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Recent Cases

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RECENT CASES

Constitutional Law—Free Exercise of Religion—Trial Court Allowed to Bar the Wearing of Clerical Collar by Priest-Attorney in Jury Trial

I. Facts and Holding

Petitioner, a Roman Catholic priest[1] and practicing attorney,[2] brought suit to prohibit the respondent, a New York City Criminal Court judge, from ordering petitioner to remove his clerical collar[3] before appearing as defense counsel in a jury trial.[4] Petitioner contended that the order to remove his collar infringed his right to free exercise of religion[5] guaranteed by the first amendment.[6] Petitioner argued that his religious freedom could not be abridged absent the showing of a compelling state interest.[7] Maintaining that the state's interest could have been accomplished by the less restrictive alternative of *voir dire*,[8] petitioner insisted that the compelling interest test had not been met.[9] Respondent claimed that the state's interest in providing a fair trial to all litigants outweighed petitioner's right to wear his religious insignia while arguing before a jury. The Criminal Term of the New York Supreme Court[10] granted petitioner's

1. Petitioner had been an ordained priest for twenty-five years prior to the filing of this suit.

2. Petitioner was admitted to the New York State Bar in 1973 and was employed by the Brooklyn Criminal Court Office of the Legal Aid Society's Criminal Justice Division.

3. Petitioner stated that his bishop had "designated" that he practice law as a Catholic priest and thus wear his clerical garb at all times. He wore his clerical collar throughout law school, at his appearance before the New York State Bar Committee on Character and Fitness, at his admission to the Bar, and at all previous court appearances. The proceeding in question was petitioner's first occasion to serve as counsel in a jury trial.

4. Petitioner's client was charged with commission of a misdemeanor in an alleged assault upon her child's schoolteacher. People v. Daniels, No. K 324146/1973 (Kings County Crim. Ct.).

5. Petitioner contended that the wearing of his clerical collar constituted a continuing act of worship.

6. U.S. Const. amend. I provides: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof . . . ."

7. *See* note 31 *infra*.

8. Petitioner asserted that *voir dire*, the traditional means by which jury prejudice is minimized, could be utilized to preserve a fair trial in that the particular biases of potential jurors could be grounds for exclusion from empanelment. This means of preventing jury prejudice obviously would not infringe upon petitioner's constitutional right to free exercise of religion.

9. Petitioner raised two other arguments. He contended that the court's order barring him from trial until he removed his clerical collar violated his client's right to counsel of her choosing and his own right to practice law.

10. LaRocca v. Lane, 77 Misc. 2d 123, 353 N.Y.S.2d 867 (Crim. T. 1974).

application for an order in the nature of a prohibition;[11] the Appellate Division reversed.[12] On appeal the State of New York Court of Appeals *held*, affirmed. A state court's order barring an attorney from wearing his clerical collar as an ordained priest while representing his client before a jury is a proper exercise of the state's power to guarantee a fair trial to all litigants and does not violate the priest's right to free exercise of religion. *LaRocca v. Lane*, 37 N.Y.2d 575, 338 N.E.2d 606, 376 N.Y.S.2d 93 (1975), *petition for cert. filed*, 44 U.S.L.W. 3429 (U.S. Jan. 19, 1976).

II. Legal Background

The first amendment guarantee of free exercise of religion, although couched in absolute terms, has never been considered an absolute right. The first significant free exercise case, *Reynolds v. United States*,[13] upheld the conviction of a Mormon polygamist who claimed a religious exemption from the bigamy laws on the basis of the first amendment.[14] The Court held that while Congress was left powerless to legislate in matters of mere opinion, it was nonetheless "left free to reach actions which were in violation of social duties or subversive of good order."[15]

Subsequent free exercise cases often utilized an approach similar to the *Reynolds* case. The courts repeatedly asserted that, although the right to religious freedom was a "preferred" one[16] in the constitutional hierarchy, the freedom to act out of religious conviction was subject to reasonable governmental regulation. After the free exercise clause was applied to the states in *Cantwell v. Connecticut*,[17] state courts exhibited this same analysis. As a consequence, even substantial free exercise claims seldom were upheld throughout much of this century.[18] For example, state regulations designed to protect public health and safety almost always survived free exercise challenges. Faith healers were successfully prosecuted

11. The Criminal Term found that no jury bias could be presumed from petitioner's appearance in his clerical collar and that the effective use of *voir dire* could prevent the possibility of jury prejudice.

12. 47 App. Div. 2d 243, 366 N.Y.S.2d 456 (1975).

13. 98 U.S. 145 (1878).

14. The Court noted that the Mormon church imposed upon its male members a duty to marry several women and procreate in order to bring more souls into the church.

15. 98 U.S. at 164.

16. The "preferred" status of the free exercise clause was first articulated in footnote 4 of Chief Justice Stone's opinion in United States v. Carolene Products Co., 304 U.S. 144, 152 (1938).

17. 310 U.S. 296 (1940).

18. Marcus, *The Forum of Conscience: Applying Standards Under the Free Exercise Clause*, 1973 Duke L.J. 1217, 1234.

for practicing medicine without a license[19] and individuals were convicted for not submitting to compulsory vaccination despite their religious objections to such medical treatment.[20] In an unusual case, the preacher of a snake-handling religious group was prosecuted for manslaughter after his wife, also a member of the sect, died from snake bite.[21] Other governmental interests of varying importance also defeated free exercise claims. Mormons continued to serve sentences for commission of bigamy,[22] and Jehovah's Witnesses were convicted under child labor laws for allowing their children to sell religious literature.[23]

The concession to colorable state interests is apparent in the 1961 Supreme Court decision of *Braunfeld v. Brown*.[24] A Jewish merchant challenged state Sunday closing laws as a violation of his right to free exercise of religion. The merchant contended that he could not maintain his business and his belief in abstaining from work on the Jewish Sabbath if he were forced to close his shop on Sunday. The Court cited the *Reynolds* action-belief distinction and held that since the closing law was enacted to further a legitimate state interest, the regulation would be valid "unless the State [might] accomplish its purpose by means which [did] not impose such a burden."[25] The Court, nevertheless, found no alternative means of guaranteeing a day of rest to the state's citizenry.[26] Justice Brennan in dissent applied the same test as did the majority of the Court to achieve the opposite result. He noted that the state might have granted plaintiff an exemption to the closing law without sacrificing its goal of providing a day of rest and reasoned that the failure of the state to choose this less burdensome method was a fatal constitutional flaw.

A striking change in the free exercise standard was introduced in *Sherbert v. Verner*,[27] an opinion authored by Justice Brennan.

19. People v. Handzik, 410 Ill. 295, 102 N.E.2d 340 (1951), *cert. denied*, 343 U.S. 927 (1952).

20. Jacobson v. Massachusetts, 197 U.S. 11 (1905).

21. Kirk v. Commonwealth, 186 Va. 839, 44 S.E.2d 409 (1947). *See also* Hill v. State, 38 Ala. App. 404, 88 So. 2d 880, *cert. denied*, 264 Ala. 697, 88 So. 2d 887 (1956); Lawson v. Commonwealth, 291 Ky. 437, 164 S.W.2d 972 (1942).

22. Cleveland v. United States, 329 U.S. 14 (1946).

23. Prince v. Massachusetts, 321 U.S. 158 (1944).

24. 366 U.S. 599 (1961).

25. *Id.* at 607.

26. Plaintiffs suggested that an exception for Sabbatarians could be carved out of the closing law without damaging the state's interest in creating a day of rest. The Court noted that many (21 of 34 states having Sunday closing laws) states had created statutory exemptions for religious groups, apparently without deleterious effects to the system. Nevertheless, the Court held that it was not concerned with the "wisdom of legislation." *Id.* at 608.

27. 374 U.S. 398 (1963).

Although the Court was careful to note that it was not overruling *Braunfeld*, two Justices[28] dissented because they felt that *Braunfeld* in fact was being discarded. The plaintiff in *Sherbert* was a Seventh Day Adventist who was denied unemployment compensation under a South Carolina statute[29] because she refused to take an available job that required work on Saturday, the Sabbath day of her faith.[30] In upholding the plaintiff's claim that the South Carolina unemployment law violated her right to free exercise of religion, the Court held that the state must justify *any* infringement upon religious liberty by a compelling state interest.[31] The Court's pronouncement of the importance of religious freedom was not new, but the scrutiny given the state's interest was unique. South Carolina advanced the legitimate objective of protecting its unemployment fund from fraudulent claims. The Court, however, held that the mere possibility of fraudulent claims by feigned objections to Saturday work was insufficient to override plaintiff's free exercise claim, stating:

> [E]ven if the possibility of spurious claims did threaten to dilute the fund and disrupt the scheduling of work, it would plainly be incumbent upon the appellees to demonstrate that no alternative forms of regulation would combat abuses without infringing First Amendment rights.[32]

The trend of stricter scrutiny for state regulations that limit religious liberty continued in the recent decision of *Wisconsin v. Yoder*,[33] an attack by Amish parents on a Wisconsin compulsory school attendance statute.[34] While agreeing that plaintiffs' religious

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28. Justices Harlan and White filed the dissenting opinion. *Id.* at 418.

29. S.C. CODE tit. 68, §§ 68-1 to -404. This statute required that any applicant for unemployment compensation not have failed, without good cause, to apply for or to accept available work.

30. Plaintiff had worked at a textile mill; she terminated her employment when the mill began to require Saturday work. Plaintiff then applied for work at several other mills in her area, but all plants required Saturday work.

31. Mr. Justice Brennan first distinguished the case from the public health and safety decisions in which the free exercise claim had posed a serious threat to public welfare:

> Plainly enough, appellant's conscientious objection to Saturday work constitutes no conduct prompted by religious principles of a kind within the reach of state legislation. If, therefore, the decision of the South Carolina Supreme Court is to withstand appellant's constitutional challenge, it must be either because her disqualification as a beneficiary represents no infringement by the State of her constitutional rights of free exercise, or because any incidental burden on the free exercise of appellant's religion may be justified by a compelling state interest in the regulation of a subject within the State's constitutional power to regulate. . . .

