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ct. 23-24	2nd Annual International Trade Law Update - with separate seminars on U.S.-China and U.S.-Brazil Trade, Four Seasons Hotel, Georgetown, Washington, DC
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eb. 20	4th Annual Grant Law Seminar, Four Seasons Hotel, Georgetown, Washington, DC
pril 9-10	6th Annual Indian Law Conference, Hyatt Regency Phoenix, Phoenix, Arizona
ept. 7-11	1981 ANNUAL CONVENTION, FAIRMONT HOTEL, DENVER, COLORADO

to the public. The regulations and State plan approval were both within the Section 553(a)(2) exemption for grants. The court did not rule on the merits of the plaintiff's argument. Because the original regulations had been superseded and only temporary regulations were being used, the court declined to provide any relief regarding the regulations. The plaintiffs did not show any prejudice resulting from the unlawful advisory committee meetings, were able to comment on the plan while it was pending, and were entitled to judicial review of the State plan on other grounds. Hence, the court declined to invalidate the State plan approval based on a Federal Advisory Committee Act violation. It remains an open question as to whether the failure to comply with Federal Advisory Committee Act requirements will invalidate regulations or directives which were discussed at a closed advisory committee meeting.

Another potential argument is whether due process requires notice and opportunity for comment in the development of agency directives. To establish a denial of due process under the Fifth Amendment plaintiffs must establish that: (1) property interests have been invaded by the government without an opportunity to challenge that invasion, and (2) the purported justification for the invasion is at least plausibly disputable.[145] To have a protected property interest in a benefit, a person must have a legitimate claim of entitlement to it instead of a unilateral expectation to it.[146] The difficulty with this argument is that private individuals or organizations do not have a claim of entitlement to a grant[147] and that public entities which are generally the recipients of entitlement grants may not be considered to be "persons" within the meaning of the Fifth Amendment.[148] Furthermore, the Tenth Amendment does not provide a bill of procedural rights for the States.[149]

Where an agency directive is issued without an opportunity for comment in the first instance, Section 553(e)[150] may be used to obtain some agency consideration of comments. This was the suggestion made by at least one court.[151]

Aside from rulemaking, a Federal grantor agency may make available public participation procedures to be used during its decision making process.[152] Violation of such procedures may give rise to a cause of action to remedy the lack of compliance.[153]

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[145] *Rainbow Valley Citrus Corp. v. Federal Crop Insurance COrp.*, 506 F.2d 467, 469 (9th Cir. 1974).

[146] *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972).

[147] *See City of Santa Clara, California v. Andrus, supra* at note 74. Even prior year funding creates no more than a unilateral expectation of continued funding. *National Consumer Informational Center v. Gallegos*, 549 F.2d 822, 828 (D.C. Cir. 1977) and *Mil-Ka-Ko Research and Development Corporation v. Office of Economic Opportunity*, 352 F. Supp. 169, 171 (D.D.C. 1972), *aff'd*, 497 F.2d 684 (D.C. Cir. 1974). However, this unilateral expectation may be overcome where a project is approved for multip-year support. *Southern Mutual Help Association v. Califano*, 514 F.2d 518, 528 (D.C. Cir. 1977).

[148] *State of South Carolina v. Katzenbach*, 383 U.S. 301, 323 (1966).

[149] *Arizona State Department of Public Welfare v. Department of Health, Education and Welfare*, 449 F.2d at p. 479.

[150] *Guardian Federal Savings and Loan Association v. federal Savings and Loan Insurance Corporation*, 589 F.2d at p. 668.

[151] 5 U.S.C. §553(e) provides that:

> "Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule."

to follow advisory agency directives will not generally create rights in third parties.[124]

Where an agency intends that procedures in an agency directive are mandatory, agency officials are bound to follow the procedures.[125] Compliance is required even though the procedures are possibly more rigorous than otherwise would be required.[126] However, even where a court finds that an agency has flagrantly violated its own rules of procedure, the present positions of the parties may not warrant equitable relief.[127]

Grantees must comply with mandatory requirements contained in agency regulations.[128] Unless otherwise provided in Federal law, grantees cannot add additional eligibility requirements to federally funded programs.[129] Requirements in agency directives also can become mandatory when they are incorporated by reference in a grant agreement.[130] The grantee and contractors under a grant are then bound to comply with the requirements.[131] The U.S. Court of Claims stated in *State of Texas v. United States* that unless the agency circular at issue was incorporated into the Federal assistance agreement, the cost eligibility principles contained in the circular did not create a basis of reimbursement to the State.[132] On the other hand, the court in *Qonaar Corporation v. Metropolitan Atlanta Rapid Transit Authority* determined that the policy contained in Attachment 0 of Office of Management and Budget (OMB) Circular No. A-102 was applicable to a procurement under grant even though the Federal grantor agency had not issued any regulations to implement the policy.[133] Courts have also imposed upon Federal assistance recipients mandatory requirements contained in agency circulars where the requirements define procedural due process rights.[134] This has been done even where the assistance was given before the issuance of the circular so that the requirements at the time of acceptance were not known to the recipient.[135]

Aside from specific statutory requirements to promulgate regulations, there may exist a duty to issue mandatory directives or regulations. This duty

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[124]*Roberts v. Cameron - Brown Company,* 556 F.2d 356 (5th Cir. 1977); *Encarnacion Hernandez v. Prudential Mortgage Corporation,* 553 F.2d 241 (1st Cir. 1977); *McCullough v. Redevelopment Authority of the City of Wilkes-Barre,* 522 F.2d 858 (3d Cir. 1975), and *Brown v. Lynn,* 385 F. Supp. 986 (N.D. Ill. 1974).

[125]*City of New Haven v. Train,* 424 F. Supp. 648, 654 (D. Conn. 1976); *Estrada v. Hills,* 401 F. Supp. 429, 438 (N.D. Ill. 1975); and *Brown v. Lynn,* 392 F. Supp. 559 (N.D. Ill. 1975).

[126]*Morton v. Ruiz,* 415 U.S. at p. 235.

[127]*Grumman Ecosystems Corporation v. Gainesville-Alachua County Regional Electric, Water and Sewer Facilities Board,* 402 F. Supp. 582, 588-89 (N.D. Fla. 1975).

[128]*School Committee of the Town of Monson, Massachusetts v. Anrig,* 520 F.2d 577 (1st Cir. 1975).

[129]*Doe v. Pickett,* 480 F. Supp. 1218, 1220 (S.D. W.Va. 1979).

[130]*See Red School House, Inc. v. Office of Economic Opportunity,* 386 F. Supp. 1177, 1189 (D. Minn. 1974).

[131]55 Comp. Gen. 911 (1976). When a grantee's compliance with mandatory directives is put into issue by a third party, the grantor agency may be an indispensible party defendant. *Boles v. Greenville Housing Authority,* 468 F.2d 476 (6th Cir. 1972), and *Gardner v. Nashville Housing Authority,* 468 F.2d 480 (6th Cir. 1972).

[132]*State of Texas v. United States,* 537 F.2d 466, 471 (Ct. Cl. 1976). *See also, M.B. Guran Company, Inc. v. City of Akron,* 546 F.2d 201, 204 (6th Cir. 1976).

There are advantages that are derived from publishing agency rules in the Federal Register. Some of the advantages include assuring that affected parties will be bound, informing the public of the rules which may affect them, and giving a reviewing court an insight into the agency's thinking which led to the final rules. Additional advantages are enumerated in the Federal Register Act as follows: (a) constructive notice of the rule, (b) rebuttable presumption as to the validity of the rule, and (c) judicial notice of the rule.[93] It is noted that rules published in the Federal Register either pursuant to 5 U.S.C. §553 or §552(a)(1) are accorded the same status under the Federal Register Act.[94]

There may be one additional advantage. If agency rules are published, then an argument can be made that the rules become a part of any applicable grant agreement even though such rules have not been incorporated by reference into the agreement. This argument is based on the general rule that ". . .the laws which subsist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it, as if they were expressly referred to or incorporated in its terms."[95] This general rule includes regulations as well as statutes[96] and has been applied to grant agreements.[97]

C. *INTENT OF AGENCY DIRECTIVES*

Federal agency directives do have impact. They may be used for the basis on which a project is disapproved,[98] a budget request is disapproved,[99] or a subgrant is terminated by the grantee.[100] Agency directives may set time limits,[101] limit the Government's liability,[102] prescribe hearing rights for third parties,[103] express a preference among available alternatives,[104] or prescribe procurement procedures.[105] A reviewing court may cite an agency directive as

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[93] 44 U.S.C. §1507.

[94] Section 1507 of 44 U.S.C. applies to a document required by 44 U.S.C. §1505(a) to be published in the Federal Register. The term "document" is defined at 44 U.S.C. §1501 to mean a regulation or rule issued by a Federal agency. Section 1505(a) provides that regulations and rules that may be required to be published by an Act of Congress shall be published in the Federal Register. Both 5 U.S.C. §§552(a)(1) and 553 require publication in the Federal Register. Hence. 44 U.S.C. §1507 is applicable to any rule published as a result of an APA requirement.

[95] *Wood v. Lovett*, 313 U.S. 362, 370 (1941). *See also Home Building & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934).

[96] *Holbrook v. United States*, 194 F. Supp. 252, 256 (D. Ore. 1961).

[97] *Maryland - National Capital Park and Planning Commission v. Lynn*, 514 F.2d 829, 833 (D.C. Cir. 1975).

[98] *Port Authority of the City of Saint Paul v. United States*, 432 F.2d 455 (Ct. Cl. 1970).

[99] *See Fletcher v. Housing Authority of Louisville, supra* at note 5.

[100] *See Economic Opportunity Commission of Nassau County, Inc. v. Weinberger*, 524 F.2d 393 (2d Cir. 1975).

[101] *Like v. Carter*, 448 F.2d 798 (8th Cir. 1971), *cert. denied*, 405 U.S. 1045 (1972).

[102] *Gosman v. United States*, 573 F.2d 31 (Ct. Cl. 1978); *People of the State of California ex rel. Department of Transportation v. United States*, 547 F.2d 1388 (9th Cir. 1977), *cert. denied*, 434 U.S. 824 (1977). *See also St. Elizabeth Hospital v. United States, supra* at note 88.

[103] *Thorpe v. Housing Authority of the City of Durham*, 393 U.S. 268 (1969); *Brown v. Housing Authority of the City of Milwaukee*, 471 F.2d 63 (7th Cir. 1972); *Glover v. Housing Authority of the City of Bessemer, Alabama*, 444 F.2d 158 (5th Cir. 1971); *Randall v. Newark Housing Authority*, 384 F.2d 151 (3d Cir. 1967), *cert. denied*, 393 U.S. 870 (1968); and *Shavers v. Youngstown Metropolitan Housing Authority*, 397 F. Supp. 483 (N.D. Ohio 1975).

nificance of the impact on the public can be a valid criterion to determine if the opportunity for comment is required.

The impact test can be argued, however, to be inappropriate to distinguish between paragraphs (a)(1) and (a)(2) of Section 552. Under the impact test, if an interpretative rule, for example, has significant impact, it is an interpretative rule of general applicability requiring publication pursuant to Section 552(a)(1). But query? If the term "interpretative rule of general applicability" as used in Section 552 (a)(1) is defined as one having significant impact, then it may be the same as a substantive rule requiring an opportunity for public comment as provided under Section 553. If the two are the same, however, then the statutory distinction created between Sections 552(a) and 553 is eroded.

A different approach to distinguish between paragraphs (1)(D) and (2)(B) of 5 U.S.C. §552(a) is to focus on the definition of the terms "rule" and "applicability". Both paragraphs are within the definition of the term "rule" as defined in 5 U.S.C. §551(4). The term "rule" includes an agency statement of *general or particular* applicability designed to implement, interpret, or prescribe law or policy. Applying this definition to the types of rules referred to in Section 552(a)(1)(D) and (2)(B), it appears that there is contemplated by the APA substantive rules, interpretative rules, and statements of policy which each have either general or particular applicability. Section 552(a)(1)(D) by its language includes substantive rules of general applicability, statements of general policy, and interpretations of general applicability. What must then be included in Section 552(a)(2)(A) and (B) are the remaining types of rules; namely, substantive rules of particular applicability, statements of policy, and interpretations of particular applicability.

There can be a reasonable explanation for this interpretation. If the purpose of Section 552(a) is to provide notice, the purpose is accomplished because the particular application will provide the notice otherwise required by Section 552(a)(1). For example, a grant agreement which makes applicable an agency directive to a grantee is a particular application of a rule or policy statement. This application may be made through incorporation by reference since under Section 552(a)(2) the matter must only be made available.

The term "applicability" is also helpful in distinguishing between paragraphs (a)(1) and (a)(2) of Section 552. The term is not defined within the APA. However, the language used within Section 552(a)(2) that a statement of policy or interpretation may be ". . . relied on, used, or cited as precedent by an agency. . ." is instructive in defining the term "applicability". If this were substituted for the term "applicability", then Section 552(a)(1)(D) would include substantive rules, statement of policy, and interpretations which are to be relied on, used, or cited as *general* precedent by the agency. Section 552(a)(2)(B) would include statements of policy and interpretations which are to be relied on, used, or cited as *particular* precedent. In other words, where a rule is anticipated to be applied to a large segment of the general public, then publication in the Federal Register is required irrespective of the significance still comply with the requirements of 5 U.S.C. §552(a)(1) and (2).[73] However, compliance with Section 552(a)(1) and (2) does not require that any rule-making procedures in terms of notice and opportunity for public comment be followed.[74] Section 552(a)(1) merely requires that certain enumerated items be published in the Federal Register. For example, rules of procedures[75] and substantive rules of general applicability, statements of general policy, and interpretations of general applicability[76] must be published. Failure to comply with the Section 552(a)(1) publication requirements can result in the rule being held invalid by a court and set aside.[77]

Under Section 552(a)(2), final opinions made in adjudication of cases,[78] statements of policy and interpretations not required to be published in the Federal Register,[79] and administrative staff manuals and instructions to staff that affect a member of the public[80] are merely to be indexed and made available for public inspection and copying.

Where an agency directive is not published, a problem may arise for failing to comply with the Section 552(a)(1) publication requirement. This can be demonstrated through four examples. For each example, assume that a Federal grantor agency has an administrative rule such as an organizational conflict of interest provision which is contained in its available but unpublished agency guidelines. An organizational conflict interest provision precludes, for example, a contractor that prepared the specifications for follow-on work from competing for such work.[81]

Example 1: The grantor agency writes out the organizational conflict of interest provision in the grant agreement as a grant condition. The grantee writes out the same provision in the solicitation for the initial contract. The grantor agency has no problem requiring compliance with the provision because the grantee and contractor have actual notice.

Example 2: The grantor agency incorporates by reference into the grant agreement the unpublished agency directive which contains the organizational conflict of interest provision. The grantee incorporates by reference the agency directive into the initial solicitation and resulting contract. Is there a problem? Section 552(a)(1) requires actual and timely notice in lieu of publication. There is a potential problem where the rule should have been published and incorporation by reference is construed to provide only constructive notice.

Example 3: The grantor agency makes no reference to the agency direc-

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[73] *Northern California Power Agency v. Morton,* 396 F. Supp. 1187, 1191, n. 6 (D.D.C. 1975), *aff'd,* 539 F.2d 243 (D.C. Cir. 1976).

[74] *City of Santa Clara, California v. Andrus,* 572 F.2d 660, 675 (9th Cir. 1978), *cert. denied,* 439 U.S. 859 (1978).

[75] 5 U.S.C. §552(a)(1)(C). *See W.G. Cosby Transfer & Storage Corporation v. Froehlke,* 480 F.2d 498 (4th Cir. 1973), and *Gonzales v. Freeman,* 334 F.2d 570 (D.C. Cir. 1964).

[76] 5 U.S.C. §552(a)(1)(D). *See* Administrative Conference of United States recommendations at 1 C.F.R. §§305.72-5, 305.76-2, 305.76-3, and 305.76-5.

[77] *Aiken v. Obledo,* 442 F. Supp. 628, 654 (E.D. Cal. 1977).

The term "general statements of policy" as used in Section 553(b)(A) has been defined to include ". . . statements issued by an agency to advise the public prospectively of the manner in which the agency proposes to exercise a discretionary power."[49] This exception is also construed in terms of impact. A general statement of policy does not establish a binding norm[50] nor does it impose any rights and obligations on an affected party.[51] A policy statement is not within the exception where it effects a substantial change in existing regulations and it has a direct and significant impact upon the substantive rights of a segment of the general public.[52]

Whether a rule is classified as substantive or interpretative may be important in terms of the standard of judicial review that is applied by the reviewing court. One court stated that judicial review of a substantive rule is limited by 5 U.S.C. §706, but an independent inquiry by the court can be made into the correctness or propriety of an interpretative rule although deference is given to the agency's interpretation.[53] If what is at issue is the application of a general statement of policy or an interpretative rule, the agency must be prepared to defend it and cannot claim that the matter is foreclosed by the prior policy statement or interpretative rule.[54] It is not necessary to classify a rule as substantive or interpretative if the Section 553(a)(2) exemption has not been waived and if the issue before the court is the propriety of the procedure followed by the agency in issuing the rule. However, if the issue is the substantive reasonableness of the rule, then a strong presumption exists that a rule within the exemption is merely interpretative.[55]

The second exception in 5 U.S.C. §553(b)(B) permits substantive rules to become effective immediately without notice or opportunity for public comment upon a showing of good cause. In using this exception an agency must state its supporting reasons.[56] Good cause has been found to exist where Congress intended expeditious implementation of a program.[57] However, good cause has been found not to exist where the agency has delayed in implementing the program and desires to be excused from the 30 day public comment period to avoid any further delay.[58]

In order for a substantive rule to be effective, it is not necessary that the rule be published in the Code of Federal Regulations[59] nor is it necessary to

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[49] *Guardian Federal Savings and Loan Association v. Federal Savings and Loan Insurance Corporation*, 589 F.2d 658, 666 (D.C. Cir. 1978).

