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THE CONTRACT DISPUTES ACT OF 1978 — SOME OBSERVATIONS AND PREDICTIONS

By Trial Judge Louis Spector

In a reversal of the conventional order, this paper will set forth certain conclusions and predictions at the outset. Thereafter it will underpin those conclusions with relevant history, and support those predictions with the rationale upon which they are based.

The provisions of the Contract Disputes Act of 1978[1] should be analyzed in the order of their importance, not merely in the order of their appearance. With that premise in mind, the most important provision by far is Section 10, subdivision (b). It achieves that questionable distinction by retaining the essential finality of agency decisions, whenever a contractor aggrieved by a contracting officer's decision elects to appeal to the agency's board of contract appeals. The retention of essential finality at this early stage means that the board procedure is both the beginning of the road and, for all practical purposes, the end of the road for those contractors and their legal advisors who elect to take that route. As later detailed, that route is thereby rendered far less attractive than it would have been without that burden. It is therefore less likely to be elected under the options now provided by the Act.

The "finality" rule, as originally imposed by the trilogy of Supreme Court decisions in 1963 and 1966,[2] created genuine hardships which eventually helped to bring about the Act authorizing the Commission on Government Procurement,[3] followed by 3 years of intensive study by that bi-partisan Commission and its competent staff, and its two major recommendations specifically designed to ameliorate the cited hardships in the remedies area.[4] Both of those two major recommendations were in fact incorporated in the originating bills[5] which eventually culminated in the Contract Disputes Act. But in a last minute change, one of those two important Commission Recommendations was discarded.[6] As a result, the Act in effect retains the strictures of the *Bianchi* decision,[7] contrary to the Commission's Recommendation which had found this to be the principal cause of the hardships it sought to alleviate,[8] and

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[1]Contract Disputes Act of Nov. 1, 1978, Pub. L. No. 95-563, 92 Stat. 2383 (codified at 41 U.S.C.A. § 601-613 (West Supp. 1979)) (hereinafter cited as "the Act").

[2]*United States v. Anthony Grace & Sons, Inc.*, 384 U.S. 424 (1966); *United States v. Utah Constr. & Mining Co.*, 384 U.S. 394 (1966); *United States v. Carlo Bianchi & Co.*, 373 U.S. 709 (1963).

[3]Pub. L. No. 91-129 as extended by Pub. L. No. 92-47, 83 Stat. 269 *et seq.* and 85 Stat. 102, 1969 and 1971.

[4]Report of the Commission on Government Procurement, Vol. 4, Part G, chs. 1 and 2, specifically Recommendations 6 and 9 (December 1972) (hereinafter cited as Commission Report or Commission Recommendation.) For an analysis *see also*, Spector, *Disputes Arising in Connection With Contract Performance — A Comment on the Report of the Commission on Government Procurement*, 33 Fed. B.J. 160 (1974).

[5]H.R. 11022, 95th Cong., 2d Sess., House Report No. 95-1556, Sept. 8, 1978; S. 3178, 95th Cong., 2d Sess., Senate Report No. 95-118, Aug. 15, 1978.

[6]Commission Recommendation 9. *See* notes 4 and 5 *supra* and the Act, note 1 *supra*, Section 10, subdivision (b).

[7]*See* note 2 *supra*.

policy and upon national need. Otherwise they constitute overregulation at its worst. No regulatory requirement is more costly than one that is unnecessary. The great cost in this instance results from diminished interest in and diminished competition for Government contracts. Extracting finality for an agency's decision at the first stage of a contract dispute is therefore a classic example of just such a useless and costly requirement.[16] The "finality" requirement is not to be confused with a concomitant Governmental requirement that a contractor meanwhile proceed with the work pending resolution of a dispute. Sound public policy can be demonstrated for the latter requirement, at least in the case of a unique and essential procurement mission where the mission might be frustrated were the Government deprived of that unique power.[17]

No such reasons of public policy support the finality requirement, however, and none have been put forward. If it is urged that compulsory disputes procedures of this nature are necessary in order to bring public contract disputes to an earlier conclusion, the same result could be achieved more quickly and efficiently by simply reimposing sovereign immunity in contract cases, if that could be justified. By way of comparison, imagine the consequences if all insurance contracts, which are also instruments of adhesion drafted by the insurance carrier, contained a similar "disputes" clause requiring that all claims under the policies would be decided by a company official, whose decision would be final unless appealed to the head of the company, or a board designated by him. That board's decision would then be final and binding unless found by a court to be arbitrary, capricious, fraudulent, grossly erroneour or not supported by "substantial" evidence. It is doubtful that such a standard provision could be sustained on grounds of public policy.

How then did there develop the concept of according finality to a contracting officer's decision and, on appeal, of according finality to a decision of the department head or his duly authorized representative? The concept developed historically in the unilateral drafting of contract provisions by Government personnel, as part of the unilateral issuance of procurement regulations in which those contract provisions are contained. That regulatory trend ran contrary to the statutory trend. Back in Lincoln's administration, the doctrine of sovereign immunity had presumably been abandoned in this country.[18] For the next century, our contract remedies system worked quite nuclear and space age. During that long period of procurement history, the vast majority of contract disputes were settled within the agency under procedures which were relatively informal, inexpensive and expeditious. Only 3 - 4% of contractors dissatisfied with agency action on their claims, found it economically feasible to seek a judicial remedy in court. Those who elected to

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[16]*See* note 12 supra. *See also* Congressional Record for June 2, 1976 at S.8343 setting forth the statement of Senator Lawton M. Chiles, Jr. accompanying introduction of S.3512, the first Senate version of the Contract Disputes Act of 1978.

[17]*See* discussion in Commission Report, note 4 *supra*, at 31-32. *See also*, Shedd, *Disputes and Appeals: The Armed Services Board of Contract Appeals*, 29 Law & Contemp. Prob. 39, 39-40 (1964) (hereinafter cited as Shedd);

invested with a broad band of discretion. A citizen aggrieved by such action is entitled only to a judicial review of the agency decision confined to the agency record. There is a strong presumption that the agency decision is correct, and the presumption can be overcome only by a showing that the decision was arbitrary, capricious, fraudulent, grossly erroneous or not supported by substantial evidence. That relationship between the regulatory, ratemaking agencies and the public bears no resemblance, however, to the relationship between the Government and one of its contractors. There, as Lincoln observed, the Government, as buyer, steps down into the marketplace, and the transaction is typically at arm's length.[28]

That is apparently how the contract relationship continued to be perceived following passage of the Anti-Wunderlich Act in 1954. For about 10 years thereafter, there was no perceptible change in the manner in which contract disputes were traditionally handled. About 97% of contract claims and appeals continued to be disposed of within the agencies by informal, inexpensive, expeditious procedures. As always, only about 3% proceeded further to court, where a full and conventional judicial remedy was available. The word "final" appearing in the standard "disputes" clause was defined as meaning the "final" position of the agency, not as totally final and immune from review.

But then that trilogy of Supreme Court decisions in 1963 and 1966[29] focused again upon interpretation of the "disputes" provision, and concluded that the "substantial" evidence language placed agency decisions on contract disputes in the same posture as decisions of the regulatory, ratemaking agencies under the APA. They ruled that a court could no longer take any evidence or provide any kind of a trial in a contract case. Judicial review was thereafter confined to a perusal of the agency's record, and the agency's decision was essentially final if it met the tests earlier mentioned.

A period of turmoil followed these decisions.[30] A court reviewing prior board decisions without the benefit of currently developing the record on which the decisions were bottomed, had just as much or more work examining a record made elsewhere, but the dispute could no longer examine into the merits of the dispute or provide a meaningful remedy, even though it might have decided the case differently. If an agency record proved to be defective or inadequate, the court could not remedy the defects or inadequacies by taking evidence, but had to send the case back to the contracting agency. Even if it found on judicial review that the board decision failed to meet the standards earlier described, it could not take evidence on the amount of recovery, but had to return the case to the agency on that issue. Although they are not detailed here, a flood of problems in court and back at the agencies developed as a result. Some unfortunate cases resembled the ball in a ping-pong game between court and agency.[31] Suffice it to say that an inordinate amount of lawyer and court time was wasted now on matters unrelated to the merits of a its 1972 report was devoted to these problems.[36] The Report concluded that "the present system for resolving contract disputes needs significant institutional ans substantive change if it is to provide substantial justice to the contractors and the Government. The present disputes-resolving procedures are leading to increased contractor frustration and disillusionment. This widespread view has been clear in every type of input received by the Commission, including open hearings, answers to questionnaires, and individual letters and recommendations. If the concerns about inequities and inefficiencies in disputes-resolving procedures cause potential contractors to avoid Government work, the procurement process will suffer.[37]

When he introduced his remedial bills in 1976 and 1977 (forerunners of the Contract Disputes Act of 1978), Senator Chiles, a former member of the Commission, echoed these sentiments, noting:

> Government contracting its coextensive with Government itself. Inefficient, unfair procurement procedures are not in the Government's best interests. Not only are essential contractors driven out of competition for Government contracts, but those who remain are forced to submit consistently higher bids at the taxpayers' expense. The point is, of course, that procurement procedures, if they are to be in the national interest, must be fair to both parties to a Government contract. Otherwise, both parties to the contract are poorly served.[38]

As stated, however, one of those two important recommendations of the Commission, as embodied in earlier versions of the Contract Disputes Act of 1978, was discarded in the final version of the Act. The essential finality of agency decisions and the "substantial" evidence test of judicial review have been retained in those cases where a contractor aggrieved by a contracting officer's decision elects to seek review by the agency's board of contract appeals. That route does not guarantee a "preponderance of the evidence" hearing at the board, and it prohibits one thereafter at the court. But the Act, by adopting the other recommendation of the Commission, provides an alternative route which would guarantee the traditional level of due process in court.[39] A contractor aggrieved by a contracting officer's decision may elect to proceed directly to court, where he is entitled to a full trial and a decision based on a preponderance of the evidence, just as in a tax case, a condemnation case, or any other matter over which the court has jurisdiction. If aggrieved by the court's decision, an appeal lies to the appellate division (or to the proposed Circuit Court for the Federal Circuit),[40] and that appeal is not burdened by the strictures of finality or by the "substantial" evidence standard of review.[41] A further appeal to the United States Supreme Court is available in appropriate instances.

Contrast that remedy with the one that is available to a contractor who elects at the threshold to appeal the contracting officer's decisions to an agency board. He can receive an adverse decision which is against the weight of the evidence, but which is nevertheless totally final, if the claim is

[36]*See* Commission Report, note 4 *supra*.

agencies to court can be expected. If the number of contract disputes generated in the procurement agencies and ultimately filed in court increases from the present 3% to merely 6%, that would represent a doubling in the number of cases currently filed.

Two relatively formal and expensive alternatives are now open to an aggrieved contractor, and no alternative is available which is informal, expeditious and inexpensive and at the same time retains the right to a meaningful judicial review. In the case of small claims, alternatives may not really exist at all. Because of the relatively high cost of seeking a judicial remedy, that route may be economically foreclosed in the case of small claims. Moreover, the hard choice must be made *before* an administrative decision can be obtained. The claimant is in effect advised that if he wants a decision on his claim from the agency, he must agree in advance that the decision will be essentially final and binding on him when received.[45]

All of these detrimental results flow from the requirement that the initial administrative decision on a contract dispute be essentially final, a requirement that serves no demonstrably useful purpose and which has no counterpart in non-governmental contracts. The simple solution would have been to disavow or at least to soften the "finality" accorded to agency decisions, to insist that contractors proceed with deliveries pending resolution of a dispute in appropriate cases, and not to insist uselessly that the agency's decision on that dispute be final even though a court later determined that it was contrary to the weight of the evidence. All of the problems above-outlined date from the overturning of that long-standing rule and practice. Had the Act adopted the "preponderance of the evidence" test for review of board decisions,[46] or the "clearly erroneous" standard proposed in the final House and Senate Reports,[47] major problems which have been preserved and exacerbated by the legislation would instead have been alleviated.

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[45]This is because the election under the Act must be made before an agency board will review the claim. *See* the Act,

The wide scope of the 1978 Act is apparent from Section 3. The Act applies to any express or implied contract for:

"(1) the procurement of property, other than real property in being;
(2) the procurement of services;
(3) the procurement of construction, alteration, repair or maintenance of real property; or
(4) the disposal of personal property."[11]

The Act does away with the limited concurrent jurisdiction of the district courts under the Tucker Act, by which the district courts could pass on contract claims not exceeding $10,000.[12] Because of its limitations, that jurisdiction was insignificant and its abolition is of no concern.

A special regulation was provided for with respect to maritime contracts. Section 4 of the Act provides that appeals to contract appeal boards and the direct reviews by the Court of Claims, stipulated in the Contract Disputes Act, shall apply only to the extent that the Suits in Admiralty Act (46 U.S.C. §§741-752) and the Public Vessels Act (46 U.S.C. §§781-790) "are not inconsistent with this Act." Apparently this provision retains the *status quo,* and only the future will tell whether this statutory regulation will satisfactorily solve the problems.[13]

Clearly, the new Act does not apply to the peculiar situations—and the limited concurrent jurisdiction of the district courts would still seem to prevail—where, in order to overcome the well-established doctrine that "implied" contracts do not cover "contracts implied-in-law,[14]—a contract "implied-in-fact" was found by the Court of Claims. For instance, where the Director of Internal Revenue had improperly seized the money of A and had applied it to the income tax obligations of B,[15] or where money had been voluntarily proffered to the Internal Revenue Service but with a time limitation which had expired,[16] the court found a contract "implied-in-fact" to return the money. The context of the new Act makes it clear that the Act is concerned only with Government procurement contracts.[17]

Still dealing generally with both the administrative enforcement of claims and the court enforcement, Section 5 provides for a new penalty for a fraudulent presentation of a claim by the contractor. If a contractor is unable to support any part of his claim, whether before the administrative agency or before the Court, due to misrepresentation of fact or fraud, he shall be liable to the

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[11]Thus, practically all government contract situations are covered, whether they involve purchase or sale of personal property, or services. Provisions of the Act except contracts of the TVA for the sale of fertilizer or electric power or related to the conduct or operation of its electric power system (Sec. 3(b), also Secs. 8(a)(2), 8(b)(2), 8(g)(2), 8(i)). The TVA was likewide excluded from the coverage of the Tucker Act in the second paragraph of 28 U.S.C. §1491 (1976) and the Federal Torts Claims Act, 28 U.S.C. §2680(1) (1976).

Contracts of non-appropriated fund activities (Army Exchange Services, etc.) are covered (Sec. 3(a)); contracts with foreign governments are not covered if the agency head determines that application of the Act would not be in the public interest (Sec. 3(c)).

[12]28 U.S.C. §1346(a)(2) (1976); *see also* Secs. 8(g)(1), 10(a)(1) and 14(a) of the new Act.

[13]*See* the memorandum submitted by Acting Chief Judge Davis for all members of the Court of Claims on March 2, 1978, to the House Committee on the Judiciary, which outlines the problems occasioned by the dichotomy between Court of Claims and admiralty jurisdiction. *H. R. Rep.* 95-1556, 95th Cong., 2d Sess. 73, 74-76 (1978).

tractor" (Section 6(c)(3)). Another speed-up device is the power of the Board of Contract Appeals to order the contracting officer to render a decision (Section 6(c)(4)), and the third is the provision under which the failure of a contracting officer to render a decision as required shall be considered a denial of the claim and shall permit an appeal or suit as provided in the Act in Section 6(c)(5).[22] Thus, this section seeks to insure prompt action on all claims, and provide recourse for the contractor when a decision is unreasonably delayed.

The new Act permits either appealing the decision of the contracting officer within ninety days to the Board of Contract Appeals (Section 7), or bringing an action within twelve months directly in the Court of Claims for a *de novo* determination by that Court (Section 10(a)(1)). This choice of remedies by the contractor is completely new and probably constitutes the most significant innovation of the new Act. It fundamentally modifies the philosophy of the judicial enforcement of government contracts and will require the lawyer of the contractor to make an important strategic decision, namely whether he should go to the Board of Contract Appeals or directly to the Court of Claims.

THE FORMER PROCEDURAL SYSTEM FOR ENFORCING CONTRACT CLAIMS

In order to appreciate properly the significance of the new system, a short description is given of the method which existed before the November 1, 1978 Act. This description is also important for the reason, discussed at the end of this article,[23] that the former procedure may still be applied in the case of a contract entered into before March 1, 1979, even though the contracting officer determines the claim after March 1, 1979. Over the years in the contract field a metamorphosis of the Court of Claims from a trial court to largely a review court occurred.[24] Originally, simply on the basis of the broad language of 28 U.S.C. §1491,[25] trials *de novo* were held in the Court of Claims in contract cases. But with the insertion of the so-called "Standard Disputes Clause"[26] in government contracts a fundamental change occurred. That clause was construed in the light of the so-called Wunderlich Act of 1954, which made the decision of the head of the agency (normally that of a Board of Contract Appeals) final and conclusive on questions of fact unless it is "fraudulent or capricious or arbitrary, or so grossly erroneous as necessarily to

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[22]This provision is analogous to the second sentence of 28 U.S.C. §2675(a) (1976) permitting the claimant under the Federal Tort Claims Act to consider as a denial the failure of the administrative agency to make a decision within six months.

[23]*See* text at pp. 74-75 *infra*.

[24]Cuneo-Anthony, *Beyond Bianchi: The Impact of Utah and Grace on Judicial Review of Contract Appeals Boards' Decisions*, 55 *Geo. L.J.* 602 (1967); 2 *West's Federal Practice Manual* §1863, at 796 (2d rev. ed. 1977).