374 U.S. 398, 403 (1963), *citing* NAACP v. Button, 371 U.S. 415, 438 (1963).

32. 374 U.S. at 407.

33. 406 U.S. 205 (1972).

34. WIS. STAT. § 118.15 (1969). This statute requires all children between the ages of seven and sixteen to attend public school. The Amish community objects to public schooling beyond the eighth grade.

objections to public schooling past the eighth grade were sincere,[35] the Court found that the state also had an interest in providing compulsory public education to develop responsible, self-sufficient citizens. The Court resolved the issue by examining the *barrier* to state objectives that would flow from recognizing an exception to the regulation for those of Amish faith. Noting that the Amish were a capable, self-supporting group of citizens, the Court held that any impediment to the state's goal of producing self-reliant individuals would be minimal. The plaintiffs' right to free exercise of religion thus was held to outweigh the state interest.

Decisions in state and federal courts since the articulation of the strict scrutiny standard in *Sherbert* have attempted to apply the principles laid down by the Supreme Court with varying results. Most courts no longer will accept untested assertions that the state's interest will be undermined by religious exemption to state regulation. Such courts examine the religious belief only to determine if it is sincere,[36] and then scrutinize the state's regulation to determine whether it furthers a compelling state interest. Many free exercise claims have been upheld under this new analysis. For example, in one of the first cases decided after *Sherbert*, the Minnesota Supreme Court reversed a criminal contempt conviction for failure to serve on a jury because of religious objections.[37] The Court of Appeals of Maryland reversed the contempt conviction of a criminal defendant who refused to remove his filaas (religious head-covering) at his arraignment.[38] Moreover, the California Supreme Court has allowed an exemption from its drug regulations for members of the Native American Church, a group that uses peyote in its religious ceremonies.[39]

Several courts, however, have denied free exercise claims on the ground that the state interests asserted met the *Sherbert* require-

35. The Court noted that the plaintiffs believed that children must be instructed at home during impressionable teenage years to maintain a detachment from the world, a requirement of the Amish religion.

36. The Court in United States v. Ballard, 322 U.S. 78 (1944), held that while the truth of religious beliefs may not be placed on trial, the sincerity of such beliefs may be examined.

37. *In re* Jenison, 267 Minn. 136, 125 N.W.2d 588, *rev'g* 265 Minn. 96, 120 N.W.2d 515, *vacated & remanded*, 375 U.S. 14 (1963). Defendant's religious objection to jury duty was based on the Biblical directive "Judge not, so you will not be judged," *Matthew* 7:1 (rev. stand. ver.) 265 Minn. at 97, 120 N.W.2d at 516.

38. McMillan v. State, 258 Md. 147, 265 A.2d 453 (1970). Defendant stated at trial that he was a member of a religious sect known as Ujamma, which had originated in Tanzania. Defendant testified that his religion required that he wear his head-covering whenever confronted by oppressors and that he felt that all white persons in America were oppressors of the black race. 258 Md. at 154, 265 A.2d at 457.

39. People v. Woody, 61 Cal. 2d 716, 394 P.2d 813, 40 Cal. Rptr. 69 (1964).

ments. In *People v. Woodruff*,[40] the New York Appellate Division upheld a criminal contempt conviction for failure to testify before a grand jury since the state had a compelling interest in procuring defendant's testimony.[41] The Arkansas Supreme Court in *Wright v. DeWitt School District*[42] held that the state's interest in promoting public health was so compelling that plaintiff could not be exempted from compulsory vaccination even though there had been no smallpox reported in the county for fifty years. Others courts have not applied the *Sherbert* standard expressly but arguably have found that state regulations would meet the compelling interest standard. Thus the Oklahoma Court of Criminal Appeals sustained a conviction for marijuana use in allegedly religious ceremonies because "there is no possible justification for the use of [marijuana] in the name of religious freedom."[43]

The problem remains difficult in close cases where a valid invocation of the constitutional guarantee of religious freedom conflicts with a substantial state objective. The instant decision, one such case, represents an attempt to weigh a free exercise claim against the state's interest in the unbiased functioning of its jury system.

III. The Instant Opinion

The instant court[44] began its opinion with a lengthy discussion of whether the writ of prohibition was an appropriate remedy for preventing the trial court's alleged violation of petitioner's constitutional rights.[45] After determining that prohibition was the proper remedy to vindicate the "preferred" right to free exercise of religion, the court decided that such vindication was not necessary on the instant facts. The court noted that religious practices, unlike reli-

40. 26 App. Div. 2d 236, 272 N.Y.S.2d 786 (1966).

41. Defendant refused to testify at an investigation into narcotics use because her religion, an unnamed faith similar to Hinduism, prohibited her from causing any person harm by testifying against him. Experts on Oriental religions testified that devotees of the Hindu religion held beliefs similar to that asserted by defendant. *Id.* at 237, 272 N.Y.S.2d at 788.

42. 238 Ark. 906, 385 S.W.2d 644 (1965).

43. Lewellyn v. State, 489 P.2d 511, 516 (Okla. Crim. App. 1971).

44. Chief Justice Breitel wrote the majority opinion in which all justices except Gabrielli, J., concurred.

45. Normally the correction of litigation errors is a matter handled by standard review or appeal procedures. The court held that prohibition was available in this case, however, to prevent the inferior court from acting in excess of its powers. Since petitioner advanced a substantial claim that the trial court exceeded its powers by violating his constitutional rights, the writ of prohibition was appropriate, even though the petitioner's claim was denied on the merits of the case. The court concluded that the petitioner should not be forced to pursue other available remedies such as contempt proceedings or an appeal in the criminal case. Such remedies were held to be inadequate because they either were too burdensome to petitioner or failed to present squarely the significant constitutional issue.

gious beliefs, are subject to regulations necessary for the protection of society.

Expressing concern that petitioner's appearance in clerical garb could prejudice a jury either in favor of[46] or against[47] his client, the court decided that the guarantee of a fair trial to all litigants was a state interest of "paramount" importance. The court then balanced petitioner's free exercise claim against this paramount state interest. The court noted that all lawyers are subject to reasonable dress regulations in order to preserve order and decorum in the courtroom and "generally to [further] the administration of justice." The court also deemed important the need to avoid the "improper displacement of client by attorney" that might be caused by the "idiosyncracies" of an attorney's "dress, appearance, character or status." All these considerations were held to outweigh any incidental burden[48] on petitioner's religious liberty.

Although the court cited the compelling interest test set forth in *Sherbert v. Verner*, it dismissed *Sherbert* and other Supreme Court free exercise cases as "not particularly helpful" because such cases did not deal with "paramount" state interests such as the preservation of a fair trial. Finally, the court expressly limited its opinion to the facts of the instant case. The court emphasized that its decision had no bearing on whether non-clerical religious practices, symbols, or expressions were permissible in the courtroom.

One justice[49] dissented from the instant decision on the basis of the dissenting opinion filed in the Appellate Division.[50] The dissenting justice in the Appellate Division voted to hold respondent's order unconstitutional on the ground that the less restrictive alternative of *voir dire* should have been utilized before petitioner's religious liberty was abridged.

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46. The court noted that since a clergyman "is accorded a measure of respect and trust unlike that which is given to those of other vocations . . . a juror might ascribe a greater measure of veracity and personal commitment to the rightness of his client's cause." 37 N.Y.2d at ___, 338 N.E.2d at 613, 376 N.Y.S.2d at 101 (1975).

47. The court also expressed concern that religious prejudices might extend from the attorney-priest to his client. The court felt that its duty was to protect the client's right to a fair trial, even though the client herself expressly had requested that petitioner remain her defense counsel.

48. The court found that petitioner's wearing of his clerical collar was a requirement of his religion "not unconditional or beyond dispensation." 37 N.Y.2d at ___, 338 N.E.2d at 613, 376 N.Y.S.2d at 102.

49. Justice Gabrielli filed the dissent in the Court of Appeals. 37 N.Y.2d at ___, 338 N.E.2d at 613, 376 N.Y.S.2d at 103.

50. Justice Shapiro authored the dissenting opinion in the Appellate Division. 47 App. Div. 2d 243, 253, 366 N.Y.S.2d 456, 465 (1975).

IV. Comment

The instant opinion is important as a vehicle for reexamination of the confusion in the cases interpreting the free exercise clause. The decision is illustrative of a lower court's struggle with the free exercise standards set forth by the Supreme Court; its avoidance of the compelling interest test adopted by the Supreme Court in *Sherbert* and affirmed in *Yoder* is a definite departure from those standards. The court did not openly reject the compelling interest standard. Instead, it first decided that the state had a "paramount" interest in assuring a fair trial to all litigants, and after citing *Sherbert's* compelling interest test, concluded that the test was not "helpful" because the interest involved in *Sherbert* was not "paramount." The Supreme Court, however, has determined that the compelling interest test is *the* yardstick by which the state's interest is to be measured.

The distinction between the court's paramount test and the traditional Supreme Court standard is more than semantic. First of all, there are many cases that establish whether particular state interests are compelling; these cases lose their precedential value under the court's new test. Secondly, the *Sherbert* standard imposes on the court a concomitant duty to find that no alternative form of regulation will effectuate the state purpose in question without abridging first amendment rights. Petitioner contended that judicious use of *voir dire* could serve the same purpose, elimination of bias, as did the trial court's order. The instant court, however, failed even to discuss whether *voir dire* might be a less restrictive alternative to barring petitioner's clerical collar from the courtroom.

It thus seems clear that the court was hesitant to follow the principles laid down in *Sherbert*. Admittedly, the compelling interest test, applied in various cases, can lead to unpalatable results. Under the *Sherbert* standard, any state regulation that accidentally infringes on religious liberty must be justified by a rigorous compelling state interest test. Such a strict scrutiny potentially creates many claims for exemptions from otherwise legitimate state regulations. Courts will not be adverse to allowing such exceptions when laws confiict with traditional religious beliefs and practices so well-known that their sincerity is not apt to be questioned. The cases that will cause problems involve claims by *unconventional* religious groups to exemptions from statutes applicable to the citizenry at large and in no way designed to interfere with religious liberty. As otherwise valid regulations are attacked by novel religious sects, it seems possible that courts will be tempted to find a compelling interest more readily as the religious belief becomes more far-

fetched.[51] This type of religious scrutiny would be antithetical to the free exercise clause. The Supreme Court's opinion in *Yoder*[52] disclosed the potential for such discrimination between religious groups. The Court allowed Amish children an exemption from compulsory education laws *only after* an extended discussion of the self-sufficiency of the Amish community.

