authorize the Council to subpoena books and other documents relating to wages, prices, costs, etc., by product line, the law as enacted limits this power to business and unions with annual gross revenues exceeding $5,000,000.

Second, although both drafts apparently authorize COWPS to require periodic reports relating to wages, prices, costs, etc., by product line (without a lower limit on the size of business or union which may be required to submit such a report), the law as enacted shifts a significant administrative burden onto COWPS. That is, under the Proxmire-Stevenson draft COWPS could require periodic reports without the restriction contained in the law as enacted that they be limited to "information maintained in the ordinary course of business." Under the Proxmire-Stevenson draft, COWPS could require any company to incur the expense of preparing a report on wages, prices, costs, profit and productivity on a product by product basis, even if, as is thought to be the usual case, the company does not maintain such data on a product by product basis.[114] Under the law as enacted, if the company does not maintain that information "in the ordinary course of business,"[115] or if its gross revenues are $5,000,000 or

111 *Id.* § 4.
112 *Id.* § 7.
113 *Id.* § 6.
114 *See* text accompanying note 173 *infra.*
115 This raises an interesting and potentially important question: should the law remain unchanged? Suppose a company that presently does not maintain such information is required to maintain it at some point in the near future in order to comply with the FTC Line of Business reporting requirements. *See* text accompanying note 174 *infra.* Is maintenance of the data in order to meet FTC requirements then "in the ordinary course of business" for the purposes of this Act? Legal realists would argue that it is, because all business activity is subject to government regulation, whether in the form of specific statutes or more general

less, COWPS is left in the dark. Even if the size of the business is large enough to permit a subpoena to issue, the company need only turn over a mass of raw data. COWPS must then sift through it, correlate it, and, with limited knowledge about how the company or industry works, devise some rule of thumb for allocating joint costs among the products of a multi-product firm. Considering that COWPS has fewer than 50 people on its staff, the shift in administrative burden accomplished by this slight change in language was dispositive.

A third major difference between S. 409 as proposed and as enacted is that the draft would require COWPS to disclose information submitted to it that would not impose a "competitive disadvantage on the firms submitting it,"[116] while the final legislation expressly prohibits the Council from disclosing product line information.[117] Furthermore, periodic reports to COWPS are immune from legal process.[118]

During 1975, the Consumer Price Index's upward movement decelerated a bit but towards the year's end was still increasing at a distressing 8.4 percent per year.[119] Food and fuel prices continued to be a major problem.[120] Inflation in services' prices continued at six percent per year — no faster than in 1974. But medical costs rose at a rate of one percent *per month* in 1975.[121]

Since enactment of the 1975 amendments, COWPS has been engaged in efforts to assess the inflationary impact of new government regulations.[122] "It has challenged regulatory proposals across

common law rules. Others would argue that an involuntary response to a specific FTC request is sufficient to show extraordinary business purpose for keeping the data. If Line of Business Data were not available to COWPS, this difference in the language between the proposal and the enactment would greatly undercut the Council's monitoring powers. *See* text accompanying note 179 *infra*.

116 *Hearings on S. 409, supra* note 8, at 2-3.

117 Pub. L. No. 94-78 § 5(f)(1) (August 9, 1975).

118 *Id.* § 5(f)(2).

119 U.S. BUREAU OF LABOR STATISTICS, DEPT. OF LABOR, CPI DETAILED REPORT 1 (October 1975). Seasonally Adjusted Monthly Rate was .7%; without Adjustment, .6%.

120 Food prices rose 3.2% during June and July after rising only 1.5% during the first five months of 1975. Wholesale food prices from March through July rose 7% indicating that food price figures for the final quarter of 1975 would keep rising strongly. BUSINESS WEEK, September 8, 1975, at 15-16.

121 *Id.* at 16.

122 *See* Cowan, *One U.S. Agency Worries About Costs,* N.Y. Times, January 11, 1975, § 3, at 2.

a broad spectrum of health, safety and environmental topics — airport noise, shellfish, truck and bus brakes, design of tanker bottoms, Amtrak passenger routes, vinyl chloride in food packaging, lawn mower safety, motorcycle emissions."[123] Some critics allege that these efforts have been antiregulatory but not necessarily anti-inflationary.[124] Even taken on its own terms, COWPS' analysis has been faulted on numerous grounds.[125] COWPS has reportedly been operating on the assumption that if the costs of a regulation do not outweigh its benefits (express or imputed), then the regulation is inflationary.[126] Consumer Product Safety Commission economist Walter J. Prunella has argued that the legislative history of the 1972 Consumer Product Safety Act indicates that Congress did not want a cost-benefit analysis done.[127] Regardless of whether or not Mr. Prunella is correct in his reading of legislative history, it is clear that COWPS policy has been grounded upon a different operating assumption.[128] A

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123 *Id.*
124 *Id.*
125 *Id.*
126 *Id.*
127 *Id.*
128 *Id.* COWPS' assumption results from a confusion of relative price changes (which must occur in noninflationary as well as inflationary times to achieve efficient resource allocation) with changes in the absolute price level (i.e. true inflation). To take the simplest case, suppose the regulation confers no benefit. The firm's cost of compliance, with the regulation will be similar to a per unit excise tax. The price of the regulated good will increase to the extent that this tax is shifted onto consumers of the good. The extent of shifting depends on the market power of the firm, which in turn depends in large part on the availability of close substitutes, the prices of which have decreased relative to the price of the regulated good. *See,* F. SCHERER, INDUSTRIAL MARKET STRUCTURES AND ECONOMIC PERFORMANCE 288-90 (1970). Whatever increase occurs in the price of the regulated good, its inflationary impact depends on the good's importance in the consumer budgets and the availability of substitutes.

Secondly, the assumption in no small way hinges on COWPS' ability to resolve very tricky definitional problems. Suppose private benefits of the regulation exceed private costs (compliance) but public plus private benefits fall short of public plus private costs (administration plus compliance). What resolution? Moreover, if costs and benefits occur over time, what discount rate should be used to reduce these flaws to present value? A private market rate of return? A social time preference rate? How is the latter chosen? *See* R. MILLWARD, PUBLIC EXPENDITURE ECONOMICS 195-98 (London 1971). Clear counterexamples to COWPS' assumption are cases where the real dollar benefits exceed the real dollar costs of a regulation but imputed adverse side-effects (that are not recognized by the private market) increase total costs such that they exceed benefits. In such a case, imposition of the regulation would not be inflationary as defined by the private market

New York Times report on COWPS concluded with the following observation:

> One view within the administration is that although the council does good analysis, its scatter-shot method of going after what it sees as a few flagrant examples of unjustified regulatory proposals represents a misallocation of resources. In this view, the council has little over-all inhibiting effect.
>
> Alternatively, it is said the resources could be better used if they were devoted to a single problem regulatory area or agency....[129]

One cannot help concluding that by haphazardly applying questionable techniques in regulatory areas in which COWPS has no expertise, it is engaging in make-work insofar as this policy provides little benefit other than employment for COWPS' 47 staffers. Moreover, the Ford Administration refuses to use COWPS directly to attack inflation in the American economy at large.

II. The Current Inflation and How to Control It

The severity of the current inflation and its persistence despite excess capacity of 30 percent in manufacturing and despite unemployment of 8.4 percent[130] have shaken many economists' faith in the orthodoxies of preceding generations. This note does not offer a neo-orthodoxy. It instead presents a practical guide to action which translates a moderate, centrist view of the political economy of inflation into a legislative framework.[131]

since the dollar increase in value of the regulated good exceeds the dollar increment in cost.

Finally, simple comparisons of dollar benefits with dollar costs contain implicit assumptions about the constancy of or changes in the marginal utility of money to different consumers as the regulation is imposed. That is, COWPS must assume that the marginal utility of money to all individuals with respect to regulation of all commodities is unchanged or always is changed by the same amount when any regulation is imposed. There is no foundation for this assumption. T. Dougherty, The State of Thought about Consumers' Surplus, Economic Theory Seminar, Oxford University, Michaelmas Term 1972 (unpublished essay criticizing: Harberger, *Three Basic Postulates for Applied Welfare Economics: An Interpretive Essay*, J. Econ. Literature (September 1971)). For all these reasons COWPS's approach to this problem is at one and the same time too simplistic and too reliant on subjective choice of determinative parameters.

129 Cowan, *supra* note 122.

130 *See* notes 2 and 3 *supra*.

131 For a classification of modern economic schools of thought see P. Davidson, Money and the Real World 4 (1972). The economic literature offers only a

Development of an effective strategy must begin with an appreciation of the special characteristics of the current inflation.[132] First, it is unprecedented in peacetime. Only during the World Wars and one year during the Korean War were there greater rates of inflation.[133] Second, it was largely unforeseen by economic forecasters. For example, in November 1972, the Department of Agriculture predicted that retail food prices in 1973 would increase an average of 4 to 4.5 percent; the actual figure, however, was 14.5 percent.[134] Third, the inflation of 1973 was global. The *Economist* index of world commodity prices in dollars increased 46.2 percent for all items during 1973.[135] During 1974-75, those

limited theoretical framework for a direct antiinflation policy. *See* R. LANZILLOTTI, M. HAMILTON, & R. ROBERTS, PHASE II IN REVIEW, THE PRICE COMMISSION EXPERIENCE 80-97 (1975); A. WEBER, IN PURSUIT OF PRICE STABILITY, THE WAGE PRICE FREEZE OF 1971 (1973); M. EVANS, MACROECONOMIC ACTIVITY, THEORY FORECASTING AND CONTROL, AN ECONOMETRIC APPROACH 290-309, 540-41 (1969); P. DAVIDSON, MONEY AND THE REAL WORLD 338-64 (1972); F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 288-90 (1971); J. Dunlop, Inflation and Incomes Policies: The Political Economy of Recent U.S. Experience, (unpublished Harvard Inflation Policy Seminar Paper) 1974 (on file with HARVARD JOURNAL ON LEGISLATION); Lerner, *Employment Theory and Employment Policy,* AM. ECON. REV. PAP. PROC. 1-18 (May 1967); S. WEINTRAUB, SOME ASPECTS OF WAGE THEORY AND POLICY (1963); Bronfenbrenner and Holzman, *Survey of Inflation Theory,* 53 AM. ECON. REV. 594-661 (1963); H. JOHNSON, ESSAYS IN MONETARY ECONOMICS (1967); David Fand, *Keynesian Monetary Theories, Stabilization Policies and Recent Inflation,* 1 J. MONEY, CREDIT AND BANKING, 556-87 (1969); Smith, *On Some Current Issues in Monetary Economics: An Interpretation,* J. ECON. LIT., 767-82; E. PHELPS, MICROECONOMIC FOUNDATIONS OF EMPLOYMENT AND INFLATION THEORY (1970); Brunner and Meltzer, *Money Debt and Economic Activity,* J. POL. ECON. 951-77 (1972); Friedman, *The Role of Monetary Policy,* AM. ECON. REV. 147 (1968); Gordon, *The Recent Acceleration of Inflation and Its Lessons for the Future,* BROOKINGS PAPERS ON ECONOMIC ACTIVITY 8-41, vol. 1, 1970; Holt, *Improving the Labor Market Trade-Off Between Inflation and Unemployment,* AM. ECON. REV. 135-46 (1969); Lucas and Rapping, *Price Expectations and the Phillips Curve,* 39 AM. ECON. REV., 342-50 (1969); Perry, *Inflation versus Unemployment: The Worsening Trade-Off,* 94 MONTHLY LABOR REVIEW, 68-71 (1971); Rees, *The Phillips Curve as a Menu for Policy Choice,* 37 ECON., 227-38 (1970) and Shapiro, *The Efficacy of Monetary and Fiscal Policy,* 3 J. OF MONEY, CREDIT AND BANKING, 550-54 (1971).

132 J. Dunlop, *supra* note 22, at 1-4.

133 *See Id.* at 37. The annual rates of increase in consumer prices measured by the Bureau of Labor Statistics for selected wartime years were as follows:

1916-17	17.6%	1941-42	10.7%
1917-18	17.2%	1944-45	8.5%
1918-19	15.0%	1946-47	14.4%
1919-20	15.8%	1947-48	7.7%
		1950-51	8.0%

134 *Id.* at 2.

135 *Id.* at 2.

commodity price increases were translated into sharp increases in consumer prices throughout the world.[136] Fourth, and perhaps most important, inflation has been sectoral. This last characteristic is the focus of the next part of our analysis.

A. *Sectoral Inflation*

As the following Bureau of Labor Statistics tables indicate, the 1973 inflation was highly sectoral, with the primary concentration in food and fuel.

WHOLESALE PRICE INDEX CHANGES
[in percent]

	April 1973 to April 1974	March 1974 to March 1975
All items	18.8	12.5
Contribution of major groups to WPI change:		
Fuels and related products	29.4	17.0
Farm products	19.9	(−)14.0
Processed foods and needs	12.0	12.0
Metal and metal products	10.3	21.0
Chemical and allied products	6.6	18.0
Textile products and apparel	4.8	(−) 1.0
Machinery and equipment	5.2	19.0
Pulp, paper and allied products	5.0	8.0
Lumber and wood	1.6	(−) 3.0
Other	8.6	21.0
Total	100.0	100.0

(Figures may not add to totals because of rounding.)

136 The following table shows the rise in consumer price indices for selected countries:

	Percentage Change			Percentage Change		
	Average 1961-1971	1972 over 1971	1973 over 1972	Latest Date	1 yr. earlier	Average Annual 3 months earlier
United States	3.1	3.3	6.2	June '74	11.1	11.7
Canada	2.9	4.8	7.6	June '74	11.4	15.3
Japan	5.9	4.5	11.7	June '74	21.8	16.9
United Kingdom	4.6	7.1	9.2	June '74	16.5	25.8
France	4.3	5.9	7.3	June '74	13.9	16.9
W. Germany	3.0	5.5	6.9	June '74	6.9	6.5
Italy	4.2	5.7	10.8	June '74	16.6	16.9
Australia	2.8	5.8	9.5	II Q '74/ II Q '73	14.4	17.3 (II Q '74/ I Q '74)

Id. at 3.

CONSUMER PRICE INDEX CHANGES
[in percent]

	March 1973 to March 1974	March 1974 to March 1975
All items	10.2	10.3
Contribution of major groups to CPI changes:		
Food at home	33.8	6.7
Food away from home	6.3	11.5
All energy	17.8	8.8
Household services less rent	16.5	13.9
Medical services	4.0	14.4
Rent	2.3	5.5
Apparel commodities	4.8	5.9
Durables	5.5	14.3
Nondurables	5.3	2.5
Other services	3.7	9.1
Total	100.0	100.0

(Figures may not add to totals because of rounding.)[137]

To a substantial extent, in contrast to the primary sector inflation of 1973, inflation in 1974-75 was downstream sector inflation, as the soaring cost of food and energy rippled through other sectors of the economy.

