Vanderbilt Law Review

Volume 23
Issue 4 *Issue 4 - May 1970*

Article 7

5-1970

# Recent Cases

Law Review Staff

# RECENT CASES

## Accountants—Auditors—Compliance with General Accounting Principles Not a Complete Defeuse To Crimiual Fraud

Defendants[1] are members of a certified public accounting firm which was retained annually by Continental Vending Corporation (Continental) to audit its financial statements. While conducting a yearly audit, defendants learned that an affiliated company, Valley Commercial Corporation (Valley),[2] was not in a position to repay its debt[3] to Continental. The president of Valley, however, offered to secure the debt personally. Defendants determined that if adequate collateral[4] was posted, Continental's statements could be certified without reviewing Valley's books.[5] The collateral was obtained,[6] its value was confirmed,[7] and the receivable was entered on the balance sheet[8] subject to an explanation in a footnote.[9] The statements were

1. Defendants are a senior partner, a junior partner, and a senior associate in the national accounting firm of Lybrand, Ross Bros. & Montgomery.

2. The president of both Continental and Valley was Harold Roth, who owned about 25% of the stock of each corporation. In a prior proceeding, he was charged with criminal fraud but pleadcd guilty and appeared at defendants' trial as a Government witness. Mr. Roth was sentenced to 6 months in jail, with an added year suspended.

3. Valley, whose business was lending money to Continental and other vending machine companies, had conducted numerous business dealings with Continental. Specifically, Continental used Valley as a source of funds by borrowing money from Valley. In return, Continental issued negotiable notes to Valley which were then discounted to local banks. By the end of the fiscal year in question, Continental's debt to Valley was slightly over $1 million. In addition, Continental had, for several years, lent cash to Valley. The debt owed by Valley amounted to $3.5 million at the end of the fiscal year but had increased to $3.9 million by the date of certification. Evidence disclosed that Roth had borrowed a large portion of this money and had used it for private investments.

4. Defendants insisted that a satisfactory legal opinion be obtained and that Continental's board of directors be apprised of the situation.

5. Valley was to be audited by another accounting firm and its statements were not yet available.

6. Approximately 80% of the collateral was stock and convertible debentures of Continental.

7. The collateral was confirmed by another member of the firm (not a party to this suit) who arrived at a value of approximately $3 million. He failed to discover, however, that the stock was subject to other encumberances and that the equity interest was really worth $1 million less.

8. Since the account payable (the amount owed by Continental to Valley) consisted of negotiable notes, it could not be netted against the account receivable, which was a cash item.

9. Defendants' note provided: "The amount receivable from Valley Commercial Corp. (an affiliated company of which Mr. Harold Roth is an officer, director and stockholder) bears interest at 12% a year. Such amount, less the balance of the notes payable to the company, is secured by the assignment to the Company of Valley's equity in certain marketable securities. As of February 15, 1963, the amount of such equity at current market quotations exceeded the net amount receivable." United States v. Simon, CCH FED. SEC. L. REP. ¶ 92,511, at 98,384 (2d Cir. Nov. 12, 1969).

subsequently certified,[10] and, shortly thereafter, Continental failed. The Government, alleging that the balance sheet was fraudulent[11] and that the footnote was false and misleading,[12] charged defendants with conspiracy to commit criminal fraud[13] by knowingly drawing up and certifying a false and misleading financial statement. The defendants contended that since they had followed generally accepted accounting principles,[14] they could not be subjected to liability. Even if the

10. The typical certification statement reads: "We have examined the balance sheet of X company as of [date] and the related statements of income and retained earnings for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion the accompanying balance sheet and statements of income and retained earnings present fairly the financial position of the X company at [date], and the results of its operations for the year then ended, *in conformity with generally accepted accounting principles* applied on a basis consistent with that of the preceding year." R. MAUTZ, FUNDAMENTALS OF AUDITING 508 (1967) (emphasis added).

11. The Government contended that defendants were under a duty to disclose that the money lent to Valley was subsequently channelled to Roth.

12. The Government claimed that if the defendants had included what they knew, their footnote would have read: "The amount receivable from Valley Commercial Corp. (an affiliated company of which Mr. Harold Roth is an officer, director and stockholder), which bears interest at 12% a year, was uncollectible at September 30, 1962, since Valley had loaned approximately the same amount to Mr. Roth who was unable to pay. Since that date Mr. Roth and others have pledged as security for the repayment of his obligation to Valley and its obligation to Continental (now $3,900,000, against which Continental's liability to Valley cannot be offset) securities which as of February 15, 1963, had a market value of $2,978,000. Approximately 80% of such securities are stock and convertible debentures of the Company." United States v. Simon, CCH FED. SEC. L. REP. ¶ 92,511, at 98,384 (2d Cir. Nov. 12, 1969).

13. Defendants were charged under 18 U.S.C. §§ 1001 & 1341 (1964), and § 32 of the Securities Exchange Act of 1934, 15 U.S.C. § 78ff (1964). Section 1001 provides: "Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined not more than $10,000 or imprisoned not more than five years, or both." Section 1341 makes criminal the use of the mails in aid of "any scheme or artifice to defraud." Section 32 of the Securities Exchange Act renders criminal a willful and knowing statement in any report which is false or misleading with respect to any material fact. A defense of no knowledge, however, is available. The Justice Department, rather than the SEC, normally prosecutes criminal proceedings.

14. Defendants produced eight expert witnesses: six accounting practitioners, a professor of accounting, and a former Chief Accountant of the SEC, who testified that neither generally accepted accounting principles nor generally accepted auditing standards required disclosure of the nature of the collateral or of the increase in the receivable after the closing date of the balance sheet. Likewise, the witnesses testified that disclosure of the Roth borrowings from Valley was not required and would have been inappropriate on the balance sheet. The Government produced two experts, an SEC staff accountant and the Chief Accountant of the SEC, who took a contrary view. For an excellent discussion on generally accepted accounting principles, see Graham, *Some Observations on the Nature of Income, Generally Accepted Accounting Principles, and Financial*

financial statement departed from generally accepted accounting principles, the defendants maintained that a jury could not find criminal fraud unless the Government demonstrated a willful disregard of these standards with an intent to deceive. Defendants were convicted by the jury on all counts.[15] On appeal to the United States Court of Appeals for the Second Circuit, *held,* affirmed. Compliance with generally accepted accounting principles is not an absolute defense to criminal fraud when the certified statements do not fairly present the financial position of the audited company. *United States v. Simon*, CCH FED. SEC. L. REP. ¶ 92,511 (2d Cir. Nov. 12, 1969), *cert. denied,* 90 S. Ct. 1235 (1970).

The standards of reasonable care which apply to auditors or public accountants are the same as those applied to lawyers, doctors, and other professional men.[16] Generally, an accountant is not liable to third parties for negligence when there is no privity.[17] Civil liability, however, may run, even in the absence of privity, if there is a reckless misrepresentation[18] or fraud.[19] Fraud may be evidenced by either an affirmative act[20] or a failure to disclose.[21] On the other hand, although criminal convictions have been returned against accountants who have affirmatively misrepresented figures on a financial statement,[22] criminal liabilty for failure to make disclosures assertedly required by professional standards is a case of first impression.

---

*Reporting*, 30 LAW & CONTEMP. PROB. 652 (1965); and Pines, *The Securities and Exchange Commission and Accounting Principles*, 30 LAW & CONTEMP. PROB. 727 (1965).

15. Although defendants were fined up to $7,000, no jail sentences were imposed.

16. Gammel v. Ernst & Ernst, 245 Minn. 249, 253, 72 N.W.2d 364, 367 (1955). *See generally* Hawkins, *Professional Negligence Liability of Public Accountants,* 12 VAND. L. REV. 797 (1959).

17. Ultramares Corp. v. Touche, Niven & Co., 255 N.Y. 170, 174 N.E. 441 (1931) (accountants not liable for negligence to creditors and investors because of honest mistake). *But cf.* Biakanja v. Irving, 49 Cal. 2d 647, 320 P.2d 16 (1958) (sustaining negligence action by beneficiary of will prepared by notary public).

18. State St. Trust Co. v. Ernst, 278 N.Y. 104, 15 N.E.2d 416 (1938) (a representation of knowledge when knowledge is lacking or a failure to investigate, if sufficiently gross, will create third party liability even though no deliberate fraud is demonstrated).

19. O'Connor v. Ludlam, 92 F.2d 50 (2d Cir. 1937) (accountants liable to investors only for fraud and not for mistake, even if the mistake is a result of negligence).

20. State St. Trust Co. v. Ernst, 278 N.Y. 104, 15 N.E.2d 416 (1938); *see* H.L. Green Co. v. Childree, 185 F. Supp. 95 (S.D.N.Y. 1960) (false statements knowingly prepared to induce merger deemed fraudulent); Ultramares Corp. v. Touche, Niven & Co., 225 N.Y. 170, 176, 174 N.E. 441, 447 (1931).

21. *See* Fischer v. Kletz, 266 F. Supp. 180 (S.D.N.Y. 1967) (nondisclosure held grounds for deceit action); Duro Sportswear, Inc. v. Cogen, 131 N.Y.S.2d 829 (1st Dep't 1955) (failure to report incurred but unposted liabilities, of which accountant had knowledge, was actionable). *See also* RESTATEMENT OF TORTS § 551 (1937).

22. United States v. Benjamin, 328 F.2d 854 (2d Cir. 1964) (conviction for mail fraud under 18 U.S.C. § 1341).

In the instant case, the court held that generally accepted accounting principles provide guidelines for an accountant when the business affairs of a company are being conducted honestly. The court concluded, however, that if dishonesty is suspected, the accountant must extend his investigation. Furthermore, if his suspicions are confirmed, the accountant must fully disclose the information he obtains.[23] After determining that the collateral securing Valley's debt was completely inadequate,[24] the court reasoned that a full description of the collateral would have evoked inquiry into the final destination of the money.[25] Therefore, although generally accepted accounting principles were followed, the failure to disclose the nature of the collateral could be construed as a deliberate effort to conceal the diversion of corporate funds. The court concluded that failing to report the increase in the receivable[26] and "netting" the accounts[27] were further evidence of a conscious suppression of information. In conclusion, the court held that while the falsity of one item could not, by itself, support an inference of knowledge, the totality of circumstances supported the jury's finding of a deliberate and willful intent to defraud.

In the recent civil case of *Escott v. BarChris Construction Corp.*,[28] the court concluded that "[a]ccountants should not be held to a standard higher than that recognized in their profession." In the instant case, however, the jury was allowed to find criminal liability even though defendants complied with the applicable professional standards.[29] It appears, therefore, that accountants have now been placed in an anomalous position since it may be easier to support a criminal, rather

23. The court held that full disclosure would not be necessary if the situation were corrected and adequate steps were taken to avoid repetition.

24. The court correctly concluded that the property most unsuitable to collateralize this debt was securities of the corporation whose solvency was in question.

25. The court reasoned that since only Roth could have furnished such a large amount of Continental securities, disclosure of the contents of the collateral would have implicitly acknowledged Roth as the ultimate recipient of the loan. It is submitted, however, that such disclosure would have only assisted parties who had an intimate knowledge of the financial structure of the companies to trace the loans back to Roth.

26. Since the value of the collateral was determined as of February 15, the court concluded that the amount of the liability should also be determined as of that date.

27. While the figures which appeared on the financial statement were gross amounts, the footnote actually referred to the net amount.

28. 283 F. Supp. 643, 703 (S.D.N.Y. 1968). *See also* W. PROSSER, LAW OF TORTS 168 (3d ed. 1964) (professional men held to standard of care that is customary and usual in that profession).

29. The district court instructed the jury that proof of compliance with generally accepted standards was "evidence which may be very persuasive but not necessarily conclusive." CCH FED. SEC. L. REP. ¶ 92,511, at 98,388.

than a civil, prosecution against them.[30] On the other hand, a holding that adherence to professional standards is an absolute shield to criminal responsibility would provide a dangerous precedent that might allow the unscrupulous to operate with impunity. The conflicting testimony presented at the trial[31] would seem to indicate a widespread lack of understanding of the scope of an auditor's duty.[32] The instant case, however, does little to clarify the area since its treatment of the precise extent of the accountant's newly acquired obligations is extremely vague. The decision clearly indicates that while a mere peccadillo need not be disclosed, a large diversion must be reported. The area between these extremes, however, is uncertain and could prove to be highly litigious. Based on hindsight, a jury could easily deem inadequate the actions of an accountant which appeared to be sufficient at the time. Thus, if an auditor's suspicions are aroused during his investigation, he faces a dilemma: an extensive investigation might make his services too costly,[33] but a cursory probe may subject him to criminal liabilities.[34] The accounting profession, therefore, needs to

30. It also appears that the effect of this decision will be to hold accountants to a higher standard of care than other professions. For example, an honest crror of judgment does not provide a civil cause of action against physicians. *See, e.g.*, St. George v. State, 283 App. Div. 245, 127 N.Y.S.2d 147 (3d Dep't), *aff'd*, 308 N.Y. 681, 124 N.E.2d 320(1954) (wrongful death action for releasing killer from mental institution dismissed); Loudon v. Scott, 58 Mont. 645, 194 P. 488 (1920) (no liability for erroneous judgment concerning the administration of anesthetic). This also holds true for attorneys. *See, e.g.*, Hodges v. Carter, 239 N.C. 517, 80 S.E.2d 144 (1954) (no liability if reasonable doubt may be cntertained by well-informed lawyers on the point of law). *See also* Wade, *The Attorney's Liability for Negligence*, 12 VAND. L. REV. 755, 760-63 (1959) (if law uncertain or doubtful, it is unlikely that an attorney will be found negligent). In addition, criminal liability based soley upon a mistaken professional opinion has been refused. People v. Kresel, 243 App. Div. 137, 277 N.Y.S. 168, 175-76 (1935) (lawyer not criminally responsible for mistakcn advice on doubtful question of law).

31. *See* note 14 *supra*.

32. There is a serious question whether defendants received fair warning as to what type of conduct would invoke criminal sanctions. *See* United States v. Harris, 347 U.S. 612, 617 (1954) (constitutional requirement of definiteness is violated by criminal statute that fails to give a person fair notice); Connally v. General Constr. Co., 269 U.S. 385, 391 (1926) (if requirements are so vague that men of common intelligence must guess at their meaning and differ as to their application, due process is violatcd). *See also* Quarles, *Some Statutory Construction Problems and Approaches in Criminal Law*, 3 VAND. L. REV. 531, 539-43 (1950).

33. Although costs to a customer should not be the sole criterion by which an accountant's conduct is judged, economic reasonableness must be considered. *See* R. MAUTZ, *supra* note 10, at 5.

34. When faced with only civil liability an auditor could balance the risks involved and, based on his professional experience, make a determination as to the necessary scope of his investigation. In addition, most professional organizations have insurance to cover the risks of civil liability. It scems, however, that under the threat of criminal prosecution an accountant will be very reluctant to stop short of anything less than an exhaustive, even though expensive, investigation.

establish more uniform standards with a narrowed range of alternatives so that accountants, the public, and the courts will have a more objective basis for evaluating an auditor's professional performance.[35] Furthermore, since the precise function of an auditor is generally misunderstood by a majority of the public,[36] the accounting profession should take steps to define the extent of the responsibility assumed by the certifying auditor. Although cooperation between the accounting profession and the Securities and Exchange Commission has raised accounting standards over the past 35 years,[37] improvements are still needed. The improvements, however, should come through professional, civil,[38] or administrative actions, rather than through criminal prosecutions.

## Administrative Law—Standing to Challenge Administrative Actions—Anyone Arguably Protected by Statute May Sue

Petitioners, sellers of data processing services for the general business community, sought a declaratory judgment, an injunction, and compensatory damages against respondents, American National Bank & Trust Company and the Comptroller of the Currency of the United States. Petitioners contended that a ruling by the Comptroller[1]

35. Analyzing the district court opinion in *Simon*, another author reached the same conclusion. Note, *Federal Criminal and Administrative Controls for Auditors: The Need for a Consistent Standard*, 1969 WASH. U.L.Q. 187. *See also* Bradley, *Auditor's Liability and the Need for Increased Accounting Uniformity*, 30 LAW & CONTEMP. PROB. 898 (1965).

36. An auditor is not a guarantor of the statements which he certifies. R. MAUTZ, *supra* note 10, at 487. Financial statements are the assertions of management and are not the representations of the auditor. *Id.* at 10. Although fraud may be discovered through normal audit procedures, the detection of criminal acts is not an auditor's primary responsibility. *See* COMMITTEE ON AUDITING PROCEDURE, AICPA, AUDITING STANDARDS AND PROCEDURES 10-12 (Statements on Auditing Procedure No. 33, 1963).

37. Although the SEC is not bound to follow accounting principles it deems faulty, the Commission's general policy is to require adherence to generally accepted accounting principles. For the most part, the development and formation of new principles has been left to the accounting profession. *See* L. RAPPAPORT, SEC ACCOUNTING PRACTICE AND PROCEDURE 2.1-4.39 (1966). The SEC, however, may prescribe whatever rules and procedures it deems necessary for more accurate and informative financial statements. *See, e.g.*, Accounting Series Release No. 73 in 4 CCH FED. SEC. L. REP. ¶ 72,092 at 62,194 (Oct. 30, 1952).

38. Although it is difficult to formulate accounting standards in civil courts, civil liability is probably the most effective means of enforcing compliance with developed standards and providing sufficient incentive for the profession to undertake further self-regulation. *But see* W. PROSSER, *supra* note 28, at 165 (courts should not burden a profession with liability based on an uneducated judgment).

1. "Incidental to its banking services, a national bank may make available its data

permitting national banks to make data processing services available to bank customers was threatening immediate economic damage to their competitive interests and was in violation of the Bank Service Corporation Act of 1962, which limits the activities of banking corporations to "the performance of bank services for banks."[2] The district court rejected petitioners' claim of standing based on section 10 of the Administrative Procedure Act[3] and dismissed the complaint for lack of jurisdiction.[4] The Court of Appeals for the Eighth Circuit affirmed.[5] On certiorari to the United States Supreme Court, *held*, reversed. Any party injured in fact by an administrative action adverse to an interest arguably protected by a statute or the Constitution has standing to challenge the action. *Association of Data Processing Service Organizations, Inc. v. Camp*, 38 U.S.L.W. 4193 (U.S. Mar. 3, 1970).[6]

In its recent analysis of the policies behind the law of standing, the Supreme Court in *Flast v. Cohen*[7] stated that the constitutional requirement of a case or controversy[8] limits "the business of federal courts to questions presented in an adversary context and in a form historically viewed as capable of resolution through the judicial process."[9] Quoting from *Baker v. Carr*,[10] the Court reiterated its statement that "[t]he 'gist of the question of standing' is whether the party seeking relief has 'alleged such a personal stake in the outcome

processing equipment or perform data processing services on such equipment for other banks and bank customers." COMPTROLLER'S MANUAL FOR NATIONAL BANKS ¶ 3500 (October 15, 1966 ed.).

2. "No bank service corporation may engage in any activity other than the performance of bank services for banks." 12 U.S.C. § 1864 (1964).

3. "A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof." 5 U.S.C. § 702 (Supp. IV, 1969).

4. 279 F. Supp. 675 (D. Minn. 1968).

5. 406 F.2d 837 (8th Cir. 1969).

6. In a companion case, Barlow v. Collins, 38 U.S.L.W. 4195 (U.S. March 3, 1970), the Court held that tenant farmers eligible for payments under the Upland Cotton Program have standing to challenge the validity of amended regulations promulgated by the Secretary of Agriculture.

7. 392 U.S. 83 (1968).

8. U.S. CONST. art. III, § 2. *See, e.g.*, Tileston v. Ullman, 318 U.S. 44 (1943); Frothingham v. Mellon, 262 U.S. 447 (1923). Standing is but one aspect of the case or controversy requirement. Other elements are: ripeness, Poe v. Ullman, 367 U.S. 497 (1961); advisory opinions, Muskrat v. United States, 219 U.S. 346 (1911); mootness, California v. San Pablo & T.R.R., 149 U.S. 308 (1893); the policy against friendly or collusive suits, Chicago & Grand Trunk Ry. v. Wellman, 143 U.S. 339 (1892); and, political questions, Luther v. Borden, 48 U.S. (7 How.) 1 (1849).

9. 392 U.S. 83, 95 (1968).

10. 369 U.S. 186 (1962).

of the controversy as to assure that concrete adverseness which sharpens the presentation of issues upon which the court so largely depends for illumination of difficult constitutional questions.' "[11] In the area of administrative law, a troublesome question regarding standing has been whether a person who asserts an adverse effect has standing to attack an allegedly illegal administrative action. The courts have complicated this problem by tending to confuse standing with reviewability.[12] Presently, there are two views regarding who has standing to seek a review of administrative decisions.[13] The narrower and more traditional test has been that a party always has standing when damage to a legal right is alleged.[14] "Legal right"[15] is a term of art that includes property rights, rights arising out of contract, rights protected against tortious invasion, rights founded on a statute that confers a privilege,[16] and rights guaranteed by the Constitution.[17] According to this traditional view, economic injury resulting from lawful competition cannot, by itself, confer standing on the injured party in the absence of a statute reflecting a legislative purpose to protect the party[18] or the class of which he is a member from competition.[19] The more liberal test of standing, on the other hand, requires only that the plaintiff allege injury in fact, even though the

11. 392 U.S. at 99.

12. *See, e.g.*, Perkins v. Lukens Steel Co., 310 U.S. 113 (1940). As a general rule, the right to appeal from an administrative decision is dependent upon a statute, and it is for the legislature to determine how the rights that it creates shall be enforced. *See* Switchmen's Union v. National Mediation Bd., 320 U.S. 297 (1943). Davis suggests that to focus on the question of standing, one "must assume that a legislative or judicial determination has been made that the particular type of governmental action should be subject to review." K. DAVIS, ADMINISTRATIVE LAW 398 (1959).

13. L. JAFFE, JUDICIAL CONTROL OF ADMINISTRATIVE ACTION 501 (1965).

14. *See, e.g.*, Hardin v. Kentucky Util. Co., 390 U.S. 1, 5-6 (1968); Stark v. Wickard, 321 U.S. 288 (1944); Tennessee Elec. Power Co. v. TVA, 306 U.S. 118 (1939); Chicago Junction Case, 264 U.S. 258 (1924).

15. "Legal right" may be distinguished from "interest." Every businessman has an interest in freedom from competition that may reduce his profits; however, businessmen have no legal right to be free from such competition. *See* United States v. Storer Broadcasting Co., 351 U.S. 192 (1956) ("legal wrong" requires something more than an adverse personal effect); K. DAVIS *supra* note 12, at 400.

16. Tennessee Elec. Power Co. v. TVA, 306 U.S. 118, 137-38 (1939).

17. *See* Flast v. Cohen, 392 U.S. 83 (1968).

18. *See, e.g.*, Hardin v. Kentucky Util. Co., 390 U.S. 1, 7 (1968); Perkins v. Lukens Steel Co., 310 U.S. 113 (1940).

19. Jaffe would phrase the question: "Is the plaintiff's continued well-being one of the statute's concerns?" L. JAFFE, *supra* note 13, at 510. He notes that various common law doctrines of unfair competition and improper interference with advantageous relations act as limits on competitive methods; however, not all illegal competition is unfair, and "the common law does not transmute every illegality into a cause of action . . . ." *Id.* at 509.

injury may not be to a legal right.[20] The leading case supporting this view is *FCC v. Sanders Brothers Radio Station*,[21] where the Court found that an existing broadcasting station with *no legal right* to be free from competition had standing to challenge the grant of a license to a competitor. In reaching this decision, the Court reasoned that Congress must have intended a competitor to be "a person aggrieved" under the relevant statute since there would be no one to be "aggrieved" unless the competitor could object.[22] In recent decisions involving challenges to the entrance of national banks into new fields of business activity, courts have used both the legal right and the damage in fact tests to determine standing.[23]

Most of the law of standing has been created by the courts, and until recently few statutes contained provisions regarding standing.[24] Statutes dealing with the problem normally provide that a "party in interest," or any person or party "aggrieved" or "adversely affected" by administrative action may have standing to sue.[25] Similarly, the Administrative Procedure Act (APA) grants standing to "[a] person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute . . . ."[26] Much academic debate has centered around the meaning of "adversely affected." Davis, after an examination of the legislative history of the APA, concludes that "adversely affected" means "adversely affected in fact."[27] Jaffe contends that the words "in fact" were not included in the statute and that Davis's view is logically

20. Davis, the chief proponent of this view, states that 3 strong reasons require that one adversely affected in fact be able to challenge the action: (1) an elemental principle of justice is that one injured by illegal action should have a remedy; (2) the artificiality and complexity of the law of standing would disappear if his view were accepted; (3) the APA should be interpreted to allow anyone adversely affected in fact to have standing. K. DAVIS, *supra* note 12, at 398. *See* text accompanying notes 28-30 *infra*.

21. 309 U.S. 470 (1940).

22. *Id.* at 477. The Court in Scripps-Howard Radio, Inc. v. FCC, 316 U.S. 4 (1942), explained that in cases such as *Sanders* the "private litigants have standing only as representatives of the public interest." *Id.* at 14. *Sanders* was further explained in Associated Indus., Inc. v. Ickes, 134 F.2d 694, 704 (2d Cir.), *vacated as moot*, 320 U.S. 707 (1943), where the court stated that the plaintiff need not have a private interest; it is enough that a statute authorizes him to represent the public interest as a "private attorney general."

23. *See, e.g.*, Investment Co. Institute v. Camp, CCH FED. BANKING L. REP. ¶ 95,157 (D.C. Cir. July 1, 1969) (Bazelon, J., concurring); Arnold Tours, Inc. v. Camp. 408 F.2d 1147 (1st Cir. 1969); Wingate Corp. v. Industrial Nat'l Bank, 408 F.2d 1147 (1st Cir. 1969); Saxon v. Georgia Ass'n of Ind. Ins. Agents, Inc., 399 F.2d 1010 (5th Cir. 1968); Baker, Watts & Co. v. Saxon, 261 F. Supp. 247 (D.D.C. 1966).

24. L. JAFFE, *supra* note 13, at 502.

25. K. DAVIS, *supra* note 12, at 400.

26. 5 U.S.C. § 702 (Supp. IV, 1969).

27. K. DAVIS, *supra* note 12, at 398.

difficult to support.[28] The majority of courts considering this issue have concluded that this provision in the APA was not intended to alter the concepts of standing or to create any new legal rights.[29]

In the instant case, the Court stated that the first inquiry in determining standing is "whether the plaintiff alleges that the challenged action has caused him injury in fact, economic or otherwise."[30] Analyzing petitioners' complaint, the Court found that the allegation that respondent bank was performing or preparing to perform services for two of petitioner's customers was sufficient to meet this requirement. The majority found that the " 'legal interest' test goes to the merits." Consequently, it rejected the approach of *Tennessee Power Co. v. TVA*,[31] which required a showing of a "legal interest." The second inquiry relating to the question of standing, the instant Court continued, concerns "whether the interest sought to be protected by the complainant is arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question."[32] Applying this test, the majority found that petitioners were arguably protected from competition by the Bank Service Corporation Act.[33] The Court justified this new two-part test for standing by noting a trend toward enlargement of the class of people who may challenge administrative actions.[34] Treating the questions of reviewability and the merits separately, the Court held that the generous provisions of the APA[35] provide for review of the Comptroller's action and remanded the cause for consideration on the merits.

Mr. Justice Brennan, joined by Mr. Justice White, concurred in the result but dissented from the Court's formulation of a new test for standing.[36] Rather than adopting the majority's two-part test, which

28. L. JAFFE, *supra* note 13, at 529.

29. *See, e.g.*, REA v. Northern States Power Co., 373 F.2d 686, 692 (8th Cir. 1967); Pennsylvania R.R. v. Dillon, 335 F.2d 292, 295 (D.C. Cir.), *cert. denied*, 379 U.S. 945 (1964); Kansas City Power & Light Co. v. McKay, 225 F.2d 924, 932 (D.C. Cir.), *cert. denied*, 350 U.S. 884 (1955).

30. 38 U.S.L.W. at 4193.

31. 306 U.S. 118, 137-38 (1939).

32. 38 U.S.L.W. at 4194.

33. Section 4 of the Bank Service Corporation Act of 1962, 76 Stat. 1132, 12 U.S.C. § 1864 (1964). *See* text accompanying note 2 *supra*.

34. The Court noted that aesthetic, conservational, and recreational values as well as economic interests may be alleged to gain standing under appropriate statutes. *See* Scenic Hudson Preservation Conf. v. Federal Power Comm., 354 F.2d 608, 616 (2d Cir. 1965).

35. Text accompanying note 26 *supra*.

36. Mr. Justice Brennan dissented to both the instant case, and its companion case, Barlow v. Collins, 38 U.S.L.W. 4195, 4198 (U.S. Mar. 3, 1970). *See* note 6 *supra*.

requires an allegation of injury, as well as an allegation that the injury was to an arguably protected right, the minority would limit the Court's inquiry to whether the plaintiff has alleged injury in fact. The two Justices stated that injury in fact would assure the constitutionally required adverseness since one injured in fact would have such a personal stake in the outcome of the suit that he could be expected to litigate the issues intensely. Turning to the question of reviewability,[37] the minority noted that there must be a determination from the statutory language, legislative history, and public policy considerations that Congress has not precluded review. They suggested that any slight indications that plaintiff's class is a beneficiary of a statute should support the inference that Congress intended that the grievance be reviewable by federal courts. In determining the merits, the dissenting Justice stated that courts should consider "whether the specific legal interest claimed by the plaintiff is protected by the statute and . . . whether the protested agency action invaded that interest."[38] Finally, the minority attacked the "arguably within the zone of interests" test as being too obscure and as confusing a determination of the merits with the issue of standing. They concluded that an approach that treats standing, reviewability, and the merits as three separate issues is needed to insure that judges will not use standing to prevent the hearing of plaintiffs entitled to full consideration of their claims on the merits.

The law of administrative standing has been characterized as a "complicated specialty of federal jurisdiction."[39] The fact that the Court in the instant case stated that "[g]eneralizations about standing to sue are largely worthless as such"[40] indicates that the present rules of standing are unsatisfactory and that a reconsideration of the fundamental rules is needed. The instant Court was presented with an opportunity to reevaluate the law of standing in accordance with the policies enunciated in *Flast v. Cohen*[41] and as a consequence, a new standard has emerged. The pronounced requirement that a complainant need only "arguably" show that he is "within the zone of interests to be protected or regulated by the statute" has in effect overruled the long line of cases[42] holding that the plaintiff must prove he is within a class protected by a relevant statute. It must be determined, however,

37. The minority felt that consideration of petitioner's claim should involve treatment of the three separate, discrete, and complicated issues—standing, reviewability, and the merits.

38. 38 U.S.L.W. at 4200.

39. United States *ex rel.* Chapman v. FPC, 345 U.S. 153, 156 (1953).

40. 38 U.S.L.W. at 4193.

41. 392 U.S. 83 (1968).

42. *See* note 7 *supra*.

if this new standard will yield any practical results. On its face, this requirement would seem merely to postpone the determination of the success of plaintiff's claim. It is doubtful whether the ultimate result in any case will be different than it would have been prior to this decision because the plaintiff, in order to succeed on the merits, must still show that a legal right as opposed to an interest has been violated.[43] Interpreted differently, it may be argued that the majority intends that once standing has been granted the only appropriate question on the merits is whether the alleged activity is lawful.[44] Whichever view of the instant case is adopted, it is inevitable that "new and novel lawsuits" will result.[45] The Court's emphasis on the trend toward enlarging the class of people with standing to litigate administrative actions and its emphasis on the fact that the interest to be protected "may reflect 'aesthetic, conservational, and recreational' as well as economic values"[46] indicates that challenges to agency decisions on pollution and conservation issues as well as zoning, highway, and mass transit matters may be forthcoming. This decision may open the doors of the courts to those persons who have been allowed to intervene in administrative actions but have been denied standing in judicial actions;[47] these persons may well be deemed to satisfy the "arguably within the zone of interests" requirement.

The Court seems to have found a middle ground between the narrow legal right view and the more liberal injury in fact view. However, the fact that the complainant has to allege only that he is *arguably* within the statute indicates that the Court has gone almost to the injury in fact test. The majority's statement that "[t]he question of standing . . . . concerns, *apart from the 'case' or 'controversy' test,* the question whether the interest sought to be protected . . . is arguably within the zone of interests to be protected by the statute . . . ."[48] indicates that they view the question of standing as being comprised of two parts—a constitutional inquiry to determine if a case

43. The instant case was remanded for a hearing on the merits. The dissent stated that on the merits the plaintiff would still have to prove that a specific legal interest protected by statute has been invaded.

44. This interpretation receives some logical support from the fact that both the majority and the dissent spoke of enlarging the class of persons with standing and a need to gain relief from the complexities of government. It may be inferred that in order for any new relief to be granted, the question of legal right must be removed entirely from consideration after standing is granted.

45. Wall Street Journal, March 4, 1970, at 6, col. 2 (S.W. ed.).

46. 38 U.S.L.W. at 4194.

47. *See, e.g.*, Alexander Sprunt & Son, Inc. v. United States, 281 U.S. 249 (1930).

48. 38 U.S.L.W. at 4194 (emphasis added).

or controversy exists and a nonconstitutional inquiry into the zone of statutory interests. From this language it may be surmised that while injury in fact gives the appropriate constitutionally required adverseness, there must also be a consideration of the nonconstitutional element for judicial policy reasons.[49] However, the traditional justification for this second inquiry—that it is good policy to limit the number of persons challenging government action[50]—appears inconsistent with the Court's indorsement of a trend toward enlargement of the class of people who may protest administrative action. Yet it is significant that the Court has recognized that the only constitutional requirement for standing is injury in fact; any other requirement for standing is of judicial construction and may be done away with upon judicial discretion.

The majority's pronounced requirement that the complainant arguably fall within the zone of interests to be protected by the statute has done little to clear up the confusion in the area of administrative standing. As the dissent points out, "the Court's formulation of its nonconstitutional element of standing is obscure."[51] The meaning of "arguably" is uncertain; thus, in applying this formulation the courts may continue to confuse the merits of the controversy with the question of standing.[52] The approach of the dissent may offer the best resolution of the law in this complicated area. By dividing the consideration of the Court into three distinct issues—standing, reviewability, and the merits—and requiring that standing be based only upon actual harm, the constitutional requirement for a case or controversy would be met and considerable confusion would be avoided.