Given the potential for misapplication of the *Sherbert* standard, the instant court in rejecting that standard nevertheless fails to replace the Supreme Court test with a more workable guideline. The problems that plague the compelling interest standard also will inhere in the "paramount" criterion because the court failed to define exactly what is a paramount interest. The flexibility thus built into the standard allows a court to vary the test according to its sympathy with the asserted free exercise claim. Additionally, religious beliefs that traditionally have been accepted as sincere and "true" will be jeopardized by the creation of a loosely-defined standard. In the instant case, for example, although the basis for petitioner's claim was a widely-recognized form of religious expression, the court decided, without closely scrutinizing the state's asserted interest, that the infringement on religious liberty was justified. There was no demonstrated prejudice involved in this case, yet the court took at face-value the state's contention that a fair trial was endangered by petitioner's appearance in his clerical collar. Additionally, it could be argued that, even if "idiosyncracies" should be eliminated, their existence is inherent in the American system of trial advocacy. Often unusual traits of attorneys, witnesses or parties may be latent influences on a jury determination, but such traits are permitted to flourish in the courtroom. Although the highly visible manifestation of a priest's status may be so obtrusive as to warrant different treatment, the court nevertheless was remiss in failing even to examine this argument.

Finally, the court ignored petitioner's contention that *voir dire* was the least restrictive alternative for eliminating potential juror bias. This omission is the most drastic departure from the *Sherbert* standard and perhaps the most unwarranted. In the instant case, *voir dire* was certainly an arguable alternative to the trial court's order barring petitioner's clerical collar. It is the traditional method by which factors potentially prejudicial to a jury determination are reduced or eliminated. The use of the least restrictive alternative prohibits the state from infringing upon religious freedom when it

51. *But see* McMillan v. State, 258 Md. 147, 265 A.2d 453 (1970), discussed *supra* note 38 and accompanying text.

52. *See* notes 33-35 *supra* and accompanying text.

could accomplish its goals by means that do not interfere with constitutional rights. By abandoning the least restrictive alternative, the instant court's opinion would allow a state to abridge religious freedom even when the encroachment could be minimized without sacrificing the state's legitimate purpose. The first amendment's absolute prohibition seemingly demands that the infringement in this situation be avoided. It thus seems that the court should have confronted petitioner's *voir dire* contention.

The present case thus represents a break from the standards set forth by the Supreme Court to govern decisions in free exercise cases. This divergence may be designed to avoid problems inherent in the compelling state interest test. The instant opinion, however, fails to provide a more workable gnideline for such cases and additionally compromises the force of the free exercise clause.

SUSAN E. DOMINICK

Constitutional Law—Interstate Commerce—Federal Regulations Requiring States to Enact Statutes Enforcing Federal Air Pollution Control Programs Exceed the Commerce Power by Intruding Upon State Sovereignty Protected by the Tenth Amendment

I. FACTS AND HOLDING

Petitioners[1] sought review[2] of transportation control regulations issued pursuant to section 110(c)(1)[3] of the Clean Air Act by the

1. The state of Maryland, the Commonwealth of Virginia, the District of Columbia, the County of Prince William, Virginia, and the Cities of Alexandria and Fairfax, Virginia were petitioners.

2. Jurisdiction is conferred upon the D.C. Circuit by 42 U.S.C. § 1857h-5(b)(1) (1970), which provides in pertinent part: "A petition for review of the Administrator's action in approving or promulgating any implementation plan . . . may be filed only in the United States Court of Appeals for the appropriate circuit."

3. 42 U.S.C. § 1857c-5(c)(1) (1970). The Clean Air Act, 42 U.S.C. § 1857 (1970), requires the Administrator to promulgate national primary air quality standards necessary to protect public health, and national secondary air quality standards necessary to protect the public from any known adverse effects. 42 U.S.C. § 1857c-4 (1970). These standards were promulgated on April 30, 1971. 40 C.F.R. pt. 50 (1974). Under 42 U.S.C. § 1857c-5(a)(1) (1970), each state is responsible for submitting an implementation plan designed to achieve the national primary and secondary air quality standards that meet the specific criteria in 42 U.S.C. § 1857c-5(a)(2)(A)-(H) (1970). If the state plan is inadequate the Administrator must disapprove the plan and, pursuant to 42 U.S.C. § 1857c-5(c)(1) (1970), must promulgate federal regulations setting forth an implementation plan for the state. Petitioners submitted an

Administrator of the Environmental Protection Agency (EPA) as part of the implementation plan for the National Capital Interstate Air Quality Control Region.[4] The EPA plan[5] included the requirements that petitioners submit legally adopted regulations implementing programs for vehicle inspections and retrofit, and refuse to register nonconforming vehicles.[6] Petitioners asserted that the inherent limitations of federalism embodied in the tenth amendment[7] prevent the Administrator from requiring states to enforce and administer federal air quality control regulations.[8] Respondent argued that congressional authority under the commerce clause[9] includes

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implementation plan to the EPA in April and May 1973. The Administrator approved some portions of the plan and disapproved others. The Administrator then proposed his own regulations that, as finally adopted, form the hasis of this appeal.

4. The National Capital Interstate Air Quality Control Region consists of Montgomery and Prince George Counties, Maryland; Arlington, Fairfax, Loudoun, and Prince William Counties, and the cities of Alexandria, Fairfax, and Falls Church in Virginia; and the District of Columhia.

5. The regulations for the District of Columbia are found at 40 C.F.R. § 52.470-96 (1974); for Maryland at 40 C.F.R. § 52.1070-112 (1974); and for Virginia at 40 C.F.R. § 52.2420-47 (1974). The pertinent transportation controls required in summary:

(1) Purchase of additional buses by 1977, with costs spread over the three jurisdictions. 40 C.F.R. §§ 52.476(g), 52.1080(g), 52.2435(e) (1974).

(2) Creation of reversible bus lanes on specified corridors. 40 C.F.R. §§ 52.476(h), 52.1080(h), 52.2435(f) (1974).

(3) A state-created vehicle inspection and maintenance program. 40 C.F.R. §§ 52.490, 52.1089, 52.2441 (1974).

(4) Creation of 60 miles of bicycle lanes. 40 C.F.R. §§ 52.491, 52.10190, 52.2442 (1974).

(5) Retrofitting of all heavy-duty vehicles and certain medium-duty vehicles with an Air/Fuel Control Device. 40 C.F.R. §§ 52.492, 52.494, 52.1091-92, 52.2444-45 (1974).

(6) Retrofitting of all pre-1968 light-duty vehicles with a Vacuum Spark Advance Disconnect (VASD). 40 C.F.R. §§ 52.496, 52.1094, 52.2447 (1974).

The plan also contained gasoline vapor recovery regulations and dry cleaning solvent evaporation control regulations not challenged by petitioners. 40 C.F.R. §§ 52.487-89, 52.1086-88, 52.2439-440 (1974).

6. The vehicle inspection and retrofit regulations followed a basic pattern:

(a) Definitions.

(b) Application of the regulation to the state's portion of the National Capital Region.

(c) Requirement that the states adopt the necessary statutes and regulations implementing the EPA program.

(d) Submission of the legally adopted regulations by a set date.

(e) Prohibition against state registration of nonconforming vehicles.

(f) Prohibition against the operation of nonconforming vehicles.

7. U.S. CONST. amend. X, which provides: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

8. Petitioners also asserted that the Administrator did not have statutory authority under the Clean Air Act to force states to enact the instant regulations; that the regulations violated the constitutional guarantee of a republican form of government; and that various portions of the regulations were arbitrary and capricious.

9. U.S. CONST. art. I, § 8, cl. 3, which provides: "The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with Indian Tribes."

the power to require states to cooperate in achieving national air quality standards.[10] On appeal to the District of Columbia Circuit, *held*, the regulations affirmed in part and remanded in part to the EPA. Federal regulations promulgated under the Clean Air Act that require states to enact statutes enforcing and administering federal air pollution control plans exceed congressional power under the commerce clause by drastically intruding on state sovereignty protected by the tenth amendment. *District of Columbia v. Train*, 521 F.2d 971 (D.C. Cir. 1975), *petition for cert. filed*, 44 U.S.L.W. 3439 (U.S. Jan. 26, 1976).

II. Legal Background

Chief Justice Marshall, in his classic opinion in *Gibbons v. Ogden*,[11] declared that congressional power to regulate commerce was plenary and limited only by other provisions of the Constitution.[12] The Supreme Court, in opinions subsequent to *Gibbons*, initially limited the doctrine as set forth by Justice Marshall.[13] In recent years, however, in response to labor strife,[14] increased governmental economic regulation,[15] and the civil rights movement,[16] the

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10. Respondent also argued that the Clean Air Act authorized him to enact the regulations because under 42 U.S.C. § 1857c-8(b) (1970) the Administrator may enforce an applicable implementation plan against "any person" in violation of the plan, and 42 U.S.C. § 1857h(e) defines "person" to include states and municipalities. Respondent further contended that Congress intended that states be required to cooperate in the achievement of national air quality standards. *See* statement of Congressman Staggers:

> If we left it all to the Federal Government, we would have about everybody on the payroll of the United States. We know this is not practical. Therefore, the Federal Government sets the standards, we tell the States what they must do and what standards they must meet. These standards must be put into effect by the communities and the states, and we expect them to have the means to do the actual enforcing.

116 Cong. Rec. 19,204 (daily ed. June 10, 1970). *See also* respondent's Preamble to the transportation control regulations:

> . . . the amendments of 1970 were designed to cure deficiencies that had resulted from total reliance upon state and local action to solve what was increasingly recognized as a national health problem. The regnlations now being promulgated will provide the necessary assurance that such state and local action will be forthcoming.

38 Fed. Reg. 30633 (1973).

11. 22 U.S. (9 Wheat.) 1 (1824).