One of the most important lessons of our experience with wage and price restraints in recent years is that the various sectors of the economy have different problems and different needs, and that inflation in these sectors has different causes and different symptoms. The failure of the uniform, nationwide wage/price guidelines of the Kennedy Administration was largely due to their undifferentiated treatment of dissimilar sectors of the economy.[138] In manufacturing, where today there is excess capacity of 30 percent,[139] pressure for increases in unit prices stems from the need to spread the fixed cost of overhead over 30 percent fewer units of output. Such inflationary pressure is reversible by stimulative fiscal and monetary policy that induces increased output, higher capacity utilization, and lower overhead costs per unit of output.[140]

137 121 CONG. REC. 7547 (daily ed. May 6, 1975) (remarks of Sen. Kennedy).

138 *See* text accompanying note 14 *supra.*

139 *See* note 3 *supra.*

140 This type of inflationary pressure becomes especially significant as more costs which were once thought of as variable become fixed in practice; *e.g.*, for

In concentrated industries, administered pricing often creates inflationary pressure.[141] A firm possessing market power is better able to initiate price increases, or to maintain its prices during periods of weakening demand. It may be more willing to yield to demands for inflationary wage demands or other cost-push inflationary pressures.[142] It may earn higher profits than competitive producers would earn on the same product, and these profits may serve as a bargaining target out of which unions strive to win above-average wage gains.[143] Such a firm may even raise prices unilaterally in order to increase profit margins. This is the so-called "profit-push inflation." It is difficult to pinpoint clear examples of profit-push inflation. One case is probably the steel industry's attempt in 1955 to raise its after tax rate of return from eight percent at 80 percent capacity utilization to 12 percent — ostensibly to generate a higher cash flow for an anticipated capital modernization program.[144]

Even when producers with market power do not initiate inflationary pressures, their cost-plus pricing practices facilitate the spread of inflation and intensify it. Under the standard economic pricing assumptions, both of monopoly and competitive short term profit maximization, any increase in costs usually leads to a rise in prices less than the actual unit cost increase. Part of the higher cost is borne by the firm and only part by customers.[145] Markup pricing, on the other hand,

> . . . tends to facilitate the inflationary potential of a cost-push under conditions of stable or gently rising demand, and

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all practical purposes, long term wage contracts with high lay-off benefits transform wage costs into a fixed charge.

141 *See* F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 288-90 (1971).

142 *Id.*

143 Statistical evidence of the significant relationship between wage increases and profit margins is provided by H. LEVINSON, POSTWAR MOVEMENT OF PRICES AND WAGES IN MANUFACTURING INDUSTRIES, in Study of Employment, Growth, and Price Levels, Study Paper No. 21, Joint Economic Committee, Washington 1960 at 1-61; W. BOWEN, WAGE BEHAVIOR IN THE POSTWAR PERIOD, 67-69, (1960), Bhatia, *Profits and the Rate of Change of Money Earnings in the United States, 1935-1959,* 29 ECONOMICA 255, 255-62 (1962); Eckstein and Wilson, *The Determination of Money Wages in American Industry,* Q.J. ECON. 379, 379-414 (Aug., 1962).

144 *Id. See* Blair, *Administered Prices: A Phenomenon In Search of a Theory,* 49 AM. ECON. REV. 431, 442-43 (1959).

145 Bronfenbrenner and Holzman, *Survey of Inflation Theory,* 53 AM. ECON. REV. 593, 621-22 (1963); F. SCHERER, *supra* note 141.

> rigid prices at low levels of employment or in the face of declining demand.[146]

Other inflationary pressures arise from the dynamics of sectoral interaction. Even in a generally slack economy, as is the case presently in the United States full capacity utilization in key sectors can create demand-pull inflationary conditions there which create cost-push pressures elsewhere.[147]

What is needed is a policy to keep inflation under control, by giving adequate early warning signals when particular sectors of the economy begin to show signs of new inflationary pressures. A policy is needed which will enable appropriate countervailing measures to be adopted before emerging inflation in one sector becomes a crisis for the whole economy.

The advantage of the sector by sector approach is that it would target anti-inflation policy on individual areas of the economy where inflation is a serious problem. It would encourage the development of programs tailored to meet the

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146 Bronfenbrenner and Holzman, *supra* note 145, at 621. They describe the phenomenon as follows:

> Assume stable demand. To the extent that [costs] are "pushed up" in oligopolistic enterprises . . . , the cost increase will usually be translated into a price increase, regardless of the price-setting technique practiced. An enterprise that attempted to maximize short-run profits (and whose prices were set flexibly in the face of changes in demand) would, after a wage-push or any other cost increase, cut back on employment and output. Under an assumption of stable demand, price would then rise until demand for output was equated with reduced supply. Similarly, if the enterprise followed some form of "full cost markup" pricing, prices also would be raised to reflect the higher costs. Under markup pricing, the cost push tends to be facilitated for the following reasons. First, the price rise follows directly, and therefore more rapidly, upon the wage increase. Second, when prices are insensitive to demand, profit rates tend to be maintained. The resulting price is apt to be set at a higher level than short term profit maximization [especially if declining output involves rising average unit costs, as discussed above. *See* text at note 200 *supra*] . . . .
>
> The same arguments apply to the case of declining demand (or of relatively high levels of unemployment). Under these circumstances, markup pricing translates rigid wages . . . into a price floor . . .

Id.

147 The steel industry has been suggested as being one that achieves near full capacity utilization earliest in a recovery, setting off demand-pull pressures there and cost-push pressures elsewhere as the increased cost of steel becomes built into the cost structures of firms in all other sectors. M. EVANS, *supra* note 12, at 301-02. C. SCHULTZE, RECENT INFLATION IN THE UNITED STATES, JOINT ECONOMIC COMMITTEE STUDY PAPER No. 1, at 1-134 (1959).

specific needs of each sector, with full regard for structural, supply, and other problems both of the entire sector and of local industry and its practices.

Under a sector by sector approach, for example, price increases that reflect excessive market power in a sector rather than competitive economic forces would be discouraged and rolled back if they occur. Pay increases that might be justified by productivity gains in one sector might be unjustified in another sector in the absence of such gains. The sectoral approach would allow anti-inflation policy to deal with the unique characteristics of inflation, wherever it occurs.

Perhaps the most successful example of the success of a sectoral approach to fighting inflation, and of the need for such a policy today, is the work of the Construction Industry Stabilization Committee during 1971-73, under the leadership of John Dunlop.[148]

Construction is one of the economy's most important sectors. It is bigger by far in dollar volume than such key sectors as automobiles and steel. Even during the recession of 1975, construction contracts totaled about $130 billion and created employment for 3.5 million workers.[149]

But, unlike the auto and steel sectors, the construction's corporate structure is dominated by tens of thousands of small employers. With such fragmentation of management, labor negotiations have been messy; both strike-prone and susceptible to wage spirals as local unions have sought to match and exceed the gains of other locals.[150]

Working closely with industry and labor, and adopting an approach tailored to specific situations, the Construction Industry Stabilization Committee was able to reduce the size of first year wage settlements in newly negotiated construction agreements from 17 percent in 1970 to 11 percent in 1971, to 5.9 percent in 1972, and to 5.4 percent in 1973.[151] With the end of the Nixon economic controls program in April 1974 the inflation rate in the construction industry jumped back to ten percent, and it

148 *See* J. Dunlop, *supra* note 22, at 6-22.

149 Raskin, *Hard Hats and their Focal Role,* N.Y. Times, January 4, 1976, § 3, at 1, col. 1.

150 *Id.*

151 J. Dunlop, *supra* note 22, at 22. *See also* Raskin, *supra* note 149 at 9, col. 3

stayed at roughly that level last year. However, the ten percent national average concealed large regional disparities.[152]

Wage-push inflation in the construction industry is likely to be substantial this year. The resignation of Labor Secretary John Dunlop and the walkout of top union leaders from the Ford Administration's Collective Bargaining Committee in Construction resulting from President Ford's veto of the common-situs picketing bill leaves the Administration without a labor policy and bereft of all ties with organized labor.[153] The only tool the Administration has left for building a wage stabilization policy is the ineffectual Council on Wage and Price Stability. The Council, however, has no authority to reject wage settlements.[154] Furthermore it has neither the mandate nor the ability to pursue a broad concept of the public interest in labor-management relations.[155]

Construction is not the only sector where large wage settlements are likely. Double-digit pay increases will be a major union target in negotiations this year covering 4.5 million workers in such pivotal industries as autos, rubber, trucking and electrical manufacturing.[156] Many of the present collective bargaining agreements in those industries were negotiated during the wage-price controls of the Nixon Administration, and labor leaders hope to catch up for ground lost under controls.[157]

At least three different sets of variables are widely believed to serve as desiderata for unions in determining their contract wage demands: changes in the cost of living index (CPI), the economic situation of their enterprise (as suggested by profits and productivity), and wage rates in neighboring or strategic firms and sectors.[158] Only the first of these factors is directly related to the general economy; the other two are sector-specific. Attempts to

152 *Id.*

153 *Ford's Evaporating Labor Policy,* BUSINESS WEEK, January 26, 1976, at 22.

154 *Id.*

155 *See* text at notes 95 *supra* and 203 *infra.*

156 Raskin, *Labor Goal Portends Strikes,* N.Y. Times, January 4, 1976, § 3, at 60, col. 1.

157 *Id.* at col. 3.

158 *See* THE THEORY OF WAGE DETERMINATION (J. Dunlop ed. 1957). These 'wage contours" or "orbits of coercive comparison" are ordinarily narrower in the U.S. than in other developing countries, thereby facilitating government policies of wage restraint. J. Dunlop, *supra* note 22, at 32.

lower wage differentials between sectors are most inflationary since they tend to be relatively uncorrelated with excess demand, excess profits or productivity increases.[159] Inflation in wages, therefore, means the creation of widespread distortions in the historical wage structure.[160] Such distortions are the inevitable result of greater union concern about higher wages than about the increase in or prolongation of existing unemployment that may result from a higher level of wages.[161]

To adopt a uniform wage restraint guideline would perpetuate the inequities in wage differentials created by inflation. A sectoral approach to wage restraint would encourage economic policy to steer clear of the misguided tendency to fix a single wage standard on the economy. As the Labor-Management Advisory Committee to the Cost of Living Council stated in February 1973, in a unanimous statement on economic stabilization policy:

> The parties to collective bargaining agreements should address themselves both to short-term and longer run structural problems which they confront in their industries, localities and particular economic environments. Collective bargaining is pre-eminently a method of problem solving through negotiations. No single standard or wage settlement can be equally applicable at one time to all parties in an economy so large, decentralized and dynamic.[162]

As simple and appealing as a uniform wage guideline might be at this time, it should be opposed as we would oppose the suggestion that everyone wear a size 10 shoe.

B. *The Food Sector*

The food sector of our economy is singled out for special treatment here for a number of reasons. Food price increases are

159 Bronfenbrenner and Holzman, *supra* note 145, at 618.

160 J. Dunlop, *supra* note 22, at 21. *See* O. ECKSTEIN and R. BRINNER, THE INFLATION PROCESS IN THE UNITED STATES (study prepared for the Joint Economic Committee 92d Cong. 2d Sess., 1972).

161 Most economists believe that this is the way unions behave. Unions either take no account of the unemployment effects of their wage gains, A. ROSS, TRADE UNION WAGE POLICY, at 19, 75-98 (1948); or only take account of these effects when unemployment is high or when these effects are likely to be severe, Schultze and Meyers, *Union Wage Decisions and Employment*, AM. ECON. REV. 362, 362-380 (1950) (Unions may prefer to ration jobs rather than acceed to below-target wage gains.

162 COST OF LIVING COUNCIL, STATEMENT OF THE LABOR-MANAGEMENT ADVISORY COMMITTEE 44 (Feb. 26, 1973).

especially important because they are the bellwether of inflation to the American public. "Changes in prices of no other commodity generate as much public and subsequent political reaction as a ten percent rise in the price of milk, meat or eggs."[163] As was indicated in Part I, *supra,* food and agricultural issues have been a major policy concern since mid-1972 as a result of the rapid inflation in food prices.[164] Food prices have historically been much more volatile than most other prices as a result of seasonal changes in agricultural production. Fluctuations in government policy in recent years have exacerbated normal food price volatility. These policy shifts include large grain purchase agreements with the Soviet Union, marked reduction in government grain reserves, devaluations of the dollar which made United States agricultural commodities cheaper in the world market, emergency actions to increase dairy product imports and restrict soybean exports, and the abrupt series of policy changes marked by Phases I through IV of the Economic Stabilization Program.[165]

The following discussion of food policy sets forth "legislative history" for the proposed COWPS Act Amendments in Section III. It suggests the type of particularlized attention to special problems of each troublesome sector which should characterize the reformed COWPS approach to fighting inflation.

1. Food Processing and Distribution Sector

Some major food processing and distribution activities are highly concentrated in a few firms.[166] This raises the question whether prices are administered rather than competitive. William Mueller, former chief economist at the Federal Trade Commission has stated, "Empirical studies show that firms in food industries where four firms control 60 percent or more of sales enjoy considerable discretion in setting prices, with the result that they enjoy profit rates 50 percent larger than firms in industries where four firms control 40 percent or less of sales."[167] The final report

163 G. Nelson, *supra* note 26, at 1.
164 See text accompanying note 61 *supra.*
165 G. Nelson, *supra* note 26, at 1.
166 *Id.* at 113, appendix tables 24 & 25.
167 Statement presented by Willard F. Mueller at the Agriculture and Food

of the National Commission on Food Marketing, *Food from Farmer to Consumer* made a similar statement:

> Concentration of much of the food industry is not yet high enough to impair seriously the effectiveness of competition, and we do not suggest divestiture of current holdings even where concentration is highest unless future conduct demonstrates the need for it. Nor do we believe that internal growth should be restrained if achieved fairly. The principal danger of impairment of competition appears to be merger and acquisition by dominant firms.
>
> *It is our conclusion that acquisitions or mergers by the largest firms in any concentrated branch of the food industry, which result in a significant increase in their market shares or the geographic extension of their markets, probably will result in a substantial lessening of competition in violation of the Clayton Act.* (emphasis in original).[168]

Profits as a percentage of sales in food manufacturing and retailing are low — usually between one and three percent.[169] Reduction of profits on sales, therefore, would not reduce food prices significantly. It is possible that increased competition might reduce advertising costs and executive compensation, but the saving to consumers, if any, has not been estimated. Profits as a percentage of stockholders' equity have risen both absolutely and relatively since the early 1960's. Profit rates have increased from a range of 9.2 to 9.4 percent in 1960-63, to a range of 10.9 to 13.2 percent in 1970-73. Profit rates in other manufacturing sectors have on the average been higher than those in the food sector; they also improved over the 1960-1970 period. During 1970-73, however, the profit rate of food manufacturers *exceeded* the average of all manufacturing.[170] From the third quarter of 1972 through the first quarter of 1975, the average quarterly after tax profit rates in food and in all other manufacturing were approximately equal at 12.7 and 12.9 percent respectively.[171] How-

Economic Conference, in Chicago, Illinois, Sept. 12-13, 1974, quoted in G. Nelson, *supra* note 26, at 114.

168 NATIONAL COMMISSION ON FOOD MARKETING, FOOD FROM FARMER TO CONSUMER at 106 (1966).

169 G. Nelson, *supra* note 26, at 114.

170 *Id.* at 116.

