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Recent Cases

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RECENT CASES

Constitutional Law—Action Under Color of State Law—Legislative Authorization of Private Action Resembling Public Function Constitutes Action Under Color of State Law

I. Facts and Holding

Plaintiffs, tenants in defendant's hotel, brought suit for damages under 42 U.S.C. § 1983[1] claiming that defendant's seizure of their possessions[2] pursuant to the Arizona Innkeeper's Lien Statute[3] without prior notice and hearing violated the due process clause of the fourteenth amendment. Defendant contended that, because the seizure was a private act and not under color of state law, no federal question existed and moved to dismiss for lack of jurisdiction. The trial court found that defendant had not acted under color of state law and granted the motion to dismiss.[4] On appeal to the United States Court of Appeals for the Ninth Circuit, *held*, reversed and remanded. When a state statute provides the sole authority for a landlord's seizure of a tenant's property as security for unpaid rent, the seizure constitutes action under color of state law and thus satisfies the jurisdictional prerequisite to an action under 42 U.S.C. § 1983. *Culbertson v. Leland*, 528 F.2d 426 (9th Cir. 1975).

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1. 42 U.S.C. § 1983 (1970) provides:

Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceedings for redress.

2. Since plaintiffs were in arrears on their rent, defendant entered plaintiffs' room and seized some of their possessions, including medicine and specially processed food belonging to Helen Culherton, an almost blind diabetic, as well as medicine and special clothing belonging to her husband.

3. Ariz. Rev. Stat. Ann. § 33-951 (1956):

Lien on baggage and property of guests

Hotel, inn, boarding house, lodging house, apartment house and auto camp keepers shall have a lien upon the baggage and other property of their guests, boarders or lodgers, . . . for charges due for accomodation, board, lodging or room rent and things furnished at the request of such guests, boarders or lodgers, with the right to possession of the baggage or other property until charges are paid.

4. Additionally, the trial court held that because defendant no longer asserted her lien and had returned plaintiffs' possessions, the challenge to the Innkeeper's Lien Statute was moot.

II. Legal Background

The United States Supreme Court decisions in *Sniadach v. Family Finance Corp.*[5] and *Fuentes v. Shevin*[6] greatly expanded the due process requirements of notice and hearing that must be afforded a debtor prior to a creditor's seizure of his property pursuant to judicial action.[7] When a creditor utilizes various self-help provisions, however, the debtor's constitutional protection is less certain since no judicial action is involved. The debtor's only protection against seizures of his property by a creditor may be either a replevin action under state law,[8] or an action for damages under 42 U.S.C. § 1983 for violation of due process.[9] Since the former remedy is a state remedy to recover possessions taken unlawfully, it may prove unsatisfactory where the seizure is authorized by state law. Under the latter remedy, however, the creditor's liability for a violation of due process through absence of notice and hearing prior to seizure is a federal action conditioned upon characterization of the creditor's seizure as action under color of state law to satisfy the prerequisite of 42 U.S.C. § 1983 and as state action to find a violation of the fourteenth amendment.[10] Consequently, the debtor's only

5. 395 U.S. 337 (1969). The Supreme Court held that the Wisconsin prejudgment wage garnishment procedure violated the due process clause of the fourteenth amendment when the debtor's wages could be frozen by *ex parte* judicial action before the defendant had a chance to be heard.

6. 407 U.S. 67 (1972). The Supreme Court held that the Florida and Pennsylvania prejudgment replevin laws authorizing summary seizure of property by state agents upon petition of a court violated the due process clause of the fourteenth amendment because no prior opportunity to be heard was afforded. *See also* North Georgia Finishing, Inc. v. Di-Chem, Inc., 419 U.S. 601 (1975); Mitchell v. W.T. Grant Co., 416 U.S. 600 (1974) (upholding the *Fuentes* and *Sniadach* principles).

7. *See* Clark & Landers, *Sniadach, Fuentes and Beyond: The Creditor Meets the Constitution*, 59 VA. L. REV. 355 (1973) [hereinafter cited as Clark & Landers]; Neth, *Repossession of Consumer Goods: Due Process for the Consumer: What's Due for the Creditor*, 24 CASE W. RES. L. REV. 7 (1972).

8. *See* Anastasia v. Cosmopolitan Nat'l Bank, 527 F.2d 150, 158 n.19 (7th Cir. 1975).

9. *See* note 1 *supra*; Burke & Reber, *State Action, Congressional Power and Creditors' Rights: An Essay on the Fourteenth Amendment*, 47 S. CAL. L. REV. 1, 47-52 (1973) (continuation of article beginning in 46 S. CAL. L. REV. 1002 (1973) [hereinafter cited as Burke & Reber].

10. To bring an action for violation of fourteenth amendment rights under 42 U.S.C. § 1983 and receive judgment, a claimant must satisfy the following four-step analysis:

(1) Plaintiff must make a colorable claim that defendant's acts were under color of state law to satisfy the jurisdictional prerequisite of 28 U.S.C. § 1343 (1970).

28 U.S.C. § 1343 provides:

> The district courts shall have original jurisdiction of any civil action authorized by law to be commenced by any person . . . .
>
> (3) to redress the deprivation, *under color of any State law, statute, ordinance, regulation, custom or usage*, of any right, privilege or immunity secured

meaningful alternative may be a federal action under 42 U.S.C. § 1983.

When the nature of the creditor's self-help remedy is repossession of a chattel in which the creditor has a security interest, federal courts generally have held that repossession without judicial assistance is strictly private action which will not support a cause of action under 42 U.S.C. § 1983.[11] In *McCormick v. First National Bank*[12] the district court held that the bank's repossession of an automobile in which it had a security interest was a private contractual remedy and not action under color of state law even though the repossession was authorized by section 9-503 of the Florida Uniform Commercial Code.[13] Since the contract adopted the provisions of the U.C.C., the court reasoned that the repossession was effected pur-

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> by the Constitution of the United States or by any Act of Congress providing for equal rights of citizens or of all persons within the jurisdiction of the United States . . . . (emphasis added)

See Santiago v. Corporación de Renovacion Urbana y Vivienda de Puerto Rico, 453 F.2d 794, 797 (1st Cir. 1972); Meredith v. Allen County War Memorial Hosp. Comm'n, 397 F.2d 33 (6th Cir. 1968).

(2) To satisfy the tort cause of action, under 42 U.S.C. § 1983, the wrongful acts must be "under color of [state law]." 42 U.S.C. § 1983 (1970); *see* note 1 *supra*.

(3) When the wrongful acts are alleged to be a violation of the fourteenth amendment, the language of the fourteenth amendment—"[n]o State shall"—requires a finding of "state action." The term "state action," however, is the descriptive term given the fourteenth amendment requirement of state involvement. The term action "under color of [state law]" is merely the term used by 42 U.S.C. § 1983 for the same state involvement requirement. Therefore, the terms are virtually synonymous in a suit under 42 U.S.C. § 1983. *See* Parish v. National Collegiate Athletic Ass'n, 506 F.2d 1028, 1031 n.6 (5th Cir. 1975).

(4) Finally, the court must find that the wrongful acts violate the due process or equal protection clauses.

The above analysis was suggested by Thomas R. McCoy, Professor of Law at Vanderbilt University.

Since "action under color of state law" and "state action" in practical terms are almost identical concepts, courts confuse and mingle steps (2) and (3). *See* United States v. Price, 383 U.S. 787, 794 n.7 (1965); Parish v. National Collegiate Athletic Ass'n, 506 F.2d 1028, 1031 n.6 (5th Cir. 1975); Gibbs v. Titelman, 502 F.2d 1107, 1110 (3rd Cir.) *cert. denied*, 419 U.S. 1039 (1974). Therefore, when one court requires "state action" and another requires "action under color of state law," they both are treating steps (2) and (3) as one requirement.

11. *See* Burke & Reber note 9 *supra*, at 52-53. *See also* Calderon v. United Furniture Co., 505 F.2d 950 (5th Cir. 1974); Turner v. Impala Motors, 503 F.2d 607 (6th Cir. 1974); Gibhs v. Titelman, 502 F.2d 1107 (3rd Cir.), *cert. denied*, 419 U.S. 1039 (1974); Brantley v. Union Bank & Trust Co., 498 F.2d 365 (5th Cir.), *cert. denied*, 419 U.S. 1034 (1974); Nichols v. Tower Grove Bank, 497 F.2d 404 (8th Cir. 1974); Nowlin v. Professional Auto Sales, Inc., 496 F.2d 16 (8th Cir.), *cert. denied*, 419 U.S. 1006 (1974); James v. Pinnix, 495 F.2d 206 (5th Cir. 1974); 11 HOUSTON L. REV. 991 (1974); 62 ILL. B.J. 404 (1974); 28 SW. L.J. 796 (1974); 35 U. PITT. L. REV. 882 (1974).

12. 322 F. Supp. 604 (S.D. Fla. 1971).

13. FLA. STAT. ANN. § 679.9-503 (1966).

suant to the contract and not under the authority of any state law.[14] In *Adams v. Southern California First National Bank*[15] the Ninth Circuit reached the same result, but for a different reason. The court held that since self-help repossession pursuant to an installment sales contract traditionally had been a private remedy, its enactment into statutory form did not convert the private action into action under color of state law.[16] Borrowing the test of "significant state involvement" from *Burton v. Wilmington Parking Authority*[17] and *Moose Lodge v. Irvis*,[18] the court determined that the state's involvement in enacting the statute was not significant enough to characterize the repossession as under color of state law.[19]

When a creditor uses self-help in seizing the debtor's goods pursuant to a landlord lien statute, however, he takes possession of property which is unrelated to the debt and which is not subject to a prior contractual agreement.[20] In *Hall v. Garson*,[21] the Fifth Circuit found these factors sufficiently significant to find state action since the statute authorizing the landlord's entry into the tenant's room and seizure of his property "vests in the landlord . . . authority that is normally exercised by the state and historically has been a state function"[22] and thus takes on the characteristics of state

14. 322 F. Supp. at 606.

15. 492 F.2d 324 (9th Cir. 1973), *cert. denied*, 419 U.S. 1006 (1974).

16. 492 F.2d at 336.

17. 365 U.S. 715, 722 (1961). The Supreme Court held that exclusion of a hlack solely on account of his race from a restaurant operated by private individuals but under lease in a public building was discriminatory state action that violated the equal protection clause of the fourteenth amendment.

18. 407 U.S. 163, 173 (1972). The Supreme Court held that a state liquor license issued to a private club is not sufficient state involvement to subject the club to equal protection requirements due to its discriminatory memhership policies.

19. 492 F.2d at 336. In Reitman v. Mulkey, 387 U.S. 369 (1967), the Supreme Court affirmed a finding of state action in an amendment to the California constitution providing that a person's right to rent or sell property to whomever he chooses could not be limited by the state. Thus the amendment itself was state action without ongoing state involvement. The enactment of a statute, however, does not carry the permanence or weight of a constitutional amendment. Therefore, it seems doubtful that Congress or the Supreme Court would intend that state action be found solely in the enactment of a statute.

20. *See* Arizona Innkeeper's Lien Statute in note 3 *supra*.

21. 430 F.2d 430 (5th Cir. 1970). In *Hall* the landlord's agent removed a television set from the tenant's apartment to secure payment of back rent pursuant to the Texas landlord lien act. TEX. REV. CIV. STAT. ANN. art. 5238a. The district court dismissed the suit under 42 U.S.C. § 1983 for lack of jurisdiction but the Fifth Circuit reversed, finding that the landlord's acts constituted state action. Hall v. Garson, 430 F.2d 430 (5th Cir. 1970). On remand, the district court denied injunctive relief and dismissed the suit in an unreported decision. On appeal, the Fifth Circuit reversed, finding that the statute violated the due process clause of the fourteenth amendment and remanded for further proceedings. 468 F.2d 845 (5th Cir. 1972). *See* 20 DEPAUL L. REV. 750 (1971).

22. 430 F.2d at 439.

action. The *Hall* court based its finding on the principle forwarded by the Supreme Court in *United States v. Classic*[23] that misuse of power authorized solely by a state statute and made possible because the "wrongdoer is clothed with authority of state law" constitutes action under color of state law.[24] *Classic* and the other cases cited by the court in *Hall* as supporting the state function (or public function)[25] doctrine, however, involved not only acts by private individuals but also acts by public officials.[26] Additionally, some commentators feel that the public function doctrine is applicable only in cases involving first amendment rights.[27]

The First Circuit, in *Davis v. Richmond*,[28] rejected the holding of *Hall* that a landlord's exercise of a lien against a tenant's possessions was tantamount to a "public function." The *Davis* court reasoned that state action depends on finding significant state involvement which is not present where a private creditor invokes a private remedy.[29] The court noted that private action could be deemed state action if the state has delegated its power to private individuals to act as agents of the state. The court determined that the landlord lien statute in question, however, merely distinguished the permissible private remedies from those requiring state involvement.[30]

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23. 313 U.S. 299 (1941). The Supreme Court held that election officials' failure to count properly all votes in a congressional election were acts under color of state law and deprived the voters of their constitutional right to choose representatives.

24. 430 F.2d at 439, citing 313 U.S. at 326.

25. The "state function" doctrine, also known as the "public function" doctrine, finds its origin in many Supreme Court cases. *See* Burke & Reber, note 9 *supra*, 46 S. CAL. L. REV. at 1050-74; Clark & Landers, note 7 *supra*, at 377-79.