[25]"The Court of Claims shall have jurisdiction to render judgment upon any claim against the United States [illegible] the United States ..." 28 U.S.C. §1491 (1976). The right of the

when the board of contract appeals had made its final decision.[36] When a "breach of contract" claim was presented on grounds separable from any disputes claim, the limitation on the breach claim began to run when the breach first occurred.[37] When a disputes claim and a claim for breach were coupled, as based upon the same facts, limitations began to run, for both, only at the time of exhaustion of administrative remedies as to the disputes claim.[38]

MODIFICATIONS OF THE SYSTEM BY THE CONTRACT DISPUTES ACT OF 1978

These three preceding paragraphs describe the Wunderlich Act procedure, and problems, as they existed before enactment of the November 1, 1978 Act. Essentially all these matters were modified in some form by the new Act. First, as to statute of limitations: Under Section 10(a)(1) and (3) the direct action in the Court of Claims can be brought only within twelve months from the date of the decision of the contracting officer. Only ninety days are allowed for an appeal from the contracting officer's decision to the agency board of appeals,[39] and then one hundred and twenty days from the decision of the Board of Contract Appeals to the Court of Claims.[40] Clearly, this reduction from the six-year period conforms with the legislative policy of expediting the enforcement of government contracts. The time differences appear interesting. Perhaps the longer period (twelve months) seems fair for a person preparing a petition for a trial *de novo* for the Court of Claims, whereas the shorter period (one hundred and twenty days) seems adequate for the person who institutes only a review proceeding with the Court of Claims after having gone to the Board of Contract Appeals. But a strange result may be faced. The situation may arise where, after a decision by the contracting officer, the Government might make substantial payments, but it needs to know whether the contractor will seek any review of the contracting officer's decision. Ninety days have passed but the Government would like to know whether a direct suit in the Court of Claims will be filed. Obviously, the contractor may voluntarily in such a case forego his right to institute action, but apparently he cannot be forced to do so, and future payments apparently cannot be conditioned on his renouncing his right to bring the action. Perhaps a notification requirement of the contractor should be established.

Second, as to the right of the Government to appeal from a decision of the Board of Contract Appeals: Clearly, the ruling of the *S. & E. Contractors* case, *supra*, was modified by the new Act by creation of a new statutory provision, 28 U.S.C. §2510(b).[41] Now, within one hundred and twenty days, the head of the agency involved, with the approval of the Attorney General, may refer the decision of the Board to the Court of Claims for judgment. 28 U.S.C.

[36] *Crown Coat Front Co. v. United States*, 386 U.S. 503 (1967).
[37] [illegible] *United States*, 345 F.2d 833 (Ct. Cl. 1965).

Rules of Civil Procedure governing the district courts and the Rules of Appellate Procedure governing the United States courts of appeal, are promulgated directly by the Court of Claims, not by the Supreme Court.[51]

Also, the ruling of *United States v. Anthony Grace & Sons*[52] was reversed by the new Act. While that case provided that in conformity with principles of administrative law the Court of Claims cannot rule on matters which should first have been considered by the Board of Contract Appeals,new Section 10(c) specifically provides that in appeal proceedings from decisions of the boards of contract appeals the Court of Claims in its discretion, in lieu of remanding the case to the Board, may retain the case and take such additional evidence or action as may be necessary for final disposition of the case. This new authority of the Court of Claims is in accordance with the views expressed to the Judiciary Committee by the Court of Claims as a body, the Court agreeing "wholeheartedly with this provision."[53] A statement of an entire court in the legislative history of federal law is rare and, perhaps, is symptomatic of the particular attention which historically Congress has given to the Court of Claims, more so than to other federal courts.[54] Of course, the views of individual judges are frequently heard in the legislative committees; (see, *e.g.*, the short statement of Chief Judge Friendly, November 4, 1977, on H.R. 6922 which seeks to abolish diversity jurisdiction.)[55] But in connection with the Contract Disputes Act of 1978 the Acting Chief Judge of the Court of Claims submitted to the House Committee on the Judiciary an extensive memorandum of well over eight printed pages, commenting on the various provisions of the bill relating to the work and operations of the Court of Claims.[56]

Section 8 of the new Act contains detailed provisions guaranteeing a high caliber of agency boards of Contract Appeals. Workload studies are called for to determine whether a full-time agency board should be established. And a board of at least three members shall be established who shall have no other inconsistent duties. They are to be appointed under the Administrative Procedure Act and must have had not fewer than five years experience in public contract law. The salary scales of the board members are specified in the statute. If the volume of contract work does not justify a separate board, the agency head shall arrange that appeals from decisions of its contracting officers be heard by a board of contract appeals of another executive agency. Section 11 grants to the members of the appeal boards broad subpoena powers and authority to conduct discovery procedures generally. Clearly, the new Act seeks to assure the independence, stature, and efficiency of the boards.[57]

Informal and inexpensive resolution of contract disputes shall be furnished. If the amount in dispute is less than $50,000, the boards of appeals

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[51]Compare 28 U.S.C. §2071 (1976) with the first paragraph of 28 U.S.C. §2072 (1976).

[52]*See* note 29 *supra* and text accompanying that note.

[53]**H. R. Rep.** at 78 (memorandum of March 2, 1978, of Acting Chief Judge Davis speaking for all members of the Court).

[54]*See generally,* **D. Schwartz & S. Jacoby, Litigation ☆ With the FEderal Government** §6.119.2 (ALI-ABA 1970).

[55]Diversity of Citizenship Jurisdiction: Hearings on H. R. 6922 before a Subcomm. of the House Judiciary Comm., 95th Cong., 1st Sess. 877 (1977) (letter from Judge Friendly).

of the head of the agency. The problem remains as to whom the head of the agency should name as defendant in the referral action, nothing having been stated in that connection in §2510(b). The defendant should be the provate claimant in whose favor the higher award was rendered, but the problem must be faced that Court of Claims Rule 34(a) in describing the names of the parties in a petition now contains the specific language: "the United States being designated as the party defendant in every case." That language of the Rule, which in any event seems to be of no particular significance, should be repealed in view of the new Section 2510(b) of Title 28 of the United States Code.

In fact, an earlier statute, the Tax Reform Act of 1976,[63] previously had called for repeal of that clause of Rule 34(a). Under the Tax Reform Act there was created a duty of the Secretary of the Treasury to make deletions from a written determination before a public inspection is permitted, and if the Secretary of the Treasury fails to make such a deletion, the recipient of such a determination may bring suit in the Court of Claims against the Secretary. If there was an intentional or willful violation, the United States is liable for the actual damages, but not less than $1,000 plus costs and reasonable attorney's fees.[64] This statutory action is against the "Secretary of the Treasury," thus also calling for repeal of the above-quoted language of Rule 34(a) of the Court of Claims Rules.

STRATEGIC DECISIONS OF THE PRIVATE PRACTITIONER

The new Contract Disputes Act of 1978 has added the need for the private practitioner handling of government contract case to make an important policy decision, namely the fundamental strategic decision whether it is desirable for him after the ruling of the contracting officer to go directly to the Court of Claims for a trial *de novo* under Section 10(a)(1) and (3) or whether he should appeal the decision of the contracting officer to the Board of Appeals under Section 7, from which board decision he may then seek review under the "substantial evidence" test in the Court of Claims (Sections 8(g)(1)(A) and 10(b)). As pointed out above,[65] the distinction between "disputes arising under" and "breach of contract" claims has been abolished. Formerly "disputes arising under" had to be submitted to the board of contract appeals,[66] and there was no jurisdiction in the boards of appeals, as such, to pass upon "breach of contract" claims.[67] Now, all claims are treated the same way; all must be filed with the contracting officer; and from there the decision of the contracting officer's ruling on all claims may be taken either directly to the Court of Claims for a *de novo* determination or may be appealed to the board; clearly, the contractor has only the choice of taking

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[63] Pub. L. No. 94-455, §1201(a), 90 Stat. 1525 (1976).

are rather frequent in the Court of Claims,[74] have a complicated history. Originally, the lack of equity jurisdiction in the Court of Claims[75] prevented the bringing there of a suit seeking reinstatement, and such reinstatement suit had to be brought by the discharged employee against the head of the agency in the district court. On the other hand, suit for back pay was completely forbidden in the district courts by former 28 U.S.C. §1346(d)(2).[76] When the latter provision was repealed, the result was that thereafter both the Court of Claims and the district court (claims of up to $10,000) could grant the monetary relief of back pay. But it was only with the enactment of the Remand Statute in 1972 that the need of two suits was avoided, the 1972 statute giving the Court of Claims power to "provide an entire remedy and to complete the relief afforded by the judgment," such as "orders directing restoration to office or position." The present situation frequently favors going to the Court of Claims rather than the district court. Of course, if plaintiff seeks *only* reinstatement, and no back pay, he still must go to the district court, because the Court of Claims has no jurisdiction to grant only equitable relief; but if in addition to reinstatement he seeks damages of over $10,000 he must go to the Court of Claims; if less than $10,000 he can go to either district court or Court of Claims. But, in any event, it should be realized that the amount of monetary relief, though not so clear at the institution of the action, often at the time of judgment will exceed $10,000. Consequently, it frequently is advisable to reach the strategic decision of bringing the action in the Court of Claims.

These considerations have shown that the strategic decision of bringing the action now frequently tilts toward the Court of Claims in the tax field, in the civil service field, and with the enactment of the 1978 Contract Disputes Act sometimes in the government contract field (as against the possibility of first going to the Board of Contract Appeals).

EFFECTIVE DATE OF THE ACT

The provision of the Act prescribing its effective date (Section 16) may produce a strange consequence. The first sentence making the statute, enacted November 1, 1978, applicable only to contracts entered into one hundred twenty days after the date of enactment, *i.e.*, to contracts entered into after March 1, 1979, clearly was promulgated in order to make possible in practice the changeover from the former system of board of contract appeals to the new system of consolidating appeals, *viz.*, the new procedure of transferring appeals to the board of contract appeals of another agency, if the contract claims work of the former agency does not justify the existence of a separate board of contract appeals.[77] However, the second sentence of Section 16 raises a problem. In the case of contracts entered into before March 1,

[illegible] constituted 13 percent of the business of the Court of Claims in 1966. Peartree, *Statistical Analysis*

35 U.S.C. §103: A QUEST FOR OBJECTIVITY

*By Trial Judge Joseph V. Colaianni**

In Lewis Carroll's *Alice in Wonderland,* Humpty Dumpty says to Alice, "When I use a word, it means just what I choose it to mean — no more, no less! It is just a question of who is to be the master."

Patent attorneys ought to envy Humpty Dumpty. For many years, they had to use a magic word without really knowing what it meant. That word was — "invention."

The word "invention" is kaleidoscopic. To the 1941 Supreme Court, it meant "a flash of creative genius,"[1] while to Thomas Edison, it was "99 per cent perspiration and 1 per cent inspiration."

The word "invention," which should have been our obedient servant, became our master, and a very capricious master at that. In 1943, the National Patent Planning Commission recommended:[2]

> [T]he enactment of a declaration of policy that patentability shall be determined objectively by the nature of the contribution to the advancement of the art, and not subjectively by the nature of the process by which the invention may have been accomplished.

In an attempt to recapture the atmosphere which prompted the Commission's recommendation, it is worthwhile to examine, case-by-case, the courts' struggle with the concept of "invention." Article I, section 8, of the Constitution, the fountainhead of the patent system, provided that:

> The Congress shall have power *** To promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries.

In addition to providing the basis for the granting of patents, many have argued that this also establishes a Constitutional standard by which all patents are to be measured. See, for example, Justice Douglas' concurring opinion in the *A & P* case[3] where he states:

> Article I, §8, contains a grant to the Congress of the power to permit patents to be issued. But, unlike most of the specific powers which Congress is given, that grant is qualified. *The Congress does not have free rein, for example, to decide that patents should be easily or freely given. The Congress acts under the restraint imposed by the statement of purpose in Art. I,* §8. The purpose is "To promote the Progress of Science and the useful Arts ***. The means for achievement of that end is the grant for a limited time to inventors of the exclusive right to their inventions. [Emphasis added.]

The subject matter of a patent under all pre-1952 legislation was a "new and useful invention." Gradually, the term "invention" took on substantive

[1]Cuno Engineering Corp. v. Automatic Devices Corp., 314 U.S. 84 (1941).

[2]Efforts to Establish a Statutory Standard of Invention, Study No. 7, Senate Subcommittee on Patents, Trademarks, and Copyrights, 85th Cong., 1st Sess. (Comm. Print, 1958), at 2.

[illegible] 340 U.S. 147, 154 (1950) (hereinafter "A & P").

On the other hand, the remaining justices might be surprised to learn that their decision had kindled enthusiasm for "negative rules of invention". Hotchkiss, you will recall, had substituted a clay or porcelain doorknob for a metallic doorknob. But, according to the Supreme Court, "this, of itself, can never be the subject of a patent".[8] Thus, we have one of the first of the judicially-created "negative rules of invention". The list grew quite rapidly as the courts became more accustomed to and adept at second-guessing inventors.[9] By 1937, the courts, through these rubrics, had credited journeymen mechanics with the ability to automate manual operations, to make heavy machines portable, to change the form, degree, or proportions of the elements of machines or compositions, and to omit, reverse, relocate, unify, divide, or multiply parts. That year's edition of *Walker on Patents* claimed that these "negative rules of invention" were "entirely authoritative and sufficiently clear".[10]

Had *Hotchkiss* said no more than that the substitution of one material for another cannot, by itself, be considered "invention," we would be content to let it rest in peace. However, since in fact that decision contains the kernel of the modern statutory approach to patentability, it deserves to be exhumed for close inspection. The kernel of §103 was planted in the last paragraph of *Hotchkiss:*

> [U]nless more intenuity and skill *** were required *** than *** possessed by an ordinary mechanic acquainted with the business, there was an absence of that degree of skill and ingenuity which constitute essential elements of every invention.

While the thought is excellent, there is no guidance for its application. It does not explain how obviousness is to be determined. Subjectively or objectively? By judicial introspection, or by evaluation of the history of the art? No one could say.

Even worse, these words of wisdom, obscured by dicta, were soon forgotten. The cases of this era, by and large, are devoid of attempts to determine the problem that the inventor faced, and establish the level of ordinary skill in the pertinent art, at the time the invention was made. Instead, they show a preoccupation with negative tests of "invention."

The confusion surrounding a standard of patentability undoubtedly reached its high water mark during this period. Not only do we find that second-guessing the Patent Office was very much in vogue during this period, but the cases made it clear that patents were being examined and tested by personal subjective standards.

However, it would be unjust to represent that all patent cases decided between the years 1850 and 1950 turned on a subjective, judicially-imposed

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[8] Hotchkiss, *supra*, 52 U.S. (11 How.) at 266.

[9] These rules were reminiscent of Section 2 of the Patent Act of 1793, 1 Stat. 318:

In an analysis that is as timely today as it was when first written, Judge Hand points out that every patented invention combines elements which individually are old, yet, nonetheless, the combination may be patentable. Going on, he observed:

> In the case at bar it seems to us that the evidence is at hand to show that Paulson's combination was beyond the scope of even the most skilled routineers. The record is peppered with a score of patents upon spark-plugs distributed more or less evenly over more than fifteen years. They show a manifold ingenuity and all sorts of permutations, but not Paulson's; it is uncommon to find so much ingenuity devoted to so small a device. During that time the motor car was being made in prodigious, almost monstrous quantities, millions upon millions; a new discovery which gave its possessor an exploitable advantage was likely to be the source of great wealth; the stimulus to invention was rarely strong. Moreover, nothing stood in the path; the defendant's very argument may be turned against itself; for Paulson's metals were all being used and were all available commercially; yet they did not suggest this combination, which would have been as serviceable at any time as it has been since the patent issued.

Similarly, in the case of *Todd Protectograph Co. v. Safe-Guard Check Writer Co.*,[14] Judge Hand stated that it was:

> [I]dle to speculate a priori upon what new steps are within the imagination of an ordinary journeyman. At times no doubt we must do it, but the history of the art is a safer test, when we have it, and if after numerous efforts a need of long standing is successfully met, it is a mistake to suppose that the answer all along was apparent. One should not so discredit past inventors.

Again, in 1932, Judge Hand applauded a new method of chromium plating by resorting to an objective, historical analysis of patentability. He stated:

> The need had long existed; competent investigators had tried to fill it, they had hit the target but not the bull's eye ***.

The objective, historical approach to patentability, in spite of Judge Hand's enhancement of its standing, was by no means universally embraced. The standards, in those days, as in these, were set by the Supreme Court. The Supreme Court's "high standard of patentability," so well known to the practitioners of our time, is not a recent development. The trend was noted by Judge Hand in *Picard v. United Aircraft Corp.*,[15] when he observed:

> We cannot, moreover, ignore the fact that the Supreme Court, whose word is final, has for a decade or more shown an increasing disposition to raise the standard of originality necessary for a patent. In this we recognize "a pronounced new doctrinal trend" which it is our "duty, cautiously to be sure, to follow, not to resist."

In amplification of this point in his concurring opinion, Judge Frank stated:[16]

> [B]ecause my colleagues are far better versed than I in passing on patents, I am reluctantly constrained to join in their decision, since it represents their experienced interpretation of that "doctrinal trend" to which Judge Hand refers and which, at least since 1928, has spelled itself out in Supreme Court decisions sustaining a very small percentage of patents.

This "doctrinal trend" culminated in the Supreme Court's well-known passage of the 1952 Act continued and was even magnified by the Supreme Court's trilogy opinions in 1966.[18]

The hope of stability was, however, dashed by the Supreme Court's most recent §103 opinions in *Black Rock*[19] and *Sakraida.*[20] These decisions render combinations of old elements unpatentable when the elements functioned in the same old way. It is hard to see how any mechanical or electrical invention could be patentable under this test. As Judge Hand said in *Walter Kidde Co.:*

> All machines are made up of the same elements; rods, pawls, pitmans, journals, toggles, gears, cams, and the like, all acting their parts as they always do and always must. *** But the elements are capable of an infinity of permutations, and the selections of that group which proves serviceable to a given need may require a high degree of originality.[21]

The Patent and Trademark Office, to its credit, has adhered to the statutory "nonobviousness" standards as developed in *Graham v. John Deere Co.* But the divergence of the Patent Office and the courts only underscores my conclusion that §102's "stabilizing effect" has been limited. And, thanks to the vacillation of the Supreme Court, the judiciary is now a house divided.

Perhaps it is time that we remembered that §103 was never intended to be the last word on patentability. Its drafters invited the elaboration of objective criteria for determining what should be patentable. This invitation was accepted by that earnest and eminent proponent of the historical approach, Judge Learned Hand.