12. Chief Justice Marshall stated:

> It is the power to regulate; that is, to prescribe the rule by which commerce is to be governed. This power, like all others vested in Congress, is complete in itself, may be exercised to its utmost extent, and acknowledges no limitations, other than are prescribed in the constitution.

Id. at 196.

13. *See, e.g.*, Carter v. Carter Coal Co., 298 U.S. 238 (1936); Hammer v. Dagenhart, 247 U.S. 251 (1918).

14. NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1937).

15. Wickard v. Filburn, 317 U.S. 111 (1942).

16. Katzenbach v. McClung, 379 U.S. 294 (1964).

Court has sanctioned congressional regulation of nearly any activity, or class of activities,[17] that even remotely affects interstate commerce. Exercise of sweeping regulatory powers by the federal government inevitably conflicts with sovereign powers of state and local governments.[18] The Court's struggle in attempting to preserve a federalist system of government is illustrated by opinions dealing with the federal taxing power. Early in its history the Court recognized that if state and federal governments were allowed to tax each other, the practice could lead to the destruction of both.[19] In 1905, however, the Court in *South Carolina v. United States*[20] limited the protection afforded to states by characterizing a state-operated liquor monopoly as a "private business" rather than "governmental" activity and refusing to grant immunity from a federal tax to the state. [21] Justice Frankfurter, writing a two-judge plurality opinion in *New York v. United States*,[22] further limited the protection of states from federal regulation by seemingly abandoning the "governmental" versus "private business" distinction and holding that a state could not claim immunity from a "non-discriminatory" federal tax.[23] Frankfurter nevertheless acknowledged that some state activity, such as maintaining a statehouse, is so intrinsically a state function that it never could be taxed without unjustifiably interfering with the state's sovereign powers.[24]

State sovereignty has presented less impediment to the exercise of federal commerce power than it has to the extension of federal taxing power. The Supreme Court has analyzed the question in two

17. Maryland v. Wirtz, 392 U.S. 183, 192-93 (1968) (the only question is whether a rationally defined class of activities affects interstate commerce).

18. The preemption doctrine determines the extent to which federal regulation of an activity forecloses state regulation. *See* Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520 (1959); San Diego Bldg. Trades Council v. Garmon, 359 U.S. 236 (1959). For a discussion of the effect of preemption on state environmental legislation see Note, *State Environmental Protection Legislation and the Commerce Clause*, 87 HARV. L. REV. 1762 (1974).

19. In *McCulloch v. Maryland*, Chief Justice Marshall described a state's power to tax as the "power to destroy," 17 U.S. (4 Wheat.) 316, 431 (1819), and held that Maryland could not tax the operations of the National Bank. The same principle later was extended to protect states from federal taxation. Texas v. White, 74 U.S. (7 Wall.) 700 (1868).

20. 199 U.S. 437 (1905).

21. *Id.* at 461.

22. 326 U.S. 572 (1946).

23. *Id.* at 583-84. Frankfurter considered congressional power to tax no less broad than congressional power to regulate commerce. *Id.* at 582.

24. *Id.* In a concurring opinion, Chief Justice Stone agreed that the "governmental" and "proprietary" distinction should be abandoned, but disagreed that state sovereignty adequately could be protected by merely requiring a federal tax to be nondiscriminatory. Stone contended that the actual interference with state functions must be examined. *Id.* at 588. Dissenting, Justices Douglas and Black would have found the state activity protected and would have overruled *South Carolina*. *Id.* at 590.

ways: (1) whether Congress may regulate intrastate conduct that affects interstate commerce when a state has chosen to remain inactive; and (2) whether Congress may regulate state activity that if conducted by an individual would be subject to federal regulation. The Court considered the first issue in 1941 in *United States v. Darby*.[25] The Court upheld a Fair Labor Standards Act indictment of an employer who sold lumber in interstate commerce produced by employees earning substandard wages. Responding to defendant's claim that the statute contravened the tenth amendment by regulating intrastate activity, the Court declared that the commerce power is complete in itself and cannot be diminished by the exercise or nonexercise of state power.[26] The Court then described the tenth amendment as stating but a "truism" that all power is retained that has not been surrendered.[27] Five years earlier, in *United States v. California*,[28] the Court addressed the alternative issue of whether state conduct is immune from federal commerce regulation. The Court held that an intrastate railroad, wholly owned and operated by the state of California, was subject to the federal Safety Appliance Act. Considering petitioner's claim that the state operated the railroad in a "sovereign" rather than "private" capacity, the Court noted that the railroad had all the attributes of a private railroad but dismissed as irrelevant the question whether the state acted in its sovereign capacity. The Court focused instead on whether the Safety Appliance Act was a valid exercise of federal commerce power,[29] holding that once this test is met the activity can be regulated whether conducted by a state or an individual. In the 1968 *Maryland v. Wirtz*[30] decision, the Court applied the *California* rationale to Maryland's attack upon an extension of the federal minimum wage law to state school and hospital employees. The Court, sustaining the extension, found that labor conditions in state institutions had the requisite effect on interstate commerce.[31] Although the Court asserted that the federal commerce power could override countervailing state interests,[32] the Court acknowledged that inherent limitations in the commerce clause gave the Court power to

25. 312 U.S. 100 (1941).
26. *Id.* at 114.
27. *Id.* at 124.
28. 297 U.S. 175 (1936).
29. The Court concluded: "The state can no more deny the power [to regulate commerce] if its exercise has been authorized by Congress than can an individual." *Id.* at 185.
30. 392 U.S. 183 (1968).
31. *Id.* at 194.
32. *Id.* at 195.

prevent the destruction of states as sovereign political entities.[33] In *Fry v. United States*[34] the Court upheld a federal injunction preventing Ohio from raising state employee wages by 10.6% in violation of the 7% ceiling imposed by the President acting pursuant to the Economic Stablilization Act. Rather than emphasizing the limitations on the federal commerce power, petitioners claimed that the injunction violated the tenth amendment. The Court found the necessary nexus between state employee wages and interstate commerce,[35] but noted that the Economic Stabilization Act intruded even less upon state sovereignty than the minimum wage law upheld in *Wirtz*.[36] The Court also indicated that petitioner's tenth amendment argument may have substance, stating in a footnote that the tenth amendment is not "without significance" and reflects a constitutional policy that Congress may not exercise power in a fashion that drastically impairs a state's ability to function in a federal system.[37]

While the Court's consideration of conflicts between federal regulation under the commerce clause and state sovereignty heretofore has been in terms of federal power to regnlate private activity that otherwise could have been regulated by the states, as in *Darby*, and federal power to regulate state activity that if conducted by individuals could be regulated federally, as in *California, Wirtz*, and *Fry*, the Clean Air Act presents the fundamentally different question whether Congress, acting pursuant to the commerce clause, can compel a state to regulate its own citizens.[38] In 1974 the Third Circuit in *Pennsylvania v. EPA*[39] considered an EPA-imposed implementation plan for the Philadelphia region that included a requirement that the state submit legally adopted regnlations establishing

33. *Id.* at 196. *But cf.* Murphy v. O'Brien, 485 F.2d 671, 675 (Temp. Emer. Ct. App. 1973) (*Wirtz* implies that state sovereignty no longer imposes any limit on the authority of Congress to regulate commerce).

34. 421 U.S. 542 (1975).

35. *Id.* at 547.

36. *Id.* at 548.

37. The Court stated:

> While the Tenth Amendment has been characterized as a "truism," stating merely that "all is retained which has not been surrendered," . . . it is not without significance. The Amendment expressly declares the constitutional policy that Congress may not exercise power in a fashion that impairs the States' integrity or their ability to function effectively in a federal system.

Id. at 547 n.7.

38. For a general discussion of federal efforts to fight air pollution see Stevens, *Air Pollution and the Federal System: Response to Felt Necessities*, 22 HASTINGS L.J. 661 (1971).

39. 500 F.2d 246 (3d Cir. 1974). For a commentary on the *Pennsylvania* decision see 53 TEXAS L. REV. 380 (1975).

a vehicle retrofit program.[40] Pennsylvania argued that the Administrator's alleged authority under section 113(c) of the Clean Air Act to impose criminal sanctions[41] against state officials for failure to submit the regulations exceeded the federal commerce power. Relying on the *Wirtz* analysis, the court found that transportation systems utilizing highways and automobiles affected interstate commerce and dismissed as irrelevant the assertion that highways, unlike railroads, are uniquely governmental entities.[42] The court concluded that Congress could require states to enact measures reducing air pollution caused by the states through their choice of transportation systems,[43] and upheld the EPA plan. Recently, in *Brown v. EPA*[44] and *Maryland v. EPA*[45] the Ninth and Fourth Circuits considered similar EPA plans for California[46] and Baltimore[47] air quality control regions. In *Brown*, the court examined the enforcement sections of the Clean Air Act and held that the Administrator was not authorized to force states to adopt regulations implementing EPA programs.[48] Although the court explicitly limited the basis of its holding to statutory interpretation,[49] the court felt obligated to discuss the serious constitutional questions it purposely was avoiding. The court then expressed grave misgivings about the constitutionality of the EPA plan, noting that the extensions of the commerce power approved by the Supreme Court in *Wirtz* and *Fry*

40. 40 C.F.R. § 52.2039 (1974).

41. 42 U.S.C. § 1857c-8(c)(1) (1970) provides: "Any person who knowingly . . . [violates an applicable implementation plan] shall be punished by a fine of not more than $25,000 per day of violation, or by imprisonment for not more than one year, or by both."

42. The court stated: "The Commonwealth cannot, by denominating traffic control and vehicle registration as 'governmental' activities, immunize them from federal regulation . . . ." 500 F.2d 246, 261 (3d Cir. 1974).

43. *Id.* In the Preamble to the instant regulations, the Administrator also attributed automobile pollution to state activity:

> By building and maintaining roads and highways, by licensing vebicles and operators, by providing a system of traffic laws, and in many otber ways, government has encouraged tbe growth of automobile use to its present levels. There is nothing inevitable ahout such a choice. Governments could equally well have chosen to discbarge their basic function of maintaining a transportation system in ways that would have discouraged the use of single-passenger automobiles, and encouraged the use of mass transit. But often they have not.