## Constitutional Law—Abortion—Standard Excepting Abortions Done as "Necessary for the Preservation of the Mother's Life or Health" Held Unconstitutionally Vague

Defendants, a nurse's aide and a physician licensed in the District of Columbia, sought to dismiss indictments under a District of

49. *See* Flast v. Cohen, 392 U.S. 83, 92 & n.6 (1968); JAFFE, *supra* note 13, at 502.

50. *See* Flast v. Cohen, 392 U.S. 83, 93 (1968); Frothingham v. Mellon, 262 U.S. 447, 487 (1923).

51. 38 U.S.L.W. at 4201.

52. "What precisely must a plaintiff do to establish that 'the interest sought to be protected . . . is arguably within the zone of interests to be protected or regulated by the statute'? How specific an 'interest' must he advance? Will a broad, general claim, such as competitive interest, suffice, or must he identify a specific legally protected interest?" 38 U.S.L.W. at 4201 (Brennan, J. dissenting).

Columbia statute which provided a felony penalty for an abortion[1] performed on any woman unless "done as necessary for the preservation of the mother's life or health and under the direction of a competent licensed practitioner of medicine."[2] The defendants asserted that the statute in its entirety must fall since the "life or health" standard was unconstitutionally vague and improperly limited the physician in carrying out his professional responsibilities to the pregnant woman. Furthermore, since hospitals differed in interpreting the language, the statute denied equal protection to certain economic groups and denied the constitutional right of a woman, regardless of economic circumstances, to determine whether or not she shall bear a child. The United States District Court for the District of Columbia, *held*, judgment for the defendants. The "preservation of life or health" standard was unconstitutionally vague since it did not provide the physician with the certainty due process of law considers essential. Vuitch v. District of Columbia, 305 F. Supp. 1032 (D.D.C. 1969), *appeal docketed*, 38 U.S.L.W. 3303 (U.S. Feb. 5, 1970) (No. 1155).

At English common law, aborting a woman was an offense only if done after "quickening"[3] since only after the mother first felt fetal movement was life considered developed enough to warrant protection by the state. Early American courts accepted the "quickening" distinction,[4] but as government performed an increasing role in protecting health and safety, the states replaced the common law formula with legislation prohibiting all abortions except those performed under the few circumstances the legislatures felt justified.[5] The prevailing pattern was an absolute prohibition except for the

1. Abortion is the expulsion of the fetus at so early a stage of uterogestation that it has not acquired the ability of sustaining an independent life. A criminal abortion is the wilful bringing about of an abortion without statutory justification or excuse. 1 AM. JUR. 2d *Abortion* § 1 (1962).

2. The statute provides: "Whoever, by means of any instrument, medicine, drug or other means whatever, procures or produces, or attempts to procure or produce an abortion or miscarriage on any woman, *unless the same were done as necessary for the preservation of the mother's life or health and under the direction of a competent licensed practitioner of medicine*, shall be imprisoned in the penitentiary not less than one year or not more than ten years, or if the death of the mother results therefrom, the person procuring or producing, or attempting to procure or produce the abortion or miscarriage shall be guilty of second degree murder." D.C. CODE ANN. § 22-201 (1967) (emphasis added).

3. R. PERKINS, CRIMINAL LAW 101 (1957). Quickening is the state of gestation, usually 16 to 20 weeks after conception, when the mother first feels fetal movement.

4. *E.g.* Mitchell v. Commonwealth, 78 Ky. 204 (1879); Commonwealth v. Parker, 50 Mass. (9 Met.) 263 (1845); Commonwealth v. Bangs, 9 Mass. 387 (1812). For a discussion of the common law see Means, *The Law of New York Concerning Abortion and the Status of the Fetus, 1664-1968: A Case of Cessation of Constitutionality*, 14 N.Y.L.F. 411, 418-28 (1968).

5. *See* L. LADER, ABORTION 86-87 (1966).

purpose of saving the mother's life.[6] The District of Columbia statute went further and recognized preservation of health as an independent justification.[7] While there is no significant case law under the District of Columbia statute, there are numerous decisions interpreting statutes which contain only the language "necessary to preserve the life of the woman." There is wide agreement that the words do not mean that the peril to life must be imminent and certain but only that a dangerous condition "be potentially present, even though its full development might be delayed to a greater or less extent."[8] There is controversy, however, whether the words go so far as to include the health and well-being of the woman.[9] Under the standard the determination that an abortion is necessary to preserve the woman's life is regarded as a medical decision, but the opinion of the individual physician is not of itself authoritative. The diagnosis and performance of the operation must conform to the recognized and approved standards of the physicians practicing in the community.[10] In *People v. Belous*,[11] the Supreme Court of California questioned such a standard in ruling that the state had not demonstrated a compelling interest which would warrant interference with the fundamental constitutional right of the

6. Only Louisiana does not justify abortion on any grounds. LA. REV. STAT. § 14:87 (Supp. 1969). Massachusetts and Pennsylvania have statutes which prohibit any abortion performed "unlawfully." MASS. ANN. LAWS ch. 272, § 19 (1968); PA. STAT. tit. 18, § 4716 (1963). The Massachusetts Supreme Court recently ruled that the word "unlawfully" was not unconstitutionally vague because it has been made definite by judicial decisions which state that a physician may lawfully perform an abortion if he acts in good faith and in an honest belief that the operation is necessary for the preservation of the life or health of the woman. Kudish v. Board of Registration in Medicine, 248 N.E.2d 264 (Mass. 1969).

7. Seven other states have a similar provision. *See* ALA. CODE tit. 14, § 9 (1958); CAL. HEALTH & SAFETY CODE § 25951 (West Supp. 1970); COLO. REV. STAT. ANN. §§ 40-2-50 to -51 (Supp. 1969); GA. CODE ANN. § 26-1201-02 (Supp. 1969); KAN. STAT. ANN. § 21-410 (Supp. 1969); N.C. GEN. STAT. § 14-45.1 (1969); N.M. STAT. ANN. § 40A-5-1 (Supp. 1969).

8. State v. Dunkelbarger, 206 Iowa 971, 980, 221 N.W. 592, 596 (1928) (pregnant girl had threatened to kill herself). *See* People v. Ballard, 167 Cal. App. 2d 803, 335 P.2d 204 (1959) (abortion justified in the case of a woman who was very nervous, had 2 previous miscarriages and menstrual complications); State v. Hatch, 138 Minn. 317, 164 N.W. 1017 (1917).

9. *Compare* People v. Abarbanel, 239 Cal. App. 2d 31, 48 Cal. Rptr. 336 (1965) (psychiatrists recommendation is justification for performing an abortion), *with* State v. Brandenburg, 58 A.2d 709 (N.J. 1948) (court of appeals upheld trial court's refusal to charge the jury that protection of patient's well-being would constitute lawful justification for performing an abortion).

10. Commonwealth v. Brunelle, 341 Mass. 675, 171 N.E.2d 850 (1961); Commonwealth v. Nason, 252 Mass. 545, 148 N.E. 110 (1925); State v. Powers, 155 Wash. 63, 283 P. 439 (1929).

It is implicit that the physician have a good faith and honest belief that the abortion is necessary to preserve the mother's life. The jury is allowed to infer from the circumstances whether this is so. Commonwealth v. Wheeler, 315 Mass. 394, 53 N.E.2d 4 (1944).

11. 80 Cal. Rptr. 354, 458 P.2d 194 (1969). The Supreme Court has refused to review the merits of the case. 38 U.S.L.W. 3313 (Feb. 24, 1970).

mother to life and to choose whether to bear children. Consequently, the court held that the term "necessary to preserve" was not sufficiently certain to satisfy due process requirements without improperly infringing on the woman's constitutional rights.[12]

In deciding the present case, the court first determined that the exceptions which justified an abortion evidenced a concern with the medical factors bearing on the circumstances of the pregnant woman and a belief in the clear necessity of placing the matter in the hands of competent doctors. Since no evidence presented refuted the original proposition of Congress that abortion cannot be safely and hygenically performed at any stage of pregnancy except under medical direction, the court ruled that the part of the statute prohibiting abortions not performed by a qualified licensed practitioner of medicine was a constitutionally valid exercise of the police power. The court found, however, that the "life or health" exception was not sufficiently precise to guide the physician. The word "health", undefined, did not indicate whether the standard encompassed varying degrees of mental health as well as physical health. More importantly, no body of medical knowledge delineated what degree of mental or physical health or combination of the two is required to make an abortion legal or illegal under the standard. Furthermore, the court reasoned that the good faith professional judgment that an abortion was necessary to preserve a woman's health should not be open to challenge by a jury's acceptance or non-acceptance of an individual doctor's interpretation of the ambivalent and uncertain word.[13] Consequently, the standard was unconstitutionally vague since it did not give the doctor the certainty which is essential to due process in a criminal statute. The

12. The court found that the fundamental right of the woman to choose whether to bear children followed from the Supreme Court's and the California court's repeated acknowledgement of a "right of privacy" or "liberty" in matters related to marriage, family, and sex. 80 Cal. Rptr. 354, 359, 458, P.2d 194, 199-200. *See, e.g.*, Loving v. Virginia, 388 U.S. 1, 12 (1967) (statute prohibiting interracial marriages violated due process); Griswold v. Connecticut, 381 U.S. 479, 485-86 (1965) (state law prohibiting the use of contraceptives violated the constitutional right to martial privacy), Skinner v. Oklahoma *ex rel.* Williamson, 316 U.S. 535, 536, 541 (1942) (marriage and procreation involve a basic liberty).

Since California had already adopted a more liberal abortion statute at the time the case reached the court, the case has had limited importance.

13. The words "unless necessary for the preservation of life or health" in the District of Columbia statute are "intended to furnish the defense an opportunity for justification and are no part of the description of the offense required to be proved by the prosecution." Peckham v. United States, 210 F.2d 693, 679 (D.C. Cir. 1953). *See also* Williams v. United States, 138 F.2d. 81, 83 (D.C. Cir. 1943). For a survey of where other states place the burden of proof, see Harper, *Abortion Laws in the United States, in* ABORTION IN THE UNITED STATES 187 (M. Calderone ed. 1958).

court then ruled that striking this standard did not leave unprotected the proper and separate legislative objective of protecting the pregnant woman from incompetent medical treatment. Consequently, the statute was severable,[14] and the court held that abortions may now be performed under the statute only at the direction of a competent physician.[15]

Unlike the *Belous* decision, the court found it unnecessary to stress the tenuous constitutional right of women to choose to bear children, but rather invalidated the preservation of life or health standard for a more conspicuous weakness—vagueness from the physician's viewpoint. The statute offers little assistance to the physican faced with this delicate problem.[16] There are no statutory guidelines to elucidate what constitutes a threat to the pregnant woman's life or health and the case law does little more than stress the inherent competence of the medical profession for setting its own standards.[17] Yet, the medical profession does not agree on the meaning of the words or the extent to which they justify abortion.[18] Consequently, it is unfair to reserve the power to punish the physician when, in fact, the statute requires

14. *See* United States v. Jackson, 390 U.S. 570 (1968); Stewart v. Washington, 301 F. Supp. 610 (D.D.C. 1969).

15. The court acknowledged the defendants' argument that the statute denied equal protection because the exception was more liberally applied in some private hospitals than in the city hospitals, but added that eliminating the preservation of life or health standard removed the principal basis for existing uncertainty so that now the statute would be evenly applied throughout the city.

For a comprehensive examination of the constitutional questions raised by abortion statutes see Lucas, *Federal Constitutional Limitations on the Enforcement and Administration of State Abortion Statutes*, 46 N.C.L. REV. 731 (1968).

16. Since the doctor is exposed to liability only if he performs the operation, he is likely to be reluctant to terminate the pregnancy except in the most obvious case. This conservative tendancy may deny a woman a justifiable abortion—a decison for which she has no legal recourse. *See* Gleitman v. Cosgrove, 227 A.2d 689 (N.J. 1967). Furthermore, the doctor's position is especially difficult when he knows that if he refuses, the woman may then seek out a criminal abortionist who operates in conditions which are clearly dangerous to her life and health.

17. Beyond agreement that the woman does not have to be at death's door, there is little valuable instruction for the physician. *See* notes 8 & 9 *supra* and accompanying text.

On the other hand, the California statute, which is one of the most permissive, specifically excepts, among others, physical and mental health indices. The statute defines mental health as intending mental illness to the extent that the woman is dangerous to herself or to the person or property of others or is in need of supervision of restraint. CAL. HEALTH & SAFETY CODE § 25954 (West Supp. 1970).

18. In one case study, 11 hypothetical applications for abortion were submitted to 29 California hospitals. Two clearly required abortion to save the mother's life; two were questionable; and the remaining were delicate problems but in the researcher's estimation, were not justifiable as necessary to save the woman's life. Results showed that each request would have been accepted in at least one hospital. Packer & Gampell, *Therapeutic Abortion: A Problem in Law and Medicine*, 11 STAN. L. REV. 417, 444 (1959).

nothing more than his medical determination that the woman's circumstances fall within the exception.[19] Not only has the growth of psychiatry complicated the medical circumstances bearing upon the abortion decision,[20] but the advances made in modern medical practice have rendered the standard archaic.[21] When abortion was a very dangerous operation, the standard may have been meaningful. The cases when that alternative was chosen were rare and could be diagnosed consistently.[22] Today, however, it is safer for the woman to have a hospital abortion in the first three months of pregnancy than it is to carry the pregnancy to term.[23] Interpreting the standard literally then, the physician conceivably could act to preserve the woman's life by terminating a statistically dangerous condition.

The documented uncertainty in the medical profession concerning this type of statute and the inconsistency in its application evidence that the life or health standard does not meet the first essentials of due

19. The Supreme Court has ruled that the delegation of decision-making power to a directly involved individual violated the fourteenth amendment. Tumey v. Ohio, 273 U.S. 510, 523 (1927).

The doctor's position vis-a-vis the statute is particularly sensitive since the authority justifying falling within the exception is his exercise of discretionary judgment that the abortion is necessary to preserve the life or health of the woman. While it appears that legislatures enacted the statute primarily to provide the woman with the medically safer alternative, the popular conception is that the standard is a limitation protecting the fetus from destruction. *See* Means, *supra* note 4, at 434-41. This confusion is crucial because it is the lay jury's responsibility to determine whether the physician's exercise of discretion was in fact justified. *See* note 9 *supra*.

A solution seems to lie in a procedure similar to the one enacted by California which provides an authoritative pre-operative procedure through hospital committees. CAL. HEALTH & SAFETY CODE § 25951-4 (West Supp. 1970). This not only enables the performing physician to predict his potential criminal liability and shifts the burden of unjustifiable abortion to the committee, but also reduces the inconsistency in granting permission to perform abortions. *See also* MODEL PENAL CODE § 230.3 (Proposed Official Draft, 1962). A recent survey, however, revealed serious short-comings in many of the liberalized abortion laws, including California's. Interviews with physicians and hospital officials indicated that many doctors were still uncertain of their liabilities under the new law. N.Y. Times, Apr. 13, 1970, at 1, col. 6.

20. Guttmacher, *The Shrinking Non-Psychiatric Indications for Therapeutic Abortions*, in THERAPEUTIC ABORTIONS 12 (H. Rosen ed. 1954).

21. Many of the abortion statutes are over 100 years old—before the advent of antiseptic surgery and the findings of Joseph Lister. The District of Columbia statute was enacted in 1901, before curettage, the most widely used abortion technique, became routinely safe after the development of antibiotics in the early 1940's. *See* authorites cited, People v. Belous, 80 Cal. Rptr. 354, 360-61, 458 P.2d 194, 200-01 (1969).

22. The evidence indicates that abortion statutes were enacted to protect women from the inherent dangers accompanying the operation. Because of uncontrollable infection, any form of surgery involving insertion of instruments into the body cavity was higbly dangerous; abortion was accordingly, an extremely dangerous procedure at the time the statutes were enacted. *See* Means, *supra* note 4, at 434-41.

23. People v. Belous, 80 Cal. Rptr. at 361 n.7, 458 P.2d at 201 n.7 (1969).

process.[24] The immediate effect of striking down the standard is to legalize abortion in the District of Columbia at the demand of the pregnant woman; more importantly, the decision, if upheld, will nullify abortion statutes in the almost 40 states which have similar provisions. Since the growing pressures for the repeal of all restrictions on the abortion decision have been successful recently in reforming two state abortion laws,[25] it may be that legislatures will require no more than the private decision between the woman and her physician to justify an abortion. At any event, in the effort to make the statutory provisions consistent with modern medical practice, the re-examination of abortion policy seems overdue.

## Constitutional Law—Civil Rights—Discrimination by a Third Party in Connection with the Rental of Property Entitles the Injured Party to a Private Right of Damages Under Section 1982

Petitioners, a Negro lessee and his white lessor, brought an action for monetary and injunctive relief against defendant corporation, alleging discrimination in violation of section 1982 of title 42 of the United States Code.[1] The defendant, a Virginia corporation, was organized to operate recreational facilities for the benefit of the subdivision in which the lessor's house was located. A shareholder in the corporation and his immediate family were entitled to use the corporation's recreational facilities and the share could be assigned by the shareholder to the lessee of his residence, subject to approval by the board. After receiving such an assignment of the lessor's shares in the

24. "[A] statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential of due process . . . ." Connally v. General Const. Co., 269 U.S. 385, 391 (1926).

It is also important to note that the instant court indicated that the inconsistent application of the statute denied poorer women equal protection of the law. *See* note 15 *supra.*

25. Both New York and Hawaii recently repealed statutes which were more than 100 years old and had authorized abortions only if the woman's life was in danger. The new New York statute permits an abortion for any reason up to the 24th week of the pregnancy. After the 24th week, abortions can be performed only to save the mother's life. N.Y. Times, Apr. 11, 1970, at 1, col. 1. The Hawaiian statute legalizes abortion at the request of the woman if performed by a licensed physician or osteopath in a hospital licensed by the state or federal government. N.Y. Times, Feb. 25, 1970, at 1, col. 6.

1. The section states: "All citizens of the United States have the same right, in every State and Territory, as is enjoyed by white citizens thereof to inherit, purchase, lease, sell, hold, and convey real and personal property." 42 U.S.C. § 1982 (1964).

corporation as partial consideration for the lease of the residence, petitioner was refused admittance to the nonstock corporation and was denied use of its facilities.[2] In addition, the defendant corporation expelled the white petitioner from membership for his activities in the Negro's behalf.[3] The Virginia Supreme Court of Appeals dismissed the action on procedural grounds, stating that the appeal was not perfected in the manner provided by the rules of court.[4] On certiorari to the United States Supreme Court, *held*, reversed and remanded. Discrimination by a third party in connection with the rental of property entitles the injured party to a private right of action for damages under section 1982. *Sullivan v. Little Hunting Park, Inc.*, 396 U.S. 229 (1969).

Prior to the Supreme Court's decision in *Jones v. Alfred H. Mayer Co.*,[5] section 1982 had been a relatively little-used civil rights statute. Originally enacted as section one of the Civil Rights Act of 1866,[6] the ambiguous language of the statute,[7] coupled with its unclear

2. After assignment of the membership share to the lessee, the board of directors for the corporation refused to approve petitioner's membership. Since there were no membership standards or previous patterns of exclusiveness, race was apparently the ground for exclusion.

3. Once the lessor learned of the refusal to admit his lessee into membership, he began a campaign to convince the board to reverse its decision. As a result of his phone calls to board members, letters to local clergy, and petitions circulated among residents, the board expelled him, after tendering cash for his 2 shares.

4. The Supreme Court of Appeals of Virginia originally dismissed the suit pursuant to VA. SUP. CT. of APP. R. 5:1, § 3(f), which requires reasonable written notice to opposing counsel of the time and place of tendering the transcript of the trial and a reasonable opportunity to examine the original copy. The court ruled that the appellant's counsel had not given respondent a reasonable opportunity to examine the trial transcripts even though the respondent's counsel examined the transcript and did not at that time complain that he lacked time to properly examine them. Sullivan v. Little Hunting Park, Inc., 209 Va. 279, 163 S.E.2d 588 (1968). The Supreme Court then granted certiorari and remanded the cause to the Virginia court for further consideration in light of Jones v. Alfred H. Mayer Co., 392 U.S. 409 (1968). Sullivan v. Little Hunting Park, Inc., 392 U.S. 657 (1968). On remand, the Virginia court once again refused to hear the merits of the case, relying on its former ruling. 209 Va. 279, 163 S.E.2d 588 (1968). The instant case represents the second time certiorari was granted. 394 U.S. 942 (1969).

5. 392 U.S. 409 (1968).

6. Civil Rights Act of 1866, ch. 31, § 1, 14 Stat. 27. This Act, passed over the veto of President Andrew Johnson, was based on the thirteenth amendment, and passed in accordance with the enabling clause of that amendment, which states that: "Congress shall have the power to enforce this article by appropriate legislation." U.S. CONST. amend XIII, § 2. Later, fearing that the Act was unconstitutional under the thirteenth amendment, Congress re-enacted the 1866 Act in § 18 of the 1870 Enforcement Act, which was based on the fourteenth amendment. Enforcement Act of 1870, cb. 114, § 18, 16 Stat. 140 (codified at 42 U.S.C. § 1982 (1964)).

7. *See, e.g.*, Casper, *Jones v. Mayer: Clio, Bemused and Confused Muse*, 1968 SUP. CT. REV. 89, 96-99, 104, where the author argues that the word "right" as used in the statute is not correlative with duty, thus limiting § 1982 to state-induced discrimination. Other ambiguities are apparent within § 1982 itself. For example, the Court in *Jones* listed the areas of possible

legislative history,[8] served as the greatest deterrent to its effective use.[9] As a result, early Supreme Court cases under section 1982 assumed that the section only prohibited discrimination by state action,[10] although prior to *Jones* the Court had not faced squarely the issue of private discrimination under section 1982.[11] The earlier restriction to state action came from two sources: (1) application of section 1982 to the fourteenth amendment; and (2) restrictive interpretation of the thirteenth amendment provisions. Although the *Civil Rights Cases*[12] left open the question whether section 1982 was authorized solely by the thirteenth amendment,[13] one of the few cases before *Jones* which actually relied on the statute intimated that the fourteenth amendment provided, at least in part, the constitutional authority upon which section 1982 was based,[14] thus subjecting the section to the state action

discrimination which § 1982 purportedly did not cover, including discrimination in the provision of services and facilities. Jones v. Alfred H. Mayer Co., 392 U.S. 409, 413 (1968). In the instant case, however, the Court explicitly recognized that a cause of action exists against a third party service facility which is not a party to the lease. 396 U.S. at 236-37. It has been suggested that § 1982, due to its all-inclusive language, could bar all discrimination in the sale of such widely varying types of property as private franchises, corporate stocks, or consumer items. Note, *Jones v. Mayer: The Thirteenth Amendment and the Federal Anti-Discrimination Laws*, 69 COLUM. L. REV. 1019, 1029 (1969). The Court's language in *Jones* would seem to support this view. 392 U.S. at 443.

8. Gressman, *The Unhappy History of Civil Rights Legislation*, 50 MICH. L. REV. 1323 (1952). Much of the confusion surrounding the Act arose from the re-enactment of the statute in 1870 under the fourteenth amendment. *See* note 6, *supra*. The problems in determining the intention of Congress in passing the Act can readily be seen by comparing Justice Stewart's opinion for the majority with the dissent by Justice Harlan in the *Jones* case. 392 U.S. at 409, 449.

9. The state action requirement, although not supported by the language of the statute alone, evolved from the legislative and judicial confusion surrounding the Act. *See, e.g.*, the court of appeals' decision in Jones v. Alfred H. Mayer Co., 379 F.2d 33 (8th Cir. 1967), *rev'd*, 392 U.S. 409 (1968), which dismissed plaintiff's cause of action after an extensive investigation of judicial and legislative history, holding that the section does not bar private discrimination. In the same opinion the court indicated, however, that this legislative and judicial history could possibly support 3 other bases for which to bar private discrimination under § 1982 by using the thirteenth amendment, the fourteenth amendment, or by relating private subdivision to a government function. The Supreme Court in *Jones* selected the first alternative.

10. *See, e.g.*, Hurd v. Hodge, 334 U.S. 24 (1948); Buchanan v. Warley, 245 U.S. 60, 78 (1917). *See also* Corrigan v. Buckley, 271 U.S. 323 (1926).

11. In Hurd v. Hodge, 334 U.S. 24 (1948), the only material application of § 1982 by the Court before *Jones*, the Court upheld a racially restrictive covenant in Washington, D.C., but stated that § 1982 prohibited its enforcement in federal courts. While this is the closest case on the facts to *Jones*, it did not present a purely private discrimination question. The *Jones* Court used this to distinguish *Hurd*. 392 U.S. at 419.

12. 109 U.S. 3 (1883).

13. "Whether this legislation [the 1866 Civil Rights Act] was fully authorized by the Thirteenth Amendment alone, without the support which it afterward received from the Fourteenth Amendment . . . it is not necessary to inquire." *Id.* at 22.

14. Hurd v. Hodge, 334 U.S. 24 (1948). In that case, the Court stated: "In considering

requirement as enunciated in the *Civil Rights Cases*. Furthermore, restrictive interpretation of the thirteenth amendment, the other possible basis for the Act,[15] also had the effect of limiting the application of section 1982 to state-induced discrimination. In those early cases which had interpreted the amendment, the Court had stated that private action did not have the effect of reducing the individual to a condition of slavery,[16] which was then necessary for the application of the thirteenth amendment.[17] In the face of this judicial history, the Court in *Jones*, analyzing the Act in light of its legislative history,[18] concluded that it was enacted pursuant to the thirteenth amendment exclusively, which, in their interpretation, authorized legislation to remove the "badges and incidences" of slavery. Holding that private discrimination is such a badge or incident, the Court determined that section 1982 prohibited private discrimination in the sale or rental of real property.[19] Even though section 1982 has no express remedial provisions,[20] the Court declined to deal specifically with the issue of damages indicating only that equitable relief would be permitted.[21]

---

whether judicial enforcement of restrictive covenants is the kind of governmental action which the first section of the Civil Rights Act of 1866 was intended to prohibit, reference must be made to the scope and purposes of the Fourteenth Amendment; for that statute and the Amendment were closely related both in inception and in the objectives which Congress sought to achieve." *Id.* at 31-32.

15. *See* notes 7 & 9 *supra*. The *Jones* case has prompted considerable writing dealing with the legislative history of the Act, the result of which has been a split of opinion as to whether the legislature intended for the Act to rest on the fourteenth amendment and whether they intended in 1866 for the Act to reach private discrimination. *Compare* Casper, *supra* note 7, at 99-125, *with* Morris & Powe, *Constitutional and Statutory Rights to Open Housing*, 44 WASH. L. REV. 1, 57-74 (1968).

16. Hodges v. United States, 203 U.S. 1 (1906). In that case, the Court declared that the thirteenth amendment did not protect individual rights which were not connected with slavery. The Court in *Jones* overruled *Hodges* to the extent that its interpretation of the thirteenth amendment was inconsistent with the holding in *Jones*. 392 U.S. at 441 n.78. *See Civil Rights Cases*, 109 U.S. 3, 24-25 (1883), where the Court stated that it would run the slavery argument into the ground to apply it to private action. *Contra*, United States v. Morris, 125 F. 322, 330 (E.D. Ark. 1903) where the court stated that private discrimination involves an element of servitude within the meaning of the thirteenth amendment if the denial of fundamental rights is based solely on race or color.

17. "Neither slavery nor involuntary servitude, except as a punishment for crime . . . shall exist within the United States, or any place subject to their jurisdiction." U.S. CONST. amend. XIII, § 1. Section 2 of the amendment gives the power to Congress to enforce § 1 by appropriate legislation. The Court in *Jones* held that this enabling clause gave Congress the power to enforce § 1 by removing all "badges and incidences" of slavery. 392 U.S. at 438-39.

18. 392 U.S. at 441-43.

19. In a collateral issue, the Court held that § 1982 was not superseded by the provisions of the Fair Housing Act, 42 U.S.C. §§ 3601-31 (Supp. IV, 1968).

20. See note 1 *supra* for the text of the statute. The language of the statute is declaratory and is not framed in the form of a command or prohibition.

21. 392 U.S. at 414 n.14.

Since the decision in *Jones*, however, federal district courts have allowed both damages and equitable relief,[22] relying on ample precedent to the effect that the existence of a statutory right implies an appropriate remedy.[23] Furthermore, 28 U.S.C. section 1343(4)[24] and 42 U.S.C. section 1988[25] have provided a basis upon which damages can be awarded by giving the federal courts original jurisdiction to award damages and other relief necessary to effectuate the policy expressed by these statutes.[26] Since these statutes are bottomed on federal rights, actions originating in state courts would also be governed by the appropriate remedies.[27] Later cases in the lower federal courts have extended the *Jones* principles to the sale of used residences,[28] and the

22. *See, e.g.*, Pina v. Homsi, 1 RACE REL. L. SURVEY 183 (D. Mass. July 10, 1969); Newbern v. Lake Lorelei, Inc., 1 RACE REL. L. SURVEY 185 (S.D. Ohio April 22, 1969). In the *Newbern* case, the court found that the property owners' association, from which the plaintiffs had been excluded on the basis of race, was an alter ego of the real estate corporation which refused to sell land to the plaintiffs because they could not obtain membership in the association. In this manner, the court managed to avoid the question which was decided in the instant case—whether discrimination by a third party to the property transaction violates § 1982.

23. *See, e.g.*, Wyandotte Transp. Co. v. United States, 389 U.S. 191 (1967) (judgment in personam allowed although not provided by statute); Deckert v. Independence Shares Corp., 311 U.S. 282 (1940) (equitable relief granted although the act did not state the procedure the claimant was to employ); Texas & Pac. Ry. v. Rigsby, 241 U.S. 33 (1916) (civil cause of action given under act giving only a penal remedy).

24. The section states: "The district courts shall have original jurisdiction of any civil action authorized by law to be commenced by any person . . . [t]o recover damages or to secure equitable or other relief under any Act of Congress providing for the protection of civil rights, including the right to vote." 28 U.S.C. § 1343(4) (1964). This section does not require that the amount in controversy exceed $10,000.

25. The section states: "The jurisdiction in civil . . . matters conferred on the district courts by the provisions of this chapter and Title 18, for the protection of all persons in the United States in their civil rights . . . shall be exercised and enforced in conformity with the laws of the United States, so far as such laws are suitable to carry the same into effect; but in all cases where they are not adapted to the object, or are deficient in the provisions necessary to furnish suitable remedies and punish offenses against law, the common law, as modified and changed by the constitution and statutes of the State wherein the court having jurisdiction of such civil or criminal cause is held, so far as the same is not inconsistent with the Constitution and laws of the United States, shall be extended to and govern the said courts in the trial and disposition of the cause . . . ." 42 U.S.C. § 1988 (1964).

26. *See, e.g.*, Brazier v. Cherry, 293 F.2d 401 (5th Cir. 1961), *cert. denied*, 368 U.S. 921 (1961); Pritchard v. Smith, 289 F.2d 153 (8th Cir. 1961). Both cases, utilizing § 1988, involve the application of state survival statutes in determining survival of a cause of action under federal civil rights statutes.

27. *See, e.g.*, Testa v. Katt, 330 U.S. 386 (1947), where, in an action originating in state court under the Emergency Price Control Act, the court stated: "If an act of Congress gives a penalty to a party aggrieved, without specifying a remedy for its enforcement, there is no reason why it should not be enforced, if not provided otherwise by some act of Congress, by a proper action in a State court." *Id.* at 391. The Court also pointed out that states are not free to refuse enforcement of a federal law if it has jurisdiction.

28. Contract Buyers League v. F. & F. Inv., 300 F. Supp. 210 (N.D. Ill. 1969).

leasing of houses[29] and apartments.[30]

In the present case, the Court, noting that section 1982 reached discriminatory actions by private parties, held that the defendant's conduct was clearly prohibited. The Court found that the membership share, whether it was considered to be either realty or personalty, was within the protection of section 1982, since a portion of the purchase price for the leasehold was in consideration for the assignment of the share. Holding that the right to lease is protected from the discriminatory actions of third parties as well as the immediate lessor,[31] the Court found that the defendant's "action in refusing to approve the assignment of the membership share to be clearly an interference with the right to 'lease'."[32] In addition, the Court found that the expulsion of the lessor was also a violation of 1982, reasoning that punishment for trying to vindicate protected minority rights would serve to perpetuate racial restrictions on property. Although 1982 has no provisions for damages, the Court held that "the existence of a statutory right implies the existence of all necessary and appropriate remedies."[33] Analogizing from section 1988, the Court directed that both state and federal rules of damages could be utilized to fashion a remedy consistent with federal policy.[34] In his dissent Justice Harlan objected to the Court's ruling, considering it unwise to expand a vague statute in an area where Congress has already provided comprehensive legislation.[35] Furthermore, the dissent felt that the Court's interpretation of section 1982 was not definitive on either the issue of statutory coverage or damages and added further confusion to an already vague statute.

---

29. Vaughn v. Ting Su, 1 RACE REL. L. SURVEY 45 (N.D. Cal. July 19, 1968); Bush v. Kaim, 297 F. Supp. 151 (N.D. Ohio 1969).

30. Taylor v. Castagna, 1 RACE REL. L. SURVEY 43 (S.D.N.Y. Dec. 13, 1968); Pina v. Homsi, 1 RACE REL. L. SURVEY 183 (D. Mass. July 10, 1969).

31. "There has never been any doubt but that Freeman paid part of his $129 monthly rental for the assignment of the membership share in Little Hunting Park." 396 U.S. at 236-37.

32. *Id.*

33. *Id.* at 239.

34. "[A]s we read § 1988 . . . both federal and state rules on damages may be utilized, whichever better serves the policies expressed in the federal statutes." *Id.* at 240.

