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

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Federal Jurisdiction—"Federal Common Law" vs. State Law.—***United States v. Yazell.***[1]—Respondent and her husband signed a promissory note to repay money borrowed as a disaster loan from the Small Business Administration (SBA).[2] A local Texas law firm, employed by the SBA to assist respondent and her husband in complying with the terms of the loan, and the Acting Regional Counsel of the SBA certified that " 'all action has been taken deemed desirable . . . to assure the validity and legal enforceability of the Note.' "[3] After default by the husband, the federal government foreclosed on a chattel mortgage and instituted this action to recover the remaining deficiency. The district court granted summary judgment in respondent's favor[4] because at the time the loan was made, Texas law provided that a married woman could not bind her separate property unless she had first obtained a court decree removing her disability to contract.[5] The court of appeals affirmed by a vote of two-to-one.[6] The Supreme Court HELD: The federal interest in collecting the SBA loan does not warrant overriding the Texas law of coverture.[7]

The problem of delineating the proper spheres for the application of federal and state laws has been with us ever since the decision of *Erie R.R. v. Tompkins*.[8] Although the *Erie* doctrine originally required federal courts to apply state law only when exercising their "diversity jurisdiction,"[9] the courts soon began to apply state law to situations much broader than diversity proceedings, *e.g.*, where the Government rather than a private citizen was one of the parties to the litigation.[10] One recently have guidelines for determining the applicability of state or federal law in government agency proceedings begun to appear. Thus, federal law has been applied where the activities of the Government or the government agency were authorized by the Constitution[11] or a relevant federal statute,[12] or where there was a sufficient federal interest to override the state law.[13] The underlying reason for the application of federal law in all these instances is the require-

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[1] 382 U.S. 341 (1966).

[2] See Small Business Act, 72 Stat. 384 (1958), 15 U.S.C. §§ 631-47 (1964).

[3] Supra note 1, at 345.

[4] A judgment was entered against the husband from which no appeal was taken.

[5] Tex. Rev. Civ. Stat. Ann. art. 4626 (1960). This section is now amended so as to give married women the capacity to contract. Texas Acts 1963, ch. 472, § 6.

[6] 334 F.2d 454 (5th Cir. 1964).

[7] Supra note 1. Harlan, J., concurring insofar as the federal interest is not overriding; Black, Douglas and White, JJ. dissenting.

[8] 304 U.S. 64 (1938).

[9] U.S. Const. art. III, § 2: "The Judicial Power shall extend . . . to Controversies . . . between Citizens of different States."

[10] Mishkin, The Variousness of "Federal Law": Competence and Discretion in the Choice of National and State Rules for Decision, 105 U. Pa. L. Rev. 797, 798 (1957).

[11] See, e.g., United States v. County of Allegheny, 322 U.S. 174, 182 (1944); Clearfield Trust Co. v. United States, 318 U.S. 363, 366 (1943); United States v. McCabe, 261 F.2d 539, 543 (8th Cir. 1958).

[12] See, e.g., United States v. View Crest Garden Apts., Inc., 268 F.2d 380, 382 (9th Cir.), cert. denied, 361 U.S. 884 (1959).

[13] See, e.g., United States v. Taylor, 333 F.2d 633, 638 (5th Cir. 1964); United States v. Sommerville, 324 F.2d 712, 714-15 (3d Cir. 1963); American Houses, Inc. v. Schneider, 211 F.2d 881, 883 (3d Cir. 1954).

ment of a uniform national disposition in matters which vitally affect the interests and powers of the United States or its agencies.[14]

The application of "federal common law" in the area of governmental activities began with the Supreme Court's decision in *Clearfield Trust Co. v. United States*,[15] involving a government claim against the endorser of a forged check. In affirming a court of appeals decision,[16] the Supreme Court stated:

> [T]he rule of *Erie R. Co. v. Tompkins* . . . does not apply to this action. The rights and duties of the United States on commercial paper which it issues are governed by federal rather than local law. When the United States disburses its funds or pays its debts, it is exercising a constitutional function or power. . . . The authority to issue the check had its origin in the Constitution and the statutes of the United States and was in no way dependent on the laws of . . . any . . . state.[17]

Although *Clearfield* dealt with commercial paper issued by the government, the language used by the Court suggested that the general rule of *Erie* was inapplicable whenever the litigation concerned the exercise of a constitutional grant of power or any federal action that was designed to carry out that grant of power.