26. In its 2 treatments of *Hall*, the Fifth Circuit relied on the following cases for support of its public function theory: Adickes v. S.H. Kress & Co., 398 U.S. 144 (1970), in which the Supreme Court found state action where private discrimination involved the concerted action of a policeman; Screws v. United States, 325 U.S. 91 (1945), which involved the finding of state action in a criminal prosecution of a sheriff, policeman, and special deputy for willful deprivation of rights; United States v. Classic, 313 U.S. 299 (1941), which involved election officials' failure to count properly all the votes in a congressional election; and *Ex parte* Virginia, 100 U.S. 399 (1879), which involved a habeas corpus petition by a Virginia county court judge heing held for violation of a federal law requiring jury lists to include hlacks.

None of these cases deals with a situation in which strictly private actions are found to constitute action under color of state law, and all of the cases involve active, ongoing activity by a state official.

27. Some commentators feel that the public function theory is applicahle only to first amendment rights with the "white primary" and "delegation-circumvention" cases better explained on other grounds. Burke & Reber, note 9 *supra*, 46 S. CAL. L. REV. at 1050-74 and 47 S. CAL. L. REV. at 50.

28. 512 F.2d 201 (1st Cir. 1975).

29. *Id.* at 202.

30. *Id.* at 205.

Subsequently, in *Anastasia v. Cosmopolitan National Bank*,[31] the Seventh Circuit followed the *Davis* decision and held that seizure of a tenant's property by a landlord constitutes state action only when the state is involved continuously in the seizure.[32] The court reasoned that the legislature simply had expanded the common law innkeeper's lien[33] to cover all landlord-tenant relationships and thus to end any need for state involvement in the private debtor-creditor relationship. Consequently, the court disagreed with the proposition stated in *Hall* that execution of a lien traditionally had been a state function since innkeeper's liens have been enforced since early common law.[34] Thus the First and Seventh Circuits expressly refuted the "public function" theory which had been adopted by the Fifth Circuit in *Hall*[35] to find that a landlord's execution on his tenant's possessions is action under color of state law. Instead, they found that the enactment of a statute extending a traditionally private remedy was not sufficient state involvement to support a finding of action taken under color of state law.

III. The Instant Opinion

The instant court first examined the applicability of *Adams*[36] to the immediate facts and concluded that the finding of no state action in that case was limited to repossession of a chattel subject to a security interest and thus was not dispositive.[37] The court then examined the common law to determine whether a landlord had a lien on the belongings of his tenant, reasoning that the enactment of a statute would more likely constitute state action if the common law had not permitted the lien. The court established that at common law only innkeepers held such a lien and that the defendant in the instant case did not enjoy the status of an innkeeper.[38] The court next examined the relationship between the property seized

31. 527 F.2d 150 (7th Cir. 1975) (decided one week prior to the instant case).

32. *Id.* at 156.

33. At common law innkeepers that served transient guests and provided food and entertainment were required to provide lodging for all travelers, if possihle, and to accept their belongings for safekeeping. The common law, however, gave the innkeeper a lien on his tenant's possessions as security for the rent due. Hotel, boarding-house, and lodging-house keepers did not have a duty to accept transient guests or keep their belongings safe, and therefore, had no common law lien against those belongings. 528 F.2d at 429-31.

34. 527 F.2d at 157-58. *See* text accompanying note 22 *supra*.

35. *See* notes 21-27 *supra* and accompanying text.

36. *See* notes 15-19 *supra* and accompanying text.

37. 528 F.2d at 429.

38. *Id.* at 429-31; *see* note 33 *supra*.

and the debt enforced and concluded that indeterminate seizure of property as collateral for a general debt, as distinguished from repossession of a specific chattel giving rise to the debt, is the type of activity which is a function of the state and over which the state ordinarily has a monopoly. The court found that no contractual relationship covering plaintiffs' property existed between the parties and that plaintiffs had no notice or knowledge of defendant's right to seize their belongings upon eviction.[39] Consequently, the court felt that Arizona had involved itself in the seizure since the statute was the sole authority for the defendant's action. Therefore, because the common law innkeeper's lien did not encompass the instant landlord, because the execution of a lien against a debtor's possessions traditionally has been a state function, and because the statute provided the sole authority for the seizure, the court determined that the state's involvement was siguificant enough to hold that the seizure constituted action under color of state law which satisfied the prerequisite for a cause of action under 42 U.S.C. § 1983.[40]

Disclaiming the court's common law basis, the concurring opinion relied solely on the public function doctrine enunciated in *Hall*. Judge Ely felt that use of the common law theory would perpetuate common law distinctions which may have become obsolete.[41]

IV. COMMENT

The instant case creates a two to two split in the circuits on the question whether the seizure of a tenant's possessions under a landlord lien statute is action under color of state law. The decisions in *Davis* and *Anastasia* provide the potential for abuse that *Fuentes* was designed to prevent—the indiscriminate entry into the debtor's home and seizure of his belongings without prior notice and hearing. *Hall* and the instant opinion, however, provide a more equitable result. While the debtor in the repossession cases, such as *Adams* and *McCormick*, had notice that repossession of a specific chattel would occur, pursuant to a contract, upon default, it is unlikely that the tenant either knew the consequences of his default or would have consented to them if he had known. Thus the statute makes the landlord judge and jury over the tenant without providing the tenant an opportunity to defend prior to the unannounced entry and

39. 528 F.2d at 431-32.
40. *Id.* at 429-32.
41. *Id.* at 432-35.

seizure as *Fuentes* seems to dictate. Additionally, the lien gives the landlord power to seize any of the tenant's property regardless of whether it is of value to anyone other than the tenant or whether it is, as in the instant case, of immediate necessity to the tenant.[42] From a policy standpoint, therefore, the landlord lien appears to be an unduly harsh means of securing rent if notice and an opportunity to be heard are not afforded.

The equitable considerations, however, do not overcome the lack of case support for *Hall* and the instant opinion. The public function doctrine used in *Hall* finds its origin in cases that are distinguishable on the facts[43] and, according to some commentators, applicable only in first amendment rights cases.[44] Additionally, the instant court's reliance on the public function doctrine that execution of liens has exclusively been a function of the state seems to contradict its finding that private innkeeper's liens were authorized at common law.[45] Therefore, without precedent for finding action under color of state law, the prerequisite for applying the *Sniadach-Fuentes* notice and hearing requirements, the proponents of *Davis* and *Anastasia* would hold that the landlord lien is outside the reach of the fourteenth amendment and should be left to the discretion of the state legislatures as solely a state matter.

Consequently, while *Davis* and *Anastasia* have narrowly followed the precedent and refused to find a cause of action, *Hall* and the instant opinion have followed the equities and judicially extended the concept of action under color of state law. In the process, however, the latter decisions have provided support for subjecting any private action authorized solely by state statute to due process restrictions. Is this, however, a bad result? If the state legislature authorized a public official to carry out the seizure, state action, and thus due process protection, would clearly be found. Consequently, why should a tenant not be afforded due process protection simply because the state authorized a private citizen to perform the same seizure? Has the state not significantly affected the rights of the parties to a point where the courts can find a significant state involvement and thus action under color of state law? Hopefully, the Supreme Court will provide a definitive answer in the near future and, in the process, more narrowly define the sphere within which

42. *See* note 2 *supra*.
43. *See* note 26 *supra* and accompanying text.
44. *See* note 27 *supra*.
45. *Compare* section A of Judge Weigel's opinion, 528 F.2d at 429-31 *with* section B, *id.* at 431-32.

the *Sniadach-Fuentes* due process restrictions apply. Until that time, however, the scope of the fourteenth amendment will expand or contract depending upon which decisions the lower courts rely.

RICHARD T. HURT

Copyright—Damages—The Owner of the Performance Rights in a Dramatico-Musical Must Receive At Least the Minimum "In Lieu" Damages for Each Song Included in Each Performance of the Entire Work

I. FACTS AND HOLDING

Plaintiffs, owners of the United States copyrights in the rock-opera *Jesus Christ Superstar*,[1] the separate musical compositions therein,[2] and the performing stage rights, brought an action to re-

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1. The rock opera *Jesus Christ Superstar* [hereinafter referred to as *Superstar*] was composed by Englishmen Tim Rice and Andrew Webber. This musical presentation of the last seven days in the life of Christ has been an outstanding commercial success. Sales from the long play album and tape have achieved a retail gross of some forty million dollars. VARIETY, Oct. 13, 1971, at 1. The touring production was likewise successful, prompting *Variety* to declare *Superstar* as the "biggest all-media parlay in show business history." *Id.* *See* Allison, *Protection of Performance Rights to "Jesus Christ Superstar": the Dramatic-Nondramatic Dilemma*, 4 PERFORMING ARTS REV. 13 [hereinafter cited as Allison]; Perrone, *Small and Grand Performing Rights? (Who Cared Before "Jesus Christ Superstar")* 20 BULL. CR. SOC. 19 (1972) [hereinafter cited as Perrone].

Rice and Webber secured copyrights on each of the twenty-two songs in *Superstar* and assigned all but one of these to plaintiff Leeds Music Ltd., along with the rights in the entire opera. Leeds Music Ltd. then assigned the United States rights to plaintiff Leeds Music Corp. Plaintiff Robert Stigwood Group Ltd. obtained the professional stage rights. These three organizations joined in bringing the instant action.

2. The individual songs of *Superstar* were copyrighted by Leeds Music Ltd. as "musical compositions" pursuant to 17 U.S.C. § 5(e) (1970). Section 5 provides:

§ 5. Classification of works for registration.

The application for registration shall specify to which of the following classes the work in which copyright is claimed belongs:

(a) Books, including composite and cyclopedic works, directors, gazetteers, and other compilations.

(b) Periodicals, including newspapers.

(c) Lectures, sermons, addresses (prepared for oral delivery).

(d) Dramatic or dramatico-musical compositions.

(e) Musical compositions.

(f) Maps.

(g) Works of art; models or designs for works of art.

(h) Reproductions of a work of art.

cover statutory damages pursuant to 17 U.S.C. § 101(b)[3] against defendants who had infringed plaintiffs' copyrights by giving numerous public performances of the opera without permission.[4] Plaintiffs asserted that each performance[5] of *Superstar* infringed the dramatic rights in three of the separate musical compositions,[6] as well as the dramatic rights in the work as a whole.[7] Plaintiffs further

(i) Drawings or plastic works of a scientific or technical character.
(j) Photographs.
(k) Prints and pictorial illustrations including prints or labels used for articles of merchandise.
(l) Motion-picture photoplays.
(m) Motion pictures other than photoplays.

The above specifications shall not be held to limit the subject matter of copyright as defined in section 4 of this title, nor shall any error in classification invalidate or impair the copyright protection secured under this title.

Leeds Music Ltd. also registered three copyrights as "dramatico-musical compositions" pursuant to 17 U.S.C. § 5(d) (1970). *Id.* The three class (d) copyrights allegedly infringed are (1) *Jesus Christ Superstar, A Rock Opera* (Musical Excerpts Complete Libretto); (2) *Jesus Christ Superstar, A Rock Opera* (Libretto) (Additional Words); (3) *Jesus Christ Superstar* (Vocal Score). Robert Stigwood Group Ltd. v. O'Reilly, Civil No. 75-7076, at 1598 (2d Cir., Jan. 19, 1976).

3. 17 U.S.C. § 101 provides in pertinent part:

If any person shall infringe the copyright in any work protected under the copyright laws of the United States such person shall be liable: . . .

(b) *Damages and profits; amount; other remedies.*

To pay to the copyright proprietor such damages as the copyright proprietor may have suffered due to the infringement, as well as all the profits which the infringer shall have made from such infringement, . . . or in lieu of actual damages and profits, such damages as to the court shall appear to be just, and in assessing such damages the court may, in its discretion, allow the amounts as hereinafter stated, . . . and such damages shall in no other case exceed the sum of $5,000 nor be less than $250, and shall not be regarded as a penalty.

4. Defendants were ordained priests in the Roman Catholic Church who, as part of their "musical ministry," performed *Superstar*. The lower court rejected defendants' contention that they were not subject to the provisions of the Copyright Act under the "religion" exclusion of 17 U.S.C. § 104. The lower court also rejected defendants' first amendment and "fair use" defenses. Robert Stigwood Group Ltd. v. O'Reilly, 345 F. Supp. 376, 379-80 (D. Conn. 1972), *aff'd*, No. 72-1826 (2d Cir., May 30, 1973). Thus the only question before the instant court was the amount of damages. The current defendants are not the only violators of the *Superstar* rights. Plaintiffs' copyrights allegedly have been infringed so many times that the litigation generated has been referred to as the *Superstar* cases. Nine other cases are collected in Robert Stigwood Group Ltd. v. Sperber, 457 F.2d 50, 51 n.1 (2d Cir. 1972).

5. Defendants conceded that they performed *Superstar* at least fifty times and the district court based its award on this figure. Plaintiffs were able to show by affidavit that there were at least sixty performances, and contended that this number should be the basis for the computation of damages. Robert Stigwood Group Ltd. v. O'Reilly, Slip Op. at 1591. The parties also disagreed on whether performances given in Canada should be included in determining damages. *Id.* at 1591-93.

6. Though plaintiffs owned the dramatic rights in all of the songs, damages were sought for the violation of the rights in only three songs. It is unclear why only three infringements were alleged.

