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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1953

No. 199

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER,

vs.

GLENSHAW GLASS COMPANY AND WILLIAM
GOLDMAN THEATRES, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED JULY 8, 1954

CERTIORARI GRANTED OCTOBER 14, 1954

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1953

No. 199

COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

vs.

GLENSHAW GLASS COMPANY AND WILLIAM GOLDMAN THEATRES, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

INDEX

1 The Tax Court of the United States

Docket No. 30821

GLENSHAW GLASS COMPANY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

DOCKET ENTRIES

1950

Oct. 2. Petition received and filed. Taxpayer notified. Fee paid.

Oct. 2. Notice of appearance of Max Swiren, Ben W. Heineman, Joseph D. Block and Sidney B. Gambill as counsel filed.

Oct. 3. Copy of petition served on General Counsel.

Dec. 1. Answer filed by General Counsel.

Dec. 1. Request for hearing in Pittsburgh, Pa. filed by General Counsel.

Dec. 11. Notice issued placing proceeding on Pittsburgh calendar. Service of answer and request made.

1951

Sep. 4. Hearing set December 3, 1951, Pittsburgh.

Dec. 6. Hearing had before Judge Arundell on the merits. Amendment to petition, amended answer to petition, reply to amended answer, motion to withdraw as counsel, Max Swiren—granted—filed. Stipulation of facts filed. Briefs, Feb. 4, 1952. Replies, March 6, 1952.

Dec. 21. Transcript of hearing 12/6/51 filed.

2 1952

Feb. 1. Motion for extension of time to Feb. 18, 1952 to file brief, filed by respondent. Granted 2/1/52.

Feb. 1. Brief filed by taxpayer.

Feb. 18. Motion for extension to Feb. 28, 1952 to file brief filed by General Counsel. Granted 2/20/52.

Feb. 28. Brief filed by General Counsel.

Feb. 29. Taxpayer's brief served on General Counsel.

Mar. 28. Motion for extension to April 10, 1952 to file reply brief filed by taxpayer. Granted 3/31/52.

Mar. 31. Reply brief filed by General Counsel.

Apr. 9. Reply brief filed by taxpayer. Copy served.

Apr. 16. Motion to strike portion of respondent's reply brief, and, in the alternative, for leave to file memorandum in answer thereto filed by taxpayer. Memorandum lodged. 8/12/52 denied. Copy served 8/12/52.

1952

Aug. 13. Findings of fact and opinion rendered. Arundel J. Decision will be entered under Rule 50. Copy served.

Dec. 1. Agreed computation for entry of decision filed.

Dec. 3. Decision entered, Van Fossan J. Div. 9.

1953

Mar. 2. Petition for review by U. S. Court of Appeals, Third Circuit, filed by General Counsel.

Mar. 2. Notice of filing petition for review sent to Sidney B. Gambill, Esq. filed.

Mar. 5. Proof of service of notice of filing petition for review filed.

Apr. 6. Motion for extension of time to May 29, 1953 to
3 prepare and transmit the record filed by General Counsel.

Apr. 7. Order enlarging time to May 29, 1953 to prepare and transmit and deliver the record entered.

May 15. Statement Re Diminution of record filed by General Counsel with statement of service thereon.

May 15. Motion to retain exhibits until ten days prior to hearing in Circuit Court filed by General Counsel.

May 19. Order that the Clerk of this Court retain the original exhibits 10 days prior to the hearing in the U. S. Court of Appeals, entered.

Stipulation of Facts

It is hereby stipulated with respect to the above-entitled proceeding that the following statements may be accepted as facts and that this stipulation shall be without prejudice to the right of either party to object to the relevancy or materiality of any fact set forth herein and to introduce other and further evidence at the trial of this case not inconsistent with the facts herein stipulated:

1. The petitioner is a Pennsylvania corporation organized in 1900 as a successor to a limited association formed in 1895. Its principal office and place of business is in Glenshaw, Pennsylvania. From the date of its incorporation to the present time, the petitioner has been continuously engaged in the manufacture of glass bottles and glass containers. For the fiscal year here involved the petitioner's Federal income tax return was filed with the Col-
4 lector of Internal Revenue for the 23rd Collection District of Pennsylvania. A copy thereof will be offered in evidence at the hearing without formal proof of authenticity.

2. For some years prior to 1923, the petitioner was licensed by Howard Automatic Glass Feeder Company to use royalty-free Howard feeder machines in its manufacturing operations. Except with respect to the manufacture of milk bottles, the Howard license

agreements were without restriction as to the type of glass containers that could be manufactured by the petitioner.

3. Early in 1923, Hartford-Empire Company, representing that it had acquired control of the Howard patents, induced the petitioner to cancel its royalty-free Howard license agreements and to enter into new license agreements with Hartford covering the use of both Howard and Hartford feeder machines. The Hartford license agreements imposed upon the petitioner the obligation to pay royalties computed upon ware production, and also prohibited the petitioner from using the feeders to manufacture a wide variety of glassware and containers, including fruit jars, prescription and proprietary medicine ware, milk bottles, and certain other items.

4. From 1923 until 1931 petitioner used and operated only glass-feeding machines under license agreements with Hartford providing for payment of royalties upon all production from such feeders and limiting the type of containers which petitioner could produce therewith. Each license agreement contained a provision
5 permitting its termination by petitioner upon the payment of a prescribed lump sum minimum royalty. Pursuant to the license agreements, royalties were paid by petitioner to Hartford from 1923 through the fiscal year ended September 30, 1931.

5. The royalty payments and the restrictions upon its manufacturing operations led the petitioner to endeavor to free itself from the Hartford license agreements. In 1931, the license agreements covering the Howard feeders expired, and the petitioner took the position that those feeders, having been originally purchased by the petitioner, remained its property and could be retained and freely used upon the expiration of the license agreements. Accordingly, the petitioner embarked upon the manufacture of fruit jars through the use of those feeders in July, 1931, and a five-year contract for the sale of its fruit jar output was extended with the Samuel Mallinger Company in September of that year. In December, 1932, the royalty-free, unrestricted use of the Howard feeders by the petitioner was terminated as the result of litigation instituted by Hartford for that purpose.