35. Justice Harlan, relying on Riee v. Sioux City Cemetery, 349 U.S. 70 (1955), was of the opinion that the writ of certiorari should be dismissed as improvidently granted in light of the 1968 Fair Housing Act. In that case, a statute, which did not govern the petitioner's case, but which deeided precisely the same issues as were before the Court, caused the writ of certiorari to be dismissed. The Court stated that its jurisdiction should not be utilized "for the benefit of particular litigants." *Id.* at 74. The *Jones* Court dismissed this contention by pointing out that the 1968 Fair Housing Act and § 1982 have remarkably different coverage. 392 U.S. at 417 n.21. For a comparison of the coverage of the 2 statutes, see Smedley, *A Comparative Analysis of Title VII and Section 1982*, 22 VAND. L. REV. 459 (1969).

Rights created by statute would be meaningless if there were not a judicial remedy provided for the disregard of such rights when no explicit remedy exists within the statutory framework itself. Rights are dependent upon remedies for their redress; denial of such relief would, in effect, transfer the consequences of the legal wrong to the victim, causing him to suffer in his innocence. To infer such a purpose to Congress would be paradoxical—recognizing a right while denying its effectiveness. This assumes, of course, that the right recognized is the right which the legislature intended to protect. Arguable ambiguities aside, it is not unusual that the Court, holding that protection against private discrimination was the right created by Congress in 1866, provided monetary and equitable relief commensurate with the broad scope of the Act.[36] Accepting, *arguendo,* that section 1982 bars private discrimination, the Court was not really breaking new ground by allowing damages, but was applying an established legal principle to section 1982. It has long been held that

> [t]he power to *enforce* implies the power to make effective the right of recovery afforded by the act. And the power to make the right of recovery effective implies the power to utilize any of the procedures or actions normally available to the litigants according to the exigencies of the particular case.[37]

Furthermore, when the statute which condemns the act is bottomed on a federal right, it becomes the duty of any court of competent jurisdiction, whether it be a state or federal court, to afford a remedy for breach of the statutory duty consistent with federal policy. Conflicting state law and policy must yield. In this respect, federal policy can be inferred from other statutory authority. As mentioned earlier, section 1343(4) confers original jurisdiction upon federal district courts for damages or other equitable relief for violation of any civil rights statute.[38] Section 1988 also allows these courts to use whatever other remedies are available to protect these rights where the statute does not provide an adequate remedy.[39] In utilizing section 1988, a simple test evolves: "what is needed in the particular case . . . to make the civil rights statutes fully effective?"[40] The reasoning process is relatively simple: first look to federal law; if it is not sufficient, then apply state law. State law may be used whenever it is appropriate to supplement the federal remedy. Congress, having the

36. 396 U.S. at 238-40. The Court also extended the application of § 1982 to third parties to the lease, when their actions amount to an interference with the right to lease.

37. Deckert v. Independence Shares Corp., 311 U.S. 282, 288 (1940).

38. *See* note 24, *supra.*

39. *See* notes 25 & 27 *supra* and accompanying text.

40. Brazier v. Cherry, 293 F.2d 401, 409 (5th Cir.), *cert. denied,* 368 U.S. 921 (1961).

power to create the right, also has the power to prescribe the remedy. "It [section 1988] reflects a purpose on the part of Congress that the redress available will effectuate the broad policies of the civil rights statutes."[41] In order to carry out the purpose of Congress under 1982, or any other civil rights statute, both state and federal courts should apply a remedy with protection of the individual's civil rights as the overriding consideration. Unfortunately, the Court failed to set any guidelines for the measure of damages and has apparently left this to the discretion of the lower courts on a case-by-case basis. As a result, widely divergent remedies have been utilized, with no consistent patterns developing.[42] While flexibility is desired in the area of compensatory damages, the application of a federal right requires some degree of uniformity in determining the other types of damages to be awarded, in order to assure an equal application of the laws to all citizens. The problem is especially apparent in the areas of punitive damages and awards of attorneys' fees. It is submitted that these awards are proper and should be allowed with the Court setting the guidelines for their application. For example, actions evincing an element of maliciousness or wantonness could be used as the standard for allowing punitive damages. Attorneys' fees should also be awarded since this has been one of the greatest obstacles to bringing an action to enforce civil rights. Such relief would equalize section 1982 with the 1968 Act in this area.[43]

---

41. *Id.* at 408.

42. An analysis of the cases which have been decided in federal district courts under § 1982 since the ruling in *Jones* demonstrates this fact. Some courts have allowed: attorneys' fees, *e.g.*, Pina v. Homsi, 1 RACE REL. L. SURVEY 183 (D. Mass. July 10, 1969); damages for mental distress, *e.g.*, Vaughn v. Ting Su, 1 RACE REL. L. SURVEY 45 (N.D. Cal. July 19, 1968); and punitive damages, *e.g.*, Newbern v. Lake Lorelei, Inc., 1 RACE REL. L. SURVEY 185 (S.D. Ohio April 22, 1969). On the other hand, damages have been denied altogether in Lee v. Southern Home Sites Corp., 1 RACE REL. L. SURVEY 131 (S.D. Miss. April 7, 1969), on the basis that the plaintiff suffered no harm since he was allowed to purchase the lot under court order. The court in Harris v. Jones, 296 F. Supp. 1082 (D. Mass. 1969), refused any monetary relief, applying a de minimus rule. In these last 2 cases, apparently the courts were concerned only with compensatory damages, not considering relief for mental distress, attorneys' fees, or punitive damages.

43. The 1968 Act allows the court to award attorneys' fees. 42 U.S.C. § 3612(c) (Supp. IV, 1968). For a good discussion of the possible guidelines for remedies under § 1982 and a comparison with remedies provided in the 1968 Fair Housing Act, see Note, *supra* note 7, at 1035-54. The author also suggests that punitive damages could be given as an alternative to attorneys' fees. *Id.* at 1039-40.

## Constitutional Law—Donble Jeopardy—*Benton v. Maryland* Applies Retroactively to State Criminal Convictions

Appellant was acquitted of a first degree murder charge, but was convicted of first degree manslaughter.[1] On appeal to the Supreme Court of Kansas, the conviction was reversed because of an erroneous instruction.[2] The trial court, on remand, rejected appellant's contention that she could be reprosecuted only for first degree manslaughter and charged her with first degree murder. The jury again returned a first degree manslaughter conviction which the Supreme Court of Kansas affirmed.[3] Appellant filed a petition for habeas corpus with a federal district court contending that the Supreme Court's decision in *Benton v. Maryland*[4] applied retroactively to prevent state courts from twice subjecting one to jeopardy for the same offense.[5] The district court dismissed the petition. On appeal to the Court of Appeals for the Tenth Circuit, *held*, reversed. The constitutional prohibition against double jeopardy applies retroactively to state criminal convictions. *Booker v. Phillips*, 418 F.2d 424 (10th Cir. 1969).

Supreme Court decisions involving a constitutional rule carry no constitutional mandate that the rule must be applied either prospectively or retrospectively.[6] At common law, the Blackstonian view (the declaratory theory) applied judicial decisions retroactively

1. Appellant, Edna Mae Booker, was charged with the murder of her husband, James Booker, after an argument concerning her extramarital relations.

2. State v. Booker, 197 Kan. 13, 415 P.2d 411 (1966). The erroneous instruction involved a statute which prohibited anyone other than a law enforcement officer from carrying a concealed weapon. Since appellant was not charged with carrying a concealed weapon, the instruction was found to be prejudicial to appellant's rights.

3. State v. Booker, 200 Kan. 166, 434 P.2d 801 (1967). After this decision, appellant began serving her sentence from which she now seeks a release.

4. 395 U.S. 784 (1969) (double jeopardy clause of the fifth amendment applicable to states through the fourteenth amendment).

5. Appellant claimed protection under the fifth amendment. U.S. CONST. amend. V: "[N]or shall any person be subject for the same offense to be twice put in jeopardy of life or limb . . . ."

6. *See* Johnson v. New Jersey, 384 U.S. 719, 728 (1966) (Escobedo v. Illinois, 378 U.S. 478 (1964), and Miranda v. Arizona, 384 U.S. 436 (1966), do not apply retroactively). At least one author has suggested that a prospective decision is one which only operates in the future and has no effect on the parties in the case, while a retroactive or retrospective decision looks backward to the rights of convicted parties. *See, e.g.*, Note, *Criminal Procedure—Retroactivity And The Linkletter Case*, 39 TEMP. L.Q. 81, 82-84 (1965). Even though this strict definition of prospectivity would not have included the defendant in *Benton*, the Supreme Court applied its decision to the defendant. Consequently, this comment uses "prospective" to mean a decision affecting parties in their case and in the future. Retroactivity can have different meanings including "limited" and "unlimited" effect. For an analysis, see Annot., 14 L. Ed. 2d 992, 993 n.4 (1965).

because judges were viewed as discoverers of law which had always existed.[7] Consequently, overruled decisions were never law, and new rules demanded retroactive application. The concept of prospectivity, which was a subsequent development, is premised on the assumption that prior decisions are valid law until judges make new law. Therefore, a change in judicial interpretation necessitates only prospective application.[8] American courts exercised an almost exclusive preference for the retroactive view[9] until Justice Cardozo contended that a state could choose to apply a principle either backward or forward.[10] Recognizing this choice, the Supreme Court rendered numerous criminal law decisions in the 1960's which necessitated a ruling as to their retroactivity. Initially, the Court reasoned that if the new constitutional rule affected the integrity of the fact-finding process, it must be given retroactive treatment. Various rules which have fallen within this category and have been applied retroactively are as follows: the right to counsel at trial,[11] at some forms of arraignment,[12] or on appeal;[13] the inadmissability of clearly coerced confessions;[14] and the availability of transcripts to indigents.[15] Despite this general guideline, the Supreme Court faced the prospect of answering numerous retroactivity questions without a clear cut standard. In order to expedite this determination, the Court established a test in *Linkletter v. Walker*[16] that balances three criteria: "(a) the purpose to be served by the new standards, (b) the extent of the reliance by law enforcement authorities on the old standards, and (c) the effect on the administration of justice of a retroactive application of the new

7. *See, e.g.*, Linkletter v. Walker, 381 U.S. 618, 622-24 (1965); 1 W. BLACKSTONE COMMENTARIES 69 (3d rev. ed., T. Cooley ed. 1884); Note, *supra* note 6.

8. *See, e.g.*, Linkletter v. Walker, 381 U.S. 618, 622-24 (1965); Note, *supra* note 6. The best example of the reasoning behind a prospective ruling is a contract made in reliance upon a court decision. The validity of the contract should not be adversely affected by future court decisions.

9. *See, e.g.*, Norton v. Shelby County, 118 U.S. 425 (1886) (an act held unconstitutional was treated as though it had never been passed).

10. Great N. Ry. v. Sunburst Oil & Ref. Co., 287 U.S. 358, 364 (1932) (states may decide whether to apply new interpretations of common or statutory law prospectively or retrospectively). *See, e.g.*, Drainage Dist. v. Baxter State Bank, 308 U.S. 371, 374 (1940) (an all-inclusive statement of a principle of absolute retroactive invalidity cannot be justified).

11. Gideon v. Wainwright, 372 U.S. 335 (1963).

12. Hamilton v. Alabama, 368 U.S. 52 (1961).

13. Douglas v. California, 372 U.S. 353 (1963).

14. Jackson v. Denno, 378 U.S. 368 (1964).

15. Eskridge v. Washington, 357 U.S. 214 (1958).

16. 381 U.S. 618 (1965). The Court denied retroactivity to its holding in Mapp v. Ohio, 367 U.S. 643 (1961), that illegally seized evidence must be excluded in state prosecutions.

standards."[17] This more specific test suggests that if the purpose of the new rule affects the fairness of a trial, the rule will be applied retroctively. Since *Linkletter*, however, the trend has been to utilize the three factors and deny retroactivity to numerous decisions: for example, the right to trial by jury in state criminal cases;[18] the right to counsel at a pretrial lineup;[19] the violation of the privilege against self-incrimination when the prosecutor or trial judge comments upon a criminal defendant's failure to testify,[20] and the *Miranda* warnings.[21] In the area of double jeopardy, the Court's most recent pronouncement in *Benton v. Maryland*[22] held that the double jeopardy clause of the fifth amendment is applicable to the states. The Court's failure, however, to state whether its holding was retroactive or prospective allowed state and federal courts to rule upon *Benton's* retroactivity. The first court to address itself to this question was the Missouri Supreme Court in *Spidle v. State*,[23] which indicated that the purpose of *Benton* was analogous to the purpose behind granting the right to a jury trial in state criminal cases.[24] Because the Supreme Court had held the latter right prospective,[25] the Missouri Supreme Court similarly held *Benton* prospective.[26]

In determining whether *Benton* has retroactive effect, the instant court applied the *Linkletter* test[27] and assumed that the purpose of the *Benton* rule was the decisive criterion. The court suggested that *Benton's* purpose was twofold: (1) to prevent the state, with its superior resources, from repeatedly attempting to convict the accused; and (2) to avoid the social stigma, harassment, expense, and ordeal that accompany a trial.[28] Since the effect of this purpose went to the

17. Stovall v. Denno, 388 U.S. 293, 297 (1967).

18. DeStefano v. Woods, 392 U.S. 631 (1968) (Duncan v. Louisiana, 391 U.S. 145 (1968), does not apply retroactively).

19. Stovall v. Denno, 388 U.S. 293 (1967) (United States v. Wade, 388 U.S. 218 (1967), and Gilbert v. California, 388 U.S. 263 (1967), do not apply retroactively).

20. Tehan v. United States *ex rel.* Shott, 382 U.S. 406 (1966) (Griffin v. California, 380 U.S. 609 (1965), does not apply retroactively).

21. Johnson v. New Jersey, 384 U.S. 719 (1966) (Escobedo v. Illinois, 378 U.S. 478 (1964), and Miranda v. Arizona, 384 U.S. 436 (1966), do not apply retroactively).

22. 395 U.S. 784 (1969) (overruling Palko v. Connecticut, 302 U.S. 319 (1937)). *See* note 4 *supra*; 22 VAND. L. REV. 1394 (1969).

23. 446 S.W.2d 793 (Mo. 1969).

24. Duncan v. Louisiana, 391 U.S. 145 (1968) (right to jury trial guaranteed in all criminal cases that would come within sixth amendment guarantee if tried in a federal court).

25. DeStefano v. Woods, 392 U.S. 631 (1968).

26. A contrary conclusion was recently reached in Galloway v. Beto, 38 U.S.L.W. 2390 (5th Cir. Jan. 6, 1970).

27. Text accompanying note 17 *supra*.

28. *See, e.g.*, Benton v. Maryland, 395 U.S. 784, 795-96 (1969), *quoting* Green v. United States, 355 U.S. 184, 187-88 (1957); 22 VAND. L. REV. 1394, 1395 n.4 (1969).

inherent fairness and integrity of the fact finding process, the *Benton* rule fell within the category of constitutional law cases that has been applied retroactively.[29] The court further reasoned that the reliance factor and the effect on the administration of justice support a retroactive application of *Benton*. Reliance by law enforcement officials upon *Palko v. Connecticut*,[30] the old standard, was not sufficiently persuasive to apply *Benton* prospectively because *Palko* had been under attack for several years. Relying upon the purpose of *Benton*, the court concluded that it must be given retroactive effect and applied to prior state criminal convictions.

In its opinion the instant court failed to discuss thoroughly the merits and demerits of each element in the *Linkletter* test. The purpose factor should be used to ascertain whether the underlying purpose of the court's decision could be adequately effectuated without retroactivity. Answering this question in the negative, the instant court indicated that the purpose of *Benton* must be given retroactive effect since it pertains to the integrity of the fact-finding process.[31] Implicit in this argument is the assumption that there is a "serious risk that the issue of guilt or innocence may not have been reliably determined"[32] in the appellant's trial. Double jeopardy, however, has little relation to the reliability of the determination of the accused's guilt,[33] because the

29. Text accompanying notes 11-15 *supra*.

30. 302 U.S. 319 (1937). Even though under attack by scholars, *Palko* had allowed states to subject the accused to double jeopardy in the absence of a controlling state constitutional provision. *See* United States *ex rel.* Hetenyi v. Wilkins, 348 F.2d 844 (2d Cir. 1965), *cert. denied*, 383 U.S. 913 (1966).

31. The argument stressing the integrity of the fact-finding process has firm proponents as well as critics. *Compare* Mishkin, *The Supreme Court, 1964 Term, Foreword: The High Court, the Great Writ, and the Due Process of Time and Law*, 79 HARV. L. REV. 56 (1965), *with* Schwartz, *Retroactivity, Reliability, and Due Process: A Reply to Professor Mishkin*, 33 U. CHI. L. REV. 719 (1966). A strict interpretation of this argument theorizes that new constitutional rules apply prospectively unless a fair trial was totally impossible without this right. Despite the ease with which courts specify the integrity of the fact-finding process, its value as the sole factor for granting retroactivity may be unjustified in light of the Supreme Court's decision in Tehan v. United States *ex rel.* Shott, 382 U.S. 406 (1966). In this decision, the Court denied retroactivity to Griffin v. California, 380 U.S. 609 (1965), which prohibited judges and prosecutors from commenting upon the accused's failure to testify. Certainly, this right goes to the essence of a fair trial.

32. Roberts v. Russell, 392 U.S. 293, 295 (1968) (per curiam).

33. *See* Schwartz, *supra* note 31, at 741. It can be argued that facing double jeopardy subjectively affects the fairness of a trial. For example, although the Tenth Circuit concluded that the accused should have been charged with first degree manslaughter, the defendant was charged with first degree murder in his retrial. The jurors, reasoning that the crime was not sufficiently heinous to justify the charge, may have agreed upon a lesser degree of punishment. Thus the degree of punishment was possibly affected by the charge of first degree murder. If the accused had faced the proper manslaughter charge, the punishment may have been even less. The strength of this reasoning, however, may be too speculative to justify a retroactive application of *Benton*.

right to be free from double jeopardy involves immunity from trial and not the fairness of the trial.[34] In *Benton*, the Supreme Court suggested a different interpretation of the purpose behind its ruling by analogizing double jeopardy with the right to trial by jury.[35] Since the Supreme Court denied retroactivity to the fundamental right to jury trial,[36] the conclusion follows that the Court, reasoning that the purpose of *Benton* can be accomplished without granting retroactivity, will deny retroactivity to *Benton*.[37]

Similarly, the reliance by law enforcement officials and the effect on the administration of justice prescribe that *Benton* be ruled prospective. The prosecutor in the instant case justifiably relied upon the prior status of the law and could not have been reasonably expected to act in accord with anticipated legal changes.[38] Finally, the possibility that the retroactive application of a constitutional rule will free many convicted prisoners merits more consideration than the court's opinion allowed.[39] The floodgate problem, however, has been discounted in the double jeopardy area since almost every state already has some type of double jeopardy provision in its constitution.[40] This would seem to militate against an alleged opening of the floodgates on the theory that few convicts are in state prisons because they were erroneously subjected to double jeopardy under state law. Even if this were true, *Benton* may imply that federal standards of double jeopardy[41] must be

34. *See* Galloway v. Beto, 38 U.S.L.W. 2390 (5th Cir. Jan. 6, 1970).

35. 395 U.S. at 794. The instant court and the Supreme Court in *Benton* both quoted identical language relating to repeated state prosecutions from Green v. United States, 355 U.S. 184, 187-88 (1957). The Supreme Court, however, immediately related such language to the right to trial by jury. *Id.* at 796.

36. DeStefano v. Woods, 392 U.S. 631 (1968).

37. Another possible purpose for double jeopardy protection is to restrain the discretionary power of prosecutors to choose the offense for prosecution of the accused. *See, e.g.*, J. SIGLER, DOUBLE JEOPARDY 15, 155-87 (1969). This purpose could not be served by a retroactive ruling that would have no effect on power already exercised.

38. The importance of the reliance factor in the area of constitutional rights has been noted. *See, e.g.*, Schaefer, *The Control of "Sunbursts": Techniques of Prospective Overruling*, 42 N.Y.U.L. REV. 631, 646 (1967).

39. The court only indirectly mentioned this factor in its conclusion by holding that the writ of habeas corpus should be granted or the prisoner should receive a third trial. If the convicted person receives another trial, the instant court's own interpretation of *Benton's* purpose as the avoidance of repeated trials would be defeated. Granting the writ frees the accused and lends support to the floodgate argument. For an expression of the 2 views concerning the importance of the floodgate theory, *compare* United States v. Clifton, 239 F. Supp. 49, 50-51 (D.D.C. 1965), *with* Schwartz, *supra* note 31, at 747. There are problems associated with a trial many years after an event, such as proof that has been destroyed and witnesses who have died. *See* United States *ex rel.* Angelet v. Fay, 333 F.2d 12, 21 (2d Cir. 1964); Comment, *Linkletter, Shott, and the Retroactivity Problem in Escobedo*, 64 MICH. L. REV. 832, 841 (1966).

40. J. SIGLER, *supra* note 37, at 78-79.

41. *See, e.g.*, 22 VAND. L. REV. 1394, 1396 n.15 (1969).

applied by the states, thus circumventing state definition of double jeopardy.[42] Even if a state had a double jeopardy provision, retroactive application of *Benton* would allow prisoners to petition under the federal double jeopardy standards with a consequent profusion of writs of habeas corpus. In conclusion, a more thorough analysis of the three elements in the *Linkletter* test suggests that the instant court erred in holding *Benton* retroactive. Consequently, it is submitted that the Supreme Court will deny retroactive application of *Benton* in accord with the Missouri Supreme Court's decision in *Spidle v. State*.[43]

## Copyright—Unfair Competition—Unauthorized Reproduction of Another's Recording for Resale Violates State Unfair Competition Doctrine

Plaintiff[1] sought a temporary injunction against the defendants[2] to restrain the sale of recordings allegedly pirated from plaintiff's phonograph record.[3] After purchasing this record, the defendant reproduced it without plaintiff's permission on magnetic tape cartridges at relatively low cost, intending to sell the product in direct competition with the plaintiff.[4] Plaintiff contended that the defendant's activities amounted to misappropriation[5] of his work product and

42. Two cases on the Supreme Court docket demonstrate the definitional problem associated with double jeopardy by questioning the meaning of the phrase "same offense" in the fifth amendment. *See* Ashe v. Swenson, 399 F.2d 40 (8th Cir. 1968); Waller v. State, 213 So. 2d 623 (Fla. 1968).

43. Text accompanying notes 23-26 *supra*

1. The plaintiff, Capitol Records, Inc., is one of America's leading producers of phonograph records.

2. The defendants included 5 individuals doing business as Phoenix Tapes.

3. In March of 1968, Capitol distributed for sale a record album by the popular vocal group, "The Lettermen," entitled "Goin' Out of My Head." This album enjoyed considerable success, grossing $500,000 for Capitol in 4 months and appearing as one of the top 100 albums on a music industry weekly survey of record sales for 16 weeks. Phoenix purchased the album on the open market and made a master recording. The master was used to produce tape cartridges that Phoenix sold to the general public. For a general discussion of record piracy, see Comment, *The Civil Remedies for Disklegging*, 33 S. CAL. L. REV. 190 (1960).

4. In May of 1968, a representative of Phoenix contacted a national tape distributor, told him that Phoenix was in the business of reproducing records and tapes cartridges recorded by other companies, and offered to sell the tape cartridge of "Goin' Out of My Head" by "The Lettermen" for less than the price charged by Capitol Records. When the distributor confronted the Phoenix representative with the question of record piracy, the representative responded that since Phoenix intended "to test the law," purchase of their product by a national distributor would be helpful. The distributor refused to buy the cartridge.

5. For a discussion of the doctrine of misappropriations, see notes 20-28 *infra* and accompanying text.

provided an unfair trade advantage for the defendant. Asserting that the plaintiff had no copyright in the record and that passing off[6] was not involved, the defendant claimed that the record was in the public domain and that the state had no power to enjoin its copy. The Superior Court, Los Angeles County, granted a preliminary injunction. On appeal[7] to the Court of Appeals, Second Division, *held,* affirmed. The unauthorized reproduction by a competing tape manufacturer of a record company's product for the purpose of resale is misappropriation and subject to injunction under a state's unfair competition doctrine. *Capitol Records, Inc. v. Erickson,* 2 Cal. App. 3d 526, 82 Cal. Rptr. 798 (1969).

The United States Constitution gives Congress the power "to promote the progress of Science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries."[8] Implementation of this power is found in the Copyright Act,[9] which enables the composer to secure a copyright in his musical composition.[10] The mechanical reproduction of the

6. For an explanation of passing off, see notes 18 & 19 *infra* and accompanying text. As evidence in support of its position, defendants produced the labels from one of the cartridges. On the front of the cartridge, a label indicated the title of the recorded performance and the name of the performer. On the back, a label disclosed the following information: "No relationship of any kind exists between Phoenix and the original recording company nor between this recording company and the original artists. The tape is not produced under a license of any kind from the original company nor the recording artist(s) and neither the original recording company nor artist(s) receives a fee or royalty of any kind from Phoenix. Permission to produce this tape has not been sought nor obtained from any party whatsoever." Although Phoenix paid no fee or royalty to Capitol or "The Lettermen," it did set aside the 2¢ royalty paid to the copyright proprietor of the musical composition as required by the Copyright Act. 17 U.S.C. § 1(e) (1964).

7. Under California law, an order granting a preliminary injunction is appealable. CAL. CIV. PROC. CODE § 904.1(f) (West Supp. 1969).

8. U.S. CONST. art. 1, § 8, ch. 8.

9. 17 U.S.C. §§ 1-216 (1964).

10. 17 U.S.C. § 5(e) (1964) (providing for the copyright of a musical composition). In addition, 17 U.S.C. § 1(e) (1964) grants to the composer the exclusive right to perform his musical work for profit and the right to make arrangements for the mechanical reproduction of his composition. Under this provision, the composer is entitled to a royalty of 2¢ per tune whenever the composition is reproduced mechanically.

Section 1(e), a provision of the 1909 Copyright Act, 17 U.S.C. § 1(e) (1964), was passed in response to the Supreme Court's decision in White-Smith Music Publishing Co. v. Apollo Co., 209 U.S. 1 (1908). The Court held that a perforated paper roll used by a player piano was not a "copy" of a composer's musical composition. The Court stated that "a copy of a musical composition . . . [is] 'a written or printed record of it in intelligible notation.'" *Id.* at 17. Section 1(e) abrogated the Court's interpretation that "the plaintiffs have no exclusive right to the production of the sounds indicated by or on those sheets of music; nor to the performance in private of the music indicated by such sheets; nor to any mechanism for the production of such sounds or music." *Id.* at 13.

musical composition, however, is not copyrightable.[11] Since their records are not protected against pirates by federal statute,[12] recording companies must seek protection under state law. The owners of noncopyrightable property interests have advanced several arguments in seeking protection, but the theories of common law copyright and unfair competition have been employed most frequently.[13] At common law, authors had the right of first publication of their literary work.[14] Similarly, recording companies have sought the protection of common law copyright on the basis that recording is an art and that a record is an artistic creation finding expression through the medium of mechanical reproduction.[15] Courts generally have rejected the application of the common law copyright doctrine to records on two grounds: 1) insufficient proprietary interest to warrant protection;[16] and 2) dedication to the public domain by the sale of records.[17] While this

11. *E.g.*, Capitol Records, Inc. v. Mercury Record Corp. 221 F.2d 657, 661 (2d Cir. 1955), Jerome v. Twentieth-Century Fox Film Corp., 67 F. Supp. 736, 742 (S.D.N.Y. 1946), *aff'd*, 165 F.2d 784 (2d Cir. 1948). The Copyright Office refused to admit a record for copyright in 1935 and the Register's ruling is quoted in Waring v. WDAS Broadcasting Station, Inc., 327 Pa. 433, 438 n.2, 194 A. 631, 633 n.2 (1937). This ruling is essentially embodied in 37 C.F.R. § 202.8 (6) (1959), which provides: "A phonograph record or other sound recording is not considered a 'copy' of the compositions recorded on it, and is not acceptable for copyright registration."

12. A Congressional Report discussing 17 U.S.C. § 1(e) (1964), suggested the purpose of the provision: "It is not the intention of the committee to extend the right of copyright to the mechanical reproductions themselves, but only to give the composer or copyright proprietor the control, in accordance with the provision of the bill, of the manufacture and use of such device." H.R. REP. NO. 2222, 60th Cong., 2d Sess. 10 (1909). *But see* Aeolian Co. v. Royal Music Roll Co., 196 F. 926 (W.D.N.Y. 1912) (a recording company was successful in obtaining protection for its music roll under the 1909 Act). The *Aeolian* decision has been discredited, however, because it was a result of the court's faulty analysis of the relatively new Act. Note, *Piracy on Records*, 5 STAN. L. REV. 433, 445 (1953).

13. In addition to common law copyright and unfair competition, copyright protection for noncopyrightable records also has been based upon the right of privacy and the theory of equitable servitude. For a discussion of these theories, see Note, *"Copyright" Protection for Uncopyrightables: The Common-Law Doctrines*, 108 U. PA. L. REV. 699, 717-28 (1960). Another author has suggested that protection could be based upon analogous trade name law. Comment, *supra* note 3, at 204-06.

14. The concept of common law copyright in the United States was articulated by the Supreme Court in Wheaton v. Peters, 33 U.S. (8 Pet.) 591 (1834), holding that the author's rights in his creation do not survive publication. Thus publication of an artistic work deprives the author of his copyright and places the work in the public domain where it can be freely copied. *See* Note, *supra* note 3, at 702-09.

15. *See* Traicoff, *Rights of the Performing Artist in His Interpretation and Performance*, 11 AIR L. REV. 225, 257 (1940); Comment, 64 HARV. L. REV. 682 (1951).

16. *E.g.*, R.C.A. Mfg. Co., Inc. v. Whiteman, 28 F. Supp. 787 (S.D.N.Y. 1939), *rev'd on other grounds*, 114 F.2d 86 (2d Cir. 1940) (holding that the recording process was not such an artistic creation as might be deemed an intellectual property right). *See* Note, *supra* note 12.

17. R.C.A. Mfg. Co., Inc. v. Whiteman, 114 F.2d 86 (2d Cir.), *cert. denied*, 311 U.S. 712 (1940); Shapiro, Berstein & Co. v. Miracle Record Co., 91 F. Supp. 473 (N.D. Ill. 1950).

approach has afforded little protection, the doctrine of unfair competition has provided substantial protection to the recording companies against record pirates. The theory of unfair competition was initiated by equity to prevent a person from profiting "from the labor, skill, expenditures, and reputation of others."[18] Originally, the concept of unfair competition was synonymous with a seller's passing off—the representation of another's product as his own. Courts granted relief because of the two wrongs which were inflicted: 1) the deceit and fraud on the public; *and* 2) the misappropriation of the benefit of a name, reputation, or business good will belonging to another.[19] Subsequent cases extended the concept of unfair competition beyond passing off, finding that the misappropriation alone of another's work product was sufficient to warrant relief from an unfair business practice.[20] This trend was initiated by the Supreme Court in *International News Service v. Associated Press*,[21] where the Court found that even in the absence of misrepresentation, the *INS* could not appropriate news dispatches from *AP* papers and bulletin boards. Broad language in that case,[22] however, evoked the fear that states, under the guise of the misappropriation doctrine, could create monopolies in areas that Congress had not intended the courts to protect. As a result of this

18. Metropolitan Opera Ass'n v. Wagner-Nichols Recorder Corp., 199 Misc. 786, 796, 101 N.Y.S.2d 483 (Sup. Ct. 1950), *aff'd*, 279 App. Div. 632, 107 N.Y.S.2d 795 (1st Dep't 1951); *accord*, Waring v. WDAS Broadcasting Station, Inc., 327 Pa. 433, 194 A. 631 (1937); Lehrenkrauss v. Universal Tours, 262 N.Y. 332, 186 N.E. 802 (1933).

19. In their zeal to do equity when dealing with unfair competition, courts often fail to distinguish between the following: 1) passing off; 2) wrongful injury, without misrepresentation, to another's established reputation or good will; and 3) misappropriation of another's expenditures and industry. Comment, *supra* note 15.

20. " 'Unfair competition,' as known to common law, is a limited concept. Primarily, and strictly, it relates to the palming off of one's goods as those of a rival trader. . . . In recent years, its scope has been extended. It has been held to apply to misappropriation as well as misrepresentation, to the selling of another's goods as one's own,—to misappropriation of what equitably belongs to a competitor." A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495, 531-32 (1935).

Implicit in the early unfair competition cases were 3 necessary elements: 1) passing off; 2) misappropration; and 3) competition. With the growth of the misappropriation doctrine in International News Serv. v. Associated Press, 248 U.S., 215 (1918), the necessity for passing off was eliminated. Furthermore, after Metropolitan Opera Ass'n v. Wagner-Nichols Recorder Corp., 199 Misc. 786, 101 N.Y.S.2d 493 (Sup. Ct. 1950), *aff'd*, 279 App. Div. 632, 107 N.Y.S.2d 795 (1st Dep't 1951), the competition requirement was attenuated at best. Goldstein, *Federal System Ordering of the Copyright Interest*, 69 COLUM. L. REV. 49, 57-61 (1969).

21. 248 U.S. 215 (1918).