In *Lyon v. Barusch & Lomb Optical Co.,*[22] he upheld a patent on a method of applying a nonreflective coating to optical elements. Judge Hand wrote:

> The most competent workers in the field had for at least ten years been seeking a hardy, tenacious coating to prevent reflection; there had been a number of attempts, none satisfactory; meanwhile nothing in the implementary arts had been lacking to put the advance into operation; when it appeared, it supplanted the existing practice and occupied substantially the whole field. We do not see how any combination of evidence could more completely demonstrate that, simple as it was, the change had not been "obvious *** to a person having ordinary skill in the art" ***[23]

In *Reiner v. I. Leon Co.,*[24] Judge Hand declared that §103 mandated a detailed historical approach:

> The test laid down is indeed misty enough. It directs us to surmise what was the range of ingenuity of a person "having ordinary skill" in an "art" with which we are totally unfamiliar; and we do not see how such a standard can be applied at all except by recourse to the earlier work in the art, and to the general history of the means available at the time. To judge on our own that this or that new assemblage of old factors was, or was not, "obvious" is to substitute our ignorance for the acquaintance with the subject of those who were familiar with it. There are indeed some signposts: e.g., how long did the need exist; how many tried to find the way;

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[18] Graham v. John Deere Co., 383 U.S. 1 (1966); Calmar, Inc., and Colgate-Palmolive Co. v. Cook Chemical Co., 383 U.S. 1, 26 (1966); and United States v. Adams, 383 U.S. 39 (1966).

[19] Anderson's Black Rock, Inc. v. Pavement Salvage Co., 396 U.S. 57 (1969).

[20] Sakraida v. Ag Pro, Inc., 425 U.S. 273 (1976).

importance.[31] First, it said, you set forth the facts in the *Graham* format, and then you consider commercial success, long felt demand, and so on. In *In re Fielder and Underwood*,[32] the CCPA went so far as to insist that "such evidence must *always* be considered in connection with the determination of obviousness."

Graham required the resolution of the "level of ordinary skill in the art". It seems to me that the best and surest way in which the "level of ordinary skill in the art" can be ascertained is by weighing the objective, historical evidence available. Insofar as this factual determination is concerned, long felt demand and failure of others are of *primary* importance. They are secondary to the final determination of obviousness or nonobviousness in the sense that any preliminary question of fact is secondary to the ultimate question of law. This, I feel, is the proper reading of *Graham*.

I am pleased to say that the Court of Claims was among the first to recognize that the level of ordinary skill in the art could be inferred from objective, historical evidence. In 1967, then-Commissioner Lane wrote:[31]

> In attempting to ascertain the level of ordinary skill in the art, logical factual inquiries include the length of time a need for the invention existed, the criticality of the need for the invention, and the existence of attempted unsuccessful solutions by others. These factual inquiries may be relevant in ascertaining the level of skill in the art because presence of one or more of the above-listed factual patterns suggests that skilled artisans either were presented with the motive to find a solution to the need or actually attempted to solve the problem, and subsequently failed.[33]

A broader use of history was made by Trial Judge Cooper in 1974, who called attention to:

> [T]he various prior art approaches employed, the types of problems encountered in the art, the rapidity with which innovations are made, the sophistication of the technology involved, and the educational background of those actively working in the field***[34]

He added that "[c]onsiderations such as commercial success and the failure of others, *** are *** *invaluable* as real-life indicia *** of the level of skill in the art ***." [Emphasis added.][35]

In *Reeves Instrument Corp. v. Beckman Instruments, Inc.*,[36] the Ninth Circuit stated that the level of ordinary skill in the art could *only* be determined "by an analysis of the problem allegedly solved by the invention and the efforts of others to arrive at a satisfactory solution,"[37] and in its 1977 decision of *Austin v. Marco Dental Products, Inc.*,[38] it held that the obviousness of the use of diaphragm valves in dental equipment was belied by defendant's re-

[31] In re Meng and Driessen, 181 USPQ 94, 96 (CCPA 1974).

[32] 176 USPQ 300, 303 (CCPA 1973).

[33] Simmonds Precision Products, Inc. v. United States, 153 USPQ 465, 469-70 (1967).

[34] Jacobson Bros., Inc. v. United States, 184 USPQ 181, 185 (1974).

essential that you buttress this inference as best you can. Evidence of unsuccessful research should be accompanied by evidence of the educational backgrounds of the researchers. Rightly or wrongly, a Ph.D.'s failure will be more telling than an illiterate's.[45] Show that the researcher was familiar with the field. Langmuir's unsuccessful radio experiments were discounted in *General Electric Co. v. De Forest Radio Co.*[46] because that great physicist had little acquaintance with the history of the art.[47] In particular, make it clear that the researcher had been familiar with the key prior art cited against the patent. Above all, show that the unsuccessful research was directed at the same problem as that solved by the patentee. An unsuccessful attempt to devise a continuous process of manufacturing a chemical may not imply the nonobviousness of the patentee's batch process.

If you are not aware of any "failures of others," a discussion by the inventor of his own failures may be telling. If even this evidence of the level of ordinary skill in the art is lacking, an attempt could be made to show the existence of a long felt but unsatisfied demand for the invention. The continued existence of a problem in an industry implies that the "routineers" have tried and failed to devise a solution. Point this out in your briefs! Then show that the problem was of great importance to the industry.[48] In *Nockola v. Peterson,*[49] the historical approach foundered when the defendant pointed out that there was no immediate need for the invention, gas meters for mobile homes, as there was no provision for supplying them with gas. If the market is oligopic, whos that the industry leaders were innovative, *i.e.*, that the "long felt need" was not a consequence of suppression.[50]

The most significant portion of the period of "long felt demand" is that measured from the time that the researchers became aware of the most pertinent art, and the implementary arts became available, until the time the patented invention was made.[51] And this period must be compared to the normal "lead time" for innovations in the pertinent art.

Earlier I mentioned that you should show the importance of the problem solved by the invention. The shorter the period of the demand, the more material the magnitude of the problem will be. The latter can be established by expert testimony. But what if the patentee had pioneered a new art[52] and thus satisfied a *latent* demand? How does one show the size of this demand?

A latent demand for an invention may be inferred from its commercial success. If this demand were obvious to the journeymen of the art, one might fairly suggest that they would have satisfied the demand and reaped the profits.

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[45]*Cf.* Reeves Instrument Corp. v. Beckman Instruments, Inc., 170 USPQ 74, 81 (9th Cir. 1971) (MIT failure); Euctectic Corp. v. Metco, Inc., 191 USPQ 505, 521 (E.D. N.Y. 1976) (failure of leading metals lab).

[46]23 F.2d 698 (D. Del. 1928), *aff'd.* 283 U.S. 664 (1931).

[47]*Id.* at 705-706.

[48]Hewlett-Packard Co. v. Tel-Designs, Inc., 174 USPQ 140 (9th Cir. 1972); and *cf.* Johnson & Johnson v. W.L. Gore & Assoc., 195 USPQ 487 (D. Del. 1977), with Clopay Corp. v. Blessings Corp., 191 USPQ 751 (D. Del. 1976).

History and synergy were successfully blended in *Huyck Corp. v. Albany Int'l. Corp.*[59] In *Huyck Co.* the court explained that:

> [A]t the time of the invention and for a year theretofore, both the Plaintiff and the Defendant had their experts working in an effort to invent a forming belt which would defeat the problems at that time associated with all current forming belts, that is, their tendency to stretch and wear beyond usability within a very short time ***. The tremendous success enjoyed by Plaintiff *** show[s] clearly that there was a synergistic result accomplished through the novel combination suggested by the Lefkowitz patent and that the Defendant, while it was conscious of the old art, was not conscious of the way to accomplish that result. The facts are that once the Plaintiff commenced to manufacture the forming belts in question they furnished forming belts to a large part of the paper industry and that the Defendant *** lost *** [its] leadership in the manufacture and furnishing of forming belts to the paper industry. The *** Defendant was most conscious of this result, and the Defendant was at a complete loss to know exactly what to do about it even though they had acquired a sample of the forming belt manufactured by Plaintiff as early as 1967 and were attempting to perfect a copy thereof. Unlike the dairy-flushing device in Sakraida, *** it is clear that the Lefkowitz patent produced a synergistic result through a novel combination of elements, ***. The cheaper, faster and more successful way of manufacturing paper and the commercial success enjoyed by Plaintiff tends to confirm this observation.[60]

In a "*Graham* court," use history to establish the level of ordinary skill in the art. In a "*Sakraida* court," use it to show a nonobvious result. The important thing is that the court be given a viable alternative to "hindsight appraisal" of the invention by itself or by experts.

If the courts do not react favorably to objective proofs of patentability, the patent profession will have to consider legislative remedies.

In 1948, Congressman Ralph A. Gamble of New York introduced a bill which would have added "long felt want" as the third test for patentability.[61] The bill required an applicant for a patent to show that he had filled a "long felt want" and that the art as it existed at the time of the appellant's invention was "unable" to fill this want.

Unfortunately, the Gamble bill implied that, if you could not show "long felt want," you could not get a patent. This would have penalized those inventors who supplied a need within a short time after the need developed, and those inventors for whom necessity had *not* been the mother of invention. The shorter the span of time from problem to solution, the more difficult it is to find unsuccessful attempts on the part of others to solve the problem, and the weaker the inference of "nonobviousness" to be drawn from the silence of the art.

In other words, it would be a mistake to rely exclusively on the historical approach. As Judge Hand warned, "No doubt it is true that when history speaks, it is the best guide upon the issue of invention; but it is too often an equivocator, like other oracles."[62]

Congress avoided the problem of equivocation by adopting an "obviousness" test instead of a "long felt want" test. But it is unfortunate that it did not

JURISDICTION OF THE PATENT AND TRADEMARK OFFICE TO CONSIDER THE VALIDITY OF ISSUED PATENTS

By Edward C. Walterscheid and Kenneth L. Cage

In 1966 the Supreme Court took the Patent and Trademark Office rather severely to task, stating:

> . . . it must be remembered that the primary responsibility for shifting out unpatentable material lies in the Patent Office. To await litigation is for all practical purposes to debilitate the patent system. *We have observed a notorious difference between the standards applied by the Patent Office and by the courts.*[1] [Emphasis supplied]

During the late 1960's and early 1970's it was rather commonly assumed that about 70% of those patents litigated were found to be invalid. More recently, the Office has suggested that the more correct figure for those patents invalidated by the courts is about 50%.[2]

To avoid the debilitation of which the Court speaks, it might reasonably be assumed that the Office, whenever an issued patent is properly before it, would be desirous of checking the validity of that patent. But such has not been the case. Simply put, the Office has until very recently espoused the general position that it has no jurisdiction to consider the validity of an issued patent.

A former Commissioner of Patents and Trademarks has expressed this position rather succinctly:

> In view of the fact the Patent Offices loses jurisdiction over the subject matter once a patent is issued, it has long been the policy of the Patent Office to refrain from commenting on the possible invalidity of a patent. . . .[3]

The Manual of Patent Examining Procedure (M.P.E.P.) is considerably more emphatic:

> The question of validity or invalidity is exclusively a matter for the courts to determine. * * * As pointed out above, the determination of validity of a United States patent is strictly a matter for determination by competent judicial authority.[4]

One might infer from the foregoing quoted language of the Commissioner and the M.P.E.P. that the Office has no jurisdiction over an issued patent. This, of course, is not true. By way of example, the Office has statutory authority to reissue a patent,[5] issue certificates correcting a patent,[6]

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[1]Graham v. John Deere, 383 U.S. 1, 18 (1966).

[2]See, e.g., "Address given by Commissioner C. Marshall Dann to Members of Patent Examining and Documentation Organization," United States Department of Commerce News (July 15, 1975), reprinted in Horwitz, 3 Patent Office Rules and Practice 2489, 2497. The final report of the Office's "Patent Invalidity Study" is reprinted at pages 155-177 of Energy-Research and Development Administration report ERDA-76-16 Appendices C, D, and E (1976).

[3]United States v. General Electric Co. 183 U.S.P.Q. 551, 553 (Com'r. Pat. 1974).

[4]M.P.E.P. §1701 (3rd Ed., Rev. 49, July 1976).

[5]35 U.S.C. §251.

[illegible]

Proposed rules to implement Commissioner Banner's advisory opinion practice were published on December 20, 1978.[17a] Significantly, and contrary to the oft-repeated view of the Office that it has no authority to consider the validity of an issued patent, the explanation of the proposed rules states:

> *The advisory opinion procedure would change the Office's longstanding policy of not commenting on the possible invalidity of a patent.* However, the Office would continue to refrain from commenting on the validity of patents other than in connection with advisory opinions under §1.294 or reissue applications[17b] (emphasis supplied).

Although the Office has deferred consideration of the proposed rules,[17c] it is useful to examine in some detail the jurisdiction of the Office to consider or reconsider the validity of issued patents. If the Office does indeed have such jurisdiction—as Commissioner Banner clearly assumes it does—then it would be useful to ascertain the extent to which such jurisdiction might be exercised and how this might affect Office practice. Hopefully, this article will provide answers to questions of this type.

[17a]The Federal Register (Vol. 43, No. 245, at 59,901 *et seq*); the text of the proposed rules on advisory opinions is 37 C.F.R. §1.294 which states:

§1.294 Advisory opinions on patent validity.

(a) Any person may request an advisory opinion from the Commissioner on the validity of claims of a United States patent in view of prior patents or publications. The requester of the opinion must: (1) Identify the claims of the patent on which an opinion is sought; (2) submit a prior art statement containing the information specified in §1.98 and explaining why each of the claims is believed invalid; (3) remit the required fee (see §1.21); and (4) state that a copy of the request has been served upon the patent owner or a duplicate copy filed as prescribed by §1.293(b). The Commissioner reserves the right to refuse requests for advisory opinions at his discretion.

(b) Requests for advisory opinions will be announced in the *Official Gazette*. The announcement shall include at least the patent number, title, class and subclass, name of the inventor, name of the owner of record, name of the attorney or agent of record, and, if known, name of the requester of the opinion. Any information submitted by any member of the public which is timely received will be considered in the course of providing an advisory opinion. Papers from members of the public should be served upon the patent owner or filed in duplicate as prescribed by §1.293(b).

(c) The patent owner may file a response in the Office within three months after service of the request for opinion, or two months after the *Official Gazette* announcement, whichever is later. The time for response may be extended by the Commissioner upon a showing of sufficient cause. The patent owner and the requester of the opinion may file further papers only with the approval of the Commissioner.

(d) The patent owner's response may be the filing of a reissue applicant pursuant to §1.175. A reissue application filed in response to an advisory opinion request, or one already on file, will be examined in lieu of rendering an advisory opinion. The advisory opinion request will be treated as a protest against the reissue application. This paragraph does not preclude the filing of a reissue application after an advisory opinion is rendered.

(e) An advisory opinion shall state whether each of the claims identified by the requester is believed valid or invalid in view of the prior patents or publications submitted by the requester, and may discuss other prior patents or publications if deemed appropriate. Advisory opinions will be announced in the *Official Gazette;* the claims considered valid and the claims considered invalid will be listed. Copies of advisory opinions will be entered in the patent file and mailed to the patent and the requester.

(f) There shall be no appeal from an advisory opinion by either the patent owner or the requester of the opinion.

Justice Brown went on to state that the Circuit Court of Appeals had sustained the validity of the claims in question.[23] As a consequence, the net result of the *Aultman* opinion was that the claims were held valid and infringed.

Aultman made plain the Court's view that the Patent and Trademark Office had no authority whatsoever to invalidate, cancel, or annul an issued patent. That remains the law today, except to the extent that such is expressly permitted by statute.[24] As emphasized in *Aultman*, only the federal courts have authority to invalidate or otherwise set aside an issued patent.[25]

The Rule Changes Effective March 1, 1977

For almost 80 years the Office relied on *Aultman* for its view that, lacking jurisdiction over an issued patent, it should not consider or comment on its validity.[26] Then in 1976 former Commissioner Dann did a rather abrupt about face[27] and proposed certain significant rule changes whereby in circumstances set forth in the proposed rule changes the Office not only could—but would be required to—consider and comment on the possible invalidity of an issued patent. The rule changes became effective March 1, 1977.

Before considering these rule changes in detail, it is appropriate to discuss the reasons why they occurred. According to the Office:

> The purpose of the rules that are being adopted is to improve the quality and reliability of issued patents by strengthening patent examining and appeal procedures. It is desirable that patents be as dependable as possible, so as to enhance the incentives provided by the patent system to make inventions, to invest in research and development, to put new or improved products on the market, and to disclose inventions that otherwise would be kept as trade secrets. It is believed that the rules being aopted will help to maintain strong patent incentives.[28]

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[23] *Id.* But it should be noted that this point is not clear from the facts given in the opinion. Without this statement by the Court, those facts appear to suggest that the Circuit Court had made no holding in this regard prior to seeking the opinion of the Supreme Court as to the effect of the examiner's action. See 169 U.S. at 607. Presumarly, if it did sustain the claim on their merits, the Circuit Court of Appeals must have considered the prior art relied on by the examiner and found it not to teach or otherwise disclose the claims in question.

[24] As, for example, by 35 U.S.C. §135 which states that in an interference proceeding:

> A final judgment adverse to a patentee from which no appeal or other review has been or can be taken shall constitute cancellation of the claims involved from the patent, and notice thereof shall be endorsed on copies of the patent notice thereof shall be endorsed on copies of the patent thereafter distributed by the Patent and Trademark Office.

[25] 169 U.S. at 609.

[26] See, e.g., United States v. General Electric Co., 183 ZU.S.P.Q. 551, 552 (Com'r. Pat. 1974); Ex parte Overstrom,

Moreover, under the rules as now amended, all reissue applications are open to inspection and copying by the general public.[33] In addition, the filing of reissue applications is now announced in the Official Gazette.[34] While the rules had previously required that reissue applications be acted upon in advance of other applications, such action now cannot occur sooner than two months after the announcement of filing in the Official Gazette.[35] The reason for the two-month hiatus is because:

> Protests against pending applications will be acknowledged and referred to the examiner having charge of the subject matter involved. A protest specifically identifying the application to which the protest is directed will be entered in the application file and, if timely submitted and accompanied by a copy of each prior art document relied upon, will be considered by the examiner.[36]

The significance of the foregoing is that not only will the Office consider prior art pertaining to patentability[37] developed by the Examiner or presented by the applicant, it will also in appropriate circumstances consider other information relevant to patentability brought to its attention by anyone desiring to protest the reissue.[38]

The Efect of the New Rules

Unfortunately, the rules as amended do not define what is meant by a "protest." It is reasonably clear, however, that initially a "protest" was not in any way intended to be a full-scale opposition proceeding or other inter partes contest. Thus, under the old rules, reissue prosecution was "essentially an ex parte matter," without the right of a protester to do more than file a written submission on prior art.[39] Under the new rules, the Office stated in February 1977 that it

> . . . does not contemplate permitting a protester to participate as a party in further proceedings. In the case of applications available to the public, such as reissue applications, the protester may file papers rebutting statements made by the applicant. The examiner at his discretion may request a protester to submit additional written information or may provide extra time for comments by a protester to be filed.[40]

While not permitting a full inter partes contest, it was apparently the desire of the Office to liberalize the role played by a protester. The idea of a rebuttal was certainly new[41] and is an excellent approach. Moreover, speaking

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[33] 37 C.F.R. §1.11(b).