171 A. MASSON & R. PARKER, PRICE AND PROFIT TRENDS IN FOUR FOOD MANUFACTURING INDUSTRIES 13, July, 1975 [hereinafter cited as MASSON & PARKER].

ever, profits of retail food chains as a percent of stockholders' equity have *declined* both absolutely and relatively since the early 1960's, in contrast to food manufacturers' profits. Profit rates in this sector fell from 12-13 percent in 1960-61 to six to eight percent in 1972-73.[172]

However helpful such aggregate data are to the formation of general notions about the competitiveness of the food sector, they are an inadequate basis for policy formation. Data by industry, by firm, and by product line within firms are needed. Such data are often not available due to the conglomerate nature of many food concerns. As mentioned above, the COWPS Act Amendments of 1975 gave COWPS the power to subpoena cost, price, profit and other information from firms on a product line by product line basis — provided the firms maintain that information in the ordinary course of business.[173] Apart from the problems created by the technical wording of the amended Act, COWPS will probably have considerable difficulty developing a product-line data base, if the experience of the FTC is any indication.

The FTC has recently initiated a Line-of-Business reporting program in an effort to provide more accurate information on industry in the United States.[174] Under the program, conglomerate multiproduct corporations must provide the FTC with detailed financial information on their activities according to particular product lines. After obtaining the individual company product line data, the FTC will publish statistical reports on aggregate (but not individual company) profits, costs, and other financial data for each line of business.[175] Individual company product line data is precisely the type of information that the 1975 COWPS Act Amendments authorized COWPS to subpoena from the companies themselves.[176] Moreover, the original COWPS Act requires

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172 G. Nelson, *supra* note 26, at 116.

173 *See* text accompanying note 114 *supra.*

174 FTC Resolution Requiring Annual Line of Business Reports from Corporations, 39 Fed. Reg. 30377 (1974); Rules and Procedures for the Use of Confidential Individual Company Data Collected Under the FTC's Line of Business Report Program, 39 Fed. Reg. 30970 (1974).

175 Note, *The FTC's Annual Line of Business Reporting Program,* 1975 DUKE L.J. 389 (1975) [hereinafter cited as Duke Note].

176 Pub. L. No. 94-78, § 3 (Aug. 9, 1975).

"[a]ny department or agency of the United States which collects, generates, or otherwise prepares or maintains data or information pertaining to the economy or any sector of the economy . . . , upon the request of the Chairman of the Council, [to] make that data or information available to the Council."[177] The FTC, therefore, could be required to make its product line data available to COWPS.[178]

COWPS' administrative burden would be lightened if it obtained product line reports from the FTC. Unfortunately, the FTC has met strong opposition from businesses to its requests for line of business data. At least 193 motions to quash requests for information have been filed with the FTC.[179] Litigation of the FTC's right to the data could take three or four years.[180] COWPS would meet similar resistance if it tries to subpoena a product line information under its own authority.

The food sector provides a good illustration of how the lack of a product line data capability hinders policy formation. Last July, the FTC Staff released an Economic Report entitled, *Price and Profit Trends in Four Food Manufacturing Industries.*[181] That report attempted to determine for the period of rapid food price increases following the Economic Stabilization Program, whether increased profits in four food processing industries were a contributing factor. It found that profit-push pressure was not significant in the meat, milk, bread and beer industries.[182] But its analysis was severely hampered by the lack of product line data.

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177 Pub. L. No. 93-387 (Aug. 24, 1974), 88 Stat. 750, 751 § 4(a).

178 *But see* Rules and Procedures for the Use of Confidential Individual Company Data Collected Under the FTC's Line of Business Report Program, 39 Fed. Reg. 30970 (1974) (intra-FTC regulation prohibiting individual company reports from being "inspected or otherwise used for taxation, regulation or investigation. . . . [FTC] persons authorized to have access to this information may not release, discuss or in any way provide access to such information to anyone not authorized to have access."). However the COWPS Act mandate would control. *Id.*

179 Duke Note, *supra* note 175, at 392 n.17. Grounds for these motions to quash include claims that the FTC has exceeded its statutory authority by implementing the program because data collected would be unreliable, that the order was excessively burdensome, and that the order to file reports was illegal because safeguards were not taken against disclosure of individual company data.

180 Conversations with FTC Staff, August 1975.

181 MASSON & PARKER, *supra* note 171.

182 *Id.* at 51.

Only 30 and 15 percent of industry sales by bread and fluid milk manufacturers, respectively, could be studied because "most of the important producers are parts of very large, diversified corporations"[183] for which product by product information was not available. Without it, the costs of producing fluid milk cannot be separated from the costs of producing any other product that the conglomerate makes. Probably none of the major fluid milk producers could be studied.[184] Large bread makers such as Continental, a subsidiary of ITT which makes Wonder Bread, also could not be studied.[185] In light of such limitations on the data base, the report's conclusions are hardly authoritative.

2. Control of Raw Agricultural Products

Part I sketched the Economic Stabilization Program's consistent avoidance of any attempt to control raw agricultural products. Yet the explosion of food prices during the early 1970's was primarily due to price increases in raw agricultural goods and not due to inflation in farm-retail price differentials.[186] The theory behind government policy was that it could not improve on the efficiency inherent in agricultural commodity markets, which were viewed as classic examples of perfectly competitive markets, with many buyers and producers.[187] That, however, was and remains an assumption that has not been tested.

> To say that controls on [the farm] sector will not work implies a set of expectations as to what workability constitutes. Rationing, black markets, cumbersome administrative provisions, and shortages are the indicators of unworkability. . . . [T]he matter is not one that can be dismissed by reference to simple articles of faith.[188]

Indeed, there are a number of instances where government

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183 *Id.* at 8, 9.
184 *Id.* at 9.
185 *Id.* at 10.
186 *See* text accompanying notes 38, 61, 71 and 77 *supra*. Two thirds of food price inflation in 1973 was directly due to rising raw agricultural prices. R. Brown, *supra* note 26, at 29. Farm income roughly doubled between 1972 and 1973. *Id.*
187 *See* R. Brown, *supra* note 26, at 27, 28.
188 *Id.* at 29.

policies *constrain* farm prices or supplies, thereby encouraging or condoning departures from the competitive ideal:

(1) Throughout most of the country, dairy prices are regulated by either state or federal governments.[189] Dairy cooperatives maintain and raise prices in regulated and unregulated areas. The government's role here, however, is to set minimum, not maximum prices.

(2) "It can be argued that 20 of the 50 odd U.S.D.A. agricultural marketing orders effectively raise price levels for a number of vegetables, fruits, and nuts."[190] Marketing orders sanction the operation of grower cooperatives in price setting.

(3) Sugar prices are buoyed up by government quotas. A system of market risk sharing contracts between sugar beet growers and processors tend to distribute supranormal profits to processors when cane prices are abnormally high.[191]

(4) Meat production is subject to government import quotas and is characterized by levels of concentration higher than the competitive norm. Department of Agriculture data for 23 major states in 1973 indicate that two percent of the feedlots of those states, 2000 in number, handle two-thirds of fed cattle marketed in 1973, up from 55 percent in 1970.[192] "At the very least, the data might suggest the feasibility of controlling beef prices at the feedlot level by regulating the 2000 or so feedlots in excess of 1000 head capacity. The argument often heard, that there are too many units to regulate, is lessened somewhat by these numbers."[193]

Aside from government regulatory policies affecting prices, food industry practices themselves evidence anticompetitive behavior and suggest methods of administering raw agricultural prices without having to oversee the behavior of vast numbers of primary producers. The common practice is for farmers to contract with buyers and processors of fruits and vegetables prior to planting. Farmers' uncertainty is reduced by this practice. The large number of primary producers need not constitute an ad-

189 *Id.* at 30. *See also* G. Nelson, *supra* note 26, at 69-73.
190 R. Brown, *supra* note 26, at 30. *See also* G. Nelson, *supra* note 26, at 15.
191 R. Brown, *supra* note 26, at 30.
192 G. Nelson, *supra* note 26, at 138; R. Brown, *supra* note 26, at 31.
193 R. Brown, *supra* note 26, at 31.

ministrative barrier to controls of the raw agricultural sector, if control of the few large processors (which control a large share of production) would yield sufficiently broad coverage of the market.[194]

3. Grain Reserves

The last aspect of anti-inflation policy in the food sector of which space permits treatment is grain reserve policy. Grain reserves are a key instrument in attaining the objective of food price stability. Since there is every indication that food price instability will continue, the need for an intelligent reserve policy remains critical.

Grain prices today are floating free of federal support levels; both world grain and rice stocks are depleted and offer no buffer against harvest changes.[195] A significant liquidation of hogs and poultry flocks due to high grain prices in 1974-75 may well lead to higher prices for meat and poultry in late 1975 or 1976.[196] Soviet demand remains unpredictable, but the recent five year Soviet-American agreement should facilitate planning. That agreement obligates the Soviet Union to buy at least six million tons of wheat and corn a year, and requires the United States to make at least eight million tons available, provided American crops remain above 225 million tons, a distress level below which they have not fallen in 15 years.[197] The important lesson of the Russian wheat deal is that sales should be closely monitored as they approach or exceed the 8 million tons level to assure domestic supply at non-inflationary price levels.[198]

The principle of grain reserve policy is simple. Stocks are accumulated in years when production is above normal and prices are below average, forcing prices up toward their normal level. In years of poor production, stocks are sold lowering the price

194 *See id.* at 32.
195 G. Nelson, *supra* note 26, at 124.
196 *Id.*
197 Robbins, *U.S. Grain Assumes Vital Role,* N.Y. Times, January 4, 1976, § 3, pt. II, at 55, col. 7.
198 *See* text accompanying notes 57, 58, and 59 *supra.*

toward the average and below what it would otherwise be in a year of shortage. Two especially difficult problems demand solution today, one a temporary worry, the other a perennial dilemma. First, grain reserves should not be replenished this year, unless production increases and prices are lowered. It would intensify inflationary pressures if a crash reaccumulation program were implemented at a time when current private demand exceeded supply. Moreover, it would also be extremely expensive for the U.S. taxpayer.[199] Second, use of the grain reserve policy (and price support policies discussed above)[200] to achieve policies other than food price stabilization limit its overall effectiveness. "Minimum prices and trigger prices for selling government reserves have traditionally been set at such high levels that stock accumulations became burdensome and costly. Attempts to use the policy as a means to raise farm income constrained the achievement of other objectives. Price supports have often led to government policies to restrict production in order to reduce government costs."[201] The value of a grain reserve policy, therefore, hinges on how policy makers weight the often conflicting objectives of price stability, higher farm income, and low government administrative costs.[202]

In summary, control of inflation in the food sector is especially important to the success of an anti-inflation program. COWPS should give attention to measures to control inflation in raw agricultural products since, without such control, restraints on processing and distribution activities are liable to be fruitless. Grain reserve policy, marketing orders and feedlot regulation are among the government actions that most deserve study.

Other sectors of the economy such as health (where prices are rising by one percent per month), legal services, and automobile insurance will each require detailed study. Every stage in the process of delivering the final product or service must be investigated and no assumptions of competitive behavior or difficulty of regulation should be left unquestioned. Such investigations are beyond the scope of this note.

199 See G. Nelson, *supra* note 26, at 128.
200 See text accompanying notes 189-93 *supra*.
201 G. Nelson, *supra* note 26, at 128.
202 *Id.* at 129.

C. *Wage Policy*

Wage policy should aim primarily at preventing distortions in the national wage structure rather than at direct control of the national wage level.[203] "Stabilization and restraint should involve a restoration of the old or the emerging differentials in the wage structure which requires that different amounts be awarded different groups."[204] Wage increases that have autonomous inflationary effect are usually the result of unions trying to one-up their rivals, or of nonunion employees attempting to maintain traditional wage differences vis-à-vis the unionized sector. General increases in wages nationwide, on the other hand, "are usually symptomatic of inflationary pressures that already suffuse the economy than of the independent exercise or augmentation of 'union power'."[205] A sector by sector approach to wage stabilization based on holding wage increases to productivity increases in that sector and stabilizing wage differentials in the wage structure is, therefore, required.[206] A uniform national wage standard or guideline would not contribute to the solution of wage inflation:[207]

> The critical task of a wage stabilization agency is to identify and to prevent compensation adjustments which represent substantially higher levels or new patterns of compensation that are likely to spread and prove inconsistent with continuing wage moderation. The first element is to distinguish how much of any compensation adjustment in our decentralized wage system represents the restoration of past relationships and how much constitutes new relative rates and benefits. The second element is to decide how much of a new pattern

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203 *See* text accompanying notes 159-60 *supra*.

204 J. Dunlop, *supra* note 22, at 21.

205 Weber, *The Continuing Courtship*, in EXHORTATION AND CONTROLS, THE SEARCH FOR A WAGE-PRICE POLICY 1945-1971 353, 380 (C. Goodwin ed. 1975) [hereinafter cited as Weber].

206 Attempts to measure and improve productivity in the services sector, particularly public services have always been problematical. One of the major achievements of the Lindsay administration in New York City (now overshadowed by its financial crisis) was the development of productivity programs for various city agencies such as construction inspection, refuse disposal, and pollution abatement. Productivity Programs, Office of the Budget, City of New York 1972 (unpublished; discussed in Harvard Business School Management Cases Nos. 9-674-084; 9-113-027; 9-113-028; 9-372-127.

207 *See* J. Dunlop, *supra* note 22, at 22.

> is appropriate and responsive to emerging conditions and how much unwarranted and likely to spread and to prove dislocating and destablizing to other parties. The concepts of "wage inequities" and "appropriate stabilized wage or benefit differentials" among occupations, localities and product markets are at the center of the analysis of wage inflation, and thus to the formulation of policy prescription, the design of an information system for wage, salary and benefit data, and to the operation of an administrative agency charged with stabilization responsibilities. Indeed, the definition and restoration (or establishment) of appropriate wage and benefit relationships over some time period is the central business of wage restraint.[208]

COWPS should also analyze the inflationary impact of changes made in working conditions and work rules as well as wage rates. It should attempt to secure from workers and managers, who have claims for wage or benefit changes as a result of work rule or productivity changes, a meeting of minds as to the size of the additional compensation adjustment warranted for those making the rule or productivity change. It also should seek an advance commitment from all related union-management groups that the change will not be used as the basis for further adjustment claims by others unless a comparable change in rule or productivity is made in each instance.[209]

A longer term objective of wage stabilization is improvement in the collective bargaining machinery sector by sector. Initiatives that will improve the quality of collective bargaining and create a less inflation-prone situation include the development of voluntary dispute settling machinery where none exists, encouraging the joint study and introduction of new technology and changes in work rules, and developing new sources of wage and fringe benefit data for the parties.[210]

COWPS should work through tripartite boards representative of labor, management and the public. The boards should have responsibility both for policy making and for administration so that policies are not developed in a vacuum but are subjected to case by case testing. The boards should link stabilization of com-

208 *Id.* at 24.
209 *Id.* at 26.
210 *Id.*

pensation claims with dispute settlement under collective bargaining to insure maximum participation and support of management and unions in the stabilization program. "It is an abdication of responsibility under conditions of a wage stabilization program for its administrators to say that disputes are someone else's responsibility, particularly when disputes often involve the extent of compensation increases permissible under the program."[211]

The boards need not make recommendations for dispute settlements, but should maintain continuing communications with labor and management; gather the real facts on wages, salaries, fringe benefits, and working conditions; encourage attention to productivity issues and to longer-run collective bargaining problems; and try to understand the sequence of activity in any sector to determine the leaders and the followers.[212] Finally, they should coordinate wage policy with price policy in that and related sectors.