6. In 1931, and in the forepart of 1932, the petitioner, the McKee Glass Co., George R. Haub, and others formed a corporation, the Shawkee Manufacturing Company, for the purpose of building and selling a new glass feeder. During 1931, and in the forepart of 1932, Haub developed and built in the petitioner's plant a new feeder, known as the Shawkee feeder. The petitioner received a nonexclusive license to use the Shawkee feeder free from the payment of any royalties. In March, and May, 1932, the peti-
6 tioner installed two Shawkee feeders, replacing two Howard (Hartford licensed) feeders. In April, and May, 1933, two

additional Shawkee feeders were installed in the petitioner's plant. On the date of the permanent injunction, October 19, 1934 (referred to hereinafter in paragraph 8), the petitioner had seven royalty-free Shawkee feeders in operation and was manufacturing 65 percent of its total production on these machines. It had by then dismantled five Howard (Hartford licensed) feeders. Upon the issuance of the permanent injunction, herein referred to, the royalty-free Shawkee feeders were dismantled. In order to do business and comply with the injunction, it was necessary for the petitioner to reinstall, and it did reinstall, the Howard feeders and pay royalties, which will be hereinafter mentioned. The Shawkee feeder proved to be an efficient, workable feeder, equal to those covered by the Hartford licenses. Were it not for the injunction of 1934, the petitioner would have continued to install royalty-free Shawkee feeders to replace the Howard and Hartford feeders.

7. On May 31, 1933, Hartford filed suit against the petitioner, Shawkee, and others, in the United States District Court for the Western District of Pennsylvania, entitled *Hartford-Empire Company* v. *Shawkee Manufacturing Company, et al.*, Docket No. 2791. A copy of Hartford's Bill of Complaint will be offered in evidence at the hearing without formal proof of authenticity. Shawkee Manufacturing Company, the petitioner, and others filed a timely answer to the Hartford Bill of Complaint. A copy of this
7. answer will be offered in evidence at the hearing without formal proof of authenticity. On the basis of an earlier decision in *Hartford-Empire Company* v. *Hazel-Atlas Glass Company*, 59 F. (2d) 399 (C.A. 3rd), the Complaint charged that the Shawkee feeder infringed the patent owned by Hartford. Relying on the *Hazel-Atlas* decision, the District Court, on June 27, 1933, entered a preliminary injunction which restrained the defendants from selling Shawkee feeders, but did not apply to the continued use of Shawkee feeders by the petitioner. A copy of the decree and order for preliminary injunction will be offered in evidence at the hearing without formal proof authenticity.

8. Relying upon its earlier decision in the *Hazel-Atlas* case, supra, the Court of Appeals for the Third Circuit affirmed the order for the preliminary injunction. The decision of the Third Circuit affirming this order is reported at 68 F. (2d) 726, which is incorporated herein by reference. Pursuant to the mandate of the Court of Appeals for the Third Circuit, following the affirmance of the order for the preliminary injunction, hereinbefore mentioned, the United States District Court for the Western District of Pennsylvania entered an order for a permanent injunction on October 19, 1934. A copy of such interlocutory decree of the United States District Court will be offered in evidence at the hearing without formal proof of authenticity.

9. The accounting directed by the interlocutory decree referred to in the preceding paragraph was finally concluded by a
8 settlement of the parties in 1939, whereby the petitioner paid Hartford the sum of $11,167.85. A final decree was thereupon entered.

10. In 1939, the United States instituted a Civil Action No. 4426 in the United States District Court for the Northern District of Ohio, Western Division, in which Hartford-Empire was ultimately held to have violated the Federal anti-trust laws. On August 25, 192, the District Court handed down an opinion which is reported as *United States* v. *Hartford-Empire Company, et al.*, 6 F. Supp. 541. Upon appeal, the United States Supreme Court on January 8, 1945 affirmed the judgment insofar as the District Court had found and held that Hartford-Empire had violated the anti-trust laws. This opinion is reported as *Hartford-Empire Company, et al.* v. *United States*, 323 U. S. 386. Upon petition for clarification of the Supreme Court's opinion that Court handed down a second opinion on April 2, 1945 which is reported as *Hartford-Empire Company, et al.* v. *United States*, 324 U. S. 570. These opinions of the District and Supreme Courts are incorporated herein by reference.

11. After December 1940, the petitioner decided to discontinue all further payments of feeder royalties to Hartford. This decision was a result of information disclosed in anti-trust proceedings prosecuted against Hartford by the United States. Hartford-Empire thereupon filed an action for royalties against petitioner in 1941 in which petitioner interposed a counter-claim which is described more fully n paragraph 12 of this stipulation. In addition,
9 based upon documents uncovered in the Government anti-trust action, petitioner in 1941 instituted proceedings to re-open and set aside the decree in *Shawkee Manufacturing Company* v. *Hartford-Empire Company*, 68 F. (2d) 726. These latter proceedings are described more fully in paragraphs 13-15 of this stipulation.

12. The action for recovery of royalties under the Hartford and Howard feeder licenses brought by Hartford-Empire against petitioner in 1941 was entitled *Hartford-Empire Company* v. *Glenshaw Glass Co.* Civil Action No. 1650, in the United States District Court for the Western District of Pennsylvania. Following the disclosures made in the Government's anti-trust case, the petitioner filed an answer and counter-claim in such action asking for a return of certain royalties and damages for violation of the anti-trust laws. A copy of such answer and counterclaim will be offered in evidence at the hearing without formal proof of authenticity. Hartford's motion to strike the petitioner's counterclaim on the ground it stated no cause of action was denied by District

Judge Schoonmaker in 1942. The opinion is reported at 47 F. Supp. 711. Such opinion is incorporated herein by reference. No further proceedings were had in Civil Action No. 1650 prior to the settlement hereinafter referred to.

