

taxes. An unfortunate result of the emphasis in the Second Circuit on its qualified gross income rule, however, is the picture it may present of casual handling by the courts of other difficult and important compensatory variables when they are considered in combination with the income tax question.<sup>44</sup>

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**Government Contracts—"Team" Projects—Prime Contractor's Relation to Subcontractor—Joint Enterprise.—*Air Technology Corp. v. General Elec. Co.*<sup>1</sup>**—In 1961 General Electric (GE) began preparing a proposal to the Air Force for the establishment of a nuclear detection system. Representatives of GE and Air Technology (AT), discussed the possibility of GE incorporating AT's design of the EM sensor subsystem<sup>2</sup> in a "team" proposal to the Air Force if AT could demonstrate that Air Force accuracy requirements had been met. For "team" membership, GE required that AT (1) justify to GE the scientific basis for its EM sensor design, (2) assist in preparing and presenting the proposal to the Air Force, and (3) submit, at GE's request, a properly priced proposal for the EM sensor subsystem. AT fulfilled its first requirement without imposing proprietary restrictions on the included data. At about this time, GE informed the Air Force that AT was a "team member" and subcontractor of GE's. GE then submitted its proposal to the Air Force including material contained in AT's proposal to it. Subsequently, AT fulfilled its second team membership requirement by assisting GE in orally presenting its proposal to the Air Force. The Air Force then selected GE as prime contractor, provided a suitable contract could be negotiated. GE was not selected on the basis of its proposal, which\*was not completely acceptable technically, but rather on a statement of its expected performance. During negotiations with the Air Force, AT informed GE that it "expected a sole source procurement from GE on the EM sensor."<sup>3</sup> GE, however, after successfully negotiating the prime contract, solicited competitive bids for the EM sensor from a number of companies including AT, and ultimately decided to build part of the EM subsystem itself. AT brought this bill in equity to restrain GE from using sensor information

<sup>44</sup> Compare the technique used effectively in *Nollenberger v. United Air Lines Inc.*, 216 F. Supp. 734 (S.D. Cal. 1963), where eleven special interrogatories allowed the court to compute the award as the sum of five items (of several steps each), under the provisions of Rule 49(b), F.R. Civ. P. The variables of income taxes on earnings and on yield from the award and inflation were included explicitly.

<sup>1</sup> 1964 Mass. Adv. Sh. 949, 199 N.E.2d 538 (1964).

<sup>2</sup> Nuclear explosions generate various types of radiated effects, including optical, acoustical, seismic and electromagnetic; measurement of the different effects is accomplished by means of sensing devices called "sensors," optical radiation being measured by optical sensors, and electromagnetic radiation by electromagnetic (EM) sensors. The contract finally awarded by the Air Force to GE stipulated the use of EM sensors and required that they be capable of determining the direction and measuring the yield, or magnitude, of nuclear detonations.

<sup>3</sup> *Air Technology Corp. v. General Elec. Co.*, supra note 1, at 954, 199 N.E.2d, at 543.

supplied to it by AT and sought damages on grounds that GE breached its trust to AT. The lower court denied injunctive relief but found for AT on the issue of damages for breach of trust. The Supreme Judicial Court of Massachusetts reversed on the issue of damages and remanded for their recomputation and to allow AT to amend its pleadings to conform to the proof. The court HELD: Even though there was no joint venture there was a joint undertaking and GE is liable for depriving AT of a valuable business opportunity, GE's liability being predicated upon its contractual responsibility to AT as a team member.

Modern defense systems are generally complex and rapidly rendered obsolete. The federal government, in keeping pace with advancing technology often makes its defense needs known to private enterprise and invites it to propose how these needs might best be met. The extreme complexity of these systems may require the association of several companies in the submission of a comprehensive proposal. The relationship of the United States Government with private defense firms has created a developing body of "government contract" law.<sup>4</sup>

In the absence of a clear federal rule of decision, it may be difficult to ascertain whether federal or local law should govern suits involving government contracts. The basic consideration is whether or not there exists a sufficient federal interest in the litigation to warrant the application of federal law.<sup>5</sup> The United States Supreme Court has indicated that such a federal interest exists in suits involving commercial paper issued by the Government,<sup>6</sup> government savings bonds,<sup>7</sup> and government contracts to which the United States is a party.<sup>8</sup> Even in cases involving a great federal interest, however, the applicable state law is held to govern essentially private aspects of the transaction.<sup>9</sup> The Ninth Circuit, in *American Pipe & Steel Corp. v. Firestone Tire & Rubber Co.*,<sup>10</sup> nevertheless recently required the application of federal law to a dispute between a prime contractor and subcontractor on a government contract. This represented the furthest extension of the *Clearfield Trust Co. v. United States*<sup>11</sup> doctrine that a sufficient federal interest requires the application of federal law.