7. These rights are customarily referred to as tbe "grand rights." 2 NIMMER, COPYRIGHT

contended that the court was required to award at least the statutory minimum amount of damages for each infringement.[8] Defendants maintained that the entire tour constituted one infringement and that the court was free to award the amount of damages it thought reasonable and just.[9] The district court found that each performance was a separate infringement of the copyrights in the three musical compositions and of the three copyrights covering the entire work, but failed to award plaintiffs the minimum damages specified by statute.[10] On appeal to the United States Court of Appeals for the Second Circuit, *held*, reversed and remanded. Each unauthorized performance of a dramatico-musical constitutes a separate infringement of the dramatic rights in the entire work and in every separate musical composition, and requires that at least the statutory minimum amount of damages be awarded.[11] *Robert Stigwood Group Ltd. v. O'Reilly*, No. 75-7076 (2d Cir., Jan. 19, 1976).[12]

II. Legal Background

There are three ways of computing damages under the copyright statute: (1) actual damages; (2) profits that the infringer has made from the infringement; or (3) "in lieu of actual damages and profits, such damages as to the court shall appear to be just . . . and such damages shall [not] exceed the sum of $5,000 nor be less than the sum of $250 . . . ."[13] In 1919 the United States Supreme

§ 125.6 (1975) [hereinafter cited as NIMMER]; Perrone, *supra* note 1, at 25. Leeds Music Corp. entered into the customary membership arrangement with the American Society of Composers, Authors, and Publishers (ASCAP) with respect to the nondramatic performing rights in the individual songs, commonly referred to as the "small rights." Rice v. American Program Bureau, 446 F.2d 685, 686 (2d Cir. 1971); *see* note 36 *infra* and accompanying text.

8. Plaintiffs contended that the minimum award of damages should be $90,000 (6 copyrights X $250 X 60 performances). *See* notes 2 & 6 *supra*.

9. Defendants argued that the award of damages should be $3,800 (1 copyright X $100 X 38 performances). The discrepancy in plaintiffs' and defendants' calculations of the number of performances is discussed in note 47 *infra*.

10. Judge Zampano awarded counsel fees of $4,700 and damages of $22,800. The instant court believed his award was based on a formula of 6 copyrights X $100 X 38 performances. Robert Stigwood Group Ltd. v. O'Reilly, Slip Op. at 1589 n.8.

11. The instant court directed the district court to award $48,000 (4 copyrights X $250 X 48 performances). *Id.* at 1601.

12. The instant decision was a consolidation of two cases, Robert Stigwood Group Ltd. v. O'Reilly, Civil No. 75-7076 (2d Cir., Jan. 19, 1976), and Track Music, Inc. v. Contemporary Mission, Inc., Civil No. 75-7077 (2d Cir., Jan. 19, 1976). The latter case involved nearly identical facts dealing with defendants' unauthorized performance of the rock-opera *Tommy*. The instant decision discussed *Tommy* only to the extent that it applied the damages formula derived from its analysis of *Robert Stigwood Group Ltd. v. O'Reilly* to *Tommy*.

13. 17 U.S.C. § 101(b) (1970); *see* note 3 *supra*. *See also* Robert Stigwood Group Ltd. v. O'Reilly, Slip Op. at 1593.

Court case of *L.A. Westermann Co. V. Dispatch Printing Co.*[14] first considered the problem of what constitutes an "infringement" that compels a separate award of "in lieu" damages. After determining that at least the minimum amount of "in lieu"[15] damages must be given for each infringement,[16] the Court found that defendant newspaper publisher had infringed each of plaintiff's five copyrighted illustrations by publishing them in separate issues as part of the advertisements of plaintiff's competitors.[17] A sixth copyrighted illustration was published on behalf of two independent advertisers.[18] The Court explicitly left open the question of whether two infringements of the sixth copyright would have been found had the second publication been merely a continuation or repetition of the first advertisement.[19] The numerous post-*Westermann* courts addressing

14. 249 U.S. 100 (1919).

15. The statute referred to in *Westermann* is Act of March 4, 1909, ch. 320 § 25, 35 Stat. 1075. Though not identical with the current statute, the *Westermann* statute is substantially similar—including the maximum and minimum figures for "in lieu" damages. *See* note 3 *supra*. *But cf.* note 26 *infra* and accompanying text.

16. 249 U.S. at 106-07; *see* NIMMER, *supra* note 7, at §§ 154.2, 154.3. Although *Westermann* clearly states that a court has no authority to make awards outside the statutory amounts prescribed, the Court left the question of *when* a court may award statutory damages unsettled. *Id.* at § 154.11. In F. W. Woolworth Co. v. Contemporary Arts, Inc., 344 U.S. 228, 232-33 (1952), the Court stated:

> In this case the profits realized were established by uncontradicted evidence, hut the court was within bounds of its discretion in concluding that the amount of damages suffered was not computable from the testimony. Lack of adequate proof on either element would warrant resort to the statute in the discretion of the court, subject always to the statutory limitations.

Thus it appears that *Woolworth* allows the court to award statutory damages unless both the amount of actual damages and defendant's profit have been established. Shapiro, Bernstein & Co. v. 4636 S. Vermont Ave., Inc., 367 F.2d 236, 240 (9th Cir. 1966); Note, *Joint and Several Liability for Copyright Infringement: A New Look at Section 101(b) of the Copyright Act*, 32 U. CHI. L. REV. 98, 113 (1964).

17. Plaintiff owned six separate copyrights in pictorial illustrations of women's apparel and gave an exclusive license for their exploitation to a store in Columbus, Ohio. Defendant had received no authorization before publishing the illustrations. 249 U.S. at 102-03; *see* Robert Stigwood Group Ltd. v. O'Reilly, Slip Op. at 1595.

18. 249 U.S. at 105.

19. *Id.* at 105-06. The Court limited its opinion by stating:

> Whether it would be otherwise if that publication had been merely a continuation or repetition of the first, and what bearing the "third" and "fourth" subdivisions of § 25, before quoted, would have on the solution of that question, are matters which we have no occasion to consider now.

The third and fourth subdivisions referred to by the *Westermann* Court were stated in Jewell-LaSalle Realty Co. v. Buck, 283 U.S. 202, 207 (1931), to be mere guidelines to be used by the court in fashioning a damages award where an infringement has resulted in the publication of numerous copies of a copyrighted work. *See* Hubbard, *Monetary Recovery Under the Copyright, Patent, and Trademark Acts*, 58 TRADEMARK REP. 560, 573-74 (1968).

this question have not achieved uniform results.[20] Professor Nimmer has suggested that the cases can be harmonized by examining the length of time between the alleged infringements.[21] If the interval is a matter of days, the court will find only one infringement;[22] if the interval is substantially longer, the court will probably find each publication to be a separate infringement.[23] Other courts, relying on *Westermann*, have concluded that multiple infringements will be found if the alleged copyright violations have been arranged by separate and distinct transactions.[24] The most recent solution to the problem whether multiple unauthorized uses of a single copyright constitute separate infringements is offered by the copyright revision bill passed by the United States Senate.[25] Section 504(c)(1) of this bill specifically provides that only one award of statutory damages will be allowed for all infringements with respect to "one work."[26]

In defining an infringement for purposes of a damage award, the courts also have considered the separate issue of whether the performance of the individual musical compositions[27] from a dramatico-musical[28] constitutes a violation of the dramatic perform-

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20. Davis v. E. I. DuPont de Nemours & Co., 249 F. Supp. 329 (S.D.N.Y. 1966); NIMMER, *supra* note 7, at § 154.32; Rosen, *Multiple Infringements*, 50 J. PAT. OFF. SOC'Y 254 (1968).

21. NIMMER, *supra* note 7, at § 154.32 at 689. *See* Baccaro v. Pisa, 252 F. Supp. 900 (S.D.N.Y. 1966); Davis v. E. I. DuPont de Nemours & Co., 249 F. Supp. 329 (S.D.N.Y. 1966).

22. *See, e.g.*, Gordon v. Weir, 111 F. Supp. 117 (E.D. Mich. 1953), *aff'd per curiam*, 216 F.2d 508 (6th Cir. 1954); Zuckerman v. Dickson, 35 F. Supp. 903 (W.D. Pa. 1940); Doll v. Libin, 17 F. Supp. 546 (D. Mont. 1936).

23. *See, e.g.*, Baccaro v. Pisa, 252 F. Supp. 900 (S.D.N.Y. 1966); Harry Alter Co. v. A. E. Borden Co., 121 F. Supp. 941 (D. Mass. 1954); Eliot v. Geare-Martson, Inc., 30 F. Supp. 301 (E.D. Pa. 1939).

24. Cory v. Physical Culture Hotel, Inc., 14 F. Supp. 977, 985 (W.D.N.Y. 1936), *aff'd*, 88 F.2d 411 (2d Cir. 1937). *See also* Lindsay & Brewster, Inc. v. Verstein, 21 F. Supp. 264 (S.D. Maine 1937); Doll v. Libin, 17 F. Supp. 546 (D. Mont. 1936).

25. On February 19, 1976, the United States Senate unanimously passed (by a vote of 97-0) S. 22, 94th Cong., 2d Sess. (1976). An identical bill, H.R. 2223, was introduced in the House of Representatives on January 28, 1975, by Representative Robert W. Kastenmeier.

26. Section 504(c)(1) provides:

> Except as provided by clause (2) of this subsection, the copyright owner may elect, at any time before final judgment is rendered, to recover, instead of actual damages and profits, an award of statutory damages for all infringements involved in the action, with respect to any one work, for which any one infringer is liable individually, or for which any two or more infringers are liable jointly and severally, in a sum of not less than $250 or more than $10,000 as the court considers just. For the purposes of this subsection, all parts of a compilation or derivative work constitute one work.

27. *See* note 2 *supra*.

28. *See* NIMMER, *supra* note 7, at § 16.3.

ance rights in the entire work ("grand" rights).[29] Although *Brady v. Daly*[30] established that the performance of only a scene of a dramatic work will violate the grand rights;[31] although the court implied in *M. Witmark & Sons v. Pastime Amusement Co.*[32] that even a single song could be inherently dramatic,[33] it was not until 1955 in *April Productions, Inc. v. Strand Enterprises, Inc.*,[34] that a court considered whether dramatic performance rights are infringed by a performance of the separate musical compositions.[35] In *April Productions*, plaintiff alleged that his dramatic rights in the musical play *The Student Prince* were infringed when defendant's night club presented a show including a medley of songs from the production. Defendant contended that the performance was not dramatic, and that he was therefore protected by his ASCAP license which authorized *nondramatic* performances of the individual musical compositions.[36] The court concluded that the mere performance of

29. Section 5(d) of the Copyright Act includes under a single classification both dramatic and dramatico-musical works, and there are only minor differences in their statutory treatment; *see* note 2 *supra*; NIMMER, *supra* note 7, at § 16.4. For a discussion of the various tests used to determine when a work is dramatic, see Perrone, *supra* note 1, at 21-23. *See also* note 36 *infra*.

30. 83 F. 1007 (2d Cir. 1897), *aff'd*, 175 U.S. 148 (1899).

31. *Id.* at 1010; *see* Herbert v. Sbanley Co., 222 F. 344 (S.D.N.Y. 1915), *aff'd*, 229 F. 340 (2d Cir. 1916), *rev'd on other grounds*, 242 U.S. 591 (1917).

32. 298 F. 470, 475 (E.D.S.C. 1924).

33. The court found the song "Kiss Me Again" to be nondramatic in nature, apparently for want of action, scenery and lighting. *Id.* at 474; *see* Perrone, *supra* note 1, at 22-23.

34. 221 F.2d 292 (2d Cir. 1955).

35. *See* note 36 *infra* and accompanying text.

36. In order to understand fully the inherent conflict presented in *April Productions*, it is necessary to analyze the role of the ASCAP organization in the entertainment business. The court in Robert Stigwood Group Ltd. v. Sperber, stated:

> The Copyright Act of 1909 granted several rights to the holders of copyrights in works including the exclusive right "to perform the copyrighted work publicly for profit if it be a musical composition." 17 U.S.C. § 1(e). Composers and publishers soon realized it was impractical for each copyright holder to attempt to enforce this right since he could not possibly police all public performance for profit of every musical composition throughout the United States. ASCAP was formed to meet this need. By obtaining licenses from its members, this organization, staffed for the purpose, could enforce the performing rights of its members. It was believed, however, that each copyright owner could appropriately police and license performances of musical comedies or operas because of the relative infrequency of such productions and the lengthy preparation and publicity which must precede these productions.

457 F.2d at 52. Thus the holder of an ASCAP license is allowed to give only non-dramatic performances of the musical compositions. *Id.* at 52; Rice v. American Program Bureau, 446 F.2d 685 (2d Cir. 1971); Allison, *supra* note 1, at 16. These rights are commonly referred to as the "small" performing rights, as compared to the "grand" rights not covered by the ASCAP license.

In *April Productions*, defendant contended that the performance of tbe songs from *The Student Prince* was entirely within the bounds of the ASCAP license, whereas plaintiff the songs, unaccompanied by words, pantomime, dance, or visual representation, did not violate plaintiff's grand rights.[37] In *Rice v. American Program Bureau*,[38] the Second Circuit again considered whether an ASCAP license was a valid defense to an alleged infringement of the dramatic performance rights in a dramatico-musical.[39] The court granted an injunction, but found the record insufficient to conclude that the mere performance of the songs would violate plaintiff's grand rights.[40] One year later, in *Robert Stigwood Group Ltd. v. Sperber*,[41] the Second Circuit abandoned the test of *April Productions* and answered the unresolved question from *Rice* by stating that the mere performance[42] of the songs in sequence could infringe plaintiff's grand rights.[43] In fashioning its injunction,[44] the court held that a dramatic performance will be found whenever the performance "tells the story" of the dramatic work.[45]

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asserted that the performance was dramatic in nature and therefore outside the small rights grant from ASCAP.