13. In the proceedings instituted to reopen the decree in *Shawkee Manufacturing Company* v. *Hartford-Empire Company*, supra, petitioner charged that the judgment entered in 1932 in *Hartford-Empire Company* v. *Hazel-Atlas Glass Company*, supra, had been secured through fraud, and that the Hazel-Atlas judgment
10 was fraudulently employed to secure the permanent injunction against the petitioner in 1934 in *Shawkee Manufacturing Company* v. *Hartford-Empire Company*, supra. Simultaneously, Hazel-Atlas Glass Company filed its petition making the same charges of fraud in the procurement of the judgment against it. The proceedings were consolidated for hearing and the applications to vacate the judgments were denied by the Court of Appeals for the Third Circuit, by a divided Court. The opinion of the Court of Appeals is reported at 137 F. (2d) 764, and this opinion is incorporated herein by reference. On appeal, the Supreme Court of the United States, in 1944, ordered both the judgment against Hazel-Atlas and the judgment against the petitioner set aside upon the grounds of fraud. These opinions are reported at 322 U. S. 238, and 322 U. S. 271, and are incorporated herein by reference. The Supreme Court ordered that the fraudulently obtained judgment entered against the petitioner in 1934 be annulled and set aside, that Hartford's Bill of Complaint be dismissed, and that the petitioner be permitted to bring appropriate proceedings for restitution and damages.

14. Pursuant to the decision of the United States Supreme Court, the petitioner filed a counterclaim in the United States District Court for the Western District of Pennsylvania, in the original Hartford injunction proceedings, Case No. 2791, seeking compensatory damages in the amount of $1,500,000, and exemplary damages in a like amount based upon the fraud findings of the Supreme Court. The District Court denied all of the petitioner's
11 claims for damages except the claim for restitution of the $11,167.85 paid by the petitioner to Hartford in 1939, in settlement of the accounting order above referred to. The opinion of the District Court is reported at 67 F. Supp. 26 (D.C.W.D. Pa. 1946), which is incorporated herein by reference. Both Hartford and the petitioner appealed to the United States Court of Appeals for the Third Circuit from the judgment entered by the District Court. A copy of the brief filed with the Court of Appeals by petitioner will be offered in evidence at the hearing without formal proof of authenticity. This appeal culminated in the opinion of the Court of Appeals for the Third Circuit filed August 14, 1947,

and reported at 163 F. (2d) 474. This opinion is incorporated herein by reference.

15. Both Hartford and the petitioner filed petitions for rehearing with the Court of Appeals, and Hartford filed "comments" upon the petitioner's petition for rehearing. Copies of the two petitions for rehearing and of the comments will be offered in evidence without formal proof of authenticity. The petitions for rehearing were denied by the Court of Appeals for the Third Circuit on October 1, 1947.

16. In December, 1947, prior to the expiration of the period for the filing of a petition for certiorari in the United States Supreme Court, a settlement was concluded between the petitioner and Hartford of all litigation then pending between them. This settlement was evidenced by a settlement agreement dated December 15, 1947, executed by the petitioner and Hartford and two mutual releases dated December 19, 1947, and December 22, 1947.
12 Pursuant to the settlement agreement, Hartford paid the petitioner $813,358.24 on December 23, 1947. Concurrently therewith Hartford paid the petitioner the sum of $48,000 which the petitioner immediately returned to Hartford in consideration of the license for Hartford and Howard feeders, dated December 22, 1947. Copies of the settlement documents will be offered in evidence without formal proof of authenticity.

17. In the fiscal year involved in this proceeding, ended September 30, 1948, the petitioner paid legal fees in connection with the Hartford litigation and settlement in the total amount of $225,000.

SIDNEY B. GAMBILL,
Counsel for Petitioner.

Of Counsel:
Reed, Smith, Shaw & McClay
747 Union Trust Building
Pittsburgh, Pennsylvania

(S.) CHARLES OLIPHANT
JTR
Chief Counsel
Bureau of Internal Revenue.

13 OPINION

Docket No. 30821. Promulgated August 13, 1952.

1. Where a lump sum of money is received in settlement of various claims, an allocation of specific amounts to each of the several claims is necessary and proper.

2. Sums received in settlement of punitive damages do not constitute taxable income.

3. Sums received in settlement of claims for anticipated profits are taxable as ordinary income.

Sidney B. Gambill, Esq., for the petitioner.
Albert J. O'Connor, Esq., for the respondent.

The respondent has determined deficiencies of $31.82 and $126,361.06 in the petitioner's income tax liability for the taxable years ending September 30, 1947, and September 30, 1948, respectively.

The petitioner contests the deficiency determined for the taxable year 1948 which results from the inclusion as ordinary income of the proceeds received in a compromise settlement of various claims.

All stipulated facts are found as stipulated.

Findings of Fact

The petitioner is a Pennsylvania corporation organized in 1900 as a successor to a limited association formed in 1895. Its principal office and place of business is in Glenshaw, Pennsylvania. From the date of its incorporation to the present time, the petitioner has been continuously engaged in the manufacture of glass bottles and glass containers. For the taxable year 1948 the petitioner's
14 income tax return was filed with the collector of internal revenue for the twenty-third district of Pennsylvania.

For some years prior to 1923, the petitioner was licensed by Howard Automatic Glass Feeder Company to use royalty-free Howard feeder machines in its manufacturing operations. Except with respect to the manufacture of milk bottles, the Howard license agreements were without restrictions as to the type of glass containers that could be manufactured by the petitioner.