22. The Court concluded that a person cannot reap what he has not sown and cannot appropriate to himself the harvest of those who have sown precisely at the point where the profit is to be reaped. *Id.* at 239-40. Furthermore, the Court indicated that if rights and privileges of competitors are likely to conflict, each party is under a duty to conduct business so as to avoid unnecessary harm to the other party. *Id.* at 235.

fear, the doctrine of *INS* has been judically restricted to analogous pirating situations.[23] In 1964, *Sears, Roebuck Co. v. Stiffel Co.*[24] and *Compco v. Day-Brite Lighting, Inc.*[25] called into question the efficacy of the protection given to noncopyrightable materials by the common law unfair competition doctrine.[26] It has been held that although these cases did not refer to the *INS* case, they have abrogated state protection based on the misappropriation theory. For example, one court relied on the cases in holding that the remedy of misappropriation no longer exists because the *INS* case was a federal common law decision and the theory was clearly overruled by *Sears* and *Compco*.[27] Several other post-*Sears* and *Compco* cases, however, have distinguished these two decisions on their facts and granted injunctive relief in misappropriation cases.[28]

In the instant case, the court utilized the common law doctrine of misappropriation[29] to reach its decision. Citing a long line of authority

23. *E.g.*, Ettore v. Philco Television Broadcasting Corp., 229 F.2d 481 (3d Cir. 1956) (telecast of fight film without fighter's permission); Columbia Broadcasting Sys., Inc. v. Documentaries Unlimited, Inc., 42 Misc. 2d 723, 248 N.Y.S.2d 809 (Sup. Ct. 1964) (use of a news broadcast without broadcaster's or company's consent was misappropriation); Metropolitan Opera Ass'n v. Wagner-Nichols Recorder Corp., 199 Misc. 786, 101 N.Y.S.2d 483 (Sup. Ct. 1950), *aff'd*, 279 App. Div. 632, 107 N.Y.S.2d 795 (1st Dep't 1951) (the sale of records made from radio broadcast was unfair competition); Mutual Broadcasting Sys. v. Muzak Corp., 177 Misc. 489, 30 N.Y.S.2d 419 (Sup. Ct. 1941) (transmission of radio broadcast over telephone lines was misappropriation); Twentieth Century Sporting Club v. Transradio Press Serv., 165 Misc. 71, 300 N.Y.S. 159 (Sup. Ct. 1937) (supplying of ringside description of a fight was unfair competition); Fisher v. Star Co., 231 N.Y. 414, 132 N.E. 133 (1921) (unauthorized use of comic strip characters was misappropriation).

24. 376 U.S. 225 (1964).

25. *Id.* at 234 (1964).

26. In both cases, the Court held that articles which were not given patents by the government were in the public domain and could be freely copied without prohibition by state unfair competition law. For a discussion by several scholars of the *Sears* and *Compco* decisions, see Symposium, *Product Simulation: A Right or Wrong?*, 64 COLUM. L. REV. 1178 (1964). *See also* Note, *Unfair Competition after Sears and Compco*, 22 VAND. L. REV. 129 (1968).

27. Columbia Broadcasting Sys. v. DeCosta, 377 F.2d 315 (1st Cir.), *cert. denied*, 389 U.S. 1007 (1967). *See* Cable Vision, Inc. v. KUTV, Inc., 335 F.2d 348 (9th Cir. 1964); Aerosol Research Co. v. Scoville Mfg. Co., 334 F.2d 751 (7th Cir. 1964). One author has suggested that *Sears* and *Compco* mark the "final demise" of the *INS* misappropriation doctrine. Treece, *Patent Policy and Preemption: The Stiffel and Compco Cases*, 32 U. CHI. L. REV. 80, 95 (1964).

28. *See, e.g.*, Flexitized, Inc. v. National Flexitized Corp., 335 F.2d 774, 781 (2d Cir.), *cert. denied*, 380 U.S. 913 (1964); Capitol Records, Inc. v. Greatest Records, Inc., 43 Misc. 2d 878, 252 N.Y.S.2d 553 (Sup. Ct. 1964); CBS v. Documentaries Unlimited, 42 Misc. 2d 723, 248 N.Y.S.2d 809 (Sup. Ct. 1964); Flamingo Telefilm Sales v. United Artists Corp., 141 U.S.P.Q. 461 (N.Y. Sup. Ct.), *rev'd on other grounds*, 22 App. Div. 2d 778, 254 N.Y.S.2d 36 (1st Dep't 1964).

29. *See* notes 20-28 *supra* and accompanying text. The court cited as persuasive authority a provision of the California Penal Code: "(a) Every person is guilty of a misdemeanor who: (1) Knowingly and willfully transfers or causes to be transferred any sounds recorded on a

beginning with *International News Service v. Associated Press*,[30] the court acknowledged that the law protects competition in business, but recognized that this protection does not give a competitor the right to usurp the product of another's expenditure and industry.[31] The court concluded that the defendant had appropriated the plaintiff's product for his own benefit and had not merely copied or imitated that product.[32] Applying this distinction between copying and appropriating, the court distinguished the *Sears* and *Compco* cases since "[n]either of those learned decisions stands for the proposition that the plaintiff is not entitled to protection against the unauthorized appropriation, reproduction, or duplication of the actual performance contained in its records."[33] Finally, the court emphasized that allowing such appropriation would have a discouraging effect on invention and free competition.[34]

When a court is asked to grant common law copyright protection to noncopyrightable articles based upon a theory of unfair competition, a fundamental socio-economic conflict looms before the court.[35] On one hand, a sense of equity urges the court to grant relief to prevent the unjust enrichment of the defendant.[36] On the other hand, the court may be tempted to deny relief because of a fear of monopoly and consequent injury to consumers and the public interest.[37] In the typical

---

phonograph record, disc, wire, tape, film or other article on which sounds are recorded, with intent to sell or cause to be sold, or to use or cause to be used for profit through public performance, such article on which sounds are so transferred, without the consent of the owner." CAL. PENAL CODE § 653 (h) (West Supp. 1969).

30. 248 U.S. 215 (1918).

31. Capitol Records, Inc. v. Erickson, 82 Cal. Rptr. 798, 801 (Ct. App. 1969).

32. *Id.* at 806.

33. *Id.* at 804, *quoting* Capitol Records, Inc. v. Greatest Records, Inc., 43 Misc. 2d 878, 881, 252 N.Y.S.2d 553, 556 (Sup. Ct. 1964).

34. Capitol Records, Inc. v. Erickson, 82 Cal. Rptr. 798, 806 (Ct. App. 1969).

35. For a discussion of this conflict, see Note, *supra* note 12, at 457-58. Recent challenges of the state's role in providing copyright protection have raised some doubt as to the viability of state copyright protection. *See* Goldstein, *supra* note 20; Treece, *supra* note 27; Note, *supra* note 13, at 728-34.

36. *See* Callmann, *He Who Reaps Where He Has Not Sown: Unjust Enrichment in the Law of Unfair Competition*, 55 HARV. L. REV. 595 (1942). The basis for this position is that courts are unwilling to allow a person to appropriate another's business as his own.

37. The granting of a copyright by definition permits a limited monopoly to encourage creativeness and inventiveness. One author has stated that "[t]he federal statute should surely be held to preclude free-wheeling protection under the name of unfair competition. The *INS* case, even if there be a disposition no longer to confine it to its facts, cannot be allowed to range very far." Kaplan, *Performer's Right and Copyright: The Capitol Records Case*, 69 HARV. L. REV. 409, 439 (1956). In this common law copyright situation, a fear of monopoly is created since the

record piracy case,[38] however, the threat of the creation of a monopoly for the recording company is nonexsistent since the Copyright Act provides that upon the composer's mechanical reproduction of his musical work, any other person may benefit from the performance subject to the royalty requirement.[39] In basing its decision upon the theory of misappropriation, the instant court chose the only method presently available to protect recording companies from record pirates. Although the court reached the correct result, the utilization of the misappropriation theory does not offer a permanent solution to the piracy problem.[40] Obviously, this area calls for statutory regulation. The Copyright Revision Act[41] would afford the recording companies statutory protection from record pirates. The proposed Act makes records copyrightable[42] and gives to the owner of the copyright in a sound recording the exclusive right to reproduce the work.[43]

state's protection could effectively circumvent the Constitution's provision for copyrights of limited duration. *See* note 8 *supra* and accompanying text. "Judge [Learned] Hand viewed the copyright clause of the Constitution, particularly in its restriction of congressional protection to 'limited times,' as a mandate with which both state and federal regulation must comply." Goldstein, *supra* note 20, at 51.

38. In the typical record piracy case, the pirated record is in current production. In the case at bar, Phoenix Tapes could have lawfully attempted to contract with "The Lettermen" or any other singers to perform the songs at issue in this case. Furthermore, Phoenix could have lawfully used its own equipment to capture that performance on tape, provided it paid the composer royalty. *See* note 39 *infra*. A different situation arises when the pirated records are out of print since the fear of monopoly in such cases is quite valid. For a discussion of the effect that limited production of "collector's" records can have on the market, see Note, *supra* note 12, at 433-43.

39. 17 U.S.C. § 1(e) (1964) provides in part that upon reproduction mechanically of a musical work by a composer, "any other person may make similar use of the copyrighted work upon the payment to the copyright proprietor of a royalty of 2 cents on each such part manufactured, to be paid by the manufacturer thereof. . . ." For a limited discussion of the history of § 1(e), see note 10 *supra*.

40. The utilization of the unfair competition theory as a basis for relief in this and similar cases is an *ad hoc* approach which the courts use "to fill the interstices occasioned by the application of an outdated copyright law in a culturally and economically expanding society." Goldstein, *Copyrighting the New Music*, 17 BUFFALO L. REV. 355, 369 (1968). Consequently, this approach engenders neither uniform regulation nor adequate remedy. As in the case at bar, the injunction granted applies to the pirate in one jurisdiction, but will not prevent his moving to another jurisdiction and pirating again. If the injunction is granted after the pirate has marketed his record, the harm may have already been done to the recording company. Finally, if the recording company seeks damages, it has a difficult burden in proving damages. The adequacy of these remedies is discussed in Note, 49 YALE L.J. 559, 560-61 (1940).

41. S. 543, 91st Cong., 1st Sess. (1969).

42. "Copyright protection subsists, in accordance with this title, in original works of authority fixed in any tangible medium of expression, now known or later developed, from which they can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. Works of authorship include the following categories: . . . (7) sound recordings." *Id.* § 102 (7).

43. The exclusive right to the reproduction of sound recordings would be regulated by § 106 as modified by § 114 of the proposed Act. *Id.* §§ 106, 114.

Furthermore, the proposed Act would furnish nationwide uniformity of regulation by specifically preempting the state's right to provide common law copyrights in sound recordings[44] and by providing the specific remedies available for copyright infringements.[45] Indeed, such legislation is long overdue.[46]

## Corporations—Attorney-Client Privilege—Corporate Employee's Communication to Attorney at Direction of Corporation Held to be Privileged

Plaintiffs, state and local governments, public schools, and public libraries, sought treble damages from defendants, publishers and wholesalers, in more than 40 separate antitrust actions for alleged conspiracies to inflate the prices for children's editions of library books.[1] The actions were transferred to the United States District Court for the Northern District of Illinois for consolidated discovery and pretrial proceedings.[2] Since many of the events central to the alleged price fixing occurred several years prior to the instigation of these actions, plaintiffs, in order to aid discovery, moved under Rule 34 of the Federal Rules of Civil Procedure for production of debriefing memoranda summarizing grand jury testimony of prospective deponents.[3] Defendants contended that the debriefing memoranda were

44. The appropriate section of the Act provides in part: "[A]ll rights in the nature of copyright in works that come within the subject matter of copyright as specified by sections 102 and 103 . . . are governed exclusively by this title. Thereafter, no person is entitled to copyright, literary or property rights, or any equivalent legal or equitable rights in any such work under the common law or statutes of any State." *Id.* § 301(a).

45. Copyright infringements are defined in § 507 of the proposed Act. *Id.* § 507. The specified remedies include: injunctions (*id.* § 502); impounding and disposition of infringing articles (*id.* § 503); damages and profits (*id.* § 504); and the imposition of criminal penalties (*id.* § 506).

46. The last major change in copyright law, which was basically a reshuffling of existing law, came in 1947 when copyright was codified in Title 17 of the United States Code. The last substantive change of copyright law was enacted in 1909. *See* Act of March 4, 1909, ch. 320, 35 Stat. 1075.

1. In the late 1950's, the publishing industry introduced a library edition of children's books with a reinforced binding specifically designed for use by public schools and libraries. Plaintiffs averred that defendants only quoted "net" prices for the library editions and overcharged them as a result of either (1) a horizontal agreement among the industry's book publishers, or (2) a series of vertical conspiracies between each publisher and its wholesalers.

2. The transfers were made pursuant to 28 U.S.C. § 1407 (Supp. IV, 1969).

3. The memoranda were prepared by defendants' attorneys while "debriefing" employees and former employees shortly after each had testified before a federal grand jury investigating the priee fixing. Each employee made his disclosure at the direction of his corporate employer in order to assist in defending against antitrust actions.

protected by the attorney-client privilege or, alternatively, as attorney's work products.[4] The district court held that since the employees interviewed were not in a position to influence the corporation's litigation response to the price fixing actions, the documents were not protected by the attorney-client privilege[5] and must be produced. Defendants sought mandamus to compel the district judge to vacate his order for production. The United States Court of Appeals for the Seventh Circuit, *held*, petition for writ of mandamus granted. When a corporate employee, at the direction of the corporation, makes a communication to the corporation's attorney concerning the employee's performance of his duties of employment, the communication is privileged. *Harper and Row Publishers, Inc. v. Decker*, 423 F.2d 487 (7th Cir. 1970).

The application of the attorney-client privilege[6] to corporations has raised a number of analytical difficulties because the privilege concept originally was developed to protect the individual client.[7] The initial problem has been whether the privilege is available to a corporation.[8] A substantial line of authority has treated corporations as clients for purposes of the privilege[9] on the assumption that no good reason exists for denying corporations the availability of the privilege. However, the district court in *Radiant Burners, Inc. v. American Gas*

4. Two facets of the attorney-client privilege were invoked. Defendants maintained that either a personal attorney-client privilege or an attorney-corporate client privilege existed between counsel and the interviewed employees.

5. The lower court found that defendants failed to present any factual support for their assertion of a personal privilege. Also, it noted that plaintiffs' need for discovery established good cause when compared to defendants' minimal work product claims.

6. In order for a communication to be protected by the privilege, the common law requires: (1) that a professional relationship be established between the client and his legal adviser; (2) that the communication be relevant to the legal problem involved; (3) that the communication be confidential; and (4) that the communication originate with the client or his authorized agent. 8 J. WIGMORE, EVIDENCE § 2292 (McNaughton Rev. 1961).

7. For an extensive discussion of the history and policy of the privilege, see Garner, *A Re-Evaluation Of The Attorney-Client Privilege* (pts. I & II), 8 VILL. L. REV. 279, 447 (1963).

8. If the privilege is available to protect a corporate communication, the communication must still satisfy the general common law requirements. *See* note 6 *supra*. *See generally* Comment, *The Lawyer-Client Privilege: Its Application to Corporations, the Role of Ethics, and Its Possible Curtailment*, 56 NW. U.L. REV. 235 (1961).

9. Corporations are specifically included in the definition of "clients" who are entitled to claim the privilege in one state statute and the model acts. N.J. STAT. ANN. § 2A:84A-20(3)(a) (Supp. 1969-70); MODEL CODE OF EVIDENCE rule 209(a) (1942); UNIFORM RULE OF EVIDENCE 26(3)(a). A number of federal and state cases have allowed corporations to assert the privilege as a client. *See, e.g.*, Cole v. Hughes Tool Co., 215 F.2d 924, 931 (10th Cir. 1954); Belanger v. Alton Box Bd. Co., 180 F.2d 87, 93-94 (7th Cir. 1950); Holm v. Superior Ct., 42 Cal. 2d 500, 267 P.2d 1025 (1954); Stewart Equip. Co. v. Gallo, 32 N.J. Super. 15, 107 A.2d 527 (L. Div. 1954).

*Association*[10] found good reason to deny the privilege. It held that corporations could not invoke the privilege because an attempt to fix complex corporate structures into the traditional framework of the privilege raised impossible problems. Although reversed on appeal, this holding has caused subsequent cases to discuss more carefully the problems inherent in an application of the privilege to corporate clients.[11] A second and more complex problem has been defining the class of persons entitled to speak for the corporate client.[12] Since the privilege only protects communications made by the attorney's *client*, and a corporation, as merely a legal entity, cannot speak except through its employees and agents, the relationship between the communicating agent and the corporation has to be analyzed to determine whether the agent acts for the corporation as the client. Much of the confusion in the federal courts regarding the proper test for client status stems from the landmark case of *Hickman v. Taylor*[13] and its offspring. In dealing with the protection against discovery of privileged matters under the Federal Rules of Civil Procedure,[14] many of the lower federal courts had failed to separate two overlapping

10. 207 F. Supp. 771 (N.D. Ill. 1962), *rev'd*, 320 F.2d 314 (7th Cir.), *cert. denied*, 375 U.S. 929 (1963). In *Radiant Burners* plaintiff brought an antitrust suit against defendant corporation and sought discovery of certain documents. Defendant alleged that the documents were privileged material. The decision denying the privilege to corporations was made the subject of extensive commentary, most of it critical. *See, e.g.*, 48 CORNELL L.Q. 551 (1963); 61 MICH. L. REV. 603 (1963).

11. *Compare* American Cyanamid Co. v. Hercules Powder Co., 211 F. Supp. 85 (D. Del. 1962) (disagreeing with *Radiant Burners* but recognizing the perplexity and problem of applying attorney-client privilege to corporations), *with* Philadelphia v. Westinghouse Elec. Corp., 210 F. Supp. 483 (E.D. Pa.), *mandate denied sub nom.*, General Elec. Co. v. Kirkpatrick, 312 F.2d 742 (3d Cir. 1962), *cert. denied*, 372 U.S. 943 (1963) (stating that availability of privilege to corporations is so generally accepted that it must be recognized as entrenched in American law). *See also* Maurer, *Privileged Communications And The Corporate Counsel*, 28 ALA. LAW. 352, 368 (1967).

12. For good discussions of all facets of the problem of who is the client, see Pye, *Fundamentals of the Attorney-Client Privilege*, 15 PRAC. LAW. 15, 18 (Nov. 1969); Simon, *The Attorney-Client Privilege as Applied To Corporations*, 65 YALE L.J. 953, 956-63 (1956).

13. 329 U.S. 495 (1947). In *Hickman* the client was a partnership whose attorney interviewed employees of the partnership in contemplation of litigation, and recorded his observations of these interviews. These observations were among the materials plaintiff sought to discover. Defendant partnership argued that the attorney-client privilege extended to the employees as third party witnesses. There was no mention of the possibility that the employees were speaking to the attorney on behalf of the partnership. Supplemental Memorandum for Respondent at 2-3, Hickman v. Taylor, 329 U.S. 495 (1947).

14. FED. R. CIV. P. 26(b), 34 (permitting depositions or discovery as to designated matters if "not privileged"). The term "privileged" seems to be intended in its traditional evidentiary sense. *See* United States v. Reynolds, 345 U.S. 1, 6 (1953); 4 J. MOORE, FEDERAL PRACTICE ¶ 26.22 (2d ed. 1969). As to whether state law defining privilege applies, see note 19 *infra* and accompanying text.

principles—the attorney-client privilege and the protection from discovery afforded certain documents and prospective witnesses' statements.[15] The Supreme Court in *Hickman* refused to apply the attorney-client privilege broadly to cover statements made by the client's employees to its attorney in the course of the attorney's preparation for trial;[16] instead, the Court recognized a qualified immunity from discovery for the "work product of the lawyer" and clarified the distinction between the two principles. Despite this apparently authoritative declaration by the Court of the proper scope of the attorney-client privilege, the lower courts have continued to formulate tests to determine the extent of the privilege.[17] Some of the courts have suggested as a test the mere presence of an agency relationship between the communicating agent and the corporation;[18] thus whenever any employee or corporate spokesman originates a communication for the advice of corporate counsel, the corporation is the client and the communication is privileged. A few federal courts have adopted the state law on the question of privilege as a test of client status.[19] Most federal courts have followed the "control group"

15. *See* Gardner, *supra* note 7, at 501. The author asserts that the confusion which has developed in the general law of privilege has resulted from this failure to recognize the distinction between the classical privilege and the quasi-privilege.

16. Summarily disposing of the argument that the privilege protected the statements, the Court declared: "For present purposes, it suffices to note that the protective cloak of this privilege does not extend to information which an attorney secures from a witness while acting for his client in anticipation of litigation. Nor does this privilege concern the memoranda, briefs, communications and other writings prepared by counsel for his own use in prosecuting the client's case; and it is equally unrelated to writings which reflect an attorney's mental impressions, conclusions, opinions or legal theories." 329 U.S. at 508.

17. Most authorities consider the statement in *Hickman* concerning the attorney-client privilege dictum. The opinion itself remarked that "it [was] unnecessary here to delineate the content and scope of the [attorney-client] privilege as recognized in the federal courts." *Id.* at 508. *See* Simon, *supra* note 12, at 958; 29 OHIO ST. L.J. 1046, 1050 & n.18 (1968).

18. United States v. United Shoe Mach. Corp., 89 F. Supp. 357 (D. Mass. 1950). The opinion of Judge Wyzanki can be read for the broad proposition that any persons not "strangers"—anyone "affiliated with the corporation as employees, officers, directors"—are qualified to speak for the corporate client. *United Shoe* and *Hickman* are factually distinguishable, but their ratio decidendi conflict since the latter stands for withholding the privilege from employee statements, the former for extending it. *Compare* Zenith Radio Corp. v. RCA, 121 F. Supp. 792, 794 (D. Del. 1954) (following *United Shoe* test in relation to the confidentiality requirement). Substantial authority has rejected the test as creating too great an immunity from discovery.

19. There exists a great deal of controversy as to whether a federal court is bound by state law in applying privileges, especially in federal question litigation. Most federal courts in diversity cases have considered themselves compelled to follow state law viewing the claim of privilege as substantive rather than procedural. The Seventh Circuit has clearly stated that a privilege granted by statute in the forum state is substantive and must be recognized in diversity litigation. Palmer v. Fisher, 228 F.2d 603 (7th Cir. 1955), *cert. denied*, 351 U.S. 765 (1956) ((statutory privilege

test[20] enunciated in *Philadelphia v. Westinghouse Electric Corp.*[21] In that case the court held that if a communication from an employee is to be privileged, the employee making the communication must be in a position to play a substantial role in making the corporation's decision after receiving advice from the attorney—the employee must be a member of the "control group" of the corporation.[22] Despite judicial acceptance, the control group test has been criticized as an unsatisfactory method of determining the extent of the corporate attorney-client privilege.[23]

The court in the instant case found that the district judge had followed substantially the "control group" test[24] and had not erred in his application of it.[25] The court determined, however, that the control group test is not wholly adequate, and that the communications of

for accountants). *Quaere* as to a privilege granted by state judicial decision? *See* Golminas v. Fred Teitelbaum Const. Co., 112 Ill. App.2d 445, 251 N.E.2d 314 (Ct. App. 1969) (adopting "control group" standard in Illinois as adequately defining the scope of privilege as applied to the corporate client). In federal question cases the majority of courts appear to adhere to the view that neither state statutes nor judicial decisions necessarily control. *But see* Baird v. Koerner, 279 F.2d 623 (9th Cir. 1960) (state privilege rule applicable in an administrative proceeding before the IRS); Leonia Amusement Corp. v. Loew's, Inc., 13 F.R.D. 438, 441 (S.D.N.Y. 1952) (the court in an antitrust suit looked to state law in construing the attorney-client privilege under FED. R. CIV. P. 26). Generally, state law has been more restrictive on the admission of evidence; hence the application of state law by the federal courts results in a broader privilege. For an excellent analysis of whether a federal court must apply state law of privilege, see Note, *Evidence: Federal Rules of Civil Procedure: Attorney-Client Privilege as Applied to Corporations,* 48 CORNELL L.Q. 551, 552 (1963).

20. *See, e.g.,* Natta v. Hogan, 392 F.2d 686 (10th Cir. 1968) (test is whether person has authority to control a decision regarding action to be taken); Garrison v. General Motors Corp., 213 F. Supp. 515 (S.D. Cal. 1963) (an employee not a member of a control group is not an agent of the corporation within the scope of privilege).

21. 210 F. Supp. 483 (E.D. Pa.), *mandate denied sub nom.,* General Elec. Co. v. Kirkpatrick, 312 F.2d 742 (3d Cir. 1962), *cert. denied,* 372 U.S. 943 (1963). Defendant's counsel had interviewed employees in connection with violations of the antitrust laws; plaintiff propounded interrogatories to defendant concerning information derived from these interviews. Defendant claimed the privilege, hut the court ordered answers to include all such information received.

22. A similar test appears in Rule 5-03(a)(3), Preliminary Draft of Proposed Rules of Evidence for the United States District Courts and Magistrates, March, 1969.

23. *See* Burnham, *Confidentiality and the Corporate Lawyer: The Attorney-Client Privilege and "Work Product" in Illinois,* 56 ILL. B.J. 542, 545-48 (1968); Lasky, *Lawyer-Client Privilege,* 38 CALIF. ST. B.J. 427, 442 (1963). Broader tests have been suggested. *See, e.g.,* D.I. Chadborne, Inc. v. Superior Ct., 60 Cal. 2d 723, 388 P.2d 700, 36 Cal. Rptr. 468 (1964) (sets forth specific instances when privilege extends beyond control group); Maurer, *supra* note 11, at 375; Pye, *supra* note 12, at 19.

24. 423 F.2d at 491. The court acknowledged that the test has been followed by other courts and appears in the Proposed Rules.

25. Although some of the employees had supervisory and even policy-making responsibilities, the court concurred with the lower court's finding that the employees were not members of the control group. *Id.* at 491.

some corporate agents who are not within the control group are protected by the corporation's attorney-client privilege.[26] It held that when, as in this case, the employee makes the disclosure to the attorney at the direction of his corporate employer and the subject matter is germane to his duties of employment, his communication to the corporation's attorney is privileged.[27] Since the district judge's order for production rested entirely upon the control group test, the court concluded that the extraordinary remedy of mandamus was appropriate.[28]

The control group test has been justified on the grounds that without such a restriction on corporate use of the attorney-client privilege a vast "zone of silence" would be created, insulating great numbers of corporate documents from discovery.[29] On the other hand, the test has been denounced as limiting the corporate privilege to the extent that the purposes of the privilege are negated.[30] The test unjustifiably denies the privilege to communications made by middle-management executives not in the control group, but who have responsibilities for making recommendations that are adopted by higher management as a matter of course.[31] Furthermore, the *Philadelphia* test is especially inadequate in the antitrust area, where low-ranking employees who are engaged in actions for which the corporation may be liable often are interrogated by corporate attorneys.[32] The instant decision by the Seventh Circuit tacitly

26. The court did not analyze the criticisms that have been made, nor did it discuss why the control group test was deemed by it inadequate.

27. The instant communications were distinguished from those where the agents act as third parties or witnesses: "It is clear we are not dealing in this case with the communications of employees about matters as to which they are virtually indistinguishable from bystander witnesses." *Id.* at 491.

28. Consideration of defendants' work product claims was not necessary, inasmuch as the debriefing documents were protected from discovery by the corporation privilege; nonetheless, the court noted that the district judge had also improperly restricted the application of the work product doctrine.

29. *See* 44 B.U.L. REV. 123, 129 (1964). Since the privilege does not bar the employee's testimony as to facts embodied in the communication, but only disclosure of the contents of the communication itself, the dimensions of the "zone of silence" have been exaggerated. The effect of the privilege lies in counsel's ability to make the opposition do its own work.

30. The purpose of the attorney-client privilege is to encourage open and candid disclosure between client and attorney. If the number of persons within a corporation who can represent it is limited, the purpose of the privilege is defeated by encouraging the corporation to be silent.

31. This observation is especially true in the instant case, for some of the employees interviewed were in policy-making positions and could have been ultimately responsible for the alleged price fixing policy.

32. Application of the test may discourage corporations from carrying on a vigorous program of antitrust compliance, since they may be developing evidence against themselves.

recognizes these inadequacies by abandoning the control group test in favor of a test that emphasizes the purposes for disclosure and the subject matter of the communications made. This test, proximating that of many state courts,[33] does not suggest distinctions among types of corporate agents, but rather seems to assume that any employee might speak for the corporate client if the disclosure is attributable to a corporate purpose. Such a view of not limiting the persons who can make communications avoids some of the problems inherent in the more restrictive tests but leaves a number of difficulties unresolved. First, the instant test flies in the face of the conflicting assumption in *Hickman* that some employees can only speak as third-party witnesses.[34] Secondly, the new test is susceptible to abuse, since nothing restricts the corporation from placing too much information within the protection of the privilege. The state courts have limited the "zone of silence" by a strict application of other requirements of the privilege, such as that the communication be legal in nature and confidential.[35] The only qualifications on the privilege set forth in the instant case—directed disclosure and germane subject matter—are incapable of preventing misuse. All employees of the corporate client could be directed to channel their regular business reports to the corporate attorney and, under the new test, such reports would then be privileged.

The instant court's departure from the control group test reflects a growing judicial awareness of the inequities that result from a mechanical application or non-application of absolute privilege.[36] The court recognizes the inadequacy of the control group test, but, unfortunately, fails to recognize that no test can be adequate to determine in all instances the applicability of the corporate privilege.

33. *See* Simon, *supra* note 12, at 960-62 for an analysis of state courts' handling of the corporate privilege.

34. *See* note 16 *supra* and accompanying text.

35. In applying the privilege, state courts have relied upon a number of tests to prevent ordinary business records from masquerading as attorney-client communications. The tests defy logical analysis but for classification purposes fall roughly into 3 groups: (1) the sole purpose test; (2) the multi-purpose test; and (3) the anticipation-of-litigation test. *See* Gardner, *A Personal Privilege for Communications of Corporate Clients—Paradox or Public Policy?* 40 U. DET. L.J. 299, 389 (1963); Simon, *supra* note 12, at 960-62.

36. In reversing *Radiant Burners,* the Seventh Circuit did not attempt to set out a test to which each communication would have to comply in order to fall within the privilege. "In balancing the competing goals of the free and unobstructed search for the truth with the right and absolute necessity for confidential disclosure of information by the client to its attorney to gain the legal advice sought thereby, the courts will realize they are not dealing with a blanket privilege. The limitation surrounding any information sought must be determined for each document separately considered on a case-by-case basis." Radiant Burners, Inc. v. American Gas Ass'n, 320 F.2d 314, 324 (7th Cir. 1963).

It is submitted that the most appropriate analysis is a case-by-case balancing approach, the application of the corporate privilege depending on whether the harm resulting from restricting discovery outweighs the benefit derived from the privilege. Utilizing this approach, the courts could look to the relative inaccessibility of other sources of information to the party seeking discovery in order to ascertain the harm in ruling the communication privileged.[37] Correspondingly, the social utility of the privilege and its incentive towards complete disclosure by the corporate client could be considered to determine the benefit of the privilege. Contemplating a change in the nature of the corporate privilege from absolute to discretionary, the balancing approach creates a corporate privilege distinct from the individual privilege. This is justifiable and desirable as a solution to the substantially different problems that are raised in applying the attorney-client privilege to corporations.

## Criminal Law—Homicide—Fetus is a Human Being Within Meaning of the Homicide Statutes When it Reaches the State of Viability

Petitioner, charged with aggravated assault upon his divorced wife and the murder of the 31 to 36 week-old unborn child she was carrying when the alleged assault took place, sought a writ of prohibition to stay his prosecution on the murder charge. The facts established that the petitioner told the mother that he was going to destroy the unborn child by beating her up and then proceeded to do so in a savage fashion.[1]

37. Factors apposite in this analysis would be: (1) the hostility and availability of witnesses to the moving party; (2) the lapse of time and its effect upon the witnesses' memories; and (3) the public policy desired in a particular type of litigation. These criteria are analogous to those now employed in determining good cause for the work product doctrine. *See generally* Hunt, *Corporate Law Department Communications—Privilege and Discovery,* 13 VAND. L. REV. 287 (1959).

1. "Mrs. Keeler had secured an interlocutory degree of divorce from petitioner . . . . On February 23, 1969, she was driving on a narrow mountain road . . . enroute to Stockton where she was living with another man in a nonmarital relationship. She was pregnant by this man. As she drove along, petitioner drove his own car in front of her, blocking her passage. She stopped, and he walked over to her and said he had heard of her pregnancy. He opened the door of her car and drew her out by the arm. He looked at her abdomen and said: 'You sure are. I'm going to stomp it out of you.' He pushed her back against the car with his hands on her shoulders and kicked his knee into her abdomen. He then struck her in the face several times. She lost consciousness. After the attack he left." Keeler v. Superior Ct. for County of Amador, 80 Cal.

Petitioner contended that a fetus is not considered in law a human being and that therefore, no homicide can be committed by one who terminates its fetal development.[2] On appeal to the California Court of Appeals, *held*, petition denied. A fetus which has reached the stage of viability, when premature separation from the mother would not end the child's life, is a human being within the meaning of the California homicide statutes. *Keeler v. Superior Court for County of Amador*, 80 Cal. Rptr. 865 (Dist. Ct. App. 1969).

The early common law did not attach human status to a fetus for the purposes of protection under the homicide statutes until quickening had occurred.[3] Quickening, or animation, usually occurs between the sixteenth and twentieth week of pregnancy.[4] By the mid-nineteenth century, however, the common law had shifted to the "born alive" theory. This theory stated that the unborn child is not a human being and hence cannot be the victim of homicide unless it is subsequently born alive.[5] Early cases under the rule required a complete live birth[6] as evidenced by an independent circulation.[7] The rule was rather ambiguous, however, since there was no recognized standard of what

---

Rptr. 865-66 (Dist. Ct. App. 1969). When the doctors examined her injuries she was bleeding extensively from the nose and mouth, had lacerations on her face requiring stitches, a fractured nose, and a tooth knocked out. On her abdomen were two or three crescent-shaped marks which appeared to be heel imprints. The doctor performing the Caesarean section to remove the fetus said its head "was constricted like a bag of mush." *Id.*

2. CAL. PENAL CODE § 187 (West 1955) defines murder as "the unlawful killing of a human being, with malice aforethought."

3. "A woman is said to be pregnant with a quick child, or quick with child, when the motion of the fetus becomes perceptible . . . ." State v. Patterson, 105 Kan. 9, 10, 181 P. 609, 610 (1919).

4. T. STEDMAN, MEDICAL DICTIONARY 1340-41 (1966).

5. R. PERKINS, CRIMINAL LAW 29 (2d ed. 1969). Sir Edward Coke described the "born alive" theory as the English law in the 18th century: "If a woman be quick with childe, and by a potion or otherwise killeth it in her wombe; or if a man beat her, whereby the childe dieth in her body, and she is delivered of a dead childe, this is a great misprision, and no murder; but if the childe be born alive, and dieth of the potion, battery, or other cause, this is murder: for in law it is accounted a reasonable creature, *in rerum natura*, when it is born alive." 3 E. COKE, THE THIRD PART OF THE INSTITUTES OF THE LAWS OF ENGLAND 50 (1797) (misprision, as used by Coke, means misdemeanor).