37. 221 F.2d at 296. *See also* Allison, *supra* note 1, at 24-25; Perrone, *supra* note 1, at 26-27.

38. 446 F.2d 685 (2d Cir. 1971).

39. *See* note 36 *supra*.

40. The court stated:

> [T]he presentation of all of the songs from the opera *Jesus Christ Superstar* without costumes, words, or scenery, but in sequence could arguably develop the overall plot of the opera, and thus it might possibly be "dramatic" or be a presentation of the opera in its "entirety." But we have no proof of this here and until there is proof, we cannot so hold.

446 F.2d at 690. In fashioning its injunction, the court prohibited defendants from performing the songs of *Superstar* accompanied by "words, pantomime, dance or visual representation of the work from which the music is taken. . . ." *Id.* at 690. *See* Allison, *supra* note 1, at 19-20; Perrone, *supra* note 1, at 28-34.

41. 457 F.2d 50 (2d Cir. 1972)

42. The facts in *Sperber* are substantially similar to those in *Rice*. Defendant Sperber was a booking agent for a touring company whose show consisted of twenty-three songs from *Superstar* sung sequentially (with one exception) along with three additional works. *Id.*

43. Explicitly addressing the unresolved problem in *Rice*, the court stated:

> Even the presentation of five or six songs could under certain circumstances, develop an essential portion of the drama, for example, the last two days in the life of Christ, thus infringing on a part of the opera. *The sequence of the songs seems to be the linchpin in this case.* If the songs are not sung in sequence, i.e., no song follows another song in OATC concert in the same order as in the original opera, and there are no costumes, scenery, or intervening dialogue, we are confident that the resulting performance could not tell the story of *Jesus Christ Superstar*.

Id. at 55-56 (emphasis added).

44. Defendant was enjoined from performing any two songs in the same order as in the original *Superstar* opera, and from accompanying any song with dramatic action, scenery, or costumes. *Id.* at 56.

45. Professor Nimmer states that "a performance of a musical composition is dramatic if it aids in telling a story; otherwise it is not." NIMMER, *supra* note 7, at § 125.6 at 55. The

III. THE INSTANT OPINION

The instant court first determined that *Westermann* and *Woolworth* required an award of at least the statutory minimum amount of damages for each infringement.[46] The court next considered whether defendants' forty-eight performances of *Superstar* would constitute forty-eight infringements, each giving rise to "in lieu" damages.[47] Since the post-*Westermann* courts have not indicated clearly whether separate performances will result in multiple infringements, the court considered Professor Nimmer's time-test rule[48] but found it inconclusive in cases of theatrical performances.[49] Using the hypothetical of an extended theatrical engagement in one location, the court implied that a performance near the end of the "run" somehow would be independent of an opening night performance even though the performances would be "practically continuous."[50] The court then focused on the "separate transaction" test discussed in *Westermann*,[51] and concluded that separate infringements occur when the components of the infringing activity are heterogeneous.[52] Applying this test to the instant facts, the court found that the varying terms of separately negotiated contracts with auditoriums, newspapers, and radio stations in the different cities

Sperber court relied heavily on this test, stating that the performance of the songs out of sequence could not tell the story of *Superstar*. 457 F.2d at 55-56 & n.6; *see* NIMMER, *supra* note 7, at § 16.3. For other comments on the appropriate test for determining whether the performance of musical compositions violates the dramatic performing rights, see Allison, *supra* note 1, at 25-28 and Perrone, *supra* note 1, at 35-37.

46. Thus the district court was found to he in error for using its discretion to award less than $250 for each infringement. Robert Stigwood Group Ltd. v. O'Reilly, Slip Op. at 1593-94.

47. The court initially indicated that the base figure of sixty performances should be used in determining damages. Although defendants had admitted that they performed *Superstar at least* fifty times, such admission did not rebut plaintiffs' affidavit that there had been at least sixty performances. *Id.* at 1591.

The court next considered whether damages should be awarded for the twelve Canadian performances. The court concluded that these performances should be excluded because copyright laws do not have extraterritorial operation. *Id.* at 1591-93.

48. *See* note 21 *supra* and accompanying text.

49. The court indicated that the time-test rule was much easier to apply to the "publication" cases from which it evolved. Slip Op. at 1596-97 & nn.13 & 14.

50. The court's hypothetical situation posited repetitive infringement of the performing rights in a musical play for a period of several weeks. Considering the number of infringing performances in the hypothetical situation, the court stated:

> Under the time-test rule, while the second performance on the Tuesday night after the play opened on Monday night might not be a separate infringement, what of the performance three weeks later?

Id. at 1596-97.

51. *See* note 18 *supra* and accompanying text.

52. Slip Op. at 1596.

in which defendants performed *Superstar*[53] evidenced heterogeneous transactions and concluded that each performance was a distinct infringement.[54]

In determining the *number* of copyrights infringed at *each* infringing performance, the court's stated objective was to arrive at a "[m]iddle ground between possibly excessive damages and possibly insufficient damages."[55] To implement this policy, the court determined that the three class (d) copyrights, covering the entire dramatico-musical,[56] essentially were overlapping,[57] and thus a single infringement should be found for a violation of these duplicative rights.[58] The court reasoned that a contrary holding would allow owners of a dramatico-musical composition to increase their statutory damages at whim simply by obtaining more class (d) copyrights.[59] In considering the class (e) copyrights,[60] the court found that the rights in every musical composition were independent of each other and of the rights in the entire dramatico-musical and thus the overlap theory was inapplicable.[61] Relying on the *Westermann* holding that liability attaches for each copyright infringed,[62] the court found a separate infringement of the *dramatic* performance rights in each song every time it was performed.[63]

53. Defendants were never in any one city more than two nights. *Id.* at 1597.

54. *Id.* at 1597. Because of the heterogeneous components, the court rejected defendants' contention that the entire tour was only one infringement. *Id.*

55. *Id.* at 1598.

56. *See* note 2 *supra.*

57. The court indicated that the three class (d) copyrights were "superfluous protective layers" of one entire work. Slip Op. at 1598.

58. *Id.* at 1598.

59. *Id.* at 1599. The court compared the instant situation to a scene in a drama being protected by a single copyright of the entire work. Citing Brady v. Daly, 83 F. 1007 (2d Cir. 1897), *aff'd,* 175 U.S. 148 (1899), and Herbert v. Shanley Co., 222 F. 344 (S.D.N.Y. 1915), *aff'd,* 229 F. 340 (2d Cir. 1916), *rev'd on other grounds,* 242 U.S. 591 (1917), the court stated that copyrighting individual scenes would not he permitted in order to increase the minimum statutory damages.

60. *See* note 2 *supra.*

61. Slip Op. at 1599.

62. The court reconciled its use of the overlap concept with the *Westermann* decision by stating:

> We do not believe that the *Westermann* language must be taken literally in every case, however, for the problem now before us was surely not in the contemplation of the Court when Justice Van Devanter wrote. When the copyrights on the songs can live their own copyright life, we take the teaching of *Westermann* to apply. When the particular copyrights on the dramatico-musical composition itself are essentially duplicative, however, we perceive no mandate to thwart what we think is otherwise a sensible construction.

Id. at 1600.

63. *Id.* at 1599. The court's only citation of authority for this aspect of its holding was

IV. Comment

The instant opinion is the first circuit court decision to consider the amount of "in lieu" damages for multiple unauthorized performances of a dramatico-musical. In attempting to provide plaintiffs with both adequate and nonexcessive compensation, the court adopted the "heterogeneous components" test and found that each performance was a separate infringement.[64] This test is an acceptable derivation of previous authorities,[65] and its implementation did assist the court in equitably resolving the the instant case. Nonetheless, an equally just result would not be obtained in other situations determined through similar analysis. In the court's hypothetical,[66] for example, where at least part of a theatrical tour consists of an extended engagement at one locale arranged by a single contract,[67] even an application of the heterogeneous components rule would probably result in a finding of only one infringement. In this situation plaintiff would be forced either to abandon his request for "in lieu" damages,[68] or to be content with an award of $5,000 or less. Future courts could avoid this result by interpreting expansively the term "heterogeneous component." A liberal construction of the test would be consistent with the instant court's policy of providing adequate and just compensation.[69]

The proposed copyright legislation clearly would affect the determination of the number of infringements resulting from multiple performances. Section 504(c)(1) of Senate Bill 22 specifically states that, regardless of the number of infringements by a single defendant, the injured party is entitled to only one award of statutory damages for each infringed copyright.[70] The bill, however, does miti-

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to Rice v. American Program Bureau, 446 F.2d 685 (2d Cir. 1971), for the factual statement that the dramatic performance of the copyrighted songs was excluded from the ASCAP license.

64. *Id.* at 1597.

65. The court seemed to combine the joint tortfeasor and diverse business features of the *Westermann* decision. *See* note 18 *supra* and accompanying text.

66. *See* note 50 *supra* and accompanying text.

67. In the instant case, the court maintains that "[e]ach of the defendants' performances was given pursuant to a separately negotiated agreement made with a specific auditorium, and in conjunction with separately arranged advertising with local newspapers and radio stations." Slip Op. at 1597. Thus even the two-night stands consisted of separately arranged performances. Normally, however, a series of engagements in any one town would be arranged by a single contract covering all of the performances.

68. Plaintiff would be able to pursue the alternative remedies of recovering the infringer's profits or recovering his actual damages. 17 U.S.C. § 101(b) (1970). *See* note 3 *supra*.

69. *See* note 55 *supra* and accompanying text.

70. S. Rep. No. 94-473, 94th Cong., 1st Sess. 144 (1975); *see* note 26 *supra* and accompanying text.

gate the harshness of this revision by increasing the maximum statutory award to $10,000.[71] Further, when only a few copyrights are infringed,[72] the new legislation may discourage plaintiffs from seeking statutory damages to redress their injuries. The bill also would seem to increase the use of injunctions when it is extremely difficult to prove injury and profits. In such cases, where statutory damages are the only alternative, an immediate injunction will be necessary to insure that the non-compensable injury will not occur.[73]

The proposed legislation does *not* aid in determining the number of copyrights infringed at each performance. Section 504(c)(1) simply states that the copyright owner may recover "an award of statutory damages for all infringements involved in the action, with respect to *any one work*."[74] "Work" is not mentioned in the definitional section, but since the bill does not disallow copyrighting of individual songs within a dramatico-musical, it is likely that each copyrighted song would be considered a separate "work." Thus, although the proposed legislation specifically states that only one infringement will be found for a series of performances, it does not alter the instant court's determination that the unauthorized performance of a dramatico-musical infringes the dramatic performance rights in each of the individual musical compositions. The court, however, overlooked the implications of *Witmark*, *April Productions*, *Rice*, and *Sperber*.[75] When considering the concepts of overlapping copyrights in the entire work,[76] and dramatic performance rights in the separate musical compositions, the instant court's holding can be combined with these cases, which state that the sequential non-dramatic performance of the songs will infringe the dramatic rights in the entire work. Once this infringement is

71. *See* note 26 *supra*.

72. When there are only a few copyrights infringed at numerous performances, the decrease in the damages award required by the proposed statute is obvious. But, when there are numerous copyrights infringed at these performances, the proposed legislation may not effectively eliminate "in lieu" damages as a viable remedy. The latter situation is discussed in note 78 *infra* and accompanying text.

73. A concomitant result will be the necessity of developing an effective policing mechanism to ensure that injunctions are obtained as soon as possible after the initial act of infringement.

74. S. 22, 94th Cong., 2d Sess. § 504(c)(1) (1976). For a full reading of this section, see note 26 *supra*.

75. The only citation of authority was in a negative sense—*Westermann* did not prohibit the court's conclusion. Slip Op. at 1600.

76. The overlap concept used by the court is a practical result of the duplicitive coverage provided by the class (d) copyrights. This portion of the instant opinion, though not as significant as other aspects of the decision is a sensible implementation of the court's policy to avoid excessive or inadequate compensation.

found, a plaintiff can *then* rely on the instant decision, and increase his damages award by claiming infringement of the *dramatic* rights *in each song*.[77] The impact of this rationale could be severe. For example, a defendant erroneously relying on an ASCAP license to protect his sequential performance of the songs in *Superstar* could be liable for $276,000 in damages[78] if the plaintiff elected to demand statutory damages for each of the twenty-two songs in the opera every time they were performed. The harshness of this result would be mitigated by the single infringement rule of the proposed statute because plaintiff would be entitled to only one award of damages for each song.[79] Consequently, the proposed legislation may not be an obstacle prohibiting adequate compensation,[80] but may be necessary to avoid *excessive* awards when numerous songs are used in one performance. Until the proposed statute becomes law, however, the principal impact of the instant case will be the increased protection it gives the owner of dramatico-musical copyrights, by allowing damages for the infringement of the dramatic performing rights in each song.

JAY D. CHRISTIANSEN

Invasion of Privacy—Constitutional Privilege—The First Amendment Does Not Protect The Publicizing of Unnewsworthy Private Facts

I. FACTS AND HOLDING

Plaintiff,[1] a private citizen, sued[2] defendant magazine pub-

77. It should be noted that the *Sperber* decision did not address the question considered by the instant court because the only remedy sought in *Sperber* was an injunction.