D. *Price Policy: Disclosure and Profit Margins*

As noted in Part I,[213] the 1975 Amendments to the COWPS Act as enacted expressly prohibits the Council from disclosing product line cost, price and profit information that it obtains by subpoena. The difficulty of obtaining such information in the first place has already been discussed.[214] Once obtained, however, there are strong arguments for granting COWPS the authority to publicize that information when it will have a pro-competitive and anti-inflationary effect. In testimony before the Senate Banking Committee regarding the Proxmire-Stevenson draft, the COWPS staff noted:

> Senator Proxmire in his remarks on introducing S.409 stated that the ability to make a large part of the information public will result in a more informed citizen debate and give the President a freer hand in presenting his case to the American people if he feels a wage or price increase is not justified. In

211 *Id.* at 17.
212 *Id.* at 17, 18.
213 *See* text accompanying note 117 *supra.*
214 *See* text accompanying notes 114 and 179 *supra.*

> addition, he stated that the availability of cost, price, and profit information also should help to keep prices down by attracting new entrants into an industry showing high profits. This would mean greater competition, increased supply, and lower price to the consumer.[215]

Presumably, businesses might resist disclosure for a variety of reasons ranging from a gut sense of privacy to more rational concerns about competitors and the responses of other governmental agencies. A closer look indicates, however, that these reasons are undeserving of protection: concern that other government agencies, such as the FTC and Antitrust Division of the Justice Department, may take enforcement action against the business if they have COWPS' product by product information[216] should not prevent disclosure if indeed the underlying behavior is unlawful. Antitrust law aims to foster competition not to protect individual competitors.

More persuasive is the concern that nonuniform disclosure is discriminatory. Differences in the timing, amount and quality of disclosure among firms could lead to a competitive advantage to the firm which discloses less information later than its competitors. Competitors which comply fully and promptly will reveal information without receiving the same in return from noncompliant firms. Although this is a problem, it is inherent in every type of government enforcement. It is a more appropriate argument for evenhanded enforcement and for COWPS refusal to publish individual firm data until there has been industry-wide reporting than it is for not going ahead with a disclosure-enforcement program.

Finally, firms may be worried that disclosure of product line information will reveal to the most efficient firms the identity and cost-price information of the least efficient.[217] That could lead to

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215 COUNCIL ON WAGE AND PRICE STABILITY, STAFF ANALYSIS OF THE PROXMIRE-STEVENSON PROPOSAL TO INCREASE THE POWERS OF THE COUNCIL ON WAGE AND PRICE STABILITY, in *Hearings on S. 409, supra* note 8, at 18.

216 Short of full public disclosure, COWPS could be required to make such information available to other federal agencies. The same argument would apply.

217 The assumption that disclosure "would be resisted strongly by business" implies a very conservative underlying business attitude in the absence of information and/or an efficiency distribution of firms that is marked by a minority of very efficient firms and a larger number of less efficient ones. In the former case, firms

price cutting by the more efficient firms, driving out less efficient firms and increasing industrial concentration. Such concern is only deserving of protection to the extent it relates to predatory pricing, since efficiency related price cutting is pro-competitive and, therefore, lawful.[218]

Predation is price cutting below the firm's average variable cost level. It is unlawful.[219] The policy behind the prohibition of predation is that price cutting by more efficient firms benefits consumers unless less efficient firms are given insufficient time to respond to competitive pressure and are unnecessarily driven from the market, increasing market concentration.[220] Non-predatory price cutting forces efficient firms to increase efficiency or lose market share. Drastic price cutting below a predator's average variable cost is unlawful because even if the target firm is less efficient than the predator, pricing below average variable cost of the most efficient producer will not generate enough revenue for the target firm to increase efficiency through increased investment, research and development or other means. Predation, therefore, puts unreasonable pressure on the target firm and could lead to exit from production when less drastic price pressure might have stimulated efficiency measures in the target firm and allowed that firm time to adjust and to remain in the market.

If disclosure of COWPS cost-price data subjects firms to predation, that is remediable through the civil and criminal enforcement procedures of the antitrust laws.[221] Fear of predation, there-

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which don't know their position in the efficiency distribution of firms producing their product(s) believe that the threat to their market shares from disclosure outweighs the opportunity to expand market shares at the expense of less efficient firms. In the latter case, a strong majority of firms assume they would be revealed to be less efficient than a minority; the majority, who may already have a qualitative feel that they are less efficient, fear price cutting by the efficient few once those few know, following COWPS disclosure, just how far to cut.

218 15 U.S.C. §§ 2, 13a (1970).

219 *Id.*

220 *See generally,* Areeda and Turner, *Predatory Pricing and Related Practices under Section 2 of the Sherman Act,* 88 HARV. L. REV. 697 (1975). The predator may not be more efficient, but may merely have a cash reserve which it can tap while losing money on sales of its predatory products. In this case, it hoped to increase market share by literally forcing an equally efficient firm out of the market. The damage is that it will then raise prices to compensate for losses during the price war and keep price above the competitive level. Predation unrelated to efficiency advantages is therefore doubly harmful.

221 15 U.S.C. §§ 2, 13a (1970) (imposing imprisonment and/or fines paid to

fore, is not a legitimate reason to prevent COWPS disclosure of individual firm data. Fear of price-cutting behavior short of predation in response to COWPS disclosure is even less deserving of protection because such price-cutting is pro-competitive.

There remains only one category of cases where disclosure should not be made, and in this class of cases, presumably, businesses would not object to disclosure. Disclosure should *not* be made where it would thwart antitrust policy. Specifically, there are highly concentrated industries in which disclosure of cost information of each firm would encourage, aid and abet tacit price fixing agreements among firms.[222] That would lead to higher prices than would probably otherwise occur. COWPS should be charged to assess whether disclosure would lead to price fixing or would otherwise thwart antitrust policy, and should refrain from disclosing such information when it appears likely that that would happen.

In summary, granting COWPS authority to make public disclosure of individual firm cost price, profit and other related information on a product line basis would strengthen the anti-inflation program four ways:

(1) it would result in a more informed public debate;

(2) the President would be better able to demonstrate lack of justification for price increases to the Congress and the public;

(3) availability of cost, price and profit information would help keep prices down by attracting new entrants into an industry that has high profits;

(4) price cutting by more efficient firms would mean greater competition, increased supply and lower prices to the consumer.

Beyond disclosure, COWPS should have authority to impose graduated measures of direct control to match the severity of inflation in a sector. This would entail the power to require pre-notification of price increases, to delay price increases pending a hearing, to allow price increases only to the extent of cost increases,[223] to impose controls on price mark-ups, to impose price

Government by violating companies); 15 U.S.C. § 15 (1970) (imposing treble damage liability to injured parties).

222 *See,* F. SCHERER, *supra* note 141, at 158-82, especially formula book pricing at 160.

223 *See* HISTORICAL WORKING PAPERS, *supra* note 26, at 270-72.

ceilings on a sector by sector basis, and to roll back prices. Control of price mark-ups and rollback of prices deserve elaboration.

There are three main criticisms of controlling the mark-up that a company employs in setting its products price. First, joint costs of production may be hard to allocate between products, in which case firms will not know what individual product line costs are, and therefore a markup rule applied to product lines would break down. The answer to this criticism is that rules of thumb will have to be derived, and that the FTC Line of Business Program has already stimulated firms to think and respond in these terms.[224]

Secondly, if firms are required to apply a constant markup to product costs, they will be jeopardized if demand is cyclical. That is, in times of weak demand price may have to fall below average total costs in order to stimulate sales. If so, price and profit margin would have to rise above average levels in times of strong demand both in order to recoup losses of the past and to perform an efficient allocative function in the economy. If profit margins were held rigid, firms subject to cyclical demand could not flexibly adapt to it. But there is no need for controlled profit margins to remain constant under such circumstances. Profit margins (or mark-ups) could be set at the historical norm for that product of that firm, but be allowed to rise in a period of strong demand if such a rise were necessary to recoup prior losses. Once prior losses are recouped, the profit margin should return to normal levels.

Thirdly, profit margin controls could decrease innovation, increase pseudo-innovation, and encourage unnecessary cost increases. Innovation, however, would not be discouraged if profit margins of new products were not controlled. They should be the one major exception to the policy of holding a firm to at most its historical profit margin on a product line. If this is the case, however, would not firms artificially create "new" products in order to escape the limit of the historical margin on old ones? The fact is that line drawing between artificial product differentiation and true innovation will be unavoidable if a mark-up rule is imposed on a sector.

224 *See* text accompanying note 174 *supra.*

It is arguable that firms will be encouraged to increase costs if their profit margins are controlled.[225] For example, a limit of a ten percent markup above total costs applied to total costs of $100 yields a total profit of $10, whereas the same mark-up applied to total costs of $150 yields $15 in profits. But that incentive can be minimized if the allowable mark-up varies inversely with costs.[226] In that case, a competitor who can cut will be allowed a higher percentage return than it formerly had whereas the firm that increases its costs will find its allowable margin reduced.[227] Disclosure of cost, price and profit margin information by COWPS to all affected firms would stimulate private policing.[228] Finally, profit margins could be readjusted periodically to account for general cost increases to the extent that they have affected all firms in the sector.[229]

Although the impetus for price rollbacks is not as visible to the public as that for control of a price increase, the problem is nonetheless significant. COWPS should not overlook the inflationary impact of the tendency of some prices to move upwards in a ratchet effect. It should consider graduated restraints up to and including rolling back prices which, in a period of weak demand or falling input prices, fail to demonstrate a downward flexibility commensurate with the upward flexibility demonstrated by such price levels in a period of strong demand or rising input prices.

E. *Sector by Sector Application and Enforcement Policy*

The novel feature of the proposed amendments to the COWPS Act is its recognition that responses to inflationary signals must

225 *See* HISTORICAL WORKING PAPERS, *supra* note 26, at 273-75.

226 A cost increase would then result in a decrease in the profit margin allowed to the firm. When costs increase above the historical level the allowable profit margin could decrease proportionately or more than proportionately whereas if costs decrease below the historical level the allowable profit margin could increase by more than it decreases when costs increase. The elasticity of profit margins with respect to a price decline can and should be greater in absolute value than the elasticity of profit margins with respect to a cost increase. In that case frivolous cost increases will be discouraged and efficiency will be encouraged.

227 Firms with roughly equal costs of production of similar products may not have similar historical profit margins, in which case their allowable margins would differ. Revelation of the cost/price pattern should stimulate competition.

228 *See* text accompanying notes 215-22 *supra*.

229 *See generally,* P. DAVIDSON, *supra* note 131; at 354-55; Weber, *supra* note 205, at 380-83.

be tempered by an appreciation of the different economic and social conditions in which they arise. The proposal eschews the macro-approach of a universal wage-price freeze or set of guidelines, in favor of an approach characterized by flexibility and sectoral specificity, directed by Congressional guidelines and oversight and implemented by a relatively small, knowledgeable staff.

The hallmark of the proposal is its provision for *continuous stand-by authority* under which direct controls within a tailored regulation program can be imposed quickly and removed as soon as can be done safely. To that end, COWPS is made a permanent body. Although a permanent wage-price commission has been considered unacceptable in the past, in fact the United States has had a wage-price policy body in one form or another for thirty years. Government efforts to influence wage and price decisions are here to stay.[230] However,

> . . . the organizational arrangements for carrying out wage-price policy have had all the continuity of a pickup volleyball team. For the most part, wage-price policy has been administered by a cast of thousands drawn from different agencies at different times. Because the objectives, coverage, and legal authority associated with wage-price policy have never been clearly established on a continuing basis, the organizational arrangements have had a consistent quality of improvisation.[231]

A permanent COWPS can serve as an institutional depository for expertise in devising and administering programs.

The proposal authorizes invocation of formal measures only after certification that a sector is a "subject of concern as an inflationary sector."[232] COWPS is authorized to hold hearings, receive testimony, subpoena witnesses and information in order to reach that determination. Full wage and price controls may be imposed on a sector subject to negative affirmance by Congress; that is, if Congress does not act within thirty days, the controls would go into effect. The political branches of government, therefore, and not a tripartite body or other artificial assemblage of economic interest groups must bear the responsibility for setting policy.

230 *See* EXHORTATION AND CONTROLS: THE SEARCH FOR A WAGE PRICE POLICY 1945-1971, at 7, 380-83 (C. Goodwin, ed., 1975).

231 Weber, *supra* note 205, at 380.

232 *See* Proposed Amendments to COWPS § 105(a) *infra*.

Each year, sectors under full control would be decertified unless COWPS finds that removal of controls would be followed by renewed inflationary wage and/or price increases in that sector.

Review and enforcement of regulations and orders of COWPS would be centralized in one special court, just as was done during the Emergency Price Control Program during World War II.[233] The Court, to be known as the Cost of Living Court of Appeals, would consist of three Federal District or Circuit Judges and would have the powers of a district court with respect to the jurisdiction conferred on it by the Act, except that it would not have power to issue any temporary restraining order or interlocutory decree staying the effectiveness of any order, regulation or price schedule issued under the COWPS Act. This Court would have exclusive jurisdiction to determine the validity of any regulation or order issued by COWPS including requests for product line information and wage price restraint orders. No other court in the U.S. would have jurisdiction over these matters. In order to overcome the foreseeable delay caused by businesses' motions to quash subpoenas for product line information,[234] challenges to COWPS subpoenas are given preference on the Court's docket over all other cases except older matters of the same character. Judicial review of COWPS activities is, therefore, centralized and streamlined, so that government and private resources would be conserved in the anti-inflation effort.[235]

III.
PROPOSED AMENDMENTS TO THE COUNCIL ON WAGE AND PRICE STABILITY ACT

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233 Emergency Price Control Act of 1942, § 204(c), 56 Stat. 23.

234 *See* text accompanying note 179 *supra.*

235 See Title II of Proposed Amendments, *infra*; *See generally* HART AND WECHSLER'S THE FEDERAL COURTS AND THE FEDERAL SYSTEM 317-22 (2d ed., Bator, Shapiro, Mishkin & Wechsler eds. 1973).

TITLE II: ADMINISTRATION AND ENFORCEMENT

COMMENT: For ease of presentation, existing provisions of the COWPS Act are set out in Roman type. Sections of the Act that are deleted by the Amendments are enclosed in brackets. New Sections appear in italics.[236]

Section 101. *Short Title*

That this Act may be cited as the 'Council on Wage and Price Stability Act.'

TITLE I: COUNCIL ON WAGE AND PRICE STABILITY

Section 102. *COWPS Membership and Factfinding Duties*

(a) The President is authorized to establish, within the Executive Office of the President, a Council on Wage and Price Stability (hereinafter referred to as the 'Council').