[34] *Id.*

[35] 37 C.F.R. §1.176.

[36] 37 C.F.R. §1.291(a).

[37] Note that such information is in no way limited to prior art, although such will undoubtedly be considered in the majority of cases. Thus, e.g., it may reasonably be expected that 35 U.S.C. §112 issues will frequently also be present.

[38] Although it could apparently have done this prior to March 1, 1977, see, e.g., In re Altenpohl, 198 U.S.P.Q. 289 (Com'r. Pat. 1976) and In re Bom, 193 U.S.P.Q. (Com'r. Pat. 1976), the rules did not then expressly require it. In *Altenpohl,* prior public use and sale were considered relevant to the determination whether a reissue application should be stricken for fraud.

[39] International Paper Co. v. Fibreboard Corp., 181 USPQ 740, 742 (D.C. Del. 1974). In re Altenpohl, 198 U.S.P.Q. [illegible] (Com'r. Pat. 1976); and In re Gabriel, P.T.C.J. No. 406, p. A-

sophistication of the particular court with respect to patent matters, and (c) the desire of the court to receive testimony on relevant patentability issues beyond prior art. Indeed, this is borne out by what little judicial commentary exists concerning the new rules as of the time of this writing (April 1979).[48]

There is as yet no published decision which has taken into account a reissue proceeding under the new rules. However, in *Corometrics Medical Systems, Inc. v. Berkeley Bio-Engineering, Inc.*,[49] which involved a protested reissue application prosecuted in 1975[50] the court stated:

> The presumption of patent validity is here further strengthened in view of the extraordinary Inter Partes protest proceeding . . . wherein all of the contentions now raised by defendant were rejected by the Patent and Trademark Office.[51]

The use of the phrase "extraordinary Inter Partes protest proceeding" has caused one commentator to state that "despite the limited nature of the PTO reissue proceeding, (whether) courts will regard them as the equivalent of full inter partes contests or whether the language in question is merely the result of the facile pen of the prevailing party's attorney is not at all clear."[52]

None of the opinions published to date has recorded any challenge to the new rules. Nonetheless, their legality is quite likely to be questioned, if for no other reason than that they represent such a drastic departure from previous Office practice. It is therefore useful to consider the scope of the Commissioner's rule-making authority and whether the new reissue rules fall properly within that scope.

Determining How Far the Rule-Making Authority Extends

Title 35 of the United States Code, which is the codification of the Patent Act of 1952, gives the Commissioner authority to ". . . establish regulations, not inconsistent with law, for the conduct of proceedings in the Patent Office."[53] Unless otherwise specifically noted, the Rules of Practice in Patent Cases have been promulgated pursuant to this authority.[54] The Court of Customs and Patent Appeals (C.C.P.A.) has consistently taken the position that the Rules of Practice have the force and effect of law when not incon-

[48]F.B. Lacey, "A Federal District Judge's Views on Patent Reissue, Protest and Duty of Disclosure," 60 J.P.O.S. 529 (September 1978); See, also, D. R. Dunner et al., "The New Reissue Practice," 61 J.P.O.S. 68, 84, 85, note 8, (February 1979) where some eighteen reported reissue cases are catalogued into ones with "stays granted," "stays denied," "severed and stayed," and "dismissed and ordered patentee to seek reissue." See, e.g., General Tire and Rubber Co. v. Watson-Bowman Associates, Inc., 193 U.S.P.Q. 479 (D. Del. 1977); PIC Inc. v. Prescon Corp. 195 U.S.P.Q. 525 (D. Del. 1977); Fisher Controls Co., Inc. v. Control Components, Inc., 196 U.S.P.Q. 817 (S.D. Iowa 1977); Alpine Engineering Products, Inc. v. Automated Building Components, Inc. v. Automated Building Components, Inc. P.T.C.J. No. 367, p. A-12 (S.D. Fla. 1978); AMI Industries, Inc. v. E. A. Industries, Inc. P.T.C.J. No. 369, p. A-10 (W.D. N.C. 1978); Reynolds Metal Co. v. Aluminum Co. of America, P.T.C.J. No. 375, p. A-5 (N.D. Ind. 1978); Perkin-Elmer Corp. v. Westinghouse Electric Corp., P.T.C.J. No. 376, p. A-11 (E.D. N.Y. 1978); and In re Certain Ceramic Tile Setters, P.T.C.J. No. 385, p. A-21 (Int'l Trade Comm. 1978).

[49]193 U.S.P.Q. 467 (N.D. Cal. 1977).

[50]193 U.S.P.Q. at 472

contemplated that Section 251 could or would be used as a vehicle for the Office to consider the validity of an issued patent.

When an applicant seeks a reissue for the sole purpose of having matters relating to patentability considered which were not considered in the prosecution of his original patent, then, in effect, he is seeking an advisory opinion from the Office concerning the validity of the original patent. Once it is recognized that the Office is now giving reissue applicants advisory opinions, questions arise (a) as to whether it is necessary to present the advisory opinion in the guise of prosecution of a reissue application, and—if it is not—(b) why such advisory opinions on patent validity should not be made available to anyone.

Commissioner Banner has at least tentatively answered these questions by stating his belief that it is within his rule-making authority under 35 U.S.C. §6 to promulgate procedures whereby advisory opinions on patent validity will be available to anyone and that he intends to enact rule changes implementing this approach.[60] Indeed, the changes proposed by Commissioner Banner have now been published, and the reaction of the patent bar is likely to be determinative of whether the proposed changes are adopted.[61]

An advisory opinion is of course just that, advisory. It can have no direct, immediate effect on an issued patent.[62] But to the extent it influences judicial review of a patent, it can bring tremendous potential to bear on ultimate patent validity. It is apparent that the quality of advisory opinions will be the single greatest factor in determining the judicial weight that is given to

[60]Several Federal agencies, e.g., Department of Justice, 28 CFR §50.6; Federal Trade Commission, 16 CFR §1.1-1.4; Internal Revenue Service, 26 CFR §601.201; Security and Exchange Commission, 17 CFR §202.2; Department of Energy, 10 CFR §205.80 issue advisory reviews or opinions. Similar to Commissioner Banner's reliance on 35 USC §6, the "rulings and determinations letters" of the Internal Revenue Service are based on Section 7805(a) of the Code stating "***The Secretary or his delegate shall prescribe all needful rules and regulations of this title, ***"

> Query, would an advisory opinion conflict with 35 U.S.C. §282, providing a patent shall be presumed valid? See, Idaho Power Co. v. C.I.R., 477 F.2d 688 (1973) rev. on other grounds 418 U.S. 1 (1973) where a treasury ruling was held to conflict with the internal revenue code.

[61]See, e.g., the Federal Register note 17a, *supra*, where Office requests public comment on such questions as:

> Whether an advisory opinion should be given by the same xaminer who issued the patent, whether advisory opinions should be provided on issues of patent validity other than prior patents and publications,

Office. The statute gives the Board express authority to decide "(t)he question of priority of invention," and "(a) final judgement adverse to a patentee from which no other review has been or can be taken or had, shall constitute cancellation of the claims involved from the patent, and notice thereof shall be endorsed on copies of the patent thereafter distributed by the Patent Office."[64]

But the only basis for cancelling issued claims is if they are invalid. The statutory authority for finding issued claims invalid for lack of priority is 35 U.S.C. §102(g) which provides that a person shall be entitled to a patent unless "before the applicant's invention thereof, the invention was made in this country by another, who had not abandoned, suppressed, or concealed it." It is thus apparent that in rendering an adverse priority decision which results in the cancellation of claims of an issued patent, the Board has considered the validity of an issued patent, and properly so.

Former Commissioner Dann expressly recognized this view by stating that ". . . the Patent Office has no jurisdiction to cancel or invalidate patents, except as this result is incidental to awards of priority in interferences. . ."[65] It should be noted that there is a critical limitation in this statement, namely, that such an invalidation can only occur "incidental" to an award of priority.[66] This inevitably raises questions as to what is incidental to priority. As will be seen, the Office has attempted to tightly circumscribe and limit those issues which it considers to be "incidental" to priority.

Fraud in the Issuance of a Patent Which is in Interference

Consider the situation wherein an allegation of fraud in the issuance of the patent claims which are the counts in interference is made.[67] At the very least, it would seem that if such an allegation is proven, the patentee would lose his standing as a party in the interference.[68] But proof of such an allegation is a direct attack on the validity of the claims in question. In such a situation "(i)t is contrary to public policy to award priority to the guilty party. . .".[69] But what if the other party has not proven priority in himself? Can the Board of Patent Interferences award priority to the other party in those circumstances, knowing full well that such an award must result in a

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[64]35 U.S.C. §135(a).

[65]In re Baak, 187 U.S.P.Q. 249, 250 (Com'r. Pat. 1974).

[66]Jurisdiction to make an award of priority based on issues "incidental" thereto is given the Board of Patent Interferences by 37 C.F.R. §1.258(a) which states in pertinent part:

> Questions of patentability of a claim generally will not be considered in the decision on priority; and neither will the patentability of a claim to an opponent be considered, unless the nonpatentability of the claim to the opponent will necessarily result in the conclusion that the party raising the question is in fact the prior inventor on the evidence before the Office, *or relates to matters which have been determined to be ancillary to priority.* (Emphasis supplied.)

As the C.C.P.A. has noted, whether an issue is ancillary to priority determines whether it is within the Board's jurisdiction. See, e.g., Weil v. Fritz, 512 F.2d 856, 196 U.S.P.Q. 600, 608 (1978).

Office. Unfortunately, there is no express indication from the Office of the reason for the reversal in attitude, but it can be surmised that the Office and the Board found themselves in a quandry.

The Patentability Versus Priority Dichotomy

The quandary arises from the fact that:

> . . .[T]heoretically, the division of functions between the Board of Patent Interferences and the Board of Appeals is sharp—the former is to decide questions of priority and questions ancillary thereto, and the latter is to decide questions of patentability and, at the least, questions "logically related" thereto.[79]

But as Judge Lane of the C.C.P.A. has pointed out:

> Patentability in general has long been held not to be ancillary to priority.* * * Accepting this this principle it is nevertheless noted that in Norton v. Curtiss . . . this court held fraud to be a matter ancillary to priority. The theory expressed inNorton is that if fraud were proved, the party that committed it would lose its right to have the interfering claim present in its application and would therefore lose its standing as a party to the interference. We reaffirmed the Norton holding in Langer v. Kaufman . . . observing a distinction between fraud and other ground of unpatentability. *It is clear, however, that fraud on the part of a party to an interference falls within the broad scope of patentability.*[80] (Emphasis supplied.)

Therein lay the crux of the problem for the Office. It continued to hew to the line that the Board of Patent Interferences would not consider issues of patentability. If the fraud issue concerned patentability, then the Board should not consider it.[81] But, as a practical matter as Judge Lane has indicated, almost any fraud issue involves patentability.

The Office repeatedly cited the 1956 C.C.P.A. opinion in *Glass v. De Roo*[82] to support its position.[83] There the court stated:

> Our jurisdiction in a patent interference is limited to a review of the decision of the Board of Patent Interferences, 35 U.S.C. 141. The jurisdiction of that board is limited to a determination of the question of priority of invention, 35 U.S.C. 135. As to both the board and this court, certain questions which are "ancillary" to priority may also be considered. Patentability is not one of those questions.* * * In reviewing a decision of the Board of Patent Interferences, we are obviously without jurisdiction to consider an issue which the board is not authorized to decide.[84]

The *per curiam* opinion cited a large number of decisions rendered both by the C.C.P.A.[85] and its predecessor in jurisdiction over appeals from the Patent

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[79]C. L. Gholz, "Patent and Trademark Jurisdiction of the Court of Customs and Patent Appeals," 55 J.P.O.S. 184, 188 (1973).

[80]Techler v. Norstrud, 475 F.2d 1192, 177 U.S.P.Q. 390, 393 (C.C.P.A. 1973) (Lane, J., dissenting).

[81]See, e.g., Poole v. Sugaya v. Iwabuchi, 182 U.S.P.Q. 571 (1974).

[82]239 F.2d 402, 112 U.S.P.Q. 62.

[83]See, e.g., Poole v. Sugaya v. Iwabuchi, 182 U.S.P.Q. 571 (Bd. Pat. Int. 1974); La Barge v. Bakke, 175 U.S.P.Q. 626 (Bd. Pat. Int. 1970); Smith v. Pittman, 172 U.S.P.Q. 569 (Bd. Pat. Int. 1972); and Bandel v. Samfield, 168 U.S.P.Q. 725 (Bd. Pat. Int. 1961).

[84]112 U.S.P.Q. at 63.

various grounds including nonpatentability of the counts. The Primary Examiner denied the motion except as to one count which he found to be unpatentable. This decision was appealed to the Commissioner of Patents, although not with respect to the holding that all counts save one were patentable. The opinion of the court clearly implies that the issue of patentability was not appealed to the Commissioner because "neither the rules of the Patent Office, nor any section of the Revised Statutes, provide for, not permit, such appeals."[91]

The Commissioner upheld the decision of the Primary Examiner and the interference proceeding was thereupon continued by the Examiner of Interferences who awarded priority to Holsclaw.[92] Sobey then moved the Interference Examiner to direct the attention of the Commissioner to certain reasons relating to patentability why the interference should be dissolved. This motion was made under then Rule 126[93] which provided "that the Examiner of Interferences, or the Board of Examiners-in-Chief, either before or in their decision on the question of priority, may direct the attention of the Commissioner to any matter not relating to priority which may have come to their notice, and which, in their opinion, establishes the fact that no interference exists, or that there has been irregularity in declaring the same, or which amounts to a statutory bar to the grant of a patent to either of the parties for claim or claims in interference."[94]

The interference Examiner refused to act under Rule 126 and on appeal the Board of Examiners-in-Chief stated:

> We have considered the question which we have been petitioned to consider, in view of the patents cited by Sobey to sustain his contention against the claim, and of the decision of the Principal Examiner, and decline to express the opinion that the counts of the issue are unpatentable.[95]

The Commissioner, in turn, refused to consider the issue of patentability saying that "well-established policy, expressed, in Rule 124, denies the right of appeal from decisions affirming the patentability of claims."[96]

And so the issue came to be presented to the Court of Appeals for the District of Columbia. The court expressed it thusly:

> We are asked to reverse the Commissioner because he refused to dissolve the interference for the reason that the issues are not patentable, and because no interference in fact exists between the parties. In this connection, it becomes necessary to consider to what extent we are called upon, or bound, to review the action of the Patent Office tribunals upon these, and analogous, findings.[97]

They began by summarizing the views expressed in a number of their earlier

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91. 28 App. D.C. at 69.
92. At that time, there was no Board of Patent Interferences.
93. This was a predecessor rule to the present 37 C.F.R. §1.259.

The court went on to hold that the Commissioner had adopted the views expressed by these subordinate tribunals.[102]

When Patentability is Ancillary to Priority

The Office quickly used *Sobey v. Holsclaw* to support its view that patentability issues should not be considered in an interference proceeding. The position espoused ever since by the Office[103] is frequently summed up in the rote rule "patentability is not ancillary to priority." But like many summary rules this one quickly lost any literal truth that it may have had. For—through the years—a variety of exceptions to this rule have been acknowledged.[104] That is to say, certain issues clearly relating to patentability have been held to be ancillary to priority andhence properly considered in an interference proceeding.

Unfortunately, there is no straightforward way to ascertain what is a patentability issue which is in fact ancillary to priority. It does appear, however, that the various requirements set forth in the first paragraph of 35 U.S.C. §112 are ancillary to priority. Thus, for example, whether a party's application or patent "supports the count" in the sense of the description,[105] how to make,[106] how to use,[107] and best mode[108] requirements of the first paragraph of Section 112 have all at least implicitly been held to be ancillary to priority.

Indeed, as pointed out by Gholz, what is meant by the rote rule "is that, generally speaking, patentability over theprior art and double patenting are not ancillary to priority."[109] There are even certain exceptions to the rule as so limited.[110]

Clearly, any patentability issue which involves fraud is now ancillary to priority. Thus, whether the Board of Patent Interferences will be willing to consider any particular patentability issue may in large measure depend on

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[102] *Id.*

[103] See, e.g., the quoted portion of Rule 258 set forth in footnote 66, *supra.*

[104] As the C.C.P.A. noted in Weil v. Fritz, 572 F.2d 856, 196 U.S.P.Q. 600 (1978):

> 35 U.S.C. 135(a) limits the board's jurisdiction to "(t)he question of priority of invention," but, as explained by this court in Hendrickson v. Ronning, 22 CCPA 1040, 1045, 76 F.2d 137, 140, 25 USPQ 42, 45 (1935), "(i)t was found, early, that certain matters ancillary to the question of priority were immediately involved in such profeedings and, hence, these were considered.

196 U.S.P.Q. at 608, n. 14.

[105] Wagoner v. Barger, 175 U.S.P.Q. 85 (1972). Implied holding in Fields v. Conover, 443 F.2d 1386, 170 U.S.P.Q. 276 (C.C.P.A. 1971).

[106] See, e.g., Sze v. Bloch, 458 F.2d 137, 173 U.S.P.Q. 498 (C.C.P.A. 1972); Strashun v. Dorsey, 345 F.2d 201, 145 U.S.P.Q. 476, 481 (C.C.P.A. 1965); and Bennett v. Halahan, 286 F.2d 807, 128 U.S.P.Q. 158 (C.C.P.A. 1961).

[107] Implied holding in Kawai v. Metlesics, 480 F.2d 880, 178 U.S.P.Q. 158 (C.C.P.A. 1973).