78. 22 class (e) copyrights
+1 class (d) copyright
23 copyrights x 48 performances x $250 = $276,000.

79. Under the proposed statute, the award could be as little as $5,750 (23 copyrights X $250).

80. *See* note 68 *supra* and accompanying text.

1. Plaintiff is a body surfer at the "Wedge," a public beach in California, where he is well known for his skill and daring in this dangerous sport. Virgil v. Time, Inc., 527 F.2d 1122, 1123-24 (9th Cir. 1975), *cert. denied*, 44 U.S.L.W. 3661 (May 25, 1976).

2. The suit originally was brought in the California state courts, but was removed to the United States District Court for the Southern District of California by the defendant on grounds of diversity. *Id.* at 1122, 1123.

lisher for violating his right of privacy[3] by publishing without his consent[4] an article[5] that contained facts about plaintiff's private life that were not matters of public interest.[6] Defendant contended that the first amendment protected its publication of these admittedly private facts because they were true.[7] The United States District Court for the Southern District of California denied defendant's motion for summary judgment. On appeal[8] to the United States Court of Appeals for the Ninth Circuit, *held*, vacated and remanded. In an action for invasion of privacy, absent a showing that the facts publicized are newsworthy, the publicizing of true but private facts is not protected by the first amendment. *Virgil v. Time, Inc.*, 527 F.2d 1122 (9th Cir. 1975), *cert. denied*, 44 U.S.L.W. 3661 (May 25, 1976).

II. LEGAL BACKGROUND

The first amendment guarantees of free speech and press[9] never have been held absolute by the United States Supreme Court.[10] For example, the Court in 1919 developed the "clear and present danger" doctrine, which allowed Congress to prohibit speech that reached a certain level of incitement to unlawful activity.[11] The

3. The case was controlled by California law, which has recognized a common law action for invasion of privacy since 1931. Kapellas v. Kofman, 1 Cal. 3d 20, 459 P.2d 912, 81 Cal. Rptr. 360 (1969); Melvin v. Reid, 112 Cal. App. 285, 297 P. 91 (1931). Specifically, the violation involved was that of publicity given to private life, one of four branches of the tort. *See* notes 29, 30, & 48-50 *infra* and accompanying text.

4. Plaintiff originally had consented to the article and had given interviews to its author. Upon discovering that the article would deal with events in his private life as well as with body surfing, however, plaintiff had completely revoked his consent prior to publication. 527 F.2d at 1123-24.

5. The article, entitled *The Closest Thing to Being Born*, appeared in the Feb. 22, 1971, issue of *Sports Illustrated*, a magazine owned by defendant. It dealt with the sport of body surfing as engaged in by plaintiff and others at the Wedge. *Id.*

6. Plaintiff complained that, in purporting to probe the psychological makeup of those who engage in body surfing, the article related that plaintiff had (among other things) dived down a flight of stairs at a party, extinguished a lighted cigarette in his mouth, and eaten spiders and insects. Plaintiff also complained of the publication of his photograph in conjunction with this material. *Id.* at 1124-25 n.1.

7. Defendant further contended that plaintiff had made the facts public by relating them to defendant's reporter. Plaintiff did not dispute the truth of the contents of the article. *Id.* at 1124, 1126.

8. Plaintiff took this interlocutory appeal pursuant to 28 U.S.C. § 1292(b).

9. "Congress shall make no law . . . abridging the freedom of speech, or of the press . . . ." U.S. CONST. amend. I.

10. *But cf.* the position of Mr. Justice Black in, *e.g.*, New York Times Co. v. Sullivan, 376 U.S. 254, 293 (1964) (Black, J., concurring).

11. The Court stated:

The question in every case is whether the words used are used in such circumstances

Court also has maintained consistently that obscene publications are not protected by the first amendment.[12] The primary reason for this interpretation is undoubtedly the concept of the first amendment as a safeguard for the public's right to know,[13] a right not served by all types of speech in all situations.[14]

In contrast to freedom of speech, protection of the right of privacy is a fairly recent development in the law.[15] The tort of invasion of privacy arose primarily as the result of a famous article by Messrs. Samuel D. Warren and Louis D. Brandeis,[16] which urged development of an individual's right to be free from unwarranted prying into his personal affairs and found support for such a right in the earlier common law.[17] Gradually the states have come to

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and are of such a nature as to create a clear and present danger that they will bring about the substantive evils that Congress has a right to prevent.

Schenck v. United States, 249 U.S. 47, 52 (1919).

12. *E.g.*, Miller v. California, 413 U.S. 15 (1973); Roth v. United States, 354 U.S. 476 (1957).

13. *See, e.g.*, Columbia Broadcasting Sys., Inc., v. Democratic Nat'l Comm., 412 U.S. 94, 102 (1973); Thornhill v. Alabama, 310 U.S. 88, 102 (1940).

14. The concept of the public's right to know is also at the core of Alexander Meiklejohn's first amendment theory, set forth in A. MEIKLEJOHN, FREE SPEECH AND ITS RELATION TO SELF-GOVERNMENT (1948) [hereinafter cited as MEIKLEJOHN], and Meiklejohn, *The First Amendment Is An Absolute*, 1961 SUPREME COURT REV. 245. Simply stated, Meiklejohn's theory is that, because the American people are the governors as well as the governed, they must have access to all information that may relate to their ability to govern wisely and effectively. MEIKLEJOHN 15-16, 24-25. Therefore, according to Meiklejohn, the first amendment absolutely protects only that speech that may be said to relate to the self-governing function of the people. *Id.* at 24-25, 46. This results in the division of speech into two categories: one is "public" in nature and not susceptible of abridgment by the government, the other "private" and abridgable. The latter is afforded only the limited protection of due process under this analysis. *Id.* at 37-39. Thus Meiklejohn's theory, although not entirely orthodox, accords with the general view that the first amendment does not protect all speech absolutely.

For more detail as to Meiklejohn's concept of the content of the protected public speech category, see Meiklejohn, *The First Amendment Is An Absolute*, 1961 SUPREME COURT REV. 245, 255-57. For a criticism of Meiklejohn's views, see Chafee, Book Review, 62 HARV. L. REV. 891 (1949).

See notes 36-41 *infra* and accompanying text.

15. For another aspect of the right of privacy (not dealt with herein), that of constitutional restrictions on governmental interference with the right of privacy, see Roe v. Wade, 410 U.S. 113 (1973); Griswold v. Connecticut, 381 U.S. 479 (1965).

16. Warren & Brandeis, *The Right to Privacy*, 4 HARV. L. REV. 193 (1890) [hereinafter cited as Warren & Brandeis]. The article was intended primarily to establish the individual's right of privacy against the "yellow journalism" of the time. *See id.* at 196. On the right of privacy in general, see Green, *The Right of Privacy*, 27 ILL. L. REV. 237 (1932); Kalven, *Privacy in Tort Law—Were Warren and Brandeis Wrong?*, 31 LAW & CONTEMP. PROB. 326 (1966); Prosser, *Privacy*, 48 CALIF. L. REV. 383 (1960); Wade, *Defamation and the Right of Privacy*, 15 VAND. L. REV. 1093 (1962) [hereinafter cited as Wade]. Other treatments are listed in W. PROSSER, LAW OF TORTS 802-03 (4th ed. 1971) [hereinafter cited as PROSSER].

17. Warren & Brandeis, *supra* note 16, at 198-214.

recognize a right of privacy, either by judicial decision[18] or by statute,[19] until today it is accepted in most jurisdictions,[20] including California.[21] Courts have recognized a cause of action for invasion of the right in a variety of situations, including publication of pictures of plaintiff without his consent,[22] false attribution of statements to plaintiff,[23] intrusion on the plaintiff's personal solitude,[24] and disclosure of embarrassing private facts about the plaintiff.[25] Along with this broad legal acceptance of the right of privacy has come a recognition of its limitations, the most important of which is that no liability can be imposed when the subject matter publicized is "newsworthy."[26] This limitation, mentioned by Warren and Brandeis,[27] has been interpreted so broadly by many courts that publication of some arguably private matters has not resulted in liability.[28] Today, the cause of action for invasion of privacy generally is recognized to consist of four separate torts:

(a) Intrusion upon the seclusion of another . . .
(b) Appropriation of the other's name or likeness . . .
(c) Publicity given to the other's private life . . .
(d) Publicity which places the other in a false light before the public . . . .[29]

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18. *See, e.g.*, Melvin v. Reid, 112 Cal. App. 285, 297 P. 91 (1931); Pavesich v. New England Life Ins. Co., 122 Ga. 190, 50 S.E. 68 (1905).

19. *E.g.*, N.Y. CIV. RIGHTS LAW §§ 50-52 (McKinney Supp. 1975-76).

20. PROSSER, *supra* note 16, at 804.

21. Melvin v. Reid, 112 Cal. App. 285, 297 P. 91 (1931); *see* note 3 *supra*.

22. Daily Times Democrat v. Graham, 276 Ala. 380, 162 So. 2d 474 (1964); Gill v. Hearst Publishing Co., 40 Cal. 2d 224, 253 P.2d 441 (1953); Barber v. Time, Inc., 348 Mo. 1199, 159 S.W.2d 291 (1942).

23. Pavesich v. New England Life Ins. Co., 122 Ga. 190, 50 S.E. 68 (1905).

24. Dietemann v. Time, Inc., 284 F. Supp. 925 (C.D. Cal. 1968).

25. Kapellas v. Kofman, 1 Cal. 3d 20, 459 P.2d 912, 81 Cal. Rptr. 360 (1969); Brents v. Morgan, 221 Ky. 765, 299 S.W. 967 (1927).

26. Afro-American Publishing Co. v. Jaffe, 366 F.2d 649 (D.C. Cir. 1966); Sidis v. F-R Publishing Corp., 113 F.2d 806 (2d Cir.), *cert. denied*, 311 U.S. 711 (1940); Gill v. Hearst Publishing Co., 40 Cal. 2d 224, 253 P.2d 441 (1953); Cason v. Baskin, 155 Fla. 198, 20 So. 2d 243 (1945). *Afro-American Publishing Co. v. Jaffe* is particularly notable for its discussion of the need for accommodation between conflicting privacy and first amendment values, though it does not articulate a comprehensive standard by which to effect that accommodation.

27. Warren & Brandeis, *supra* note 16, at 214-16.

28. For example, in Sidis v. F-R Publishing Corp., 113 F.2d 806 (2d Cir.), *cert. denied*, 311 U.S. 711 (1940), plaintiff was a former child prodigy who bad once been the object of public attention but had fallen into obscurity. Plaintiff objected to publication of his current whereabouts and situation by defendant, but the court held the public interest in this "newsworthy" item superior to plaintiff's privacy interest.

29. RESTATEMENT (SECOND) OF TORTS § 652 (Tent. Draft No. 21, 1975). The *Restatement*'s analysis follows that of Dean Prosser. *See* PROSSER, *supra* note 16, at 802-18; Prosser, *Privacy*, 48 CALIF. L. REV. 383 (1960).

Of these, the third[30] is at the heart of the instant cause of action because it imposes liability for publication of facts simply because they are private, their truthfulness being no defense.[31]

The United States Supreme Court first and indirectly confronted the relationship between the right of privacy and free speech in *New York Times Co. v. Sullivan*.[32] The Court, focusing on the status of the plaintiff, held that the first amendment prohibits a public official from recovering damages for a defamatory falsehood published about his official conduct unless he can show "actual malice" on the part of the defendant.[33] After discussing the importance of the first amendment in safeguarding discussion, the Court decided that any lesser standard of liability would allow insufficient "breathing space" for first amendment freedoms and would tend to discourage their exercise.[34] Later, the Court expanded the impact of the actual malice standard[35] in *Time, Inc. v. Hill*[36] by applying it to the publication of matters of public interest. Although the Court since has dealt with the scope of first amendment protection in several defamation cases,[37] *Hill* is one of only two cases that has

30. The *Restatement*'s formulation of this tort is as follows:

> One who gives publicity to a matter concerning the private life of another is subject to liability to the other for unreasonable invasion of his privacy, if the matter publicized is of a kind which
> (a) would be highly offensive to a reasonable person, and
> (b) is not of legitimate concern to the public.

RESTATEMENT (SECOND) OF TORTS § 652D (Tent. Draft No. 21, 1975). This current version of the *Restatement* incorporates the "public interest" concept as a limitation on the cause of action and not as a privilege as was previously done. *See* RESTATEMENT (SECOND) OF TORTS § 652F (Tent. Draft No. 13, 1967).

31. Brents v. Morgan, 221 Ky. 765, 299 S.W. 967 (1927); Themo v. New England Newspaper Publishing Co., 306 Mass. 54, 27 N.E.2d 753 (1940) (dictum). For the same reason, this branch of the cause of action is also at the heart of the conflict between the right of privacy and the first amendment. For an extensive discussion of this conflict in the present context, see Beytagh, *Privacy and A Free Press: A Contemporary Conflict in Values*, 20 N.Y.L.F. 453 (1975).

32. 376 U.S. 254 (1964). *New York Times* involved defamation, the relationship of which to invasion of privacy is noted in Warren & Brandeis, *supra* note 16, at 197-98, and discussed at length in Wade, *supra* note 16.

33. 376 U.S. at 279-80.

34. *Id.* at 269-72.