Early in 1923, Hartford-Empire Company (hereinafter referred to as Hartford) representing that it had acquired control of the Howard patents, induced the petitioner to cancel its royalty-free license agreements and to enter into new license agreements with Hartford covering the use of both Howard and Hartford feeder machines. The Hartford license agreements imposed upon the petitioner the obligation to pay royalties computed upon ware production, and also prohibited the petitioner from using the feeders to manufacture a wide variety of glassware and containers, including fruit jars, prescription and proprietary medicine ware, milk bottles, and certain other items. Each Hartford license agreement contained a provision permitting its termination by petitioner upon the payment of a prescribed lump-sum minimum royalty. From 1923 until 1931, petitioner used and operated only glass feeding machines under the Hartford license agreements, and pursuant to such agreements petitioner paid royalties to Hartford from 1923 through the fiscal year ended September 30, 1931.

15 The royalty payments and the restrictions upon its manufacturing operations led the petitioner to endeavor to free itself from the Hartford license agreements. In 1931, the license agreements covering the Howard feeders expired, and the petitioner took the position that those feeders, having been originally purchased by the petitioner, remained its property and could be retained and freely used upon the expiration of the license agreements. Accordingly, the petitioner embarked upon the manufacture of fruit jars through the use of those feeders in July 1931, and a 5-year exclusive distribution contract for the sale of its entire fruit jar output was executed with a distributor in September of that year. In December 1932 the royalty-free, unrestricted use of the Howard feeders by the petitioner was terminated as the result of litigation instituted by Hartford for that purpose.

In 1931 and in the forepart of 1932, the petitioner, the McKee Glass Co., George R. Haub, and others formed a corporation, the Shawkee Manufacturing Company, for the purpose of building and selling a new glass feeder. During that period, Haub developed and built in petitioner's plant a new feeder known as the Shawkee feeder. Petitioner received a nonexclusive license to use the Shawkee feeder free from the payment of any royalties. By October 19, 1934, the date of the permanent injunction hereinafter referred to, petitioner had seven royalty-free Shawkee feeders in operation in its plant and was manufacturing 65 per cent of its total production on these machines. It had by then replaced five Howard (Hartford licensed) feeders. The Shawkee feeder proved
16 to be an efficient, workable feeder, equal to those covered by the Hartford licenses.

On May 31, 1933, Hartford filed suit against the petitioner, Shawkee, and others, in the United States District Court for the Western District of Pennsylvania, entitled *Hartford-Empire Co. v. Shawkee Manufacturing Co., et al.*, Docket No. 2791. On the basis of an earlier decision, in *Hartford-Empire Co. v. Hazel-Atlas Glass Co.*, 59 F. 2d 399, the complaint charged that the Shawkee feeder infringed the patent owned by Hartford. Relying on the *Hazel-Atlas* decision, the District Court, on June 27, 1933, entered a preliminary injunction which restrained the defendants from selling Shawkee feeders, but did not apply to the continued use of Shawkee feeders by the petitioner.

Relying upon its earlier decision in the *Hazel-Atlas* case, the Circuit Court of Appeals for the Third Circuit affirmed the order for the preliminary injunction, with an opinion reported at 68 F. 2d 726. Pursuant to the mandate of the Circuit Court, the United States District Court for the Western District of Pennsylvania entered an order for a permanent injunction on October 19, 1934. The permanent injunction enjoined the use of Shawkee feeders

by petitioner for the manufacture of any and all glassware, and ordered an accounting. Upon the entry of the permanent injunction, the royalty-free Shawkee feeders were dismantled by petitioner. In order to do business and comply with the injunction, it was necessary for the petitioner to reinstall, and it did reinstall, the Hartford licensed feeders and to pay royalties. Were it not for the permanent injunction, the petitioner would have
17 continued to install royalty-free Shawkee feeders to replace the Hartford licensed feeders.

The accounting directed by the permanent injunction was finally concluded by a settlement between the parties in 1939, whereby petitioner paid Hartford the sum of $11,167.85. A final decree in Docket No. 2791 was thereupon entered in 1939.

In 1939, the United States instituted a civil action in the United States District Court for the Northern District of Ohio, in which Hartford was ultimately held to have violated the Federal antitrust laws. *United States* v. *Hartford-Empire Co.*, 46 F. Supp. 541. The judgment of the District Court finding and holding that Hartford had violated the antitrust laws was affirmed by the United States Supreme Court. *Hartford-Empire Co.* v. *United States*, 323 U. S. 386; 324 U. S. 570.

After December 1940, petitioner decided to discontinue all further payments of feeder royalties to Hartford. This decision resulted from information disclosed in the antitrust proceedings prosecuted against Hartford by the United States. Hartford thereupon filed an action for royalties against petitioner in 1941 in the United States District Court for the Western District of Pennsylvania, entitled *Hartford-Empire Co.* v. *Glenshaw Glass Co.*, Civil Action No. 1650. Following the disclosures made in the Government's antitrust case, the petitioner filed an answer and counterclaim asking for a return of certain royalties and treble damages for destruction of certain lines of its business in violation of the antitrust laws. Hartford's motion to strike the petitioner's counterclaim on the ground that it stated no cause of action was
18 denied in 1942. No further proceedings were had in Civil Action No. 1650 prior to the settlement hereinafter referred to.

Also, following the disclosures in the Government's antitrust case, petitioner instituted proceedings to reopen and set aside the permanent injunction entered against it in 1934 in Docket No. 2791. Petitioner charged that the judgment which Hartford had obtained against Hazel-Atlas Glass Company had been secured through fraud, and that the Hazel-Atlas judgment was fraudulently employed to secure the permanent injunction against petitioner in 1934. Simultaneously, Hazel-Atlas Glass Company filed its petition making the same charges of fraud in the procurement of the judgment against it. The proceedings were consolidated for hearing, and the applications to vacate the judgments were denied by the Circuit Court of Appeals for the Third Circuit, by a divided court. On appeal, the Supreme Court of the United States in 1944 ordered both the judgment against Hazel-Atlas and the judgment against the petitioner set aside upon the ground of fraud. The Supreme Court ordered that the fraudulently obtained injunction entered against the petitioner in 1934 be annulled and set aside, that Hartford's complaint be dismissed, and that the petitioner be permitted to bring appropriate proceedings for restitution and damages.