6. Rex v. Poulton, 172 Eng. Rep. 997 (Nisi Prius 1832). In this case the defendant was accused of killing her infant by strangulation, but the facts were unclear as to whether the child had died before or after the birth was completed. The Court at Old Bailey told the jury that a conviction of homicide was not possible unless the infant had been born alive. Being born alive, the court continued, requires, "that the whole body is brought into the world; and it is not sufficient that the child respires in the process of birth." *Id.* at 998.

7. In the case of Rex v. Enoch, 172 Eng. Rep. 1089 (Nisi Prius 1833), the court again held the complete live birth a prerequisite for a child to be sufficiently alive to be the subject of murder. That court's criterion of live birth was the establishment of "an independent circulation in the child." *Id.; accord,* Regina v. Wright, 173 Eng. Rep. 1039 (Nisi Prius 1841).

constituted a complete live birth or an independent circulation.[8] Despite these difficulties the supposed medical criterion of an independent circulation was the favorite view in England from 1780[9] until the passage of the Infanticide Acts of 1922 and 1938.[10] No authoritative view of infanticide had been adopted by the courts in the United States by the end of the nineteenth century.[11] By the middle of the twentieth century, however, the now prevailing view requiring live birth had been established.[12] Basically, this majority American view is an elaborate version of the old common law rule, and a flood of cases have appeared trying to determine the exact moment when live birth actually occurs.[13] A minority of states have attempted to resolve this question by statutory enactment, making the abortion of a quick child manslaughter.[14] Two jurisdictions, perhaps in a reaction to the vagueness of the common law rule, have eliminated the fine distinctions frequently drawn by courts trying to determine the exact moment of

8. The case of Rex v. Brain, 172 Eng. Rep. 1272 (Nisi Prius 1834), again required that the child be "wholly in the world in a living state to be the subject of a charge of murder," but the court did not consider breathing to be essential since "many children are born alive, and yet do not breathe for some time after their birth." *Id.* The rule was also particularly difficult in its use by the English courts because the juries were often sympathetic with the defendants in these cases and looked for some excuse to acquit them. Meldman, *Legal Concepts of Human Life: The Infanticide Doctrines*, 52 MARQ. L. REV. 105, 107 (1968).

9. Winfield, *The Unborn Child*, 8 CAMB. L.J. 76, 79 (1944).

10. After the legislation, the doctrine of live birth became largely irrelevant, for the courts could prosecute on the charge of manslaughter for the killing of a fetus, and no proof of live birth was necessary.

11. Atkinson, *Life, Birth, and Live-Birth*, 20 L.Q. REV. 134 (1904).

12. Montgomery v. State, 202 Ga. 678, 44 S.E.2d 242 (1947); Shedd v. State, 178 Ga. 653, 173 S.E. 847 (1934); Jackson v. Commonwealth, 265 Ky. 295, 96 S.W.2d 1014 (1936); Morgan v. State, 148 Tenn. 417, 256 S.W. 433 (1923); State v. Merrill, 72 W. Va. 500, 78 S.E. 699 (1913); Benett v. State, 377 P.2d 634 (Wyo. 1963). *See also* Note, *Proving Live Birth in Infanticide*, 17 WYO. L.J. 237, 242 (1963).

13. Note 12 *supra*.

14. *See, e.g.*, FLA. STAT. ANN. §§ 782.09, 782.10, 797.01 (1965). Section 797.01 is a general statute which makes abortion criminal at any stage of pregnancy. Section 782.09 is as follows: "The willful killing of an unborn quick child, by any injury to the mother of such child which would be murder if it resulted in the death of such mother, shall be deemed manslaughter." *See* Williams v. State, 34 Fla. 217, 15 So. 760 (1894). Section 782.10 is as follows: "Every person who shall administer to any woman pregnant with a quick child any medicine . . . with intent thereby to destroy such child . . . shall, in case of the death of such child . . . be thereby produced, be deemed guilty of manslaughter." For other statutes with similar provisions, see ARK. STAT. ANN. § 41-2223 (1964); GA. CODE ANN. §§ 26-9920a to -9925a (1969); MICH. STAT. ANN. §§ 28-554 to -555 (1954); MISS. CODE ANN. § 2222 (1957); MO. REV. STAT. §§ 559-090, 559-100 (1959); NEV. REV. STAT. §§ 200.210, 200.220 (1967); N.H. REV. STAT. ANN. § 585:13 (1955); N.Y. PENAL LAW §§ 125.40, 125.45 (McKinney 1967); N.D. CENT. CODE §§ 12-25-02 to -03 (1960); OKLA. STAT. tit. 21-713 to -714 (1958); PA. STAT. ANN. §§ 18-4718 to -4719 (1963); S.C. CODE ANN. § 16-82 (1962); WIS. STAT. ANN. § 940-04 (1958).

live birth.[15] Leading this development was the California case of *People v. Chavez*[16] which first rejected the precedent of the absolute live birth requirement by holding that a fetus is a human being under the homicide statutes when the process of labor and delivery, which has already started, would naturally produce a living infant. In a persuasive argument, the court's dictum indicated that viability should be the determining factor in deciding when to consider a fetus a human being for the purposes of homicide law.[17]

Relying on *Chavez*, the court in the instant case refused to apply the "born alive" theory to twentieth-century America. The court recognized that modern advances in obstetrics and pediatrics have produced the expectation that premature infants delivered after 30 weeks of pregnancy will live.[18] Furthermore, the majority pointed out that, even though viability of the fetus will still be the subject of expert medical testimony and will be submitted to the jury as a question of fact demanding proof beyond a reasonable doubt, the criterion of viability is more in keeping with the realities of continuous human development than the medically unrealistic tests used in applying the "born alive" rule.[19] The court determined that a rule which recognizes the slaying of a viable fetus as homicide would not conflict with the state's present abortion law since abortions are not sanctioned after the twentieth week of pregnancy[20] and a fetus reaches the stage of viability

15. These 2 jurisdictions are Alabama and California. Singleton v. State, 33 Ala. App. 536, 35 So. 2d 375 (1948); People v. Chavez, 77 Cal. App. 2d 621, 176 P.2d 92 (1947).

16. 77 Cal. App. 2d 621, 176 P.2d 92 (1947).

17. The court stated: "There is no sound reason why an infant should not be considered a human being when born or removed from the body of its mother, when it has reached that stage of development where it is capable of living an independent life as a separate being, and where in the natural course of events it will so live if given normal and reasonable care. It should equally be held that a viable child in the process of being born is a human being within the meaning of the homicide statutes, whether or not the process has been fully completed." *Id.* at 625-26, 176 P.2d at 94.

18. 8 ENCYCLOPEDIA BRITANNICA 327 (1968) states: "Infants born before 6¼ months (27 weeks) are rarely viable; from 6¼ to 7 months they may survive with good care, and after 7 months (30 weeks) they are generally viable." A set of 1954 statistics shows an 80% rate or survival for infants delivered after 32 to 33 weeks of pregnancy, weighing 1500 to 1750 grams; an 88% rate when delivered after 33 to 34 weeks of pregnancy and weighing 1750 to 2000 grams; a 96% rate when delivered after 34 weeks and weighing 2000 to 2500 grams, 5 LAWYERS' MEDICAL CYCLOPEDIA § 37.17 at 420 (1960). Demonstrating the rapidly developing medical technology is a set of 1961 statistics which shows a 98% survival rate for infants weighing 2000 to 2500 grams. 7 THE CYCLOPEDIA OF MEDICINE, SURGERY, AND SPECIALTIES 275 (1939-40). The fetus in the instant case weighed 2205 grams (about 5 pounds) at the time of its death.

19. *See* Meldman, *supra* note 8, at 110; Keeler v. Superior Ct. for County of Amador, 80 Cal. Rptr. 865 (Cal. Dist. Ct. App. 1969).

20. Therapeutic Abortion Act, CAL. HEALTH & SAFETY CODE §§ 25950-54 (West Supp. 1970).

only after a minimum of 26-27 weeks. Noting that petitioner's actions evinced a general disposition to harm and destroy both the mother and the fetus, the court added that the evidence supported a finding of his malicious intent directed against the infant, a necessary element of first degree murder. In distinguishing its ruling from the recent decision of the California Supreme Court in *People v. Belous*,[21] the majority in the instant case interpreted as dictum that part of the supreme court's opinion which stated that the intentional destruction of a fetus was never treated as murder and rarely as manslaughter, but rather as the lesser offense of abortion.[22] That section was dictum, the court stated, because it was merely a description of the state of the law in most jurisdictions in the United States, not a statement of California law. In mentioning manslaughter, the *Belous* court was only noting that few states have adopted statutes defining feticide as manslaughter, the court added, and those statutes do not contemplate feticide coupled with a malicious intent against the mother, infant, or both.

This case marks the first application in the United States of the viability test to a feticide case for a murder prosecution. In doing so, the court has formulated a more reasonable criterion in view of the substantial advances of modern medicine. The viability standard, however, is not entirely free from ambiguity. Although the age of viability is generally believed to be about seven months,[23] there is no way to be certain that the fetus has reached viability in any particular case.[24] Therefore, while the question of whether a child is viable is less likely to be a problem than the question of live birth, the determination may become more difficult as the use of incubators and artificial wombs increases.[25] When that happens, the states using the viability rule will once again face the problem of integrating medical knowledge with judicial decision.[26] Another problem is that the concept of viability is only an attempt by medical science to describe conceptually a

21. 80 Cal. Rptr. 354, 458 P.2d 194 (Sup. Ct. 1969).

22. The *Belous* court's holding was actually confined to finding California's pre-1967 abortion law void for uncertainty. *Id.*

23. West v. McCoy, 233 S.C. 369, 375, 105 S.E.2d 88, 91 (1958); Chapman, *Wrongful Death of Stillborn Viable Fetus*, 1965 TRIAL LAW. GUIDE 283, 294.

24. Atkinson, *supra* note 11, at 136.

25. Recent developments in medicine have already begun to lower the time when viability is achieved. Many fetuses only 24 weeks old have been able to survive with intensive care. *See* LIFE, Sept. 10, 1965, at 59.

26. Other new developments in post-mortem enzyme analysis may soon make it possible to pinpoint every detailed biological fact surrounding a peri-natal death. Majorska, *The Determination of Time of Death in a Case of Suspected Infanticide*, 5 J. FORENSIC SCIENCE 33 (1960).

biological process. Thus, legally distinguishing between killing a fetus that is viable and killing one that is not viable is presumptuous because medical science never intended for the term to carry such significant legal consequences. Because it represents an arbitrary cut-off point, the viability concept is not sufficient to deal with homocide cases. In other words, malice, not viability, should determine whether destruction of a fetus is murder. Since medical science, in the very early stages of pregnancy, cannot determine if life exists, a practical cut-off point would have to be formulated to avoid the problem of trying to determine if life has been extinguished in the case of a very young fetus. Probably the simplest and best method to determine this cut-off point would be the use of the existence of a fetal heartbeat. If a fetal hearbeat exists, the fetus is protected under the homocide statutes as a human being; if no heartbeat exists, then no homocide can be committed on that fetus. On the other hand, viability is the best way to achieve a compromise in cases when no malice is present, that is, when we are dealing with the conflicting rights of a nonviable fetus and a pregnant woman. In considering the liberalization of abortion laws, the right of the mother to decide whether to have children must be balanced with the right of the fetus, once conceived, to continue its development. Although the right of the fetus to develop from conception should be absolute in relation to a party with a malicious intent to destroy it, that right must be compromised in the absence of malice and in relation to the rights of the mother.

## Criminal Law—Resentencing—Jury May Impose a Harsher Sentence on Retrial

Appellant, Isaiah Pinkard, was convicted of the unlawful carnal knowledge of a female under the age of twelve years and was sentenced by the jury to a term of twenty years in the state penitentiary. Successful in having his conviction set aside and a new trial granted, appellant was reconvicted and received a jury-imposed sentence of 99 years in prison. After serving more than the originally imposed twenty years, appellant sought his release by a petition for writ of habeas corpus, contending that his constitutional rights[1] were violated when, upon reconviction he received a sentence harsher than that given at the

1. In his brief appellant alleged that the court, by allowing the imposition of a harsher sentence on retrial, denied appellant's right to a fair trial. Appellant also asserted the equal protection clause and the double jeopardy clause as a bar to harsher sentences on retrial.

first trial. In defense, the State asserted that appellant lost the right to rely on the original sentence when he sought and was granted the dismissal of his original conviction and the right to a new trial.[2] Before the Tennessee Court of Criminal Appeals, *held,* petition denied. Where an appellant by his own initiative seeks and obtains the reversal of his original conviction and the right to a second trial for the same offense, the sentence imposed by the jury upon reconviction is not limited by the first but may be harsher in degree. *Pinkard v. Henderson,* 6 Crim. L. Rptr. 2148 (Tenn. Crim. App. 1969).

The propriety of imposing a more severe punishment upon retrial does not present a novel issue but rather one that has been often litigated to different results. Among those federal circuits allowing a harsher sentence to be imposed on retrial, the First Circuit will permit the harsher sentence only when justified by conduct of the defendant subsequent to the original conviction, provided the reasons for increasing the sentence be made to appear affirmatively in the record;[3] the Second Circuit will uphold the harsher sentence if it is justified by newly revealed evidence and is supported in the record;[4] the Seventh Circuit allows the harsher sentence if justified by circumstances disclosed in a presentence report unless the lower court is apparently penalizing appellant for having exercised his right of appeal;[5] and the Third, Tenth, and District of Columbia Circuits allow the judge, in his discretion, to impose whatever sentence is deemed warranted unless he appears to be penalizing the appellant for exercising his right of appeal.[6] The states are similarly divided in the resolution of this issue with the great majority finding no absolute prohibition barring harsher

2. The State based its case on Murphy v. State, 221 Tenn. 351, 426 S.W.2d 509 (1968), which held that the defendant who seeks a new trial faces a new court and a new jury with no limitation placed on their action, and state *ex rel.* Austin v. Johnson, 218 Tenn. 433, 404 S.W.2d 244 (1966), which held that by seeking a new trial appellant loses the defense of double jeopardy. The briefs for this case were prepared and filed before the Supreme Court handed down its opinion in North Carolina v. Pearce, 395 U.S. 711 (1969).

3. Marano v. United States, 374 F.2d 583 (1st Cir. 1967).

4. United States v. Coke, 404 F.2d 836 (2d Cir. 1968). The Second Circuit refuses to limit the imposition of harsher sentences, as the First Circuit does, to only those situations where the defendant's conduct since the first trial warrants the increase. *Id.* at 845-46.

5. United States v. White, 382 F.2d 445 (7th Cir. 1967). This view makes no requirement that the justification for the increase be made a part of the record.

6. United States *ex rel.* Starner v. Russell, 378 F.2d 808 (3d Cir. 1967); Newman v. Rodriques, 375 F.2d 712 (10th Cir. 1967); Short v. United States, 344 F.2d 550 (D.C. Cir. 1965). *Contra,* Patton v. North Carolina, 381 F.2d 636 (4th Cir. 1967); United States v. Adams, 362 F.2d 210 (6th Cir. 1966). Two circuits have not ruled on this question but have indicated that they would prohibit the harsher sentence on double jeopardy grounds. *See* Castle v. United States, 399 F.2d 642 (5th Cir. 1968); Jack v. United States, 387 F.2d 471 (9th Cir. 1967).

penalties.[7] The rationale of a rule allowing more severe punishment to be imposed upon reconviction has been frequently attacked as contrary to the constitutional restrictions imposed by the equal protection, double jeopardy, and due process clauses of the federal constitution. Courts have held, on equal protection grounds, that this rule creates an arbitrary classification,[8] because it increases only the sentences of those who have successfully resorted to appeal,[9] while there are equally valid reasons for increasing the punishment of those who have not. The threat of a harsher sentence acts as an invidious discrimination against those availing themselves of a fair trial[10] and thereby frustrates the pursuit of the post conviction remedies provided by the states.[11] The double jeopardy clause of the fifth amendment,[12] consisting of three related rules prohibiting retrial after acquittal,[13] retrial after

7. *E.g.*, Moon v. State, 250 Md. 468, 243 A.2d 564 (1968); State v. Young, 200 Kan. 20, 434 P.2d 820 (1967); State v. Squires, 248 S.C. 239, 149 S.E.2d 601 (1966).

8. "Classification must always rest upon some difference which bears a reasonable and just relation to the act in respect to which the classification is proposed, and can never be made arbitrarily and without any such basis." McLaughlin v. Florida, 379 U.S. 184, 190 (1964). *See, e.g.*, Douglas v. California, 372 U.S. 353, 356-57 (1963); Morey v. Doud, 354 U.S. 457, 465-66 (1957).

9. "In none of the states permitting harsher sentences upon retrial, is there a procedure established to increase the sentence of any other convict originally sentenced in accordance with the appropriate statute. The risk of a harsher sentence is borne exclusively by those who pursue some postconviction remedy." Van Alstyne, *In Gideon's Wake: Harsher Penalties and the "Successful" Criminal Appellant*, 74 YALE L.J. 606, 638 (1965). *See also* Honigsberg, *Limitations Upon Increasing a Defendant's Sentence Following a Successful Appeal and Reconviction*, 4 CRIM. L. BULL. 329, 335 (1968).

10. "The risk of a harsher sentence is borne exclusively by those who pursue some postconviction remedy. Yet there is no reason to suppose that the original sentences of this group are any more likely to warrant review as a class than the sentences of other convicts who are not subject to the same risk. The vulnerable class appears to be quite equivalent to a class described by race, right-handedness, indigence, or some other factor equally irrelevant in any proper determination of those whose sentences might appropriately be reviewed." Van Alstyne, *supra* note 9, at 638. *See, e.g.*, Patton v. North Carolina, 381 F.2d 636 (4th Cir. 1967); Texas v. Gundstrom, 404 F.2d 644 (5th Cir. 1968). *Contra*, United States v. Coke, 404 F.2d 836 (2d Cir. 1968). "It is not a denial of equal protection for the state to effectuate a proper policy . . . on those on whom it constitutionally can, simply because there are others on whom it constitutionally cannot." *Id.* at 845.

11. *See* Patton v. North Carolina, 381 F.2d 636 (4th Cir. 1967); VanAlstyne, *supra* note 9, at 639.

12. *See* Benton v. Maryland, 395 U.S. 784 (1969) (holding that the double jeopardy prohibition of the fifth amendment is enforceable against the states through the fourteenth amendment). *Compare* Spidle v. Missouri, 446 S.W.2d 793 (Mo. 1969) (holding *Benton* rule does not apply retroactively), *with* Galloway v. Beto, 38 U.S.L.W. 2390 (5th Cir. Jan. 6, 1970), *and* Booker v. Phillips, 38 U.S.L.W. 1081 (10th Cir. Nov. 12, 1969) (both cases holding that *Benton* rule applies retroactively to retrials held before the *Benton* decision).

13. *See* United States v. Ball, 163 U.S. 662, 671-72 (1896). *See also* Green v. United States, 355 U.S. 184, 190 (1957) (extended the federal rule to bar prosecution after an "implicit

conviction,[14] and multiple punishments for the same offense,[15] has been held to prohibit an increase of sentence once service has commenced, regardless of any new or additional adverse evidence that may be produced.[16] Because some courts have extended this restriction to prohibit increases in punishment following retrial,[17] it has been argued that an appellant may be given a harsher penalty on retrial if he "waives" his double jeopardy protection;[18] however, such a "waiver" requirement places an impermissible condition upon the enjoyment of a constitutional right.[19] Courts have also held that the due process clause of the fourteenth amendment demands that a defendant denied a fair trial be permitted to vindicate his right to a new trial without risking a harsher resentence. Since this risk unreasonably burdens his exercise of the right to appeal,[20] and any procedure which substantially deters an individual from the exercise of his constitutional rights is

acquittal"); People v. Henderson, 60 Cal. 2d 482, 386 P.2d 677 (1963) (extended the double jeopardy limitation to include punishment as well as degree of offense). *Contra,* Stroud v. United States, 251 U.S. 15 (1919) (allowing the imposition of death sentence on retrial where original sentence was imprisonment).

14. *E.g., In re* Nielson, 131 U.S. 176 (1889).

15. "Why is it that, having onee been tried and found guilty, he can never be tried again for that offense? Manifestly it is not the danger or jeopardy of being a second time found guilty. It is the punishment that would legally follow the second conviction which is the real danger guarded against by the Constitution. But if, after judgment has been rendered on the conviction, and the sentence of that judgment executed on the criminal, he can be again sentenced on that conviction to another and different punishment, or to endure the same punishment a second time, is the constitutional restriction of any value? . . .

The argument seems to us irresistible, and we do not doubt that the Constitution was designed as much to prevent the criminal from being twice punished for the same offense as from being twice tried for it." *Ex parte* Lange, 85 U.S. (18 Wall.) 163, 173 (1873). *See, e.g.,* Patton v. North Carolina, 381 F.2d 636, 643 (4th Cir. 1967); Comment, *Twice in Jeopardy,* 75 YALE L.J. 262 (1965).

16. *See, e.g.,* United States v. Benz, 282 U.S. 304, 307 (1931); United States v. Adams, 362 F.2d 210 (6th Cir. 1966); Kennedy v. United States, 330 F.2d 26 (9th Cir. 1964).

17. "We perceive no constitutionally significant distinction between the increases prohibited [once service has commeneed] and an increase in punishment following retrial." Patton v. North Carolina, 381 F.2d 636, 645 (4th Cir. 1967). *See also* Whaley v. North Carolina, 379 F.2d 221 (4th Cir. 1967); Walsh v. United States, 374 F.2d 421 (9th Cir. 1967).

18. "[U]nless a defendant is held to waive this double jeopardy protection in seeking a new trial, a harsher penalty may not be imposed." Patton v. North Carolina, 381 F.2d 636, 645 (4th Cir. 1967).

19. *See* Whaley v. North Carolina, 379 F.2d 221 (4th Cir. 1967); United States v. Walker, 346 F.2d 428 (4th Cir. 1965); Fay v. Noia, 372 U.S. 391 (1963); Grcen v. United States, 355 U.S. 184 (1957).

20. "This Court has never held that the States are required to establish avenues of appellate review, but it is now fundamental that, once established, these avenues must be kept free of unreasoned distinctions that can only impede open and cqual access to the courts." Rinaldi v. Yeager, 384 U.S. 305, 310-11 (1965). *See, e.g.,* Lane v. Brown, 372 U.S. 477 (1963); Douglas v. California, 372 U.S. 353 (1963); Griffin v. Illinois, 351 U.S. 12 (1956).

invalid,[21] the risk of a harsher sentence will unconstitutionally deter those entitled to a new trial because of error in the first proceeding from exercising that right.[22] While the courts, both state and federal, have responded to the question with differing answers, the Supreme Court of the United States has been reluctant to issue a pre-emptory decision.[23] However, in *North Carolina v. Pearce*[24] the Supreme Court issued a ruling which in theory would effectively inhibit the power of trial judges to impose harsher sentences on retrial. Speaking for the majority, Mr. Justice Stewart stated that while neither the equal protection[25] nor the double jeopardy[26] clauses pose any restriction on a

21. *E.g.*, United States v. Jackson, 390 U.S. 570 (1968); Spevack v. Klein, 385 U.S. 511, 514 (1967); Griffin v. California, 380 U.S. 609 (1965); Torcaso v. Watkins, 367 U.S. 488, 495-96 (1961).

22. Following is a reproduction of the often cited letter received by United States Circuit Judge Craven, Fourth Circuit.

"Dear Sir:

"I am in the Mecklenburg County jail. Mr. _____ chose to re-try me as I knew he would.

* * * * *

"Sir the other defendant in this case was set free after serving 15 months of his sentence, I have served 34 months and now *I am to be tried again and with all probility I will receive a heavier sentence than before as you know sir my sentence at first trile was 20 to 30 years. I know it is usuelly the courts prosedure to give a larger sentence when a new trile is granted I guess this is to discourage Petitioners.*

*"You Honor, I don't want a new trile I am afraid of more time* * * *

"Your Honor, I know you have tried to help me and God knows I apprecete this but *please sir don't let the state re-try me if there is any way you can prevent it.*

"Very truly yours"

Patton v. North Carolina, 256 F. Supp. 225, 231 n.7 (W.D.N.C. 1966). *See* Note, *Increased Sentence and Denial of Credit on Retrial Sustained Under Traditional Waiver Theory*, 1965 DUKE L.J. 395, 399 n.25.

23. Certiorari has been repeatedly denied by the Supreme Court in cases dealing with this problem. *E.g.*, United States v. White, 382 F.2d 445 (7th Cir. 1967), *cert. denied*, 389 U.S. 1052 (1968); Patton v. North Carolina, 381 F.2d 636 (4th Cir. 1967), *cert. denied*, 390 U.S. 905 (1968); United States *ex rel.* Starner v. Russell, 378 F.2d 808 (3d Cir.), *cert. denied*, 389 U.S. 889 (1967).

24. 395 U.S. 711 (1969). This case was decided on Chief Justice Warren's last day on the Court.

25. The majority rejected in toto the equal protection argument as inapplicable: "It simply cannot be said that the State had invidiously 'classified' . . . those prisoners whose conviction are *not* set aside by denying the members of that group the opportunity to be acquitted." *Id.* at 722-23. *See* United States v. Coke, 404 F.2d 836 (2d Cir. 1968).

26. The majority based its holding that a harsher sentence may be imposed on retrial on "the premise that the original conviction has, at the defendant's behest, been wholly nullified and the slate wiped clean." 395 U.S. at 721. Acknowledging that this premise is inconsistent with the requirement that credit be given for that portion of the sentenee already served, the majority relied on "an unbroken line of decisions that have followed that principle for almost 25 years" and held the premise valid in resentencing situations. *Id.* at 721.

In rendering its decision the Court distinguished Grcen v. United States, 355 U.S. 184 (1957), by restricting the *Green* holding to only prohibit the conviction on retrial of an offense of which

court's power to impose harsher sentences on retrial, the due process clause prohibits the practice of vindictively "imposing a heavier sentence upon every reconvicted defendant for the explicit purpose of punishing the defendant for his having succeeded in getting his original conviction set aside."[27] Consequently, the Court established a constitutional rule allowing the trial judge to impose a harsher sentence only for reasons "based upon objective information concerning identifiable conduct on the part of the defendant and occurring after the time of the original sentencing proceeding,"[28] provided these reasons be made a part of the record.[29]

In the instant decision, the court concluded that since the appellant by his own initiative sought and obtained the dismissal of his conviction and the right to a new trial, the due process clause of the fourteenth amendment would not prohibit the imposition of a harsher sentence on retrial. Similarly, the court ruled that since the appellant had procured the dismissal of his conviction, thereby avoiding the jeopardy in which he stood, he was precluded from asserting double jeopardy as a bar to a subsequent sentence. The majority further stated that since the appellant was resentenced by a jury rather than a judge, and since there was no hint of vindictiveness on the part of the jury in imposing the harsher sentence, the rule of *North Carolina v. Pearce*[30] did not restrict the sentence imposed by the jury. The court therefore held that the *Pearce* rule was limited only to judge-imposed sentences and that the appellant must take the "burden with the benefit." Dissenting, Judge Galbreath argued that the *Pearce* rule was applicable

---

the defendant was earlier acquitted. In a concurring opinion, Mr. Justice Douglas contended that *Green* was not distinguishable. "From the point of view of the individual and his liberty, the risk here of getting from 1 to 15 years for specified conduct is different only in degree from the risk in *Green* of getting life imprisonment or capital punishment for a specified conduct." *Id.* at 728. Mr. Justice Douglas agreed with Van Alstyne that "when a particular penalty is selected from a range of penalties prescribed for a given offense, and when that penalty is imposed upon the defendant, the judge or jury is impliedly 'acquitting' the defendant of a greater penalty . . . ." Van Alstyne, *supra* note 9, at 634-35.

27. 395 U.S. at 723-24.

28. *Id.* at 726.

29. The Court stated that the purpose for requiring the "factual data upon which the increased sentence is based" to be made part of the record is to allow "the constitutional legitimacy of the increased sentence" to be "fully reviewed on appeal." *Id.* In other words, the Court was saying that in view of the constitutional guarantee of the due process clause, appellant's sentence can legitimately be increased only when justified by his conduct since the time of his original conviction. Therefore, the Court, in adopting the narrow ruling of the First Circuit in *Marano*, intended to prohibit all but the extraordinary judge-imposed harsher sentence. For a criticism of the workings of the *Pearce* rule, see *The Supreme Court, 1968 Term*, 83 HARV. L. REV. 7, 187 (1969).

30. 395 U.S. 711 (1969).

to the facts of this case and that in the absence of affirmative justification in the record for the increased sentence, such harsher sentence must be considered unconstitutional.[31]

The rule enunciated in the instant decision, granting juries a free hand in setting penalties upon retrial, denies to appellants retried and sentenced by a jury the same constitutional rights enjoyed by those resentenced by a judge. While such a rule is not inconsistent with the narrow holding of the *Pearce* case, which dealt only with judge-imposed sentences, this decision clearly yields a result that is contrary to the policy underlying the *Pearce* decision. In *Pearce* the Supreme Court was faced with the dilemma of balancing the societal interest in having the punishment fit the offense against the individual's interest in having an unfettered right of appeal. Seemingly swayed by the policy interest in adequate sentencing, the Court refused to find a constitutional prohibition barring harsher punishment. In truth, however, the Court took away with one hand what it gave with the other by stipulating that the harsher sentence is constitutionally valid only when based upon evidence of appellant's conduct occurring since the time of the original trial. In so doing, the Supreme Court promulgated the most restrictive rule possible without absolutely barring judge-imposed harsher sentences.[32] Conversely, the Tennessee court has given the jury a carte blanche in resentencing. In refusing to extend *Pearce* to jury situations, this court attempted to distinguish between judge-imposed and jury-imposed harsher sentences.[33] However, in due process terms, the

31. Judge Galbreath felt that vindictiveness might have influenced the resentencing jury to impose the harsher sentence on retrial causing the harsher sentence to be invalid. "I must further disagree with my brethern who in the majority opinion said 'it is practically inconceivable that the second jury had such knowledge' (of the original conviction for raping a child). To me, it is completely, not practically, inconceivable that in rural Maury County a jury impaneled some two weeks after the first trial and a few days after the setting aside of its result (the first trial was April 6, 1948; the second April 24, 1948) did not know of the prior proceeding! That there might exist a strong resentment on the part of the members of the second jury that the defendant was trifling with justice and should be severcly punished for his audacity in trying to escape his just desserts is too strong a probability to dismiss lightly. If the United States Supreme Court does not belicve it proper for a judge to double or triple a man's punishment without some affirmative showing that facts not known during the first trial justify such increase, I cannot agree that such awesome power of vindictiveness should be entrusted to laymen." 6 Crim. L. Rptr. at 2149.

32. The Supreme Court followed the prccedent set by the First Circuit. *See* note 3 *supra*. It is submitted that the Court intended to causc harsher resentencing to be an extraordinary result justified only in the exceptional situation. *But see The Supreme Court, 1968 Term*, 83 HARV. L. REV. 7, 187 (1969) for a recognition of the possibility that this rule "will result more in demonstrating the ingenuity of sentencing judges than in restraining such vindictivcness as they may entertain." *Id.* at 192.

33. *But see* May v. Peyton, 398 F.2d 476, 477 (4th Cir. 1968), where in recognition of the artifical distinction between judge-imposed and jury-imposed harsher sentences, the Fourth Circuit Court of Appeals extended its ruling in *Patton* to situations where the jury is thc sentencing body.

convicted is no less deterred at the prospect of a harsher sentence whether imposed through the vindictiveness of the court or the jury.[34] This case brings into sharp focus the need for the Supreme Court to supplement its decision in *Pearce* and set forth a constitutional rule applicable to jury situations.[35]

Disregarding the artificial distinctions between judge and jury sentencing,[36] the rationale of the *Pearce* restriction is equally applicable to jury situations. Although this is the reasonable extension of the *Pearce* policy,[37] since most states forbid evidence of the appellant's prior conviction and subsequent conduct to be presented to the jury, it is an extension fraught with procedural problems. Therefore, if, as *Pearce* states, the appellant's constitutional right to be free of the inhibiting threat of vindictiveness prohibits increased punishments unless justified by objective information concerning conduct of the appellant occurring after the time of the original sentencing procedure, in these states the jury is incapable of constitutionally imposing a harsher sentence in accord with the *Pearce* restrictions. In view of this inherent limitation, the Court could cast on the trial judge the additional task, prior to sentencing, of determining whether the appellant's conduct subsequent to the original conviction warrants an increase in punishment. Under such a procedure the judge would still be bound by the *Pearce* restriction and would rule on the validity of any additional punishment imposed by the jury. As an alternative, the *Pearce* rule can be extended directly to the jury in those states providing a separate sentencing procedure in jury trials.[38] In these states the jury first determines the guilt of the defendant and then in a separate

34. The dissent discerned this inconsistency and noted that "[a] jury should not be allowed to violate the Constitution any more than a court." 6 Crim. L. Rptr. at 2149.

35. That this rule is inadequate and that there is a need to set forth sufficient guidelines is evideneed by the contrary holding of the Texas Court of Criminal Appeals in Branch v. State, 445 S.W.2d 756 (Tex. Crim. App. 1969) (ruling on motion for rehearing, the court held the *Pearce* rule limited to judge sentencing, but by implication held the *Pearce* reasoning applicable to jury situations by requiring that jury-imposed harsher sentences be justified by additional proof).

36. Surely it cannot be honestly contended that the jury is incapable of exercising vindictiveness. Granted that in many circumstances the jury will not know of the original conviction and retrial, but this concession does not insure against the possibility of vindictiveness. *See* note 31 *supra*.

37. In his definitive article regarding harsher sentencing, Professor Van Alstyne opts for a rule barring harsher sentences by the judge, jury, or other sentencing authority. Van Alstyne, *supra* note 9, at 611.