[50] *Pacific Gas and Electric Co. v. Federal Power Commission*, 506 F.2d at p. 38.

[51] *Texaco, Inc. v. Federal Power Commission*, 412 F.2d 740, 744 (3d Cir. 1969).

[52] *Lewis v. Weinberger*, 415 F. Supp. at p. 661.

[53] *Guardian Federal Savings and Loan Association v. Federal Savings and Loan Insurance Corporation*, 589 F.2d at pp. 664-65.

[54] *Ibid.* at p. 666.

[55] *Opelika Nursing Home, Inc. v. Richardson*, 356 F. Supp. at p. 1342.

[56] *Arizona State Department of Public Welfare v. Department of Health, Education and Welfare*, 449 F.2d 456, 481 (9th Cir. 1971), *cert. denied*, 405 U.S. 919 (1972).

[57] *Energy Reserves Group v. Federal Energy Administration*, 447 F. Supp. at p. 1150.

[58] *Kelly v. United States Department of Interior*, 339 F. Supp. 1095, 1101 (E.D. Calif. 1972). *See also*, *City of New York v. Diamond*, 379 F. Supp. at p. 517o.

is not waived, the approval of a State plan required for Federal financial assistance funding is considered to be within the exemption.[32]

Where a Federal grantor agency has not waived the Section 553(a)(2) exemption but the agency has solicited public comment on a particular matter, the agency may still be able to rely upon the exemption if the agency's procedures are challenged as falling short of Section 553 requirements. The court in *Lewis v. Richardson*[33] found unpersuasive plaintiffs' argument that the Economic Development Administration's voluntary publication in the Federal Register and permissive invitation for public comment estopped EDA from using the exemption as a defense. The court did not want to penalize EDA for going beyond its minimum duty to inform the public.[34] A factor in the court's consideration was that EDA stated in each voluntary publication that Section 553 requirements were not applicable. Hence, the court found a manifest intent to retain the Section 553(a)(2) exemption.

The ability of a court to find this manifest intent may be a decisive factor. The U.S. District Court opinion in *City of New York v. Diamond*[35] is instructive on this point. In this case, the Department of Labor (DOL) published a regulation without the requisite 30 day public comment period. DOL referred to the requirement in the regulation's preamble but claimed exception from the requirement as being in the public interest pursuant to 5 U.S.C. §553(b)(B).[36] After litigation had been initiated, the Federal defendant argued that the 30 day public comment period was not applicable because of the Section 553(a)(2) exemption. The court held that it did not have to decide whether Section 553(a)(2) was applicable for two reasons. First, after finding that the explanation for the good cause exception was inadequate, the court stated that the regulation's mere invocation of the 30 day public comment period requirement was an implied acceptance of the applicability of Section 553 as a whole.[37] Secondly, DOL had waived by regulation the Section 553(a)(2) exemption's applicability.

Where an agency fully waives the Section 553(a)(2) exemption, the rule-making requirements of Section 553 are still inapplicable if the agency claims one of the two exceptions in 5 U.S.C. §553(b). The first excepts interpretative rules, general statement of policy, or rules of agency organization, procedure, or practice.[38] The second excepts matters otherwise covered by Section 553 but for a good cause finding by the agency that adherence with Section 553 requirements is impracticable, unnecessary, or contrary to the public interest.[39] The first exception makes the publication, notice, and public com-

[32] *Center for Auto Safety v. Tiemann*, *supra* at note 22.

[33] 428 F. Supp. 1164 (D. Mass. 1977).

[34] *Ibid.* at p. 1168, n. 6.

[35] *Supra* at note 27.

[36] 5 U.S.C. §553(b)(B) provides that Section 553(b) does not apply:

> "when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefore in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest."

understand the requirements and relationship between Section 552 and 553.

The purpose of this article is to discuss APA and Federal Register Act requirements applicable to the formulation of rules contained in Federal grantor agency regulations or circulars, guidelines, instructions, manuals, handbooks, etc.[11] and to discuss the legal status of such rules.

B. *APA REQUIREMENTS APPLICABLE TO FORMULATION OF GRANT RULES*

Federal agencies basically have the discretion to formulate their own rules. The authority of a Federal grantor agency to administer a congressionally created and funded program carries with it the authority to formulate policy and make rules to fill any gap left, implicitly or explicitly, by Congress.[12] However, this authority to formulate rules must be exercised consistent with the requirements of the APA and Federal Register Act since they must be read as a part of every congressional delegation of authority unless specifically excepted.[13] Compliance with these procedural requirements is necessary to give legal effect to agency regulations and directives.

1. *Section 553 Requirements*

The requirements of 5 U.S.C. §553 are applicable to substantive rules which must be published in the Federal Register to have the force of law.[14] 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.[15] The Supreme Court in *Vermont Yankee Nuclear Power Corporation v. Natural Resources Defense Council, Inc.*[16] construed Section 553 as the maximum procedural requirements which a reviewing court may impose upon agencies in conducting rulemaking procedures. Reviewing courts may not generally impose additional procedural rights unless the agency has chosen to provide them.[17] Even where an authorizing statute contains its own rulemaking and publication provision, a court may not read into the provision requirements which are more rigorous than required by the APA.[18]

Matters, however, related to public property, loans, grants, benefits, or contracts are exempted from the Section 553 requirements.[19] This exemption has been held not to be unconstitutional as creating an arbitrary and capri-

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[11]These will be referred to hereinafter as agency directives.

[12]*Morton v. Ruiz*, 415 U.S. at p. 231.

[13]*Hotch v. United States, supra* at note 10.

[14]44 U.S.C. §1507.

[15]*Saint Francis Memorial Hospital v. Weinberger*, 413 F. Supp. 323, 328 (N.D. Calif. 1976).

[16]435 U.S. 519 (1978).

[17]*Ibid.* at p. 524.

[18]*Neighborhood Legal Services, Inc. v. Legal Services Corporation*, 466 F. Supp. 1148, 1152 (D. Conn., 1979).

[19]5 U.S.C. §553(a)(2). *See* 41 ALR Fed. 926 for general discussion of this exemption. The Administrative Conference

provisions, but also the goals of the new Code and the subtleties of practice in the bankruptcy court. The existing rules serve as only partial recognition of the unique nature of bankruptcy practice. There are wide procedural gaps in the Code, many intentional, but some not, which necessitate precise rule drafting based upon actual bankruptcy court practice.

This article's substantial discussion of the prior law, proposals for reform and debate of those proposals, leading to enactment of the new bankruptcy court system, was a deliberate attempt to emphasize the source of the new Code provisions. As the article suggests, the Code draftsmen made wise use of the research, opinion and experience of capable practitioners and judges as well as responsible organizations having an interest in bankruptcy practice and the direction of reform. Unfortunately, the wide disparity between certain sections of the final House and Senate bills (and the lack of time necessary to consider an effective and consistent compromise) has left the Code too liberal, vague and flexible in some areas, and too conservative, narrow and stagnant in others. The result is a generally well-drafted statute in which, unfortunately, certain provisions drift from the uniform purposes of the Code, creating confusion among those attempting to comprehend it.

Yet the ragged edges and minor inconsistencies of the Code are a small price to pay for the substantial reform which it embodies. The Code clearly reached its goal and lacks little in accomplishment. For the most part it is a soundly structured and carefully worded statute providing a classic text for the proper and complete resolution of bankruptcy proceedings and controversies. The Code is evidence of Congress' successful attempt to enact a single, precise body of bankruptcy law and practice which is really an integration of separate insolvency statutes into one smooth, workable statute.

All three alternative appeals procedures constitute collectively a unique attempt to preserve the increased dignity of bankruptcy courts while continuing to assure economy and expediency in the bankruptcy decision-making process. The Commission Report, and the legislative history of the bankruptcy appeals debate evidences the expediency of district court appeals lacking in the proposed circuit court appellate process. The appellate panel may, if utilized, avoid the criticism of district court appeals while adequately protecting the speed of review recognized as a requirement by legal scholars.[135] Unlike district court judges, the appellate panel's sole purpose will be the hearing of appeals of bankruptcy court decisions. Furthermore, since the appellate panels will consist only of bankruptcy judges, there will be no lack of expertise in, or familiarity with, bankruptcy law and practice, an essential ingredient to competent and efficient review. Like any system hastily devised, however, there are potential problems. Judges of the panel who are the brother judges of those whose decisions they are reviewing. The individual members of the panel will have no more experience, resources or greater status than the bankruptcy trial judge. Additionally, if the panel system is uniformly utilized within a circuit, there is a strong likelihood that a member of the panel could have decisions reviewed by an appellate panel of which the judge whose decision he is now reviewing will be a member. The appellate panel system, therefore, must be carefully weighed by each circuit council to determine the feasibility and effectiveness of such a system in each circuit. Hopefully, at least a few circuits will utilize the panel so that its effectiveness can be tested and reported to Congress and the Judicial Conference. The system could not properly be tested without its utilization throughout a circuit rather than in selected districts, although it is certainly possible that its implementation may be easier in some districts rather than others.

Because of the very nature of some decisions made by the bankruptcy court, the direct appeal to the circuit court may be pursued with more frequency than many practitioneers might think at first glance. The reservation probably stems from the normal situation in which one side is seeking a recovery and, thus, a speedy determination, while the other side seeks to delay. In many cases in the bankruptcy courts, however, large monetary or proprietary interests are involved. The delay caused by appellate review may adversely affect both parties' interests which, as a practical matter, procedural safeguards such as supersedas bonds may not always adequately protect. Therefore, if both parties are concerned about potential damage to their respective interests, and the appeal is expected to go beyond the district court or appellate panel level, all parties may want to take advantage of the direct appeal to the circuit court. Thus economy can be served even though an appeal directly to the circuit court will take longer than an initial appeal to the district court or panel.

Before leaving the area of bankruptcy appeals, one final note should be made. Decisions, orders and decrees of the bankruptcy court may not be

$1,000 or consumer debts the trustee may commence a case in the bankruptcy court for the district in which the case could have been brought under applicable non-bankruptcy jurisdiction and venue statutes.[127] This provision is not intended to displace proper venue in the court in which the bankruptcy case commenced. When both apply, subsections (a) and (c) of Section 1473 provide alternative venue.[128] The effect of the venue provisions of the Code is both significant and unique considering the expansive ability of the bankruptcy court in which the bankruptcy case commenced to hear matters in or related to that case. With the exception of specific types of minor litigation noted above, and suits arising from the debtor's business operations, all matters may be heard in the same court. While the legislative history of the Code's venue provisions is sparce, the broad venue in the bankruptcy court in which the bankruptcy commenced presumably is based upon the same goals of economy, uniformity, and efficiency which influence much of the Code. Nevertheless, Section 1473 provides one of the few examples in the Code where the language enacted differs widely from the Commission proposal which sought to limit the possibility of country-wide litigation.[129] The Code provision seems to encourage it by endorsing extensive venue in one location. The general venue provisions of the Code are even more significant when coupled with the country-wide service of process available currently under Rule 704 of the Bankruptcy Rules of Procedure. Of course, the new rules being drafted may affect the scope of the venue provisions. However, promulgation of the new Rules may be many months, even years subsequent to the effective date of the Code. In addition, any rule drastically restricting the venue provided by the Code may well run afoul of the rulemaking authority for promulgation of the bankruptcy rules which eliminates interference by the rules with law or procedure enacted by the Code.[130]

The practical consequence of general venue in the court in which the bankruptcy commenced is a debtor's dream and a creditor's nightmare. The debtor, or his trustee will, with few exceptions, litigate all issues (from collection or receivables, to the trustee's avoiding powers) in his "home court", forcing the other party to litigate in what will often be an adverse, and perhaps unfamiliar, forum. One possible consequence is the practical impossibility of economy and efficiency in hearing cases in which the parties (and therefore, much of the discovery, documentation, witnesses, etc.) are in distant geographical locations. The venue provisions are an attempt to support and emphasize the pervasive jurisdiction granted to the bankruptcy court. However, while the legislators clearly have the ability to grant jurisdiction, venue, the place where that jurisdiction may be exercised, though de-

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

[128] Statement of Hon. Don Edwards, 124 Cong. Rec. No. 161, H. 11086 (September 28, 1978).

[129] See discussion in Broude, "Jurisdiction and Venue Under the Bankruptcy Act of 1973", *supra*, pp. 251-2.

[130] The present Bankruptcy Rules of Procedure were promulgated under rulemaking authority granted to the Supreme

property. The Court reasoned that the interests of justice and economy were best served by letting the state court decide a complex question involving state real estate law.[114] Although the abstention doctrine is founded upon sound equitable principles, generally, it creates a potential deleterious effect on the goal of uniformity in decision-making if it is not applied consistently among the bankruptcy courts, especially across districts in the same circuit. Appropriate and careful rulemaking in this area may alleviate some of the potential harm and truly limit abstention to those cases in which justice or expediency demand it. Much of the effect of the abstention doctrine, in any event, will probably depend upon the continued quality of bankruptcy judges, even sharing of case loads and rules which foster uniformity of application. Only time and practice under the new Code will indicate the extent, if any, of misuse of the abstention doctrine.

In addition to the jurisdiction which the bankruptcy court has over cases commenced subsequent to the filing of a petition in the bankruptcy court, cases already pending in another forum may be removed to the bankruptcy court through a provision unique to the previous bankruptcy practice.[115] There is no restriction on the right of removal of cases within the bankruptcy court's jurisdiction except for proceedings pending in the tax court or relating to a governmental agency's police or regulatory power.[116] Otherwise, the removal power extends to all matters, in all forums. The criticism of the broad, vague language of the jurisdiction section[117] is equally applicable to the removal language of 28 U.S.C. Sec. 1478. The Code does not limit the right of removal to debtors or officials of a bankruptcy proceeding. Any party, in any proceeding not specifically exempted as stated above, may remove a proceeding to the bankruptcy court. There is a real danger of spurious use of the removal provision to delay pending trials or remove cases from potentially adverse forums where there is no substantial contact with a pending bankruptcy proceeding. Hopefully, the rulemakers will succeed in eliminating much of the potential misuse. Proper procedural limitations on the removal provision will avoid the forum shopping which is likely to occur if the statute is left without accompanying procedural restrictions. Part of the resolution can come from the bankruptcy court's discretion to accept or reject a case sought to be removed.[118] Again the new rules will determine whether this discretion will be uniformly applied among the bankruptcy courts. It should be noted that, like the abstention doctrine, a decision of the bankruptcy court to accept a case from another forum, or to remand the case, is not subject to review.[119]

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[114]309 U.S., at 483-4.
[115]Code, Sec. 241(a), 28 U.S.C. Sec. 1478(a).
[116]*Id.*

somehow relates to a debtor or a proceeding under title 11. In addition to the general language of Sec. 1471(b), Section 505 of the Code gives the bankruptcy court specific authority to decide tax claims and disputes involving unpaid taxes, including, in some instances, the amount of a refund due the estate.[106] No mention is made in the Code or the legislative history whether jurisdiction under the Code extends far enough to preempt the jurisdiction of governmental agencies such as the National Labor Relations Board or other regulatory agencies, although cases pending before such agencies and related to their police or regulatory power may not be stayed or removed to the bankruptcy court.[107]

The jurisdiction sections of the Code completely obliterate any questions involving the authority of the bankruptcy court to decide all issues in a bankruptcy proceeding. The point has already been made, but for the longstanding bankruptcy practitioner, it bears repeating. Even if the dispute merely involves the debtor, without being pertinent or essential to the bankruptcy proceeding, or merely relates to a bankruptcy proceeding, the bankruptcy court not only has jurisdiction, it has original jurisdiction. Furthermore, the bankruptcy court will continue to maintain its jurisdiction after the bankruptcy case is closed, as long as the issue or dispute arose out of a bankruptcy case. Thus, the bankruptcy court will decide issues concerning reaffirmation agreements, bankruptcy discrimination, validity of securities issued pursuant to a plan of reorganization, and other matters normally arising after a case is closed.[108] The new expanded jurisdiction will enable the bankruptcy court to take a more active role in the many matters pertinent to bankruptcy proceedings but heretofore beyond the bankruptcy court's jurisdiction. In the future, bankruptcy judges will be in a better position to make the necessry overview of the debtor's situation which, under the old law was virtually impossible because of the court's lack of first hand knowledge of many ongoing controversies concerning the debtor. The entire case will be before the court, the administration as well as all controversies regarding the debtor's assets and liabilities. The extensive increase in the jurisdiction of the bankruptcy court will mean, for most practitioners, much more than making adjustments in practice and procedure in bankruptcy proceedings, it will also necessitate a conceptual change in attorneys' approaches to all areas of bankruptcy and insolvency law, from the informal workout, to reorganizations under Chapter 11 of the Code.