35. The Court has substantially equated actual malice with "recklessness":

> There must be sufficient evidence to permit the conclusion that the defendant in fact entertained serious doubts as to the truth of his publication. Publishing with such doubts shows reckless disregard for truth or falsity and demonstrates actual malice.

St. Amant v. Thompson, 390 U.S. 727, 731 (1968).

36. 385 U.S. 374 (1967), *commented in* 67 COLUM. L. REV. 926 (1967).

37. *E.g.*, in Curtis Publishing Co. v. Butts, 388 U.S. 130 (1967), the Court applied the actual malice standard when the plaintiff was a figure who was known to the public but was

addressed the problem in the context of a right of privacy. *Hill* involved an action for invasion of privacy against defendant magazine, which had falsely represented a play as depicting a true experience of the plaintiffs. The Court focused on the nature of the published material in holding that the first amendment forbids imposition of liability for invasion of privacy by publication of false reports on matters of public interest unless actual malice can be shown.[38] Taking a similar approach, a plurality of the Court applied the *New York Times* standard in *Rosenbloom v. Metromedia, Inc.*,[39] a defamation case in which the plaintiff was a private individual involved in a matter of public interest.[40] The Court thus appeared tentatively to have chosen the public interest concept as a suitable first amendment limitation on recovery in both defamation and privacy cases.[41] In *Gertz v. Robert Welch, Inc.*,[42] however, the Court rejected the *Rosenbloom* formula and ruled that the states may define their own standards of liability for defamation when the plaintiff is a private individual.

Cox Broadcasting Corp. v. Cohn,[43] a recent case arising under a Georgia statute that forbade publication of the names of rape victims,[44] directly presented the question of the impact of the first amendment in an action for invasion of privacy by public disclosure of true but private facts. While acknowledging a California Supreme Court case that resolved the conflict between the first amendment and privacy by concluding that there were times when the former must yield,[45] the Court expressly avoided this more fundamental question[46] by deciding the case on the narrow ground that the name

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not a public official. *See also* Time, Inc. v. Firestone, 96 S. Ct. 958 (1976); Rosenblatt v. Baer, 383 U.S. 75 (1966); Garrison v. Louisiana, 379 U.S. 64 (1964).

38. 385 U.S. 374, 387-88 (1967).

39. 403 U.S. 29 (1971).

40. *Id.* at 43-44.

41. Both the *Hill* and *Rosenbloom* opinions were written by Mr. Justice Brennan, who is conversant with Meiklejohn's first amendment theory and has written of its influence on the Court. *See* Brennan, *The Supreme Court and the Meiklejohn Interpretation of the First Amendment*, 79 HARV. L. REV. 1 (1965).

42. 418 U.S. 323 (1974).

43. 420 U.S. 469 (1975).

44. GA. CODE ANN. § 26-9901 (1972).

45. Briscoe v. Reader's Digest Ass'n, 4 Cal. 3d 529, 483 P.2d 34, 93 Cal. Rptr. 866 (1971), *noted in* 5 LOYOLA U.L. REV. (LA) 544 (1972). The case provides a good discussion of privacy and first amendment theory and resolves the issue in favor of a right of privacy when matters of public interest are not involved.

46. The Court stated:

Rather than address the broader question whether truthful publications may ever be subjected to civil or criminal liability consistently with the First and Fourteenth Amend-of the victim was a matter of public record.[47]

III. The Instant Opinion

The instant court, recognizing that the only tort involved in the appeal was the public disclosure of embarrassing private facts,[48] adopted the definition of the *Restatement (Second) of Torts*[49] as one comporting with the requirements of applicable California law.[50] Concluding that plaintiff's conversation with defendant's reporter had not made public the facts disclosed,[51] the court next turned to defendant's contention that the admitted truth of the statements in the article rendered them privileged under the first amendment. The court first noted that the same argument had been presented to the Supreme Court in *Cox*, and was specifically left unanswered.[52] Phrasing the issue as "whether . . . this tortious violation of privacy is, as a tort to be written out of the law,"[53] the court indicated that it could not accept a result that would mean a denial of "private" status to all true facts, effectively relegating the boundaries of individual privacy to definition by the press. The court asserted that the public's right to know, which defines the extent of first amendment protection, does not entitle individuals or the press "to pry into the unnewsworthy private affairs" of others, and that reasonable limitations may be placed upon the right to know in respect of those affairs.[54]

As to the scope of the newsworthy privilege, the court again turned to the *Restatement (Second) of Torts*[55] and adopted as a

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> ments, or to put it another way, whether the State may ever define and protect an area of privacy free from unwanted publicity in the press, it is appropriate to focus on the narrower interface between press and privacy that this case presents . . . .

420 U.S. at 491.

47. The Court held the publication privileged because the name was obtained from the public record in a criminal prosecution, an event unquestionably "of legitimate concern to the public." 420 U.S. at 492.

48. Virgil v. Time, Inc., 527 F.2d 1122, 1125 (9th Cir. 1975), *cert. denied*, 44 U.S.L.W. 3661 (U.S. May 25, 1976).

49. Restatement (Second) of Torts § 652 (Tent. Draft No. 21, 1975); *see* notes 29-30 *supra* and accompanying text.

50. 527 F.2d at 1126 n.4; *see* notes 3 & 21 *supra*.

51. The court characterized plaintiff's disclosures to defendant as a consent to publicity which was expressly withdrawn by plaintiff prior to publication. *See* note 4 *supra*.

52. *See* notes 43-47 *supra* and accompanying text.

53. 527 F.2d at 1127.

54. *Id.* at 1128. Thus the court adopted a distinction between newsworthy private facts, publication of which is privileged, and other private facts, publication of which is not privileged.

55. Restatement (Second) of Torts § 652F (Tent. Draft No. 13, 1967). The court

constitutional standard the view that determination of what constitutes "a matter of legitimate public interest" in the realm of private facts is ultimately to be made according to community values.[56] Although the court regretted the lack of clarity in this formulation, it indicated that it is difficult to be more precise when the problem, as here, is to minimize the risk of loss of conflicting values in striking a balance between them.[57] Having adopted this standard to effect the mutual accommodation of privacy and first amendment principles it found necessary, the court held that, unless privileged as newsworthy, the publicizing of true but private facts is not protected by the first amendment.

IV. Comment

As the first United States Court of Appeals case to confront the first amendment problem in cases of public disclosure of private facts since the Supreme Court highlighted the importance of the issue in *Cox*,[58] the instant case is highly significant as a precedent for future privacy cases. Because of the fundamental nature of the conflict involved and the frequency with which it arises, it also is likely that the Supreme Court will soon be called upon to resolve the problem. In practical terms, the instant court's resolution is a good one. It seems evident, especially given the nature of the Supreme Court's first amendment interpretation[59] and the stress recently laid on the value of privacy,[60] that the better solution lies in striking a balance between the two conflicting values rather than in sacrificing one completely. The problem, as the instant court recognized, is one of developing a standard that will accommodate both

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assumed that the comments to this section were applicable to the current *Restatement* formulation of the tort. 527 F.2d at 1129 n.10; *see* note 30 *supra*.

56. This standard will dictate loss of the privilege when publicity "becomes a morbid and sensational prying into private lives for its own sake, with which a reasonable member of the public . . . would say that he had no concern." RESTATEMENT (SECOND) OF TORTS § 652F, comment f (Tent. Draft No. 13, 1967).

57. 527 F.2d at 1129-30. The court found that the standard was a suitable one for the jury to apply, and emphasized the availability of summary judgment and judgment n.o.v. procedures to the trial court to insure that the scope of first amendment protection is not unduly narrowed by the jury. Believing that the trial judge should have the opportunity to reconsider his denial of summary judgment in light of its opinion, however, the court vacated the order below and remanded the case. *Id.* at 1130-32.

58. The issue has been generally dealt with on this level at least once before in Afro-American Publishing Co. v. Jaffe, 366 F.2d 649 (D.C. Cir. 1966). *See* note 26 *supra* and accompanying text.

59. *See* notes 9-13 *supra* and accompanying text.

60. *See* notes 15-21 *supra* and accompanying text.

interests with minimum injury to each.[61] The public interest standard set forth by the court accomplishes this effectively because it focuses on the prime concern of the first amendment—the public's right to know of matters in which it has a legitimate interest. A standard based on the public interest of the subject matter rather than on categorization of the person publicized as a public or private figure is the logical result of viewing the first amendment as based on the public's right to know; if a particular subject is relevant to the public's necessary knowledge, this surely is not altered by the involvement of a private person. The Supreme Court, however, showed a disinclination to accept this formulation when, in *Gertz*, it rejected the *Rosenbloom* approach.[62] *Gertz* certainly evinced the Court's willingness to protect interests other than those of the first amendment[63] but, unfortunately, it also rejected as a guideline the public interest idea utilized in the instant case.

The instant court might have developed its position more persuasively had it referred to the first amendment theory propounded by Meiklejohn.[64] That theory, in articulating and expanding on the right to know as a basis for freedom of speech, is strongly supportive of the instant court's public interest standard. Further, the court might have buttressed its rationale by discussing *Hill*, a privacy case (albeit of the "false light" type) in which the Supreme Court adopted the public interest approach and showed a definite affinity for Meiklejohn's theory.[65] A discussion of that theory in the context of *Hill* would have emphasized much more effectively than did the court's heavy reliance on the *Restatement (Second) of Torts* the important fact that constitutional principles were being adjudicated. The court also might have argued that *Hill*'s public interest analysis is controlling because *Gertz* and *New York Times* were defamation cases and could be distinguished on that basis. Furthermore, the instant court could have pointed out that in none of its cases, including *Hill*, has the Supreme Court reached the crux of privacy's conflict with free speech: a case in which the private facts publicized are true. This analysis clearly indicates that, in resolving the first amendment problem with regard to privacy, there is room

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

62. *See* notes 39-42 *supra* and accompanying text.

63. The instant court did not fail to recognize this. Virgil v. Time, Inc., 527 F.2d 1122, 1128 n.8 (9th Cir. 1975), *cert. denied*, 44 U.S.L.W. 3661 (U.S. May 25, 1976).

64. *See* note 14 *supra*.

65. The same might be said of *Rosenbloom*, though its precedential value is much diminished since *Gertz* declined to follow it. *See* notes 37-41 *supra* and accompanying text.

both to borrow what is sound in the defamation cases and to reject what is not.

As the instant court admits,[66] there are problems with its approach. An obvious one is defining what constitutes a matter "of legitimate concern to the public."[67] Although the phrase is not a model of clarity, the court is correct in noting that some type of "reasonableness" or "community mores" standard[68] is the only feasible one when an accommodation of two fundamental values is sought.[69] An added problem in the present context, however, is the possibility of a "chilling" effect on speech, whereby the press would refrain from publishing material of legitimate concern to the public for fear of offending the standard. Here the courts must be careful to prevent indirect encroachment on the public interest area that the standard seeks to protect. Because juries seem less likely to be sensitive to this first amendment concern than the court, it may be doubted that the instant court is wise in entrusting determination of this issue to the jury with the court retaining only the "veto" power of summary judgment and judgment n.o.v. procedures as a safeguard.[70] But the chilling problem is one that will arise under any standard that delimits an area of liability for publication as, for example, defamation, the exact boundaries of which are equally difficult to predict in advance. It would seem at present that the chilling effect of the defamation action on the press has been minor, and no reason appears for it to be any more acute in pure privacy cases. Finally, in addition to comporting more closely with the basis of the first amendment than the public figure concept, the public interest standard has a history of broad interpretation[71] that renders it more effective in minimizing any chilling effect and protecting first amendment freedoms. The problems of the instant court's approach thus are outweighed by its basic soundness, and it is

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

67. *See* notes 55-56 *supra* and accompanying text.

68. *See* note 56 *supra* and accompanying text.

69. It might be pointed out that the same objections of vagueness could be made to the "reasonable prudent person" test, successfully utilized in negligence cases for years. *See* PROSSER, *supra* note 16, at 149-66. Of course, it is open to serious doubt that the RPP test is as vague as the community mores standard adopted in the instant case. The latter more closely resembles the standard utilized by the Supreme Court in that vaguest of areas, obscenity, as the instant court points out. 527 F.2d at 1129 n.12 (9th Cir. 1975); *see* cases cited note 12 *supra*.

70. *See* note 57 *supra*. It has been asserted that it is wiser to treat this question as one of law. *See* Wade, *supra* note 16, at 1124.

71. See notes 26-28, 30 *supra* and accompanying text.

hoped that the case will serve as a basis for other courts to substantiate, develop, and apply this area of the law.

WILLIAM J. REES

Securities—Aiding and Abetting Under Rule 10b-5—A Stock Exchange May Be Liable for Aiding and Abetting a Securities Fraud Solely on the Basis of Its Failure To Act

I. FACTS AND HOLDING

Plaintiffs brought an action under Rule 10b-5[1] charging defendant New York Stock Exchange (NYSE) with aiding and abetting the alleged securities law fraud of defendant Pickard & Company, Inc. (Pickard), a defunct brokerage firm. Pickard's alleged violation consisted of fraudulently inducing plaintiffs to enter into and renew written subordinated loan agreements[2] without disclosing that disciplinary actions had been taken against it by the NYSE.[3] Plaintiffs based their claim against the NYSE[4] on the Exchange's knowledge

1. Rule 10b-5, 17 C.F.R. § 240.10b-5 (1975), was promulgated under section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78(j) (1970), and provides:

It sball 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,

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.