(b) The Council shall consist of eight members appointed by the

236 For the most part, comments will be limited to the proposed amendments to the COWPS Act. For comments on the 1975 Amendments to the COWPS Act *see* text accompanying note 103 *supra* and *Hearings on S. 409, supra* note 8. For the text of the Act as enacted see Council on Wage and Price Stability Act, Pub. L. No. 93-387, 88 Stat. 750 (1974), *as amended,* Emergency Home Purchase Assistance Act of 1974, Pub. L. No. 93-449, § 4(e), 88 Stat. 1367; Council on Wage and Price Stability Act Amendments of 1975, Pub. L. No. 94-78, §§ 2(a), 3, 4, 5, 6, 7, 89 Stat. 411.

President and four adviser-members also appointed by the President. The Chairman of the Council shall be designated by the President.

(c) There shall be a Director of the Council who shall be appointed by the President by and with the advice and consent of the Senate. The Director shall be compensated at the rate prescribed for level IV of the Executive Schedule by Section 5315 of Title 5, United States Code (Section 5315 of Title 5). The Director of the Council shall perform such functions as the President or the Chairman of the Council may prescribe. The Deputy Director shall perform such functions as the Chairman or the Director of the Council may prescribe.

(d) The Director of the Council may employ and fix the compensation of such officers and employees, including attorneys, as are necessary to perform the functions of the Council at rates not to exceed the highest rate for grade 15 of the General Schedule under Section 5332 of Title 5, United States Code (Section 5332 of Title 5). Except that the Director, with the approval of the Chairman may, without regard to the provisions of Title 5, United States Code (Title 5, Government Organization and Employees), relating to appointments in the competitive service, appoint and fix the compensation of not to exceed [five] positions the rates provided for grades 16, 17, and 18 of such General Schedule, to carry out the functions of the Council. *In appointments to the additional positions authorized by the amendment made to this subsection by the Council on Wage and Price Stability Act Amendments of 1975, the Council shall give preference to economists and other persons with special ability and experience in one or more of the various sectors of the economy.*

COMMENT: The expanded duties of COWPS authorized by these amendments will require increased personnel. Perhaps fifty positions should be authorized rather than five. However, the sector by sector approach to inflation control authorized by these amendments will minimize the need for additional staff by targeting COWPS efforts to particularly troublesome sectors. Preference for personnel with sectoral specialties is proposed in appointment to any new COWPS staff positions just as it was proposed for the two new COWPS staff positions created by the 1975 Amendments to the COWPS Act.[237]

(e) The Director of the Council may employ experts, expert wit-

237 *See* Sec. 2(c) of Pub. L. No. 94-78, 89 Stat. 411.

nesses, and consultants in accordance with the provisions of Section 3109 of Title 5, United States Code (Section 3109 of Title 5), and compensate them at rates not in excess of the daily rate prescribed for grade 18 of the General Schedule under Section 5332 of Title 5, United States Code.

(f) The Director of the Council may with their consent, utilize the services, personnel, equipment, and facilities of Federal, State, regional, and local public agencies and instrumentalities, with or without reimbursement therefor, and may transfer funds made available pursuant to this Act to Federal, State, regional, and local public agencies and instrumentalities as reimbursement for utilization of such services, personnel, equipment, and facilities.

(g) The Council shall have the authority, for any purpose related to this Act, to

(1) require periodic reports [for the submission of information maintained in the ordinary course of business];

(2) *hold such hearings, sit and act at such times and places, take such testimony and receive such evidence as the Council may deem advisable; when so authorized by Council, any member or agent of the Council may take any action which the Council is authorized to take by this section; and*

(3) issue subpoenas signed by the Chairman or the Director for the attendance and testimony of witnesses and the production of relevant books, papers, and other documents, [only to entities whose annual gross revenues are in excess of $5,000,000]; relating to wages, costs, productivity, prices, sales, profits, imports, and exports by product line or by such other categories as the Council may prescribe.

COMMENT: COWPS expanded duties will require factfinding regarding inflationary pressures in the various sectors of the economy. As discussed in the text[238] the 1975 Amendments to the COWPS Act as enacted limited COWPS's ability to obtain data from businesses. Deletion of the "in the ordinary course of business" language will ease COWPS's administrative burden by shifting to the private sector responsibility for assembling and correlating new types of data required by COWPS. COWPS is also given discretion to inspect data from firms and unions below

238 *See* text accompanying note 114 *supra.*

the old $5,000,000 threshold. Old subsection (g)(2) has been renumbered as a new subsection (g)(3).

(h) The Council shall have the authority to administer oaths to witnesses; witnesses summoned under the provisions of this Section shall be paid the same fees and mileage as are paid to witnesses in the courts of the United States; in case of refusal to obey a subpoena served upon any person under the provisions of this Section, the Council may request the Attorney General to seek the aid of the United States district court for any district in which such person is found, to compel that person after notice, to appear and give testimony or to appear and produce documents before the Council.

(i) *If a person issued a subpoena under subsection (g)(3) refuses to obey such subpoena or is guilty of contumacy, any court of the United States within the judicial district within which the hearing is conducted or within the judicial district within which such person is found or resides or transacts business may (upon application by the Council) order such person to appear before the Council to produce evidence or to give testimony touching the matter under investigation; any failure to obey such order of the court may be punished by such court as a contempt thereof.*

(j) *The subpoenas of the Council shall be served in the manner provided for subpoenas issued by a United States district court under the Federal Rules of Civil Procedure for the United States district courts.*

(k) *All process of any court to which application may be made under this Section may be served in the judicial district wherein the person required to be served resides or may be found.*

COMMENT: New subsections (g)(5), (g)(6), and (g)(7) merely clarify the nature of the subpoena power which COWPS possesses under the Act as amended in 1975.

Section 103. *Graduated Program of Inflation Restraint*

[(a)] The Council shall

(1) review and analyze industrial capacity, demand, supply, and the effect of economic concentration and anticompetitive practices, and supply in various sectors of the economy, working with the industrial groups concerned and appropriate governmental agencies to encourage price restraint;

COMMENT: Pursuant to this Section, COWPS should review government practices which keep prices above competitive levels.[239] It should review product line information reports gathered by its own requests and subpoenas, and should study individual firm and aggregate sector Line of Business Reports received from the FTC pursuant to COWPS requests under subsection 104(a). Subsection headings are numbered (1) through (14) for easy reference to the existing COWPS Act. Enactment of all amendments should be accompanied by relabeling of subsection headings as (a) through (n) respectively.

(2) work with labor and management in the various sectors of the economy having special economic problems, as well as with appropriate government agencies, to improve the structure of collective bargaining and the performance of those sectors in restraining prices;

(3) improve wage and price data bases for the various sectors of the economy to improve collective bargaining and encourage price restraint;

(4) conduct public hearings necessary to provide for public scrutiny of inflationary problems in various sectors of the economy;

(5) focus attention on the need to increase productivity in both the public and private sectors of the economy;

COMMENT: Wage policy has been discussed in the text.[240]

(6) monitor the economy as a whole by acquiring as appropriate reports on wages, costs, productivity, prices, sales, profits, imports, and exports;

(7) review and appraise the various programs, policies and activities of the departments and agencies of the United States for the purpose of determining the extent to which those programs and activities are contributing to inflation; [and]

(8) intervene and otherwise participate on its own behalf in rulemaking, licensing and other proceedings before any of the departments and agencies of the United States, in order to present its views as to the inflationary impact that might result from the possible outcomes of such proceedings[.];

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239 *See, e.g., The Food Sector supra.*

240 *See* text accompanying note 203 *supra.*

COMMENT: COWPS has recently been focussing its efforts on the possible inflationary impact of proposed government rulings.[241]

[(b) Nothing in this Act, (1) authorizes the continuation, imposition, or reimposition of any mandatory economic controls with respect to prices, rents, wages, salaries, corporate dividends, or any similar transfers, or (2) affects the authority conferred by the Emergency Petroleum Allocation Act of 1973 (Section 751 et seq. of Title 15).]

COMMENT: This Section expressly prohibiting COWPS from administering mandatory controls is deleted. Under these amendments, mandatory controls become one step in the sector by sector policy of incremental response to inflationary pressures.

(9) promulgate, by rule, for any sector or sectors of the economy, norms for noninflationary price and wage adjustments;

COMMENT: National uniform wage/price guidelines are rejected by this approach.[242] Instead, in each sector subject to inflationary pressure, COWPS shall issue recommendations based on price/profit and wage data for that sector consistent with short and longer run goals.[243]

(10) promulgate, by rule, reporting, requirements which direct persons to give prior, written notice to the Council of all proposed price and wage increases;

COMMENT: This is a standard element of a controls scheme.[244] COWPS will have to use its discretion in applying it to small businesses and to firms subject to rigid fluctuation in the prices of inputs.[245]

(11) from time to time, issue such regulations and orders as the Director of the Council may deem necessary or proper in order to carry out the purposes of this Act;

(12) prohibit any person which the Council finds is violating its price or wage norms issued according to subsections (10), (13), and (14) of this Section from obtaining any contract during the one year

241 *See* text accompanying note 122 *supra.*
242 *See* text accompanying note 207 *supra.*
243 *See Wage Policy supra* and *Price Policy supra.*
244 *See, e.g.,* text accompanying note 51 *supra.*
245 *See, e.g.,* text accompanying notes 51 and 52 *supra.*

period commencing on the date of such finding to provide goods or services to any agency or instrumentality of the United States government;

COMMENT: Withdrawal of government purchasing power from demand for products of firms that fail to comply with government norms for wage and price restraint should encourage compliance with these norms. Stiffer sanctions against such firms may only be taken pursuant to subsection (14) of this Section and Section 105.

(13) suspend any wage or price increase for a period of ninety days, or for a longer period not to exceed ninety calendar days from the end of a hearing held to consider evidence regarding the increases in question, provided that the hearing is conducted without undue delay;

COMMENT: Although it has been argued that power to temporarily delay price or wage increases will lead to anticipatory increases in advance of the date that they would otherwise be posted,[246] that danger is outweighed by the increased bargaining strength delay power gives to COWPS.[247] COWPS could pressure firms to accept a lower increase at once rather than wait ninety days and risk the consequences of certification as an "inflationary sector" as the result of a hearing on the proposed price increases. See Section 105. Ninety days may be enough time for inflationary pressures to subside of their own accord in some sectors.

(14) retain full wage and price controls on a sector only after certifying that the sector is a "subject of concern as an inflationary sector" as provided in Section 105, provided that within thirty days of the Council's order to retain full wage and price controls on such sector neither House of Congress, after referral of the matter to the appropriate committee, passes a resolution stating in substance that the House does not favor the order;

COMMENT: Full wage and price controls mean mandatory price, wage, profit and other norms set by COWPS, administered by it subject to review of the Cost of Living Court, and enforced by the sanctions set out in Section 203. The hallmark of a sector by

246 *Hearings on S. 409, supra* note 8, at 19.
247 *Id.*

sector approach is that COWPS focusses it's activity on the most troublesome parts of the economy. Certification provides a formal procedure whereby COWPS may increase its control of wage and price movements. After certification, COWPS can move from hortatory norm setting and refusal to purchase to mandatory norm setting and refusal to purchase.

The negative affirmance provision allows Congress to exercise discretionary power over the application of full controls to a sector. The political branches of government thereby share responsibility for major shifts in anti-inflation policy.[248]

Section 104. *Disclosure of Information*

(a) Any department or agency of the United States which collects, generates, or otherwise prepares or maintains data or information pertaining to the economy or any sector of the economy shall, upon the request of the Chairman of the Council make that data or information available to the Council.

COMMENT: It is this subsection which authorizes COWPS to obtain the FTC Line of Business Program data on an individual firm by firm basis. The FTC would otherwise only make aggregate data available.[249]

[(b) Disclosure of information obtained by the Council from sources other than Federal, State, or local government agencies and departments shall be in accordance with the provisions of Section 552 of Title 5, United States Code (Section 552 of Title 5).]

(b) Notwithstanding subsection (b)(4) of Section 552 of Title 5, United States Code (5 U.S. Code § 552(b)(4)), information obtained by the Council relating to wages, costs, productivity, prices, sales, profits, imports and exports by product line or by other such categories as the Council may prescribe, whether obtained from Federal, state, or local governmental agencies and departments or from sources other than these, shall be made available to the public unless the Council determines that public disclosure of such information would thwart the policies of the antitrust laws of the United States, except that the Council may not make such a determination with respect to

248 *See* Watson, *Congress Steps Out: A Look at Congressional Control of the Executive,* 63 CAL. L. REV. 983 (1975).

249 *See* text accompanying note 174 *supra.*

any information which could not be excluded from public annual reports to the Securities Exchange Commission pursuant to Section 13 of 15(d) of the Securities Exchange Act of 1934 by a business enterprise exclusively engaged in the manufacture or sale of a single product or service;

COMMENT: This important amendment was discussed at length in the text.[250] The Proxmire-Stevenson proposed 1975 Amendments would have authorized disclosure except where the firm would have suffered undue competitive disadvantage.[251] This amendment focuses on competition, not competitors, and mandates publication except where the result would be anticompetitive. For administrative economy, information made public under Securities Law provisions need not concern COWPS. The existing Section 104(b), which would prevent disclosure of confidential commercial or financial information is deleted.

(c) Disclosure of information, other than that specified in subsection (b) of this Section, obtained by the Council from sources other than Federal, state, or local government agencies and departments shall be in accordance with the provisions of Section 552 of Title 5, United States Code (Section 552 of Title 5).

COMMENT: The policy of existing subsection (b) is retained except with respect to disclosure provided in the new subsection (b).

[(c)] ***(d),*** **disclosure by the Council of information *other than that provided for in subsection (b) of this Section* obtained from a Federal, State, or local agency or department must be in accord with Section 552 of Title 5, United States Code, and all the applicable rules of practice and procedure of the agency or department from which the information was obtained.**

COMMENT: The existing provision is, again, adjusted for the new disclosure requirements of subsection (b).

[(d)] ***(e)*** **Disclosure by a member or any employee of the Council of the confidential information as defined in Section 1905 of Title 18, United States Code, (Section 1905 of Title 18), shall be a violation of the criminal code as stated therein.**

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250 *See* text accompanying note 213 *supra.*

251 *Hearings on S. 409, supra* note 8, at 7. *See* text accompanying note 105 *supra.*

COMMENT: This subsection remains in force without amendment and is merely re-indexed.

[(e) Consistent with the provisions of Section 7213 of the Internal Revenue Code of 1954 (Section 7213 of Title 26), nothing in this Act shall be construed as providing for or authorizing any Federal agency to divulge or to make known to the Council the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed solely in any income tax return, or to permit any income tax return filed pursuant to the provisions of the Internal Revenue Code of 1954 (Title 26, Internal Revenue Code), thereof, to be seen or examined by the Council.]

[(f) (1) Product line or other category information relating to an individual firm or person and obtained under Section 102(g) shall be considered as confidential financial information under Section 552(b)(4) of Title 5 of the United States Code (Section 552(b)(4) of Title 5) and shall not be disclosed by the Council.]