Most legal scholars and almost all bankruptcy reformers have long recognized the need for substantial change in, and expansion of, the bankruptcy court's jurisdiction. However, the language of Section 1471(b) escapes even the most optimistic predictions. It contains a breadth of language and statutory construction which invite nightmares worse than those it sought to erase. The vagueness of Subsection (b) of Section 1471 was strongly criticized under or related to bankruptcy cases.[94] Instead of granting bankruptcy courts jurisdiction outright, however, the Code confers all bankruptcy jurisdiction on the district court and, in turn, delegates that jurisdiction to the bankruptcy court.[95] Unfortunately, the statutory language delegating jurisdiction restricts the grant of jurisdiction to the bankruptcy court in which the original petition is filed, rather than the appropriate court in the United States bankruptcy court system. Thus, no bankruptcy court has jurisdiction to hear controversies concerning bankruptcy cases which are not pending before that court. A strict reading of the delegating language would limit jurisdiction to one particular bankruptcy court, rather than any bankruptcy court in the system. None of the legislative history of this section indicates an intent to limit jurisdiction as suggested by Subsection 1471(c), nor does it suggest a reason for this apparent limitation on the jurisdictional grant. Furthermore, such a limitation appears to be completely inconsistent with the venue provisions enacted by the Code,[96] discussed in more detail below. Hopefully, this will be the subject of a corrective amendment to the Code in the present session of Congress. Regardless of this presumably inadvertent limitation on jurisdiction, t he new bankruptcy court will see a substantial increase in litigation. Debtors and creditors alike will have the advantage of a single forum hearing all bankruptcy matters plus the efficiency and economy in decision-making already built into the bankruptcy system. Actions which presently must be tried in state or federal, non-bankruptcy courts, often causing costly delays and prohibitive expense, will be tried in the bankruptcy court, a result clearly intended by the draftsmen:

> The forum shopping and jurisdictional litigation that have plagued the bankruptcy system, the unfairness to defendants from 'jurisdiction by ambush', and the dissipation of assets and the expense associated with bifurcated jurisdiction will be eliminated.[97]

Hopefully, the new expanded jurisdiction of the bankruptcy court will provide a remedy for the lack of uniform case law in the bankruptcy area. The existing disparity has been traced largely to the previous split of jurisdiction among state, federal and bankruptcy courts, with each court providing decisions affecting bankrupts, property of bankrupts and debtors and creditors' rights, generally, in bankruptcy proceedings. The comprehensive jurisdiction conferred on the bankruptcy courts by the new Code will certainly foster the development of a more uniform, cohesive body of substantive and procedural bankruptcy law.[98]

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

[95]Code Sec. 241(a), 28 U.S.C. Sec. 1471(c), which reads:
"The bankruptcy court for the district in which a case under Title II is commenced shall exercise all of the jurisdiction conferred by this section on the district courts".

[96]Code Sec. 241(a), 28 U.S.C. Sec. 1478

A. *Bankruptcy Courts and Judges*

The bankruptcy court system finally adopted by Congress was a hybrid of the House and Senate bills, but largely adopted from the Senate version. All provisions concerning bankruptcy courts and judges and the jurisdiction of the new court system are contained in Title II of the Code, as amendments or additions to appropriate sections of title 28 of the United States Code. Section 201(a) of Title II adds Chapter 6 to Title 28 creating the new bankruptcy court system and also contains provisions relating to bankruptcy judges and appeals. The new bankruptcy court is still an adjunct of the district court but it is a separate and distinct court of record known as the United States Bankruptcy Court.[80] Bankruptcy cases will no longer be filed in the district court. Under the Code, a bankruptcy will have its entire history, from commencement to conclusion, in the bankruptcy court. Another important, though limited measure of increased dignity results from the authority to provide facilities for a bankruptcy court wholly and completely separate from those of the district court or the federal courthouse,[81] a practice which existed under the old law, in certain instances, and may continue under the new Code. In practice, the separation of location and facilities of bankruptcy courts from those of the district courts could add important independence to bankruptcy courts. However, logistics and economy weigh heavily against any widespread physical separation of the bankruptcy courts. The bankruptcy judge will usually need to take advantage of the facilities and resources of the district court and economy will dictate combining the facilities of these two courts as much as possible.

The increased prestige and status which many reformers sought for the bankruptcy court is lacking in the present statutory language. The bankruptcy court is still stagnated in the image and likeness of the district court. Although the district court has lost many of its controls over bankruptcy cases and bankruptcy judges, the bankruptcy court still stands in the shadow of its older brother, the district court — less dominated, more mature, and with greater responsibility, but still dependent.

The Senate's view finally prevailed as to the status of the new bankruptcy court. On the status of bankruptcy judges, however, the Code represents a true compromise between the positions of the House and Senate. H.R. 8200, as passed by the House on February 1, 1978, provided for Presidential appointment of bankruptcy judges.[82] The House bill also provided for tenured bankruptcy judges, serving during good behavior.[83] The Senate bill, on the other hand, provided for 12 year terms for bankruptcy judges[84] and appointment by the Circuit Court with the numbers and locations of the bankruptcy judges determined by the Judicial Conference of the United States.[85] The

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[80] Code, Sec. 201(a), 28 U.S.C. Sec. 141(a).

[81] Code, Sec. 201(a), 28 U.S.C. Sec. 158.

The judicial power of the United States (currently exercised in the United States District Court, Court of Appeals and the Supreme Court) is exercised pursuant to Article III, Section 1 of the Constitution:

> The judicial power of the United States, shall be vested in one Supreme Court, and such inferior Courts as the Congress may, from time to time, establish. The judges, both of the supreme and inferior Courts, shall hold their Offices during good Behavior, and shall, at Stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.

Generally, then, an Article III Court is a permanent, tenured court. Such a court is mandated normally only when laws of national applicability constitute the court's subject matter.[70] In certain cases, however, Article III status can be waived, where specialized areas having particularized needs and warranting distinctive treatment are involved.[71] The relation of the Supreme Court's analysis of Article III status to the specialized requirements of bankruptcy practice was a subject of disagreement among legal scholars. However, it was clear that any departure from the formal Article III requirements must be based upon a significant showing of "special needs."[72]

Article I, Sec. 8, Clause 4, of the Constitution provides Congress with authority to establish uniform laws on bankruptcy. Clause 9 of the same Section vests Congress with authority to constitute courts inferior to the Supreme Court. The combination of these two clauses provides an adequate basis for constituting the bankruptcy court as a legislative court under Article I. Article I courts are not courts of general jurisdiction, but generally courts of specialized and narrow jurisdiction. Examples of existing Article I courts are the United States Tax Court, the Court of Claims and the Court of Customs and Patent Appeals. Article I courts are neither permanent nor are their judges tenured. Furthermore, Article I judges do not have the same compensation, benefits and representation rights as Article III judges.[74]

The issue of the appropriate jurisdiction of the bankrupcty courts presented the House and Senate draftsmen with a sizeable dilemna regarding the proper status for bankruptcy courts and judges and the logistics of constitutionally providing that status. The House bill sought Article III status. However, constitutional courts may only exercise judicial power in a justifiable case or controversy. They may not be invested with or be required to perform, administrative or legislative functions.[75] Of course, bankruptcy courts, even under the reform legislation, maintain a variety of administrative functions thus clouding the status proposed by the House bill. A very different problem existed in the Senate's proposal, however, due to the intended expanded jurisdiction of the bankruptcy court. A constitutional problem could exist if

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[70] *Palmore v. United States,* 411 U.S. 389, 407, 93 S.Ct. 1670, 36 L.Ed.2d 342 (1973).

[71] *Id.*, p. 408.

[72] See Hearings on H.R. 31 and H.R. 32, Part 4, at 2682-2706 and House Report No. 95-595, Chapter II, pp. 77-78, containing the response of Professor Mishkin to an inquiry of Chairman Rodino of the House Judiciary Committee concerning the constitutionality of the proposed status for the new bankruptcy courts

> the district courts. Certain perceived constitutional impediments to the exercise of the judicial power of the United States by non-tenured judges are thus eliminated.
>
> (3) The dislocation associated with continued evolution of the present referee system into a functionaly independent adjunct of the district court are minimal in comparison to those attendent upon the establishment of a separate bankruptcy court system.
>
> (4) The fragmentation of Federal Court jurisdiction envisioned by some is thus avoided.
>
> (5) The convenience and economy of district court appeals are preserved.[58]

For the most part, however, the Senate's proposal did little to upgrade the bankruptcy court or the status of bankruptcy judges, desipte an intense lobbying campaign from many different segments of the legal and judicial fraternities. The concept of an independent court, separate and distinct from the district court was supported overwhelmingly in testimony before both the House and Senate subcommittees. The Commission first formally proposed it, the National Conference of Bankruptcy Judges and the National Bankruptcy Conference testified in its favor. The American Bankers Association and the Commercial Law League of America urged its creation. The proposal eventually gained the support of the prestigious Association of the Bar of the City of New York and the American Bar Association.[59]

S. 2266 also watered down the prestige of the bankruptcy judge granted by the House bill. Proposed 28 U.S.C. Sec. 152 of the Senate bill provided for the appointment of bankruptcy judges by the Circuit Court for 12 year terms. Although the Senate bill recognized the need for increasing the powers of bankruptcy courts, it stopped short of the House proposal by prohibiting a bankruptcy judge from enjoining other courts[60] and limiting contempt punishments to only $250. More serious contempt matters would have been certified to the district court[61] in the same manner as present law provides for contempts exceeding $200. Appeals under the Senate bill would have remained in the district court.[62]

Both the House and the Senate recognized the need for granting substantially increased jurisdiction to the bankruptcy courts. However, the manner of providing that grant represented a potentially significant difference between the two bills. The House proposed a new 28 U.S.C. Sec. 1471 which, in effect, gave an independent bankruptcy court pervasive jurisdiction, not only of cases under Title II, but also of all controversies related to or arising from bankruptcy cases. The Senate bill, however, retained jurisdiction in the district courts. S. 2266 merely copied present 28 U.S.C. Sec. 1334 while applying new language to upgrade the district court's jurisdiction over bankruptcy matters.[63] The most shocking element of the Senate bill, as finally passed, was its failure to mandate delegation of bankruptcy cases to the bank-

[58]See Senate Report No. 95-989, 95th Cong., 2nd Sess. (1978), p. 18 (hereinafter "Senate Report").

[59]House Report No. 95-595, *supra,* p. 18. See also Senate Hearings, generally, *supra.* The testimony of the Commercial Law League of America before the Senate subcommittee is reprinted in Comm. L.J., vol. 83, No. 1, p. 34 (1978).

appeals and life tenure for bankruptcy judges and generally adopted the previous recommendations of the Commission and the National Conference concerning the status of bankruptcy courts and bankruptcy judges.[46]

H.R. 8200, the final designation of bankruptcy reform legislation in Congress, emerged from the House mark up of H.R. 6, substantially intact in the areas of jurisdiction and the powers and status of bankruptcy courts and judges. H.R. 8200 proposed a bankruptcy court whose major function would be the resolution of disputes. The old administrative functions were generally purged. However, the bankruptcy court would continue to handle certain enumerated administrative functions, mainly in reorganization and chapter 13 cases.[47] Congress had a sound basis for continuing at least some of the existing administrative duties in the bankruptcy courts. Part III of the Commission Report included the findings of a study on the old bankruptcy practice which analyzed comments from a panel consisting of judges, lawyers, social scientists, trustees, bankrupts and referees.[48] While the panel supported an independent bankruptcy court involving the judicial function more with the overall solution of the case rather than minor disputes, continuation in the court of the present administrative duties also received widespread endorsement. Apparently the panel considered the institution of administrative procedures aimed at assisting the court in its judicial function more acceptable than the removal of the court from the administrative process.[49] Interestingly enough, enactment of the panel's recommendations would have returned bankruptcy practice to its early stages when bankruptcy masters were used by the district court judges to report their findings for judicial decision making. The difference, of course, is that the trial court contemplated by the panel was a specialized, independent bankruptcy court. The panel wanted to relieve the bankruptcy judge from concentration on minor issues so he could focus on the major resolution of bankruptcy cases, a wish that could translate into an endorsement of administrative masters for bankruptcy judges.[50]

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[46]*Id.*, pp. 20-21.

[47]*Id.*, p. 33.

[48]Commission Report, *supra,* Part III, "Some Considerations Concerning Bankruptcy Reform", an analysis of a study conducted by the Institute for the Future.

[49]Selwyn Enzer, "Some Views on Bankruptcy Reform", Am. Bankr. L. J., vol. 47, p. 313 (Fall, 1973).

[50]If the U.S. Trustee system doesn't work under the Code, and the same evils regarding the status of the bankruptcy judge as administrator are perceived in 1984, this could be one of the few viable alternatives to the present system. Conceivably, an administrator who reports to the bankruptcy judge could preside over the First Meeting of Creditors perform

No significant change was suggested by the Commission concerning proper venue for filing petitions under the proposed Act.[33] The Commission Bill did, however, add substantial venue provisions to coordinate the commencement of actions arising from bankruptcy cases with the new, proposed jurisdictional grant. These provisions were contained in proposed Section 2-203(b). Generally, the district in which the bankruptcy case was filed was proper venue,[34] with three significant exceptions. The first exception involved the application by the trustee (or the debtor) of his avoiding powers under the proposed bankruptcy act. In those cases, the trustee or the debtor was required to sue in the bankruptcy court in the district in which the defendant resides or the subject property is located.[35] A suit by the trustee or debtor to establish rights to property or to establish rights as a lien creditor could only be brought in the bankruptcy court for the district in which an action could have been brought by the debtor or his creditors, absent a pending petition in the bankruptcy court.[36] The final exception concerned suits arising from the operation of the debtor's business by the debtor or the trustee. In those cases, the trustee or debtor could only sue in the bankruptcy court for the district in which the action could have been brought in a state or federal court as if no bankruptcy proceeding were pending. However, the trustee or debtor could have been sued either in the bankruptcy court stated above or the bankruptcy court in which the bankruptcy case was pending.[37] The language of the proposed venue statute was somewhat strained and complex as the attempt to describe it above may indicate. However, the intent expressed by these provisions is logical and straightforward, even if the drafting was not. The Commission saw no reason why the expanded jurisdiction of the proposed bankruptcy court should automatically compel a similar expansion (or limitation depending upon the status of litigants) of venue in the bankruptcy court having jurisdiction of the underlying bankruptcy case.[38] The proposed provisions attempted to follow venue guidelines similar to the old divisions between summary and plenary jurisdiction in bankruptcy proceedings. What were summary proceedings under the old law would be heard in the bankruptcy court in which the bankruptcy case was filed. What were plenary proceedings would still be heard in the bankruptcy court, bur for the district in which the case would be proper under the old venue statutes concerning plenary actions.[39]

[33]See Commission Bill, *supra,* Section 2-203(a). The Commission Bill does have language respecting the filing of involuntary partner and partnership petitions and petitions of affiliates which are not relevant to this discussion.

[34]Commission Bill, Section 2-203(b)(1).

[35]Commission Bill, Section 2-203(b)(2). It is unclear, due to the Commission's reference to the defendant's residence as the factor determining venue, whether this section would apply to corporate defendants. However, there does not appear to be any substantial reason to differentiate between individual and corporate defendants.

[36]Commission Bill, Section 2-203(b)(3).

arena promoted a significant growth spurt for the bankruptcy system and added momentum to the reform suggested by the Commission. The Commission emphasized the need for an upgraded status for the bankruptcy judges if the proposed, new jurisdiction of the bankruptcy courts were to become palatable to the judges, lawyers and other parties coming into contact with it.[23] The Commission justifiably reasoned that the extensively expanded jurisdiction it recommended would require high caliber individuals for the bankruptcy judgeships. While no one in the Commission criticized the competency of current bankruptcy judges, it was evident that restrictions on salary, benefits and tenure would not attract the volume of high caliber judges necessary to implement the Commission proposal. To alleviate this potential problem, the Commission recommended Presidential appointment of bankruptcy judges, with advice and consent of the Senate,[24] rather than appointment by the district court, as under the old law. The old system of appeals to the district court which appointed the bankrupcty trial judge constituted one of the inherent prejudices in bankruptcy practice under the old law. The Commission also recommended an increase from six to fifteen years in the term of the bankruptcy judge, reasoning that a fifteen year term might make a judicial career in the bankruptcy court more attractive to prospective applicants.[25]

Appeals from the bankruptcy court was another subject of some controversy which occupied a large segment of the Commission Report. The Commission noted the relatively small number of bankruptcy court decisions which were appealed. The Commission concluded that fear by counsel of adverse reaction of the bankruptcy judge in future cases constituted a major reason for the paucity of appeals, along with the burden on appellants at the appellate level.[26] However, in its report, the Commission apparently overlooked another significant reason for the lack of appeals. In many instances, the bankruptcy judge makes decisions requiring expeditious handling to avoid substantial losses in value of the subject property, or property interests or claims. The very real and simple truth is that many decisions of the bankruptcy judge, especially those involving the disposition of property, or interests in property of the estate, must be made quickly and finally. The appeals process, in many instances, may mean substantial depreciation of the subject property interest or asset, usually a situation which hurts all parties, including the prospective appellant. Additionally, the potential harm of an appeal may require a substantial supersedeas bond which adds to the appellant's burden at the appellate level. Thus, all too frequently there is a reluctance to appeal because the resultant delay may substantially impair the value of a reversal at the appellate level, while the risk of bearing the responsibility for substantial damages to the other parties if the appeal is lost could be significant. Whatever the reason, the lack of appeals from decisions of the bankruptcy judges

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[23]Commission Report, *supra*, Part I, p. 94

The jurisdictional limits imposed by the old law posed major obstacles to the administration of bankruptcy estates. Because of the bankruptcy court's lack of plenary jurisdiction,[10] many controversies involving the trustee in bankruptcy and parties other than the bankrupt or debtor could not be tried in a federal or state non-bankruptcy court. Bankruptcy litigation was further complicated by the division of jurisdiction between the federal and state courts. Many issues involving property of a bankrupt, the determination of which was not expressly within the old law fell short of the federal question jurisdiction requirements and, had to be decided in state courts. The complexity of the jurisdictional litigation caused by this result was seen in *Creel v. Lawler*, et al.[11] In *Creel*, the trustee of a bankrupt individual and bankrupt companies, of which the bankrupt individual was apparently the sole or a major stockholder, sought to recover transfers of the bankrupts to family trusts on the theory that the transfers were either preferences or fraudulent conveyances under Secs. 60 and 67 of the old Act and that the family trusts were mere alter egos of the bankrupts allowing recovery by the trustee under Sec. 70 of the old Act. The court's discussion provides a detailed analysis of the preexisting grant of jurisdiction to district courts and bankruptcy courts, and its limitations. The Court dismissed the trustee's complaint as it related to Secs. 60 and 67 since the basis of the claim (alter ego) amounted to a claim grounded in state law. However, the Court allowed continuation of the fraudulent conveyance action under Sec. 70(e) of the old Act since 70(e) specifically allowed attack of conveyances fraudulent under federal or state law, thus creating federal jurisdiction. In its decision, the Court emphasized the narrow grant of jurisdiction to the bankruptcy courts and the district courts. Although the Court recognized the loss of extensive pre-trial proceedings and duplication of effort resulting from dismissal of the state law claim counts in the federal district court, the Court, nevertheless, considered federal jurisdiction over the trustee's avoiding powers too limited to permit consideration of the (alter ego) state law claim in the federal court.[12] The conclusion of the court in *Creel* emphasized the multiplicity of proceedings which were encouraged by the old bankruptcy court's limited jurisdiction, which in *Creel*, did not even extend far enough to allow a federal court (not the bankruptcy court) to determine the trustee's potential claim to property disposed of by the bankrupts.