38 Fed. Reg. 30632 (1973).

44. 521 F.2d 827 (9th Cir. 1975), *petition for cert. filed*, 44 U.S.L.W. 3380 (U.S. Dec. 24, 1975).

45. 8 ERC 1105 (4th Cir. Sept. 19, 1975), *petition for cert. filed*, 44 U.S.L.W. 3417 (U.S. Jan. 7, 1976).

46. 40 C.F.R. § 52.242 (1974) (the state was required to implement a vehicle inspection and maintenance program).

47. 40 C.F.R. §§ 52.1095-100 (1974).

48. 521 F.2d 827, 835 (9tb Cir. 1975).

49. *Id.* at 836.

did not involve regulations requiring states to exercise their police powers.[50] In *Maryland*, the Fourth Circuit also rejected the Administrator's statutory authority to promulgate the EPA plan,[51] but similarly felt compelled to comment on the doubtful constitutionality of the plan, emphasizing that the clearest attribute of state sovereiguty is the "right of their legislature to pass, or not to pass, laws."[52] Despite the fact that the language of the courts in *Brown* and *Maryland* casts doubt on whether Congress has the constitutional authority to require states to enforce federal air quality control standards, both decisions expressly declined to reach the issue. Thus the holding of constitutionality in *Pennsylvania* remained the only definitive pronouncement on the issue prior to the instant case.

III. The Instant Opinion

After first determining that the Clean Air Act did not authorize the Administrator to force states to enact statutes pursuant to a federally promulgated implementation plan,[53] the court acknowledged a distinction between ordering a state to adopt regulations as part of a federal plan and ordering a state to enforce federal regulations against vehicles registered by the state. Finding nothing in the Act specifically rejecting the Administrator's authority to require states to enforce federal regulations,[54] the court considered whether Congress constitutionally could regulate states in such a manner. First, the court found that Congress clearly has authority under the commerce clause to regulate sources of air pollution, including the power to require owners of motor vehicles to install air pollution devices. Secondly, the court found it equally clear that Congress

50. *Id.* at 838.

51. 8 ERC 1105, 1114 (4th Cir. Sept. 19, 1975).

52. *Id.* at 1112.

53. The court stated that the Administrator did not have authority under 42 U.S.C. § 1857c-5(a)(1) (1970) to require states to submit implementation plans. The court described the EPA plan as an effort to compensate for lack of authority by requiring states to enact appropriate regulations pursuant to a federal plan. Examining 42 U.S.C. § 1857c-8(a)(1) (1970), which requires, prior to federal action against a violator of an applicable implementation plan, notices to the polluter and the state in wbich the pollution occurs, the court concluded that if Congress intended to authorize the Administrator to move against an individual by requiring states to take action a second notice to the individual would be superfluous. The court also noted that 42 U.S.C. § 1857c-8(a)(2) (1970) provides a separate procedure for direct federal enforcement of a plan when the Administrator determines that widespread violations are occurring. The court reasoned that if Congress intended the Administrator to force states to adopt and enforce adequate air pollution control regulations, the separate provisions of this section would be meaningless.

54. The Court cited statements made during congressional debates suggesting tbat Congress did intend to authorize the Administrator to force states to administer federally-promulgated programs. *See* statement of Congressman Staggers, note 10 *supra*.

could regulate state-operated sources of pollution.[55] Addressing the EPA regulation requiring states to refuse to register vehicles failing to meet federal standards, the court determined that this regulation was a valid exercise of congressional power to prescribe the "rule by which commerce is to be governed."[56] The court analogized to prohibitions against unsafe railroad equipment and emphasized that the EPA merely was requiring modifications of a "traditional" state activity with no added state expenditures. The court then rejected the EPA regulations requiring states to establish vehicle inspection and retrofit programs as unauthorized attempts under the commerce power to substitute compelled state regulation for permissable federal regulation. The court cited both the Supreme Court's acknowledgement in *Wirtz* that limits on the federal commerce power are adequate to prevent drastic interference with state sovereignty,[57] and the Court's statement in *Fry* that the Economic Stabilization Act intruded even less upon state sovereiguty than the minimum wage law in *Wirtz*[58] as evidence that state sovereignty is of some relevance when federal commerce power is exercised. The court recoguized that the Third Circuit in *Pennsylvania* interpreted *Wirtz* to hold that state sovereignty does not impose a limit on federal commerce power, but noted that *Pennsylvania* was decided prior to the Supreme Court's explanation of *Wirtz* in *Fry*. The court also adverted to the Supreme Court's statement in *Fry* that the tenth amendment is not without siguificance. Granting that the Supreme Court has yet to reconcile the federal commerce power and the tenth amendment, the court suggested that the tenth amendment may prevent congressional regulation of commerce in a manner that drastically interferes with state sovereignty. Noting that while the tenth amendment provides an additional ground for its holding, and emphasizing the *Wirtz* and *Fry* suggestion that federal commerce power is not limitless, the court concluded that the instant regulations are clearly massive intrusions upon state sovereignty that exceed the federal commerce power.[59]

55. The court affirmed the regulations requiring petitioners to purchase additional buses and create reversible bus lanes, finding state-owned bus systems and highways analogous to the railway system in *California*. 521 F.2d at 989.

56. *Id.* at 991 (quoting Gibbons v. Ogden, 22 U.S. (Wheat.) 1, 196 (1824)).

57. *See* text accompanying note 33 *supra*.

58. *See* text accompanying note 36 *supra*.

59. Since the substance of the inspection and retrofit regulations was not invalidated, the court considered and rejected petitioner's claim that the programs were arbitrary and capricious. 521 F.2d at 996. The court, however, did conclude that the regulations requiring bicycle lanes were without adequate factual support. *Id.* at 997. Finally, the court recoguized that the District of Columbia is in a different position than states concerning

IV. COMMENT

The instant decision appears to be the first in recent times to invalidate an exercise of federal commerce power because of intrusion upon state sovereignty. Aptly noting that the Supreme Court itself, in *Wirtz* and *Fry*, never refused to consider the impact of a federal regulation upon the ability of a state to function in the federal system, the court reaches the eminently logical conclusion that while a showing of interference with state sovereignty per se will not defeat an otherwise valid exercise of federal commerce power, a point does exist on a commerce power continuum beyond which state sovereiguty is so seriously impaired that the exercise of the power becomes unconstitutional. Although acknowledgement of this limitation does not necessarily resurrect the antiquated distinction drawn in the federal tax cases between "proprietary" and "governmental" state functions,[60] the limitation affirms Justice Frankfurter's observation in *New York v. United States* that the vitality of the federal system requires protection of certain state functions intrinsically related to a state's sovereign status.[61] Although the court is unclear concerning the extent to which the tenth amendment is central to its holding, the instant decision indicates that the tenth amendment is more than a truism.[62] The court buttressed its invalidation of the inspection and retrofit regulations by citation to the Supreme Court's statement in *Fry* that the tenth amendment may prevent Congress from exercising power in a fashion that impairs a state's ability to function in the federal system.[63] The court quite properly hesitated to impart too much significance to this statement, and concluded that although the Supreme Court has yet to reconcile the federal commerce power and the tenth amendment, the tenth amendment "may" prevent Congress from selecting methods of regulating commerce that "drastically" interfere with state sovereiguty. Nevertheless, the instant decision suggests that the tenth amendment may be a source of affirmative constitutional rights that a state, in its sovereign capacity, may assert against the exercise of federal power, independent of the inherent limitations on that power, in the same fashion that an individual may assert first

immunity from federal regulation, but treated the District as a state on the basis of its treatment in the Clean Air Act and the need for uniform implementation of air quality standards. *Id.* at 995.

60. *See* text accompanying notes 20-23 *supra.*
61. *See* text accompanying note 24 *supra.*
62. *See* text accompanying note 27 *supra.*
63. *See* note 37 *supra* and accompanying text.

or fifth amendment rights.[64]

Significantly, the instant decision also explores the distinction, noted in *Brown* and *Maryland* but apparently overlooked in *Pennsylvania*, between federal regulation of a particular activity, whether conducted by a state or an individual, and federal regulation of that activity by compelling states to exercise their police powers.[65] In the Supreme Court's *California*, *Wirtz*, and *Fry* analyses the Court first examined the activity itself to determine whether it could be federally regulated. Once the interstate commerce nexus was established and a determination was made that state sovereignty was not impaired drastically, the regulation was sustained regardless of the character of the party conducting the activity. The issue in *Pennsylvania* and the instant case is not whether the particular activity—air pollution—is subject to federal regulation, as it quite obviously is, but whether a particular source of pollution—automobile emissions—can be classifed as state activity that Congress, under the *Wirtz* rationale, may regnlate by compelling states to take remedial action. Viewed in this context, the Third Circuit's dismissal as irrelevant the contention that highways, unlike railroads, are uniquely state entities is itself irrelevant because highways themselves are not the source of pollution. While the Third Circuit hints that automobiles are sufficiently related to an overall state-operated transportation system to bring them within the reach of *Wirtz*,[66] the instant court takes the sounder position that automobile emissions involve private activity that the federal government may not regulate by utilizing state police power. Thus the court limits the *Wirtz* holding to those situations in which the activity regulated specifically is conducted by a state and not merely subject to state regnlation. In so doing, the instant court poses the question whether federal regulations that directly interfere with state police powers are "drastic" invasions of state sovereignty exceeding the *Wirtz* limitations on the commerce clause, or whether police powers are so fundamentally different from other sovereign state powers that they deserve affirmative constitutional protection under the tenth amendment.

By focusing on the critical question of the character of automo-

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64. Justice Rehnquist took this position in his *Fry* dissent:

> . . . the State is not simply asserting an absence of congressional legislative autbority, but rather is asserting an affirmative constitutional right, inherent in its capacity as a State, to be free from congressionally asserted authority.

421 U.S. 542, 553 (1975).

65. *See* 521 F.2d at 994 n.27.