[108] Implied holding in Weil v. Fritz, 196 U.S.P.Q. 600 (C.C.P.A. 1978). The specific holding was "that when a §120 benefit is sought, the best mode disclosure requirement is ancillary to priority." 196 U.S.P.Q. at 609. The reason given was that it logically affects the burden of proof under the facts presented. This argument can be applied to any interference situation, regardless of whether the benefit of Section 120 is sought. Thus, for example, the question of whether the senior

> If the charges made by Norton are found to be of substance, Curtiss stands to lose, at the least, his right to have those claims in his present application to which the charges relate mature into a patent. That translates, in his case, to a loss of standing as a party to the interference. This question iss clearly one which is ancillary to priority and was therefore properly considered by the board and must now be reviewed by this court.[118]

This was a clear and substantial departure from the traditional test which stated that an issue is ancillary to priority only if it is "a question which, if decided in favor of the party raising the question, would necessarily result in a judgment against his opponent."[119] Loss of standing does not automatically result in judgment for the other party.

More importantly, the reasoning relied on by the C.C.P.A. logically suggested that *any* issue which translates into a loss of standing of a party to an interference is ancillary to priority. Since patent validity certainly affects the standing of the patentee as a party to any interference, it was reasonable to suppose that the validity of the patent should be an issue properly considered during the interference. On its face then, *Norton* appeared to portend a broad expansion of the jurisdiction of the Board of Patent Interferences.

But such was not to be. Soon thereafter the court took the opportunity to severely restrict its jurisdictional pronouncement by stating that its holding in *Norton*

> . . . reflected this court's sensitivity, which it shares with the other federal courts, to the acts and consequences of fraudulent misconduct before the Patent Office. Our conclusion that the charge of fraud is ancillary to priority was unquestionably tied to our views on the nature of the charge. . . We felt then, as we do now, *that unlike other assertions of invalidity or unpatentability,* the charge of fraud has special significance, and we are unwilling to ignore it in reviewing an award of priority.[120] (Emphasis added.)

In other words, *Norton* is not to be construed as opening the door to a routine consideration of patent validity during an interference proceeding.

But during this same time frame (1972), the C.C.P.A. enunciated a new test for being ancillary, namely, whether the issue "is 'logically related' to the basic, jurisdiction-giving question of priority."[121] In so doing, the court ackowledged that this new test was a departure from the traditional test.[122] This test has now been used to hold ancillary to priority (a) the burden of proof imposed on the junior party,[123] (b) interference in fact,[124] and (c) the best mode disclosure requirement when a 35 U.S.C. §120 benefit is sought.[125] Although the court readily recognized that the issues of interference in fact and disclosure of the best mode are directly concerned with patentability, the reasons given for holding them "logically related" to the issue of priority were said to have nothing to do with patentability.[126] Rather, the court is still

[118] 167 U.S.P.Q. at 535-536.

[119] Rivise and Caesar, Interference Law and Practice §251 (1943).

[120] Langer v. Kaufman, 465 F.2d 915, 920-921, 175 U.S.P.Q. 172, 175-176 (1972).

[121] Myers v. Feigelman, 455 F.2d 596, 172 U.S.P.Q. 580, 584 (1972).

[122] *Id.*

[123] *Id.*

set forth by the C.C.P.A.,[131a] patentability is the threshold question which must be decided in an interference proceeding.[132] Under most circumstances, it would be futile to continue an interference where the subject matter itself is unpatentable to either of the parties.[133] It therefore follows that the standing of a party is logically related to the issue of priority.[134]

But says the Board, it has no jurisdiction to dissolve an interference,[135] and a loss of standing does not in and of itself ensure an award of priority to the other party. A ready answer is given in the words of the Supreme Court:

> . . . there is no basis for the proposition that even where an applicant for an interference presents a claim which on its face is unpatentable, a complicated and frequently lengthy factual inquiry into priority of invention must inexorably take place.[136]

Moreover, a determination that a patentee has no standing by reason of patent invalidity would rationally and logically recognize the steady and continued C.C.P.A. erosion of the rote rule that patentability is not ancillary to priority.[137]

Perhaps more importantly, a consideration of the validity of the patent is of concern both to the patentee and another party in interest, namely, the general public. The patentee has the opportunity of having the presumption of validity reinforced if, under challenge, the patent's validity is upheld by the Board and if he wins the priority contest. In any case, because the issue would be ancillary to priority, the patentee would have the right to appeal any decision based on presumed invalidity. The public's interest would be better protected in that it would have an opportunity to know when the Office con-

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[131]aSquires v. Corbett, 560 F.2d 424, 194 U.S.P.Q. 513 (1977).

[132]Hilborn v. Dann, 546 F.2d 401, 192 U.S.P.Q. 132 (C.C.P.A. 1976).

[133]An exception is the circumstance wherein the Office may have been guilty of "inadvertent discrimination" in permitting the patent to issue in the first place. See In re Krambeck, 198 U.S.P.Q. 253 (Com'r. Pat. 1976), aff'd. In re Krambeck, 198 U.S.P.Q. 255 (Com'r. Pat. 1977), aff'd. Mobil Oil Co. v. Dann, 198 U.S.P.Q. 347 (D.D.C. 1978); cf. Mobil Oil Co. v. Dann, 197 U.S.P.Q. 59 (D.D.C. 1976).

[134]Indeed, this point was specifically relied on by the C.C.P.A. in its acceptance of jurisdiction in *Norton v. Curtiss*. See text accompanying note 118, *supra*.

tion.[139] Indeed, the most significant addition to its jurisdiction would be that it would now consider patent invalidity based on prior art.[139a] To the extent that such jurisdiction might be considered inconsistent with the holding of *Glass v. De Roo, supra,* it is believed that the C.C.P.A. can and will modify that holding in a proper case.

Moreover, if, as Commissioner Banner proposes, the Office commences to issue advisory opinions as to patent validity, it is difficult to rationalize a dichotomy wherein the Office comments on patent validity for purposes of subsequent judicial review but refuses to permit the Board of Patent Interferences to act on any finding of patent invalidity or even to consider the issue. Clearly, if the time has come for advisory opinions on patent validity, the time has also come for patentability to be declared ancillary to priority.[140]

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[139]For a contrary view, see C. L. Gholz, "Patent and Trademark Jurisdiction of the Court of Customs and Patent Appeals," 55 J.P.O.S. 184, 193 (1973).

[139a]Unlike the quasi inter partes proceedings in reissue applications and proposed advisory opinions, interferences before the Board are full inter partes proceedings. As such prior art should be added to the list of issues of patentability — including description, how to make, how to use, best mode, public use, fraudulent procurement, etc. and, which should be adjudicated in interferences even if they involve the validity of a patent claim.

The authors suggest the following procedure to enable the Board to assert jurisdiction over a patent and cancel claims invalid over the prior art or other validity issues. If during the Rule 231 motion procedure a count based on a patent claim is determined unpatentable by the primary examiner, the patentee will be required under revised rules to seek a reissue patent in order to rebut a presumption of priority to the applicant. Failure to rebut such a presumption by reissue will result in priority being awarded to the applicant, and the Board having authority to cancel patent claims from the patent. The applicant would be returned to ex parte prosecution for disposition of the application claim. Such a disposition would clearly be preferable to the Board's present practice of relinquishing jurisdiction over a patent having a claim unpatentable over the prior art. See generally notes 111, 128, and 133, *supra.*

Query, could the Commissioner under existing Rule 259 direct the resolution of an interference in the above manner proposed changes in the ninety-third Congress.[5] The report was based on extensive hearings conducted throughout the United States and covered all aspects of current bankruptcy law and procedure. The Commission's findings provided the foundation for the reform efforts resulting in the legislation which was effective October 1, 1979. There is little question in the minds of those knowledgeable of bankruptcy practice that the Commission's Report to Congress was thorough, balanced and the basis for all subsequent efforts to reform bankruptcy practice. Early in its existence, the Commission members realized, almost unanimously, that the old bankrupcty system did not provide an adequate forum for the resolution of present day bankrupcty and insolvency cases. Under the old law, the bankrupcty court's jurisdiction extended only to property in the possession of the bankrupt or, in certain Chapter proceedings, property in which the debtor had title.[6] The bankruptcy court had no jurisdiction over in personam actions unrelated to the bankrupt's property,[7] and its in rem jurisdiction did not extend to property in which a third party had a valid, adverse claim.[8] While such limitations were probably warranted in the infancy of our bankruptcy system, these jurisdictional restrictions could no longer be justified in light of significant changes in credit, banking and commercial practices, as well as equal substantial changes in the ability of the district court to act as the trial court for bankruptcy matters as originally contemplated by the early framers of our bankruptcy laws. The history of bankruptcy in the United States suggests that early bankruptcy referees were little more than administrative masters.[9] Today the bankruptcy judge acts as a trial judge and frequently is called upon for expert legal opinions, not only on bankruptcy law, but also on real estate law, commercial law, domestic relations, tax law and partnership and corporate law. He must decide issues related to the substantial and complex case law developed under the Uniform Commercial Code, the Internal Revenue Code and many other state and federal statutes, some of broad application while others are unique and narrow in scope. In short, the role of the bankruptcy court, and particularly the bankruptcy judge, has changed rapidly in the last forty years. The bankruptcy judge's status has already changed from a master making administrative recommendations to a trial judge, to a trial judge himself who must be competent to make decisions on issues covering a variety of subject matters and overlapping legal subject areas.

[5]See note 1, *supra*.

[6]See Report of the Commission on the Bankruptcy Laws of the United States, part I, p. 88 (July 31, 1973) (hereinafter referred to as "Commission Report").

[7]See, for example, *In Re: Leo Goodwin, Jr.*, 3 Bankr. Ct. Dec. 156 (D. Md, 1977), and discussion in Vol. 8, *Collier on*

complicated and protracted, certainly beyond the intent of the statutory framework.

> Delay is critical in cases under the Bankruptcy Act, particularly in business cases where litigation is most likely to occur. This is true because of the prejudicial effect it might have on prospects for rehabilitating an enterprise in financial distress and the aggravated risk of deterioration of the estate in the course of liquidation.[14]

The Commission also emphasized the lack of desirability and costliness of filing suits in non-bankruptcy courts which has often led to the trustee abandoning potential claims and the reluctance of bankruptcy courts to grant permission to pursue plenary causes of action.[15] In an attempt to alleviate these problems, the Commission strongly recommended granting bankruptcy courts comprehensive jurisdiction over all controversies arising from bankruptcy cases. The Commission members firmly believed that the strength of the proposed pervasive jurisdiction of bankruptcy courts would alleviate many of the weaknesses in the existing bankruptcy system.

> The withdrawal from state and federal district courts of jurisdiction of the so-called plenary proceedings, when coupled with establishment of uniform federal standards and rules, as proposed by the Commission for adoption and application in lieu of the diverse state laws governing debtor's and creditor's rights, should eliminate a source of uncertainty and division of authority which has characterized bankruptcy law.[16]

In order to adequately implement the new jurisdiction of the bankruptcy courts, the Commission recommended upgrading the status of bankruptcy judges following the lead already established by the Advisory Committee on the Bankruptcy Rules of the Judicial Conference of the United States.[17] The Bankruptcy Rules, as promulgated by the Supreme Court, were generally considered the forerunner of bankruptcy reform, making numerous substantive as well as procedural changes in existing bankruptcy practice. The Rules did much to enhance the image of bankruptcy courts and the prestige of bankruptcy judges, changing prior bankruptcy law and procedure in many areas, including the status of judges, appeals from decisions of bankruptcy judges, removal, transfer of cases and jury trials.[18] The promulgation of the new Bankruptcy Rules resulted in a significant maturing of the bankruptcy system. The term "referee" was eliminated in favor of "bankruptcy judge"[19] and the bankruptcy judge earned the right to conduct jury trials.[20] Appeals were no longer de novo to the district courts and the bankruptcy judge's findings of fact were deemed accepted on appeal "unless clearly erroneous".[21] Along with other changes instituted by the Rules,[22] their introduction into the bankruptcy

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[14] *Id.*

[15] *Id.*, pp. 89-90.

[16] *Id.*, pp. 90-91.

[17] At the time of preparing the Commission's report the Advisory Committee had just issued its preliminary draft of the new Bankruptcy Rules of Procedure. The preliminary draft remained substantially intact upon promulgation by the Supreme Court in 1973.

[18] For a good discussion on the intent of the new Rules see Herzog, "The Impact of the Proposed Bankruptcy Rules on the Court". Am. Bankr. L. J., vol. 45, p. 363 (Fall, 1971).

[19] Rule 920, Bankruptcy Rules of Procedure.

[20] Rule [illegible], Bankruptcy Rules of Procedure

may, in a very real sense, make the bankruptcy court the court of last resort in the vast majority of controversies, at least in the sense that their decisions will usually be the final determination of a particular matter. That alone is a very compelling reason for ensuring that the bankruptcy bench consists only of the highest caliber appointees. The Commission criticized the old system of appeals to district court judges who were themselves primarily trial judges. Despite its criticism of district court appeals, however, the Commission viewed all other alternatives inconsistent with the expeditious handling of appeals from decisions of bankruptcy judges. The Circuit Court appeal process, the most supported alternative, was considered too protracted, assuring costly delays adverse to the goal of prompt resolution of bankruptcy related disputes.[27]

The recommendations of the Commission served as the framework for a proposed bill offered to Congress as part of its Report.[28] Part 2 of the Commission Bill contained the provisions related to jurisdiction and procedure in the proposed bankruptcy courts. Section 2-201 of the Commission Bill provided that the jurisdiction of the bankruptcy court "shall extend to the determination of all controversies that arise out of a case commenced under this Act. . ." The Commission clarified this jurisdiction by enacting eighteen specific matters over which the bankruptcy court was to have jurisdiction. In essence, Section 2-201 granted the bankruptcy court jurisdiction over specific matters which are essential or unique to bankruptcy proceedings (such as avoidance actions and discharge complaints) and actions commenced by or against the trustee or other bankruptcy officers (including a debtor-in-possession).[29] Section 2-201 represented a very broad extension of jurisdiction for the new bankruptcy courts, along with an elimination of the old division of jurisdiction between the district court and the bankruptcy court. In certain instances, Section 2-201 of the Commission Bill extended even beyond the jurisdictional grants to the district court conferred by the Bankruptcy Acts of 1841 and 1867.[30] The Commission Bill also represented a considerable liberalization of the old law regarding removal of bankruptcy related matters to the bankruptcy court. Section 2-202 of the Commission Bill allowed either party to a case pending in a state or federal court to remove the case to the bankruptcy court. Removal was limited to those matters over which the bankruptcy court exercised original jurisdiction under proposed Section 2-201.[31] In an important restriction, the removal power proposed by the Commission did not supercede 28 U.S.C. Sec. 959, which permitted actions against a trustee, receiver, or debtor operating a business to proceed in a court other than the bankruptcy court.[32]

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[27] *Id.*

[28] See H.R. Doc. No. 93-137, 93rd Cong., 1st Sess., Part II (July, 1973) (hereinafter referred to as "Commission Bill").

[29] Commission Report, *supra*, Part II, pp. 30-32. See also, Broude, "Jurisdiction and Venue Under the Bankruptcy Act of 1973", 48 Am. Bankr. L.J. 231, 235 (1974).

[30] See Commission Report, *supra*, Part II, p. 32, n. 2. Section 2-201 specifically granted the bankruptcy court juris-

LEGISLATIVE HISTORY

The Commission Bill, which attempted to legislate the findings and recommendations contained in the Commission's thorough, and well reasoned report, was introduced in the 93rd Congress. Alternative legislation was offered shortly thereafter by the National Conference of Bankruptcy Judges and introduced in the second session of the 93rd Congress as H.R. 16643. Both bills were reintroduced in the 94th Congress as H.R. 31 and H.R. 32, respectively. In May, 1975, the House held extensive hearings on both bills covering all aspects of bankruptcy law. A large segment of the testimony centered on the structure of the bankruptcy system and the implementation of the increased jurisdiction of the proposed new bankruptcy court.[40] The hearings lasted almost twelve months and provided the House subcommittee with opinions of lawyers, judges, consumer groups, credit organizations and financial institutions representing every facet of bankruptcy practice from commencement to the appeal, and the full range of business and consumer contact with the bankruptcy system.[41] As a result of these hearings the House subcommittee drafted H.R. 6, a new bill introduced in the 95th Congress. H.R. 6 was substantially a compromise between the Commission's bill (H.R. 31) and the Bankruptcy Judges' bill (H.R. 32).[42] Although the Judges' bill supported many of the Commission's proposals, it deviated sharply in several substantive provisions, most of which are not relevant to this discussion.[43] A few of the changes suggested in the Judges' bill were designed to add to the prestige and authority of the proposed bankruptcy court and its judges. For example, H.R. 32 proposed direct appeals to the Circuit Court and the maintenance of most administrative functions in the bankruptcy court rather than an administrative agency.[44] One of the major differences of H.R. 32 was the proposal of life tenure for bankruptcy judges instead of the fifteen year term recommended by the Commission Bill.[45] H.R. 6 represented a legislative attempt to combine the provisions of H.R. 31 and H.R. 32 into a cohesive, uniform bankruptcy reform bill. The framework of H.R. 6 was largely taken from a proposal made by the National Bankruptcy Judges after lengthy negotiations designed to resolve the differences between the Commission bill and the Judges' bill. The proposal recommended appeals to the circuit courts of

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[40]See generally, Hearings on H.R. 31 and H.R. 32 before the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary, 94th Cong., 1st and 2d Sess., ser. 27 (1975-76) (hereinafter referred to as "Hearings on H.R. 31 and H.R. 32"). The Senate also commenced extensive hearings at the same approximate time. See Hearings on S. 235 and S. 236, before the Subcommittee on Improvements in Judicial Machinery of the Senate Committee on the Judiciary, 94th Cong., 1st Sess. (1975).

[41]House Report No. 95-595, pp. 2-3.

[42]See *The Proposed Federal Bankruptcy Reform Act*, published April, 1978, by the American Law Institute. This is a brief but excellent treatise on the history and effect of H.R. 8200 as passed by the House of Representatives on February 1, 1978, as well as some of the differences on pending Senate bill, S. 2266. The analysis is the work of J. Ronald Trost of Los Angeles, California, bankruptcy practitioner and lecturer on bankruptcy matters nationwide, Lawrence P. King, Professor of Law at New York University on debtor's and creditor's rights and currently editor of *Collier on Bankruptcy* (14th ed., 1976), and Kenneth N. Klee, associate counsel to the House Judiciary Committee (1974-77) and participant in much of the drafting and research leading to the legislation which was finally enacted as the Bankruptcy Reform Act of 1978.