The Commission recognized in its report that these proceedings had a deleterious effect on the rights of both the debtor and its creditors,[13] leading to delays and additional expense which began to make bankruptcy proceedings

[10]With the possible exception of certain actions commenced under sections 60, 67 and 70 of the Act, all suits involving controversies between trustees and adverse claimants are presently commenced in the applicable federal district court. These are termed plenary proceedings over which the bankruptcy court does not have jurisdiction under current law. See Report of the Committee on the Judiciary, House Report No. 95-595, 95th Cong., p. 43, published, vol. 124 Cong. Rec.

THE NEW BANKRUPTCY COURT UNDER THE BANKRUPTCY REFORM ACT OF 1978
THE DISTRICT COURT'S LITTLE BROTHER GROWS UP

By Philip J. McNutt

Culminating over six years of legislative activity in Congress,[1] President Carter, on November 6, 1978, signed into law H.R. 8200,[2] enacting comprehensive bankruptcy reform for the first time in almost 40 years.[3] The Bankruptcy Reform Act of 1978 created a new bankruptcy court with pervasive jurisdiction completely obliterating the old summary-plenary jurisdiction distinction of the old bankruptcy laws. H.R. 8200 was the result of a substantial legislative effort to bring the federal bankruptcy laws into focus with present commercial law and credit practices. But more than that it recognized the need for a new bankruptcy court system in which all decisions pertinent to bankruptcy cases can be heard and disposed of expeditiously. This recognition provided the impetus for significant changes in the status and powers of both the bankruptcy court and bankruptcy judges.[4] These changes constitute the major focus of this article. The bankruptcy court system, the little brother of the district court system, nourished by proponents of bankruptcy reform and five years of congressional debate, and framed in the legislative history of H.R. 8200, has indeed grown up. This article will investigate the growth of the system, the significant changes enacted by the Bankruptcy Reform Act of 1978, the effect of the new bankruptcy court on present day bankruptcy practice, and its limitations.

THE COMMISSION BILL

The Commission commenced its work in 1970 and after three years of intensive study it filed an extensive report on existing bankruptcy practice and

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[1]The Commission on the Bankruptcy Laws of the United States was appointed by Senate Joint Resolution No. 88 on July 24, 1970 (P.L. 91-354, 84 Stat. 468). The Commission filed its report on July 31, 1973 and also recommended a bankruptcy bill which was introduced in the 93rd Congress (H.R. 10793) by Congressmen Don Edwards and Charles E. Wiggins of California, both appointed members of the Commission by the Speaker of the House. An alternative bill drafted by the National Conference of Bankruptcy Judges was introduced in the 93rd Congress by the same Congressmen. Both bills were reintroduced in the 94th Congress as H.R. 31 and 32, respectively. After extensive hearings in the House, a new bill, H.R. 6, was introduced in the 95th Congress by Congressmen Edwards and M. Caldwell Butler. After substantial mark up, the Subcommittee on Civil and Constitutional Rights of the Committee on the Judiciary of the Constitutional Rights of the Committee on the Judiciary of the House of Representatives introduced H.R. 8200, which passed the House on February 1, 1978. On September 7, 1978 the Senate passed its version of H.R. 8200. Subsequent amendments passed the House and the Senate and, after a hectic informal conference among the House and Senate floor leaders, a final bill was sent to the President for signing.

[2]The Bankruptcy Reform Act of 1978 (referred to hereinafter as "the Code") The Chandler Act of 1938 (as amended, referred to hereinafter as "the Act"), the last major revision of the bankruptcy laws).

[3]A person filing for relief under the Code is no longer referred to as a bankrupt, which Congress deemed too demeaning and took away from the fresh start concept. All persons or entities filing for relief under the Code are referred to as debtors.

[4]For the most part, the provisions of the Code are effective October 1, 1979. However, most of the provisions concerning the expanded power and status of the bankruptcy court and judges will not take effect until April 1, 1983, the date the new court system will be fully operative. Nevertheless, these provisions will effect all cases filed on or after October 1, 1979.

sidered that it had improperly permitted the patent to issue.[137a] Likewise, a successful defense to a validity challenge lets the public know that even under adversarial attack the validity has been upheld. This reinforcement of the presumption of validity is as much to the public benefit as is a disclosure of invalidity.[137b]

Any such proceeding would in many respects be analogous to the patentability determination now permitted by the reissue rules whereby reissue applications may be filed solely for the purpose of having prior art not previously considered brought to the attention of the Office.[138] Admittedly the applicant for reissue has a right of review through the Board of Appeals whereas a patentability determination under theproposed jurisdictional change would be made by the Board of Patent Interferences. But the Board of Patent Interferences now routinely handles the wide variety of matters relating to patentability which have been held to be ancillary to priority, and it should not require any additional specialized expertise for it to accept the added jurisdic-

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[137a]Consider 37 C.F.R. §1.237 which sets forth the existing practice of considering prior art by dissolution of the interference at the request of the primary Examiner:

> *37 C.F.R. §1.237 Dissolution at the request of examiner.*
>
> "If, during the pendency of an interference a reference or other reason be found which, in the opinion of the primary examiner, renders all or part of the counts unpatentable, the attention of the Board of Patent Interferences shall be called thereto. The interference may be suspended and referred to the primary examiner for consideration of the matter, in which case the parties will be notified of the reason to be considered. Arguments of the parties regarding the matter will be considered if filed within 20 days of the notification. The interference will be continued or dissolved in accordance with the determination by the primary examiner. If such reference or reason be found while the interference is before the primary examiner for determination of a motion, decision thereon may be incorporated in the decision on the motion, but the parties shall be entitled to reconsideration if they have not submitted arguments on the matter."

Subject to the Board's discretion to suspend the interference, primary examiners have utilized this authority to reach patentability determinations on prior art, even if it reaches a patentee's claim. Wada v. Bucklin, 192 U.S.P.Q. 233 (Com'r. Pat. 1976); Jalar v. Melott, 132 U.S.P.Q. 356 (Com'r. Pat. 1961); Noxon v. Halpert, 128 U.S.P.Q. 481 (Com'r. Pat. 1953); Kopp v. Stultz, 124 U.S.P.Q. 319 (Com'r. Pat. 1951).

In Hilborn v. Cuthbert, 192 U.S.P.Q. 134 (Com'r. Pat. 1976), the applicant copied a claim from the patentee, who purportly withheld a foreign statutory bar from the office. Acting under a Rule 237 motion, the primary examiner was of the opinion that the foreign patent was a statutory bar to the count and attempted dissolve the interference. Hilborn, the applicant, then petitioned the Commissioner to consider the issue of fraud prior to any patentability determination under Rule 237. Although an alleged fraud issue was present since the patentee was aware of the foreign patent and had failed to bring it to the attention of the office, the Commissioner held the threshold issue to be one of patentability and set the stage for suspending the interference without any determination of the fraud issue.

Unlike *Steierman v. Connelly,* footnote 111, *supra,* the patentee was released from the Board's jurisdiction with his patent intact, except for strong allegations in the file wrapper of fraud and nonpatentability. Clearly, if as in In re Altenpohl 198 U.S.P.Q. 289 (Com'r. Pat. 1976), a reissue application were involved, the Commissioner would resolve such a "prior art" fraud issue. See also *Newlin v. Jessel,* note 128, *supra.*

[137b]Compare Steierman v. Connelly, 192 U.S.P.Q. 443 (C.C.P.A. 1975) with Burnett v. General Tire & Rubber Co., PTCJ, No. 403, A-7 (1978). In *Steierman* the Board invalidated the patent of senior party Connelly et al. by awarding priority to Steierman who could not prevail in the interference "but for" in the inequitable conduct of Connelly et al. In *Burnett,* General prevailed in an interference with Burnett but had its patent declared unenforceable in part because in inequitable conduct before the Patent Office. In re Multidistrict Litigation Involving Frost Patent, 540 F.2d 601, 191 U.S.P.Q. 241 (CA3 1976). Burnett attempted to recoup royalties from General since "but for" General's conduct Burnett would have obtained a patent. Judge Young stated that the PTO may strike under Rule 56 any application in connection with which any fraud is practiced. He then ruled that the Court lacks the power to strike General's application since the Patent Office did not consider the Rule 56 issue and did not order General's application stricken. The Court held that Burnett's claim must be dismissed since Burnett cannot now claim loss of patent rights as a result of General's fraud.

paying lip service to what it terms "the well-established rule that patentability is not ancillary to priority."[127]

Bound as it is by its own traditional conservatism, the Board of Patent Interferences continues to point to such utterances by the C.C.P.A. taken together with its own jurisdiction-giving Rule 258 as justifying[128] its near standard[129] refusal to consider patent validity during an interference proceeding. But as various commentators have noted,[130] whether a particular issue is ancillary to priority is determined not by the rules of the Office but rather what the C.C.P.A. says in its opinions. Phrased somewhat differently, the jurisdiction of the Board of Patent Interferences is what the C.C.P.A. says it is.[131]

It is apparent that in recent years the C.C.P.A. has expanded the jurisdiction of the Board. A strong argument can now be made that under the "logically related" test the Board not only can but should routinely consider patent validity in any interference proceeding involving an issued patent. Simply put, the validity of the patent determines the standing of the patentee as a party to the interference. If the patent is invalid, then clearly the patentee cannot contend that the count or counts is patentable to him. But as clearly

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[127]Masciarelli v. Foerste, 94 U.S.P.Q. 181 (C.C.P.A. 1952); See, e.g., the unpublished opinion of Snitzer v. Filipescu, Patent Appeal No. 9238, decided January 10, 1974, reproduced at pages 5-56 to 5-59 of Dunner, Court Review of Patent Office Decisions: C.C.P.A.

[128]See note 66, *supra;* see also 37 C.F.R. §1.259 which provides for Recommendations by the Board of Patent Interferences:

> The Board of Patent Interferences may, either before or concurrently with their decision on the question of priority, but independently of such decision, direct the attention of the Commissioner to any matter not relative 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 bar to the grant of a patent to either of the parties for the claim or claims in interference. The Commissioner may suspend the interference and remand the case to the primary examiner for his consideration of the matters to which attention has been directed if such matters have not been considered before by the examiner, or take other appropriate action. If the case is not so remanded, the primary examiner will, after judgment on priority, consider such matters, unless the same shall have been previously disposed of by the Commissioner.

See generally, Newlin v. Jessel, 196 U.S.P.Q. 504 (1977) where the Commissioner reversed an earlier decision by the Deputy Commissioner, Jessel v. Newlin, 195 U.S.P.Q. 678 (1977), who on the recommendation of the Board of Interferences under 10 CFR §1.259, Jessel v. Newlin, 195 U.S.P.Q. 674 (1977), held that a plant application be stricken under 10 CFR §1.56 for failure of the applicant to inspect the application prior to signature.

[129]The only exception being if the issue "relates to matters which have been determined to be ancillary to priority and must be considered." See Rule 258(a) given in note 66, *supra.* See, e.g., Smith v. Pittman, 172 U.S.P.Q. 569 (Bd. Pat. App. 1971), that nonpatentability may not be urged against patentees; and Morehouse v. Armbruster, 192 U.S.P.Q. 255 (Com'r. Pat. 1976) regarding an attempt to dissolve an interference as to a patentee for public use and sale.

While Rule 259 does provide a vehicle for the PTO to act as to unpatentability of the count in interference, the C.C.P.A. in accord with *Glass v. De Roo,* note 82, *supra,* has taken the position that it will not consider patentability in determining appeals from the Board of Interferences priority. Loshbough v. Allen 404 F.2d 1400, 160 U.S.P.Q. 204, 209 (1969).

[130]See, e.g., Gholz, *op cit.* at page 131g, n. 55.

[131]It is not at all certain that the Board of Patent Interferences as a practical matter agrees with this view. Speaking at the 1978 BNA Patent Conference, Board Member Norman G. Torchin provided the following "Quote without comment (by an unnamed but reliable source)":

> The. . .reason why interference practice is complicated is that it is more of an art than a science. It re-

whether it is willing to denominate it as fraud. Nowhere is this more evident than in the case of *Steierman v. Connelly,*[111] where the Board, based on a fraud determination, effectively invalidated the patent of the senior party, Connelly, by awarding priority to the junior party Steierman even though the Board stated "Steierman would not be entitled to prevail in this interference but for our decision with respect to inequitable conduct on the part of Connelly.[112]

What was the inequitable conduct which produced this result? Simply put, it was held to be the failure to comply with the best mode requirements of 35 U.S.C. §112 by failing to disclose an ingredient, namely, cerium oxide, of a claimed glass composition essential to prevent a specific problem of X-ray browning in the use of glass. Connelly contended that the use of cerium oxide to prevent X-ray browning was well known in the prior art. The Board refused to accept this argument on the grounds that "Connelly et al. represented to the Patent and Trademark Office that strontium oxide would prevent, inter alia, X-ray browning, even though they knew otherwise at the time they filed their application."[113]

Although the facts adduced in *Steierman* rather strongly suggest that Connelly did indeed misrepresent a material fact by failing to disclose their best mode, it is considerably more difficult to perceive how those facts alone support a finding of fraud.[114] While the Board made a showing that the patent of Connelly would not have issued but for the misrepresentation, and thus met the first requirement for a showing of fraud set forth in *Norton v. Curtiss, Steierman* is totally silent as to a second and equally important criterion set forth by the C.C.P.A., namely, that there must *at least* be a showing that any misrepresentations were "made in an atmosphere of gross negligence as to their truth."[115] The problem in *Steierman* is that there was no showing as to why or under what circumstances the misrepresentations were made.[116] Thus, it appears that the Board actually based its decision on a patentability issue disguised as a fraud issue.[117]

Patent Validity as an Issue in an Interference Proceeding

In holding that it had jurisdiction to decide the fraud issue in *Norton v. Curtiss,* the C.C.P.A. stated:

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[111] 192 U.S.P.Q. 443 (Bd. Pat. Int. 1975).

[112] 192 U.S.P.Q. at 445.

[113] 192 U.S.P.Q. at 437-438.

[114] Although Gholz argues, *op cit.* at page 130, n. 23, that the C.C.P.A. has held that failure to comply with the best mode requirement is, in effect, a species of fraud, the particular holding cited does not necessarily lend itself to this view. See specifically In re Honn, 364 F.2d 454, 461, n. 7, 150 U.S.P.Q. 652, 657, n. 7 (1966).

[115] Norton v. Curtiss, 167 U.S.P.Q. at 545.

[116] At best the facts set forth therein show only that there was indeed a misrepresentation. By certain of its language, the Board implies that the misrepresentation was deliberate (see text accompanying note 113, *supra*), but no actual evidence is cited to support this interference.

opinions and noting that these opinions generally held that the issue of patentability is not appealable in an interference proceeding.[98]

They then stated their own view on the matter by saying

> . . . we must not be understood as deciding that there can be an interference without there being a patentable invention, or that, should we be satisfied that there was no patentable invention involved, we should make an award of priority. It would be our manifest duty to remand an interference to the Commissioner of Patents, or, at least, call his attention to the fact whenever it is shown that there is a bar to the issue of a patent to both parties to an interference.[99]

That language standing alone strongly suggests that patentability is appealable in an interference proceeding, for if there is a satisfactory showing of no patentability, and remand to the Office fails to produce a dissolution of the interference, then presumably the court could order such. Moreover, it would seem to have a "manifest duty" to do so. Not so, however, for the court immediately went on to state:

> But, where the Primary Examiner has held claims to be patentable, and the Examiner of Interference and the Examiners-in-Chief have omitted or declined to call the attention of the Commissioner of Patents to the unpatentability of the issue of an interference, or where the Commissioner has declined to review the decision of the Primary Examiner after his attention has been called to the alleged unpatentability of the issues, we are of the opinion that, except in an extraordinary case, we should hold the question of patentability to be settled. The statute does not provide for an appeal to this court from a ruling by the Commissioner of Patents, or of any of the subordinate tribunals, affirming the patentability of a claimed invention. It is only from a decision adverse to the patentability of a claim that an appeal will lie to this court.[100]

Consider for a moment what the court said here and on what it based its decision. It noted that the statute did not expressly permit an appeal from a decision affirming patentability, but it did not hold that this in and of itself excluded any appeal. The court clearly assumed that in an "extraordinary case", whatever that might be, an appeal from a decision affirming patentability in an interference proceeding would in fact be proper. In other words, the silence of the statute in this respect did not automatically exclude such an appeal.

In addition, the decision appears to have been based in large measure on the fact that, in accordance with the Rules of Practice then in effect, patentability had been considered during the inter partes proceeding. As the court noted:

> In the case at bar not only did the Primary Examiner pass upon the question of patentability and of the right of Holsclaw to make the claims in controversy, *ex parte*, but also in *inter partes* proceedings. Furthermore, the Examiner of Interferences and the Examiners-in-Chief had their attention called to these questions, and, in declining to call the attention of the Commissioner of Patents to the alleged unpatentability of the issues, they, in effect, held them to be patentable.[101]

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[98]The opinions discussed were Hisey v. Peters, 6 App. D.C. 68; Doyle v. McRoberts, 10 App. D.C. 445; Oliver v. Felbul, 20 App. D.C. 262; Luger v. Browning, 21 App. D.C. 201; Allen v. United States, 26 App. D.C. 8; and Podlesak v. McInnerney, 26 App. D.C. 399.