2. At various times in 1966, each of the plaintiffs deposited assets in customer accounts of Pickard and entered into written agreements that subordinated their rights to the assets to those of other creditors of Pickard. Between 1966 and 1968, plaintiffs agreed to extend the agreements each time they were about to expire. The last extension was agreed to in January, 1968, when plaintiffs were told that without their accounts, Pickard would be forced to go out of business. Although plaintiffs agreed to extend the agreements until March, 1968, Pickard was forced to liquidate in February, 1968.

3. No fewer than four disciplinary actions were taken against Pickard, three by the Exchange and one by the National Association of Securities Dealers. As a result, a number of trading restrictions and sanctions were imposed on Pickard.

4. In addition to aiding and ahetting, the Exchange is also charged with a number of securities fraud violations and a breach of contract with the SEC. The securities fraud allegations stem from the claim tbat a Vice President of the Exchange personally prevailed upon the lenders to extend their subordinated loan agreements with Pickard shortly hefore default. Plaintiffs further allege that the Exchange breached its contract with the SEC in

of the sanctions imposed on Pickard, its approval of plaintiffs' application to enter into the subordination agreements, and its alleged policy of nondisclosure of disciplinary action and restrictions imposed upon its members.[5] Responding to the Exchange's motion to dismiss the complaint[6] and motion for summary judgment,[7] plaintiffs contended that the NYSE knew of Pickard's history of noncompliance with SEC and Exchange rules, was under a duty to disclose this information to plaintiffs, and, by entering into and honoring an agreement not to disclose to investors derogatory facts about Exchange members, aided and abetted Pickard's fraud. The Exchange argued that since it was not a party to the plaintiffs' transaction with Pickard and its alleged wrongdoing consisted solely of inaction, it was under no affirmative duty to disclose. Ruling on both of defendants' motions, the United States District Court for the Southern District of New York, *held*, motions denied.[8] The existence of a duty, the breach of which will subject a stock exchange to liability for aiding and abetting a securities fraud, is a question of fact and may arise in some circumstances solely on the basis of a failure to act. *Fisher v. New York Stock Exchange*, [Current] CCH FED. SEC. L. REP. ¶ 95,416 (S.D.N.Y. Jan. 13, 1976).

II. LEGAL BACKGROUND

The first case to recognize aiding and abetting a securities fraud as a distinct cause of action was *SEC v. Timetrust, Inc.*,[9] in which the Bank of America was charged with actively aiding and abetting a securities fraud under section 17(a) of the Securities Act of 1933.[10]

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which it promised to enforce compliance by its members with securities laws as well as with SEC and Exchange rules. Fisher v. New York Stock Exch., [Current] CCH FED. SEC. L. REP. ¶ 95,416, at 99,101 (S.D.N.Y. Jan. 13, 1976).

5. Plaintiff's allegation concerning the NYSE policy of nondisclosure to the public of information pertaining to disciplinary action and restrictions imposed on its members was based on testimony given by Lloyd W. McChesney, a former Chief Examiner of the Exchange. McChesney testified at an arbitration hearing on plaintiff's right to Pickard's assets, concerning a memorandum to the Exchange's Board of Governors summarizing charges brought against several officers of Pickard in the wake of its final collapse.

6. In considering whether to grant a motion to dismiss a complaint, the court must assume that all the allegations of the complaint are true. The complaint will be dismissed only if the allegations, when taken as true, do not state a claim upon which relief can be granted. *See* Dunlap v. Tennessee, 514 F.2d 130, 133 (6th Cir. 1975).

7. A court will grant a motion for summary judgment only when it can be shown that there is no genuine issue as to any material fact, and that the moving party is entitled to judgment as a matter of law. FED. R. CIV. P. 56(c).

8. [Current] CCH FED. SEC. L. REP. ¶ 95,416, at 99,103.

9. 28 F. Supp. 34 (N.D. Cal. 1939), *rev'd on other grounds*, 142 F.2d 744 (9th Cir. 1944).

10. This section of the 1933 Act was the forerunner of Rule 10b-5, promulgated under

The court denied defendant's motion to dismiss, and held that a suit to enjoin the defendant from aiding and abetting the commission of unlawful acts stated a cause of action.[11] Similar situations occurred in *Fry v. Schumaker*[12] and *SEC v. Scott Taylor & Co.*[13] In *Fry*, the court again denied a motion to dismiss and held that one who actively assisted in the perpetration of a fraudulent scheme could be held liable under Rule 10b-5.[14] In *Scott Taylor*, the court, by way of dicta, recognized aiding and abetting as a cause of action for which a defendant would be subject to liability equal to that of a principal.[15] *Pettit v. American Stock Exchange*[16] was the first decision to recognize a cause of action for aiding and abetting based on defendant's failure to act. The defendant in *Pettit*, a national securities exchange, was alleged to have permitted a securities fraud to occur "by failing to take necessary disciplinary action against abusive conduct and practices of which [it] knew or should have known."[17] Maintaining that it did not actually participate in a securities fraud, the defendant moved to dismiss. The court denied the motion and stated that if plaintiff could prove that defendant knowingly assisted or participated in a fraudulent scheme, secondary liability under Rule 10b-5 would lie.[18] The court's failure to discuss the scope of its holding has generated speculation that the decision may have been based on grounds other than defendant's silence or inaction.[19]

authority conferred by the Securities Exchange Act of 1934. 35 U. Mo. K.C.L. REV. 320, 323 (1967).

11. 28 F. Supp. at 43. Plaintiffs were later granted an injunction on the merits, 39 F. Supp. 145 (N.D. Cal. 1940), but the decision was reversed in Timetrust Inc. v. SEC, 142 F.2d 744 (9th Cir. 1944). The basis of the reversal, however, was that defendant Bank had not taken part in the fraudulent sales scheme, and not that a cause of action did not exist. 142 F.2d at 746.

12. 83 F. Supp. 476 (E.D. Pa. 1947).

13. 183 F. Supp. 904 (S.D.N.Y. 1959).

14. 83 F. Supp. at 478.

15. 183 F. Supp. at 909 n.12.

16. 217 F. Supp. 21 (S.D.N.Y. 1963).

17. *Id.* at 28.

18. *Id.* "Since knowing assistance of or participation in a fraudulent scheme under Section 10(b) gives rise to liability equal to that of the perpetrators themselves, the facts alleged by the trustees, if proven, would permit recovery under Section 10(b)."

19. The suggestion has been made that the court was influenced more by the Exchange's affirmative acts of allowing the use of its facilities for the fraudulent distribution of stock than by its failure to discipline its members. Further, the holding may have been based on the Exchange's breach of its statutory duty under section 6(b) of the Securities Exchange Act to discipline its members. 15 U.S.C. § 78f (1970). The latter interpretation was adopted by the Second Circuit in Fisher v. Kletz, 266 F. Supp. 180 (S.D.N.Y. 1967). *See* A. BROMBERG, SECURITIES LAW FRAUD, SEC RULE 10b-5, at 208.24 (1975). Finally, the holding may stand only for the proposition that aiders and abettors may be liable in a private suit. Note, *Accountants' Liabilities for False and Misleading Statements*, 67 COLUM. L. REV. 1437, 1448 (1967).

Although these early decisions recognized a cause of action for aiding and abetting a securities law violation, the scope of this action was largely undefined and the question whether it would lie for inaction alone was undecided. Two distinct lines of cases emerged in answering this question. The district court decision in *Brennan v. Midwestern United Life Insurance Co.*[20] was the first of the line of cases that attempted to define liability in terms of the general statement of secondary liability found in section 876 of the Restatement of Torts.[21] According to the Restatement,

> For harm resulting to a third person from the tortious conduct of another, a person is liable if he . . . (b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself.[22]

Brennan involved a class action brought by defrauded purchasers of Midwestern United Life Insurance Co. stock against a brokerage firm. Plaintiffs alleged that Midwestern should be secondarily liable because it knew of the firm's illegal activities, provided substantial assistance by failing to report them to the proper authorities, and thus encouraged the price of Midwestern stock to become artificially inflated. The court rejected Midwestern's contention that aiding and abetting requires an affirmative act or breach of an affirmative duty to act and denied Midwestern's motion to dismiss. Although endorsing the *Timetrust, Scott Taylor, Fry,* and *Pettit* decisions, the court relied heavily on the Restatement of Torts, noting that it fulfilled the underlying policies and purposes of the Securities Exchange Act of 1934.[23] Commenting that not everyone with knowledge of improper securities activities is required to report them, the court held that a duty to act arises when failure to take action would provide the primary wrongdoer with substantial assistance. The court further clarified its holding by declaring that the determination of whether the assistance is substantial is a question of fact.[24]

20. 259 F. Supp. 673 (N.D. Ind. 1966).

21. Ruder, *Multiple Defendants In Securities Law Fraud Cases: Aiding and Abetting, Conspiracy,* In Pari Delicto, *Indemnification, and Contribution,* 120 U. PA. L. REV. 597, 620 (1972) [hereinafter cited as Ruder].

22. RESTATEMENT OF TORTS § 876(h) (1939).

23. The court said that a basic philosophy of the Securities Exchange Act of 1934 was disclosure and was directed toward the maintenance of a fraud-free market. The overriding consideration was protection of the investor. In the absence of a clear legislative expression to the contrary, the statute must be applied in a manner that will implement its policies and purposes. Thus courts should not hold that the 1934 Act necessarily excludes from its coverage persons who do no more than aid and abet a violation of Rule 10b-5. 259 F. Supp. at 680-82.

24. If the question of substantial assistance is a question of fact, it means that in all

The court also attacked the distinction between active and passive aiding and abetting by observing that aiding by inaction or silence is as inimical to the securities laws as aiding by affirmative act.[25] When the case subsequently was tried on the merits,[26] the court based its finding of liability on Midwestern's affirmative acts of aiding and abetting, rather than its failure to report the brokerage firm to the SEC. In dicta, however, the court endorsed its earlier holding.[27] On appeal, the Seventh Circuit affirmed, finding that Midwestern's acquiescence in the fraud through silence combined with its affirmative acts constituted aiding and abetting under Rule 10b-5.[28]

The Third Circuit also applied the Restatement test in *Landy v. Federal Deposit Insurance Corp.*[29] and enumerated three requirements for liability: the existence of an independent wrong,[30] the aider-abettor's knowledge of that wrong, and substantial assistance by the aider-abettor in perpetrating the wrong.[31] In determining whether assistance is substantial enough to make an individual liable for the act of another, the *Landy* court found the relevant factors to be: the amount of assistance given by the defendant, the defendant's presence or absence at the time of the tort, the defendant's relation to the principal, and the defendant's state of mind.[32]

cases in which the other aspects of aiding and abetting are properly alleged, a motion for summary judgment should be denied. *See* note 7 *supra*.

25. "To rest the definition of aiding and abetting solely on abstract and mechanical distinctions between active and passive assistance or to hold blindly that silence and inaction cannot constitute aiding and abetting under any possible set of circumstances would be to defeat and hamper the intelligent and responsible development of the law by subjecting it to a tyranny of labels." 259 F. Supp. at 682.

26. Brennan v. Midwestern United Life Ins. Co., 286 F. Supp. 702 (N.D. Ind. 1968).

27. *Id.* at 727.

28. Brennan v. Midwestern United Life Ins. Co., 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 189 (1970).

29. 486 F.2d 139 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

30. Although the independent wrong is easy to establish in most aiding and abetting cases, exact identification of the wrong is essential in order to determine which persons should be subject to liability for giving knowing assistance. Ruder, *supra* note 21, at 630.

31. These standards were criticized in Woodward v. Metro Bank, 522 F.2d 84 (5th Cir. 1975). The *Woodward* court said the requirements of an independent wrong and knowledge of the wrong's existence "pose a danger of over-inclusiveness and seem to lose sight of the necessary connection to the securities laws. One could know of the existence of a 'wrong' without being aware of his role in the scheme, and it is the participation that is at issue." *Id.* at 95. Moreover, the *Landy* test does not require that the substantial assistance he given knowingly. According to *Woodward*, "[t]he scienter requirement scales upward when activity is more remote; therefore, the assistance rendered should be both substantial and knowing. A remote party must not only be aware of his role, but he should also know when and to what degree he is furthering the fraud." *Id.*; *see* notes 37-40 *infra* and accompanying text.

32. 486 F.2d at 163.

Subsequently, however, the Sixth Circuit altered the Restatement standard in *SEC v. Coffey*.[33] The *Coffey* court indicated a willingness to impose liability for aiding and abetting if it could be shown that some other party had committed a securities law violation, that the accused party had a *general awareness* that his role was part of an overall improper activity, and that the accused aider-abettor knowingly and substantially assisted the violation.[34] The court clarified its standard by emphasizing that the aider-abettor must have only a general awareness of the existence of an independent wrong, but he must have actual knowledge of and conscious intent to substantially assist the violation.[35] A similar standard was employed in *Rosen v. Dick*,[36] but there the court required actual knowledge rather than general awareness of an improper scheme. In the recent case of *Woodward v. Metro Bank of Dallas*,[37] the Fifth Circuit articulated a new standard for the knowing substantial assistance requirement in *Coffey* by synthesizing the *Coffey* approach and the basic Restatement approach.[38] The court held that in the absence of an independent duty of disclosure, an alleged aider-abettor may be found to have knowingly substantially assisted only if a showing is made of scienter of the high "conscious intent" variety. Where an independent duty of disclosure exists, knowing, substantial assistance may be found with a lesser degree of scienter.[39] According to

33. 493 F.2d 1304 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975).