COMMENT: Consistent with COWPS's expanded factfinding and disclosure authority, these subsections are deleted.

[(f) (2)] *(f)* Periodic reports obtained by the Council under Section 102(g) and copies thereof which are retained by the reporting firm or person shall be immune from legal process.

COMMENT: This subsection is retained and re-indexed.

Section 105. *Certification of Inflationary Sectors*

(a) The Council shall have the authority to certify that a sector is a subject of concern as an inflationary sector, upon determining at a hearing, held pursuant to Section 103(a)(4), that:

(1) wage settlements are out of line with those of other sectors of the economy considering comparable work in other sectors, productivity, unemployment, demand for products and other factors taken into account in collective bargaining, or that

(2) price increases are unjustified by increases in demand or in input costs, or do not otherwise reflect competitive processes, or are out of line with those in other sectors of the economy, or are likely to have an inflationary impact on other sectors of the economy; or in a period of falling input prices or weak demand, prices fail to demonstrate a downward flexibility commensurate with the upward flexibility demonstrated by such prices in a period of rising input prices or strong demand.

COMMENT: This is a key amendment. Certification is the procedure by which inflationary sectors are singled out for special attention by COWPS. COWPS should look for distortions in the wage structure. Some part of these may represent changes in relative wages, but other parts may be unwarranted by productivity shifts and may be likely to spread, thereby dislocating and destabilizing wages in other sectors.[252] Price increases that appear inflationary according to the criteria listed warrant COWPS holding a hearing to determine whether they are such that stronger control powers may be helpful in checking them. The provisions that certification is proper if price rises "are out of line with those of other sectors of the economy or are likely to have an inflationary impact upon other sectors of the economy" are intended to give COWPS broad power to deal with sectoral inflation as well as more pervasive inflation in the general price level. Ratchet effect pricing and the need to control it has been discussed above.[253]

(b) The Council may define wage sectors and price sectors in any manner that furthers the purposes of this Act.

COMMENT: COWPS is not constrained to define wage and price sectors identically; it may define price sectors by industry classification and wage sectors by union and nonunion groupings. It would be convenient if wage and price sectors overlapped.

Section 106. *Wage Restraint Mechanisms*

(a) Pursuant to Sections 103, 104, and 105 the Council shall have the power to control wage increases and to issue recommendations as to the terms of labor disputes which are referred to it by the disputing parties or by the President. To this end, it shall establish and act through tripartite boards composed of an equal number of representatives chosen from labor, industry, and the public. These wage boards shall be responsible both for dispute settlement including enforcement of settlement decrees, and for stabilizing the wage level. They should maintain continuing communications with labor and management, gather facts on wages, salaries, fringe benefits and working conditions, encourage attention to productivity issues and to longer run collective

252 *See* text accompanying notes 204 and 205 *supra.*
253 *See* text following note 229 *supra.*

bargaining problems, study patterns in which cases and issues arise in various sectors and coordinate wage policy with price policy in that sector and related sectors;

(b) The wage boards shall be directly responsible to the Director of the Council who shall coordinate wage board policy with price control policy and establish liaison between wage and price control personnel.

Section 107. *Automatic Removal of Controls*

Controls imposed on a sector that has been certified as a "subject of concern as an inflationary sector" shall become inoperative one year after imposition by the Council, unless removed prior to that date, unless the Council determines that removal of such controls would more likely than not lead to renewed inflationary wage or price increases in that sector or other sectors.

COMMENT: Automatic expiration of authority of controls will help assure surveillance of the sector by COWPS to justify continued imposition. It guards against unnecessary control of a sector due to inattention by COWPS.

Section 108. *Reports to the President and to Congress*

The Council shall report to the President, and through him to the Congress, on a quarterly basis and not later than thirty days after the close of each calendar quarter, concerning its activities, findings, and recommendations with respect to the containment of inflation and the maintenance of a vigorous and prosperous peacetime economy.

COMMENT: This section is retained and is merely re-indexed.

Section 109. *Appropriation*

[Sec. 6. There is hereby authorized to be appropriated not to exceed $1,700,000 for each fiscal year ending prior to October 1, 1977, to carry out the purposes of this Act.]

There are authorized to be appropriated such sums as may be necessary to carry out this Act.

COMMENT: The existing authorization of funds for COWPS is deleted and an "as necessary" funding provision is substituted because the expanded duties of COWPS will require additional and as yet indeterminate funding.

[Sec. 7. The authority granted by this Act terminates on September 30, 1977.]

COMMENT: COWPS is made a permanent body with standby authority to issue sector by sector control measures.

TITLE II: ADMINISTRATION AND ENFORCEMENT

COMMENT: "As was said some [49] years ago, 'an important phase of the history of the federal judiciary deals with the movement for the establishment of tribunals whose business was to be limited to litigation arising from a restricted field of legislative control.'[254] In certain areas of federal judicial business there has been a felt need to obtain, *first* the special competence in complex, technical and important matters that comes from narrowly focused inquiry; *second,* the speedy resolution of controversies available on a docket unencumbered by other matters; and, *third,* the certainty and definition that come from nationwide uniformity of decision.[255] Needs such as these provoked formation of the Commerce Court and the Emergency Court of Appeals [during the World War II Price Control Program]."[256] The Cost of Living Court of Appeals created by this Title, modeled after the Emergency Court of Appeals,[257] is a response to these three needs.

Section 201. *Procedure for Protesting COWPS Rulings and Orders*

(a) Within a period of sixty days after the issuance of any regulation or order under Section 103(a)(11) of this Act any person subject to any provision of such regulation, order, or price schedule may, in accordance with regulations to be prescribed by the Director, file a protest specifically setting forth objections to any such provision and affidavits or other written evidence in support of such objections. At any time after the expiration of such sixty days any persons subject to

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254 *F. Frankfurter and J. Landis.* THE BUSINESS OF THE SUPREME COURT 147 (1927).

255 *See generally id.* at 146-86.

256 HART AND WECHSLER'S THE FEDERAL COURTS AND THE FEDERAL SYSTEM, *supra* note 235, at 384.

257 *See generally,* The Emergency Price Control Act of 1942, Ch. 26, tit. II, 56 Stat. 29, *as amended,* The Stabilization Extension Act of June 30, 1944, Ch. 325, 58 Stat. 632.

any provision of such regulation, order, or price schedule may file such a protest based solely on grounds arising after the expiration of such sixty days. Statements in support of any such regulation or order may be received and incorporated in the transcript of the proceedings at such times and in accordance with such regulations as may be prescribed by the Director. Within a reasonable time after the filing of any protest under this subsection, but in no event more than thirty days after such filing or ninety days after the issuance of the regulation or order in respect of which the protest is filed, whichever occurs later, the Director shall either grant or deny such protest in whole or in part, notice such protest for hearing, or provide an opportunity to present further evidence in connection therewith. In the event that the Director denies any such protest in whole or in part, he shall inform the protestant of the grounds upon which such decision is based, and of any economic data and other facts of which the Director has taken official notice.

(b) In the administration of this Act the Director may take official notice of economic data and other facts, including facts found by him as a result of action taken under Section 103.

(c) Any proceedings under this Section may be limited by the Director to the filing of affidavits, or other written evidence, and the filing of briefs.

Section 202. *Cost of Living Court of Appeals*

(a) Any person who is aggrieved by the denial or partial denial of his protest may, within thirty days after such denial, file a complaint with the Cost of Living Court of Appeals, created pursuant to subsection (c) of this Section, specifying his objections and praying that the regulation or order protested be enjoined or set aside in whole or in part. A copy of such complaint shall forthwith be served on the Director who shall certify and file with such court a transcript of such portions of the proceedings in connection with the protest as are material under the complaint. Such transcript shall include a statement setting forth, so far as practicable, the economic data and other facts of which the Director has taken official notice. Upon the filing of such complaint the court shall have exclusive jurisdiction to set aside such regulation or order, in whole or in part, to dismiss the complaint, or to remand the proceeding: Provided, That the regulation or order may be modified or rescinded by the Director at any time notwithstanding the pendency of such complaint. No objection to such regulation or order, and no evidence in support of any objection thereto,

shall be considered by the court, unless such objection shall have been set forth by the complainant in the protest or such evidence shall be contained in the transcript. If application is made to the court by either party for leave to introduce additional evidence which was either offered to the Director and not admitted, or which could not reasonably have been offered to the Director or included by the Director in such proceedings, and the court determines that such evidence should be admitted, the court shall order the evidence to be presented to the Director. The Director shall promptly receive the same, and such other evidence as he deems necessary or proper, and thereupon he shall certify and file with the court a transcript thereof and any modification made in the regulation or order, as a result thereof; except that on request by the Director, any such evidence shall be presented directly to the court.

(b) No such regulation or order shall be enjoined or set aside, in whole or in part, unless the complainant establishes to the satisfaction of the court that the regulation or order is not in accordance with law, or is arbitrary or capricious. The effectiveness of a judgment of the court enjoining or setting aside, in whole or in part, any such regulation or order shall be postponed until the expiration of thirty days from the entry thereof, except that if a petition for a writ of certiorari is filed with the Supreme Court under subsection (d) of this Section within such thirty days, the effectiveness of such judgment shall be postponed until an order of the Supreme Court denying such petition becomes final, or until other final disposition of the case by the Supreme Court.

(c) There is hereby created a court of the United States to be known as the Cost of Living Court of Appeals, which shall consist of three or more judges to be designated by the Chief Justice of the United States from judges of the United States district courts and circuit courts of appeals. The Chief Justice of the United States shall designate one of such judges as chief judge of the Cost of Living Court of Appeals, and may, from time to time, designate additional judges for such court and revoke previous designations. The chief judge may, from time to time, divide the court into divisions of three or more members, and any such division may render judgment as the judgment of the court. The court shall have the powers of a district court with respect to the jurisdiction conferred on it by this Act; except that:

(a) the court shall not have power to issue any temporary restraining order or interlocutory decree staying or restraining,

in whole or in part, the effectiveness of any regulation or order issued pursuant to Section 103(a)(14), and

(b) the court shall give preference on its docket to challenges to subpoenas issued by the Council pursuant to Section 102(g)(3) over all other cases except older matters of the same character.

The court shall exercise its powers and prescribe rules governing its procedure in such manner as to expedite the determination of cases of which it has jurisdiction under this Act. The court may fix and establish a table of costs and fees to be approved by the Supreme Court of the United States, but the costs and fees so fixed shall not exceed with respect to any item the costs and fees charged in the Supreme Court of the United States. The court shall have a seal, hold sessions at such places as it may specify, and appoint a clerk and such other employees as it deems necessary or proper.

COMMENT: This Section grants the Cost of Living Court of Appeals the jurisdictional power of a federal district court except that it has no power to issue any temporary restraining order or interlocutory decree staying the effectiveness of any order or regulation issued under the Act. The constitutionality of such a grant is established.[258] Exclusive jurisdiction plus this limitation on equitable relief will speed adjudication and aid enforcement. Priority on the docket is given to challenges to product line subpoenas in order to overcome the delays caused by numerous motions to quash such as those that have been directed by affected companies against analogous Line of Business Program report requests from the FTC.[259]

(d) Within thirty days after entry of a judgment or order, interlocutory or final, by the Cost of Living Court of Appeals, a petition for a writ of certiorari may be filed in the Supreme Court of the United States, and thereupon the judgment or order shall be subject to review by the Supreme Court in the same manner as a judgment of a Circuit Court of Appeals. The Supreme Court shall advance on the docket and expedite the disposition of all causes filed therein pursuant to this subsection. The Cost of Living Court of Appeals, and the Su-

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258 Lockerty v. Phillips, 319 U.S. 182 (1943); Yakus v. United States, 321 U.S. 414 (1944); Jones *ex rel.* Louisiana v. Bowles, 322 U.S. 707 (1944); HART AND WECHSLER'S THE FEDERAL COURTS AND THE FEDERAL SYSTEM, *supra* note 235, at 276, 317-22.

259 *See* text accompanying note 179 *supra.*

preme Court upon review of judgments and orders of the Cost of Living Court of Appeals, shall have exclusive jurisdiction to determine the validity of any regulation or order issued under Section 103(a)(11) and of any provision of any such regulation or order. Except as provided in this Section, no court, Federal, State, or Territorial, shall have jurisdiction or power to consider the validity of any such regulation or order or to stay, restrain, enjoin, or set aside, in whole or in part, any provision of this Act authorizing the issuance of such regulations or orders, or any provision of any such regulation or order, or to restrain or enjoin the enforcement of any such provision.

COMMENT: Exclusive jurisdiction to determine the validity of regulations and orders of COWPS centralizes in one court the judicial oversight of the anti-inflation program, speeding review and ensuring national uniformity of judicial scrutiny.

Section 203. *Enforcement*

(a) Whenever in the judgment of the Director any person has engaged in or is about to engage in any acts or practices which constitute or will constitute a violation of any provision of Section 103 of this Act, he may make application to the appropriate court for an order enjoining such acts or practices, or for an order enforcing compliance with such provision and upon a showing by the Director that such person has engaged or is about to engage in any such acts or practices a permanent or temporary injunction, restraining order, or other order shall be granted without bond.

(b) Any person who willfully violates any provision of Section 103 of this Act, and any person who makes any statement or entry false in any material respect in any document or report required to be kept or filed under Section 103 shall, upon conviction thereof, be subject to a fine of not more than $10,000, or to imprisonment for not more than two years. Whenever the Director has reason to believe that any person is liable to punishment under this subsection, he may certify the facts to the Attorney General, who may, in his discretion, cause appropriate proceedings to be brought.

(c) The district courts shall have jurisdiction of criminal proceedings for violations of Section 103 of this Act, and, concurrently with State and Territorial courts, of all other proceedings under Section 103 of this Act. Such criminal proceedings may be brought in any district in which any part of any act or transaction constituting the violation occurred. Other proceedings may be brought in any district

in which any part of any act or transaction constituting the violation occurred, and may also be brought in the district in which the defendant resides or transacts business, and process in such cases may be served in any district wherein the defendant resides or transacts business or wherever the defendant may be found. Any such court shall advance on the docket and expedite the disposition of any criminal or other proceedings brought before it under this section. No costs shall be assessed against the Director or the United States Government in any proceeding under this Act.

(d) No person shall be held liable for damages or penalties in any Federal, State, or Territorial court, on any grounds for or in respect of anything done or omitted to be done in good faith pursuant to any provision of this Act or any regulation or order, requirement, or agreement thereunder, notwithstanding that subsequently such provision, regulation, order, requirement, or agreement may be modified, rescinded, or determined to be invalid. In any suit or action wherein a party relies for ground of relief or defense upon this Act or any regulation, order, requirement, or agreement thereunder, the court having jurisdiction of such suit or action shall certify such fact to the Director. The Director may intervene in any such suit or action.