[illegible] and analysis of H.R. 31 and H.R. 32. See Hearings on H.R. 31 and H.R. 32, *supra*. The

H.R. 8200 was the final stage of bankruptcy reform legislation in the House of Representatives. It contained many significant and controversial changes from existing bankruptcy practice and offered a complete solution, albeit a controversial one, for the evils and inadequacies of the present court system. S. 2266, the Senate counterpart of H.R. 8200 was a conservative proposal, representing only a partial change from existing bankruptcy practice, perhaps with the intent of determining the effect and effectiveness of these intermediate changes before consideration of other or more significant bankruptcy reform measures. House consideration of bankruptcy reform followed closely the recommendations of the Commission, the National Bankruptcy Conference and the National Conference of Bankruptcy Judges. The Senate, meanwhile, acting conservatively and almost contrary to form, based its legislation largely upon the reservations expressed by the Judicial Conference of the propriety of sweeping bankruptcy reform. The differences were no more apparent than in the status of the court and judges. Proposed 28 U.S.C. Sec. 151 of the House bill purported to create a separate Article III United States Bankruptcy Court for each judicial district. To complete its new stature and independence, the bankruptcy court was granted significant new powers including upgraded injunctive authority[51] and ability to issue writs of habeas corpus.[52] The House bill proposed the same status for bankruptcy judges under the new system as district court judges and provided for their appointment by the President with advice and consent of the Senate.[53] Appointees would have life tenure, subject only to removal for cause.[54] On the subject of jurisdiction, the House bill was substantially on adoption of the Commission Bill.[55]

The Senate's pending legislation, S. 2266, meanwhile, had taken a very different approach to the bankruptcy court and the status of bankruptcy judges. Very little dispute existed among all those testifying before the House and Senate Hearings concerning the need for increased jurisdiction for the bankruptcy courts.[56] The Senate draftsmen disagreed with their House colleagues, however, by proposing a new, bankruptcy court which, although upgraded, remained an adjunct of the U.S. District Courts.[57] The Senate Subcommittee saw several important advantages favorable to reform proponents in its proposed legislation:

> (1) The presently established U.S. district courts can serve as Article III repositories for the broadened jurisdiction essential to efficient judicial administration in bankruptcy cases.
>
> (2) The expanded jurisdiction vested in U.S. district courts may be delegated by statute for exercise exclusively by bankruptcy judges, subject always to review, as under present law, by

[51]H.R. 8200, 95th Cong., Proposed 11 U.S.C. Section 105 and Sec. 243(a), 28 U.S.C. Section 1481.
[52]H.R. 8200, Sec. 252(a), Proposed 28 U.S.C. Section 2256.
[53]H.R. 8200, Sec. 201(a), Proposed 28 U.S.C. Section 152.
[54]H.R. 8200, Sec. 201(a), Proposed 28 U.S.C. Section 153.
[55]House Report 95-595, *supra*, p. 446.
[56]See generally, Hearings before the Subcommittee on Improvements in Judicial Machinery of the Committee on the

ruptcy courts.[64] However, the unfortunate use of the word "may" referring to a bankruptcy judge's exercise of the district court's jurisdiction implied a great deal of discretion in and among the districts. This discretion could have destroyed the efforts of reformers to provide a uniform bankruptcy system. Fortunately, this language did not survive the congressional debate. The jurisdictional language of the two bills, disregarding the court in which that jurisdiction would primarily lie, was actually quite similar, granting original and exclusive jurisdiction over all cases filed under Title II, and all proceedings related to or arising under cases filed under Title II.[66]

The Senate passed its version of H.R. 8200 more than seven months after passage by the House. The Senate version consisted of the general adoption of many passages of H.R. 8200 with a liberal insertion of parts of S. 2266. The difference between the House and Senate bills required a conference committee to untangle them. Hectic legislative activity at the end of the 95th Congress made a formal conference between members of the House and Senate impossible. However, spurred by the universal recognition of the necessity for bankruptcy reform legislation, the House and the Senate floor leaders succeeded in proposing a bill acceptable to both houses. One of the major differences between the two bills which had to be resolved in the final stages of congressional debate was the status of the new bankruptcy court. The House bill created a constitutional court under Article III of the Constitution, while its Senate counterpart opted for a legislative court established pursuant to Congress' power under Article I of the Constitution. The Judicial Conference was vehemently opposed to granting Article III status to the bankruptcy courts on the theory that such a grant was unconstitutional and could fragment the federal court system as well.[67] The fears of the federal judges were difficult to define and compartmentalize. However, one of the biggest concerns was a dilution of the talent and prestige of federal judges by appointment of dozens of new judges on a parity with the district court judges. Whatever the established, or actual reason, the Article I - Article III debate continued uninterrupted during the entire history of congressional debate on bankruptcy reform. The constitutional status of the old bankruptcy court system was hotly debated by legal commentators without clear resolution,[68] while others recognized the potential constitutional problems which could result from the proposed legislation.[69]

[64]After Senate debate the final amendment of S. 2266, Sec. 202, proposed 28 U.S.C. Sec. 1334(d)(1), read as follows:

> "(d)(1) Except as provided in paragraph (2) of this subsection, a bankruptcy judge *may* exercise all powers and jurisdiction conferred on the district court in cases under Title II and in civil proceedings arising under Title II (*sic*) or arising under or related to cases under Title II" (emphasis added).

[65]Senate Report No. 95-989, *supra*, p. 18.

[66]H.R. 8200, 95th Cong., proposed 28 U.S.C. Sec. 1471 and S. 2266, 95th Cong., proposed 28 U.S.C. Sec. 1334.

[67]Senate Hearings, p. 411.

[illegible] Constitutional Court" 45 Am. Bankr. L.J., p. 285 (1971), in which bankruptcy cases, or matters related to bankruptcy cases, heard by bankruptcy judges, are considered justifiable cases or controversies (Article III federal question jurisdiction). In that event, the Senate's proposed bankruptcy court system would have been constitutional only if Article I courts could be granted jurisdiction over Article III cases.[76] Ample precedent exists to respond in the affirmative. However, a definitive answer to the specific issue of a legislative court's ability to exercise Article III jurisdiction has never been developed.[77] In a case decided under narrow factual circumstances, the Supreme Court did specifically sanction the exercise by an Article I court of Article III jurisdiction.[78] Although the Supreme Court's conclusions may not have broad enough application to satisfy many legal scholars, and none of the theories of *Glidden,*[79] were supported by a majority of the Court, there did appear to be a sufficient basis for determining that the bankruptcy court system contemplated by the Senate, and its House counterpart, could both be constitutionally established. Unfortunately, the Senate added to the existing confusion over this issue by asserting that the bankruptcy court can exist under the Article III status of the district courts, making it almost impossible to determine, at least from the legislative history, the status of the new bankruptcy court which was established largely from the Senate proposal.

THE BANKRUPTCY REFORM ACT OF 1978

The differences in substantive law between the House and Senate bills, were relatively minor. However, significant differences did exist concerning the administration of bankruptcy cases, the status of the bankruptcy courts and judges and certain jurisdictional provisions. The final bill signed into law by President Carter on November 6, 1978 was a swiftly constructed compromise between both houses. It remains to be seen whether the Bankruptcy Reform Act of 1978 represents a compromise obviating an effectively structured, efficient bankruptcy system. As the remainder of this article will discuss, the new system is not without problems. However, as badly needed and long overdue legislation, it is a definitive and affirmative statutory design for bankruptcy reform.

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[76]*Id.*, at p. 48.

[77]Although the issue may have already been decided by the Supreme Court in *Glidden v. Zdamsk*, 370 U.S. 530, 82 S.Ct. 1459 (1962). Justices Harlan, Brennan and Stewart clearly supported the exercise of limited Article III power by Article I courts. Justices Clark and Chief Justice Warren did not specifically address that issue but decided that the courts in question (Court of Claims and the Court of Customs and Patent Appeals) were Article III courts. Justice Douglas, in a dissent joined by Justice Black, recognized the continuing validity of Justice Sutherland's opinion in *Williams v. United States*, 289 U.S. 553, 53 S.Ct. 751, 77 L.Ed. 1372. Justice Sutherland concluded that although the Court of Claims was exercising judicial (Article III) power, it was an Article I court. See further discussion on Broude, "The Referee in Bank-

Code provides for a 14 year term for bankruptcy judges[86] closely corresponding to the 15 year term recommended by the Commission.[87] Judges are appointed by the President, with advice and consent of the Senate, as originally provided in the House bill. In an apparent last minute concession to the Senate, new 28 U.S.C. Sec. 152, requires the President to give due consideration to the nominees of the Judicial Council for the applicable district.[88] In the final analysis, however, there is no restriction on the President's ability to appoint bankruptcy judges of his own choosing.[89]

In an important attempt to increase the prestige of the bankruptcy court and prompt recognition and reconciliation of its problems, the Code specifically entitles bankruptcy judges to attend Circuit Conferences. The Code also provides for representation of bankruptcy judges on the board of the Federal Judicial Center and the Judicial Conference of the United States.[90] The representation of bankruptcy judges on these judicial governing bodies is a congressional response to the previous lack of attention given by the Conference to the substantial increase in numbers and complexity of bankruptcy cases in the recent past and the corresponding strains on the bankruptcy court system.[91] Although proposals for complete independence of the bankruptcy court and full parity of bankruptcy judges with district judges did not survive the congressional chopping block, the new Code recognizes the mature stature of the bankruptcy court and provides ample evidence of Congress' intent to raise the dignity of the bankruptcy court and the judges who serve it. The Code clearly establishes that the bankruptcy court is not the equal of its brother, the U.S. District Court. However, it is equally clear that the bankruptcy court has sufficient substance and authority under the Code to operate independently of any other court with significant autonomy over bankruptcy matters.

B. *Jurisdiction.*

In an extremely important and far reaching change from the old law, the Code establishes, in the United States Bankruptcy Court, pervasive jurisdiction over all bankruptcy related matters. Section 241(a) of the Code enacts Chapter 90 of Title 28 of the U.S .Code, titled "District Courts and Bankruptcy Courts". Section 1471 contains the general grant of jurisdiction to the bankruptcy court.[92] Under the Code, the bankruptcy court for the district in which a bankruptcy case is filed has original *and* exclusive jurisdiction over that case.[93] In addition, the bankruptcy court will exercise original, *but not* exclusive jurisdiction over all civil proceedings arising under the Code, or arising

[86]Code, Sec. 201(a), 28 U.S.C. Sec. 153(a).
[87]See Commission Bill, *supra*, Sec. 2-102.
[88]See supplementary statement of Hon. Don Edwards, 124 Cong. Rec. No. 161, H. 11866 (October 6, 1978).
[89]*Id.*
[90]Code Sec. 209-210, 28 U.S.C. Secs. 331, *et seq.*

That development is imperative in the new bankruptcy system since the bankruptcy judge will be deciding matters affecting substantive areas of law other than bankruptcy. Therefore, the decisions of the bankruptcy court will be used by litigants as precedent in non-bankruptcy courts, as well as other bankruptcy courts. Most of the Code provisions concerning jurisdiction closely approximate the recommendations of the Commission made over five years prior to enactment of the Code.[99] Section 2-201 of the Commission Bill[100] extended the jurisdiction of the bankruptcy court to all matters essential or unique to bankruptcy proceedings, as well as suits commenced by or against the trustee or debtor. However, the jurisdiction contemplated by the Commission is more limited than that provided by the Code.[101] The Code grants jurisdiction to bankruptcy courts of all "proceedings" in or related to bankruptcy cases.[102] The use of the word proceedings was an intentional effort to conform to the existing terminology of Title 28 of the U.S. Code under which anything that occurs in a case is termed a "proceeding". Therefore, use of the word "proceedings" in 28 U.S.C. Sec. 1471(b) should give sufficient notice of the expansive jurisdiction of the new bankruptcy court. Proceedings will encompass what are now labelled contested matters, adversary proceedings, and plenary actions under existing bankruptcy law and practice.[103] The full extent of the bankruptcy court's ability to hear *all* matters related to a bankruptcy case is clearly defined by 28 U.S.C. 1471(b), which reads:

> (b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original, but not exclusive jurisdiction of all civil proceedings arising under Title II, or arising in or related to cases under Title II.

Of course, as we will discuss later in this article, the bankruptcy court may, in its discretion, refuse to exercise its jurisdiction over a particular matter. However, regardless of the jurisdiction over the subject matter granted by Congress to another judicial tribunal, the proceeding must start in the bankruptcy court, as an adjunct of the district court.[104] Utilized in conjunction with the automatic stay granted by Code Section 362, the statutory language of Section 1471(b) may prevent creditors, administrative agencies and governmental agencies alike, from commencing any action, whether direct or indirect, against the debtor, or any action relating to the Chapter 11 proceedings, except in the bankruptcy court.[105] Thus, for example, the bankrutcy court has original jurisdiction over labor disputes, issues relating to securities laws and disputes with the federal government, provided, of course, the issue or dispute

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[99]See House Doc. 93-137, Part II, Secs. 2-201-2-203.

[100]H.R. 31, *supra*.

[101]See Commission Report, Part II, pp. 30-32.

[102]Code, Sec. 241(a), 28 U.S.C. Sec. 1471(b).

[103]House Report No. 95-595, p. 445.

[104]Proceedings already pending prior to the commencement of the bankruptcy case will be governed by the automatic stay provisions of Code Sec. 362, and the removal provisions of 28 U.S.C. Sec. 1478. The latter is discussed in more detail

by Harold Marsh, former Chairman of the Commission on the Bankruptcy Laws of the United States. Marsh expressed concern that granting the bankruptcy court jurisdiction over proceedings merely "related to" pending bankruptcy cases went well beyond the jurisdiction necessary to implement the necessary control over bankruptcy proceedings.[109] The words "related to" are sufficiently nebulous to justify fear that extensive litigation to determine over what matters the bankruptcy court does have jurisdiction will be replaced by equally extensive litigation to determine over what matters the bankruptcy court does not have jurisdiction. An appropriate limiting word or phrase attached to the words "related to" would go a long way toward alleviating the need to develop another voluminous body of case law on the issue of jurisdiction.

C. *Abstention and Removal*

The all encompassing jurisdiction of the bankruptcy court may frequently give rise to situations in which the bankruptcy court, although the court of original jurisdiction, should refuse to hear certain matters. 28 U.S.C. Sec. 1471(d) gives the bankruptcy court that discretion. The abstention provision is broadly stated[110] allowing wide latitude among bankruptcy courts to turn down cases over which the court does exercise original, but not exclusive, jurisdiction. The abstention language recognizes that many occasions will arise when determination of an issue or question of law is best left to a court that decides similar issues regularly, especially if the issue or question of law is one that requires a particular expertise which the bankruptcy court lacks.[111] Similarly, situations will occur in which the interest of justice will dictate that a case continue in the original forum, rather than the bankruptcy court.[112] The doctrine of abstention embodied in Subsection 1471(d) is substantially a codification of practice long encouraged in the federal court system. The doctrine parallels the decision of the Supreme Court in *Thompson v. Magnolia Petroleum Co.*[113] *Thompson* involved a complicated question of rights to gas, oil and mineral rights under an easement in the possession of the trustee in bankruptcy. The Supreme Court ordered continuation of the case in the state court despite clear jurisdiction of the bankruptcy court over the bankrupt's

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[109]The following is the pertinent portion of Marsh's testimony:

". . . it seems to me that the phraseology (of Sec. 1471(b)) is too vague for a provision conferring jurisdiction on a court. It does not even require, for example, that the trustee be a party to the litigation as long as it can be determined to be 'related to' the bankruptcy proceeding. Even though he is not, either party could remove a pending case to the bankruptcy court if it is determined to be somehow 'related to' the bankruptcy proceedings". Senate Hearings, *supra*, p. 484.

[110]28 U.S.C. 1471(d) reads as follows:

"(d) Subsection (b) or (c) of this section does not prevent a district court or bankruptcy court from abstaining from hearing a particular proceeding arising under Title II or arising in or related to a case under Title II. Such abstention, or a decision not to abstain, is not reviewable by appeal or otherwise".

[111]House Report No. 95-595, *supra*, p. 51.

[112]The typical example would be litigation in which the parties have proceeded substantially toward trial. It may be in

D. *Venue.*

The jurisdictional issues which are discussed above concern the power of the bankruptcy court to adjudicate matters. The place of exercise of the bankruptcy court's jurisdiction is a question of venue governed by separate provisions of the Code.[120] Generally, the bankruptcy court wherein the bankruptcy case is pending is always proper venue.[121] However, there are two important exceptions. The first involves suits to recover money or property of a value less than $1,000 or consumer debts[122] less than $5,000. Such suits may only be commenced in the bankruptcy court in the district in which a defendant resides.[123] The language seems to presume individual defendants only since venue is dependent upon residence only. Nevertheless, corporate defendants are just as susceptible to the inherent injustice of litigation of minor claims (under $1,000) in distant courts, and no justifiable reason has been offered for distinguishing between individual and corporate defendants with respect to these venue provisions. The second exception concerns suits commenced after the bankruptcy filing which arise from the operation of the debtor's business. Those suits may be brought only by the debtor or the trustee in the bankruptcy court for the district in which the case could be commenced under applicable non-bankruptcy venue statutes.[124] The concern here, of course, is that vendors or potential customers might be reluctant to do business with a debtor if a dispute between the parties could be heard in a distant forum creating a substantial burden on the vendor or customer. The same reasoning of economy and efficiency which may justify venue in liquidation cases in the bankruptcy court in which the petition was filed, are less persuasive in cases where the debtor's business is still operating (usually under Chapter 11 of the Code). The language of subsection 1473(d) is a limited carryover from the venue proposed by the Commission based upon the old summary-plenary jurisdiction distinction.[125] The converse of the venue of the trustee's suit for an operating debtor is not as restrictive. A claim arising out of the operation of the debtor's business may be filed against the trustee or debtor in the bankruptcy court in which the case is pending, as well as the applicable non-bankruptcy court.[126] Except for venue of suits involving less than

[120]The venue provisions of the Code are contained at 28 U.S.C. Secs. 1472 through 1477. Section 1472 concerns proper venue for the commencement of a case under Title II and is substantially the same as present law. Section 1474 concerns venue of cases which are ancillary to a foreign bankruptcy proceeding. Section 1476 provides for proper venue of pending cases at the time of creation or transfer of a district or division. Sections 1475 and 1477 contain provisions allowing flexibiligy in the transfer of cases between bankruptcy courts and districts where the original venue is defective or the doctrine of *forum non conveniens* applies. The latter sections are similar to existing federal venue statutes. This article will concentrate its discussion primarily on Section 1473 which concerns venue of cases before the bankruptcy court pursuant to the jurisdiction granted by 28 U.S.C. Sec. 1471(b).