66. *See* note 43 *supra* and accompanying text.

bile emissions, the instant court emphasizes a serious weakness in federal efforts to control air pollution. Most air pollution is caused by private automobiles.[67] Congress can clearly regulate any and all sources of air pollution; a direct federal effort to enforce automobile emission controls against individual owners, however, would require a massive expenditure of federal resources. This is clearly the type of program Congress sought to avoid by placing primary responsibility for achievement of national air quality standards on the states.[68] Yet, the instant decision, by interpreting the Constitution to deny Congress the power to force states to assume this responsibility in instances of state inaction, requires that the Administrator undertake the direct federal actions necessary to meet the national air quality goals mandated by Congress in the Clean Air Act. The instant decision, therefore, does not augur well for federal air pollution control programs. It forces the Administrator to expend considerable federal monies to regulate an activity that clearly may be controlled more efficiently at the local level, and forces Congress to make the difficult decision whether the achievement of clean air is worth the additional expenditures of federal resources that the instant decision leaves as the only alternative to state inaction.

ROBERT D. BUTTERS

Securities Law—Securities Fraud—Proof of Reliance Is Unnecessary in Open Market Transactions Under 10b-5

I. FACTS AND HOLDINGS

Prompted by the financial difficulties of the Ampex Corporation in 1972,[1] several investors[2] in Ampex brought a class action

67. *See* Comment, *Air Pollution: The Problem of Motor Vehicle Emissions*, 3 CONN. L. REV. 178 (1970).

68. 42 U.S.C. § 1857c-2(a) (1970) provides: "Each State shall have the primary responsibility for assuring air quality within the entire geographic area comprising such State . . . ."

1. In Ampex's 1970 annual report (issued May 2, 1970) the corporation reported a $12 million profit. By January, 1972, the corporation estimated $40 million losses for fiscal 1972, by March the estimate of losses had increased to $80 million and the annual report (issued August 3, 1972) reported a $90 million loss. Blackie v. Barrack, 524 F.2d 891, 894 (9th Cir. 1975).

2. The named plaintiff represented a class of investors who had purchased Ampex stock

against the corporation, its officers, and its independent auditor[3] for damages suffered from purchasing securities over a two-year period during which Ampex had published numerous allegedly misleading corporate documents,[4] inflating the market price of those securities in violation of Section 10(b) of the 1934 Securities and Exchange Act[5] and Rule 10b-5[6] promulgated under that Act. Defendants[7] contended that, in light of the extended period of time and the numerous documents involved, the class was certified improperly[8] because

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between May 1970 and August 1972. Involved were some 120,000 transactions and some 21,000,000 shares of stock. *Id.* at 901.

3. The independent auditor for the Ampex Corporation was Touche Ross & Co.

4. Plaintiffs claimed that 45 documents, including two annual reports, six quarterly reports, and various press releases and SEC filings inflated the market price because the documents:

> (a) overstated earnings, (b) overstated the value of inventories and other assets, (c) buried expense items and other costs incurred for research and development in inventory, (d) misrepresented the companies' current ratio, (e) failed to establish adequate reserves for receivables, (f) failed to write off certain assets, (g) failed to account for the proposed discontinuation of certain product lines, [and] (h) misrepresented Ampex's prospects for future earnings.

524 F.2d at 902.

5. Section 10(b) of the 1934 Securities and Exchange Act, 15 U.S.C. § 78(b) (1970) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

6. 17 C.F.R. § 240.10b-5 (1975) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interestate [sic] commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

7. Defendants Ampex Corporation and Touche Ross & Co. were excluded from this appeal. They did not join the individual defendants in requesting reconsideration of the order conditionally certifying the class before they had filed notices of appeal. The District Court therefore excluded both Ampex and Touche Ross from the interlocutory appeal. 524 F.2d at 894-95 n.4; *see* note 8 *infra*.

8. The instant court also decided that an order conditionally certifying a class is not a final order and is thus not appealable under 28 U.S.C. § 1291 (1970). With this decision the Ninth Circuit joined the Sixth Circuit, Walsh v. Detroit, 412 F.2d 226 (6th Cir. 1969), and the Seventh Circuit, Thill Sec. Corp. v. New York Stock Exch., 469 F.2d 14 (7th Cir. 1972),

individual questions of reliance[9] predominated over any common questions of law or fact,[10] and therefore the class-action requirements of Rule 23(a) and (b) (3)[11] of the Federal Rules of Civil Procedure were not met. Plaintiffs claimed that individual questions of reliance were not an element of a 10b-5 cause of action and that the class had been certified properly. The trial court found that the proposed class met the requirements of Rule 23 and conditionally certified the class.[12] On appeal,[13] the Ninth Circuit Court of Ap-

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in holding that a class certification order is not appealable under § 1291. The court acknowledged that the Supreme Court in Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541 (1949), allowed the circuit courts to accept appeals from certain nonfinal orders:

> . . . which finally determine claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated.

337 U.S. at 546.

Under *Cohen*, the Second Circuit in Eisen v. Carlisle & Jacquelin, 370 F.2d 119 (2d Cir. 1966), *cert. denied*, 386 U.S. 1035 (1967) (Eisen I), and the Nintb Circuit in Weingartner v. Union Oil Co., 431 F.2d 26 (9th Cir. 1970), have allowed appeals from orders denying class certification because such an order effectively would end the litigation. In not allowing an appeal of right of an order certifying a class, the court stressed that such an order does not end the litigation. Thus the court rejected defendants' argument, accepted by the Second Circuit in Herbst v. ITT, 495 F.2d 1308 (2d Cir. 1974), that denying an appeal promotes costly litigation, treats defendants and plaintiffs differently, subjects defendants to potentially limitless liability and therefore forces them to settle class action suits. *See* Note, *Class Action Certification Orders: An Argument for the Defendant's Right to Appeal*, 42 GEO. WASH. L. REV. 621 (1974).

After determining that the certification order was not appealable under § 1291, the court considered the merits of the certification because an appeal under 28 U.S.C. § 1292(b) (1970) had been granted. As indicated in note 7 *supra*, not all defendants were allowed to join in this appeal.

9. The court also rejected defendants' argument that the question of damages predominated over any common questions of law or fact. The court stated that the trial judge can handle any such conflicts in the damages area during the trial by the use of sub-classes if that becomes necessary. 524 F.2d at 899 n.15.

10. Defendants also had urged that no common questions of law or fact existed because plaintiffs had purchased at different times and the alleged misrepresentations and omissions were contained in documents published throughout the two-year period in dispute. In rejecting this contention, the court stressed that the complaint alleged a common course of deceptive conduct and that this common course of conduct supplied the requisite common question of law or fact. 524 F.2d at 902.

11. FED. R. CIV. P. 23(b) reads, in appropriate parts:

> (b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied and in addition:
>
> . . .
>
> (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy.

12. In clarifying its holding in *In re* Hotel Telephone Charges, 500 F.2d 86 (9th Cir. 1974), the court held that while it is impermissible to certify an improper class on the basis of a speculative possibility that the class may later meet the requirements of proper certification, the trial court judge is required only to review the material before him to determine if the requirements appear to be met at that time.

13. The appeal was granted under 28 U.S.C. § 1292(b) (1970). *See* note 8 *supra*.

peals, *held*, affirmed. A common question of law sufficient to sustain a 10b-5 class action exists when investors claim that deceptive practices inflated the price of stock they purchased on the open market; proof of individual reliance on specific omissions is irrelevant. A defendant, however, can disprove causation by showing that the deception was not material, that an insufficient number of investors relied on the deception to create the inflated market price, or that the investors knew of the misrepresentation and purchased despite such knowledge. *Blackie v. Barrack*, 524 F.2d 891 (9th Cir. 1975).

II. LEGAL BACKGROUND

The Supreme Court's decision in *Affiliated Ute Citizens v. United States*[14] is the logical starting point in understanding the current confusion over the role of reliance in 10b-5 actions. While prior to this decision, cases[15] and commentators[16] had questioned the necessity of proving reliance, *Affiliated Ute* provided a clear break from the reliance requirement in cases of material omissions. In *Affiliated Ute*, terminated Ute Indians[17] formed the Ute Distribution Corporation (UDC)[18] to manage the distribution of tribal assets.[19] UDC issued stock to each terminated Ute and agreed with the First Security Bank of Utah to have the bank serve as transfer agent for the individual terminated Utes. During a five-year period the bank employees responsible for the UDC stock developed a non-Indian resale market for the securities, but did not inform the individual shareholders of the existence of this secondary market. In upholding the individual shareholders' complaint under 10b-5 the Court concluded:

> Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary

14. 406 U.S. 128 (1972).

15. *See, e.g.*, Kahan v. Rosenstiel, 424 F.2d 161 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970); Gerstle v. Gamble-Skogmo, Inc., 298 F. Supp. 66, 98 (E.D.N.Y. 1969).

16. *See, e.g.*, 2 A. BROMBERG, SECURITIES LAW-FRAUD: SEC RULE 10b-5 § 8.6, at 212 (1967); Note, *Reliance Under Rule 10b-5: Is the "Reasonable Investor" Reasonable?*, 72 COLUM. L. REV. 562 (1972).

17. The designation "terminated Ute" is used in this comment instead of the term "mixed-blood." *See* 406 U.S. 128, 133 n.3 (1972).

18. The Ute Distrib. Corp. was formed under the Ute Partition Act, 25 U.S.C. §§ 677-77aa (1970).

19. The tribal assets consisted of cash and land, oil, gas, and mineral rights, and unadjudicated and unliquidated claims against the government.

> is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision.[20]

The Court held that once a plaintiff proves an obligation to disclose information and a withholding of a material fact, he has established the requisite causation.[21] The underlying rationale for this approach is that a plaintiff should not be required to prove that he relied on that which he did not know existed.[22]

After *Affiliated Ute*, the courts adopted a variety of responses in an attempt to define the continued role of reliance in 10b-5 actions.[23] Generally these responses take one of three forms: (1) an attempt to abolish completely the reliance requirement in all 10b-5 actions, (2) an attempt to interpret *Affiliated Ute* narrowly as applicable only to nondisclosure cases, or (3) an attempt to develop and to implement a separate standard for cases in which the deception caused an inflated price in open market transactions.