(e) If any person selling a commodity violates a regulation, order, or price schedule prescribing a maximum price or maximum prices, the person who buys such commodity for use or consumption other than in the course of trade or business may bring an action either for $100.00 or for treble the amount by which the consideration exceeded the applicable maximum price, whichever is the greater, plus reasonable attorney's fees and costs as determined by the court. If any person selling a commodity violates a regulation, order, or price schedule prescribing a maximum price or maximum prices, and the buyer is not entitled to bring suit or action under this subsection, the Director may bring such action under this subsection on behalf of the United States. Any suit or action under this subsection may be brought in any court of competent jurisdiction, and shall be instituted within one year after delivery is completed or consideration is paid.

Section 204. *Separability*

If any provision of this Act or the application of such provision to any person or circumstances shall be held invalid, the validity of the remainder of the Act and the applicability of such provision to other persons or circumstances shall not be affected thereby.

BOOK REVIEW

ENDING INSULT TO INJURY: NO-FAULT INSURANCE FOR PRODUCTS AND SERVICES. By *Jeffrey O'Connell,* Urbana, Ill: University of Illinois Press, 1975. Pp. xxvi, 245, index. $7.95.

*Reviewed by W. Page Keeton**

Ending Insult to Injury is Professor O'Connell's seventh major work in the area of no-fault insurance in the past nine years.[1] Unlike his other works which centered on automobile no-fault principles and the mechanics by which such a system might work in practice, he now assumes the workability of the general scheme and turns his attention to the reform aspects needed to make the system work in the more general arena of products liability and medical malpractice law. As Daniel Patrick Moynihan, in his foreword to the book, indicates, Professor O'Connell's approach here is less that of the "inspired tinkerer" and more like that of the social reformer (pp. xi-xviii).

Professor O'Connell begins by identifying the weaknesses in the present fault-liability insurance compensation system as applied to products and services (chs. 1-4). These weaknesses are essentially the same as those which Professor O'Connell and Harvard Law School Professor Robert E. Keeton exposed in relation to the espousal of no-fault automobile insurance.[2] O'Connell describes in some detail the practices employed by personal injury

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*Dean of the Law School, University of Texas; A.B., 1929; LL.B., 1931, University of Texas; S.J.D., 1936, Harvard; LL.D. (Hon.), 1974, Southern Methodist University.

1 R. KEETON & J. O'CONNELL, AFTER CARS CRASH: THE NEED FOR LEGAL AND INSURANCE REFORM (1967); R. KEETON & J. O'CONNELL, BASIC PROTECTION AUTOMOBILE INSURANCE (1967); R. KEETON & J. O'CONNELL, BASIC PROTECTION FOR THE TRAFFIC VICTIM: A BLUEPRINT FOR REFORMING AUTOMOBILE INSURANCE (1965); R. KEETON, J. O'CONNELL & J. MCCORD, ED., CRISIS IN CAR INSURANCE (1968); J. O'CONNELL & W. WILSON, CAR INSURANCE AND CONSUMER DESIRES (1969); J. O'CONNELL, ENDING INSULT TO INJURY: NO-FAULT INSURANCE FOR PRODUCTS AND SERVICES (1975); J. O'CONNELL, THE INJURY INDUSTRY AND THE REMEDY OF NO-FAULT INSURANCE (1971).

2 *E.g.,* R. KEETON & J. O'CONNELL, BASIC PROTECTION FOR THE TRAFFIC VICTIM (1965); R. Keeton & O'Connell, *Basic Protection: A Proposal for Improving Automobile Claims Systems,* 78 HARV. L. REV. 329 (1964). *See also* R. KEETON & W.P. KEETON, COMPENSATION SYSTEMS: THE SEARCH FOR A VIABLE ALTERNATIVE TO NEGLIGENCE LAW (1971); R. Keeton, *No-Fault Insurance Developments in Perspective,* 1972 N. ATL. BUS. L. REV. 14; O'Connell, *Taming the Automobile,* 58 NW. U.L. REV. 299 (1963).

attorneys, for both plaintiffs and defendants, to cloud the issues at trial, confuse judges and juries, win cases, and earn fees, all ultimately at the expense of those injured and unwillingly forced into the legal system. To some extent the examples chosen may represent extremes within the profession, but they do tend to illustrate O'Connell's primary point: the price of dissecting every accident to see who is at fault results in a system in which "it costs too much to sue; it takes too long; [and] in the end the injured person gets too little [compensation] (p. xiii)." However, it is my opinion that one can accept the validity of each of these determinations — and also accept a limited concept of simple no-fault automobile insurance[3] — without accepting the unique alternatives proposed here by Professor O'Connell with respect to the products liability and medical malpractice insurance systems.

Before diving headlong into the solutions propounded in *Ending Insult to Injury*, a preliminary understanding of the foundations of the tort liability insurance system is needed. As a starting point, it has always seemed helpful to consider a proposition made by Clarence Morris that "the security and stability of persons who happen to be [tort liability] plaintiffs is no more important [to society] than the security and stability of persons who happen to be defendants."[4] The ultimate import of this proposition would seem to be that society must balance its need for activities which are primarily beneficial, and which incidentally may inflict harm, against the costs of devising efficient and equitable means of compensating those persons who fall victim to these activities.[5]

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3 An excellent example of "basic protection" automobile no-fault insurance is the Massachusetts plan patterned after *Basic Protection for the Traffic Victim* by Professors O'Connell and Robert E. Keeton. This kind of plan has two principle features: (1) a compulsory form of automobile insurance which compensates all persons injured in an auto accident without regard to fault for all out-of-pocket personal injury losses up to $10,000 per person; and (2) an elimination of tort liability entirely where damages for pain and suffering would not exceed $5,000. In other words, under this simple no-fault plan, the victim would not sue unless the amount of damages he could possibly collect for pain and suffering exceeded $5,000 or his amount of monetary damages exceeded the $10,000 to which he was automatically entitled from his insurance company. MASS. GEN. LAWS CH. 90 § 34A (1970).

4 C. MORRIS, MORRIS ON TORTS 10 (1953).

5 One noted commentator has taken a more general view of the purposes of the tort liability insurance system: "Arising out of the various and ever-increasing clashes of the activities of persons living in a common society . . . there must of

One means of striking this balance lies in the present fault-liability insurance system. Fault-liability insurance represents a form of indemnification in which an insurance company undertakes to estimate the risks associated with the activity, the cost of providing its services in regard to these risks, and then to indemnify the tort-feasor against losses sustained or accrued by reason of his becoming liable to some third person. Regardless of Professor O'Connell's attacks upon the present fault-liability insurance system, it has helped to bring our society to its present level of industrial advancement. Many early commentators even praised the fault-liability insurance system for providing the necessary protection at the least cost to society.[6]

A second important foundation of the present tort liability insurance system is the doctrine of loss shifting. In effect this results in a system in which losses caused by a tort-feasor's negligent action are not left on the victim, but are returned to the tort-feasor.[7] Two justifications are usually offered to support this proposition. First, notions of right and justice dictate that, as between the parties, the loss caused by the tort-feasor's activities should be shifted back on him when the victim is free from fault.[8] Second, this model assumes that the imposition of the loss on the negligent party will ultimately promote accident prevention and quality control in the future conduct of similar activities. In effect, the development of the fault-liability insurance system has provided a degree of security to those persons providing beneficial products and services whom society has held responsible for failing to measure up to expected levels of conduct.

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necessity be losses, or injuries of others. The purpose of the law of torts is to adjust these losses, and to afford compensation for injuries sustained by one person as the result of the conduct of another." Wright, *Introduction to the Law of Torts*, 8 CAMB. L.J. 238 (1944).

6 *See generally* Friedman, *Social Insurance and the Principles of Tort Liability*, 63 HARV. L. REV. 241 (1950); James & Thornton, *The Impact of Insurance on the Law of Torts*, 15 LAW & CONTEMP. PROB. 431 (1950); James, *Accident Liability Reconsidered: The Impact of Liability Insurance*, 57 YALE L.J. 549 (1948).

7 This idea finds support in the early English cases where it was said that: "In all civil cases, the law doth not so much regard the intent of the actor, as the loss and damage of the party suffering." *Lambert v. Bessey*, 83 Eng. Rep. 220.

8 This notion has been tempered somewhat by the later development of defenses to tort liability in the form of contributory and comparative negligence, and, to a lesser degree, assumption of the risk. *See* W. PROSSER, LAW OF TORTS, §§ 65, 67 & 68 (4th ed. 1971).

If we assume that this simplified model of the present tort liability insurance system has some continuing validity, then how much weight should be given to Professor O'Connell's major criticism that the victims of advance technology and medical science receive nearly nothing after being forced by this system into the legal cauldron (chs. 1-4)? There would seem to be an underlying fallacy in condemning a system solely for the failure to deliver so few dollars to those victimized if the primary objective of the system is to protect and engender those persons engaged in socially beneficial activities. However, this argument overstates my criticism. Professor O'Connell's analysis is correct to the extent that he indicates that the price for achieving both objectives is not too high if a feasible and efficient system can be devised to provide security for both victims and actors and provide the admonitory function in a like manner.

Placing aside Professor O'Connell's emphasis on victim compensation as the failing of the present system, it seems to me that a more serious criticism may be that even with the protection afforded by fault-liability insurance, the ever increasing costs imposed on those rendering beneficial services may someday prohibit these activities from continuing. For example, as Chairman of a Medical Profession Liability Insurance Study Commission, I can say — from the facts now available to the Commission — that there is a crisis in the delivery of health care services which results directly from the inordinately high costs of insurance to some specialists and hospitals and the complete unavailability of insurance to others. If such a crisis does in fact exist, it is not one produced simply by the rate policies of the insurers; rather it is causally produced by the costs of processing claims and the amounts paid in settlement of claims. In this regard, Professor O'Connell's concern for the so-called waste in the fault-liability system is merited.

A major element in the cost of settling liability claims for insurers lies in the rules applicable to, and the techniques employed by courts to measure damages in negligence cases. Attention in academic circles has recently been directed to this area.[9]

9 *See* Green & Smith, *Negligence Law, No-Fault and Jury Trials — IV*, 51 TEXAS L. REV. 825, 841-42 (1973); Comment, *No-Fault: A Perspective*, 1975 BRIGHAM YOUNG U.L. REV. 79, 86.

Professor Leon Green has argued persuasively that any assessment of the causes for dissatisfaction with the existing tort compensation system must examine not only the requirement of fault as a basis for recovery and the existence of liability insurance to protect the tort-feasor, but our techniques for the measurement of damages themselves.[10]

Professor O'Connell's awareness of this element of the problem is apparent in that he outlines in some detail the economic and sociological implications of our present system of damage measurement. He concludes, quite rightly, that the present system is rapidly becoming intolerable. Unrestricted recoveries for pain and suffering (p. 51) and the courts' continued acceptance of the collateral source rule (p. 50) are matters ripe for alteration in any proposed package of legislative reform. O'Connell, of course, does propose such reform, in *Ending Insult to Injury* (chs. 8 & 9), and nearly all no-fault plans that have been proposed in this area provide for very limited recovery and wider responsibility.[11]

In making suggestions to improve the present fault-liability system, O'Connell rejects a number of proposals advanced by other commentators. For example, the utilization of social insurance (ch. 6) as a means for compensation for all accidents is ruled out primarily because such a system fails to achieve market deterrence of unsafe products and poorly rendered services (p. 89).[12] Such a system also suffers for practical reasons:

> [I]f national health insurance is passed in the immediate future on a comprehensive scale, it would still meet only a relatively small portion of the total personal injury losses of

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10 Leon Green has suggested that the monetary evaluation of personal injuries or death presents a kind of problem that should not be entrusted to the jury. He states, "Juries have no innate standard and can be given none that will enable them to evaluate the losses that lie in the future." Green & Smith, *Negligence Law, No-Fault, and Jury Trials—IV,* 51 TEXAS L. REV. 825-828 (1973).

11 *See, e.g.,* U.S. Dep't of Health, Education, and Welfare, REPORT OF THE SECRETARY'S COMMISSION ON MEDICAL MALPRACTICE (1973) (it should be noted that the report cautioned that "the Commission . . . does not believe that we should leap headlong from a system that works into an untested one that may cause even more severe problems," at 100-102); Hovinghurst, *Medical Adversity Insurance, a No-Fault Approach to Medical Malpractice,* 1974 INS. L.J. 69; Ackerman, *"No-Fault" Insurance Could Relieve Medical Malpractice,* 172 SCIENCE 989 (1971).

12 *See* Calabresi, *Views and Overviews,* in CRISIS IN CAR INSURANCE 240, 250 (R. Keeton, J. O'Connell, & J. McCord, ed. 1968); also printed in 1967 U. ILL. L.F. 600, 610.

> accident victims. . . . But given the high costs that any national health insurance will be likely to impose, it will be a long time, indeed, before any national health insurance or social security is extended to cover wage loss as well. And one doubts that such protection will ever cover more than modest levels of subsistence income (p. 75).

O'Connell also rejects any attempt at the present time to substitute a complete no-fault scheme for the present fault system, apparently because of the difficulties of describing the compensable events — *i.e.*, the risks the activity or service typically generates — in a practical way that would serve to encompass the universe of legitimate claims (ch. 7). The problem here is basically one of defining the scope of the risk to be insured. Under a complete no-fault system, does making a doctor accountable for relatively unexpected results enlarge the scope of his potential liability to the point where he becomes uninsurable? Perhaps the solution to defining the scope of the risks to be insured lies in gathering sufficient data to actuarialize with precision the conduct sought to be insured. And, as O'Connell rightly concludes, until such precise data can be generated, "[b]usinessmen and professional men, fearful of the expense to their respective enterprises, would probably robustly — and successfully — resist passage of such comprehensive legislation on either a federal or a state level (pp. 94-5)."[13]

Professor O'Connell's alternative proposal calls for experimentation with elective, no-fault, and third party insurance. Employing O'Connell's nomenclature, the enterpriser, for example a manufacturer or doctor, would be allowed to select certain risks of personal injury it typically creates, and agree to pay for out-of-pocket losses when injury results from those risks without regard to the fault of either enterprise or victim (ch. 8). Thus, the election would be to adopt a limited no-fault system with the fault system retained as to those risks as to which the enterprises failed to elect no-fault. Furthermore, the enterpriser could elect no-fault as to specific types of harm only up to a certain amount of the out-of-pocket losses with the fault system retained even as to the elected risks for large amounts.

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13 Such resistance has surfaced recently in the southern California medical malpractice insurance crisis. *See, e.g.*, TIME, Jan. 19, 1976, at 42.

O'Connell presents a number of fact situations in which his elective no-fault restricted damage system would work.

> As an example . . . a manufacturer of a power tool could elect to take out a no-fault policy to pay for out-of-pocket losses — medical expense and wage loss — whenever an amputation results from the use of the power tool. Just as no-fault automobile insurance pays without regard to anyone's negligence, so payment would be made in this instance without regard to the victim's possible carelessness or to the lack of any defect in the tool (p. 99).

Or, in the case of a physician, the risks of an adverse result in any given surgical procedure could be calculated and a no-fault plan developed to pay automatically out-of-pocket losses resulting from the operation, regardless of fault.