[121]Code, Sec. 241(a), 28 U.S.C. Sec. 1473(a).

[122]A "consumer debt" is defined by 11 U.S.C. Sec. 101(7) as a ". . . debt incurred by an individual primarily for a personal, family, or household purpose."

[123]Code, Sec. 241(a), 28 U.S.C. Sec. 1473(b).

termined by statutory language, relates primarily to the convenience of litigants and, as such, is *always* subject to their disposition.[131] By encouraging liberal use of the Code's transfer and abstention provisions, the forthcoming rules may enable fair and uniform application of the Code's venue provisions, and thus avoid the potential unfairness to litigants which otherwise is likely to result.

E. *Appeals.*

Under the old law, appeals from decisions of the bankruptcy judges were made to the district court. This procedure has been justly criticized since bankruptcy judges were appointed by, and answerable to, the district court hearing the appeal. In addition, the district courts are themselves trial courts and generally not equipped to handle appeals from another trial court. The legislative history of the debate on bankruptcy appeals, discussed briefly above, indicates a wide disparity of opinion as to the proper forum for appeals. Reformers advocating circuit court appeals argued that appeals to the district court would detract from the dignity and respect of the bankruptcy courts. Proponents of maintaining the district court appeal stressed the necessity for expeditious handling of bankruptcy appeals, an impossibility if the appeals were to await a decision from the hopelessly backlogged circuit courts of appeals. One of the major objections to district court appeals evaporated early in the debate since all proposed legislation eliminated appointment of bankruptcy judges by the district court. However, the debate between district court and circuit court appeals continued until shortly before the passage of the final bill by Congress.[132] The solution finally enacted by the Code is an inventive one which could potentially satisfy all sides to the debate. Strangely enough, the alternative appeals procedures enacted in the Code are not visible in the legislative history apparently appearing dramatically in the final days before final passage of H.R.8200. The sections concerning appeals are contained in 28 U.S.C. Secs. 160, 1293, 1294, 1334 and 1482. Section 1334 contains the general grant of appeals jurisdiction providing that appeals of decisions of the bankruptcy courts are made to the district courts as under prior law. However, as a significant alternative to district court appeals, the circuit council for each circuit may appoint panels of three bankruptcy judges for a district or districts to hear intermediate appeals from the bankruptcy court in a district.[133] The Code also provides a third alternative. If all parties agree, a final decision of the bankruptcy court may be appealed directly to the circuit court.[134]

[131] *Neirbo v. Bethlehem Shipbuilding Corp.*, 308 U.S. 165 (1939). See discussion in Broude, "Jurisdiction and Venue Under the Bankruptcy Act of 1973", *supra*, p. 243.

[132] Proposed 28 U.S.C. Secs. 164(b) and 1334(e) of the Senate bill (S. 2266) provided for appeals directly to the district court. The House bill (H.R. 8200) proposed amendments to 28 U.S.C. Secs. 1291-4 granting jurisdiction of appeals from

deemed final decisions or orders in many instances. To a large extent the lack of finality may be due to the continuation of the bankruptcy case concerning which the order or decision is made. Therefore, final decisions related to the debtor's estate, interests in property, and other matters, may technically be interlocutory in nature and, as a result, generally not appealable.[136] Nevertheless, many decisions of the bankruptcy judge have a finality only too apparent to the parties. In order to remedy this potential inequity, the Code provides that the district courts, or appellate panels, as the case may be, will have jurisdiction over appeals from interlocutory orders, judgments, or decrees, but only by leave of the reviewing body.[137] The same jurisdiction is lacking with respect to appeals by consent to the circuit court of appeals. Appeals directly to the circuit court may only be from final judgments, orders or decrees.[138]

CONCLUSION

Many of the provisions of the Code discussed in this article do not take effect until April 1, 1984. Yet the Commission Report and Legislative History indicate that reform of the bankruptcy court system, its powers and jurisdiction, provided a primary motivation for accompanying reform of bankruptcy law and practice, generally. The anomaly of the new bankruptcy court system gathering dust for almost five years while the substantive law provisions of the Code, designed for the new court system, take effect immediately, is avoided, fortunately, by the transition provisions of the Code which apply the amendments to Title 28 during the transition period. These same provisions also allow sitting bankruptcy judges to hire some of the badly needed support personnel, including law clerks,[139] which the Code makes available to the new bankruptcy judges coming to the bankruptcy bench in 1984. This will be a significant aid to bankruptcy judges attempting to implement the new law during the transition period. At first glance, many provisions relating to the new bankruptcy court system conducive to rulemaking appear similar to the present federal civil rules of procedure. However, the new bankruptcy court will sit in a capacity far different from that of the district courts. Many of the differences are obvious, some are very subtle, but all will require careful examination prior to rules promulgation. Some of the differences have already been specifically mentioned in this article. Others may only appear from careful and multiple readings of the Code. Similarly, this discussion has briefly alluded to some areas where rules may provide significant direction to otherwise vague and misleading Code language. It is the sincere hope of this author that the rulemakers pay close attention, not only to the specific Code

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[136]Under present practice neither the Act nor the rules of procedure limit appeals to final judgments, orders and decrees. Nevertheless, the district judges have refused to hear appeals from decisions on issues which were considered merely preliminary matters. See, vol. 13, *Collier on Bankruptcy* (14th ed., 1976), Sec. 801.06, pp. 8-7, 8. Therefore, dis- [illegible] court to hear appeals of interlocutory decisions is primarily a codification of existing case law.

RULEMAKING REQUIREMENTS RELATED TO FEDERAL FINANCIAL ASSISTANCE PROGRAMS

By Gerald H. Yamada

A. *Introduction*

President Carter has proposed in his fiscal year 1981 budget to provide $96.3 billion in total direct Federal grants-in-aid to States and localities.[1] Federal financial assistance has substantially increased when compared to $24.0 billion expended in 1970, $7.0 billion expended in 1960, and $2.3 billion expended in 1950.[2] In making these funds available and developing program requirements, a Federal grantor agency may adopt regulations after providing notice and an opportunity for public comment.

Although the trend is toward adopting regulations, a Federal grantor agency can still administer Federal financial assistance programs solely or substantially through the use of rules contained in agency circulars, guidelines, instructions, manuals, handbooks, etc. The term "rule" is defined in the Administrative Procedure Act (APA)[3] as an agency statement of general or particular applicability to be used to implement, interpret, or prescribe law or policy or to describe the agency's organization, procedure, or practice requirements.[4] In order to issue a valud rule, Federal agencies must comply with both programmatic and procedural requirements. The programmatic requirement is that the rule must be "reasonably related to the purposes of the enabling legislation."[5] This requirement is applicable to both substantive and interpretative rules.[6] The procedural requirements are contained in the APA public information[7] and rulemaking[8] sections and the Federal Register Act.[9] The APA and Federal Register Act set up the procedure which must be followed in order for agency rulings to be given the force of law.[10]

The public information and rulemaking sections of the APA are generally applicable to all Federal agencies and are not limited in application only to Federal grantor agencies. Judicial challenges alleging that a Federal grantor agency has failed to comply with these requirements have occurred mainly since 1970. However, the litigation has focused primarily on Section 553 requirements. To fully appreciate a Federal grantor agency's responsibility and potential legal liability under these APA sections, it is necessary to

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[1]*The Budget of the United States Government, Fiscal Year 1981*, H.R. DOC. No. 92-246, 96th Cong., 2d Sess. 307 (1980).

[2]Advisory Commission of Intergovernmental Relations Report A-52, *Categorical Grants: Their Role and Design*, May 1978, p. 38.

[3]5 U.S.C. §551 *et seq.*

[4]5 U.S.C. §551(4). An opinion or recommendation is not a rule within the meaning of 5 U.S.C. §551(4). *Friends of Yosemite v. Frizzell*, 420 F. Supp. 390, 394 (N.D. Cal. 1976).

[5]*Mourning v. Family Publications Service, Inc.*, 411 U.S. 356, 369 (1972). For cases where this requirement was not met and the implementing rule held to be invalid, *see*, for example, *Morton v. Ruiz*, 415 U.S. 199 (1974); *Fletcher v. Housing Authority of Louisville*, 491 F.2d 793 (6th Cir. 1974), *vacated*, 419 U.S. 812 (1974); and *Findrilakis v. Secretary of Department of Housing and Urban Development*, 357 F. Supp. 547 (N.D. Calif. 1973).

[6]*See American Association of Councils of Medical Staffs of Private Hospitals, Inc. v. Mathews*, 421 F. Supp. 848, 854, n. 11 (E.D. La. 1976), *vacated*, 575 F. 2d 1367 (5th Cir. 1978).

[7]5 U.S.C. §552.

cious distinction.[20] Rather, it has been construed as applicable when an excepted subject is clearly and directly involved.[21] For Federal financial assistance programs, the exemption applies to the standards and procedures by which applicants can qualify for Federal financial assistance as well as actual commitments of funds.[22]

The purpose of the exemption is to provide greater flexibility and allow for the expeditious administration of the excepted subject.[23] However, this exemption has been waived by some Federal agencies with grant making authority such as the Department of Health, Education, and Welfare,[24] Department of Housing and Urban Development,[25] and the Department of Labor.[26] Once the exemption is waived by agency regulations, the agency must comply with the applicable requirements of 5 U.S.C. §553.[27] Of course, agency directives issued prior to the effective date of the waiver are still covered by the exemption.[28]

Waiver of the exemption can raise some interesting issues for Federal grantor agencies such as whether Section 553 requirements have been adequately met and what agency actions constitute rulemaking. For example, in this latter area, the approval by Federal agencies of State plans required by Federal enabling statutes may constitute rulemaking. The holding in *Buckeye Power, Inc., et al. v. Environmental Protection Agency*[29] can be instructive. This court found that EPA's approval of State plans for the implementation of ambient air quality standards under the Clean Air Act[30] constituted rulemaking requiring public participation under 5 U.S.C. §553. The court defined rulemaking as involving ". . . the prescription of law to effect broad policy consideration."[31] The court determined that public participation in the approval process was necessary to give interested parties an opportunity to comment before the State plans became subject to Federal enforcement. Although the *Buckeye Power, Inc.,* case did not involve a Federal financial assistance program, the court's determination may have applicability to the approval of State plans which determine eligibility requirements, funding levels, State priorities, etc., for Federal fund alloctions. Where the exemption

[20] *Rodriguez v. Swank,* 318 F. Supp. 289, 296 (N.D. Ill. 1970), *aff'd,* 403 U.S. 901 (1971).

[21] *Humana of South Carolina, Inc. v. Califano,* 590 F.2d 1070, 1084 (D.C. Cir. 1978); *National Wildlife Federation v. Snow,* 561 F.2d 227, 232 (D.C. Cir. 1976); and *Housing Authority of the City of Omaha, Nebraska v. United States Housing Authority et al.,* 468 F.2d 1, 9 (8th Cir. 1972), *cert. denied,* 410 U.S. 927 (1973).

[22] *Center for Auto Safety v. Tiemann,* 414 F. Supp. 215, 222, (D.D.C. 1976), *aff'd in part sub nom., Center for Auto Safety v. Cox,* 580 F.2d 689 (D.C. Cir. 1978), and *National Wildlife Federation v. Snow,* 561 F.2d at pp. 231-32.

[23] *Rodriguez v. Swank, supra* at note 20.

[24] 45 C.F.R. §5.13.

[25] 24 C.F.R. §10.1.

[26] 29 C.F.R. §2.7.

[27] For examples of where agencies were bound by a waiver of the Section 553(a)(2) exemption, *see National Welfare Rights Organization v. Mathews,* 533 F.2d 637 (D.C. Cir. 1976); *Rodway v. United States Department of Agriculture,* 514 F.2d 809 (D.C. Cir. 1975); *Anderson et al. v. Butz,* 428 F. Supp. 245 (E.D. Calif. 1975), *aff'd,* 550 F.2d 459 (9th Cir. 1977); *State of Florida v. Mathews,* 422 F. Supp. 1231 (D.D.C. 1976); *Lewis v. Weinberger,* 415 F. Supp. 652 (D.N.M. 1976); *State of Florida v. Weinberger,* 401 F. Supp. 760 (D.D.C. 1975); *City of New York v. Diamond,* 379 F. Supp. 503

ment requirements of Section 553 inapplicable. The second exception only excuses the notice and public comment requirements.

A difficult problem in determining whether the first exception is applicable is differentiating between interpretative rules or statements of policy and substantive rules.[40] In making this determination the label the agency puts upon its exercise of administrative power is not conclusive; rather, it must be based upon the substance and effect of the action.[41]

An interpretative rule has been defined as a clarification or explanation of existing laws or regulations in terms of what an administrative officer thinks the statute or regualtion means. A substantive rule creates law by the modification in or adoption of new regulations.[42] These definitions are not very helpful in the application of the two terms.

Courts, however, have taken basically two approaches in applying the substantive and interpretative rule distinction. Some courts have looked to the authority of the agency, the language of the rule itself, and how the agency has treated the rule in subsequent applications to determine if the agency has actually utilized the rule as substantive or interpretative.[43] Where the rule is phrased as a guide to the agency's present views, subject to change, and with no suggestion these views have the finality or force of substantive regulations, the rule is deemed to be interpretative.[44] Where the rule has no immediate inflexible impact and is specifically left open for discussion, the rule is deemed to be interpretative.[45] Where the agency, in subsequent applications of the rule, does not cite the rule as having legal force in itself but rather rules upon the merits of the case and cites the statute interpreted by the rule as authority, the rule is deemed to be interpretative.[46]

Other courts have looked at the impact on parties affected by the rule.[47] If the impact is substantial, the rule is substantive and subject to Section 553. The court in *Saint Francis Memorial Hospital v. Weinberger* applied the substantial impact test by making two inquiries.[48] First, and more important, the court would look to see if the parties subject to the rule are subjected to any new substantive duties or deprived of any preexisting substantive rights. Secondly, the court would consider whether there is a genuine ground for difference of opinion on the wisdom of the policy embodied in the rule as to make public participation a meaningful and important requirement.

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[40] *See* Davis, ADMINISTRATIVE LAW OF THE SEVENTIES §5.03 (1976). *See also* Tigert, *A Functional Approach to the Applicability of Section 553 of the Administrative Procedure Act to Agency Statements of Policy*, 43 U. Chi. L. Rev. 430 (1976), and Bonfield, *Some Tentative Thoughts on Public Participation in the Making of Interretative Rules and General Statements of Policy Under the A.P.A.*, 23 Ad. L. Rev. 101 (1971).

[41] *Lewis-Mota v. Secretary of Labor*, 469 F. 2d 478, 481-82 (2d Cir. 1972).

[42] *American Association of Councils of Medical Staffs of Private Hospitals v. Mathews*, 421 F. Supp. at p. 856 and *Continental Oil Company v. Burns*, 317 F. Supp. 194, 197 (D. Del. 1970). *See also Gibson Wine Co. v. Snyder*, 194 F.2d 329, 331 (D.C. Cir. 1952).

[43] *Energy Reserve Group,, Inc., et al. v. Federal Energy Administration, et al.*, 447 F. Supp. 1135 (D. Kan. 1978), and *Opelika Nursing Home, Inc. v. Richardson*, 356 F. Supp. 1338, *aff'd sub nom., Johnson's Professional Nursing Home v. Weinberger*, 490 F.2d 841 (5th Cir. 1974).

[44] *National Association of Insurance Agents v. Board of Governors of Federal Reserve System*, 489 F.2d 1268 (D.C. Cir. 1974).

wait until the rule is published in the Federal Register.[60] A rule becomes effective on the date that it is filed with the Office of the Federal Register and a copy made available for public inspection.[61] Unless otherwise provided by statute, the filing of the document gives constructive notice to a person subject to or affected by the rule.[62] The publication in the Federal Register creates a rebuttable presumption as to the rule's validity.[63]

In publishing final regulations, the agency is required to include a concise general statement of their basis and purpose.[64] Failure to include the statement has been used as a reason to invalidate a set of regulations.[65] However, in these cases, there were other violations of the APA. Where the failure to include a statement of basis and purpose was the only deficiency, one court directed that the agency issue within sixty days the required statement without invalidating or enjoining the regulations.[66]

Where the Section 553(a)(2) exemption is not waived, rules relating to Federal financial assistance may be adopted without notice and the opportunity for public comment as required by Section 553.[67] Whether such rules must be published will depend upon the applicability of 5 U.S.C. §552(a)(1). Similarly, even where the Section 553(a)(2) exemption is waived, interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice may be issued without notice or opportunity for comment; but the publication requirements depend upon the applicability of 5 U.S.C. §552(a)(1).

Where Section 553 requirements are applicable but not followed, the rule is generally held to be invalid.[68] Similarly, where a rule is published but the required opportunity for public comment is not afforded, the rule is generally found to be invalid.[69] This is true even where an affected party has actual knowledge of the published rule.[70] Courts have not been receptive to the argument that a substantive rule published without the opportunity for comment becomes effective 30 days after the date of publication.[71] However, parties that have actual knowledge of a rule and were given the opportunity to comment are bound by the rule even though it was not published.[72]

2. *Section 552(a)(1) and (2) Requirements*

Whether a matter is exempted from Section 553 requirements, it must

[60]38 Op. Atty. Gen. 359 (1935).

[61]44 U.S.C. §1507.

[62]*Ibid.*

[63]*Ibid.*

[64]5 U.S.C. §553(c).

[65]*National Welfare Rights Organization v. Mathews,* 533 F.2d at pp. 648-49, and *State of Maryland v. Mathews,* 415 F. Supp. 1206, 1214 (D.D.C. 1976).

[66]*American Health Care Association v. Califano,* 443 F. Supp. 612, 616 (D.D.C. 1977).