There was no allegation of a federal interest in the instant case and the court, without discussing its reasons for doing so, construed the agreement in the light of New York law, the agreement having been entered into in New York, and Massachusetts law, since no argument was made that the New

<sup>4</sup> See Paul, *United States Government Contracts & Subcontracts* 6-7, 331-32 (1964).

<sup>5</sup> See *Clearfield Trust Co. v. United States*, 318 U.S. 363, 366-67 (1943).

<sup>6</sup> *Ibid.*

<sup>7</sup> See *Free v. Bland*, 369 U.S. 663 (1962); *Bank of America Nat'l Trust & Sav. Ass'n v. Parnell*, 352 U.S. 29, 34 (1956) (dictum).

<sup>8</sup> See *Priebe & Sons v. United States*, 332 U.S. 407 (1947); *United States v. County of Allegheny*, 322 U.S. 174 (1944); *Woodbury v. United States*, 313 F.2d 291 (9th Cir. 1963).

<sup>9</sup> See *Bank of America Nat'l Trust & Sav. Ass'n v. Parnell*, *supra* note 7, at 33.

<sup>10</sup> 292 F.2d 640 (9th Cir. 1961), noted in 75 Harv. L. Rev. 1656 (1962), 61 Colum. L. Rev. 1519 (1961).

<sup>11</sup> *Supra* note 5.

York and Massachusetts law substantially differed in any relevant respects.<sup>12</sup> This appears to be a correct application of local law since there was no government subcontract actually in issue as there was in *American Pipe & Steel Corp. v. Firestone Tire & Rubber Co.*<sup>13</sup> Consequently, the transaction between GE and AT could reasonably be regarded as of such an essentially private nature that local law should govern.<sup>14</sup>

The Armed Services Procurement Regulations (ASPR),<sup>15</sup> however, might be deemed to so dominate the legal relations of parties contracting with a view toward obtaining a government contract that federal law should apply.<sup>16</sup> These regulations were published in the Federal Register, thereby placing parties whose legal relations might be affected, on notice as to their contents.<sup>17</sup> The undertaking of GE and AT might thus be construed as follows: GE and AT represented themselves to the Air Force as prime contractor and subcontractor;<sup>18</sup> they are held to notice of the federal requirement that a prime contractor use competition to the greatest practicable extent in placing subcontracts.<sup>19</sup> Consequently, GE's seeking competitive bids from other companies and itself on the EM sensor would be no breach of duty on GE's part. There is no indication that AT's design was incorporated in GE's EM sensor as finally approved by the Air Force, but even if it were, the proper way for AT to protect itself was to affix proprietary restrictions to the data supplied.

Rejecting plaintiff's theory that GE was liable for its breach of trust arising from the parties' status as joint venturers, the court found that a "joint venture within that indefinite term's ordinary usage" was not indicated by the facts, but that there existed "a more limited joint undertaking by GE and AT, as team members."<sup>20</sup> (Emphasis added.) The court also concluded that GE breached its duty by competing with AT for the EM sensor work and by failing to press for AT's continued participation in the program.<sup>21</sup> This duty was in the nature of a trust arising out of the contract for a joint undertaking. It is submitted that the court could have taken this opportunity to clarify the "nebulous concept"<sup>22</sup> of joint venture rather than distinguishing joint ventures from joint undertakings with resultant fiduciary duties. The court could conceivably have reached the same result by applying modern "joint venture" law.

The joint venture, at common law, was regarded as merely an informal

<sup>12</sup> *Air Technology Corp. v. General Elec. Co.*, supra note 1, at 959-60, 199 N.E.2d, at 546-47, n.13.

<sup>13</sup> 292 F.2d 640 (9th Cir. 1961) supra note 10.

<sup>14</sup> See *Bank of America Nat'l Trust & Sav. Ass'n v. Parnell*, supra note 7.

<sup>15</sup> 32 C.F.R. §§ 1.100-30.5 (1961).

<sup>16</sup> See *Sola Elec. Co. v. Jefferson Elec. Co.*, 317 U.S. 173, 176 (1942).

<sup>17</sup> *Federal Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 385 (1947).

<sup>18</sup> *Air Technology Corp. v. General Elec. Co.*, supra note 1, at 953, 199 N.E.2d, at 542.

<sup>19</sup> 32 C.F.R. (ASPR) § 1.300-1 (1961).

<sup>20</sup> *Air Technology Corp. v. General Elec. Co.*, supra note 1, at 960, 199 N.E.2d, at 547.

<sup>21</sup> Id. at 961, 199 N.E.2d, at 547-48.