The enterpriser would be permitted to select no-fault insurance coverage either in complete substitution for any claim based on fault or for small claims only. To emphasize the wide variety of ways in which elective no-fault insurance coverage could be utilized, an example is given of several different manufacturers of power mowers selecting different risks for different amounts (pp. 215-17). After setting forth the example in some detail, O'Connell concludes:

> It is easy to see from this example that the number of different treatments becomes enormous with each business and professional making multiple elections involving thousands of different products and possible injuries. Thus, there can be no question that elective no-fault liability does, indeed, classify consumers/patients so that similarly situated persons — all suffering injuries from products or medical procedures — are compensated for their injuries in a variety of different ways (p. 27, footnote omitted).

This proposal is a far cry from the simple first party no-fault automobile insurance plan that would guarantee a recovery to traffic victims and would not eliminate the cause of action, if any, against the manufacturers of the automobiles.[14]

O'Connell's proposals are based upon thoughtful and provocative ideas, but a number of questions remain unanswered. Is

14 *See* note 3 *supra. See generally* R. KEETON & J. O'CONNELL, BASIC PROTECTION FOR THE TRAFFIC VICTIM 76 (1965).

elective no-fault insurance, as proposed in *Ending Insult to Injury,* workable? Can it be utilized to provide data that will be helpful to the insurance industry and the tort bar? And, since this information does not presently exist, is it appropriate to compare, as O'Connell, does a no-fault-restricted damage system that involves massive complexities of its own, with a fault-unrestricted damage plan? I shall list some of my reservations:

(1) Virtually all damaging events occur in the course of the use of one or more products. Therefore those who make and sell products could be required to assume the responsibility for the costs of virtually all accidents. No one has seriously proposed such a system. Alternatively, the courts are in the process of developing a no-fault compensation system that would base liability on proof of defect as a cause of a damaging event.[15] O'Connell and others regard this as not much different from proof of fault as a cause of a damaging event (p. 57). But I think the difference is becoming increasingly significant in the medical malpractice and products liability fields. Hopefully, the courts will eliminate any theory of recovery other than a defect theory.[16]

As regards construction or fabrication defects, proof that a product was more dangerous in some way than it was intended to be ought to suffice to shift the loss back to the enterpriser. Neither contributory negligence nor assumed risk should be valid defenses. The argument has been persuasively made that concepts of proof of defect do not require elements of negligence at all. Rather, it is argued, industries producing potentially dangerous

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15 The idea of liability based on proof of defect can alternatively be stated as a species of strict liability. The late Dean William Prosser of the University of California Law School at Berkeley has marked the date of birth of this movement with the decision in Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960). *See* Prosser, *The Fall of the Citadel (Strict Liability to the Consumer),* 50 MINN. L. REV. 791 (1966).

16 The Second Restatement of Torts in dealing with the concept of strict liability has stated that a product must be "in a defective condition unreasonably dangerous to the user or consumer or to his property." RESTATEMENT (SECOND) OF TORTS § 402A (1965). This terminology may leave something to be desired since it is clear that the "defect" need not be a matter of errors in manufacture or when the product is not accompanied by adequate instructions and warnings of the dangers attending its use. The prevailing interpretation of "defective" is that the product does not meet the reasonable expectations of the ordinary consumer as to its safety. *See also* W.P. Keeton, *Product Liability: Liability Without Fault and the Requirement of a Defect,* 41 TEXAS L. REV. 855 (1963).

products (or providing potentially dangerous services) should bear the burden of harms caused, offset these losses by obtaining liability insurance, and add the cost of this protection to the price of the product or service.[17] But this reasoning fails either if the cost of obtaining the insurance is beyond the means of those providing the product or service (questions of price elasticity are left to the economists), or if, in obtaining insurance, the cost of the product is beyond the means of those who ought to be its beneficiaries. The question, then, is whether or not it is more promising to refine the defect-compensation system, including the damage recovery element, than to go to some very vague "selective risk" plan.

(2) It would appear that under Professor O'Connell's proposal the possibilities for dispute and litigation, concerning whether or not the particular harm or loss suffered was within the enterpriser's elected no-fault risk, approximate the evils condemned in the present fault-unrestricted system. Would such a system actually result in net reductions in the costs of recovery and therefore free the "accident victim [from being the] victim of the claims systems as well (p. xiii)?" It seems that the inherent complexities in this program would fail to achieve even Professor O'Connell's most valued objective, that of "allowing the businessman and his customer or a doctor and his patient to bypass the lawyers, with all their incredibly inappropriate and self-serving cumbersomeness . . . . (p. 127)."

(3) Some risks are uninsurable simply because of the lack of reliable statistical data on the basis of which the actuarial risk can be ascertained. There are some who believe this to be approximately the case at the present time as regards medical malpractice. I do not believe that insurers could be induced to participate in a plan such as that proposed without much more information. For without this additional information, the alternatives would appear to be limited to either systems of self-insurance within the industry or state-underwritten systems — each of which has its own inherent problems.

(4) Aside from all the constitutional issues posed by such a

17 *See, e.g.*, James, *The Untoward Effects of Cigarettes and Drugs: Reflections on Enterprise Liability*, 54 CALIF. L. REV. 1550 (1966).

plan,[18] to permit enterprisers, as a matter of policy, to determine in such a manner how those victimized by their activities will be compensated will necessarily result in discrepancies in recovery; this would lead undoubtedly to considerable dissatisfaction within the general public.

(5) Implementing Professor O'Connell's elective system, with its variations as to how specific risks could be handled, would not yield meaningful data on the basis of which to establish compulsory no-fault insurance plans. In fact, it would most likely produce mountains of conflicting data which would complicate further any projections necessary to refine the system to improve efficiency and responsiveness.

In my view, a more promising suggestion is the proposal that certain types of injuries might be identified as appropriate subjects for the invocation of extra-hazardous, no-fault liability on a compulsory basis (pp. 127-29). As O'Connell points out, this could be done either by the courts or by an administrative agency such as the National Commission on Product Safety.[19] Determining which products and services would fall into this compulsory category might be problematic but by no means impossible.

This suggestion by O'Connell has inspired a slightly different thought but one based on the same idea. The crisis of medical malpractice insurance relates primarily to five or six groups of specialists, including anesthesiologists, neurosurgeons, and orthopedists. Perhaps a similar no-fault plan could be devised for certain specialities that could go a long way toward resolving the existing dilemma.

Regardless of the reservations expressed above, those engaged

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18 O'Connell does discuss some of the constitutional issues in Appendix V, entitled "Is It Constitutional" (p. 204). The most serious question is whether a statutory elective no-fault system would meet the requirements of the equal protection clause of the Fourteenth Amendment and similar clauses in state constitutions. When persons similarly situated are treated differently this usually constitutes invidious discrimination. Under the elective plan proposed persons victimized by precisely the same risk by enterprisers engaged in precisely the same kind of activity would be subject to different kinds of compensation systems without having had any opportunity to make a free election. The election is unilaterally made by the enterpriser pursuant to the suggested statute.

19 The Product Safety Commission was created by Pub. L. No. 92-573, 86 Stat. 1207 (1972); 15 U.S.C. § 2051 *et seq.* (Supp. 1973). The Commission is presently charged with establishing and enforcing safety standards on consumer products.

in trying to find practical solutions to some of the dilemmas posed by our fault-liability insurance-unrestricted damage system would be well advised to include a study of the suggestions that Professor O'Connell has made in *Ending Insult to Injury,* and subsequent to its publication.[20] Without question, Professor O'Connell has once again addressed himself to a pressing public need and dramatized the necessity for change.

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20 Reference is made here to the suggestion for adopting elective no-fault liability by contract without any enabling statute. Additional questions related to the feasibility and legality of altering tort law by contract are raised by such a suggestion. *See* O'Connell, *Elective No-Fault Liability by Contract — With or Without an Enabling Statute,* 1975 U. ILL. L.F. 59; O'Connell, *No-Fault Liability by Contract for Doctors, Manufacturers, Retailers and Others,* 1975 INS. L.J. 531.

RECENT PUBLICATIONS

THE ROLE OF THE SUPREME COURT IN AMERICAN GOVERNMENT. By *Archibald Cox,* New York: Oxford University Press, 1976. Pp. vii, 118. $6.95.

Archibald Cox, the former Watergate Special Prosecutor and Samuel Williston Professor of Law at Harvard, analyzes the role of the Supreme Court in American government and society. Distilled from four Chichele Lectures delivered at Oxford University under the auspices of All Souls College in 1975, Professor Cox discusses the utility of constitutional adjudication as an instrument of social change within the context of the constitutional and social sources of the Court's power to make these kinds of decisions. Beginning with the fountainhead case of *Marbury v. Madison,* and extending through to the Pentagon Papers and the White House tapes, Cox presents a picture of the kinds of questions with which the Supreme Court deals and the extent to which its decisions are shaped by, and shape the nation's understanding of itself.

MENTAL HEALTH AND LAW: A SYSTEM IN TRANSITION. By *Alan A. Stone, M.D.,* Rockville, MD: National Institute of Crime and Delinquency, 1975. Pp. xiv, 250, appendix. $2.65.

This monograph attempts to examine the complex elements encompassed within the interactions of the legal and mental health systems. It places in perspective the accelerating changes both in law and in institutional mental health practice which have resulted in the legal status of the mentally ill being cast in the dimension of civil rights and civil liberties issues of the first order. Dr. Stone effectively illustrates and attacks the commonly held belief that the present mental health system can be reformed by simply tightening the substantive standards and legal procedures for entry or reentry into that system. *Mental Health and Law* deals largely with the system's failures with the realization that those failures must be recognized or they will be repeated to the ultimate harm of society.

POLLUTION: CASE AND MATERIALS. By *David P. Currie,* St. Paul, MN: West Publishing Co., 1975. Pp: xix, 510, appendices, index, table of cases. $16.00.

The explosion of popular concern for the quality of the environment in the years surrounding 1970 engendered corresponding explosions in the law. We are now in the midst of monumental statutory, regulatory, and litigious changes in an area that was once a somnomulent subset of the ancient common law of nuisance. Professor Currie's book is more than a case study in pollution control and ecological awareness, it is a tool in the formulation of public policy goals to combat perceived social concerns in the larger perspective. Professor Currie's style eschews the endless recitation of cases for an emphasis on textual notes that raise questions and summarize additional material.

EQUAL EMPLOYMENT OPPORTUNITY AND THE AT&T CASE. Ed. by *Phyllis A. Wallace,* Cambridge: The MIT Press, 1976. Pp. xiii, 346, appendices, index. $16.95.

Equal Employment Opportunity and the AT&T Case is an interdisciplinary study in employment discrimination. The case began innocently enough with AT&T applying to the Federal Communications Commission (FCC) for an increase in rates. The Equal Employment Opportunity Commission intervened in these proceedings claiming wholesale discrimination against women throughout the AT&T employee structure. The case culminated in 1973 in an historical consent decree involving the EEOC, the Departments of Labor and Justice, and AT&T. Edited by Phyllis A. Wallace, Professor at MIT's Alfred P. Sloan School of Management, this collection of essays explores the economic and social costs of institutionalized employment discrimination. While some of the essays discuss generally the theoretical aspects of discrimination and the associated question whether there can ever be fairness in the workplace, other essays discuss the nature of the proof needed to diagnose discrimination and measure its costs to the workers discriminated against. Central to this discussion is a pair of essays on personnel assessment that focus on the uses of testing for hiring and promotion purposes. Finally, the institu-

tional environment in which the case was fought is examined, with attention to the strategies of intervention and the scope and impact of the remedies provided by the consent decree.

There is much analysis of hard data in this anthology as well as documentary appendices that include the text of the consent decree. Rich in source material, the anthology presents an analytic framework for examination of the main issues in defining and remedying employment discrimination.

THE SOCIAL CHALLENGE TO BUSINESS. By *Robert W. Ackerman,* Cambridge: Harvard University Press, 1976. Pp. viii, 342, index. $15.00.

The Social Challenge to Business centers on the corporate response to the internal and external pressures applied to upper-level management in an age of dynamic social change. Professor Ackerman's thesis reflects the training and discipline of a lecturer of the Harvard Business School: that the problems posed by society's quest for socially responsive corporations is best understood as a managerial rather than ethical or ideological phenomena.

Primary reliance for the conclusions reached by Professor Ackerman are placed on extensive field research conducted in two large divisionalized and diversified corporations. Secondary data was collected from case studies prepared by members of the Harvard Business School research team.

Ackerman's research leads him to the conclusion that corporate managers can develop readily applicable strategies to handle social responsiveness that, in effect, do not differ materially from their corporate decision-making postures. The manager's response to societal demands is particularly subject to the influences of incremental decisions and organizational arrangements within the corporate hierarchy.

THE LITTLE VICTIMS: HOW AMERICA TREATS ITS CHILDREN. By *Howard James,* New York: David McKay Company, Inc., 1975. Pp. x, 364, index. $10.95.

Little Victims is a passionate indictment of the manner in which America treats its children. Howard James, a Pulitzer-

Prize winning journalist, presents a very personal and impressionistic account of case histories that examine all aspects of child care, ranging from the well documented and publicized frequency of physical abuse of children by their parents to more subtle psychological abuse by indifferent or inept teachers and social workers. His outrage is particularly directed at the institutions of child care, the juvenile courts and the welfare offices that have become part of a system that itself contributes to the abuse of children.

Mr. James is not without hope or suggestions for reform. In a section entitled "Seeking Solutions," he recites an honor roll of concerned individuals and lists 67 concrete suggestions for reaching out to unwanted or neglected children. The suggestions range from forming children's rights advocacy groups to volunteering as foster parents. Many of the suggestions are directed at encouraging unique individual efforts.

This book is not filled with statistics or social science jargon. Its analysis is not systematic. *Little Victims* is directed at the general reader as an urgent plea for individual and collective response to what Mr. James considers a very serious problem.

THE FOREST SERVICE: A STUDY IN PUBLIC LAND MANAGEMENT. By *Glen O. Robinson,* Baltimore, MD: The Johns Hopkins University Press, 1975. Pp. xv, 286, appendices, footnotes. $16.95 cloth, $4.95 paper.

Current interest in the environment and in the wise use and conservation of our natural resources has focused attention on the problems of resource management. Mr. Robinson takes on a small part of this picture in a study of the organization and decision-making processes of the United States Forest Service. The perspective employed is not that of the "ecology conscience," but rather that of economics, broadly defined as the study of resource allocation under conditions of scarcity. This perspective dominates the discussion of the increasingly controversial mission of the Forest Service in regard to balancing the elements of outdoor recreation, wilderness, wild life, and watershed. The analysis indicates that the Service is less controlled by the forces it is directed to regulate than by the constraints of the budgetary process.

CRIME, CRIMINOLOGY AND PUBLIC POLICY: ESSAYS IN HONOUR OF SIR LEON RADZINOWICZ. Ed. by *Roger Hood,* New York: The Free Press, 1974. Pp. xxii, 622, bibliography of the writings of Leon Radzinowicz, index. $29.95.

A collection of essays assembled as a tribute to Leon Radzinowicz, former Wolfson Professor of Criminology at Cambridge University, England, covering a wide range of criminological concerns. The complex interplay of crime, punishment, and official policy is examined in the 29 essays portraying the authors' varying perspectives from the theoretical to empirical, historical to contemporary, pragmatic to humanitarian. While the emphasis is European, the application is universal.