Pursuant to the decision of the United States Supreme Court, the petitioner filed a counterclaim in the United States District Court for the Western District of Pennsylvania, in the original Hartford injunction proceedings, Docket No. 2791, seeking
19 compensatory damages in the amount of $1,500,000, and exemplary damages in a like amount, based upon the findings of fraud made by the Supreme Court. The District Court denied all of the petitioner's claims for damages except the claim for $11,167.85 paid by petitioner to Hartford in 1939, in settlement of the accounting order above referred to.

The District Court found as a fact that on or about June 6, 1939, the petitioner paid $11,167.85 to Hartford in settlement of the accounting ordered by the District Court in 1934; that royalties paid by the petitioner to Hartford between January 1, 1934, and October 1944 aggregated $397,199.42; that subsequent to the beginning of suit, the petitioner expended $21,850.47 in litigation and travel expenses; that the expenses incurred by the petitioner in dismantling the Shawkee feeders totaled $11,920.15. The District Court made no specific finding of fact with respect to the amount of the loss on the fruit jar business.

The evidence relative to the damage claimed for destruction of the fruit jar business was directed toward a showing of lost profits. Testimony and exhibits were introduced to support an estimate of the profits lost during the period beginning 1934 and ending in 1940, the year in which Hartford's license restrictions on the manufacture of glass jars were removed.

Both petitioner and Hartford appealed to the United States Circuit Court of Appeals for the Third Circuit from the judgment entered by the District Court. In the Circuit Court, petitioner pressed its demands for the following items and amounts of damages, all of which claims were opposed by Hartford:

20

Item	Amount	Interest at 6 per cent to Jan. 1, 1947	Total
Settlement of accounting order	$11,167.85	$5,074.22	$16,242.07
Reimbursement of royalties paid to Hartford after Jan. 1, 1934 $397,199.42 $26,283.33)*	370,916.09	189,085.55	560,001.64
Litigation and travel expenses	21,850.47	2,872.50	24,722.25
Loss on dismantling Shawkee feeders	11,920.15	8,727.50	20,647.65
Loss on destruction of fruit jar business	292,500.00	162,373.54	454,873.54
Total	$708,354.56	$368,133.31	$1,076,487.15
Punitive damages (in an amount equal to the total amount of restitution and compensatory damages).			

* This $26,283.33 item is not involved in the present proceeding.

In the brief submitted on its appeal from the District Court's judgment entered in 1946, the petitioner stated that "Recovery was sought in the counterclaim for the the loss of the fruit jar business and reasonably anticipated profits." In a memorandum to the petitioner dated October 1, 1948, counsel for the petitioner in both suits against Hartford stated that in Civil Action No. 1650, "The principal items of damage were (i) injury to business by limitations and exclusions from various fields (ii) loss of profits and (iii) royalty and other expenses."

The Circuit Court of Appeals, on August 14, 1947, filed its opinion and held as follows:

(a) Settlement of accounting order. The judgment of the District Court allowing petitioner's claim in the amount of $11,167.85, with interest at 6 per cent, was affirmed.

(b) Royalties. Petitioner's claim for royalties, plus interest, was upheld. However, the court stated that "There may be elements which might possibly affect the amounts of royalties to be
21 refunded and we express no opinion as to this." The case was remanded for the taking of additional testimony, and a determination by the District Court of the specific amounts of royalties to be refunded.

(c) Litigation and travel expenses. Petitioner's claim was upheld.

(d) Dismantling Shawkee feeders. Petitioner's claim was upheld.

(e) Destruction of fruit jar business. The finding of the District Court that the evidence as to this loss was too speculative was affirmed as having "substantial justification" in the record.

(f) Punitive damages. The Court said that "This case calls for such damages although it is for the District Court, as the trier of fact, to assess them, taking into consideration the whole wretched scheme as ascertained and etched in unmistakable terms by the Supreme Court." The Court further stated that the trial court

could be governed by "the enormity of [the] offense rather than the measure of compensation."

Hartford had earned large profits as a result of its fraudulent practices.

Both Hartford and the petitioner filed petitions for rehearing with the Circuit Court of Appeals, and Hartford filed "comments" upon the petitioner's petition for rehearing. Hartford's petition for rehearing argued for complete freedom from liability under all of petitioner's claims. The petition filed by petitioner sought to persuade the Court to direct the entry of a judgment for the full amount of the royaltes it had paid, plus interest. Petitioner
22 also asserted that the Court's ruling denying recovery for the destruction of the fruit jar business rested on errors of law, as well as fact, and disregarded controlling decisions of the United States Supreme Court. In reply, Hartford continued to assert its position that it was entitled to substantial credits against the royalties to be refunded to petitioner. The petitions for rehearing were denied by the Circuit Court of Appeals on October 1, 1947.

While the petitions for rehearing were pending, settlement discussions between petitioner and Hartford were commenced. Petitioner's executive officers and counsel had agreed among themselves to ask for $1,530,000, consisting of the following items:

Accounting settlement; litigation and travel expenses; dismantling Shawkee feeders		$45,000
Reimbursement of royalties paid to Hartford		370,000
Loss on destruction of fruit jar business		250,000
Punitive damages in Docket No. 2791		500,000
Civil Action No. 1650 (antitrust suit):		
Loss on destruction of lines of glassware other than fruit jar business	$55,000	
Punitive damages	110,000	
		165,000
Interest on refund of royalties and other reimbursement items		200,000
		$1,530,000

Petitioner's counsel, in Civil Action No. 1650 and Docket No. 2791, was convinced and so advised the petitioner's president at the time negotiations for settlement began and at the time Hartford's final offer in settlement was received that upon remand of Docket No. 2791 to the District Court, the petitioner would probably receive punitive damages of approximately $500,000 to $750,000 and possibly $1,000,000 or $1,500,000; and further, that if the District Court awarded as punitive damages a sum of $250,-
23 000 or less, it would very likely be reversed upon appeal to the Circuit Court of Appeals. Counsel was of the view that such a large award would be made in view of such factors as the Circuit Court of Appeals' scathing denunciation of the fraud prac-

ticed by Hartford, the large profits it earned during the years the fraud was practiced, and the Circuit Court of Appeals' statement that the District Court, in assessing the punitive damages, could be governed by the enormity of the offense rather than the measure of compensation. The claims for punitive damages under Civil Action No. 1650 and Docket No. 2791 were serious claims, and figured prominently in the final settlement.