34. The court adopted this test from SEC v. Spectrum, Ltd., 489 F.2d 535 (2d Cir. 1973), in which a lawyer was aware that his misleading opinion letter could be used to sell unregistered securities and failed to take timely steps to prevent such use. While noting that the use of a negligence standard in *Spectrum* was proper and that the case was correct on its facts, the *Coffey* court felt it was justified in employing a general awareness standard, perhaps because the defendant in *Spectrum* had committed three prior securities law violations. *See* 493 F.2d at 1316 n.30. For an excellent analysis of the *Spectrum* decision, see Freeman, *Opinion Letters and Professionalism*, 1973 DUKE L.J. 371.

35. The court observed that if actual knowledge and conscious intent to provide substantial assistance were not required, a person who was not primarily liable for a violation could be held secondarily liable, even if he were unaware of the need to disclose information withheld by those primarily liable. The result would be to impose liability for an innocent omission. 493 F.2d at 1317. The requirements of actual knowledge and conscious intent closely parallel the criminal law concept of aiding and abetting found in 18 U.S.C. § 2 (1970).

36. CCH FED. SEC. L. REP. ¶ 94,786 (S.D.N.Y. 1974).

37. 522 F.2d 84 (5th Cir. 1975).

38. The *Woodward* court utilized the Restatement approach found in Strong v. France, 474 F.2d 747 (9th Cir. 1973), a case in the *Brennan* line of authority.

39. This test was applied to an aiding and abetting case involving silence and inaction with affirmative action in H.L. Federman & Co. v. Greenberg, CCH FED. SEC. L. REP. ¶ 95,380 (S.D.N.Y. 1975). The court found no independent duty to disclose, but did find a transaction that was so lacking in business justification that knowledge of the substantial assistance could be inferred.

Woodward, the intent required for substantiality is a function of the circumstances of the case and the relationship of the parties.[40] The *Woodward* case is an excellent example of the trend of the cases utilizing the Restatement approach. These cases have narrowed the original Restatement standard and concentrated on the problem of identifying substantial assistance. The *Woodward* requirements for substantial assistance represent the greatest departure from the Restatement test.

A second line of cases rejects the Restatement view and refuses to find aiding and abetting liability for inaction alone.[41] Although the cases articulate no reasons for this rejection, at least three reasons have been suggested in the literature.[42] First is the reasoning that since section 876 on the Restatement deals primarily with liability for physical harm rather than liability in a business setting, it should not be relied upon to impose securities law liability. The comments to the section deal only with physical harms and fail to specify the nature of the duty owed by the secondary participant.[43] An alternative ground for the rejection is that the broad and remedial scope of the Securities and Exchange Act of 1934 should be sufficient "to deal with new and unique situations within the scope of the evils intended to be eliminated."[44] This position was supported in the first decision of the trial court[45] in *Brennan* and was approved in the Seventh Circuit opinion.[46] The *Brennan* decision, however, ultimately was based on a Restatement approach. A third argument is that a holding that a defendant is subject to liability for failing to take action is not equivalent to a holding that inaction alone is sufficient to sustain liability.[47] According to this view, liability for inaction cannot arise until there is an independent duty to disclose.

The leading case in this line is *Wessel v. Buhler*[48] in which the

40. 522 F.2d at 97.

41. Hochfelder v. Midwest Stock Exch., 503 F.2d 364 (7th Cir.), *cert. denied*, 95 S.Ct. 137 (1974); Wessel v. Buhler, 437 F.2d 279 (9th Cir. 1971).

42. *See* Ruder, *supra* note 21, at 621-23, 642.

43. *Id.* at 621.

44. Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. at 680. *See* notes 20-28 *supra* and accompanying text.

45. "In the absence of a clear legislative expression to the contrary, the statute must be flexibly applied so as to implement its policies and purposes. In this regard, it cannot be said that civil liability for damages, so well established under the Securities Exchange Act of 1934, may never under any circumstances be imposed upon persons who do no more than aid and abet a violation of Section 10(b) and Rule 10b-5." 259 F. Supp. at 681.

46. 417 F.2d at 155.

47. Ruder, *supra* note 21, at 642.

48. 437 F.2d 279 (9th Cir. 1971).

plaintiffs alleged that a certified public accountant owed a duty to prospective investors to disclose his knowledge of a corporation's irregular financial conduct and of deficiencies in its financial records. Since he failed to disclose this knowledge, plaintiffs alleged that defendant should be liable for aiding and abetting. The Ninth Circuit emphatically rejected plaintiffs' contention, noting, "There is not a scrap of authority supporting this extraordinary theory of Rule 10b-5 . . . . We find nothing in Rule 10b-5 that purports to impose liability on anyone whose conduct consists solely of inaction."[49] The other major case that refused to find liability for inaction alone is the Seventh Circuit's decision in *Hochfelder v. Midwest Stock Exchange*.[50] Although the court was willing to impose liability for inaction combined with affirmative action, it cited *Wessel* approvingly as the only case in which a court was faced with a claim of aiding and abetting solely by inaction. The *Hochfelder* court, however, was not willing to hold that such a cause of action could never arise under Rule 10b-5.[51]

Not only have there been these divergent lines of cases, but there have also been inconsistencies within the lines themselves. Thus the conclusion is inescapable that this area of the law is still fluid and each new case affords the courts an opportunity to advance or settle the state of the law in this field.

III. THE INSTANT OPINION

In considering whether the defendant Exchange's motion to dismiss the complaint or motion for summary judgment should be granted, the instant court noted that the precise scope and nature of a non-participant's liability under Rule 10b-5 is largely unsettled. Following the *Brennan* and *Hochfelder* decisions, the court concluded that in some instances a duty of disclosure might exist so that silence alone would constitute substantial assistance or encouragement amounting to aiding and abetting. The court noted that the complaint alleges a fraud against the primary wrongdoer, Pickard, actual knowledge or a duty to inquire about Pickard's financial situation on the part of the Exchange, and an agreement between the Exchange and its members to conceal derogatory facts about the Exchange members from the investing public. The court held that

49. *Id.* at 283.

50. 503 F.2d 364 (7th Cir. 1974).

51. The court said that liability would lie for inaction alone if the plaintiffs could show that the alleged aider-abettor either had or should have had knowledge of the fraud, and failed to act due to an improper motive or breach of a duty of disclosure. *Id.* at 374.

if the allegations of the complaint were true, a duty might exist on the part of the Exchange to disclose disciplinary action taken against its brokers, and thus denied defendant's motion to dismiss.[52] The court noted that duty is a function of relationship, and the issue of whether a duty exists requires factual determinations going beyond the face of the pleadings. Expressing a reluctance to grant a motion for summary judgment where complex or novel issues of law are presented, the instant court refused to hold that plaintiffs could not prove facts showing a duty on the part of the Exchange to disclose the information to plaintiffs. Thus the court denied defendant's motion for summary judgment.

The instant court also commented that the scope of the Exchange's duty may be affected by the fact that the NYSE is a public or quasi-public authority and as such, has conflicting loyalties and obligations to its members and the investing public. The court noted that this is the result of potential Exchange liability for failing to make public information about members in trouble, while at the same time trying to take steps to see that the difficulty is eradicated. Finally, the court held that although the basis for plaintiffs' claim was far from overwhelming, they were entitled to an opportunity to prove their allegations.

IV. Comment

The instant opinion contains significant implications for the extension of liability for aiding and abetting, but at the same time the inherent limitations of the holding should be recognized. In denying defendant's motion to dismiss and motion for summary judgment, the instant court, for the first time, has extended to stock exchanges the line of cases expressly holding that a cause of action for aiding and abetting may lie for silence or inaction.[53] On the other hand, the court held only that a cause of action may have been alleged, and not that the stock exchange actually is liable. Plaintiffs made allegations in the pleadings sufficient to state a cause of action under the Restatement test, but whether substantial assistance

52. This was only one ground for the court's denial of defendant's motion to dismiss. The other ground for denial of the motion was that plaintiffs also alleged that the Exchange was directly involved in one episode of nondisclosure. This involved the actions of Robert M. Bishop, a Vice President of the Exchange who personally encouraged plaintiffs to make the final renewal of their loan agreements.

53. *But see* Pettit v. American Stock Exchange, 217 F. Supp. 21 (S.D.N.Y. 1963), in which a stock exchange was named as a defendant, but the holding of the case makes it unclear whether the court intended to extend aiding and abetting liability to a stock exchange.

has been rendered is a question of fact to be decided at trial.[54] The court was careful to comment, however, that plaintiffs faced a difficult burden in establishing a duty of disclosure to them on the part of the Exchange.[55] Further, the fact that plaintiffs also alleged aiding and abetting by the affirmative act of entering into and honoring an agreement not to disclose to investors derogatory facts about Exchange members' reputations may provide the court with alternative grounds for a decision on the merits and make a decision on the passive aiding and abetting question unnecessary. Therefore, both the procedural and factual postures of the case raise substantial doubt that the court will extend aiding and abetting liability when it decides the case on the merits.

Regardless of the ground the trial court relies upon, it may require plaintiffs to show that defendant rendered highly substantial assistance before finding that requirement satisfied. A major policy consideration behind this judicial reluctance to extend aiding and abetting liability to this defendant is the effect such a decision would have on the NYSE since, as a public or quasi-public authority, it is caught between conflicting loyalties and obligations to its members and the investing public. The Exchange has a duty to its members to participate in the rehabilitation of financially troubled members by taking disciplinary action designed to bolster the firm's business position. Vital to this procedure, however, is the maintenance of public support and confidence in the member firm. Disclosure of disciplinary action undermines public confidence and runs counter to the rehabilitative duties of the Exchange.[56]

On the other hand, one of the primary policies behind the Securities Exchange Act of 1934 was to substitute full disclosure policies for the philosophy of *caveat emptor* in an attempt to further the national public interest in maintaining fair and honest securities markets and protecting the innocent investor. Moreover, consistent with the fact that the policy of self-regulation has been called "the mainspring of the federal securities laws,"[57] the public has placed great reliance and trust in underwriters, attorneys, and accountants who are involved in securities transactions. These individuals are

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54. *See* note 24 *supra* and accompanying text.

55. The court noted that plaintiffs "have a long road to travel before establishing that the Exchange owed them a duty of disclosure, but they are entitled to an opportunity to develop more fully the facts of the Exchange's relationship . . . before a definitive ruling on this question is reached." CCH FED. SEC. L. REP. ¶ 95,416, at 99,105.

56. *See id.* n.10.

57. Chris-Craft Indus., Inc. v. Bangor Punta Corp., 480 F.2d 341, 370 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973).

expected to deal honestly and openly with the investor, and liability properly has been imposed upon them for activity that falls short of this expectation. The issue boils down to whether the value to the public of information of disciplinary action taken against Exchange members outweighs the potential harm to the disciplined member by the disclosure. If public disclosure is deemed more important, a stock exchange is an appropriate defendant despite its obligations to its members.

Moreover, the instant court's characterization of the Exchange as a quasi-public authority implies that it is also a quasi-governmental authority, obligating it to honor the widespread public dependence on it by making a full disclosure of disciplinary actions. The SEC has delegated to the NYSE the authority to promulgate its own rules for governing the Exchange and, subject to SEC supervision, has given these rules the force of law. In return the SEC has imposed a duty of self-regulation on the Exchange, which includes a duty to investigate the dealings and the financial condition of its members.[58] The high degree of public dependence on the information disseminated by the Exchange and the necessity of continued public confidence in this authority's integrity impose upon the Exchange a strong duty to protect the investing public.

Although the instant court characterized defendant's potential liability as arising from inaction, the plaintiffs alleged affirmative acts as well. When considering the case on the merits, the court must decide whether to characterize the alleged aiding and abetting by the Exchange as resulting from inaction alone or inaction combined with affirmative acts and whether the distinction should be significant in imposing liability. Although attempts have been made to harmonize the *Brennan* decision that inaction alone may support a cause of action for aiding and abetting and the *Wessel* holding that it cannot,[59] the better view appears to be that so long as the defendant knowingly and intentionally provided substantial assistance to the principal, whether he did so by action or inaction should make no difference in the finding of liability. Rather, the distinction should be drawn on the basis of the aider-abettor's knowledge. When an aider-abettor's liability is based on inaction alone, he must have actual knowledge that he is providing substantial assistance. Any lesser standard would tend to be overin-

58. *See generally* Gordon v. New York Stock Exch., 95 S.Ct. 2598 (1975); Evans v. Kerbs & Co., CCH Fed. Sec. L. Rep. ¶ 95,459 (S.D.N.Y. 1976).

59. *See generally* Ruder, *supra* note 21, at 641-44.

clusive and risk imposing liability for nonculpable omissions.[60] When liability is based on inaction in conjunction with affirmative acts, the knowledge requirement is a function of how the assisting activity varies from common business practice; the more it varies, the easier it will be to infer knowledge.[61] In either case, the assistance must be substantial, which is a function of all the circumstances and is a question of fact. Such an analysis suggests the continuing vitality of the Restatement approach, which recognizes the distinction between active and passive aiding and abetting based on the degree of knowledge of the aider-abettor, yet remains flexible enough to embrace the policy considerations of the nature of the parties to the transaction, the relationship between them, and the degree of public dependence inherent in the relationship.

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60. *See* note 35 *supra*.

61. *See* Woodward v. Metro Bank, 522 F.2d 84, 97 (5th Cir. 1975).