38. Such a procedure is in effect in 5 states for capital offenses. *See* CAL. PEN. CODE § 190.1 (West Supp. 1968); CONN. GEN. STAT. ANN. § 53-10 (1968); N.Y. PEN. LAW § 125.30 (McKinney 1967); PA. STAT. ANN. tit. 18, § 4701 (1963); TEX. CODE CRIM. PROC. art 37.07 (Supp. 1969). The two-trial procedure for capital cases is advocated in MODEL PENAL CODE § 210.6 (Proposed Official Draft, 1962).

hearing admits additional evidence of the defendant's background. The extension of the *Pearce* rule to these two-trial situations obviously will not present a complete solution unless the traditional rules of evidence are modified so that the fact of appellant's prior conviction and subsequent conduct can be admitted in the second proceeding.[39] In summary, while not responsible for prescribing a uniform sentencing procedure, the Court should issue a pre-emptory decision applying the *Pearce* restriction to those states allowing evidence of appellant's prior conviction and subsequent conduct to be presented to the jury and to those judges who, even in jury sentencing, determine the justification of an increased sentence. In the absence of such state procedure, the Court should apply an absolute prohibition barring harsher sentences.

It is submitted, however, that neither this proposed rule nor the rule in *Pearce* adequately rebuts the arguments for an uninhibited right to appeal. In discussion of the due process question, the *Pearce* Court quoted with approval from *Worcester v. Commissioner*[40] stating that a court "is without right to . . . put a price on an appeal. A defendant's exercise of a right of appeal must be free and unfettered."[41] It is arguable whether a court can place a prisoner in a position whereby he runs the risk of receiving a harsher sentence on retrial and simultaneously give him an unrestrained right of appeal. The Supreme Court affirmatively indicated that an unfettered right of appeal requires only that the appellant be free of the vindictiveness of the trial judge. In the last analysis, however, it matters not to the appellant whether he be subjected to the vindictiveness of the court or the jury. What concerns and deters him is the possibility of a harsher sentence for whatever reason imposed. Therefore, the reasons for an increased sentence in any particular case are constitutionally irrelevant; what remains critical is the possibility that the risk of an increased sentence deters the exercise of the right to secure a fair trial.

## Labor Law—Civil Rights—Employer's Invidious Racial Discrimination Violates Section 8(a)(1) of NLRA

The United Packinghouse Workers instituted unfair labor practice proceedings against a Texas cotton processing corporation, contending

39. The California and Pennsylvania courts have interpreted their trial statutes to permit introduction of evidence at the sentencing proceeding only when that evidence is admissible under the rules of evidence. *See, e.g.*, People v. Hamilton, 60 Cal. 2d 194, 373 P.2d 4 (2 (1963); Commonwealth v. McCoy, 305 Pa. 23, 172 A.2d 795 (1961).

40. 370 F.2d 713 (1st Cir. 1966).

41. *Id.* at 718.

in part that the company had refused to bargain in good faith over conditions of racial discrimination existing at one of its plants.[1] The National Labor Relations Board found that the employer's conduct constituted a violation of section 8(a)(5)[2] of the NLRA and issued an appropriate bargaining order. On a consolidated appeal to the Court of Appeals for the District of Columbia Circuit, the employer argued that the Board's order was not supported by the evidence, while the union contended that the decision by the Board had not gone far enough. Specifically, the union asserted that the Board should also have found that the employer's persistent discrimination against Negro and Latin American workers[3] in itself violated seetion 8(a)(1)[4] of the NLRA by inhibiting the exercise of their statutory right to act concertedly for their mutual aid and protection.[5] The Court of Appeals, sustaining the validity of the union's position, *held*, order affirmed and case remanded for further proceedings.[6] An employer's policy and

1. The union submitted 2 additional complaints: first, that the employer had violated § 8(a)(1) of the NLRA through use of interrogations, threats, and promises in an effort to impair the union's bargaining power and capacity for mounting a successful strike; and secondly, that the employer had violated § 8(a)(5) because of its refusal to bargain over certain wage and cost matters. Both of these contentions were upheld by the Board. United Packinghouse Workers Int'l Union v. NLRB, 416 F.2d 1126, 1129 (D.C. Cir.), *cert. denied*, 396 U.S. 903 (1969).

2. "It shall be an unfair labor practice for an employer . . . to refuse to bargain collectively with the representatives of his employees . . . ." 29 U.S.C. § 158(a)(5) (1964).

3. The union produced 3 independent indicia of the employer's racial discrimination: first, Negro and Latin American workers were paid less for doing the same work as whites; secondly, nonwhite employees were consistently excluded from overtime assignments; and third, minority group employees received less advantageous vacation benefits. 416 F.2d at 1132. It should be noted, however, that the contention that the employer's discrimination violated § 8(a)(1) was not specifically raised until the appeal. The Board considered the discrimination only in connection with one of the § 8(a)(5) charges. *Id.* at 1134 n.12.

4. "It shall be an unfair labor practice for an employer . . . to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 157 of this title . . . ." 29 U.S.C. § 158(a)(1) (1964).

5. To violate § 8(a)(1) an employer's conduct must interfere with, restrain, or coerce employees in the exercise of their rights guaranteed by § 7 of the NLRA, which provides that "[e]mployees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and *to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection* . . . ." 29 U.S.C. § 157 (1964) (emphasis added).

6. The posture of the case led the court to remand on the issue of whether the employer's racially discriminatory conduct violated § 8(a)(1). In the unfair labor practice hearing against the company, evidenee of raeial discrimination was produced only to aid in finding whether there had been an § 8(a)(5) bargaining violation. The Board's General Counsel did not proceed on the theory that the discrimination itself violated § 8(a)(1). Therefore, although the company's racial policies had been considered and found to be discriminatory by both the Board and the trial examiner, the court felt "that in fairness to the company it should have an opportunity to have the matter more fully litigated, with notice that the question of a § 8(a)(1) violation is specifically to be determined." 416 F.2d at 1134 n.12.

practice of invidious discrimination on the basis of race or national origin constitutes an unfair labor practice within the ambit of section 8(a)(1) of the National Labor Relations Act. *United Packinghouse Workers Int'l Union v. NLRB*, 416 F.2d 1126 (D.C. Cir.), *cert. denied*, 396 U.S. 903 (1969).

Whether racial discrimination by an employer can in itself constitute an unfair labor practice represents a novel question under the National Labor Relations Act. Although the area of employee civil rights is by no means new to the NLRB, previous litigation on racial issues has been confined primarily to union discriminatory practices.[7] In 1944, the first significant decision involving racial discrimination in a labor context was handed down by the Supreme Court in *Steele v. Louisville & N.R.R.*[8] There the Court recognized that under the Railway Labor Act,[9] unions owe a duty of fair representation to the collective interests of the employees they represent.[10] Later, in *Syres v. Oil Workers Local 23*,[11] the Supreme Court established that the union duty of fair representation extends to cases brought under the NLRA. The National Labor Relations Board has more recently applied the doctrine of fair representation[12] and has found that its violation constitutes a union unfair labor practice under section 8(b)(1)[13] of the

7. The NLRB has, however, considered the effect of employer racial discrimination during union election campaigns. For instance, it has held that if an employer makes flagrant and inflammatory appeals to racial prejudice in an attempt to defeat a union in a certification election, the election will be set aside. Sewell Mfg. Co., 138 N.L.R.B. 66 (1962). Otherwise employer racial discrimination has been only collaterally involved in decisions under the NLRA. *See, e.g.*, NLRB v. Tanner Motor Livery, Ltd., 349 F.2d 1 (9th Cir. 1965) (employees wrongfully discharged for protesting company's discriminatory hiring policies); Ozan Lumber Co., 42 N.L.R.B. 1073 (1942) (company rules and action based on racism prevented employees from exercising their § 7 rights).

8. 323 U.S. 192 (1944).

9. 45 U.S.C. §§ 151-88 (1964).

10. "We hold that the language of the [Railway Labor] Act . . . read in light of the purposes of the Act, expresses the aim of Congress to impose on the bargaining representative of a craft or class of employees the duty to exercise fairly the power conferred upon it in behalf of all those for whom it acts, without hostile discrimination against them." Steele v. Louisville & N. R.R., 323 U.S. 192, 202-03 (1944). For incisive discussion of the union duty of fair representation, see Aaron, *Some Aspects of the Union's Duty of Fair Representation*, 22 OHIO ST. L.J. 39 (1961); Cox, *The Duty of Fair Representation*, 2 VILL. L. REV. 151 (1957); Sovern, *The National Labor Relations Act and Racial Discrimination*, 62 COLUM. L. REV. 563, 576-614 (1962).

11. 350 U.S. 892 (1955).

12. Independent Metal Workers Local 1, 147 N.L.R.B. 1573 (1964). The courts have consistently upheld the extension of Board jurisdiction into the area of union racial discrimination. *E.g.*, NLRB v. Local 1367, ILA, 368 F.2d 1010 (5th Cir. 1966), *cert. denied*, 389 U.S. 837 (1967); Rubber Workers Local 12 v. NLRB, 368 F.2d 12 (5th Cir. 1966), *cert. denied*, 389 U.S. 837 (1967).

13. "It shall he an unfair labor practice for a labor organization or its agents . . . to restrain or coerce (A) employees in the exercise of the rights guaranteed in section 157 . . . or

NLRA. Thus both the courts and the NLRB have consistently enforced a union's duty to refrain from racial discrimination. By contrast, employer racial discrimination has heretofore been proscribed exclusively by the Equal Employment Opportunity Commission[14] pursuant to Title VII of the 1964 Civil Rights Act.[15] While the legislative history of the NLRA is regrettably uninstructive as to whether section 8(a)(1) was intended to comprehend employer acts of racial discrimination,[16] it is generally well established that Congress intended to endow the NLRB and EEOC with concurrent jurisdiction to interdict conduct violating both the NLRA and Title VII.[17]

In the instant case, the court of appeals initially recognized that there has been no previous judicial determination of whether an employer's racial discrimination can constitute an unfair labor

(B) an employer in the selection of his representatives for the purposes of collective bargaining or the adjustment of grievances . . . ." 29 U.S.C. § 158(b)(1) (1964).

14. *But see* note 7 *supra.*

15. "It shall be an unlawful employment practice for an employer . . . to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin . . . ." 42 U.S.C. § 2000(e)(2) (1964). This mandate applies only to employers having 25 or more employees.

16. Congress has rejected amendments to the NLRA which would expressly make both union and employer racial discrimination unfair labor practices. *E.g.*, S. 1897, 83d Cong., 1st Sess. (1953); S. 1831, 83d Cong., 1st Sess. (1953). However, it should not be inferred from these rejections that Congress intended to exclude the possibility that racial discrimination might ever violate the act. The courts have interpreted the legislative history of both the 1964 Civil Rights Act and the NLRA as permitting a finding that racial discrimination by a union can constitute an unfair labor practice. *See* Rubber Workers Local 12 v. NLRB, 368 F.2d 12, 24 (5th Cir. 1966), *cert. denied*, 389 U.S. 837 (1967).

17. The 1964 Civil Rights Act says nothing to indicate that the NLRB is ousted of jurisdiction over cases involving racial discrimination. The legislative history of Title VII clearly indicates that it was not intended to detract from the jurisdiction of the NLRB in such cases. A memorandum prepared by the Department of Justice and read to the Senate by Senator Clark (D-Pa.) stated in part: "Of course, title VII is not intended to and does not deny to any individual, rights and remedies which he may pursue under other Federal and State statutes. If a given action should violate both title VII and the National Labor Relations Act, the National Labor Relations Board would not be deprived of jurisdiction. . . . [T]itle VII would have no effect on the duties of any employer or labor organization under the NLRA or under the Railway Labor Act, and those duties would continue to be enforced as they are now." 110 CONG. REC. 7207 (1964) (remarks of Senator Clark (D-Pa.)). Later, Senator Tower (R-Tex.) proposed an amendment to the Civil Rights Act which would have made the provisions of Title VII the exclusive means of relief from racially discriminatory practices, precluding any executive or independent agency from granting relief. The amendment was defeated by a vote of 59 to 29. 110 CONG. REC. 13650-52 (1964). The Fifth Circuit in Rubber Workers Local 12 v. NLRB, 368 F.2d 12, 24 n.24 (5th Cir. 1966), *cert. denied*, 389 U.S. 837 (1967), noted that "[l]egislative history and specific provisions of the [Civil Rights Act] . . . make it apparent that Congress did not intend to establish the enforcement provisions of Title VII as the exclusive remedy in [the area of union discrimination]." *See* Berg, *Equal Employment Opportunity Under the Civil Rights Act of 1964*, 31 BROOKLYN L. REV. 62, 95-96 (1964).

practice. Turning its attention to analogous decisions involving union racial discrimination,[18] the court concluded that there was no compelling reason why an employer's conduct should be exempted from Board scrutiny as a possible 8(a)(1) violation. As a subsidiary matter, the court pointed out that Title VII of the 1964 Civil Rights Act does not purport to deprive the NLRB of jurisdiction to interdict racial discrimination which violates the NLRA.[19] Giving section 8(a)(1) its logical construction, the court observed that this provision could have been violated only if the employer's conduct, in addition to being unjustified, was shown to have inhibited the exercise of employee section 7 rights to act concertedly for their mutual aid and protection.[20] In this regard, the court reasoned that an employer's racial discrimination has a twofold effect: "(1) racial discrimination sets up an unjustified clash of interests between groups of workers which tends to reduce the likelihood and the effectiveness of their working in concert to achieve their legitimate goals under the Act; and (2) racial discrimination creates in its victims an apathy or docility which inhibits them from asserting their rights against the perpetrator of the discrimination."[21] Consequently, the court concluded that the confluence of these two factors deters employees in exercising section 7 rights and therefore violates section 8(a)(1).

The impact of the *Packinghouse* decision in the area of employee civil rights will undoubtedly be profound. Not only does the decision open a new statutory avenue for the vindication of workers' rights,[22] but in doing so it facilitates a more prompt procurement of redress through the medium of the National Labor Relations Board. An employee will no longer be compelled to resort to the cumbersome and expensive procedures of the EEOC[23] to obtain relief from his

18. 416 F.2d at 1134-35.

19. *Id.* at 1133-34 n.11.

20. *See* note 5 *supra*.

21. 416 F.2d at 1135.

22. Section 8(a)(1) is a broad and pervasive "avenue" having been frequently interpreted as being violated whenever an employer's conduct has a natural tendency to interfere with, restrain, or coerce employees in the exercise of their § 7 rights. Time-O-Matic, Inc. v. NLRB, 264 F.2d 96 (7th Cir. 1959); NLRB v. Ford, 170 F.2d 735 (6th Cir. 1948). *See* NLRB v. Clearfield Cheese Co., 322 F.2d 89, 94 (3d Cir. 1963) (holding that actual intimidation or influence is immaterial).

23. *See, e.g.*, Rosen, *Division of Authority Under Title VII of the Civil Rights Act of 1964: A Preliminary Study in Federal-State Interagency Relations*, 34 GEO. WASH. L. REV. 846 (1966). Professor Rosen points out that "[p]rimarily because the NLRB bears the expenses of enforcement of the NLRA, offers the other general advantages of administrative enforcement, has a backlog time before the NLRB six months shorter than before the federal district courts, and has no express requirement to defer to state FEP [Fair Employment Practices] agencies,

employer's racially discriminatory practices, provided he can demonstrate that such practices interfere with or restrain the exercise of his rights guaranteed by section 7 of the NLRA. In addition, a broader and more flexible spectrum of remedies is available under the NLRA[24] for workers aggrieved by racial discrimination. Hence the instant decision is both significant and admirable from a policy standpoint.

Unfortunately, however, there are two apparent shortcomings in the court's attempt to formulate a standard[25] for determining whether an employer's racial discrimination violates section 8(a)(1). In the first place, the language of the majority opinion is unclear as to whether invidious racial discrimination by an employer inevitably results in divisiveness and docility and is thus a per se violation of 8(a)(1),[26] or

representatives of civil rights organizations have preferred NLRB enforcement over Title VII enforcement of FEP." *Id.* at 887.

24. In the landmark case of Phelps Dodge Corp. v. NLRB, 313 U.S. 177 (1941), the Supreme Court construed the NLRA as conferring on the Board broad and flexible power to fashion remedies necessary to effectuate the purposes of the act. While the remedies afforded by the Board may vary, normally a cease and desist order is issued to sanction an unfair labor practice. Such an order, when enforced by a federal court of appeals, is backed up by the court's contempt power. M. SOVERN, LEGAL RESTRAINTS ON RACIAL DISCRIMINATION IN EMPLOYMENT 161 (1966). Title VII originally conferred enforcement powers on the EEOC, but these powers were deleted so that the title could pass, and the Commission was limited essentially to the function of conciliation. Berg, *Equal Employment Opportunity Under the Civil Rights Act of 1964*, 31 BROOKLYN L. REV. 62, 64-68 (1964). Amendments have been proposed that would give the EEOC enforcement powers, but thus far none has been suceessful. *See, e.g.*, S. 3465, 90th Cong., 2d Sess. (1968); H.R. 10065, 89th Cong., 1st Sess. (1965). Senator Javits (R-N.Y.) has made the following appraisal of the remedial efficacy of Title VII and the EEOC: "[T]itle VII pays lip service to the idea of equal employment opportunity, but the hard fact is that the compromise worked out in 1964 under which the Equal Employment Opportunity Commission was emasculated, has gone far to destroy the act as an effective tool to end discrimination in employment in this country." 114 CONG. REC. 16,910 (1968) (remarks of Senator Javits (R-N.Y.)).

25. The standard referred to is that of employee divisiveness and docility. *See* text accompanying note 21 *supra*.

26. The following statements from Judge Wright's majority opinion indicate that the court intended to adopt a per se rule: "Thus in the context of employer racial discrimination the question reduces to whether that discrimination inhibits its victims from asserting themselves against their employer to improve their lot.

We find that an employer's invidious discrimination on account of race or national origin has such an effect. The effect is twofold: (1) racial discrimination sets up an unjustified clash of interests between groups of workers . . . and (2) racial discrimination creates in its victims an apathy or docility which inhibits them from asserting their rights against the perpetrator of the discrimination." 416 F.2d at 1135. "[T]he employer's policy of discrimination *inevitably* sets group against group, thus frustrating the possibility of effective concerted action." *Id.* at 1136 (emphasis added). "[W]e conclude that an employer's policy and practice of invidious discrimination on account of race or national origin *is* a violation of section 8(a)(1)." *Id.* at 1138 (emphasis added). Nowhere do these unequivocal assertions suggest that employer racial discrimination may not produce docility and divisiveness. Judge Prettyman's concurring opinion intimates that he too interprets the majority opinion as adopting a per se view. *Id.*

whether such discrimination merely tends to precipitate divisiveness and docility and hence violates 8(a)(1) only upon sufficient proof of this effect.[27] Secondly, assuming that the court intended a per se approach,[28] it is highly questionable that the natural consequence of an employer's discrimination would in all cases be either divisiveness or docility. On the contrary, there is some authority to the effect that racial discrimination may tend to encourage cohesiveness within minority groups,[29] and it is conceivable that this factor could lead to collective employee action with nonminority union members. Furthermore, in light of the growing pressure for racial equality in all phases of American life, accompanied by increasing militancy of minority groups, it is slightly presumptuous for the court to forecast that an employer's racial discrimination will necessarily occasion docility.[30] In view of the fact that divisiveness and docility cannot be deemed inevitably to flow from racial discrimination, the *Packinghouse* decision should preferably be construed as establishing only the proposition that an employer's invidious racial discrimination may under some circumstances violate section 8(a)(1).[31] An independent factual determination should thus be made in each case to ascertain whether the particular discrimination involved did in fact inhibit the exercise of section 7 rights.

27. The following language implies that the court did not intend a per se rule: "We turn now to the question: *can* an employer's policy and practice of invidious discrimination against its employees on account of race or national origin violate section 8(a)(1) of the National Labor Relations Act? When established as hereinafter discussed, we answer this question in the affirmative . . . ." *Id.* at 1134 (emphasis added). In addition, Judge Danaher in his concurring opinion did not interpret the majority as employing a per se approach. *Id.* at 1138-39.

28. At least one writer has interpreted the *Packinghouse* decision as "apparently" holding that an employer's invidious racial discrimination is a per se violation of § 8(a)(1). 57 GEO. L.J. 1313, 1316 (1969).

29. *See, e.g.*, New Negro Alliance v. Sanitary Grocery Co., 303 U.S. 552 (1938). "This process of group coalition and group identification on the basis of interests is obviously more important when a group is a disadvantaged minority." L. MASSOTTI, J. HADDEN, K. SEMINATORE & J. CORSI, A TIME TO BURN? 156 (1969). *See generally* N.Y. Times, Apr. 20, 1969, at 1, col. 5.

30. The court thoroughly documented the well established proposition that racial discrimination in general can produce both divisiveness and docility. 416 F.2d at 1136-37 nn.16-21. However, these represent only possible reactions and should not be presumed to inevitably result from discrimination. There is substantial evidence that by the end of the 1960's, the formerly apathetic and submissive attitude of American Negroes in general had vanished, having been largely displaced by a sense of racial pride and an increased willingness to retaliate against unjustified discrimination. For a thorough discussion of the revolution in Negro attitudes, see L. MASSOTTI, J. HADDEN, K. SEMINATORE & J. CORSI, *supra* note 29; M. KING, WHERE DO WE GO FROM HERE: CHAOS OR COMMUNITY 18 (1967).

31. For suggested procedural alternatives to a per se rule, see 57 GEO. L.J. 1313, 1319 (1969).

## Labor Law—NLRB May Not Order Employer to Include Cbeckoff Provision in Collective Bargaining Agreement as Remedy for His Refusal to Bargain

H.K. Porter Co. refused to accede to the United Steelworkers' demands for a checkoff[1] provision during collective bargaining negotiations. The union sought relief from the NLRB which found that the company's refusal was not motivated by a valid business reason but was based upon an intention not to "aid and comfort" the union.[2] The Board then issued a cease and desist order after finding that this refusal to bargain was a violation of the "good faith" requirement of section 8(a)(5) of the National Labor Relations Act.[3] The court of appeals upheld the order and directed the company to engage in further bargaining on the checkoff.[4] In the following negotiations the company offered to discuss alternative arrangements,[5] but the union insisted that the court's order required Porter to agree to the checkoff provision. Because of this dispute over the interpretation of the order, the union filed a motion for clarification which the court of appeals denied, indicating that contempt proceedings would be the proper means to test the employer's compliance. The Regional Director declined to prosecute, stating that "the employer had 'satisfactorily complied with the affirmative requirements of the Order.'"[6] The union then filed a motion in the court of appeals for reconsideration of the earlier motion to clarify. The court granted the motion, and in a new opinion[7] held that under certain circumstances the Board might impose a checkoff provision as a remedy for "bad faith" bargaining.[8] The case was remanded to the Board, which issued an order requiring H.K. Porter to "[g]rant to the Union a contract clause providing for the checkoff of union dues."[9] The court of appeals affirmed.[10] On certiorari to the

1. A checkoff is the periodic deduction of union dues from the employee's paycheck by the employer, with subsequent payment made directly to the union. *See* CCH, GUIDEBOOK TO LABOR RELATIONS 64-66 (1968).

2. H.K. Porter Co., 153 N.L.R.B. 1370, 1372 (1965).

3. "It shall be an unfair labor practice for an employer—. . . (5) to refuse to bargain collectively with the representatives of his employees . . . ." 29 U.S.C. § 158(a)(5) (1964).

4. United Steelworkers of Am. v. NLRB, 363 F.2d 272 (D.C. Cir.), *cert. denied*, 385 U.S. 851 (1966).

5. The company offered to give the union space in their payroll office where they could collect union dues.

6. H.K. Porter Co., v. NLRB, 397 U.S. 99,100 (1970).

7. United Steelworkers of Am. v. NLRB, 389 F.2d 295 (D.C. Cir. 1967).

8. *Id.* at 298.

9. H.K. Porter Co., 172 N.L.R.B. 72 (1968).

10. H.K. Porter Co. v. NLRB, 414 F.2d 1123 (D.C. Cir. 1969).

United States Supreme Court, *held,* reversed. Where the National Labor Relations Board finds that an employer has repeatedly refused to bargain in "good faith," the Board has the power to order the employer and employee to negotiate in "good faith," but it cannot compel either party to agree to any substantive contract provision of the collective bargaining agreement. *H.K. Porter Co. v. NLRB,* 397 U.S. 99 (1970).

In 1935 Congress passed the National Labor Relations Act,[11] giving employees a federally protected right to organize and bargain collectively through their representatives. Section 8(a)(5) of the Act insures this right by requiring that an employer meet and bargain in "good faith" with his employees' representatives.[12] The legislative history indicates that Congress did not conceive this provision as a sweeping obligation to require agreement.[13] In *NLRB v. Jones & Laughlin Steel Corp.*,[14] the Supreme Court by implication restricted the Board's power to govern the substantive contract provisions.[15] In 1947 the fear was expressed that notwithstanding the Supreme Court's language in *Jones & Laughlin* the Board was extending its influence over the substantive terms of collective bargaining agreements, and this control would become more expansive if guidelines were not placed in the law.[16] In amending the Act, Congress included section

11. 29 U.S.C. §§ 151-68 (1964).

12. *See* NLRB v. Insurance Agents' Int'l Union, 361 U.S. 477, 484 (1960); S. REP. NO. 573, 74th Cong., 1st Sess. 12 (1935). *See generally* Smith, *The Evolution of the "Duty to Bargain" Concept In American Law,* 39 MICH. L. REV. 1065 (1941); Wellington, *Freedom of Contract and The Collective Bargaining Agreement,* 112 U. PA. L. REV. 467 (1964).

13. *See* S. REP. NO. 573, 74th Cong., 1st Sess. 12 (1935). "The committee wishes to dispel any possible false impression that this bill is designed to compel the making of agreements or to *permit governmental supervision* of their terms . . . . [T]he duty to bargain collectively does not carry with it the duty to reach an agreement, because the essence of collective bargaining is that either party shall be free to decide whether proposals made to it are satisfactory." *Id.* (emphasis added). "Let me say that the bill requires no employer to . . . make any agreement. . . . Nothing in this bill allows the Federal Government or any agency . . . to effect or govern working conditions in any establishment or plaee of employment." 79 CONG. REC. 7659 (1935) (remarks of Senator Walsh).

14. 301 U.S. 1 (1937).

15. "The Act does not compel agreements between employers and employees. It does not compel any agreement whatever. . . . The theory of the Act is that free opportunity for negotiation . . . may bring about the adjustments and agreements which the Act in itself does not attempt to compel." *Id.* at 45.

16. "Notwithstanding this language [in *Jones & Laughlin*] of the Court, the present Board has gone very far, in the guise of determining whether or not employers had bargained in good faith, in setting itself up as the judge of what concessions an employer must make . . . . [U]nless Congress writes into the law guides for the Board to follow, the Board may attempt to carry this process still further and seek to control more and more the terms of collective-bargaining

8(d),[17] which provides, among other things, that the obligation imposed "does not compel either party to agree to a proposal or require the making of a concession."[18] In *NLRB v. American National Insurance Co.*,[19] the Supreme Court indicated that the amendment prevents the Board from either directly or indirectly controlling the substantive terms of the collective bargaining agreement.[20] Even the dissent acknowledged that the Board lacked the power to compel either of the parties to make any concessions.[21] Likewise, in *NLRB v. Insurance Agents' Union*[22] the Court, speaking without a dissent, stated, "it remains clear that section 8(d) was an attempt by Congress to prevent the Board from controlling the settling of the terms of colleetive bargaining agreements."[23]

The NLRB is provided with broad remedial powers by section 10[24] of the Act, but the use of these powers is limited to carrying out the policies of the Act.[25] It has long been recognized that freedom of contract is basic to the entire Act.[26] Section 10(c) charges the Board with the duty of molding remedies to effectuate the policies of the Act.[27] Congress gave the NLRB broad discretion and flexibility in formulating its orders;[28] an order will not be set aside unless it can be

agreements." H.R. REP. No. 245, 80th Cong., 1st Sess. 19-20 (1947). *See* Adams & Coleman, *Can Collective Bargaining Survive the Board?* 52 GEO. L.J. 367, 372 (1964).

17. "For purposes of this section, to bargain collectively is the performance of the mutual obligation of the employer and the representative of the employees to meet . . . and confer in good faith with respect to . . . conditions of employment, or the negotiation of an agreement . . . *but such obligation does not compel either party to agree to a proposal or require the making of a concession.*" 29 U.S.C. § 158(d) (1964) (emphasis added).

18. *Id.*

19. 343 U.S. 395 (1952).

20. NLRB v. Insurance Agents' Int'l Union, 361 U.S. 477, 513 (1960) (concurring opinion); NLRB v. American Nat'l Ins. Co., 395, 401-02, 404 (1952). *See* Terminal R.R. Ass'n v. Brotherhood of R.R. Trainmen., 318 U.S. 1, 6 (1943).

21. "Certainly the Board lacks power to compel concessions as to the substantive terms of labor agreements." 343 U.S. 395, 412 (Minton, J., dissenting joined by Douglas, J.). *See* Local 24, Teamster Union v. Oliver, 358 U.S. 283, 295 (1959).

22. 361 U.S. 477 (1960).

23. *Id.* at 487.

24. 29 U.S.C. § 160 (1964).

25. 29 U.S.C. § 160(c) (1964). "If . . . the Board shall be of the opinion that any person . . . has engaged in or is engaging in any . . . unfair labor practice, then the Board shall state its findings of fact and shall issue . . . an order requiring such persons to cease and desist from such unfair labor practice, and to take such affirmative action . . . as will effectuate the policies of [the Act] . . . ."

26. *See* McCulloch, *Past, Present and Future Remedies Under Section* 8(a)(5) *of the National Labor Relations Act*, in 1968 LABOR RELATIONS YEARBOOK 114, 115 (Mr. McCulloch is chairman of the NLRB; Wellington, *Freedom of Contract and the Collective Bargaining Agreement*, 112 U. PA. L. REV. 467 (1964).

27. NLRB v. Seven-Up Bottling Co., 344 U.S. 344, 346 (1953).

28. *See generally* NLRB v. Gissel Packing Co., 395 U.S. 575 (1969); Phelps Dodge Corp.

shown that it is an attempt to achieve ends other than those that can be fairly said to carry out the policies of the Act.[29]

The instant Court found that the principal purpose of the Act was to insure that employers and employees could bargain together voluntarily to establish working conditions. It was not intended to allow the government to regulate the terms and conditions of employment or to become a party to the negotiations if the parties failed to reach an agreement. It further found that the legislative history of the Act indicates that Congress never intended for the Board to impose substantive contract provisions upon the parties. The majority also stated that section 8(d) of the Act limits the scope of the Board's remedial powers under section 10. Therefore, the Court concluded that the National Labor Relations Board was without the power to impose substantive contract provisions upon the parties as a remedy for an employer's failure to bargain in "good faith." The dissent found that in a situation where the employer has no valid business reason for refusing to include a checkoff provision in the collective bargaining agreement, and his sole reason was to prevent reaching any agreement with the union, then section 10(c) of the Act empowers the Board to order the inclusion of the checkoff as a remedy for the employer's failure to bargain in good faith.

In this case the Supreme Court reversed the first attempt by the Board in the history of the National Labor Relations Act to order an employer to include a substantive contract provision in a collective bargaining agreement. In the past, however, the Board has achieved almost the same result in other cases without directly ordering agreement by finding that an employer's refusal to grant a concession was unreasonable, constituted a refusal to bargain, and consequently was an unfair labor practice.[30] To remedy this finding, the employer was forced to grant the concession.[31]

In issuing the order in the instant case, the Board relied upon the opinion of the circuit court, which reasoned that section 8(d) defines

---

v. NLRB, 313 U.S. 177 (1941); NLRB v. Local 138, Operating Eng'rs, 380 F.2d 244 (2d Cir. 1967); J.P. Stevens & Co., Inc., 157 N.L.R.B. 869 (1966).

29. *See* Fibreboard Paper Prod. Corp. v. NLRB, 379 U.S. 203, 215-16 (1964); Virginia Elec. & Power Co. v. NLRB, 319 U.S. 533, 540 (1943).

30. *See generally* General Elec. Co., 150 N.L.R.B. 192 (1964); Radiator Specialty Co., 143 N.L.R.B. 350 (1963); Dallas Cartage Co., 14 N.L.R.B. 411 (1939); Globe Cotton Mills, 6 N.L.R.B. 461 (1938); Dodd, *From Maximum Wages to Minimum Wages: Six Centuries of Regulation of Employment Contracts*, 43 COLUM. L. REV. 643, 675 (1943).

31. See American Nat'l Ins. Co. 89 N.L.R.B. 185 (1950) (employer insisting on a management rights clause) *rev'd on other grounds*, 343 U.S. 395 (1952); Dixie Culvert Mfg. Co., 87 N.L.R.B. 554 (1949). *See also* United Steelworkers of Am. v. NLRB, 363 F.2d 272, 276 (D.C. Cir. 1966) (dissenting opinion).

collective bargaining and relates only to the determination of whether an 8(a)(5) violation has occured, and not to the scope of the remedy.[32] This reasoning seems anomalous, since it prohibits the Board from relying on an employer's refusal to reach agreement as the sole evidence of bad faith, yet it allows the Board to order the employer to accept a provision as a remedy in the same dispute. The Board also has utilized the settlement procedure[33] to force contract provisions on the parties. In the case of *Memphis Plywood Corp.*,[34] the International Woodworkers Union filed unfair labor practice charges with the NLRB. Before prosecuting the case, the employer was given the opportunity to accept an informal settlement agreement,[35] which he did. This agreement was prepared by the NLRB[36] and sent to the employer for his acceptance. It included a clause requiring the employer to include a provision providing for a checkoff in any collective bargaining agreement executed with his union.[37] Had the employer not complied with the agreement, the NLRB would have proceeded to prosecute the charges.[38]

The government's labor policy is not erected on a foundation of governmental regulation of the substantive results of negotiations.[39] The Act does not contemplate that unions will always be secure or be able to reach agreement. It does not prohibit the employer or union from ultimately resorting to economic force to accomplish what they have been unable to achieve through bargaining; indeed, the Act itself provides for the use of economic weapons. A number of writers have argued that encroachments by the Board have stifled the collective bargaining process.[40] Even if the present remedial powers of the Board are inadequate to cope with labor problems today, it is not for the

32. United Steel Workers of Am. v. NLRB, 389 F.2d 295, 299 (D.C. Cir. 1967).

33. *See* L. SILVERBERG, HOW TO TAKE A CASE BEFORE THE NATIONAL LABOR RELATIONS BOARD 209 (3d ed. 1967).