The $250,000 claim for loss on the fruit jar business was included in the total sum of $1,530,000 asked by the petitioner in settlement, mainly for bargaining purposes. Since the claim was disallowed by the District Court and the disallowance was affirmed on appeal, the petitioner was prepared to abandon it immediately. Throughout the negotiation proceedings, the representatives of Hartford took the position that the question of the allowance of that claim had been resolved by litigation and they would, therefore pay no attention to it.

The claim for compensatory and punitive damages under Civil Action No. 1650 (antitrust suit) in the amount of $165,000 consisted of $55,000 as the value placed on the claims for destruction of lines of glassware business other than the fruit jar line, and $110,000 as the value assigned to the punitive damages claim. The claims for destruction of the fruit jar line and for return
24 of royalties had also been alleged in Civil Action No. 1650.

The itemized proposal was communicated to representatives of Hartford at a meeting in September 1947. Hartford expressed a willingness to pay a sum in the area of $200,000 but any discussion of settlement in that range was declined. Thereafter, in October 1947, Hartford made a lump sum settlement offer of $600,000 to petitioner, which was rejected. In November 1947 Hartford offered the lump sum of $813,358.24. This offer was accepted by petitioner, and the settlement agreement was executed on December 15, 1947, prior to the expiration of the period for the filing of a petition for certiorari in the United States Supreme Court.

The settlement terminated the litigation in Civil Action No. 1650 and Docket No. 2791, referred to above, and was evidenced by a settlement agreement and two mutual releases. Pursuant to the settlement agreement, Hartford paid petitioner the sum of $813,358.24 on December 23, 1947. No agreement was made by the parties to the settlement as to the allocation of that amount among the various claims involved in the litigation and settlement negotiations.

In the fiscal year ended September 30, 1948, petitioner paid legal fees in connection with the Hartford litigation and settlement in the total amount of $225,000.

In its income tax return for the taxable year 1948, the petitioner reported the total proceeds of $813,358.24 from which it deducted

$225,000 for attorney fees, leaving a balance of $588,358.24 as the net proceeds. This balance was allocated to the various claims by according to each claim that proportion of the net settle-
25 ment proceeds ($588,358.24) which the value gives to such claim (under the breakdown given to Hartford in the original settlement offer of $1,530,000) bears to the total value of $1,530,000 assigned to all claims. The computation was as follows:

	Value under $1,530,000 offer	Percentage of total value of $1,530,000 assigned to all claims	Allocated net proceeds of $588,358.24
Settlement of accounting order litigation and travel expenses, dismantling Shawkee feeders	$45,000	[1] 2.9	$17,062.39
Reimbursement of royalties paid to Hartford	370,000	[1] 24.2	142,382.69
Loss on destruction of fruit jar business	250,000	[2] 16.3	95,902.40
Punitive damages in Docket No. 2791	500,000	[2] 32.7	192,393.14
Civil Action No. 1650 (antitrust suit):			
Loss on destruction of lines of glassware business other than fruit jar business	55,000	[2] 3.6	21,180.90
Punitive damages	110,000	[2] 7.2	42,361.79
Interest	200,000	[1] 13.1	77,074.93
	$1,530,000	100.0	$588,358.24

[1] On the schedule attached to the income tax return, these three items were combined at a total percentage of 40.20, and a total sum of $26,520.01.

[2] On the schedule attached to the income tax return, these four items were combined at a total percentage of 59.80, and a total sum of $351,838.23. The two items under Civil Action No. 1650 (antitrust suit) were totaled at $165,000 and referred to as "Damage to Business Covered by Antitrust suit." No part of the $165,000 sum was referred to as punitive damages.

The net effect of the computation was to allocate to each claim an amount equal to approximately 38.45 per cent ($588,358.24 ÷ $1,530,000) of the amount assigned to it in the breakdown of the original settlement offered to Hartford.

The sum of $813,358.24 received as a lump sum settlement of all claims that petitioner had against Hartford should be apportioned among the several claims in the ratio that this sum bears to the total sum of $1,530,000 claimed in the petitioner's original settlement offer.

The $225,000 in legal fees incurred by the petitioner in the litigation and settlement of the claims against Hartford should be allocated between the claims in the same proportion as the
26 $813,358.24 received in settlement is allocated to the several claims. The fees allocated to the claims that give rise to taxable income constitute an ordinary and necessary business expense.

In its claims for loss due to destruction of the fruit jar and other

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lines of glassware business, asserted in the lawsuits and in the settlement negotiations that followed, the petitioner sought recovery for loss of anticipated profits and not for lost capital.

OPINION

ARUNDELL, *Judge*: The basic issue before us is the taxability of a sum of money received by the petitioner in 1947 in compromise settlement of several claims asserted against Hartford-Empire Company (hereinafter referred to as Hartford) in two suits and in subsequent settlement negotiations. The claims were for: (1) reimbursement of the sum paid in settlement of the accounting order; (2) reimbursement of litigation and travel expenses; (3) reimbursement of loss incurred in dismantling Shawkee feeders; (4) reimbursement of royalties paid to Hartford; (5) interest on refund of royalties and other reimbursement items; (6) loss due to destruction of fruit jar business; (7) loss due to destruction of various lines of glassware business other than the fruit jar business; (8) punitive damages under section 4 of the Clayton Act (15 U. S. C. A., Title 15, section 15) for violation of Federal antitrust laws resulting in destruction of various lines of glassware business other than the fruit jar business, and (9) punitive damages for loss caused by Hartford's fraudulent practices.