Illustrative of the cases in which the courts have indicated a willingness to abolish the reliance requirement in all 10b-5 actions is *Allen Organ Co. v. North American Rockwell Corp.*[24] In *Allen Organ* the plaintiff agreed to purchase a debenture bond from the defendant for the exclusive license rights in computer components for musical instruments. The license rights, however, proved to be not as valuable as initially believed. The plaintiff ultimately brought a 10b-5 cause of action alleging that it had relied on material misstatements and omissions made by the defendant in entering into the transaction in question. The defendant asserted that during negotiations to resolve the difficulties the plaintiff had agreed in writing that it had not relied on the representations made by defendant and thus the complaint should be dismissed. In refusing to dismiss the complaint the court concluded that proof of reliance was not required in 10b-5 actions.[25] While the procedural framework of the case, a preliminary motion to dismiss, may weaken its precedential value, the court's willingness to extend the

20. 406 U.S. at 153-54.

21. In *Affiliated Ute* the Court stated: "This obligation to disclose and this withholding of a material fact establish the requisite element of causation . . . ." 406 U.S. at 154.

22. *See* note 48 *infra* and accompanying text.

23. *See generally*, Note, *The Reliance Requirement in Private Actions Under SEC Rule 10b-5*, 88 HARV. L. REV. 584 (1975).

24. 363 F. Supp. 1117 (E.D. Pa. 1973).

25. *Id.* at 1127. Specifically, the court stated:

> Moreover, it is now well established that proof of reliance need not be shown in a Section 10(b) cause of action and causation is satisfied by a showing that the *facts misrepresented* or withheld are material . . . . (emphasis added)

holding of *Affiliated Ute* is unmistakable.[26] Similarly, in *Dorfman v. First Boston Corp.*,[27] a retired school teacher and a family corporation sought to represent a class consisting of all persons who purchased Pennco Bonds after the publication of an offering circular allegedly containing misrepresentations and omissions. The defendant challenged the validity of the class and introduced evidence that Dorfman, a named representative, had not read the circular and that the family corporation purchased the securities as a result of independent research conducted by its president. Refusing to dismiss the complaint, the court cited *Affiliated Ute* for the proposition that proof of reliance was unnecessary and held that consequently "there can be no conceivable reason for requiring proof of reliance as a prerequisite for class membership."[28] Furthermore, the court stated that the substantial common questions raised by the allegations concerning the offering circular far outweighed the questions affecting only individual class members.[29]

Other courts have restricted the holding of *Affiliated Ute* to cases involving omissions. In *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[30] the defendants were underwriters for a Douglas offering of convertible subordinated debentures. As underwriters, they received confidential information that Douglas would revise its earnings estimate downward, which they disclosed to some of their customers before the information was released publicly. The plaintiff represented those investors who purchased on the national securities exchange[31] prior to the disclosure of the less favorable earn-

26. Since the plaintiff alleged both reliance and materiality, the court's statements concerning reliance could be characterized as dicta. Of interest is the fact that the plaintiff did allege reliance indicating that counsel anticipated that it still was necessary to prove reliance.

27. 62 F.R.D. 466 (E.D. Pa. 1973).

28. *Id.* at 471.

29. It is interesting to note that despite the expansiveness of the opinion, the court relied on *Affiliated Ute* only to support its conclusion that proof of reliance is unnecessary in omission cases. *Id.* Also adopting this expansive reading of *Affiliated Ute* is Davis v. Avco Corp., 371 F. Supp. 782 (N.D. Ohio 1974). In *Davis* the plaintiff invested in a pyramid sales scheme. To obtain money to invest in the venture, many investors borrowed money from the defendant after being assured by the defendant of the soundness of the investment. The defendant opposed class certification and contended that there would be different degrees of reliance for each member of the class. The court interpreted *Affiliated Ute* as abolishing the requirement of proving reliance under Rule 10b-5. In both *Dorfman* and *Davis* the facts may qualify the courts' broad language. In those cases the plaintiffs alleged both omissions and misrepresentations. It is possible to conclude that the court meant that proof of reliance is unnecessary when misrepresentations and omissions are present in the same case.

30. 495 F.2d 228 (2d Cir. 1974).

31. The court also rejected defendants' contention that *Affiliated Ute* should be limited to cases involving face-to-face transactions. 495 F.2d at 240.

ings report. The court was careful to describe the conduct in question as conduct involving an omission, thus bringing it within the *Affiliated Ute* holding that in such cases proof of reliance was unnecessary.[32] Another decision narrowly interpreting *Affiliated Ute* is *Rochez Brothers, Inc. v. Rhoades*.[33] In *Rochez*, both the plaintiff and the defendant were fifty percent shareholders in the corporation. The plaintiff sold its stock in the corporation to the defendant, who failed to disclose that he already had begun negotiations for the sale of the corporation. Subsequently, the defendant sold the corporation for a significant profit. Characterizing the plaintiff's 10b-5 cause of action as an omissions case, the court concluded that proof of reliance was not required. The court carefully noted, however, that proof of reliance had not been abolished in all 10b-5 actions.[34]

Moreover, in *Schlick v. Penn-Dixie Cement Corp.*,[35] the court frankly acknowledged that there were different standards of proof in misrepresentation and omission cases. The *Schlick* minority stockholders complained that Penn-Dixie gained control of Continental Steel Corporation and completed a merger agreement, which provided an unfair exchange ratio, through a premerger proxy statement containing both omissions and misrepresentations.[36] The court stated that a plaintiff must establish different elements of proof in cases founded exclusively on either omissions or misrepresentations; in a misrepresentation case the plaintiff must demonstrate that he relied on the misrepresentation in question when he entered into the transaction, while in an omissions case the plaintiff is not required to prove reliance.[37] The court cited *Affiliated Ute* only for the proposition that proof of reliance is unnecessary in an omissions case.[38]

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32. Since the plaintiff alleged he would not have purchased had he known of the omission, the court concluded that even under pre-*Affiliated Ute* case law in the Second Circuit the plaintiff had stated a valid cause of action. *See* List v. Fashion Park, Inc., 340 F.2d 457, 463 (2d Cir. 1965).

33. 491 F.2d 402 (3d Cir. 1974).

34. Further, the court indicated that while proof of reliance is not necessary in an omissions case, the defendant can overcome the presumption of causation by showing that the plaintiff would not have changed his investment decision even if he had known of the misrepresentation. The court interpreted *Affiliated Ute* as switching to the defendant the burden of proving nonreliance. 491 F.2d at 410. For a general discussion of the applicability of finding a rebuttable presumption see Note, *The Reliance Requirement in Private Actions Under SEC Rule 10b-5*, 88 HARV. L. REV. 584, 600 (1975).

35. 507 F.2d 374 (2d Cir. 1974).

36. The plaintiffs alleged that the defective proxy statement failed to disclose the manner in which Penn-Dixie had infiated the value of its shares at the expense of the acquired Continental. 507 F.2d at 377.

37. *Id.* at 380-81.

38. *Id.* Since the court found that the complaint included more than a claim of material

The Second Circuit reviewed the holding and the rationale for *Affiliated Ute* in *Titan Group, Inc. v. Faggen.*[39] There a conglomerate purchaser claimed that the seller's misrepresentations and omissions caused it to purchase the business. Describing *Affiliated Ute* strictly as an omissions case, the court stated that in omission cases proof of reliance is not required because it is impossible to prove.[40] The court reasoned, however, that this rationale does not apply in a misrepresentation case since it is possible to demonstrate whether the plaintiff relied on the alleged affirmative statement.[41] Reviewing the facts of the case, the court concluded that the prime motivation for the purchase came from facts that were not misrepresented. Under this factual setting, the court held that the omissions were not material. From this conclusion the court reasoned that the plaintiff had failed to establish a cause of action because he had not demonstrated sufficient reliance.

Finally, a number of cases hold that proof of reliance is unnecessary when deception is alleged to have inflated the price of stock traded on the open market.[42] In both *Herbst v. ITT*[43] and *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*,[44] the Second Circuit held that an individual shareholder does not have to prove reliance once a misstatement is shown to be material. The justification for this approach is that it is both impractical and difficult for shareholders to prove, in the aggregate, how they would have acted had they known the whole truth.[45] Other courts have held that it is not necessary to prove reliance in any open market situation. Thus, in

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omissions or misrepresentations, proof of reliance was deemed unnecessary. In Reeder v. Mastercraft Electron. Corp., 363 F. Supp. 574, 581 (S.D.N.Y. 1973), the court also acknowledged that different standards of proof existed in misrepresentation and omission cases. The court, after discussing *Affiliated Ute,* concluded that proof of reliance generally still is required in cases of misrepresentations.

39. 513 F.2d 234 (2d Cir.), *cert. denied,* 44 U.S.L.W. 3202 (U.S. Oct. 7, 1975).

40. *Id.* at 239.

41. *Id.* A number of other recent cases have also concluded that *Affiliated Ute* does not eliminate the necessity of proving reliance in misrepresentation cases. In Hickman v. Groesbeck, 389 F. Supp. 769, 776 (D. Utah 1974), the court, without mentioning *Affiliated Ute,* held that a plaintiff must prove materiality, scienter, reliance, and causation in misrepresentation and omission cases. In Chelsea Associates v. Rapanos, 376 F. Supp. 929, 939 (E.D. Mich. 1974), *aff'd,* CCH FED. SEC. L. REP. ¶ 95,374 (6th Cir. Dec. 11, 1975), the court noted tbat in 10b-5 cases the plaintiff must prove materiality and, in cases of false representations, reliance on the alleged deceptive practice.

42. *See generally* Note, *Reliance Under Rule 10b-5: Is the "Reasonable Investor" Reasonable?,* 72 COLUM. L. REV. 562 (1972).

43. 495 F.2d 1308 (2d Cir. 1974).

44. 480 F.2d 341 (2d Cir.), *cert. denied,* 414 U.S. 910 (1973). Both *Herbst* and *Chris-Craft* can be distinguished from the instant case since the deception in those cases took place in the context of an exchange offer.

45. 495 F.2d at 1316.