34. This case was assigned number 26-CA-2531 by the NLRB, Region 26, Memphis, Tennessee. The case was never heard because the employer accepted the settlement agreement.

35. An informal settlement is an agreement whereby the party charged undertakes to remedy the unfair labor practice. It always provides for withdrawal of the charge as soon as the charged party complies. L. SILVERBERG, *supra* note 35, at 209-10.

36. Various types of *prepared* settlement notices are available at the regional office, and each is worded to fit a particular unfair labor practice. *Id.* at 209-20.

37. The settlement agreement is subject to the approval of the regional director. *Id.* at 210.

38. *Id.*

39. S. REP. No. 105, 80th Cong., 1st Sess. 2 (1947); *see* NLRB v. Insurance Agents' Int'l, 361 U.S. 477, 490-91 (1960).

40. *See* Adams & Coleman, *supra* note 16; Kuelthau, *The NLRB and the Duty to Make Concessions in Bargaining*, 18 LAB. L.J. 201 (1967); Wellington, *Freedom of Contract and the Collective Bargaining Agreement*, 112 U. PA. L. REV. 467 (1964).

Board or the courts to expand those powers as they attempted to do in this case.[41] Congress should determine when to allow governmental review of collective bargaining proposals and compulsory submission to one side's proposals. The present Act does not envision such action.

## Securities Regulation—Pre-filing Corporate Press Release Which Includes the Value of the Securities to be Offered in a Proposed Exchange Offer Violates Section 5(c) of the Securities Act of 1933 and Is Not Protected by Rule 135

Plaintiff, Chris-Craft Industries, Inc. (Chris-Craft), brought a motion for a preliminary injunction to restrain Bangor Punta Corporation (Bangor Punta) from gaining control[1] of Piper Aircraft Corporation (Piper)[2] pending a trial on the merits of whether Bangor Punta violated section 5(c) of the Securities Act of 1933.[3] Plaintiff

41. *See generally* SENATE COMM. ON LABOR AND PUBLIC WELFARE, ORGANIZATION AND PROCEDURE OF THE NATIONAL LABOR RELATIONS BOARD, S. DOC. No. 81, 86th Cong., 2d Sess. (1960); SUBCOMM. ON NLRB OF HOUSE COMM. ON ED. AND LABOR, 81ST CONG., 1ST SESS., ADMINISTRATION OF THE LABOR-MANAGEMENT RELATIONS ACT BY THE NLRB 16-26 (Comm. Print 1961); McCulloch, *supra* note 26.

1. This litigation comes at the end of a hard fought battle between Chris-Craft and Bangor Punta for control of Piper Aircraft Corporation.

2. Piper Aircraft was also a defendant in this action as it also issued a press release on May 8.

3. The court held that Bangor Punta violated Rule 10b-6, 17 C.F.R. § 240.10b-6 (1969), of the 1934 Act when it purchased Piper shares between May 14 and May 23, since it was participating in the distribution. The court based its decision on the language "any right to purchase any such security." Since Piper shares carried the right to acquire Bangor Punta securities as a result of Bangor Punta's exchange offer, Bangor Punta could not purchase these securities. It might be noted that the majority could cite no authority for the proposition that an offeror in an exchange offer could not buy securities of the target company. The purpose of Rule 10b-6 was to prevent an issuer of stock from manipulating the market for that stock. Comment, *The SEC's Rule 10b-6: Preserving a Competitive Market During Distributions*, 1967 DUKE L.J. 809, 812. Bangor Punta argued that its purchases of Piper stock would serve to drive up the price of Piper stock and therefore make the Bangor Punta shares offered in exchange appear less attractive. This is not the effect which Rule 10b-6 was supposed to prevent. Rule 10b-13, not effective as to the present controversy, was adopted to prevent an offeror of an exchange offer from buying shares of the target company during distribution. The court relied on the language of the SEC's release which stated that this rule was a mere codification of existing interpretations under Rule 10b-6. SEC Securities Act Release No. 34-8995 (May 5, 1969), [Current] CCH FED. SEC. L. REP. ¶ 77,706, at 83,617. It seems tenuous at most that the SEC would adopt a rule prohibiting a transaction already prohibited by Rule 10b-6 especially in light of the fact that no cases have held that Rule 10b-6 prohibits an offeror company from buying target company stock.

contended that the publication[4] by Bangor Punta of its intention to offer securities valued at 80 dollars in exchange for Piper stock constituted an "offer to sell" before filing a registration statement in violation of section 5(c) and that defendant is not protected by Rule 135 of the Securities and Exchange Commission (SEC).[5] Defendant contended that the present state of the law concerning disclosure and the rules of the New York Stock Exchange require disclosure of this information even prior to the filing of a registration statement. The district court denied the motion for an injunction and held that Bangor Punta had not violated section 5(c). On appeal to the Second Circuit Court of Appeals, *held*, affirmed as to the injunction but reversed and remanded as to the 5(c) violation.[6] A pre-filing press release announcing a corporation's proposed exchange offer which includes the value of the securities to be offered violates section 5(c) of the Securities Act of 1933 and is not within the protection of Rule 135. *Chris-Craft Industries, Inc. v. Bangor Punta Corp.*, [Current] CCH FED. SEC. L. REP. ¶ 92,510 (2d Cir. Nov. 6, 1969).

The Securities Act of 1933 was designed by Congress to insure accurate disclosure by preventing premature disclosure of pertinent information concerning publicly offered securities. This would put all investors in a position to exercise equally informed judgment about securities offered to them for sale.[7] Section 5(c) declares it unlawful to make *any* kind of "offer to sell" before a registration statement regarding the securities has been filed.[8] This section attempted to eliminate the practice of "beating the gun" or "conditioning the market"[9] with advance publicity before the filing of a registration

4. The portion of the press release complained of reads as follows: "Bangor Punta has agreed to file a registration statement with the SEC covering a proposed exchange offer for any and all of the remaining outstanding shares of Piper Aircraft for a package of Bangor Punta securities to be valued in the judgment of The First Boston Corporation at not less than $80 per Piper share. The registration statement covering all securities to be issued will be filed as soon as possible and a meeting of the shareholders of Bangor Punta Corporation will be called for approval." Chris-Craft Indus., Inc. v. Bangor Punta Corp., [Current] CCH FED. SEC. L. REP. ¶ 92,510, at 98,374 (2d Cir. Nov. 6, 1969).

5. Rule 135 was promulgated by the SEC under § 5(c) setting forth certain categories of information to be included in an announcement which does not constitute an offer to sell. Plaintiff contended the categories of information privileged under Rule 135 are exclusive and, since price was not one of the categories, Bangor Punta made an offer to sell when it included the price.

6. The court, citing Studebaker Corp. v. Gittlin, 360 F.2d 692 (2d Cir. 1966), affirmed the denial of the motion for an injunction since the plaintiff would not suffer any irreparable harm.

7. H.R. REP. No. 1542, 83d Cong., 2d Sess. 6 (1954).

8. Roe v. United States, 316 F.2d 617 (5th Cir. 1963); 1 L. LOSS, SECURITIES REGULATION 181, 210 (2d ed. 1961).

9. SEC v. North Am. Research & Dev. Corp., 280 F. Supp. 106 (S.D.N.Y. 1968) (purpose is to protect public investors by requiring registration); 1 L. Loss, *supra* note 8, at 215.

statement. Early publicity could lead to a premature opinion of the security's value without the benefit of a complete disclosure.[10] Section 2(3)[11] defines the term "offer to sell" or "offer" broadly to include every attempt or offer to dispose of a security for value in conjunction with section 5(c). In order to exempt certain disclosures of forthcoming issuances from the definition of an "offer to sell" prohibited by section 5(c), the SEC has promulgated Rule 135.[12] The purpose[13] of this rule was to enable an issuer to furnish certain factual information to its security holders in advance of the actual offering and to illustrate exactly what information was permitted without constituting an offer to sell. In an exchange offer, the name of the issuer, the title of the securities, and the basis upon which the exchange is to be made are categories of privileged information.[14] The SEC has left the courts apparently free to interpret the language, the "basis upon which the exchange is to be made," as they see fit. The SEC's only utterances concerning the Rule characterized it as an "interpretative" rule.[15] In contrast to these provisions militating against premature disclosure, the securities laws contain specific sections that require the disclosure of any material facts. Section 10(b) of the Securities Exchange Act of 1934 was intended to empower the SEC to regulate or prohibit any manipulative or deceptive practices which it finds detrimental to the interests of the investor.[16] Rule 10b-5,[17] promulgated under section 10(b), makes it unlawful to employ any manipulative device or to make any untrue statement or omission concerning any material facts in the purchase or sale of a security. In 1968, the Second Circuit made its important decision in *SEC v. Texas Gulf Sulphur Co.*[18] that insiders

10. Chris-Craft Indus. Inc. v. Bangor Punta Corp., [Current] CCH FED. SEC. L. REP. ¶ 92,510, at 98,376 (2d Cir. Nov. 6, 1969).

11. 15 U.S.C. § 77b(3) (1964): "The term 'offer to sell,' 'offer for sale,' or 'offer' shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value."

12. Rule 135 provides: "(a) For the purposes only of section 5 of the Act, the following notices sent by an issuer in accordance with the terms and conditions of this rule shall not be deemed to offer any security for sale: . . . (2) A notice to any class of security holders of such issuer or of another issuer advising them that it proposes to offer its securities to them in exchange for other securities . . . (c) The notice shall . . . contain no more than the following additional information: . . . (4) In the case of an exchange offering, the name of the issuer and title of the securities to be surrendered in exchange for the securities to be offered, the basis upon which the exchange is proposed to be made and the period during which the exchange may be made . . . ." 17 C.F.R. § 230.135 (1969).

13. 25 SEC ANN. REP. 16 (1959).

14. Rule 135(c)(4), 17 C.F.R. § 230.135 (1969).

15. 21 SEC ANN. REP. 4 (1955).

16. S. REP. No. 792, 73d Cong., 2d Sess. 18 (1934); *see* Note, *Texas Gulf Sulphur: Its Holdings and Implications*, 22 VAND. L. REV. 359, 364 (1969).

17. 17 C.F.R. § 240.10b-5 (1969).

18. 401 F.2d 833 (2d Cir. 1968).

in possession of nonpublic material information cannot purchase or sell securities for their own benefit on the basis of that material information before it has been made public.[19] The test for "material" was described as "whether a *reasonable* man would attach importance . . . to the information in determining his choice of action in the transaction in question and whether the fact might affect the value of the securities."[20] The declared policy under the securities laws is to guarantee "that all investors trading on impersonal exchanges have relatively equal access to material information"[21] and therefore when information may affect investors' desires to sell or buy, nondisclosure may result in a violation of the securities laws.[22] It is also recognized that a corporation itself has no right to trade on the basis of inside information.[23] The New York Stock Exchange in the wake of *Texas Gulf Sulphur* dedicated itself to the policy of complete, timely disclosure by adopting a Stock Exchange Rule on July 18, 1968.[24] Because negotiations leading to acquisitions or exchange offers are the types of developments where untimely and inadvertent disclosure occur, corporations are required to disclose quickly to the public any news or information which might reasonably be expected to materially alter the market for securities.[25]

19. Address by Manuel F. Cohen, Baltimore Securities Analysts Society, Jan. 6, 1969; [1967-69 Decisions] CCH FED. SEC. L. REP. ¶ 77,652, at 83,414; *see* Bromberg, *Corporate Information: Texas Gulf Sulphur and Its Implications*, 22 Sw. L.J. 731 (1968). This decision was actually predictable from earlier such holdings. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963) (object of the securities law is to substitute philosophy of full disclosure for that of caveat emptor); Cady, Roberts & Co., 40 S.E.C. 907, 911 (1961) (10b-5 was intended to cover devices which take undue advantage of investors).

20. 401 F.2d at 849. These definitions were based on language taken from other decisions. List v. Fashion Park Inc., 340 F.2d 457 (2d Cir. 1965). The court held that a "reasonable" man includes not only the conservative investor but also the speculator so that information which might persuade investors to buy, sell, or hold securities would also include facts which affect the future of the company. Note, *supra* note 16, at 369.

21. 401 F.2d at 849; Appellee's Brief for Petition for Rehearing at 3, Chris-Craft Indus., Inc. v. Bangor Punta Corp., [Current] CCH FED. SEC. L. REP. ¶ 92,510 (2d Cir. Nov. 6, 1969).

22. SEC v. Great Am. Indus., Inc., 407 F.2d 453, 460 (2d Cir. 1968), *cert. denied*, 395 U.S. 920 (1969).

23. Kohler v. Kohler Co., 319 F.2d 634, 638 (7th Cir. 1963).

24. New York Stock Exchange Company Manual, at A-19 (July 18, 1968).

25. This disclosure is not required if such information can be restricted to a small group of top management officials. Since it is necessary to bring in other persons to conduct preliminary studies and consultations, it is almost impossible to maintain security. The extent of such disclosures depends upon the state of negotiations, but usually they should be definite as to price and ratio. *Id.* The Exchange could have delisted the Bangor Punta securities or instituted other sanctions against Bangor Punta if it had not issued the May 8 press release. Brief for Appellee at 23, Chris-Craft Indus., Inc. v. Bangor Punta Corp., [Current] CCH FED. SEC. L. REP. ¶ 92,510 (2d Cir. Nov. 6, 1969).

In the instant case the court addressed itself to whether Bangor Punta violated section 5(c) when it issued the May 8 press release by declaring that Rule 135 provides an exclusive checklist as to what is and is not an offer.[26] Since the Rule does not specifically mention disclosure of the value of the securities to be offered, the court held that Bangor Punta's inclusion of the 80 dollar value overstepped the exemption and constituted an offer to sell in violation of 5(c).[27] Noting that the evil of a premature offer is its tendency to supply the offeree with an opinion of the value of the securities before a registration statement is filed, the majority directed its attention to the defendant's argument that an immediate disclosure of market value was required by *Texas Gulf Sulphur* and by the rules of the New York Stock Exchange. The court declared that the only material fact in this case was the exchange offer itself and that by including the price Bangor Punta went too far. Finally, the majority regarded the disclosure policy of the Exchange as not binding upon the SEC and the court. The dissent noted that the need for fair and equal access to information about the terms of a tender offer must be balanced against premature disclosure of an exchange offer in contravention of the registration and disclosure requirements.[28] Relying on the language of Rule 135(c)(4) that requires notification of "the basis upon which the exchange is proposed to be made," the dissent declared that the 80 dollar figure was an essential part of the basis and thus was allowed under Rule 135. In light of *Texas Gulf Sulphur* which requires immediate disclosure of material information, the dissent felt that the 80 dollar figure was a material fact and its disclosure was required. The dissent noted the possibility of damage to Piper shareholders due to trading by a number of persons who acted as consultants for Bangor Punta.[29] Citing the disclosure policy of the New York Stock Exchange, the dissent concluded that the May 8 announcement was proper and a fair accommodation of section 5(c) and Rule 135 and the obligation to disclose material facts.

The instant case represents an affirmation of the policy behind

26. [Current] CCH FED. SEC. L. REP. ¶ 92,510, at 98,376.

27. The majority strictly interpreted the language of Rule 135 in finding price not to be a privileged disclosure.

28. The dissent did not base its decision on any single proposition but wisely sought an accommodation between 2 seemingly conflicting policies.

29. The dissent was very interested in the danger of putting investors on a different par as far as information was concerned. If the price had not been announced, any Piper shareholder who tendered his shares to Chris-Craft for a smaller amount before Bangor Punta's offer was effectively announced would suffer damage and might well have an action against Bangor Punta and Piper. [Current] CCH FED. SEC. L. REP. ¶ 92,510, at 98,380 n.2.

section 5(c) by strictly and literally interpreting its language. Although the attempt to protect the investor is meritorious, numerous difficulties concerning the obligations of disclosure are ostensibly created. In order to protect the investor from forming a premature opinion of the value of a security before a registration statement is filed, the court strictly interpreted Rule 135 to find that Bangor Punta was not within its protection.[30] The reasoning of the majority's holding creates a head-on collision with the disclosure requirements of *Texas Gulf Sulphur*. In light of the policy to place all investors on the same level and provide equal access to material information,[31] and considering *Texas Gulf Sulphur*[32] and *Kohler v. Kohler Co.*,[33] it seems logical that a corporation would be under a duty to disclose any material information it might possess if it planned to purchase the stock of a target company. Bangor Punta was placed in an irreconcilable dilemma. Various Bangor Punta consultants who gained knowledge of the exchange offer would be in a position to buy up Piper shares and later exchange them for Bangor Punta shares. At the time of the press release, Piper shares were selling in the 60's on the Stock Exchange, thus giving a decided advantage to those persons who learned of the exchange offer before it was publicly released. The dissent wisely adopted a balancing approach which led to the conclusion that the benefits of insuring equal access to information about the terms of the tender offer in this case outweighed the potential evils of premature disclosure. The SEC policy on disclosure as espoused by its former chairman, is that once news of a material pending development has gone beyond the top management of a company and their individual confidential advisers, the company takes a dangerous risk in not making prompt disclosure so as to insure that no market advantage is created for anyone.[34] Bangor Punta's somewhat dubious position was exacerbated by the immediate disclosure policy of the New York Stock Exchange.[35] If it failed to comply with these rules, Bangor Punta faced the possibility of being delisted or of suffering other sanctions at the hands of the Exchange.[36] In the midst of this utter confusion, the SEC

30. *Id.* at 98,380.

31. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969). For a discussion of disclosure requirements, see J. Flom, B. Garfinkel & J. Freund eds., DISCLOSURE REQUIREMENTS OF PUBLIC COMPANIES AND INSIDERS (1967).

32. *See* Coates v. SEC, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

33. 319 F.2d 634, 638 (7th Cir. 1963).

34. Address by Manuel F. Cohen, Baltimore Securities Analysts Society, Jan. 6, 1969, [1967-69 Decisions] CCH FED. SEC. L. REP. ¶ 77,652, at 83,419.

35. *See* notes 24-25 *supra*.

36. *Id.*

adds to the misery by contributing Rule 10b-13 which prohibits any person who is making a tender offer or an exchange offer from going outside of that offer to purchase securities of the target company from the time such exchange offer is publicly announced until the expiration of the period of exchange.[37] Numerous inconsistencies attach vividly to this new regulation. Rule 10b-13 is susceptible to two interpretations of when the purchase of target company stock is prohibited: (1) only after the public announcement of the actual exchange offer itself, or (2) after any public announcement that an exchange offer will be made in the near future. Under the first interpretation, 10b-13 seemingly would allow a corporation to buy target company shares from the time of public announcement that it will make an exchange offer in the future until public announcement of the actual exchange offer itself; the question is whether such an announcement of a future exchange offer will be deemed an offer to sell in violation of 5(c). Under the second interpretation, all purchases of target company stock would be prohibited after any public announcement of an exchange offer to be made in the future even though 10b-5 prevents market purchases before disclosure. The policy engrained in 10b-13 is to protect the target company's shareholders by assuring equal treatment during an exchange offer,[38] thus avoiding a situation where certain shareholders of target company stock who sell early on the open market are paid one amount for their shares while other shareholders of target company stock are paid a greater amount.[39] These conflicts were created by the Congress and the SEC, and the courts are unable satisfactorily to reconcile them. It is time for the SEC and Congress to deal with these problems and construct workable guidelines that are clear, understandable, and effective in light of the opposing policy considerations.

## Securities Regnlation—Standing—Defranded Tender—Offeror May Sue Under Rule 10b-5 When Made a "Forced Seller" Under Threat of Antitrust Action

Plaintiff, Crane Company, sought an injunction to prevent the consummation of a proposed merger of the Westinghouse Air Brake

37. *See* note 3 *supra.*

38. Lowenfels, *Rule 10b-13, Rule 10b-6 and Purchases of Target Company Securities During an Exchange Offer*, 69 COLUM. L. REV. 1392, 1407 (1969).

39. *Id.* at 1395.

Company (Air Brake) into defendant, American Standard, Inc. (Standard), on the grounds that defendant manipulated the price of Air Brake stock to defeat plaintiff's tender offer to Air Brake stockholders.[1] Having refused a Crane merger proposal, Air Brake's directors, upon learning that Crane was accumulating Air Brake stock, agreed to merge into Standard to resist the Crane take-over attempt. Crane then mailed an offer to Air Brake shareholders to exchange Crane stock and debentures for Air Brake stock. On April 19, 1963, the expiration date of Crane's tender offer, Standard purchased 170,000 shares of Air Brake stock on the New York Stock Exchange and that same day secretly sold 120,000 shares off the market at an average price per share about ten percent lower than the purchase price.[2] Crane's tender offer failed, and the Air Brake-Standard merger became effective. Thereafter Crane was forced to sell its Air Brake-Standard stock under threat of an antitrust divestiture action by Standard.[3] Crane contended that Standard's purchases and undisclosed sales constituted a violation of sections 9(a)(2)[4] and 10(b)[5] of the

1. Air Brake was also named a defendant in an action charging that it made false and misleading statements in soliciting proxies from its shareholders in support of the Air Brake-Standard merger. This complaint was consolidated for trial with the claim against Standard. For a review of the target company's duty of disclosure, see Krasik, *Tender Offers: The Target Company's Duty of Disclosure*, 25 BUS. LAW 455 (1970).

2. In February 1968, when Air Brake began considering Standard's merger proposal, Air Brake stock was listed at $36 per share on the New York Stock Exchange. Two weeks later it jumped to $44 per share when Air Brake publicized its intent to merge into Standard, and by April 10, 1968, while the Crane offer to exchange Crane security worth $50 for each share of Air Brake stock was outstanding, Air Brake stock had risen to $49 per share. Standard's purchases of Air Brake stock on April 19, 1968, were at an average price per share of $49.50, and its undisclosed off-the-market sales returned $44.50 per share.

3. Crane is a substantial company in the plumbing industry and Standard is its largest competitor.

4. Securities Exchange Act § 9(a)(2), 15 U.S.C. § 78i(a)(2) (1964) makes it unlawful: "To effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others." Liability for a violation of § 9(a)(2) is provided by § 9(e), 15 U.S.C. § 78i(e) (1964): "Any person who willfully participates in any act or transaction in violation of subsections (a), (b), or (c) of this section, shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction, and the person so injured may sue in law or in equity in any court of competent jurisdiction to recover the damages sustained as a result of any such act or transaction."

5. Securities Exchange Act § 10(b), 15 U.S.C. 78j (1964) provides: "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Securities Exchange Act of 1934 as market manipulation designed to increase the price of Air Brake stock for the purpose of deterring tenders of Air Brake stock under the Crane exchange offer. Defendant argued that its acquisitions were made solely for the purpose of voting in favor of the Air Brake-Standard merger and that even if the activity was unlawful, Crane had no standing to sue since sections 9(a)(2) and 10(b) protect only a defrauded "purchaser" or "seller". The district court found no fraudulent market manipulation and dismissed the claim after trial on the merits. On appeal to the United States Court of Appeals for the Second Circuit, *held,* reversed. One acting in concert with a target company has a duty to disclose transactions in that company's stock designed to frustrate the tender offer and is liable under Rule 10b-5 to a defeated tender-offeror who is subsequently forced by the antitrust laws to sell his target company stock. *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969).

The interpretation of Rule 10b-5[6] as providing a private cause of action for fraud "in connection with the purchase or sale of any security"[7] has resulted in judicial efforts to delimit actions under the Rule through restraints on 10b-5 claimants.[8] *Birnbaum v. Newport Steel Corp.*[9] limited standing under 10b-5 to defrauded purchasers or

6. Rule 10b-5 promulgated by the Securities and Exchange Commission under the authorization of § 10b, provides: "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (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." 17 C.F.R. § 240.10b-5 (1969).

7. Rule 10b-5 does not expressly provide a civil remedy, but Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946), held that 10b-5 implies a private cause of action for defrauded sellers, and Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951), recognized a private right for purchasers. J.I. Case Co. v. Borak, 377 U.S. 426 (1964), confirms by analogy this construction of Rule 10b-5. In holding a private right of action exists under proxy regulation § 14(a), 15 U.S.C. § 78(n)(a) (1964), the *Borak* Court stressed that although § 14(a) does not expressly provide for a private remedy, judicial relief will be available when necessary to effect the purpose of the securities laws. *See* Comment, *The Decline Of The Purchaser-Seller Requirement Of Rule 10b-5*, 14 VILL. L. REV. 499, 501-02 (1969).

8. For example: (1) Privity—Joseph v. Farnsworth Radio & Television Corp., 99 F. Supp. 701 (S.D.N.Y. 1951), *aff'd per curiam*, 198 F.2d 883 (2d Cir. 1952). *But see* Note, *Civil Liability Under Section 10b and Rule 10b-5: A Suggestion For Replacing The Doctrine Of Privity*, 74 YALE L.J. 658 (1965). (2) Scienter—Kohler v. Kohler Co., 319 F.2d 634 (7th Cir. 1963). *But see* Weber v. C.M.P. Corp., 242 F. Supp. 321 (S.D.N.Y. 1965). (3) Reliance—List v. Fashion Parks Inc., 340 F.2d 457 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965). (4) Foreseeability—*see* Vine v. Beneficial Fin. Co., 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967).

9. 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

sellers.[10] The apparently rigid prerequisite which *Birnbaum* established has been the subject of severe academic[11] and administrative criticism[12] and has been significantly qualified by judicial interpretation. For example, it has been held that a corporate issuer is a "seller" when it is defrauded into issuing shares of its stock.[13] *Vine v. Beneficial Finance Co.* broadened[14] the definition of a "purchase or sale" by finding "forced sale," even though no sale had been consummated, when a short-form merger left a dissenting shareholder with no alternative other than surrendering his stock for the price agreed upon in the merger. Support for a liberal construction of the purchaser-seller requirement was found in the statute itself; sections 3(a)(13)[15] and 3(a)(14),[16] which include executory contracts in the definition of purchase and sale, have been held applicable to section 10(b) and Rule 10b-5.[17] *A.T. Brod & Co. v. Perlow*[18] marked a shift in emphasis from

10. *But see* McManns v. Jessup & Moore Paper Co., 5 SEC Jud. Dec. 810 (E.D. Pa. 1948). Although *Birnbaum* did not label the purchaser-seller requirement, later decisions have properly categorized the rule as a limitation on standing. Chashin v. Mencher, 255 F. Supp. 345 (S.D.N.Y. 1965); *see* SEC v. National Securities, Inc., 393 U.S. 453 (1969). O'Neill v. Maytag, 339 F.2d 764 (2d Cir. 1964), has been most often cited as a recent reaffirmation of *Birnbaum* although it has been pointed out that *O'Neill* was based on the requirement of deception rather than the "purchaser-seller" doctrine. Lowenfels, *The Demise Of The Birnbaum Doctrine: A New Era For Rule 10b-5*, 54 VA. L. REV. 268, 270 (1968). The November, 1969 decision in Iroquois Indus., Inc. v. Syracuse China Corp., 417 F.2d 963 (2d Cir. 1969), however, seems to be a conclusive reassertion of *Birnbaum's* continuing vitality. *See* text accompanying note 24 *infra*.

11. *E.g.*, Note, *Inroads On The Necessity For A Consummated Purchase Or Sale Under Rule 10b-5*, 1969 DUKE L.J. 349; Lowenfels, *supra* note 10.

12. Brief for the SEC as Amicus Curiae, A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967); Brief for the SEC as Amicus Curiae, Vine v. Beneficial Fin. Co., 374 F.2d 627 (2d Cir. 1967). In both of these cases, the SEC urged that the language of 10b-5 does not require the purchaser-seller limitation.

13. Hooper v. Mountain States Sec. Corp., 282 F.2d 195 (5th Cir. 1960); *accord*, Ruckle v. Roto Am. Corp., 339 F.2d 24 (2d Cir. 1964) (injunctive relief granted in connection with the issuance of Treasury stock by a corporation on the grounds that such an issuance was a "sale").

14. 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967); *cf.* Dasho v. Susquehanna Corp., 380 F.2d 262 (7th Cir. 1967).

15. 15 U.S.C. § 78c(a)(13) (1964) states: "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire."

16. 15 U.S.C. § 78c(a)(14) (1964) states: "The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

17. M.L. Lee & Co. v. American Cardboard & Packaging Corp., 36 F.R.D. 27 (E.D. Pa. 1964) (holding that the promisee of an executory contract to purchase capital stock may bring a 10b-5 action against the recalcitrant promisor).

18. 375 F.2d 393 (2d Cir. 1967) (allowing suit against a defendant who ordered securities from a broker and refused to pay for them). Although the requisite "purchase" was found in the broker's buying the securities to sell to a defendant, the court stressed that the broad remedial purposes of the securities laws should be the dominant consideration in viewing new forms of deception. *Id.* at 397. This emphasis on the broad federal prohibition of fraud in connection with the purchase or sale of securities is the core of the only Supreme Court decision construing,

the purchaser-seller requirement to the "in connection with" language of 10b-5, finding that a private cause of action should not be precluded simply because the deceptive device is atypical. *Mutual Shares Corp. v. Genesco, Inc.*[19] made it clear that for injunctive relief no consummated purchase or sale of any description is necessary for a 10b-5 action if defendant's fraudulent market manipulation is threatening irreparable harm to the plaintiff. Impliedly accepting the view that *Mutual's* attenuation of *Birnbaum* should extend beyond petitions for coercive relief,[20] *Commerce Reporting Co. v. Puretec, Inc.*[21] held that in using the phrase "in connection with" Congress intended that an unconsummated transaction[22] be sufficient basis for federal relief when damages can be demonstrated. This apparent emasculation of the purchaser-seller requirement prompted a district court to observe that the Second Circuit's decisions in *Vine* and *Brod* "seriously challenge, if not overrule, its decisions in *Birnbaum* and *O'Neill*."[23] The accuracy of this observation, however, is still open to question. *Iroquois Industries, Inc. v. Syracuse China Corp.*[24] has recently reasserted "the result and reasoning of *Birnbaum*"[25] by

though not for standing purposes, the "purchase or sale" language of Rule 10b-5. SEC v. National Sec., Inc., 393 U.S. 453 (1969).

19. 384 F.2d 540 (2d Cir. 1967) (shareholders successful in enjoining outsider who had gained control of corporation through tender offer from depressing market by minimizing dividends). As to the related question of the corporate issuer's rights against an outside market manipulator, see Moore v. Greatamerica Corp., 274 F. Supp. 490 (N.D. Ohio 1967) (granting injunction under 10b-5). *Contra*, General Time Corp. v. American Investors Fund, Inc., 283 F. Supp. 400 (S.D.N.Y. 1968).

20. It has been urged that 10b-5 claimants should not be barred from attempting to prove damages even though the affected securities are retained. For example, it may be shown that a business opportunity was lost through inability to secure a loan because of the diminution in the value of the securities as collateral. Comment, *supra* note 7, at 513; *see* Lowenfels, *supra* note 10, at 276-77.

21. 290 F. Supp. 715 (S.D.N.Y. 1968).

22. In light of the fact that the *Commerce* court declined to rely primarily on a subsequent contract which would come within the § 3 definition of a purchase or sale, the interpretation that the court intended that even unconsummated transactions which are not "contracts" be sufficient basis for federal relief seems correct. Note, *supra* note 11, at 354 nn.30 & 31, 356-57; *see* Goodman v. H. Hentz & Co., 265 F. Supp. 400 (N.D. Ill. 1967) (relying entirely on the "in connection with" language of 10b-5 and ignoring a "contract to purchase" in allowing a 10b-5 action notwithstanding the fact that the transaction was incomplete). *But see* Keers & Co. v. American Steel & Pump Corp., 234 F. Supp. 201 (S.D.N.Y. 1964) (suggesting that an aborted contract will not sustain a 10b-5 action).

23. Entel v. Allen, 270 F. Supp. 60, 69 (S.D.N.Y. 1967); *see* Symington Wayne Corp. v. Dresser Indus., Inc., 383 F.2d 840 (2d Cir. 1967) (assuming standing "arguendo" where neither a purchase nor sale existed before dismissing the complaint on the merits).

24. 417 F.2d 963 (2d Cir. 1969).

25. *Id.* at 970. But *Iroquois* apparently did not repudiate *Mutual's* abrogation of *Birnbaum* in equity. The court cited Greenstein v. Paul, 400 F.2d 580 (2d Cir. 1968), for the proposition

holding that a tender-offeror whose take-over bid had been defeated by misrepresentations to the offeree shareholders had no standing to sue the target company.

In the instant case, the court found that Standard's position as a major stockholder in Air Brake coupled with the intimate relation between Standard and Air Brake's management in operating to defeat Crane's tender offer made Standard an insider with a corresponding duty of disclosure under Rule 10b-5.[26] Having found a 10b-5 violation,[27] the court addressed itself to a consideration of whether Crane was the proper party to bring suit.[28] On the issue of standing, the court recognized that it adhered to a strict construction of the purchaser-seller requirement in *Birnbaum* and *Iroquois*, but distinguished *Birnbaum* on the ground that there was no causal connection between the alleged violation of 10b-5 and the injury to the corporation in that case. *Iroquois* was summarily treated as simply being a case in which no purchase or sale was found. The court reiterated its refusal to decide whether one who is neither a purchaser nor a seller can attack a transaction under Rule 10b-5. Instead it was held that the instant case met the purchaser-seller requirement in that it involved a sale analogous to the forced sale precipitated by a short-form merger in *Vine*.[29] The court reasoned that the effect of Standard's market manipulation was to deter tenders of Air Brake stock to Crane, thereby facilitating the Air Brake-Standard merger. Crane was then forced to sell its stock in the surviving corporation under threat of an antitrust divestiture action.

Although apparently mooted on their facts by the new section 14(e),[30] the *Iroquois* and *Crane* cases are nevertheless excellent

---

that *Birnbaum* is still the rule at least insofar as actions for damages are concerned. For a discussion of the *Birnbaum* doctrine which is oriented toward the distinction between actions for damages and actions for coercive relief, see Note, *The Purchaser-Seller Limitation to SEC Rule 10b-5*, 53 CORNELL L.Q. 684 (1968).