<sup>22</sup> *Backus Plywood Corp. v. Commercial Decal, Inc.*, 208 F. Supp. 687, 690 (S.D.N.Y. 1962).

partnership relating to a specific undertaking<sup>23</sup> and governed by the same rules as an ordinary partnership.<sup>24</sup> As a separate legal concept it was unknown at common law<sup>25</sup> and in early American decisions.<sup>26</sup> Later American decisions tried to distinguish partnerships and joint ventures,<sup>27</sup> and the modern trend of American decisions is to recognize the separate nature of the joint venture. As a result, the joint venture, as a distinct legal entity, has been declared to be "purely the creature of our American courts,"<sup>28</sup> and is still in the process of development.<sup>29</sup> The courts have not evolved any clear-cut definition of joint venture, being content with a case-by-case adjudication of whether a given fact situation constitutes the relationship.<sup>30</sup>

The requirement of a contractual basis for the existence of a joint venture is generally accepted.<sup>31</sup> This contract must be express or implied in fact from the parties' conduct.<sup>32</sup> The instant court construed the actions of GE and AT as indicating a contract for a joint undertaking,<sup>33</sup> thus establishing the required contractual basis.

A joint venture contract usually embraces a specific undertaking.<sup>34</sup> Though the court did not discuss it, the facts indicate this characteristic of the parties' association. It is not enough, however, "that two parties have agreed together to act in concert to achieve some stated economic objective."<sup>35</sup> There must also be a sharing of the profits and losses of the venture.<sup>36</sup> Both GE and AT obviously shared the risk of losing both their time and effort in the joint undertaking. While, however, the court was correct in concluding that AT was not to share in the profits of the prime contract<sup>37</sup> *per se* and refusing to recognize a joint venture, it is possible that AT's expected profit under the subcontract might be construed as a sufficient share in the profits of the prime contract to warrant finding the relationship of joint adventurers. The mode of participation "in the fruits of the undertaking

<sup>23</sup> See *Lesser v. Smith*, 115 Conn. 86, 89, 160 Atl. 302, 304 (1932) (dictum).

<sup>24</sup> See Lindley, *Treatise on the Law of Partnership* 10-12 (10th ed. 1935).

<sup>25</sup> See *Chapman v. Dwyer*, 40 F.2d 468, 470 (2d Cir. 1930).

<sup>26</sup> See *The Swallow*, 23 Fed. Cas. 491 (No. 13,665) (S.D.N.Y. 1846).

<sup>27</sup> See *Nichols, Joint Ventures*, 36 Va. L. Rev. 425, 444 (1950) and cases cited therein.

<sup>28</sup> *Rowe v. Brooks*, 329 F.2d 35, 41 (4th Cir. 1964); see also *Aiken Mills v. United States*, 144 F.2d 23 (4th Cir. 1944).

<sup>29</sup> See *First Mechanics Bank v. Commissioner*, 91 F.2d 275, 278 (3d Cir. 1937).

<sup>30</sup> See *Backus Plywood Corp. v. Commercial Decal, Inc.*, *supra* note 22.

<sup>31</sup> See *Hyman v. Regenstein*, 258 F.2d 502, 512 (5th Cir. 1958); *Berwin v. Cable*, 313 Mass. 431, 435, 47 N.E.2d 951, 954 (1943); *Edgerly v. Equitable Life Assur. Soc'y*, 287 Mass. 238, 243, 191 N.E. 415, 417 (1934).

<sup>32</sup> *Tompkins v. Commissioner*, 97 F.2d 396, 399 (4th Cir. 1938).

<sup>33</sup> *Air Technology Corp. v. General Elec. Co.*, *supra* note 1, at 959, 199 N.E.2d, at 546.

<sup>34</sup> See *Kleinschmidt v. United States*, 146 F. Supp. 253 (D. Mass. 1956).

<sup>35</sup> See *Hasday v. Barocas*, 115 N.Y.S.2d 209, 216 (1952).

<sup>36</sup> See *Davis v. Webster*, 198 N.E.2d 883, 887 (Ind. 1964); *Baker v. Billingsley*, 126 Ind. App. 703, 132 N.E.2d 273 (1956).

<sup>37</sup> *Air Technology Corp. v. General Elec. Co.*, *supra* note 1, at 960, 199 N.E.2d, at 547.

may be left to the agreement of the parties"<sup>38</sup> and they could arguably have chosen the subcontract device as their method of sharing the profits.

It is usually required that joint adventurers have a mutual right of control over the carrying out of the joint transaction.<sup>39</sup> Equality of control, however, is not necessarily required among joint adventurers and a recent case has suggested that mere consultation of the lesser controlling partner shows a sufficient element of control on his part for the existence of a joint venture.<sup>40</sup> Such a degree of control existed in the instant case by virtue of the frequent consultations and close working arrangements between GE and AT in submitting the proposal.