Office, i.e., the Court of Appeals for the District of Columbia,[86] holding that patentability of the claims or counts in an interference proceeding cannot be considered on appeal from an award of priority. It then went on to say that these

> . . . decisions were rendered prior to the enactment of the Patent Act of July 19, 1952. That act, by including in section 141 an express provision that the decisions of the Board of Patent Interferences from which appeals may be taken to this court are those *"on the question of priority,"* clearly accepts the law as contained in those decisions.* * * It was because of the frequent misunderstanding of the scope of appeal to this court that the words "on the question of priority" were inserted in 35 U.S.C. (1952) 141, with a view to clarifying the situation.[87]

In setting forth this view, the court made no reference to the legislative history of the Patent Act of 1952. This is not too surprising, because the legislative history is simply silent as to why the phrase "on the question of priority" was inserted in Section 141. All that is stated therein is that the group of sections pertaining to appellate review "makes no fundamental change in the various appeals and other review of Patent Office actions. . ."[88] Nonetheless, this statement would seem to support the view expressed by the C.C.P.A., provided that the cases cited by the court do correctly represent the law.

In making a determination as to whether they do represent the proper law, one may reasonably ask why these cases hold that the Board of Patent Interferences does not have jurisdiction to consider patentability. Many of the later cases merely so hold without presenting any reasoning or case citation in support thereof. But how was such a holding originally established?

The Primogenitor

The crucial opinion seems to have been that in *Sobey v. Holsclaw*[89] decided in 1906. It is therefore of interest to review the facts of that case in some detail. Insofar as can be determined from the opinion itself, the interference was between two applications and no issued patent was involved. Holsclaw filed his application September 10, 1903 while Sobey filed his on June 22, 1904. Subsequently the Primary Examiner suggested to Sobey that he copy certain of the claims of Holsclaw. Sobey did so, but with the proviso that he did so "without prejudice to our right to make motion for dissolution of the interference, when declared, should careful search and study show that the proposed claims (1) are unpatentable for lack of novelty, or (2) raise no real conflict, as applied to the rival devices taken in conjunction with other inventions existing prior."[90]

When the interference was declared and Sobey found that he could not overcome Holsclaw's record date, he moved to dissolve the interference on

[86] D.C. Appeals decisions cited were Melling v. Gordon, 55 App. D.C. 278; Lynch v. Headley, 52 App. D.C. 269; Slingluff v. Sweet, 45 App. D.C. 302, Lecroix v. Tyberg, 33 App. D.C. 586; Moll v. Midgley; 31 App. D.C. 534; Sobey v. Holsclaw, 28 App. D.C. 65.

cancellation of the claims in interference from the patent? The question has now been answered in the affirmative,[70] but until recently, consistent with the Office view that it loses jurisdiction over the subject matter of an issued patent, except as such jurisdiction is incidental to an award of priority, the Board had refused to even consider the fraud issue.[71]

The Board's reluctance would seem to have been based in part on the fact that Title 35 does not treat fraud or inequitable conduct in any of its sections. As noted earlier, it does, however, give the Commissioner authority to ". . .establish regulations, not inconsistent with law, for the conduct of proceedings in the Patent Office."[72] Pursuant to this authority, the Commissioner has promulgated Rule 56 which provides that "[a]n application shall be stricken from the files if it is established by clear and convincing evidence that any fraud was practiced or attempted on the Office in connection with it or that there was any violation of the duty to disclose through bad faith or gross negligence."[73]

But the Board had consistently taken the position that Rule 56 is limited to applications and conferred no authority on it to assume jurisdiction to consider the validity of an issued patent.[74] The C.C.P.A. has, however, expressly held that fraud is ancillary to priority.[75] This is true even though an issued patent is involved.[76] If fraud is ancillary to priority, presumably jurisdiction to consider the validity of the claims in questions must be conferred by 35 U.S.C. §135.

A more critical point of concern is whether the Office must exercise such jurisdiction. It may reasonably be inferred that if fraud is ancillary to priority then the Office has an absolute obligation to investigate allegations of fraud or to at least permit discovery concerning such allegations by the parties to the interference. As recently as 1970, the Solicitor to the Office certainly assumed this to be the case, saying "the Patent Office *is required* to pass upon the sufficiency of any evidence submitted to any party to a proceeding before the Office on the question of fraud."[77] (Emphasis supplied.)

Since then, however, the Office has apparently had a change of heart. The Solicitor General of the United States on behalf of the Office argued before the Supreme Court in June 1976 that ". . . neither the board nor the Commissioner has a mandatory duty to require interrogatories in a patent interference proceeding, *or to investigate charges of fraud.*"[78] (Emphasis supplied.) This would seem to be a considerable turnabout, and why it occurred should be of interest to the patent bar and others dealing with the

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[70]See Steierman v. Connelly, 192 U.S.P.Q. 433 (Bd. Pat. Int. 1975).

[71]The best that it had done was to hold that when the fraud is committed before the Board, i.e., in inter parte rather than ex parte proceedings, an award of priority to the other party is proper. See Lund v. Bentley, 188 U.S.P.Q. 9 (1974).

[72]35 U.S.C. §6.

[73]37 C.F.R. §1.56(d).

[74]See, e.g., Peterson v. Scherbatskay, 118 U.S.P.Q. 544, 548 (1957); and Langer v. Kaufman, 465 F.2d 915, 175 U.S.P.Q. 172 (C.C.P.A. 1972).

[75]Norton v. Curtiss, 433 F.2d 779, 167 U.S.P.Q. 532 (1970).

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

them.[62a] As stated by the Supreme Court in *Hanover Bank v. Commissioner.*[62b] "such [advisory opinions] do reveal the interpretation put upon the statute *by the agency* charged with the responsibility of administering the [patent] law (emphasis supplied)."

It should be borne in mind, however, that there is an important area of Office jurisdiction wherein the opinion concerning validity of an issued patent need not—and indeed should not—be advisory. That area involves interference practice.

Interference Jurisdiction Over an Issued Patent

The ability to institute interferences which may result in the cancellation of claims in issued patents is of particular importance in the present context. For if claims of an issued patent may be cancelled as a result of an interference proceeding, then it should logically follow that the Office (a) does have jurisdiction in an interference over the subject matter of an issued patent, and (b) has a duty not only to comment on but to declare the invalidity of an issued patent or at least those claims thereof which are counts in interference if priority is not shown to reside in the patentee.

Rule 201 of the Rules of Practice states that

> An interference is a proceeding instituted for the purpose of determining the question of priority of invention between two or more parties claiming substantially the same patentable invention and may be instituted as soon as it is determined that common patentable subject matter is claimed in a plurality of applications or in an application and a patent.[63]

Under 35 U.S.C. §135, a three-man Board of Patent Interferences has jurisdiction over the claimed subject matter of an issued patent which the Commissioner has determined is in interference with an application before the

[62a]For this reason, it will therefore behove the Office to provide advisory opinions by Examiners apart from those who issued the patent and give full and careful consideration of all issues of patent validity based on prior patents and publications. The authors suggest that if the requester of the opinion presents a reasonable basis that validity issues such as public use and fraudulent procurement are material to the opinion, it should be expanded to cover only such issues which are within the proven expertise of the Examining Corps. Further, direct review of the opinion should be provided by delegating the review function to members of the Board of Appeals in their individual capacity as Examiners-in-Chief. Consider, since PTO advisory opinions will become part of the patent file and statement as to the patentability of the invention, would such an opinion be tantamount to a "case or controversy" under the Declaratory Judgement Act 28 U.S.C. §2201 et seq.? If, as emphasized by the Supreme Court's statement in McCormick Harvesting Co. v. Aultman, 169 U.S. 606, 612 (1898), the Commissioner has no power to revoke, cancel or annul a patent, surely an opinion of invalidity may arguably be construed as an attempt to annul the patent and fairly present a "case or controversy". The judicial review of such opinions (or lack thereof) will surely be a ripe ground for litigation on such issues as the exhaustion of remedies, likelihood of injury and actual controversy. However, see Goodrich-Gulf Chemicals, Inc. v. Phillips Petroleum Co., 376 F.2d 1015, 153 U.S.P.Q. 436 (6th Cir. 1967) where the Circuit Court stated to the effect that no "actual controversy" existed where a patent issued on a divisional application which contained the very claims which in an application in interference were determined to be unpatentable. According to the Court, the issuance of the patent ended any controversy as to the patent holders' right to receive the patent and carried with it the mandatory statutory presumption of validity. 35 U.S.C. §282. See, also, Macey, "The Collateral Estoppel Effect of Administrative Agency Actions in Federal Civil Litigation," 46 G.W.L. Rev. 65, 87, 88 (1977).

Query: to what extent will advisory opinions be res judicata during subsequent ex parte or inter partes proceedings? See generally, the statements of the CCPA in Squires v. Corbett, 560 F.2d 424, 194 U.S.P.Q. 513, 516 (1977); and Sze v. Bloch, 458 F.2d 137, 173 U.S.P.Q. 498, 501 (CCPA 1972), that a Board of Appeals decision was not binding on the Board sistent with statute.[55] More importantly, the C.C.P.A. has held that the rule-making authority is not limited to any express grant by statute.[56] Thus, the rule-making authority encompasses areas about which the patent statutes are simply silent.

Since the C.C.P.A. is the court of first authority for the Office, it is readily apparent that a Commissioner may rightly assume that his rule-making authority is quite broad. Traditionally, however, Commissioners have been reluctant to use their rule-making authority to extend the jurisdiction of the Office beyond that which was expressly set forth by statute. Indeed, where issued patents were involved, they tended to a conservative interpretation which served to restrict rather than expand the jurisdiction of the Office.[57]

Not so anymore. A comparison of the reissue statute with the old and new reissue rules strikingly illustrates this fact. Thus, according to 35 U.S.C. §251:

> Whenever any patent is, through error without any deceptive invention, deemed wholly inoperative or invalid by reason of a defective specification or drawing, or by reason of the patentee claiming more or less than he had a right to claim in the patent, the Commissioner shall, on surrender of such patent and the payment of the fee required by law, reissue the patent for the invention disclosed in the original patent, and in accordance with a new and amended application, for the unexpired part of the term of the original patent. No new matter shall be introduced into the application for reissue.

Whereas the old rules required an applicant to aver that his patent was wholly or partly inoperative or invalid, the new rules permit him merely to aver that he "is aware of prior art or other information relevant to patentability, not previously considered by the Office, *which might cause the examiner to deem the original patent wholly or partly inoperative or invalid,* particularly specifying such prior art or other information. . ." (emphasis supplied).[58]

The change is significant. While the statute does not state *by whom* the patent should be deemed wholly or partly inoperative or invalid, it has been interpreted to mean a decision by the Commissioner.[58a] The old rules placed the onus for so asserting on the applicant whereas under the new rules he has no such obligation. In determining if the original patent is wholly or partly inoperative or invalid, the Office is indirectly but nonetheless effectively commenting on the validity of the original patent.

It should be emphasized that the authority quoted for both the old and the new reissue rules is not only the Commissioner's rulemaking authority but also 35 U.S.C. §251.[59] Clearly, the Office is now construing the statute differently than it did several years ago. Based on the brief analysis presented herein, however, it would appear that the new rules are not inconsistent with the language of Section 251 and thus do indeed have the force and effect of law. That being said, it is nonetheless highly doubtful that the Congress ever

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[55]See, e.g., Norton v. Curtiss, 433 F.2d 412, 165 U.S.P.Q. 708, 711 (1970); and In re Rubinfield, 270 F.2d 391, 123 U.S.P.Q. 210, 214 (1959), cert. denied, 362 U.S. 903, 124 U.S.P.Q. 535 (1960).

[56]*Norton v. Curtiss,* note 55, *supra.*

[57]See, e.g., the text accompanying notes 4-14, *supra.*

recently, Assistant Commissioner Tegtmeyer has indicated that the Office is allowing varying degrees of participation by protesters, but is tending toward much more participation than the introductory explanation to the new rules contemplated.[42]

More specifically, the Office is granting stays in prosecution longer than two months so that protests can be filed. In a number of instances both the applicant for reissue and the protester have been asked to serve copies of papers filed in the Office on each other. Generally, protesters need only request copies of Office actions and indicate their intent to comment on Office actions in order to receive them. Sufficient time to allow a protester to comment on an applicant's response may be granted if (a) the reissue applicant concurs or (b) the Office feels the protester's comments would be helpful to the examination. The protester may be allowed to participate in any interview with the Examiner where special justifying circumstances exist. Just what such circumstances might be is not clear; however, if the applicant requests or concurs in the participation, the Office will be more inclined to permit it.

According to Assistant Commissioner Tegtmeyer, "(l)imited experience to date indicates that declaring a reissue application proceeding a contested case may be desirable."[43] In effect, the Office appears to be suggesting that if the appropriate criteria can be developed, it is willing in the future to treat certain protests as full inter partes proceedings.

Under the new rules, the reissue application becomes a means of (a) bringing to the attention of the Office matters relating to patentability which were not considered during the prosecution of the original patent, and (b) making of record the views of the Office with respect to such matters. According to the Office:

> If a reissue application is filed as a result of new prior art with no changes in the claims or specification and the examiner finds the claims patentable over the new art, the application will be rejected as lacking statutory basis for a reissue, since 35 U.S.C. 251 does not authorize reissue of a patent unless it is deemed wholly or partly inoperative or invalid. However, the record of prosecution of the reissue will indicate that the prior art has been considered by the examiner.[44]

If, on the other hand, the claims are held not to be patentable then the applicant has the right to submit an amendment overcoming the rejection.[45] A successful amendment would presumably result in issuance of the reissue application on payment of the necessary fees and surrender of the original patent.[46]

The purpose of these rule changes is purely and simply to permit the Office to use its expertise in aid of the jurisdiction of the courts.[47] The manner in which the courts treat proceedings under the new rules is therefore of interest. It may reasonably be expected that the judicial view of the new rules will be largely predicated on (a) their effect on judicial economy, (b) the

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[42]BNA 1978 Patent Law Conference, Arlington, Va. (Sept. 6 and 7, 1978), conference coursebook at page 11.
[43]*Id.* at page 12.
[44]955 O.G. at 1054.

Not stated, but nonetheless pertinent, was the fact that after an interval of 10 years the Office was finally taking strong judicial criticism and the Supreme Court admonition to heart.[29] The Office was also fully aware that it frequently was not considering the closest art during the original prosecution of applications before it. This coupled with recent studies[30] which suggested that a significantly higher proportion of litigated patents were held invalid where pertinent prior art considered by the court had not also been considered by the Office were some of the events[30a] which caused former Commissioner Dann to initiate the rule changes.

Changing the Rules for Reissues

The mechanism chosen for the volte-face was the reissue application. Under the old rules, an applicant for reissue was required to make a statement under oath or declaration (a) that he believed the original patent to be wholly or partly inoperative or invalid, (b) setting forth reasons for this belief, (c) specifying the errors relied on and how they arose or occurred, and (d) stating that those errors arose "without any deceptive intention." While these may still be set forth as a basis for an application for reissue they are no longer *required* under the new rules.[31]

Now a reissue application might be sought

> When the applicant is aware of prior art or other information relevant to patentability, not previously considered by the Office, which might cause the examiner to deem the original patent wholly or partly inoperative or invalid, particularly specifying such prior art or other information and requesting that if the examiner so deems, the applicant be permitted to amend the patent and be granted a reissue patent.[32]

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[29]See text accompanying note 1, *supra;* one view of the judicial perception of the patent system is presented in Nash, "Remarks Before the Industrial Research Institute," 59 JPOS 143, 149 (1977).

Mr. Justice Fortas stated:

> A patent monopoly is typically granted in a secret, ex parte proceeding before a minor bureaucrat called a patent examiner.

Federal District Court Judge Hubert L. Will from Illinois complained:

> [Obtaining a patent] is one of the few areas in which there are not adversary proceedings in which there is substantial economic benefits to be gained. . . This is one of the very few governmentally conferred economic privileges, monopolies, in which there is no public hearing.

As a Federal District Court judge from New York recently put it:

> To be honest, this Court is rather amazed to find that a patent as flimsy and as spurious as this one (in suit) has been granted by the Patent Office. Clearly, the Patent Office is still not applying the strict constitutional standard required in all patent cases.

Or, in the words of Federal District Court Judge Miles W. Lord from Minnesota:

> [The Patent Office] has got to be the sickest institution that our Government has ever invented. It is just as far as I can see an attritional war between the patent applicant and the patent examiner who apparently got paid on the piece work for how many patents they could put out.

[30]See, e.g., Koenig, Patent Invalidity — A Statistical and Substantive Analysis (Clark Boardman Co., Ltd. 1976), §5.05(4).

[30a]See, e.g., G. H. Bjorge, "35 U.S.C. 103: The PTO, the Courts and the Future," Vol. 5, No. 2, APLA Law Journal, Summer 1977.

It is appropriate to commence with a discussion of the new reissue rules and how they came to be.

The Status of the Original Patent After An Application for Reissue

In 1897 in *McCormick Harvesting Machine Co. v. Aultman,*[18] the Supreme Court was asked by the Circuit Court of Appeals for the Sixth Circuit to answer the following question:

> If the owner of a patent applies to the Patent Office for a reissue of it, and includes among the claims in the application the same claims as those which were included in the old patent, and the primary examiner rejects some of such claims for want of patentable novelty, by reference to prior patents, and allows others, both old and new, does the owner of the patent, by taking no appeal and by abandoning his application for reissue, hold the original patent, the return of which he procures from lthe Patent Office, invalidated as to those of its claims which were disallowed for want of patentable novelty by the primary examiner in the proceeding for reissue?[19]

Mr. Justice Brown, speaking for the Court, answered in the negative.[20] The facts behind the involved question and the reasoning used by the Court in answering it are of considerable interest in the context of the present article.