27 The taxable nature of the sum received in settlement of each of those claims is dependent upon the nature of the claim. That is, a sum received in settlement of a claim for a nontaxable item is nontaxable whereas it would be taxable as ordinary income if the item claimed was an ordinary income item, or taxable as a return of capital if the claim was for recovery of lost capital. *Raytheon Production Corporation* v. *Commissioner*, 144 F. 2d 110, certiorari denied 322 U.S. 777; *Durkee* v. *Commissioner*, 162 F. 2d 184, and cases cited therein.

The parties seem to be in agreement that the sums received in settlement of the first five claims are taxable as ordinary income. The respondent has determined that they constitute ordinary income, and petitioner has offered no evidence or argument to the contrary.

The first issue is whether the sums received in settlement of the punitive damages claims constitute taxable income. It has long been established that punitive damages do not meet the test of taxable income set forth in *Eisner* v. *Macomber*, 252 U.S. 189, 193, as "' * * * the gain derived from capital, from labor, or from both combined' provided it be understood to include profit gained through a sale or conversion of capital assets * * *." *Central R. Co.* v. *Commissioner*, 79 F. 2d 697; *Highland Farms Corporation*, 42 B. T. A. 1314. This basic definition has been recently cited with complete approval in *Commissioner* v. *Culbertson*, 337 U.S. 733,

740, and has been adhered to by the respondent in his Regulations 111, section 29.22(a)-1. Therefore, on the authority of those cases, we follow this rule of long standing that has never

28 been questioned in any court and hold that the sums received in settlement of the punitive damages claims do not constitute taxable income.

The taxability of the sums received in settlement of the claims for loss due to destruction of the fruit jar and other lines of glassware business is in issue because the parties disagree as to what the taxpayer sought to recover. The petitioner contends it sought recovery of lost capital only, and the respondent contends that recovery for the loss of anticipated profits was sought. Whether or not the sums received in settlement of those claims are taxable as a return of capital or as ordinary income is dependent upon the resolution of this question of fact. *Raytheon Production Corporation* v. *Commissioner, supra*; *Durkee* v. *Commissioner, supra*; *Jones* v. *Corbyn*, 186 F. 2d 450; *Mathey* v. *Commissioner*, 177 F. 2d 259, affirming 10 T.C. 1099.

The petitioner, in support of its contention that it sought to recover only lost capital, relies on the fact that in these claims the destruction of the business was alleged. However, destruction of a business is a factual premise that might support a claim based on the loss of anticipated profits as well as the loss of capital. We must, therefore, look further to determine what the petitioner sought to recover.

The pleadings in both suits Nos. 1791 and 1650 fail to refer to any asset, either tangible or intangible, that was damaged or destroyed. There is no allegation that any physical assets became idle or useless because of the prohibition against the manufacture of certain lines of glassware but, on the contrary, we know

29 that the same machinery used to manufacture the prohibited glassware was also used to manufacture other unprohibited lines of glassware. Intangibles such as "good will" or "reputation" are nowhere mentioned and there is no contention that with reference to the prohibited lines of glassware business the petitioner had acquired "good will" or that sums had been expended and capitalized in the development of those lines. *Martin Brothers Box Co.* v. *Commissioner*, 142 F. 2d 457.

No evidence was introduced in the litigated suit or in this proceeding to establish at least that there had been in existence an asset, later destroyed, that could conceivably have been the basis of a claim for lost capital. The petitioner offered no evidence of customers' lists, schedule of valuable established merchandise outlets for those wares, testimony of preference given to those wares by customers, or similar evidence likely to be introduced where loss of good will or a similar asset is in issue. In fact, the evidence establishes that the petitioner's fruit jar business was not begun until July 1931 and, further, that in September of that year the petitioner gave to a distributor a 5-year exclusive distribution contract for the sale of its entire fruit jar output.

The evidence in the litigated suit consisted mainly of a showing of loss of anticipated profits. Testimony and exhibits were introduced to support an estimate of the profits that would have been earned during the period beginning 1934 and ending with the removal in 1940 of the prohibitions against the manufacture of fruit jars. The significance of the petitioner's reliance on such evidence is not lessened because evidence of past profits ac-
30 tually earned is sometimes introduced to value good will. See *Raytheon Production Corporation* v. *Commissioner, supra.* It is very unlikely that the petitioner attempted to prove the value of good will by estimated anticipated profits. In any event, such a purpose cannot be inferred when there is no reference to good will or any similar asset that might need to be valued. Finally, we must note that the Circuit Court of Appeals for the Third Circuit characterized that claim as a "claim for loss of profits." *H tford-Empire Co.* v. *Shawkee Mfg. Co.*, 163 F. 2d 474, 479.

After carefully studying this and all other evidence, especially the exhibits and testimony pertinent to suits Nos. 2791 and 1650, and subsequent discussions between Hartford and the petitioner, we find the posture of the litigation and settlement negotiations to be such that on the record before us we cannot find that the recovery sought was for lost capital but, on the contrary, find that recovery was sought for the loss of anticipated profits. Therefore, the sums received in settlement of those claims represent recovery for the loss of anticipated profits and are taxable as ordinary income. *Raytheon Production Corporation* v. *Commissioner, supra; Durkee* v. *Commissioner, supra; Jones* v. *Corbyn, supra; Mathey* v. *Commissioner, supra.*

However, even if the evidence established that the petitioner sought recovery only in part for loss of anticipated profits, the entire proceeds would represent a recovery for the loss of anticipated profits. The respondent has in effect determined that none of the settlement proceeds represented a return of capital, and the petitioner has relied entirely on the proposition that recovery
31 was solely for lost capital and that the proceeds received in settlement represent a return of capital. The petitioner therefore made no attempt to, and the record does not contain any evidence on the basis of which we could, apportion the settlement proceeds between recovery of lost capital and recovery for loss of anticipated profits. Under such circumstances, the entire sum received in settlement of those claims represents a recovery for

loss of anticipated profits and is taxable as ordinary income. *Armstrong Knitting Mills*, 19 B. T. A. 32; *Arcadia Refining Co.* v. *Commissioner*, 118 F. 2d 1010; *H. Liebes & Co.* v. *Commissioner*, 90 F. 2d 932; *Martin Brothers Box Co.* v. *Commissioner, supra.*

Finally, we must determine what portion of the $813,358.24 settlement proceeds is allocable to the punitive damages claims and how much is allocable to the remaining claims which give rise to taxable income. Since the entire sum allocable to the remaining claims is taxable as ordinary income, it is not necessary that we determine what portion is allocable to each individual item in that category.