Since disaster loans are authorized by an amendment to the Small Business Act of 1953[18] and apparently rest on the constitutional authority of the commerce clause,[19] it would seem that the present case should be governed by federal law. The SBA is an agency of the sovereign government, and since it operates on the basis of a federal statute, the validity of its acts should not be decided by another sovereignty.[20] The Supreme Court, however, distinguished its *Clearfield* decision on the basis that *Clearfield* involved the *remedial* rights of the United States with regard to commercial paper issued by the United States and that local law is deemed inconsistent with the appropriate federal rule only when it frustrates the *remedies* of the government.[21] Local law, on the other hand, is not opposed to the federal interest when it merely stipulates *procedures* that have to be followed in effectuating a valid transaction. This was demonstrated in *Bumb v. United States*,[22] where the local recording statute was applied because it did not purport to

[14] United States v. Standard Oil Co., 332 U.S. 301, 307 (1947).

[15] 318 U.S. 363 (1943); Dumbauld, The Clear Field of Clearfield, 61 Dick. L. Rev. 299 (1957).

[16] United States v. Clearfield Trust Co., 130 F.2d 93 (3d Cir. 1942).

[17] Clearfield Trust Co. v. United States, supra note 11.

[18] 69 Stat. 549 (1955), 15 U.S.C. § 636(b) (1964).

[19] See Small Business Act of 1953, § 202, 67 Stat. 232 (1953), 15 U.S.C. § 631 (1964).

[20] This is the argument of the dissent, both in the court of appeals, 334 F.2d at 456, and in the Supreme Court, supra note 1, at 359-60, quoting 334 F.2d at 456 (Prettyman, J. dissenting).

[21] Supra note 1, at 354. See also United States v. View Crest Garden Apts., Inc., supra note 12.

[22] 276 F.2d 729 (9th Cir. 1960).

preclude the government's remedy in foreclosing a validity created security interest. The local requirement of filing notice did not inhibit the government's right to require security for its loans.

In the instant case the Texas statute did not frustrate any remedy of the United States. It merely provided that in order for a married woman to enter into a valid contract, she must first obtain a court decree removing her disability under coverture. Such a court decree could have been easily obtained, and the Supreme Court pointed out that the SBA must be charged with the knowledge that the contract would be subject to the Texas law of coverture since (1) the loan was individually negotiated by officials of the SBA located in Texas and (2) the transaction was approved by Texas counsel.[23] The Supreme Court, therefore, did not find that the instant case fell within the *Clearfield* rule, and it must be concluded that the authorization of the governmental activity by a constitutional grant of power and a federal statute is not sufficient to bring a case within the exclusive control of the federal common law. Another criterion is needed in these cases in which procedural rights only are regulated by local law.

Two recent decisions used the "overriding federal interest" as a criterion and reached opposite results. In *Bumb v. United States*,[24] the court held that the SBA as a creditor was subject to the California Bulk Sales Statute in regard to third party creditors and indicated that the Government should not be afforded any preferential treatment merely because it, rather than a private lending agency, had loaned the defendant money. The court phrased the test for the applicability of federal or state law in terms of commercial inconvenience and impairment of federal policy resulting from the adoption of state law as the federal rule. It found that local requirements governing the creation of a valid security interest did not interfere with federal policy and did not create any undue hardship on the SBA since the bulk sales statutes embody the well-established policy that prior creditors should be given some modicum of protection.

In *United States v. Helz*[25] on the other hand, a wife's defense of coverture under Michigan law failed in an action brought by the United States under the National Housing Act[26] for the balance due on FHA notes executed by both husband and wife. The test used here was simply stated in terms of "affecting government money and the credit of the government,"[27] and the defense of coverture was rejected because the note was executed under the National Housing Act which facilitates the building of homes by the use of *federal* credit. The only distinguishing characteristic between the *Helz* case and the instant case seems to be that different federal agencies are involved, and indeed, the dissenters in both the court of appeals and in the Supreme Court wanted to apply the *Helz* case.[28] Its test, however, was rejected as insufficient by the majority:

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[23] Supra note 1, at 345-46.

[24] Supra note 22.

[25] 314 F.2d 301 (6th Cir. 1963).

[26] 48 Stat. 1246 (1934), as amended, 12 U.S.C. § 1703 (1964).

[27] United States v. Helz, supra note 25, at 303.

[28] 334 F.2d at 456; supra note 1, at 360.