[67]The ability of affected parties to challenge an agency's failure to give notice and opportunity for public comment on a basis other than 5 U.S.C. §553 will be discussed *infra.*

[68]*See* cases cited in note 27 *supra.*

[69]See note 58 *supra.*

tive in the grant agreement but uses it as the basis for disapproving the selection of the initial contractor as the low bidder for the follow-on procurement. There may be a real problem for the grantor agency because Section 552(a)(1) provides that a matter which should have been but was not published is not binding upon a party that does not have actual and timely notice of the terms of the matter.

Example 4: The grantor agency writes out the provision in the grant agreement. The grantee fails to give notice of the provision to the initial contractor. The grantor agency uses the provision as the basis for disapproving the selection of the initial contractor as the low bidder for the follow-on procurement. As between the grantor agency and grantee, the provision is binding. If the grantee chooses to award the follow-on procurement to the initial contractor, the grantee stands the risk of having the grantor agency disallow the costs incurred under the follow-on contract.[82]

In examples 2, 3, and 4, a potential argument to be raised by the grantee or contractor is that the organizational conflict of interest provision is either a substantive rule of general applicability, a statement of general policy, or an interpretation of general applicability which must be published or actual notice of it given before it can be applied against the grantee. This highlights one of the problem areas within Section 552(a), which is to distinguish between paragraphs (1)(D) and (2)(B). In distinguishing between these paragraphs, some courts have focused on the significance of the impact that the matter will have upon the rights of the public. For example, the court in *Lewis v. Weinberger* defined statements of general policy and interpretations of general applicability as used in Section 552(a)(1)(D) as when agencies ". . .adopt new rules or substantially modify existing rules [or] regulations, . . .and thereby cause a direct and significant impact upon the substantive rights of the general public or a segment thereof."[83] A policy statement or interpretation within the meaning of Section 552(a)(2)(B) was defined by the court as where ". . .(1) only a clarification or explanation of existing laws or regulations is expressed; and (2) no significant impact upon any segment of the public results."[84]

The impact test is an extension of one of the tests used under Section 553 to determine whether a rule is substantive, interpretative, or a statement of policy. The impact test serves a useful purpose within Section 553.[85] The main purpose of Section 553 requirements is to permit interested parties to be heard before any official action that will affect them is undertaken. Hence, the sig-

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[82] If the grantee seeks to challenge the disallowance, the proper judicial forum may be in the United States Court of Claims under the Tucker Act. 28 U.S.C. §§1346(a)(2) and 1491. *Concerned Citizens of Bushkill Township v. Costle,* 592 ZF.2d 164, 171 (3d Cir. 1979), and *Commonwealth of Massachusetts v. Connor,* 248 F. Supp. 656, 658 (D. Mass. 1966), *aff'd,* 366 F.2d 778 (1st Cir. 1966). For a discussion of grantee rights and remedies, *see* Madden, *The Right to Receive Federal Grants and Assistance,* 37 Fed. B.J. 17 (1978), and Wallick and Montalto, *Symbiosis or Domination: Rights and Remedies under Grant-Type Assistance Programs,* 46 Geo. Wash. L. Rev. 159 (1978). For a discussion of contractor rights and remedies, *see* Madden, *Providing An Adequate Remedy for Disappointed Contractors Under Federal Grants-in-Aid to States and Units of Local Government,* 34 Fed. B.J. 201 (1975).

in the Federal Register is not required. Applying this interpretation to Example 2 above, the grantee and contractor would be required to comply with the unpublished directive.

In determining whether Section 552(a)(1) or (2) is applicable, it is important to bear in mind the purpose which the publication requirement in Section 552(a)(1) serves. The purpose of the requirement is ". . .to keep the outside interests informed of the agency's requirements in respect to any subject within its competence, as a guide in the conduct of their day-to-day affairs, and to instruct them in regard to the presentation to the agency of any such subject for impartial consideration or action thereon."[86] The requirement has been characterized as a shield to protect an affected party from being penalized for failing to resort to unpublished rules and not as a sword by which a rule can be struck down for failure to be published in the Federal Register.[87] Section 552(a)(1) and (2) provide that a matter which should have been published or made available but was not published or made available still remains enforceable against a party which has actual and timely notice of the terms of the rule. It is important to note that the notice must not only be actual but it must be timely.[88] If an agency wants to insure that its directives will be binding on affected parties, the directives should be published in the Federal Register.

There is a procedure to publish matters enumerated in Section 552(a)(1) by incorporation by reference. Publication in the Federal Register is deemed to be accomplished when the matter is reasonably available to the class of persons affected by the matter *and* the matter is incorporated by reference in the Federal Register with the approval of the Director of the Federal Register. The court in *Appalachian Power Co. v. Train*[89] held that the failure of the agency to obtain approval of the Director of the Federal Register to incorporate by reference a 273 page document and failure to comply with the incorporation by reference regulations[90] of the Office of the Federal Register resulted in a non-compliance with the Section 552(a)(1) publication requirement.

In sum, if a rule is otherwise valid[91] and the sole defect is failure to publish the rule pursuant to 5 U.S.C. §552(a)(1), the rule should only be found to be not applicable to adversely affected parties that did not have actual and timely notice.[92] However, this does not mean that Federal grantor agencies should ignore the publication requirement in Section 552(a)(1) by issuing unpublished rules in agency directives.

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[86] *United States v. Hayes*, 325 F.2d 307, 309 (4th Cir. 1963).

[87] *Foreman & Clark, Inc. v. National Labor Relations Board*, 215 F.2d 396, 410 (9th Cir. 1954).

[88] *St. Elizabeth Hospital v. United States*, 558 F.2d 8 (Ct. Cl. 1977); *Anderson v. Butz, supra* at note 83; and *Northern California Power Agency v. Morton, supra* at note 73.

[89] 566 F.2d 451 (4th Cir. 1977).

[90] 1 C.F.R. Part 51.

[91] *See* note 5 *supra* for examples of cases where rule was held invalid for failure to be reasonably related to the purposes of the enabling legislation.

[92] *Hogg v. United States*, 428 F.2d 274, 280 (6th Cir. 1970), *cert. denied*, 401 U.S. 910 (1971). A requirement that rules must be published in the Federal Register to be effective even against those with actual and timely notice may be

authority[106] or view it as having the force and effect of law.[107] The legal effect given to agency directives depends in addition to complying with APA requirements upon the intent of the agency as to whether the requirements are advisory or mandatory. The courts look to the language and treatment of the directives to derive the agency's intent.[108]

Where an agency intends a directive to be advisory, the courts will generally treat the directive as not having the force of law. Rather, courts will give agency directives in their deliberations a measure of weight,[109] considerable weight,[110] decisive weight,[111] great weight,[112] controlling weight,[113] deference,[114] or great deference[115] in determining statutory or regulatory compliance. This means that a reviewing court will generally accept the agency's actions in promulgating rules and awarding grants absent a showing of bad faith, bias, or corruption or a showing that the agency's determinations are in direct violation of a statutory mandate or without rational basis.[116] It does not make a difference that there may exist even more reasonable actions.[117] Courts, however, may be somewhat less inclined to defer to an administrative guideline when it conflicts with an earlier pronouncement of the agency.[118]

Where agency directives are advisory, they may be modified by grant conditions,[119] superseded by agency action,[120] or waived by regulation amendment.[121] Even where an agency directive creates a misunderstanding, this alone may be insufficient to give rise to estoppel against the Federal Government.[122] The failure to follow an internal agency directive which was not designed to protect nor actually relied upon by affected parties does not result in a cause of action against the Federal grantor agency.[123] Furthermore, failure

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[106] *King v. Smith,* 392 U.S. 309, 317-18 (1968).

[107] *Like v. Carter,* 448 F.2d at pp. 803-04, and *Blackshear Residents Organization v. Housing Authority of the City of Austin,* 347 F. Supp. 1138, 1146 (W.D. Tex. 1972). *But see Brennan v. Ace Hardware Corporation,* 495 F.2d 368, 376 (8th Cir. 1974); *Talbot v. Romney,* 334 F. Supp. 1074, 1080 (S.D. N.Y. 1971); *United States v. Braddy,* 320 F. Supp. 1239, 1241 (D. Ore. 1971); and *Graham v. Lawrimore,* 185 F. Supp. 761, 764 (E.D.S.C. 1960), *aff'd,* 287 F.2d 207 (4th Cir. 1961).

[108] *Thorpe v. Housing Authority of the City of Durham,* 393 U.S. at p. 276.

[109] *Helton v. Mercury Freight Lines, Inc.,* 444 F.2d 365, 368 (5th Cir. 1971).

[110] *Thomas v. County Office Committee of Cameron County,* 327 F. Supp. 1244, 1253 (S.D. Tex. 1971).

[111] *Shultz v. Nalle Clinic,* 444 F.2d 17, 20 (4th Cir. 1971), *cert. denied,* 404 U.S. 938 (1971).

[112] *Opelika Nursing Home, Inc. v. Richardson,* 356 F. Supp. at p. 1343.

[113] *Concerned Residents of Buck Hill Falls v. Grant,* 537 F.2d 29, 38 (3d Cir. 1976).

[114] *Dobbs v. Costle,* 559 F.2d 946, 948 (5th Cir. 1977), and *State of Maryland v. Costle,* 452 F. Supp. 1154, 1157 (D.D.C. 1978).

[115] *People of the State of California ex rel. Department of Transportation v. United States,* 561 F.2d 731, 734 (9th Cir. 1977), and *People of the State of California ex rel. Department of Transportation v. United States,* 547 F.2d at p. 1390.

[116] *City of Newburgh v. Richardson,* 435 F. Supp. 1049, 1056 (S.D.N.Y. 1977). *See also Udall v. Tallman,* 380 U.S. 1, 16-17 (1965).

[117] *Concerned Residents of Buck Hill Falls v. Grant,* 537 F.2d at p. 38.

[118] *Andrus v. Sierra Club,* ____ U.S. ____, 99 S. Ct. 2335, 2341 (1978), and *General Electric Co. v. Gilbert,* 429 U.S. 125, 143 (1976).

[119] *Illinois State Employees Union, Council 34 v. Hodgson,* 335 F. Supp. 960, 962 (N.D. Ill. 1971).

[120] *County of Alameda v. Weinberger,* 520 F.2d 344, 351 (9th Cir. 1975). *See also Concerned Residents of Buck Hill Falls v. Grant,* 537 F.2d at p. 38, and *Feldman v. U.S. Department of Housing & Urban Development,* 430 F. Supp. 1324 (E.D. Pa. 1977).

[121] *Hawkins v. State Agriculture Stabilization and Conservation Committee,* 149 F. Supp. 681, 688 (S.D. Tex. 1957), *aff'd,* 252 F.2d 570 (5th Cir. 1958).

[122] *Brown v. Richardson,* 395 F. Supp. 185, 189 (W.D. Pa. 1975). *Compare Natonabah v. Board of Education of

may be created by the financial[136] and administration[137] responsibilities which are imposed upon a Federal grantor agency.

One court has held that the failure of a Federal agency to promulgate and enforce a continuing regulatory scheme to carry out a Federal assistance program stated a valid cause of action.[138] The agency had only issued guidelines which the court considered to be statements of policy having no binding effect.

Hence, a Federal grantor agency may have a duty to develop mandatory guidelines or regulations to set forth the agency's interpretation of the various statutory provisions which the agency is charged with administering. If an agency makes a determination without issuing mandatory guideliens or regulations, the determination may be construed to be *ad hoc*[139] and subject to challenge as arbitrary, capricious, and an abuse of discretion.[140]

D. *OPPORTUNITY TO PARTICIPATE*

Where a Federal grantor agency relies on the exemption from Section 553 requirements, notice and the opportunity for public comment on rule-making for grants are not required to be provided pursuant to 5 U.S.C. §553. However, there may be other bases on which notice and the opportunity for comment may be required in developing agency directives. For example, OMB Circulars such as A-85 and A-95 do provide for notice and opportunity to comment requirements. Failure to comply with these requirements can give public entities standing to raise this issue[141] or enjoin a project until such opportunity is provided.[142]

Another basis may be the Federal Advisory Committee Act.[143] The plaintiffs in *Center for Auto Safety v. Tiemann*[144] sought to have an agency's regulation and approval of a State plan invalidated because meetings held with State officials to discuss the proposed regulations and State plan were not open

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[136]A Federal grantor agency has the responsibility to insure that a grantee uses grant funds for the purpose for which the funds are provided. *Food Service Dynamics, Inc. v. Bergland*, 465 F. Supp. 1178, 1182 (E.D.N.Y. 1979). This responsibility is also statuatorily imposed by 31 U.S.C. §628, which provides:

> "Except as otherwise provided by law, sums appropriated for the various branches of expenditure in the public service shall be applied solely to the objects for which they are respectively made, and for no others."

[137]*See* note 12 *supra*. A Federal grantor agency is responsible for seeking compliance not only with its enabling statute but also with numerous Federal requirements applicable to Federal grant programs. *Board of Public Instruction of Taylor County, Florida v. Finch*, 414 F.2d 1068 (5th Cir. 1969). The Federal Assistance Program Study conducted by OMB pursuant to 41 U.S.C. §507 identified 59 cross-cutting requirements applicable to various Federal financial assistance programs. *Managing Federal Assistance in the 1980's*, OMB, March 1980, pp. 20-26.

[138]*Brown v. Lynn*, 385 F. Supp. at p. 999. *See also Mayor and City Council of Baltimore v. Mathews*, 562 F.2d 914, 922 (4th Cir. 1977), *cert. denied*, ____ U.S. ____, 99 S. Ct. 184 (1978); *Lugo v. Simon*, 453 F. Supp. 677, 686 (N.D. Ohio 1978); *Rocky Ford Housing Authority et al. v. United States Department of Agriculture et al.*, 427 F. Supp. 118 (D.D.C. 1977); and *Cherry v. Mathews*, 419 F. Supp. 922, 924 (D.D.C. 1976).

[139]*Morton v. Ruiz*, 415 U.S. at p. 232. *See* Administrative Conference of the United States recommendation at 1 C.F.R. §305.74-2. *Compare* Mason, *Current Trends in Federal Grant Law - Fiscal Year 1976*, 35 Fed. B.J. 163 (1976).

[140]*cf. Ford Motor Company v. United States Environmental Protection Agency*, 567 F.2d 661 (6th Cir. 1977).

[141]*Hood River County v. United States*, 532 F.2d 1236, 1238 (9th Cir. 1976).

[142]*State of Texas v. United States By and Through Community Service Administration*, 426 F. Supp. 74 (W.D. Tex.

E. *CONCLUSION*

There is a continuing concern that Federal agencies must adopt procedures to improve existing and future regulations.[154] The statutory exemption from Section 553 rulemaking requirements for Federal grant programs gives Federal grantor agencies a great deal of discretion as to the procedural requirements which will be followed in formulating rules for Federal financial assistance programs.[155] Although the Section 553(a)(2) exemption may appear to manifest a clear legislative intent to permit *ad hoc* decisionmaking,[156] this discretion is not unlimited. As greater attention is given to the procedural development of rules applicable to Federal financial assistance programs or the legal effect of such rules, the more important the publication requirement in Section 552(a)(1) becomes to the ability of agencies to apply its rules. If courts are willing to recognize that affected parties have an enforceable right whether or not derived from Section 553 to participate in the formulation of agency rules, the more important it becomes for agencies to adequately provide such opportunity in order to sustain the validity of its rules.

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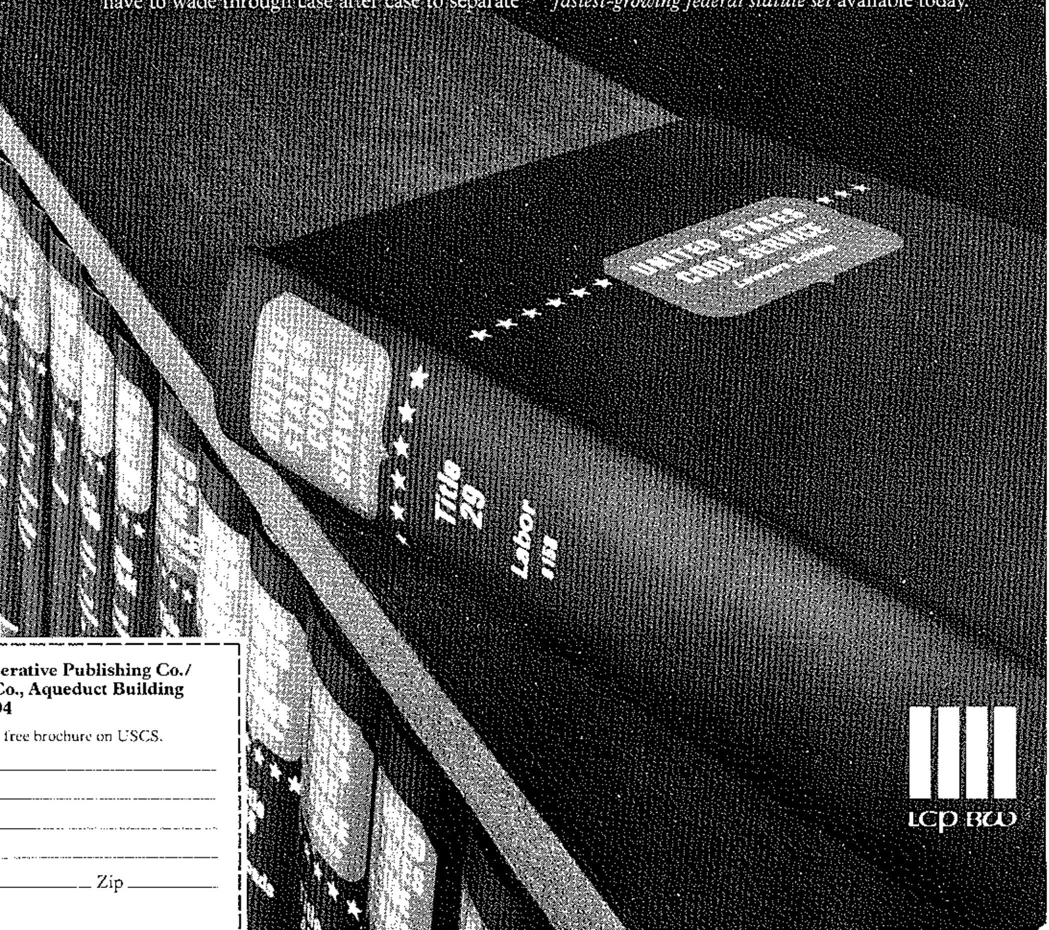

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