The majority of jurisdictions require the existence of some sort of mutual agency for a joint venture, while the minority view requires no such agency.<sup>41</sup> The court in the instant case made no specific finding on the question of agency, while indicating that the parties had no occasion to use any such agency powers as might have existed.<sup>42</sup>

More important than control or scope of agency powers is the question of the existence of a fiduciary relationship between the parties. If two parties are co-adventurers, they owe each other the utmost good faith and loyalty.<sup>43</sup> This duty of trust is a consequence of an existing joint venture status. The court, after stating that a "joint undertaking," but not a "joint venture," existed, held that GE had breached its fiduciary duties to AT. Since fiduciary duties flow from each of these associations, "joint venture" and "joint undertaking" are indistinguishable in this respect. Apparently, the fiduciary undertakings of GE and AT were tacitly examined under developing joint venture law.

Parties contemplating the formation of any joint association for obtaining government contracts should remember that courts have used the concept of joint venture where none in fact existed, "as a device for doing justice."<sup>44</sup> Unfortunately, actions which may be completely fair and equitable under government contract law may seem unjust under ordinary contract principles.<sup>45</sup> In order to avoid the improper application of joint venture law

<sup>38</sup> *Universal Sales Corp. v. California Press Mfg. Co.*, 20 Cal. 2d 751, 764, 128 P.2d 665, 673 (1942).

<sup>39</sup> See *Wagner v. Drecktor*, 306 N.Y. 386, 390, 118 N.E.2d 570, 572 (1954).

<sup>40</sup> *Kleinschmidt v. United States*, supra note 34, at 256.

<sup>41</sup> See, e.g., the majority view in *Roberts v. Craig*, 124 Cal. App. 2d 202, 208, 268 P.2d 500, 504 (1954); contra, *Wrenn v. Moskin*, 226 App. Div. 563, 235 N.Y.S. 405 (1929); see *Jaeger, Partnership or Joint Venture?* 37 *Notre Dame Law* 138, 153 (1961).

<sup>42</sup> *Air Technology Corp. v. General Elec. Co.*, supra note 1, at 960, 199 N.E.2d, at 547, n.15.

<sup>43</sup> *Flint v. Codman*, 247 Mass. 463, 471, 142 N.E. 256, 258-59 (1924); *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928).

<sup>44</sup> *Taubman, What Constitutes a Joint Venture*, 41 *Cornell L.Q.* 640, 652 (1956) and cases cited therein.

<sup>45</sup> It is possible that GE in good faith only intended to give AT an opportunity to bid on the EM sensor subsystem with the expectation that AT would be the successful bidder since AT had essentially written the specifications for the subsystem by virtue of its participation in the proposal activity. None of GE's actions were such as would unequivocally negate the existence of such an intent on the part of GE and this position would be entirely consistent with GE's carrying out its affirmative duty of placing subcontracts on a competitive basis to the greatest practicable extent.

to such seeming injustices, and to inform courts of their actual intent, parties associating themselves for the purpose of obtaining government contracts should be careful to characterize their undertaking in writing and to further stipulate their rights and duties. Care should be taken that their agreement cannot be construed as contravening the spirit or the letter of federal procurement law. In the event the parties enter into some form of joint undertaking, they should expressly determine, as definitely as possible, the subject matter of their agreement, how long their association will last, and at what point their association will cease. Even after the undertakings have been spelled out, a party should take care to acquire sufficient documentation to prove that he (usually the prime contractor) is justified in terminating some aspect of the association and embarking upon a course of action inconsistent with the prior, and now terminated, relationship.

This long and expensive litigation could have been avoided had GE and AT more definitely specified the character and terms of their relationship. Since this was not done, the court was called upon to construe the parties' undertakings from their actions. The court could have clarified developing "joint venture" law by more thoroughly examining the parties' conduct under present law governing such associations, rather than elaborating its theory of "joint undertaking."

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**Interstate and Foreign Commerce—Power of the States to Regulate Traffic in Intoxicating Liquor.—***Department of Revenue v. James B. Beam Distillery*;<sup>1</sup> *Hostetter v. Idlewild Bon Voyage Liquor Corp.*<sup>2</sup>—The United States Supreme Court recently handed down two decisions defining the right of the states, under the twenty-first amendment, to regulate commerce in intoxicating liquors within their boundaries. The amendment provides in its second section: "The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors in violation of the laws thereof, is hereby prohibited."<sup>3</sup> Although both cases deal with a reduction of state powers under the amendment, they involve interpretation of two separate constitutional provisions in relation to the amendment. *Beam* involves the effect of the amendment on the import-export clause,<sup>4</sup> while *Hostetter* concerns the impact of the amendment

<sup>1</sup> 377 U.S. 341 (1964).

<sup>2</sup> 377 U.S. 324 (1964).

<sup>3</sup> U.S. Const. amend. XXI, § 2.

<sup>4</sup> U.S. Const. art. I, § 10, cl. 2:

No State shall, without the Consent of Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws: and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Control of Congress.