Werfel v. Kramarsky,[46] the plaintiff alleged that from 1968 to 1970 the defendants, pursuant to a common scheme, had disseminated annual and quarterly reports, financial and proxy statements that falsely represented the corporation's growth and earnings situation. In fact, the company experienced $13,000,000 losses and trading of its stock was suspended in 1970. The court held that the plaintiff need not prove reliance and supported its conclusion by adopting the "indirect reliance" doctrine.[47] That approach stresses that although the investor need not prove reliance on the particular misrepresentation in question, he has relied on the market price, which is presumed to be affected by the misrepresentation.[48]

Following *Affiliated Ute*, the federal courts have not adopted a common approach in describing the role of reliance in 10b-5 cases. Some courts have interpreted *Affiliated Ute* as applicable only to omission cases, others have expanded *Affiliated Ute* to all 10b-5 cases, still others have adopted an entirely different approach to cases involving open market transactions. As evidenced by the cases discussed above, the approach taken by a particular court ultimately may affect not only an individual plaintiff's recovery, but also whether a class action can be maintained. When reliance must be proved, individual questions of reliance may be found to predominate over common questions of law or fact among the class, and thus the class action will be dismissed.

III. The Instant Opinion

Although determining that an order certifying a class is not appealable under 28 U.S.C. § 1291,[49] the court nevertheless held that dismissal was not mandated.[50] Upholding the class certification, the court rejected defendants' contentions that individual questions of reliance predominated over common questions of law or fact. The court found that despite varying individual facts, a

46. 61 F.R.D. 674 (S.D.N.Y. 1974).

47. *Id.* at 681. *See also* Reeder v. Mastercraft Electron. Corp., 363 F. Supp. 574, 581 (S.D.N.Y. 1973).

48. The clearest explanation of the indirect reliance doctrine is found in Professor Bromberg's treatise on securities laws. He states:

> If the misstatement does not come to plaintiff's attention, as can easily happen in open market trades, it would be meaningless to demand reliance. It would also be unfair, since an investor who trades with reference to market price and conditions may be affected by the misstatement although he never hears of it. This difficulty might be overcome by saying that he has relied indirectly.

2 A. Bromberg, Securities Law-Fraud: SEC Rule 10b-5 § 8.6, at 212 (1967).

49. *See* note 8 *supra*.

50. 524 F.2d at 900.

common question of law existed as to defendants' alleged misconduct over the entire period. Furthermore, the court stated that proof of individual reliance was unnecessary. To support this conclusion, the court advanced two lines of analysis. First, the court characterized the alleged misconduct as consisting of material omissions, and, applying the *Affiliated Ute* rule, stated that proof of reliance is not required in such cases.[51] Secondly, the court described the alleged misconduct as "deception inflating the price of stock traded in the open market"[52] and, citing *Herbst* and *Chris-Craft*, again concluded that proof of reliance was unnecessary.[53] Following this approach the court stated that the purpose of reliance is to establish the causal link between the defendant's wrongdoing and the plaintiff's loss. In the open market situation, the appropriate causal link is established by proof of purchase and of the materiality of the misrepresentations.[54] Materiality establishes that some market traders relied on the misstatements and, therefore, that the market price was inflated. Subsequent traders, relying on this inflated price, purchased the security and completed the causal link between the misconduct and the loss. Furthermore, characterizing the 10b-5 action as compensatory, the instant court held that once the plaintiff establishes the materiality of the misrepresentation, the burden of disproving the prima facie case of causation shifts to the defendant.[55] The court then established a twofold test for rebutting the prima facie case of causation:

> (1) by disproving materiality or by proving that, despite materiality, an insufficient number of traders relied to inflate the price; and (2) by proving that an individual plaintiff purchased despite knowledge of the falsity of a representation, or that he would have, had he known of it.[56]

In support of shifting the burden of proof, the court stated that an investor is entitled to rely on the supposition that the market price has been validly set and has not been artificially inflated.[57] The court concluded that to protect the investor, and therefore further

51. *Id.* at 905.
52. *Id.*
53. *Id.*
54. *See* note 48 *supra.*
55. 524 F.2d at 906. Other courts have also attempted to formulate approaches under which the defendant can rebut the presumption of reliance. In Kesler v. Hynes & Howes Real Estate, 66 F.R.D. 43 (S.D. Iowa 1975), the court interpreted *Affiliated Ute* as holding that, in nondisclosure cases, materiality gives rise to a presumption of reliance. Under this analysis the defendant can rebut the presumption by showing the plaintiff's nonreliance. *See* note 34 *supra* and accompanying text.
56. 524 F.2d at 906.
57. *See* note 48 *supra* and accompanying text.

the purposes of the securities laws, proof of actual reliance by the plaintiff is superfluous.[58] Characterizing the conduct in the instant case as omissions, and since the transactions involved securities traded on the open market, the Ninth Circuit ruled that proof of reliance was unnecessary.

IV. Comment

With this decision, the Ninth Circuit has indicated a willingness to abolish the requirement of proving reliance in all 10b-5 actions.[59] The two rationales advanced by the court supporting this conclusion[60] as well as its proposed test for rebutting causation, pose several difficulties. First, the court's attempt to classify the deception in the instant case as "omissions" appears conceptually unsound. By characterizing as omissions conduct that included overstating earnings, overstating the value of inventory and assets, misrepresenting profits for future earnings, and misrepresenting the company's current ratio, the court has stretched the concept of omission to the extent that it conceivably includes all misconduct under 10b-5. Analysis of the plaintiffs' claims[61] suggests that they can be described more accurately as involving both omissions and misrepresentations. The distinction is of more than semantic difference. By characterizing all 10b-5 conduct as omissions, the court is able to abolish effectively the reliance requirement without extending the holding of *Affiliated Ute*. The Supreme Court was careful in *Affiliated Ute* to restrict its holding to omission cases,[62] in which the reliance requirement was eliminated because it presented an impossible proof burden. As numerous courts[63] and commentators[64] have concluded, these same proof problems do not exist in misrepresentation cases. As discussed below,[65] the distinction between omissions and misrepresentations becomes particularly important in implementing the court's own standard for disproving causation.

The court's analysis of the role of reliance in open market transactions, however, is consonant with existing case law.[66] In abolishing the reliance requirement in this setting, the court apparently ac-

58. 524 F.2d at 908.
59. *See* notes 24-31 *supra*.
60. *See* notes 51-55 *supra* and accompanying text.
61. *See* note 4 *supra* and accompanying text.
62. *See* notes 14-21 *supra* and accompanying text.
63. *See* notes 35-41 *supra* and accompanying text.
64. *See* note 23 *supra*.
65. *See* notes 69-74 *infra*.
66. *See* notes 42-48 *supra*.

cepted the indirect reliance doctrine,[67] which eliminates the requirement of proving reliance in open market transactions because, while proof of reliance might be possible, it would restrict recovery and frustrate the purposes of the securities law. Both *Affiliated Ute* and the indirect reliance doctrine presume that purchasers bought stock in reliance on the representations and thus inflated the market price. Therefore, subsequent purchasers who bought in reliance on the inflated price are allowed to recover to further the protective purposes of the securities law.[68]

After developing two separate rationales for not requiring proof of reliance, the court formulated a twofold approach by which defendants can disprove causation.[69] By allowing a defendant to disprove causation through proof that a sufficient number of investors did not rely on the misrepresentations to inflate the market price, the court preserves, to a limited extent, the role of reliance in open market transactions. Retention of the reliance requirement in this form substantiates the above analysis that reliance is presumed in open market transactions not because it is impossible to demonstrate, but because the purposes of the securities laws are better served thereby. If reliance could not be proved or disproved, the proferred defense would have little meaning. It would seem, however, that this defense may be available only in misrepresentation cases. If the market price were affected by omissions, the defense would appear to be unavailable under the *Affiliated Ute* doctrine. Therefore it becomes important for the court to analyze correctly the case as either one of omission or misrepresentation. If these two concepts are merged, as in the instant case, the defense may well be illusory. Further, in face-to-face transactions, where the misconduct involves omissions and misrepresentations, the defendant may be able to demonstrate that the misrepresentations predominate. This could suggest that the omissions were not material and the plaintiff would then be required to prove reliance on the misrepresentations.[70]

The court's second method of disproving causation[71] also presents some conceptual problems. In the context of this case, a class action involving purchases made on the open market, the defense appears irrelevant. Plaintiffs obviously will select class representa-

67. *See* note 48 *supra*.
68. 524 F.2d at 907.
69. *Id.* at 906.
70. *See* note 42 *supra* and accompanying text.
71. *See* text accompanying note 56 *supra*.

tives who will be immune from attack on this ground. If the test is directed primarily to situations involving face-to-face transactions, it appears, unjustifiably,[72] to switch the burden of proof to a defendant in misrepresentation cases.[73] Equally puzzling is the second half of this proposed method of disproving causation, phrased ambiguously at best.[74] The court may be suggesting that in omission cases the defendant can defeat causation by proving that the plaintiff would not have relied on the omission had he known it existed. This presents the same kind of impossible proof burden properly rejected by the Supreme Court in *Affiliated Ute*.

The court's attempt to blur the distinctions between misrepresentations and omissions creates confusion in the application of the court's proposed method of disproving causation. In transactions on the open market, however, the court's abolition of the necessity of proving reliance and its adoption of the indirect reliance doctrine is a logical implementation of the purposes underlying the securities laws. The court's attempt to demonstrate methods for defendants to disprove causation, while suffering in places from problems of clarity and consistency, is an important first step in developing realistic standards of proof in 10b-5 cases. The apparent willingness of the court to consider alternative methods for defendants to disprove causation suggests a likelihood that future cases will improve and refine the court's own suggested methods.

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72. *See* notes 63-64 *supra* and accompanying text.

73. *See* text accompanying note 56 *supra*. The wording gives rise to this interpretation. The court states that a defendant, to rebut causation, can show that a plaintiff purchased "despite knowledge of the falsity of a representation." Since, throughout the opinion, the court appears to use the words omission and misrepresentation interchangeably, exact analysis is difficult. If, however, the court is using misrepresentation in its traditional sense, it appears the burden of proof has been switched to the defendant.

74. The court's wording also lends itself to the interpretation that individuals who would have purchased, but did not purchase, have standing in a 10b-5 cause of action. While this is a possible grammatical construction, in light of Blue Chip Stamps v. Manor Drugs, 421 U.S. 723 (1975), it does not seem plausible that the court intended this alternative interpretation.