An application for reissue of a patent to one Gorham was filed which included a number of claims of the original patent as well as many new claims. The Primary Examiner rejected certain of the old claims as unpatentable over prior patented devices. Thereafter, the reissue application was abandoned and the original patent was returned to the McCormick Harvesting Machine Co. which had become the owner thereof. At some later time suit was brought against Aultman for infringement of certain of the original claims of this patent which had been rejected in the reissue application. The Circuit Court held that they had been invalidated in the original patent by failure of the Primary Examiner to allow them in the reissue application. The Court was of the opinion that Aultman had indeed infringed several of the claims in question provided that they had not been invalidated by the action of the Primary Examiner. It therefore certified to the Supreme Court the question set forth above.[21]

The opinion of the Court was straightforward. It concluded that

> . . . upon the issue of the original patent, the Patent Office had no power to revoke, cancel or annul it. It had lost jurisdiction over it, and did not regain such jurisdiction by the application for a reissue. Upon application being made for such reissue the Patent Office was authorized to deal with all its claims, the originals as well as those inserted first in the application, and might declare them to be invalid, but such action would not affect the claims of the original patent, which remained in full force, if the application for a reissue was rejected or abandoned.[22]

[18] 169 U.S. 606 (1898).

accept patent disclaimers,[7] correct patent inventorship,[8] and institute interferences which may result in the cancellation of patent claims.[9]

Former Commissioner Dann[10] has made clear[11] that the Office position that it has no jurisdiction over the subject matter of an issued patent is based on an 1898 Supreme Court decision wherein the Court observed that upon the issuance of a patent the Patent Office has no power to revoke, cancel, or annul a patent because once issued, the Patent Office loses jurisdiction over the patent.[12] This view that the Office has no jurisdiction over an issued patent has persisted through the years,[13] even though, as at least one commentator has observed, it rests on a "dubious foundation."[14]

The times are changing, however, as witnessed by the new reissue practice instituted in 1977.[15] There can be little doubt that, in the appropriate circumstances, the new reissue rules not only permit but in effect require the Office — albeit indirectly — not only to consider but to pass on the validity of an issued patent.[16] Moreover, even more significant rule changes appear in the offing. Speaking before the American Bar Association Section of Patents, Trademarks, and Copyrights, at their 1978 annual meeting, Commissioner Banner had the following comments:

> I am presently of the view, however, that the Commissioner's rulemaking authority has not all been used yet. A great shortcoming of the present reissue practice is that members of the public cannot get a reexamination if the patentee doesn't apply for a reissue. It is my present view that the Commissioner has the authority to set up a reexamination system that would be available to everyone. I am not saying that the Commissioner has the authority under existing law to cancel a patent at the request of a member of the public. *But that does not mean that the Office cannot give its opinion on the validity of a patent it has issued.* (Emphasis supplied.) For the effect of such an advisory opinion would not be the same as cancelling the patent. The patentee could still sue on the patent even if the Office said it was invalid.[17]

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[7] 35 U.S.C. §253.

[8] 35 U.S.C. §256.

[9] 35 U.S.C. §135.

[10] C. Marshall Dann was Commissioner of Patents and Trademarks during the period of February 1974 to August 1977.

[11] United States v. General Electric Co., 183 U.S.P.Q. 551, 552 (Com'r Pat. 1974).

[12] McCormick Harvesting Machine Co. v. Aultman, 169 U.S. 606, 612 (1898).

[13] See, e.g., the dissenting opinion of Mr. Justice Black in Crown Cork & Seal Company v. Ferdinand Gutmann Co., 304 U.S. 171, 37 U.S.P.Q. 351, 355-356 (1938); U.S. ex rel American Gas-Accumulator Co. v. Coe, 29 U.S.P.Q. 378, 380 (D.C. App. 1936); McElrath v. Industrial Rayon Corp., 35 F.Supp. 198, 47 U.S.P.Q. 172, 184 (W.D. Va. 1940); Freeman v. Altvater, 138 F.2d 854, 59 U.S.P.Q. 426, 430 (8th Cir. 1943); Opinion of Comptroller General, 99 U.S.P.Q. 362, 327 (1953); Minnesota Mining and Mfg. Co. v. Norton Co., 240 F.Supp. 150, 145 U.S.P.Q. 81, 84 (N.D. Ohio 1965); and Slivinski v. Lane, 1922 C.D. 4; 295 O.G. 464 (1922).

[14] Patent Law Perspectives §A.15 (1975 Dev., Rel. No. 1).

[15] See text accompanying notes 26-38, *infra*.

[16] A purist might well contend that a reissue application is separate and distinct from the issued patent. It is obvious, however, that a reissue application filed for the

state that when history has spoken, it should be heeded.

I have a proposal I would like to make. In making this proposal, I owe an intellectual debt to Judge Clarence Galston. Judge Galston, not only after the passage of the 1952 Act, proposed that it be amended, adding to §103:

> [T]he simple requirement that a long existing and unsatisfied need in the art at the time the invention was made, with data available, would raise a presumption of invention.[63]

I suggest that a sentence be added to §103:

> The history of the art shall be given primary consideration in determining the level of ordinary skill in the art.

The term "history of the art" is intended to encompass both preinvention events such as "failure of others" and postinvention events such as commercial success and licensing. The phrase "shall be given primary consideration" is intended to *mandate* reliance on objective, historical evidence, *whenever it is available.*

In §103, we are asked to discern the subject matter of the invention, and the differences between it and the prior art. The chief enigma posed by §103 is whether these differences — whether in means or in result — would have been obvious to a person of ordinary skill in the art.

This enigma can be resolved in three ways. First, the judge may *infer* the past level of ordinary skill in the art from objective, historical evidence. Second, he can ask the masters of today to explain the thinking of the journeymen of yesterday. Third, instead of relying on the hindsight appraisal of the experts in the art, the judge can imagine *himself* a person of ordinary skill in the art at the time the invention was made. The first approach — which I have advocated this hour — is the most likely to achieve the stabilization of standards sought by the drafters of §103.

I have proposed an amendment to §103 which would require this approach to be preferred when feasible. With this amendment, we may at last bring to a successful conclusion the century-long quest for objectivity.

If you are trying to establish the level of ordinary skill in the art with "commercial success" evidence, it is important that you do not go about it half-heartedly. Establish the "relevant market," and produce "before" and "after" market percentages. Show the displacement of prior art devices from the market.[53]

It may, of course, be a mistake to rely too heavily on commercial success if your invention is an improvement on a recent pioneer invention. The court will be reluctant to attribute the commercial success to your contribution.[54]

Another well-known problem with commercial success is that if you have extensively advertised your new invention, your commercial success proofs will be discounted.[55] Try making use of a double-blind user survey. But be sophisticated. *Splendor Form Brassiere, Inc. v. Rapid-American Corp.*[56] tells us that:

> Such a test is obviously more persuasive than commercial success because it eliminates the question of the extent to which the public acceptance is attributable to advertising, sales promotion, and other factors extrinsic to the merits of the *commercial product*. But it does not eliminate all factors extrinsic to the merits of the *claimed invention*, such as the quality of the materials and workmanship embodied in the commercial products tested nor the effect of subsequent improvements incorporated in the patent owner's product, but not taught by the patent. Nor is it necessarily fair to assume that the particular competitive products used in the test represent the highest state of the art prior to the invention.

Check the sales literature of your competitors. If they imitate the patentee's invention and tout its attributes, this is fine evidence.

Another way of getting around the heavily advertised product problem is to show that "the innovation has permanently displaced other products", as it would then be unlikely that its commercial success was dur to "puffing".[57] Be prepared, however, to explain any failure to continue to produce the patented invention.[58]

"Synergism" has become the bugbear of the patent system. Nowhere in the patent statute is synergism made a fourth requirement for patentability. But if you are in a forum which reads §103 as imposing a "nonobvious result" requirement, you can make effective use of historical evidence. It is vital to stress the benefits of the invention, and to point out that so desirable an invention would have been made by others if its results had been expected or predictable. Commercial success, long felt demand, and failure of others, are the underpinnings of this argument. The conclusion of nonobviousness can be strengthened by delving further into the history of the art. It may prove effective to show that the art, at the time the invention was made, was still qualitative, and therefore the invention's results were not predictable. It would also be helpful to show that the skepticism which first greeted the patentee's achievements later turned to praise.

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[53]Novar Electronics Corp. v. Dunn, 192 USPQ 606 (DC D.C. 1976).

[54]U.S. Expansion Bolt Co. v. Jordan Indus., Inc., 174 USPQ 535, 538 (E.D. Pa. 1972); Lewart Co. v. Acco Int'l Inc., 192 USPQ 376 (N.D. Ill. 1976).

[55]Splendor Form Brassiere, Inc. v. Rapid-American Corp., 187 USPQ 151 (S.D. N.Y. 1975).

peated failures to develop an effective and efficient dental handpiece control.

In *Tights, Inc. v. Acme-McCrary Corp.*,[39] the Fourth Circuit's analysis of the level of ordinary skill in the art relied heavily on evidence of failure of others, initial skepticism, and later approbation.[39]

Other "history buffs" include the Northern District Court of Alabama[40] and the District Court of South Dakota.[41] Hopefully, they will serve as pacesetters for the Fifth and Eighth Circuits, respectively.

The Seventh Circuit has also taken a step in the right direction, for in *Ortho Pharmaceutical Corp. v. American Hospital Supply Corp.*,[42] it declared that:

> The unsuccessful attempts of both Dr. Ratnoff and Ortho to prepare PTT reagent containing ellagic acid in a true solution are further indications that Speck's claimed invention was not obvious even after Dr. Ratnoff's article was published. We agree with AHS that if Speck's invention was not obvious to a person of Dr. Ratnoff's eminent skill, it would not be obvious to a person of ordinary skill in the art.[43]

If you are fortunate to be in a forum which is receptive to historical evidence of the level of ordinary skill in the art, make the most of your opportunity. Ask *all* the questions which may shed light on the issue:

1. Was the problem solved by the invention a problem recognized by those working in the art to which the invention pertains?

2. If the problem was known to persons working in the art:

    a. How long was the problem known?

    b. Did motivation exist for a solution to the problem?

    c. What prior attempts were made to solve the problem by the inventor and others in the art?

    d. Was the inventor's solution to the problem contraindicated by the teachings of others in the art?

3. What tributes were paid to the invention, such as:

    a. Laudatory comments of others working in the art?

    b. Commercial success due the invention?

    c. License rights acquired from the inventor?

    d. Copying of the invention by competitors?[44]

You should, of course, not forget that you are trying to *infer* the level of ordinary skill in the art from circumstantial historical evidence. It is therefore

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[39] 191 USPQ 305, 312-13 (4th Cir. 1976).
[40] Rohms & Haas v. Owens Corning Fiberglas Corp., 196 USPQ 726, 738-39 (N.D. Ala. 1977).
[41] Farmhand, Inc. v. Lanham Mfg. Co., 192 USPQ 749, 758-59 (D. S.Dak 1976).
[42] 190 USPQ 397 (7th Cir. 1976).

how long did the surrounding and accessory arts disclose the means; how immediately was the invention recognized as the answer by those who used the new variant?[25]

While the Second Circuit, with Judge Hand at the helm, was the flagship of the historians, other courts attached themselves to the fleet.[26]

But in 1966, a squall line appeared on the horizon. In that year, the Supreme Court decided its first §103 case. It indicated that certain factual inquiries were mandatory:

> Under §103, the scope and content of the prior art are to be determined; differences between the prior art and the claims at issue are to be ascertained; and the level of ordinary skill in the pertinent art resolved.[27]

So far, so good. This is merely a gloss on §103. The term "prior art" in the statute is the antecedent for the first requirement; the term "differences" is the antecedent for the second requirement; and the term "person having ordinary skill in the art" is the antecedent for the third.

But the Supreme Court went on to say that:

> Against this background, the obviousness or nonobviousness of the subject matter is determined. Such *secondary* considerations as commercial success, long felt but unsolved needs, failure of others, etc., might be utilized to give light to the circumstances surrounding the origin of the subject matter sought to be patented. As indicia of obviousness or nonobviousness, these inquiries *may* have relevancy. [Emphasis added.][28]

The word "secondary" is the worm in the *Graham* apple, and it may spoil many a patentee's appetite for litigation. It implied that history was to be considered only when the judge, after making a hindsight appraisal of the patentability of the invention, was still in doubt as to its obviousness to a person of ordinary skill in the pertinent act. I have searched high and low, but I have yet to find a patent opinion in which a judge, after an *a priori* examination of the patent and the prior art, found it necessary to weigh in the "secondary" considerations in order to resolve a doubt about the validity of a patent.

The Seventh Circuit Court of Appeals has spoken out against the historical approach. In *Illinois Tool Works, Inc. v. Foster Grant Co.*,[29] it criticized the district court for paying "lip service" to *Graham* while relying on "secondary" considerations. In *Research Corp. of America v. NASCO Industries, Inc.*,[30] it declared that a failure to consider secondary factors when the lack of difference was "evident" — evident to a judge, after the fact, that is — would not constitute reversible error.

On the other hand, the Court of Customs and Patent Appeals has staunchly insisted that historical factors are "secondary only in time," not in

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[25]*Id.* at 27, 28.

[26]Merck & Co. v. Olin Mathieson Chemical Corp., 116 USPQ 484 (4th Cir. 1958); Sel-O-Rak Corp. v. HenryHanger & Display Fixture Corp. of America, 109 USPQ 179 (5th Cir. 1956); Cold Metal Process Co. v. Republic Steel Corp., 109 USPQ 185 (6th Cir. 1956); AMP, Inc. v. Vaco Products Co., 126 USPQ 90 (7th Cir. 1960); Stearns v. Tinker & Rasor, 104 USPQ 234 (9th Cir. 1955); and Oliver United Filters, Inc. v. Silver, 98 USPQ 240 (10th Cir. 1953).

It might be noted that the Second Circuit has a new helmsman, who may have put the ship on a different course. See Digitronics Corp. v. N.Y. Racing Ass'n., Inc., 193 USPQ 577, 584 (2d Cir. 1977).

decision of *Cuno Engineering*. After *Cuno Engineering* defined "invention" as a "flash of creative genius," the clamor for statutory clarification of the standards for patentability became deafening. In 1952, Congress rewrote the Patent Act. Sections 101, 102, and 103 of the new Act delineated novelty, utility, and nonobviousness as requirements for patentability. Section 103 reads:

> A patent may not be obtained though the invention is not identically disclosed or described as set forth in section 102 of this title, if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains. Patentability shall not be negatived by the manner in which the invention was made.

Under §103, we no longer have to insinuate ourselves into an inventor's skull, and observe his mental processes. Instead we "ask" a fictitious person, a person of ordinary skill in the pertinent art, to consider whether the subject matter claimed would have been obvious to him at the time the invention was made.

The expectation of the drafters of §103 was that the courts, being accustomed to "reasonable man" tests, would be able to apply a "person having ordinary skill in the art" test with some measure of confidence. But the new standard of patentability has been more of a cross than a crutch.

The success of the "reasonable man" test has been mainly attributable to the ease with which judges can imagine themselves "reasonable men." But their imaginations falter when they must think as would a "reasonable doctor"; and fail completely when they must envision the reaction of a person of ordinary skill in a highly technical field of art, for example, the art of cyclotron design. That is when they turn to the experts. What happens then? Omar Khayyam put it well:

> Myself when young did eagerly frequent
> Doctor and Saint, and heard great argument
> About it and about: but evermore
> Came out by the same door wherein I went.

Section 103 is objective in the sense that it forces all of us to view inventions through the same peephole; the one labeled, "person having ordinary skill in the art." That is why the misguided "negative tests of invention" — a mere change in materials is not patentable; a mere change in proportions is not patentable, and so on — have virtually vanished from the pages of the Federal Reporters.

Nevertheless, §103 has not accomplished all that its drafters hoped for. According to the revisers' notes on §103, it was added to the statute in the hope that an explicit standard of patentability might have "some stabilizing effect, and also to serve as a basis for the addition at a later time of some criteria which may be worked out".[17] The euphoria that resulted by the standard. Occasionally, courts resorted to history — an objective approach, — in deciding patentability.[11] For example, *Brunswick-Balke-Collender Co. v. Thum*[12] considered the patentability of a ball returnway for bowling alleys. The lower court found that patent to be invalid. On appeal, Judge Lacombe, speaking for the court, traced the problems experienced by prior art returnways:

> There were objections to the old style *** [returnways]; most of them arose from the circumstance that, not being retarded in its course, the ball frequently cameme at the players' end with a "smashing impact".

The patentee's runway included an upwardly inclined portion at the player's end of the alley that would slow the ball down by the time it reached the player. The lower court, in holding the patent invalid, concluded:

> Had any skilled mechanic been asked to perfect a structure that should gradually arrest the momentum of the returning ball, an ascent would obviously have been the structure used.

To the contrary, Judge Lacombe initially observed that the demand for an arrester was "before skilled mechanics for many years, and yet no one before *** [the patentee] hit upon the device which now seems so obvious". After reciting the problem with the prior art arresters, the court observed: "[T]he old style of runway persisted for 40 years. During this period there was a constand demand for an improvement which would remedy the difficulty, ***." There followed a recitation by the court of the many methods which had previously been used in an attempt to retard the balls. Finally, Judge Lacombe concludes:

> So many of these devices are shown that it is apparent that the skilled mechanics were for years trying to find some way properly to retard the ball, and the proof conclusively shows that all of them were unsatisfactory. Not one of them secured retardation by a change of grade of the trough itself, until the patentee disclosed his simple method, which has so commended itself that now, within three years after the issuance of the patent, 90 pre cent of the existing bowling alleys have the new style *** returnways. In the fact of this evidence, we cannot hold that his improvement is devoid of patentable invention.

Of course, the judge who labored the longest in advancing the objective, historical approach to deciding patentability and whose cogent and decisive decisions still stand as monuments to his intellect was Learned Hand. His foresight and complete understanding of the factors that should be faced and considered in reaching a decision in a patent case are evidenced by the case of *B.G. Corp. v. Walker Kidde & Co.*[13] In that case the invention was directed to a spark plug for use in a gas engine. Judge Hand, after reviewing the prior art, summed up defendant's defense as follows:

> [T]he defendant argues that the supposed invention is no more than a substitution of materials familiar to the art in the same uses; an aggregation of which each part performs what it did before.