26. 419 F.2d at 796.

27. The court also found a violation of § 9(a)(2) since the defendant acted for the "purpose of inducing sale" as he knew that his fraud would make the plaintiff a "forced seller". *Id.* at 794.

28. Before addressing itself to the standing question, the court held that the requirements of reliance, deception, and causation were satisfied. *Id.* at 796-97.

29. *Id.* at 798.

30. 15 U.S.C. § 78n(e) (Supp. IV, 1965-68) provides: "It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipultive acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation." Electronic Specialty

examples of the hazards inherent in the application of the purchaser-seller requirement. The cases represent virtually identical situations of fraudulent activity by a target company to defeat a take-over bidder's tender offer.[31] Yet because the plaintiff in *Crane* was forced by the antitrust laws to sell his stock in the surviving company, he was found to have standing to sue under 10b-5 while his less fortunate counterpart in *Iroquois* was without federal remedy. Whether a broad or a narrow view of the purpose of section 10(b) and Rule 10b-5 is adopted, extrinsic fortuities should not control the implementation of that purpose.[32] If, as *Iroquois* asserts, the enactment of section 14(e) is evidence that Congress never intended that section 10(b) give a private right of action to defrauded tender-offerors,[33] then it must be assumed that *Crane's* literal construction of *Birnbaum* reached the very result that the purchaser-seller requirement was formulated to avoid—overreaching the purpose of section 10(b).[34] While it seems clear that *Birnbaum* was correct in determining that Congress did not intend to regulate the internal management of corporations through the rule making power in section 10(b),[35] the broad federal prohibition of fraud

Co. v. International Controls Corp., 409 F.2d 937 (2d Cir. 1969), held that this provision gives standing in a cash tender offer case regardless of whether there has been a purchase or sale of securities and Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc., [current] CCH FED. SEC. L. REP. ¶ 92,557 (2d Cir. Jan. 8, 1970), confirmed an exchange tender offeror's standing under § 14(e).

31. Although in *Crane* the defendant is an outsider rather than the target company, the court's finding of concert between Standard and Air Brake as the basis for holding Standard to the duty of an insider renders the distinction insignificant. Standard is not the traditional type of third party insider, such as a "tippee," who acquires corporate information and then acts on it without disclosure, since Standard generated its own "inside" information by its stock transactions. Nevertheless the categorization is a logical extension of the decision in SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) and might be viewed as expanding the coverage of Rule 10b-5. It should be noted, however, that all that is required to find a 10b-5 violation is fraud in connection with the purchase or sale of securities and insider status is not a necessary prerequisite. 3 L. LOSS, SECURITIES REGULATION 1445 (1961); *see* A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967) (failure of defendant to pay for securities ordered from broker held actionable under 10b-5). Since Standard's actions clearly constituted a fraud in connection with the purchase or sale of securities, finding it to be an insider was not required and reinforces the use of an unnecessary label nowhere used in the Rule or the Act.

32. The Supreme Court has stated that the federal securities laws should be construed "not technically and restrictively, but flexibily to effectuate [their] remedial purposes." SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963).

33. Iroquois Indus., Inc. v. Syracuse China Corp., 417 F.2d 963, 969 (2d Cir. 1969).

34. The decision in *Birnbaum* has been attributed to fear that a broader pronouncement would open to federal scrutiny charges of corporate mismanagement that traditionally have been within the exclusive jurisdiction of the states. Leech, *Transactions in Corporate Control*, 104 U. PA. L. REV. 725, 833 (1956).

35. *Id.* at 834. Historically it has been the policy of Congress to reject attempts to place generally applicable federal controls on the internal workings of corporations. Note, *supra* note 8, at 681. An extensive federal common law of corporations based on the slim structure of § 10b

in connection with the purchase or sale of securities cannot be effected without expanding the narrow approach of *Birnbaum*. Mechanistic adherence to *Birnbaum* has led to liberalization by fiction through the courts' creative findings of a purchase or sale[36] and has perpetuated a rule of law that has resulted in essentially contrary decisions in *Crane* and *Iroquois*. The problem of limiting 10b-5 plaintiffs should be resolved by replacing the *Birnbaum* doctrine with a standard that will more clearly reflect in its application the broad purposes of the federal securities laws. The reliance of recent decisions on the "in connection with" language suggests a limitation of greater flexibility. If the primary target of the fraud is a transaction the essence of which lies in the trading of securities, and if the claimant can demonstrate that the deception was the cause in fact of his injury then a 10b-5 action should be allowed.[37]

## Selective Service Law—Criminal Procedure—Local Board Must Give *Miranda* Warning Before Requesting Registrant to Produce Evidence Necessary for Prosecution

Defendant, classified as a conscientous objector,[1] was convicted of failing to report for civilian work as ordered by his local board.[2] During the pre-trial administrative process within the Selective Service System, state officials were advised that the defendant could not be prosecuted without clerical evidence[3] of his having been sent a Notice

is conceivable only by attributing minor substantive significance to the phrase "in connection with the purchase or sale of securities." Leech, *supra* note 34, at 835. *But cf.* Ruckle v. Roto Am. Corp., 339 F.2d 24 (2d Cir. 1964); Ruder, *Pitfalls in the Development of a Federal Law of Corporations by Implication Through Rule 10b-5*, 59 NW. U.L. REV. 185 (1964).

36. *See, e.g.*, Vine v. Beneficial Fin. Co., 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967).

37. *See* Leech, *supra* note 34, at 835. For a suggestion that the deception requirement of O'Neill v. Maytag, 339 F.2d 764 (2d Cir. 1964), serve as the new standard, see Lowenfels, *supra* note 10, at 277. *See also* Note, *supra* note 11, at 363-65.

1. Defendant had claimed a ministerial deferment, but his local board classified him as a conscientious objector available for civilian work contributing to the maintenance of the national healtb, safety, or interest.

2. Such a failure constitutes a violation of the Universal Military Training and Service Act, 50 U.S.C. App. § 462(a) (Supp. 1968).

3. The assistant general counsel of the Selective Service System informed the state director that notations on defendant's file did not indicate whether a Notice of Classification had ever been mailed. Therefore, because of the local board's incomplete record, prosecution was not recommended at that time.

of Classification[4] informing him of his right to appeal.[5] The local board thereafter requested and received from defendant the Notice of Classification which made it possible to initiate prosecution. At the time the request for production of the form was made, defendant was not informed that the procedure was part of a criminal investigation.[6] Contending that he was entitled to be warned of his right to remain silent, defendant moved for a new trial or, in the alternative, a judgment of acquittal. The United States District Court for the District of Colorado, *held*, judgment of acquittal. Information in the form of a governmentally required document representing a vital part of a contemplated Selective Service prosecution obtained directly from the defendant, though not in custody, is inadmissible as evidence unless defendant is first warned of the prospective criminal prosecution and his privilege to refuse to supply such evidence. *United States v. Casias*, 306 F. Supp. 166 (D. Colo. 1969).

In the 1966 landmark decision of *Miranda v. Arizona*,[7] the Supreme Court set forth the procedural safeguards[8] necessary to protect the fifth amendment privilege against self-incrimination when criminal suspects have been taken into custody or otherwise significantly deprived of their freedom.[9] The development of the law since *Miranda* has been determined by interpretation of the following two questions necessary for deciding whether the specified warnings should be applied in a particular factual situation: (1) at what stage in the proceeding should the *Miranda* warnings be given; and (2) what type of evidence should be protected by the privilege against self-incrimination. In answering the first question, courts have generally decided that formal custody, or at least significant limits on the

4. SSS Form 110, the Notice of Classification, contains a statement of a registrant's right to a personal appearance or appeal. The mailing of a notice by a local board to a registrant at the address last reported by him constitutes notice of the contents of the communications, whether or not it is actually received. 32 C.F.R. § 1641.3 (1969).

5. Each registrant has the right to appeal a newly issued classification. 32 C.F.R. § 1625.13 (1969). Without evidence of a registrant's having been mailed a Notice of Classification there is no evidence of his having been given an opportunity to appeal, and any subsequent board order is invalid unless the breach in procedure is corrected. Robertson v. United States, 404 F.2d 1141 (5th Cir. 1968).

6. After the recent decision of Gutknecht v. United States, 396 U.S. 295 (1970), the Selective Service can no longer enforce its orders by forced induction of a registrant but must prosecute him criminally.

7. 384 U.S. 436 (1966).

8. The *Miranda* warnings require that a criminal suspect be informed, prior to any questioning, that he has the right to remain silent, that any statement he makes may be used as evidence against him, that he has a right to presence of counsel, and that if he is indigent, the government will appoint counsel for him. *Id.* at 442-45, 467-73.

9. *Id.* at 467.

accused's freedom of action, are prerequisites to a Miranda situation.[10] Consequently, it has been held that an individual's protection against self-incrimination is not violated by his failure to receive a *Miranda* warning when interrogated by investigators for the Internal Revenue Service[11] or when questioned by the Selective Service System as to refusal to submit to induction.[12] However, some courts have applied the *Miranda* privilege to non-custodial interrogations in which a taxpayer was questioned by an Internal Revenue Service special agent seeking to uncover possible evidence of criminal tax evasion.[13] When concerned with the kind of evidence afforded protection under the *Miranda* decision, the courts have often limited the privilege to evidence of a testimonial or communicative nature.[14] Thus, evidence of a purely physical nature such as blood tests,[15] fingerprints,[16] and handwriting exemplars[17] may be obtained without violating the privilege against

10. *E.g.*, Medved v. United States, 411 F.2d 617 (9th Cir. 1969); Davidson v. United States, 411 F.2d 75 (10th Cir. 1969); Freije v. United States, 408 F.2d 100 (1st Cir. 1969); Williams v. United States, 381 F.2d 20 (9th Cir. 1967).

11. *E.g.*, United States v. Jernigan, 411 F.2d 471 (5th Cir. 1969); Agoranos v. United States, 409 F.2d 833 (5th Cir. 1969); Cohen v. United States, 405 F.2d 34 (8th Cir. 1968). Despite the holding of Mathis v. United States, 391 U.S. 1 (1968) (taxpayer already incarcerated on another charge must be given *Miranda* warning prior to questioning concerning criminal tax investigations, the trend of decisions seems to be against applying the *Miranda* safeguards to tax fraud investigations. L. HALL, Y. KAMISAR, W. LAFAVE & J. ISRAEL, MODERN CRIMINAL PROCEDURE 551 (3d ed. 1969).

12. Pittman v. United States, 411 F.2d 635 (10th Cir. 1969); United States v. Holmes, 387 F.2d 781 (7th Cir. 1968); Noland v. United States, 380 F.2d 1016 (10th Cir. 1967). *See also* United States v. Toussie, 410 F.2d 1156 (2d Cir. 1969) (privilege against self-incrimination not a bar to prosecution for breach of continuing duty to register with the Selective Service System).

13. *E.g.*, United States v. Wainwright, 284 F. Supp. 129 (D. Colo. 1968); United States v. Turzynski, 268 F. Supp. 847 (N.D. Ill. 1967) (*Miranda* warning required when special agent takes over investigation). Although the above decisions seem to represent a minority view (*see* note 11 *supra*), a recent IRS News Release requires the special agent (criminal tax investigator) to give his identity and inform the taxpayer that he need not make any statements or produce any documents, that anything he does say may be used against him in criminal proceedings, and that he has a right to counsel. IRS News Release, IR-949 (Nov. 26, 1968). These protections have clearly not been applied within the Selective Service System, and one regulation expressly provides that no person may be represented before the local board by anyone acting as legal counsel. SELECT. SERV. L. REP. Practice Manual ¶ 1003, at 1027 (1968).

14. "We hold that the privilege [against self-incrimination] protects an accused only from being compelled to testify against himself, or otherwise provide the State with evidence of a testimonial or communicative nature . . . ." Schmerber v. California, 384 U.S. 757, 761 (1966). "Since the blood test evidenee, although an incriminating product of compulsion, was neither petitioner's testimony nor evidence relating to some communicative act or writing by the petitioner, it was not inadmissible on privilege grounds." *Id.* at 765. *See* United States v. Wade, 388 U.S. 218 (1967); Cassady v. United States, 410 F.2d 379 (5th Cir. 1969); United States v. Pelensky, 300 F. Supp. 976 (D. Vt. 1969).

15. Schmerber v. California, 384 U.S. 757 (1966).

16. United States v. De Palma, 414 F.2d 394 (9th Cir. 1969).

17. Gilbert v. California, 388 U.S. 263 (1967).

self-incrimination. Official requests for the display of motor vehicle operator's licenses have also been held to be outside the scope of a mandatory *Miranda* warning.[18] The statutory provisions requiring a driver to present his license to a law enforcement officer are upheld as a reasonable implementation of a valid state regulatory policy,[19] irrespective of whether a *Miranda* warning is given, even though the license check is directly incriminating to a driver who has no license. On the other hand, access to certain kinds of information in the form of governmentally required documents which are themselves direct indicators of criminal activity has been limited by the privilege against self-incrimination.[20]

The instant court held that when evidence essential to prosecution is obtained directly from a suspect, the *Miranda* warning must be given. Reasoning that the warning is essential because there can be no intelligent exercise of the privilege against self-incrimination without an awareness of its availability, the court established a prerequisite for the admissibility of evidence derived from the accused. In analyzing the application of *Miranda* in analogous situations, the court noted that prior Selective Service cases involving statements made at the time a registrant refused induction[21] or failed to report for civilian work[22] were distinguishable since those statements were either incidents of the crime itself or made voluntarily. The court also determined that although cases which concerned the need for *Miranda* warnings during Internal Revenue Service investigations[23] were analogous to the principal

18. Myricks v. United States, 370 F.2d 901 (5th Cir.), *cert. denied*, 386 U.S. 1015 (1967); Kennett v. Municipal Ct., 290 F. Supp. 746 (C.D. Cal. 1968).

19. Myricks v. United States, 370 F.2d 901, 904 (5th Cir.), *cert. denied*, 386 U.S. 1015 (1967).

20. The situation, in which the individual is prosecuted for failing to file the required documents yet is made subject to prosecution for another crime when he does file, had often been held violative of the privilege against self-incrimination. *See, e.g.*, Leary v. United States, 395 U.S. 6 (1969) (fifth amendment complete defense in prosecution for failure to file form under the Marihuana Tax Act); Grosso v. United States, 390 U.S. 62 (1968) (claim of privilege under fifth amendment complete defense to prosecution for failure to pay excise tax on proceeds from wagering); Haynes v. United States, 390 U.S. 85 (1968) (fifth amendment complete defense to prosecution for possession of unregistered weapon); Albertson v. Subversive Activities Control Bd., 382 U.S. 70 (1965) (fifth amendment complete defense against prosecution for failure to register as Communist party member). *But see* Witt v. United States, 413 F.2d 303 (9th Cir.), *cert. denied*, 396 U.S. 932 (1969) (prosecution for failure to make border declaration of marihuana not protected by fifth amendment); United States v. Boggus, 411 F.2d 110 (9th Cir. 1969) (failure to declare smuggled gold not protected by fifth amendment).

21. *See, e.g.*, Pittman v. United States, 411 F.2d 635 (10th Cir. 1969); Noland v. United States, 380 F.2d 1016 (10th Cir. 1967).

22. *See* United States v. Holmes, 387 F.2d 781 (7th Cir. 1968).

23. Cases cited note 11 *supra*.

situation, those decisions which required actual custody as a prerequisite to such a warning[24] had construed *Miranda* somewhat narrowly. The instant case was differentiated on the ground that here there was a vital nondisclosure under circumstances calling for disclosure. On the other hand, decisions applying *Miranda* to tax investigations without custody[25] were approved by the court to justify its conclusion that an individual, whether suspected of tax evasion or murder, is entitled to knowledge of his contemplated prosecution on the basis of fundamental standards of fairness.[26] The court thus concluded that the evidence obtained from defendant, absent his knowing and voluntary waiver of his rights, was inadmissible under the *Miranda* requirement. Since the only evidence of defendant's having been informed of his right to appeal was inadmissible, there could be no conviction.

By requiring that a *Miranda* warning be given an individual who is neither in custody nor significantly deprived of his freedom of action, the instant court seems to make a marked departure from the weight of precedent. Such departure is especially apparent in light of earlier Selective Service cases decided by the Tenth Circuit Court of Appeals,[27] which denied the applicability of *Miranda* when the accused was not in custody.[28] The great majority of criminal tax investigation cases have also determined custody of the individual to be a prerequisite to the right to a *Miranda* warning.[29] However, even disregarding the custodial limitation applied by many courts, the evidence involved in the principal case is not of the type protected by the privilege against self-incrimination; "the Fifth Amendment related only to acts of the person to whom the privilege applies."[30] While a defendant is not generally required to produce *private* documents in his possession,[31] if the form

24. *See, e.g.*, Cohen v. United States, 405 F.2d 34 (8th Cir. 1968), *cert. denied*, 394 U.S. 943 (1969).

25. *See, e.g.*, United States v. Turzynski, 268 F. Supp. 847 (N.D. Ill. 1967).

26. The court stated that the tax violator should perhaps be more entitled to protection than a suspected murderer or thief since he is often unaware that his interrogators are seeking evidence to convict him of a crime.

27. The Federal District Court for the District of Colorado is within the 10th Circuit.

28. Defendant-registrant had claimed the benefit of the privilege against self-incrimination for statements he made upon his refusal to be inducted. The court, in denying the privilege, held that since there was neither custody nor a significant deprivation of freedom no *Miranda* warnings are required. Pittman v. United States, 411 F.2d 635 (10th Cir. 1969); Noland v. United States, 380 F.2d 1016 (10th Cir.), *cert. denied*, 389 U.S. 945 (1967).

29. *See* cases and text note 11 *supra*.

30. Schmerber v. California, 384 U.S. 757, 761 n.5 (1966).

31. Jones v. Superior Ct., 58 Cal. 2d 56, 372 P.2d 919, 22 Cal. Rptr. 879 (1962).

sought is required[32] to be in the holder's personal possession, then it seems doubtful that an individual may refuse to surrender it upon request by the proper official.[33] Thus the requirement that defendant be warned of possible criminal prosecution seems futile if after the warning the defendant still has no right to refuse to produce the required form. On the other hand, limitations on the administrative power of government to require possession of certain documents have been made in several instances where the information contained in the form is directly indicative of criminal activity.[34] The Notice of Classification, however, did not directly indicate criminal activity; it merely indicated that defendant had been given notice of his right to appeal, not that he criminally refused to obey a board order. The notice is thus analogous to items of physical evidence taken from the defendant's personal possession at the time of interrogation, such as blood tests[35] and clothing.[36] Although the defendant may be forced to submit to an attempt to discover evidence that might be used to prosecute him for a criminal offence, since the form sought does not involve a written or oral utterance of the defendant himself, it is non-testimonial and unprotected by the fifth amendment.[37] Therefore, both as to the requirement of custody and as to the type of evidence privileged by the fifth amendment, the court seems to have ignored the developing case law based on *Miranda*.

It does not necessarily follow, however, that such an extension is unwarranted in light of the purposes to be served by the *Miranda* warnings. The *Miranda* holding itself was decided with respect to an in-custody police interrogation and therefore emphasized the necessity for safeguards to protect against the psychologically compelling pressures of a hostile atmosphere.[38] As a result of this emphasis, it

32. "Every person who has been classified by a local board must have in his personal possession at all times . . . a valid Notice of Classification (SSS Form No. 110)." 32 C.F.R. § 1623.5 (1969).

33. *See* cases cited note 18 *supra*.

34. *See* cases cited note 19 *supra*.

35. A blood sample indicating intoxication was taken from defendant despite his failure to consent thereto on the advice of counsel. The Supreme Court held that there was no violation of the fifth amendment privilege since there was no testimonial compulsion. Schmerber v. California, 384 U.S. 757 (1966).

36. In Cassady v. United States, 410 F.2d 379 (5th Cir. 1969), defendant, while in custody and without *Miranda* warnings, was asked to and did turn over his shoes to the authorities. The shoes were used by the prosecution to connect defendant with footprints found at the scene of the crime. The court held that defendant's rights under the fifth amendment were not violated since this was evidence of a noncommunicative nature.

37. Schmerber v. California, 384 U.S. 757, 761-65 (1966).

38. "An individual swept from familiar surroundings into police custody, surrounded by

appears that later court decisions requiring custody as a prerequisite to the need of a *Miranda* warning are assuming that protection from overt governmental oppression is the only purpose to be served by *Miranda*. This court,[39] however, has seen an extended purpose to be filled by balancing governmental prerogatives and individual liberties on the scale of "fundamental fairness."[40] Whether an individual is induced to incriminate himself by a combination of ignorance of his rights and the coercive atmosphere of custody, or by ignorance of his rights combined with the inference that the purpose of the request for information is purely administrative, the result is the same—involuntary self-incrimination. Therefore, a court using such a "fundamental fairness" approach is sound in requiring the *Miranda* warning to enforce fifth amendment rights.

## Taxation—Treasury Regulation Service 20.2031-8(b) Invalid—Mutual Fund Shares Valued at Redemption Price for Estate Tax Purposes

Plaintiff executor valued decedent's mutual fund shares[1] at their redemption price[2] on decedent's estate tax return. The Commissioner valued the shares at the public offering price[3] and assessed a deficiency, relying on Treasury Regulation section 20.2031-8(b).[4] On petition for refund in the district court, *held*, for plaintiff. Treasury Regulation section 20.2031-8(b) is invalid; for estate tax purposes, mutual fund

antagonistic forces, and subjected to the techniques of persuasion described above cannot be otherwise than under compulsion to speak." Miranda v. Arizona, 384 U.S. 436, 461 (1966).

39. *See also* United States v. Wainwright, 284 F. Supp. 129 (D. Colo. 1968); United States v. Turzynski, 268 F. Supp. 847 (N.D. Ill. 1967).

40. United States v. Casias, 306 F. Supp. 166, 170 (D. Colo. 1969), *citing* United States v. Wainwright, 284 F. Supp. 129, 132 (D. Colo. 1968).

1. Open-end investment companies, commonly called mutual funds, are discussed in Lobell, *The Mutual Fund: A Structural Analysis*, 47 VA. L. REV. 181, 182-83 (1961).

2. The redemption price is computed twice daily by totaling the current market value of the securities held by the fund, subtracting therefrom its liabilities, and dividing this figure by the number of shares outstanding. *Id.* at 183 n.6.

3. The public offering price of a mutual fund share represents the redemption price plus the "sales load"—a charge which is earmarked as compensation for distributors of the mutual fund shares. The load is sometimes as high as 9.3% of the redemption value of the fund. *See* Warren, *The Federal Estate Tax Return—Some Problems in Valuations, Deductions and Elections*, N.Y.U. 26TH INST. ON FED. TAX. 1193, 1202-03 (1968).

4. Treas. Reg. § 20.2031-8(b) (1963): "The fair market value of a share in an open end investment company . . . is the public offering price of a share . . . ."

shares are properly valued at their redemption price. *Davis v. United States*, 306 F. Supp. 949 (C.D. Cal. 1969).

In dealing with valuation problems, the Treasury Regulations provide that "value" for estate tax purposes[5] means "fair market value at the time of decedent's death,"[6] and, in section 20.2031-8(b), that the "fair market value" of mutual fund shares is their public offering price.[7] The validity of section 20.2031-8(b) was first tested in *Estate of Wells*,[8] in which the Tax Court refused to characterize the regulation as unreasonable[9] and upheld the valuation provision. The *Wells* court relied on two gift tax cases[10] in concluding that replacement cost was the proper basis for valuation. Mutual fund shares were analogized to single-premium life insurance policies on the theory that, like mutual fund shares, such policies have a cash redemption value which is substantially less than the cost of acquiring the policy;[11] it has been held that single-premium life insurance contracts are properly valued at replacement cost.[12] The *Wells* court further relied on cases, involving valuation of jewelry, which have held that a retailer's excise tax must be included in determining the value of the property.[13] Mutual fund shares were distinguished from ordinary stocks and bonds; the court adopted the Commissioner's argument that the redemption price is a

5. INT. REV. CODE of 1954, § 2031(a) provides in part: "The value of the gross estate of the decedent shall be . . . the value at the time of his death of all property . . . ." The corresponding gift tax provision is § 2512(a). *See* note 10 *infra* and accompanying text.

6. Treas. Reg. § 20.2031-1(b) (1965). This subsection goes on: "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts."

7. Treas. Reg. § 20.2031-8(b) (1963). Prior to 1963, the Treasury Department accepted valuations at the mean between public offering and redemption prices and valuations at the redemption price. Warren, *supra* note 3.

8. 50 T.C. 871 (1968), *noted in* 22 VAND. L. REV. 429 (1969) *and* 44 N.Y.U.L. REV. 416 (1969), *aff'd*, Ruehlman v. Commissioner, 418 F.2d 1302 (6th Cir. 1969).

9. To be invalidated, a Treasury Regulation must be found to be unreasonable and plainly inconsistent with the revenue statutes. Commissioner v. South Texas Lumber Co., 333 U.S. 496 (1948). In *Wells*, the Tax Court intimated that perhaps the taxpayer's contention was also reasonable. 50 T.C. at 875-76.

10. Reliance on gift tax cases is appropriate, in that gift and estate tax provisions of the Code are properly construed in pari materia. Harris v. Commissioner, 340 U.S. 106, 107 (1950); Merrill v. Fahs, 324 U.S. 308, 313 (1945).

11. 50 T.C. at 876-77.

12. Guggenheim v. Rasquin, 312 U.S. 254 (1941). The replacement cost valuation for gift tax purposes was justified by pointing to the additional value attributable to the insurance element of the contract.

13. 50 T.C. at 877, *citing* Estate of Gould, 14 T.C. 414 (1950). *See also* Publicker v. Commissioner, 206 F.2d 250 (3d Cir.), *cert. denied*, 346 U.S. 924 (1953); Duke v. Commissioner, 200 F.2d 82 (2d Cir. 1952), *cert. denied*, 345 U.S. 906 (1953).

fixed price not affected by purely economic market activity, and concluded that the "willing buyer-willing seller" test[14] for market value was satisfied only at the public offering stage.[15] The dissent in *Wells* urged consideration of what the estate "could reasonably be expected to be able to obtain" for the shares.[16] Distinguishing the life insurance and excise tax cases,[17] the dissent, in support of a valuation at redemption price, compared the redemption arrangement to the situation in which a third party holds an option to purchase the shares if the owner chooses to sell them. In such an instance, the option price is generally regarded as the maximum for valuation purposes.[18] The objectors further noted that certain United States Government bonds which can be applied at par in payment of estate taxes are valued at par, their effective redemption value, regardless of their market price.[19] Although the *Wells* dissent's displeasure with Treasury Regulation section 20.2031-8(b) has been echoed on other fronts,[20] the rationale of *Wells* has been followed in both the estate[21] and gift tax[22] areas.

The instant court noted that, unlike life insurance contracts which have cash redemption *and* risk protection value, the only "value" ascribable to mutual fund shares is their value upon redemption; therefore, to value mutual fund shares at their public offering price was, in effect, to impose "an estate tax penalty" upon mutual fund investors.[23] To distinguish the cases involving excise taxes on jewelry,

14. *See* note 6 *supra.*

15. Quoting from the Commissioner's brief, the Tax Court declared that the obligation of the company to redeem the shares at their net asset value removed the company from the "willing buyer" category, thus rendering redemption "not a true willing buyer-willing seller transaction." 50 T.C. at 876.

16. *Id.* at 878.

17. The dissent stated that the predominant element of value in a life insurance policy is the eventual collection of the face amount. 50 T.C. at 879. In distinguishing the excise tax cases, they relied on the fact that there was no evidence of value other than replacement cost. *See* 44 N.Y.U.L. REV. 416, 422 (1969).

18. 50 T.C. at 878.

19. *Id., citing* Bankers Trust Co. v. United States, 284 F.2d 537 (2d Cir. 1960), *cert. denied,* 366 U.S. 903 (1961); Candler v. United States, 303 F.2d 439 (5th Cir. 1962).

20. The wrath of the American Bar Association was put forth at 19 ABA TAXATION SECTION 73 (1966). Representative Craig Hosmer (R-Cal.) introduced a bill on January 3, 1969, to amend § 2031(b) of the Internal Revenue Code of 1954 to provide for valuation of mutual fund shares at the redemption price. H.R. 844, 91st Cong., 1st Sess. (1969). The bill has yet to be reported out of the Committee on Ways and Means.

21. Estate of York, 28 CCH TAX CT. MEM. 1271 (1969).

22. Howell v. United States, 414 F.2d 45 (7th Cir. 1969), *aff'g* 290 F. Supp. 690 (N.D. Ind. 1968), *noted in* 20 CASE W. RES. L. REV. 917 (1969). The *Howell* court referred to *Wells* only briefly; nonetheless, it handed down a practically identical opinion.

23. 306 F. Supp. at 955. The court recognized that the "additional value" of mutual fund shares—the right to hold them, alluded to by the *Wells* majority—is fallacious, in that such

the court relied on the *Wells* dissent.[24] The court then pointed out that the public buys and sells mutual fund shares in two separate and distinct markets and impliedly concluded that the proper frame of reference for estate valuation purposes is the seller's market, since to hold otherwise would be "to create an artificial value that cannot possibly be obtained by the estate in any . . . realistic market."[25] The court further stated that the analogy of an option contract situation was applicable, again noting that redemption price was the highest price obtainable.[26] On the basis of these findings, the instant court declared Treasury Regulation section 20.2031-8(b) invalid,[27] dismissing *Wells* and the cases decided thereunder as resting on "logical infirmities."[28]

The instant court's distinction of the analogies presented in existing precedent is sound. Although the *Davis* court did not mention it, the willingness of the Treasury Department to depart, in certain bond valuation cases, from the market price in favor of amounts realizable both strengthens the present decision and reveals the arbitrariness of the regulation in question.[29] While the instant decision is laudable for its result, this court, by analogizing to the valuation of other items, proceeded along the same analytical lines as those meeting the question before—a procedure of questionable propriety.[30] It is suggested that, because of the disparate nature of the mutual fund market, a more theoretical approach to the term "value," detached from the influence of case law, is warranted. The opinion did not adequately treat the major problem in the mutual fund valuation area—a determination of the proper frame of reference for arriving at

---

incidents of ownership accrue to every property owner. It would be no less appropriate to use replacement cost with respect to all marketable securities.

24. *See* note 17 *supra*. A better basis of distinction lies in the fact that jewelry is an article of consumption; as such, it is not normally resold, and any "redemption value" is hardly a germane consideration. In contrast, the power of resale is the dominant incident of ownership of mutual fund shares. *See* 44 N.Y.U.L. REV. 416, 424 (1969).

25. 306 F. Supp. at 955.

26. *Id. See* text accompanying notes 18-19 *supra*. *See also* Treas. Reg. § 20.2031-2(h) (1958). Since practically the only means of disposition of mutual fund shares was by redemption, the court found the comparison of redemption price with an option price persuasive.

27. 306 F. Supp. at 952.

28. *Id.* at 956.

29. *See* note 19 *supra* and accompanying text.

30. Because of the unique dual-market situation surrounding mutual fund share trading, comparison of those shares to life insurance, retail sales involving excise taxes, or even ordinary stocks and bonds, seems inappropriate. Because of the factual distinctions, a better analysis would concentrate on more theoretical considerations of "value" as applicable to mutual funds in the estate tax context.

"fair market value"—a buyer's market or a seller's market.[31] The better approach would cast the holder of the property to be valued in the role of the seller. This assertion is supportable on two grounds. First, at decedent's death, the property is in the hands of the estate; therefore, for a willing buyer and a willing seller to trade for the property, the estate must necessarily be viewed as the willing seller.[32] It seems unreasonable, in analysis of value, to reverse the contextual positions of the parties rather than to look to the prevailing factual situation. Secondly, one must realize that in the normal course a large part of the assets of an estate may be liquidated to meet the costs of death taxes and administrative expenses, or to effectuate distribution of the estate.[33] These normally existing circumstances lead Professor Bonbright[34] to comment:

> [A]n appraisal under the death duties requires a strict adherence to the standard of market value, defined . . . as the price . . . which the property would actually command if presently offered for sale in the manner available to executors and trustees.[35]

The forte of this assertion is an implied recognition of the distinction between "value" and "cost"—a distinction expressed by Professor Bonbright as follows:

> The contrast between 'value' and 'cost,' as fundamental concepts, is that the former term refers to the advantage that is expected to result from the ownership of a given object of wealth (or to the market price that this advantage will command), whereas the latter term refers to the sacrifice involved in acquiring this object.[36]

Since both the Internal Revenue Code and the Treasury Regulations speak exclusively in terms of "value,"[37] this distinction brings into focus the unreasonableness of Treasury Regulation section 20.2031-8(b)'s requirement of valuation at replacement cost, and clearly illustrates its inconsistency with section 2031(a) of the Code.

---

31. In this regard, issue should be taken with Treas. Reg. § 20.2031-1(b) (1965) for its failure to state what market constitutes the proper frame of reference. *See* note 6 *supra*.

32. The *Wells* court's refusal to view the mutual fund as a "willing buyer" upon redemption simply overlooks the basic fact that, given the statutory provisions in existence at the inception of the fund, the very establishment of the fund acts as an acknowledgment that the fund stands "willing" to redeem shares at the net asset value. Further, the Tax Court's statement that the redemption price is an arbitrary figure does not take into account the fact that the net asset value is determined by the "cumulative" market activity of all securities held by the fund.

33. 2 BONBRIGHT, VALUATION OF PROPERTY 695 (1937).

34. Professor of Finance, Columbia University. Professor Bonbright's two-volume treatise on valuation problems, reprinted in part from the *Columbia Law Review*, is an excellent and exhaustive study of both the legal and economic aspects of the area.

35. 2 BONBRIGHT, *supra* note 33, at 695.

36. 1 BONBRIGHT, *supra* note 33, at 19.

37. INT. REV. CODE of 1954, § 2031(a), *supra* note 5; Treas. Reg. § 20.2031-1(b) (1965), *supra* note 6; Treas. Reg. § 20.2031-8(b) (1963), *supra* note 7.