> Undeniably there is always a federal interest to collect moneys which the Government lends. . . . But this serves merely to present the question—not to answer it. Every creditor has the same interest in this respect; every creditor wants to collect. The United States, as sovereign, has certain preferences and priorities, but neither Congress nor this Court has ever asserted that they are absolute.[29]

Instead the Supreme Court promulgated the test of whether there is a "federal interest" which is so clear and substantial that it cannot be served consistently without suffering major damage if state law is applied.[30] In the instant case the Court did not find the federal interest to be so clear and substantial: There is no congressional enactment or agency regulation with regard to the particular institution of coverture; the contract was individually negotiated, and the SBA was aware and chargeable with the knowledge that the contract would be subject to the Texas law of coverture; there is no need for uniformity as the SBA can easily comply with state law requirements. On the other hand, the law of coverture is part of a complex of family and family-property arrangements which were carefully evolved and designed to serve multiple purposes, and the Court did not want to establish a new principle which might cast doubt upon the effectiveness of the laws of ten other states[31] relating to the contractual positions of married women.[32] The area of family and family-property arrangements is peculiarly within the local jurisdiction of the states, and the Supreme Court cited *Fink v. O'Neil*[33] for the principle that state law has invariably been observed in such cases. Where a federal agency is involved in a number of different functions, it seems possible that state law would be more applicable on some questions and federal laws more appropriate in others. In the instant case the Supreme Court does not lay down any guides, since it does not say under what circumstances a federal interest is so clear and substantial that it will override state law. It does not even mention the *Bumb* test of commercial inconvenience and impairment of federal policy, although that test is more concrete than the test of "clear and substantial federal interest" and would have led to the same result.

It is submitted that the only guide available to lawyers trying these cases is the "localness" of a particular agency function. In areas where real property, recording acts, homestead laws, coverture provisions and other local arrangements that are unique to the community are involved, the courts should not interfere with the local law as long as it does not frustrate the federal activity. The Supreme Court hints at this when it phrases the issue in terms of "the intensely local interests of family property and the protec-

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[29] Id. at 348-49.

[30] Id. at 352.

[31] Id. at 351, 353.

[32] Id. at 352-53.

[33] 106 U.S. 272 (1882). There the United States sought to levy execution against property defined as homestead and exempted by the state from execution. The Supreme Court held that Rev. Stat. § 916 (1875), now Fed. R. Civ. P. 69, governed, and that the remedies of the United States on judgments were limited to those provided by state law.

tion of married women."[34] It may, therefore, be more profitable to state the dividing line between federal and state law not so much in terms of a vague "overriding federal interest" but rather in terms of the localized penetration and relevance of the federal activity. If, after the local character of the governmental function has been established, it is then decided that the application of the state law will cause substantial commercial inconvenience to the government agency and will impair an important federal policy, the federal interest may be called overriding.

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Labor Law—Railway Labor Act, Section 2 First—Employer's Duty to Bargain Decision to Lease.—*United Industrial Workers v. Board of Trustees of Galveston Wharves.*[1]—Galveston Wharves owned and operated the dock facilities of the Port of Galveston, Texas, including a public grain elevator. The employees at the grain elevator were covered by a collective bargaining contract which their union and Galveston Wharves had executed on October 1, 1960. It provided, in part, that employees be given seven days notice before being laid off and also contained a broad management-prerogatives clause. The contract was dated to expire on September 30, 1963, but the parties subsequently extended its effective date to September 30, 1964. Some time before the expiration of the contract, Galveston Wharves leased the grain elevator to a third party. On July 20, 1964, pursuant to contract terms, the union served notice that it wished to open the agreement for negotiation. On July 23, Galveston Wharves notified the union of the lease, responded that it would not negotiate—presumably because of the lease—and posted notice that, effective July 31, all elevator employees would be permanently laid off. On July 29, in accordance with Section 6 of the Railway Labor Act,[2] the union served notice requesting negotiation on this matter. Galveston Wharves replied that, under the circumstances, such negotiations were impossible. On July 31, the union struck and also instituted an action against Galveston Wharves under the RLA for an injunction prohibiting consummation of the lease and restoring the status quo until RLA machinery[3] had been exhausted. Galveston Wharves claimed that its actions were justified under the lay-off and management-prerogatives clauses. The trial court accepted this argument and found for the carrier. Reversing 2-1, the Court of Appeals for the Fifth Circuit HELD: Galveston Wharves had to bargain with the union over its decision to lease the elevator.[4]

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[34] Id. at 349.

[1] 351 F.2d 183 (5th Cir. 1965).

[2] 44 Stat. 582 (1926), as amended, 45 U.S.C. § 156 (1964).

[3] 44 Stat. 582 (1926), as amended, 45 U.S.C. §§ 156, 157 (1964).

[4] Supra note 1, at 184. The interchangeability of Railway Labor Act major-minor questions with mandatory bargaining questions under the Labor Management Relations Act has been recognized by the Supreme Court. See, e.g., Order of R.R. Telegraphers v. Chicago & N.W. Ry., 362 U.S. 330 (1960), cited in Fiberboard Paper Prods. Corp. v. NLRB, 379 U.S. 203, 210 (1964).