The parties to the compromise settlement merely agreed to a lump sum payment and made no attempt to decide how much was paid and received in settlement of each claim or how much was attributable to the punitive damages claims. Under those circumstances, an allocation is necessary and proper. *Specialty Engineering Co.*, 12 T. C. 1173; cf. *Cramp Shipbuilding Co.*, 17 T. C. 516; see *Helvering* v. *Safe Deposit & Trust Co.*, 316 U.S. 56.

32 The petitioner proposes that we allocate to the punitive damages claims that proportion of the gross settlement proceeds ($813,358.24) which the value assigned to those claims by the petitioner at the beginning of settlement negotiations bears to the total value ($1,530,000) assigned to all claims at that time. Pursuant to that proposal, petitioner allocated $324,529.94 to the punitive damages claims and the balance to the remaining claims.

We accept the general method of allocation proposed by the petitioner as a reasonable one which in our opinion is fair to the respondent, and in so doing we are not unmindful of the respondent's objection that this method ignores the relative weight possessed by those various claims. However, we do not deem this material since the respondent does not suffer from the allocation as proposed. The failure to take into account relative weight did not increase, and possibly decreased, the amount of the settlement proceeds allocated to the punitive damages claims. For example, by giving equal weight to the claim for destruction of the fruit jar business, admittedly the weakest claim, the amount allocated to ordinary income was proportionately increased and the amount allocated to the punitive damages claims was proportionately decreased.

Furthermore, not only did the claims for punitive damages possess more weight than the claim for destruction of the fruit jar business but, in addition, we think they possessed at least approximately the same weight as all other claims, other than the first three relatively small claims totaling $44,938.47 and the interest thereon.

33 The claims for punitive damages, especially the claim in No. 2791, were serious claims that undoubtedly figured prominently in the settlement negotiations and final settlement agreement. In No. 1650, the petitioner pressed a claim for treble damages under section 4 of the Clayton Act. Hartford had already been found guilty of violating Federal antitrust laws and the judgment was affirmed by the United States Supreme Court. In No. 2791, the Circuit Court of Appeals for the Third Circuit ruled that the petitioner should receive punitive damages and prepared the way for a large award by scathingly denouncing the fraud of which the petitioner had been a victim, and by stating that "In those circumstances, the trial court has power to inflict such damages, 'having in view the enormity of * * * [the] offense rather than the measure of compensation * * *.'" Hartford had earned large profits as a result of those fraudulent practices.

The sum of $813,358.24 received as a lump settlement will be apportioned in the manner set forth in our findings and the tax thereon will be computed as we have determined herein.

The parties have agreed that the legal fees incurred in the litigation and settlement of the several claims against Hartford should be allocated between the claims in the same proportion as the settlement proceeds are allocated. They further agreed that the fees allocated to the claims that gave rise to taxable income are deductible as an ordinary and necessary business expense, and that the fees allocated to the claims that did not give rise to taxable income are not deductible.

Decision will be entered under Rule 50.

34

Decision

Pursuant to the Opinion of the Court promulgated August 13, 1952, the respondent herein, on December 1, 1952, filed a recomputation for entry of decision, the petitioner's acquiescence in the respondent's recomputation being noted thereon. Wherefore, it is

ORDERED and DECIDED: That there is no deficiency in income tax for the taxable year ended September 30, 1948, and that there is an overpayment in income tax for the taxable year ended September 30, 1948, in the amount of $85,709.20, all of which was paid after the mailing of the notice of deficiency.

Entered: Dec. 3, 1952.

(Signed) ERNEST H. VAN FOSSAN
Judge

35 The Tax Court of the United States

Docket No. 29450

WILLIAM GOLDMAN THEATRES, INC., *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

Docket Entries

1950

July 7. Petition received and filed. Taxpayer notified. Fee paid.

July 7. Copy of petition served on General Counsel.

Aug. 4. Answer filed by General Counsel.

Aug. 4. Request for Hearing in Philadelphia, Penna. filed by General Counsel.

Aug. 8. Notice issued placing proceeding on Philadelphia calendar. Service of Answer and Request made.

Dec. 19. Hearing set February 26, 1951, Philadelphia, Penna.

1951

Jan. 18. Motion for continuance to the next Philadelphia calendar filed by petitioner. 1/19/51—Granted.

June 25. Hearing set September 17, 1951, Philadelphia, Pa.

Aug. 10. Entry of appearance of Samuel H. Levy, as counsel filed.

36 Aug. 10. Entry of appearance of Bernard Wolfman as counsel filed.

Aug. 15. Motion for continuance to next Philadelphia calendar filed by taxpayer. Granted.

Aug. 21. Entry of appearance of D. Hays Solis-Cohen, as counsel filed.

Aug. 28. Motion to withdraw as counsel Daniel J. Hanlon, filed. Granted as to J. Daniel Hanlon.

Nov. 8. Hearing set January 21, 1952, Philadelphia, Pa.

1952

Jan. 21. Hearing had before Judge Johnson on merits. Stipulation of facts with exhibits filed. Briefs March 21, 1952. Replies April 30, 1952.

Jan. 30. Transcript of Hearing 1/21/52 filed.

Mar. 10. Joint motions to correct official record filed. Granted.

Mar. 14. Motion for extension to May 20, 1952 to file brief, filed by General Counsel. 3/19/52 Granted to May 21, 1952.