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[11]Eibel Process Co. v. Minnesota & Ontario Paper Co., 261 U.S. 45 (1923).

importance. From 1793 until 1836, the Patent Office issued patents without examination for novelty and utility.[4]

The courts, in response to the cry that the Patent Office was issuing "worthless" patents, felt constrained to invalidate patents on "gadgets" that were nothing more than the products of journeymen mechanics.

By 1850, the controversy reached the Supreme Court, which was asked to decide on the correctness of a charge by a trial judge in a patent case involving a doorknob. The patentee's improvement consisted of making the knobs of clay or porcelain. At the trial the evidence established that the combination involved was well known, with the exception that the patentee had substituted a new material (clay) for the prior art metallic knobs. The controversy swirled around the following instructions to the jury by the trial judge:

> [I]f knobs of the same form and for the same purposes as that claimed by the patentees, made of metal or other material had been before known and used; and if the spindle and shank, in the form used by them, had been before known and used, and had been attached to the metallic knob by means of a cavity in the form of dovetail and infusion of melted metal, the same as the mode claimed by the patentees, in the attachment of the shank and spindle to their know; and the knob of clay was simply the substitution of one material for another, the spindle and shank being the same as before in common use, and also the mode of connecting them by dovetail to the knob the same as before in common use, and no more ingenuity or skill required to construct the know in this way than that possessed by an ordinary mechanic acquainted with the business, the patent was invalid, and the plaintiffs were not entitled to a vertict.[5]

The majority of the court agreed with the instruction and concluded:

> [I]t is quite apparent that there was no error in the submission of the questions presented at the trial to the jury; for unless more ingenuity and skill in applying the old method of fastening the shank and the knob were required in the application of it to the clay or porcelain knob than were 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. In other words, the improvement is the work of the skillful mechanic, not that of the inventor.[6]

However, Justice Levi Woodbury dissented and would have ordered another trial and required a modified charge to the jury that recognized as "invention" the contribution of one who was able to produce a better or cheaper device.[7] All of which only highlights the difficulty that the Supreme Court has faced — for more than a century — in defining a just and workable standard for patentability.

Hotchkiss, I feel, contains the seeds of the many competing standards of patentability that have been advanced since its pronouncement. While it may be unfair to trace the genesis of *A & P* to Justice Woodbury's dissent, it appears arguable that his thesis — that an invention is patentable if it produces better results than the prior art — may have unwittingly been the source of the "unexpectedly better result" requirement enunciated in *A & P.*

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[4] P. J. Federico, The Patent Act of 1793, in Outline of the History of the Patent Office 81 (1936) (Centennial Issue of

1979, the contractor, notwithstanding any provision in the contract to the contrary, may elect the new procedure with respect to any claim pending before the contracting officer on March 1, 1979, or initiated thereafter.

One limitation seems definite. Clearly, election of the new procedure does not mean that a contractor can switch over a claim already pending before a board of contract appeals to the Court of Claims simply for the reason that under the new Act he could have gone directly to the Court (Section 10(a)(1)).[78] If the contractor makes no election whatever, the old procedure, with all its ramifications, apparently applies. It seems unlikely that a contractor will ever consciously fail to make an election of the new procedure since the new procedure (Section 12 of the Act) increases the claimant's recovery by granting him interest from the date the contracting officer received the claim.[79] But the contractor might find the old procedure to be to his advantage in a case where 12 months have expired since the contracting officer's determination so that under the new procedure he would be barred from going to the Court of Claims under Section 10(1)(1) and (3).

The changes to the new standards for the resolution of conflicts not only modified procedures; they also reduced statutes of limitations for the contractor.[80] Thus, under the old procedure the contractor could go to court directly within a six years' statute of limitations,[81] provided his claim under the old doctrine amounted to a "breach of contract" claim.[82] And no equitable doctrine of laches[83] would in that case seem to bar the plaintiff because, the contractor having filed a claim with the contracting officer, it cannot be alleged that he made no prior assertion and that the delay harmed the United States seriously.[84] In such a situation the Court of Claims may still have to determine way in the 1980's in a contract case whether claimant is protected by the six-year statute of limitations and whether the claim is a "breach of contract" claim.

While it seems not to be legally possible to exclude the contractor's right to proceed under the old procedure with respect to a contract entered into before March 1, 1979, it may be desirable to require him by regulation to make an election of the new procedure at an early stage, so that the period of uncertainty will be shortened. In any event, enactment of the Contract Disputes Act of 1978 does not mean that the ramifications of the old procedure[85] can be completely forgotten.

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[78]S. Rep. at p. 35.

[79]*See* p. 16 *supra*.

[80]*See* text accompanying footnotes 23-56, especially footnotes 39-40, *supra*.

[81]28 U.S.C. §2501 (1976).

[82]*See* text accompanying footnote 30.

[83]*Cf. D'Ascenzo v. United States*, 215 Ct. Cl. 91 (1977), *Beeny v. United States*, _____ Ct. Cl. _____, (Oct. 16, 1978, No. 8-77).

[84]A problem similar to the one here discussed might arise in the case of a "dispute arising under the contract" where

either one of the two possibilities. Accordingly, the practitioner must make the one important strategic decision fairly early in the litigation.

Commenting on the scheme, Acting Chief Judge Davis state, as the view of all the judges, that contractors would prefer to go to the board of contract appeals where large amounts were not involved "because resolution of the dispute through the administrative process is generally speedier and less expensive" than a trial *de novo* proceeding in the Court of Claims.[68] Clearly, these considerations of time and expense are likely to be important factors. There is occasionally the additional factor of chance of success. Certain boards of appeals may acquire, perhaps unjustifiably, the reputation of being less "plaintiff-minded" than the Court of Claims, and it might be argued that review of an unfavorable decision of the board by the court under the substantial evidence test offers a smaller prospect of success than a direct trial *de novo* by the Court of Claims. Whether or not such speculations are well-founded, clearly the new Act could require the government contract bar to engage in such a consideration. The new Act thus might have created the opportunity of making a strategic decision based on a comparison between a Board of Contract Appeals and the Court of Claims.

Strategic decisions based on weighing the Court of Claims and the district court have always existed, principally due to the so-called "concurrent" jurisdiction of the district courts (with the Court of Claims) for claims not exceeding $10,000.[69] The familiarity of the private practitioner with the local district court, his familiarity with the Federal Rules of Civil Procedure, etc., were among the traditional issues which the practitioner weighed in this regard.[70] But in the tax field the policy determinations still existing, become much more important because in that area the jurisdiction of the district courts like that of the Court of Claims is without any monetary limitations.[71] Many factors are involved in the strategic decision whether to sue in a district court or in the Court of Claims.[72] The contention is frequently made that the Court of Claims is more "taxpayer-minded"; in any event, the practical considerations frequently go along that line; assuming that the Supreme Court has not as yet spoken on your issue but your circuit court of appeals has made statements against your view, then you should definitely go to the Court of Claims, because that Court, unlike your district court, would not consider itself bound by the statement of the circuit court. Clearly, the attorney bringing a tax refund suit must be familiar with the detailed ramifications of tax litigation when making the strategic decision where to sue.

Finally, enactment of the so-called Remand Statute[73] over six years ago succeeded in tilting toward the Court of Claims the strategic decision of where to bring civil service suits. Suits by wrongfully discharged civil servants, which

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[68]**H. R. Rep. No.** 95-1556, 95th Cong., 2d Sess. 77 (1978).
[69]Sec. 14(a) of the new Act. Compare 28 U.S.C. §1346(a)(2) with 28 U.S.C. §1491, first paragraph.

shall provide for an accelerated disposition (Section 8(f)). If the amount in dispute on appeal is even less than $10,000, a small claims procedure shall be available (Section 9(a)). Both the accelerated and small claims procedures are to be at the sole discretion of the contractor. The small claims procedure shall provide for simplified rules; a single member of the appeals board may decide such appeals; decisions under this small claims procedure are final, except in a case of fraud, but no precedent value attaches to such decisions.

Finally, Section 12, a new provision on the payment of interest, provides that interest on contract claims be paid from the date the contracting officer received the claim. This is a modification of the former situation under 28 U.S.C. §2516(a). The latter provision, in qualification of the general rule that interest is not payable on claims against the United States, provides that interest on a contract claim shall be allowed in a Court of Claims judgment only if the contract or an Act of Congress expressly provides for payment thereof. Section 12 is such an Act of Congress; however, that section is not restricted to Court of Claims Judgments.

The interesting portions of Section 13 of the new Act provide that, in addition to the payment of judgments on contract claims under the Permanent Indefinite Appropriations Act,[58] monetary awards by a board of appeals shall also be paid according to that procedure: it is generally provided in Section 13(c) that the payment both of the judgments of contract claims and of the monetary awards by the appeal board shall be reimbursed to the Permanent Indefinite Appropriations Fund by the agency whose appropriations were used for the contract.

The newly created provision of 28 U.S.C. §2510(b) was mentioned twice.[59] This provision which clarifies the *S & E Contractors* case,[60] has been added to §2510 which has been renamed *"Referral of cases by the Comptroller General or the head of an executive department or agency."*[61] That referral jurisdiction from the Comptroller General was retained in 1966 because clearly there was in that referral the required "case or controversy" concept of Article III of the Constitution, namely a difference between the claim which the private party had filed with the Comptroller General and the denial of that claim by the Government.[62] Under the new §2510(b) the head of the agency, with the prior approval of the Attorney General, may within 120 days from the board's decision refer to the Court of Claims a board decision which in his opinion should not acquire finality. As in §2510(a) the required controversy would also seem to exist, namely the controversy between the higher board award for the private party and the contrary view

[58] 31 U.S.C. §724(a) (1976).

[59] *See supra* p. 9 and p. 11.

[60] 406 U.S. 1 (1972).

[61] The section is a remnant of the previously existing, broader reference jurisdiction of the Court. *See* 28 U.S.C. §1492, §2509, as they read before the 1966 amendment: Act of June 25, 1948, Ch. 646, §§1492, 2509; 62 Stat. 941, 977 (amended 1966). At the earlier time, they conferred congressional reference jurisdiction upon the Court of Claims, but that authority was conferred in 1966 directly upon the commissioners, without any participation by the judges, in view of

§2510(b) appears interesting but raises some questions which will be discussed below.[42]

Thirdly, appeals to a board of contract appeals and suits for *de novo* trial in the Court of Claims are no longer by law entirely exclusive remedies but the contractor, after the contracting officer's decision, has the choice of selecting either one of those remedies with respect to one simultaneous claim, Sections 7 and 10(a)(1). As mentioned above,[43] this factor seems to be the cornerstone of the new Act and may require the private practitioner to make a most important decision of strategy in every contract case, namely whether he should go to the board of contract appeals or should go directly to the Court of Claims from the decision of the contracting officer. Toward the conclusion of this article we shall attempt to set forth some of the strategic considerations which the practitioner in this, and in some other areas, now will have to weigh.[44]

Also, the scope of the contracting officer's determination and that of the possible decisions by the Board of Contract Appeals may be extremely broad. It was the legislative policy of the new Act to abolish the difference between "disputes arising under the contract" (violation of individual contractural clauses) and "breach of contract" claims.[45] Thus, Section 6(a) requires the contractor to file with the contracting officer all claims "relating" to a contract, which includes "breach of contract" claims,[46] and Section 8(d) provides that the board of contract appeals shall have jurisdiction to decide any appeal from a decision of a contracting officer "relative" to a contract. In exercising that jurisdiction the board of contract appeals shall be authorized to grant "any relief that would be available to a litigant asserting a contract claim in the Court of Claims,"[47] — which seems to include the power to grant breach of contract relief, reformation or rescission.[48] Consequently, either the board of contract appeals procedure or the direct suit in the Court of Claims may be chosen by the contractor for *all* matters relating to the contract including any breach of contract claim. There is no longer any differentiation between "disputes arising under" and "breach of contract," *i.e.*, to that extent the ruling of *United States v. Utah Const. & Mining Co.*[49] seems reversed. Similarly, the Court of Claims would have to amend Chapter XIV of its rules, Rules 161-166[50] because under the new Act there could no longer be one claim in the Court of Claims seeking simultaneously trial *de novo* relief and review relief. Such amendment of the rules, of course, is a relatively simple matter because under the Judicial Code, the Rules of the Court of Claims, unlike the Federal

[42]*Infra* p. 17.

[43]*Supra* p. 7.

[44]*See infra* p. 18.

[45]**H. R. Rep. No.** 95-1556, 95th Cong. 2d Sess. 7, 15, 17 (1978); **S. Rep. No.** 95-1118, 95th Cong. 2d Sess. 1, 2, 5, 19 (1978); *see also,* 20 **The Government Contractor** No. 23, ¶424 (1978).

[46]**H. R. Rep.** at 17 (1978).

[47]Sec. 10(d) of the new Act.

[48]*H.R. Rep.* at 7. Cf. *Applied Devices Corp. v. United States,* 591 F.2d 635, 640 (Ct. Cl. 1979) where the Court of Claims stated that, while at that time the board of contract appeals did not have jurisdiction to accord equitable reforma-

imply bad faith, or is not supported by substantial evidence."[27] When decisions of agency boards were appealed to the Court of Claims, it was held by the Supreme Court that the function of the Court of Claims was limited to the administrative record in claims over which a board of contract appeals had jurisdiction and that there was to be no trial *de novo*; rather, it was the sole function of the Court of Claims to act as an appellate court reviewing board decisions.[28] When a contract appeals board improperly (in the view of the Court) dismissed a claim as untimely, it was held by the Supreme Court that the Court of Claims could not retain the case for trial on the merits, but had to suspend its proceedings pending a decision by the board on the merits of the claim.[29] But this limitation of the Court of Claims to appellate functions, so the Supreme Court held, applied only to claims "arising under the contract," as distinguished from claims for "breach of contract."[30] The result was that the Board of Contract Appeals had no authority to make findings with respect to a "breach-of-contract" claim.[31] The Wunderlich Act specifically stated that no government contract may provide that the decision of an administrative official or board on a question of law[32] shall be final. The complications caused thereby resulted in the promulgation of a complete chapter called "Wunderlich Act Reviews" in the Court of Claims Rules.[33] According to those Rules the plaintiff had to state whether (1) relief exclusive of that Act (i.e., for a complete trial *de novo* on all issues) is sought; (2) whether relief is sought exclusively under the Wunderlich Act; or (3) partially under and partially outside the Act.

An important qualification was read into the Wunderlich Act by the Supreme Court. In *S. & E. Contractors, Inc. v. United States*[34] the General Accounting Office felt that a certain prior award of the Atomic Energy Commission had been improper. The Justice Department, without the cooperation of the Atomic Energy Commission, sought to set aside the award, but it was held that the Wunderlich Act did not in those circumstances confer a right upon the Department of Justice to appeal from the decision of the Atomic Energy Commission.

The general statute of limitations governing Tucker Act claims (six years)[35] applied to contract claims, but the six-year period began to run only

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[27] 41 U.S.C. §321 (1976).

[28] *United States v. Carlo Bianchi & Co.*, 373 U.S. 709 (1963); *see also, e.g., Artisan Electronics Corp. v. United States*, 499 F.2d 606 (Ct. Cl. 1974).

[29] *United States v. Anthony Grace & Sons*, 384 U.S. 424 (1966), where the Court stated (at 433, n. 10) that "there is analogy for the rule we announce today in other areas of administrative law."

[30] *United States v. Utah Const. & Mining Co.*, 384 U.S. 394, 412 (1966); for an instance construing the claim as a "breach of contract claim," *see Meva Corp. v. United States*, 511 F.2d 548 (Ct. Cl. 1973).

[31] 384 U.S. at 418-419. Under the doctrine of collateral estoppel the Board's valid findings with respect to a claim "arising under the contract" may be binding in the subsequent claim for "breach of contract," *i.e.*, the Board's findings in connection with requests for extensions may be binding in a subsequent "breach of contract" action for delay damages.

[32] 41 U.S.C. §322 (1976). Questions of interpretation of a contract are questions of law. *D. Schwartz / S. Jacoby, Litigation with the Federal Government* §9.110 (ALI-ABA 1970). Legal interpretations of specification requirements are questions of law, and the determination of what the parties intended in using particular words is a question of law. *Max Drill v. United States*, 427 F.2d 1233 (Ct. Cl. 1970); *Foster Const. C. A. & William Bros. Co. v. United States*, 435 F.2d 873 (Ct. Cl. 1970).

[33] Chapter XIV of the 1969 Rules, **Ct. Cl. R.** 161-166. *See* 2A **West's Federal Practice Manual** §1930 (2d rev. ed.

Government, in addition to the Government's costs incurred, for an amount equal to the unsupported part of his claim.[18] A six-year statute of limitations applies. While the statute of limitations is identical with that provided for an individual's liability under the False Claims Act, the new liability is significantly broader than the previously existing liability under the False Claims Act which covers only a person making a false claim, "knowing such claim to be false."[19] On the other hand, the new statute merely requires unsuccessful *presentation* of a claim due to misrepresentation of fact; the prior law on mere fraudulent *presentation* was concerned only with court proceedings and no affirmative remedy was provided; rather, only the forfeiture of the claim was provided.[20] Section 6(a) provides that adjudication of claims involving fraud is not within agency jurisdiction, but is the responsibility of the Department of Justice.

Dealing specifically with the administrative proceedings, the second sentence of Section 6(c)(1) requires the contractor to certify for claims of more than $50,000 that the claim is made in good faith, that the supporting data are accurate, and that the amount accurately reflects the contract adjustment for which the Government is liable. But clearly the potential liability of the contractor under Section 5 for "fraudulent misrepresentation" is not restricted to fraudulent certifications under Section 6; rather, there may be liability for claims under $50,000, where no certifications are required.

The entire Section 6 regulates the administrative activities of the contractor and of the contracting officer. It seeks to speed up the decisions of the contracting officers, and to regularize them by requiring that they be in writing. All claims by a contractor shall be in writing and shall be submitted to the contracting officer; the Government's claims relating to the contract shall also be decided by the contracting officer.[21] The reasoned decision of the contracting officer shall be in writing; specific findings of fact are not required but, if made, are not binding in any subsequent proceeding. The contracting officer's decision shall be final and not subject to review "by any forum, tribunal, or Government agency," unless appealed to the Board of Contract Appeals or sued upon in a Court of Claims suit, as provided for in Sections 7 and 10(a)(1). Expedition of claims is accomplished by requiring that the contracting officer's decision on claims of $50,000 or less be made within sixty days; for larger claims he shall, within sixty days, either render a decision or notify the contractor of the time when a decision will be rendered. In any event, with respect to any claim the decision shall be issued within a reasonable time, "in acordance with regulations promulgated by the agency, taking into account such factors as the size and complexity of the claim and the adequacy of the information in support of the claim provided by the con-

[18] The legislative history shows an intent by the Congress to discourage unwarranted claims. The committee heard testimony that the Navy had found, upon analysis of shipbuilding claims, indications that a substantial number of these outstanding claims were greatly inflated. *S. Rep. No.* 95-118, 95th Cong., 2d Sess. 8, 20 (1978).

[19] 31 U.S.C. §231 (1976); *see also*, 31 U.S.C. §235 (1976).

THE CONTRACT DISPUTES ACT OF 1978: AN IMPORTANT DEVELOPMENT

*By Sidney B. Jacoby**

On November 1, 1978, the Contract Disputes Act of 1978[1] was enacted. It did not receive the national publicity which was given to the new Bankruptcy Act[2] or the Tax Reform Act of 1978,[3] but practically it may be of equal significance. The Contract Disputes Act radically changes the manner of resolving disputes in the field of government contracts. Of course, the law of government contracts has great national importance[4] and a large percentage of the U.S. Court of Claims work deals with government contracts.[5] But though the Contract Disputes Act made radical changes in court litigation involving government contracts, its changes were not limited to court litigation. Rather, the Act also contains substantial provisions for the administrative handling of government contract claims. It is fair to say that the entire area of government contracts received detailed attention and was made a broad, newly-regulated field.

The purpose of the Act is "to provide for a fair and balanced system of administrative and judicial procedures for the settlement of claims and disputes relating to government contracts."[6] Historically, the Act finds its origin in the 1972 extensive report of the special Commission on Government Procurement, which urged the establishment of a comprehensive statutory framework for the settlement of disputes and claims arising out of federal government contracts.[7] Some of the clauses proposed in the 1975 Contract Disputes Bill[8] are in the 1978 Act, such as a special procedure for small claims, a choice of the contractor either to go to court directly for a trial *de novo* or to go to the contract appeals board, and a change of the ruling of the Supreme Court not permitting the Government to appeal from a decision of a contract appeals board.[9] The 1975 Act would have contained a major departure from the Wunderlich Act.[10]

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[1]Contract Disputes Act of 1978, Pub. L. No. 95-563, 92 Stat. 2383 (codified in 41 U.S.C. §§601-613, and scattered sections of Titles 5, 28, and 31 of the United States Code).

[2]Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codifying Title 11 U.S.C.).

[3]Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763.

[4]*J. Whelan & R. Pasley, Cases and Materials on Federal Government Contracts* 1-3 (1975).

[5]Peartree, *Statistical Analysis of the Court of Claims,* 55 *Geo. L. J.* 541, (1966). In the year ending Sept. 30, 1966, 22% of the business of the Court of Claims dealt with contracts.

[6]*H. R. Rep. No.* 95-1556, 95th Cong., 2d Sess. 5 (1978).

[7]*Id.*

[8]H. R. 6085, 94th Cong., 2d Sess. (1975), described in 2 *West's Federal Practice Manual,* §1863, at 798 n.24 (2d rev. ed. 1977).

[9]The Supreme Court decision usually cited for the proposition that the Government is not permitted to appeal, discussed p. 9 *infra,* is *S. & E. Contractors, Inc. v. United States,* 406 U.S. 1 (1972).

[10]41 U.S.C. §§321-322 (1976). While some of the proposed bills contemplated repeal of the Wunderlich Act, no such repeal is specified in the final Act; rather, the clause was merely added to 28 U.S.C. §1491 that the Court of Claims shall have jurisdiction to render judgment upon any claim as provided under the Contract Disputes Act of 1978, Section 14(i). Whereas the Wunderlich Act primarily dealt with the provisions of government contracts, the Contract Disputes Act of 1978 generally (in Sections 8(g)(1)(A) and 10(b)) deals with the scope of review.

under $10,000, and essentially final under the "substantial" evidence test if over that amount. He can have a claim for a total and material breach of the contract, (for example, nonpayment of the contract price), but if he elects to appeal to the board, its adverse decision is essentially final even if against the weight of the evidence. A favorable board decision is no longer an accord and satisfaction and a final settlement of the dispute. The agency head can now appeal from his agency board's decision.

Small claims and small businesses are particularly hard hit. The Act puts the board under severe strictures of time with respect to claims under $50,000, and under more severe strictures for those under $10,000.[42] Thus the small claim or small claimant is confronted with the prospect of an adverse decision, which is absolutely final if under $10,000, and otherwise essentially final even if against the weight of the evidence. But in addition, the time limitations imposed by the Act may very well require minimal due process, and a sparse record in the event of later judicial review. That type of procedure was characterized by the Commission staff as a "quick and dirty" remedy and it was rejected. Because of its proposed summary consideration of small claims, the Commission had recommended that decisions thereon not be final at all and that they could thereafter be tried *de novo* in court, if desired.

As to larger claims, instead of becoming more expeditious, more informal, and less expensive, board procedures promise to move in the opposite direction. This is because the Act provides them with court-like pretrial procedures,[43] but without a court's ability to limit the record. If the board's decision is to be reviewable against the "substantial" evidence test, and if "substantial" evidence can be overcome only by "overwhelming evidence to the contrary,"[44] the opportunity for keeping records within reasonable limits is lost. The cost and time of trying larger claims will in all probability be greater before a board than in court.

Faced with an increase in contract cases, the court's new rules understandably propose to route cases previously before a board directly to the appellate division of the court rather than to the trial judges as heretofore. If the trial division is going to be burdened with a relatively larger number of cases filed *de novo*, that is a rational division of burdens within the court. Such a division of burdens would also be supported by APA history, which has decisions of the regulatory and ratemaking agencies proceed directly to an appellate court. Although the parallel drawn between APA proceedings and contract suits is unsound, as earlier illustrated, the proposed new rules would mean that these often huge board records would have to be examined against the "substantial" evidence test by appellate judges whose duties provide less time for detailed analysis of huge administrative records.

In short, the appeal from a contracting officer's decision to a board is no longer an attractive alternative when compared with the right to file directly in court. A sizeable redistribution of contract disputes from procurement case; the court was rendered powerless to reverse clearly erroneous decisions; and, most importantly, court decisions on the *merits* of Government contract cases were no longer available to agencies to guide them in their settlement procedures and in their own decisions.

Even greater damage occurred back in the agencies. The court had held that under the "substantial" evidence test, a prior agency decision could not be overturned except by "overwhelming evidence to the contrary" within the agency record.[32] Because the agency hearing on the merits was the only one they were ever going to get, contractors were obliged to put on "overwhelming evidence to the contrary" in anticipation of a possible adverse decision. This provoked a corresponding response from the Government. Both parties began literally to "sweep out the kitchen" and to construct huge records. Hearings in a single case have been known to take 3, 4 and even 7 months to complete. Prior to that, anything over 2 weeks was considered to be a very long case before a board. The boards could no longer provide a relatively informal, expeditious and inexpensive remedy. Their procedures became overjudicialized, overformalized, expensive and seemingly endless. The cost of funding the dispute system skyrocketed.

The excessive formality gave rise to the idea that theretofore would have been regarded as bizarre, namely, that the Government as a "party" before its own board ought to be able to appeal from its own decisions. Prior to that, when a settlement had been achieved in accordance with a decision of one of the contracting parties which was satisfactory to the other party, it was unheard of for the party deciding the claim to appeal from its own decision. It was considered that there was no longer a dispute at that point. Both parties had come into agreement and had reached an accord and satisfaction. But when these procedures began to assume judicial characteristics, it seemed at least superficially plausible that either party should be able to appeal.[33]

Because the board hearing became the only hearing on the merits anywhere, aggrieved contractors and their counsel began understandably to demand still additional formalities such as subpoena power, prolonged discovery, and other time-consuming pretrial procedures characteristic of courts.[34] Yet an agency board within the executive branch, no matter how formalized it may become, can never provide a remedy equivalent to that available in the independent judicial branch with traditional procedures and safeguards to insure even-handed justice.

In the years that followed the trilogy of Supreme Court decisions, there developed a growing dissatisfaction with the "substantial" evidence test and with the essential finality with which it cloaked agency determinations in Government contract cases. Many critical articles were written and speeches delivered on the subject.[35] It was this turmoil that the Commission on Government Procurement confronted when it was created in 1969. A large portion of

[32]*See Kobbers v. United States*, 186 Ct. Cl. at 151, 405 F.2d at 559.

proceed to court received the same treatment as any other litigant, just as Lincoln had envisioned.

But the regulatory process was also at work. Most procurement historians trace the problem back to a case in 1878, which held it permissible to include a contract provision giving the Army Quartermaster the right to determine a single question of fact, namely, the distance between two points.[19] Thereafter, during World War I, a more general "disputes" provision was developed, but it was not mandatory. Then it was made mandatory.[20] In 1950 and 1951 the Supreme Court held that such a provision was not unconscionable and was therefore enforceable.[21] A contractor subject to the "disputes" clause (that is, every contractor) was precluded by those decisions from seeking any judicial relief from an adverse decision by the agency. There were strong dissents. One Justice stated: "I still believe one should be allowed to have a judicial hearing before his business can be destroyed by administrative action."[22] Another observed that the decision "makes a tyrant out of every contracting officer."[23] Congress also reacted strongly against those two decisions with the so-called Anti-Wunderlich Act in 1954.[24] It prohibited the use of a contract provision making agency decisions absolutely final. Unfortunately, the Act of 1954 also carried a proviso that such decisions are final, unless fraudulent, capricious, arbitrary, grossly erroneous or not supported by substantial evidence. Contrary to a legislative history which had demonstrated a clear intent to continue the existing judicial remedy,[25] that proviso eventually produced quite the opposite result.[26]

"Substantial" evidence is considerably less than the preponderance, or weight, of the evidence. It was a term theretofore unique to the APA regulatory and ratemaking agencies, where sovereign immunity had not been relinquished.[27] It is generally understood that a citizen may, for example, be denied a Government job, or a promotion, or an airline route, or a TV franchise, and be further denied a full review of that denial by a court, because those are governmental regulatory and administrative functions necessarily

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[19] *Kihlberg v. United States,* 97 U.S. 398 (1878).

[20] *See* Shedd, note 17 *supra,* at 45.

[21] *United States v. Wunderlich,* 342 U.S. 98 (1951); *United States v. Moorman,* 338 U.S. 457 (1950).

[22] *Id.* at 103 (Jackson, J. dissenting.)

[23] *Id.* at 101 (Douglas, J., dissenting).

[24] 68 Stat. 81 (1954), codified at 41 U.S.C. 321-322 (1976).

[25] *See* Hearings Before Subcomm. No. 1 of the House Comm. on the Judiciary, on the Review of Finality Clauses in Government Contracts, 83d Cong., 1st and 2d Sess. (1953-54); and Hearings Before Subcomm. of Senate Comm. on the Judiciary, 82d Cong., 2d Sess. (1952).

[26] The case reports following the *Bianchi* decision, note 2 *supra,* demonstrate the birth and growth of the serious problems described in the Commission Report, note 4 *supra.* For a few random examples, *see United States v. Marietta Mfg. Co.,* 268 F. Supp. 176 (S.D.W. Va. 1967); *Gulf & Western Precision Eng'r Co. v. United States,* 211 Ct. Cl. 207, 543 F.2d 125 (1976), and Order of April 1978, 216 Ct. Cl. ____; *Purvis v. United States,* 204 Ct. Cl. 801 (1974), and Order of February 17, 1978, 216 Ct. Cl. ____; *S & E Contractors, Inc. v. United States,* 193 Ct. Cl. 335, 433 F.2d 1373 (1970), *rev'd,* 406 U.S. 1 (1972); *Sanders Assoc., Inc., v. United States,* 191 Ct. Cl. 157, 423 F.2d 291 (1970); *Bird & Sons, Inc. v. United States,* 190 Ct. Cl. 426, 420 F.2d 1051 (1970); *J. L. Simmons Co. v. United States,* 188 Ct. Cl. 684, 412 F.2d 1360 (1969); *Koppers Co. v. United States,* 186 Ct. Cl. 142, 405 F.2d 554 (1968); *Nager Elec. Co. & Keystone Eng'r Corp. v. United States,* 184 Ct. Cl. 390, 396 F.2d 977 (1968); *Sundstrand Turbo v. United States,* 182 Ct. Cl. 31, 389 F.2d 406 (1968); *Loral Elec. Corp. v. United States,* 181 Ct. Cl. 822, 387 F.2d 975 (1967).

it provides as an optional alternative only an escape from those strictures,[9] as was also recommended by the Commission.[10]

The Commission Recommendations were designed as a package.[11] The eventual result of adopting one of those recommendations without the other, will be profound changes in the procedures by which public contract disputes are ordinarily resolved. These changes will be to the detriment of everyone involved: the executive procurement agencies, the court, and the public. There is considerable irony in this because no one has ever been able to demonstrate that the cause of these detrimental changes, namely, the imposition of virtual finality on the Government's decision at the first stage of a public contract dispute, serves any useful purpose, or any Governmental purpose, or any national purpose. On the contrary, it was the Commission's conclusion that the essential unfairness of this requirement discouraged competition for Government contracts, with consequent costly damage to the whole procurement process.[12]

It is clear that a sound and sensible remedies system does not at all require that the decision of a contracting officer, or that of the agency's board of contract appeals, be final and binding on the contractor without any further meaningful recourse to a court of law. There is no counterpart for this requirement elsewhere in the law or in commerce. Arbitration has been suggested as a parallel, but the central features of agreed upon, neutral, mutually developed, commercial arbitration procedures conducted by mutually selected arbitrators, on a case-by-case basis, are lacking in the Government's "disputes" procedures.[13] Another parallel which has been drawn is with the Administrative Procedure Act agencies. That parallel is even more unsound. It equates a public contractor's right and remedies under his contract with those of a citizen involved in statutory or regulatory enforcement procedures under the APA where, traditionally, the substantive rights of citizens have been balanced against the needs of public regulatory officials invested with broad discretion by specific regulatory statutes. The APA, in fact, does not apply to contract claims and appeals.[14]

It is, of course, well recognized that Government contracts are somewhat different from other contracts between a seller and buyer of goods. Public contracts are so-called "instruments of adhesion," contracts drafted by one party to which the other party is then privileged to adhere.[15] But the requirements unilaterally exacted from its citizens by the Government in that special type of relationship should always be based on sound national procurement

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[9]The Act, note 1, *supra,* Section 10, subdivision (a)(1).

[10]Commission Recommendation 6, note 4 *supra.*

[11]Commission Report, note 4 *supra,* specifically at p. 5.

[12]Commission Report, note 4 *supra,* specifically at p. 3.

[13]For a comparison with the high standards of independence to which commercial arbitration is held, *see and cf. Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145 (1968).

[14]*See* 5 U.S.C. 553-554 (1976). *See also,* Cuneo. *The Administrative Procedure Act Does Not Apply to Boards of Contract Appeals,* 1 Pub. Cont. L.J. 18 (July 1967). The Senate Report cited in note 5 *supra,* also reaches that conclusion at p. 15.

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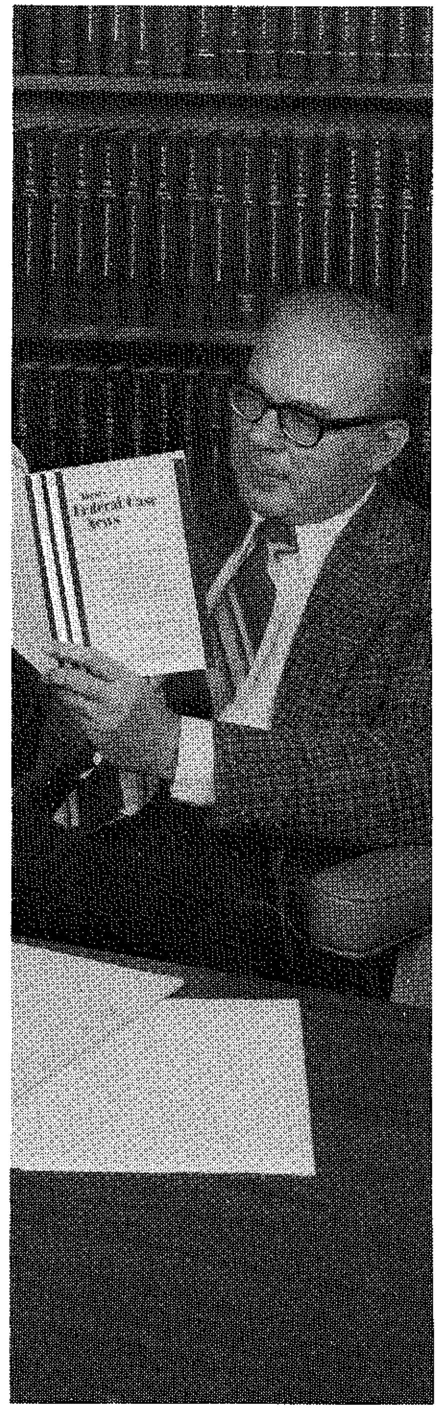

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