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Recent Case Comments

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RECENT CASE COMMENTS

Conflict of Laws—Workmen's Compensation—Forum's Use of Foreign State's Tort Law for Recovery Against Third Party Does Not Require Forum's Use of Foreign State's Election Provision in Workmen's Compensation Suit

The plaintiff, an Arkansas resident, was hired in Arkansas by a local employer. While driving the company truck in Oklahoma, the plaintiff was injured in a collision with a train. He brought suit in Arkansas on the Oklahoma cause of action in tort against the railroad company, and recovered. He then filed a workmen's compensation claim with the Arkansas commission.[1] The lower tribunals denied his claim,[2] holding that the election provision of the Oklahoma compensation statute[3] which made the tort recovery the exclusive remedy was to be given full faith and credit. On appeal to the Arkansas Supreme Court, *held,* reversed. A forum's use of foreign tort law as the basis of recovery against a third party does not carry with it the incident under foreign law of the denial of a compensation right against the employer. *Gentry v. Jett,* 356 S.W.2d 736 (Ark. 1962).

1. Under the Arkansas act an injured employee may have a judgment against a negligent third party and still receive a compensation award. "The commencement of an action by an employee . . . against a third party for damages by reason of an injury, to which this act . . . is applicable, or the adjustment of any such claim shall not affect the rights of the injured employee . . . [to compensation under this act]." ARK. STAT. ANN. § 81-1340 (repl. 1960).

2. When it was discovered that the employer had not obtained coverage under the Arkansas act, the plaintiff changed his residence to Texas and filed a diversity suit in tort against his employer in an Arkansas federal district court. The federal court dismissed, on the ground that the employer's tort liability was governed by Oklahoma law and that the recovery against the railroad company released the employer of all liability for the tort. Gentry v. Jett, 173 F. Supp. 722 (W.D. Ark. 1956), *aff'd,* 273 F.2d 388 (8th Cir. 1960). The plaintiff then returned to his compensation claim where he was met with a second issue of election of remedy under the Arkansas statute. ARK. STAT. ANN. § 81-1304 (repl. 1960). The issues of election, under the Arkansas act, and res judicata, by the holding of the federal court, were decided for the plaintiff, but are beyond the scope of this discussion.

3. Under the Oklahoma Workmen's Compensation Act a satisfied judgment against a third party tortfeasor bars an Oklahoma compensation claim for the same injury. DeShazer v. National Biscuit Co., 196 Okla. 458, 165 P.2d 816 (1946); Ridley v. United Sash & Door Co., 98 Okla. 80, 224 Pac. 351 (1924). "If a workman entitled to compensation under this Act be injured by the negligence or wrong of another not in the same employ, such injured workman shall, before any suit or claim under this Act, *elect* . . . his remedy . . . ." OKLA. STAT. ANN. tit. 85, § 44 (1951). (Emphasis added.)

Workmen's compensation statutes typically provide for the award of compensation by commissions.[4] A commission will give relief only under the statute of its own state.[5] The commissions are liberal, however, in finding a basis for the application of their respective statutes, aided in most states by provisions directed to the conflict of laws situations.[6] Any state which has a substantial connection[7] with the injury and the employee may constitutionally apply its own act.[8] In some situations a second state may give an enlarged award after an award in a first state.[9] This benevolent attitude is justified, for difficult conflict of laws problems are often involved which place employees at a disadvantage in learning of their potential rights under the several statutes.[10] The worst that will befall the employer is that he will have to pay the highest compensation allowed under one of the applicable statutes.[11] When a third party has tortiously caused the compensable injury the conflicts problems become more complicated, for the definitions of "third parties" who are liable vary from state to state as do

4. Some states have court administered acts. See, *e.g.*, TENN. CODE ANN. § 50-1018 (1956).

5. Some states have by statute provided for the enforcement, where practicable, of foreign rights in their courts or administrative tribunals. Note, 6 VAND. L. REV. 744, 749 & n.15 (1953).

6. CHEATHAM, GOODRICH, GRISWOLD & REESE, CASES ON CONFLICTS OF LAWS 478 (4th ed. 1957); 2 LARSON, WORKMEN'S COMPENSATION § 87.10 (1961). These state acts are limited by due process, full faith and credit, and the commerce clause. AARON & MATHEWS, THE EMPLOYMENT RELATION AND THE LAW 339 (1957).

7. The Supreme Court has found various local factors suffieient in Cardillo v. Liberty Mut. Ins. Co., 330 U.S. 469 (1947); Pacific Employers Ins. Co. v. Industrial Ace. Comm'n, 306 U.S. 493 (1939); Alaska Packers Ass'n v. Industrial Acc. Comm'n, 294 U.S. 532 (1935). Larson lists as sufficient connections the place where the employment relation exists or is carried out, place where the injury occurred, place where the contract was made, place where industry is localized, place where employee resides, and place that parties adopt by contract in 2 LARSON, *op. cit. supra* note 6, §§ 86.10, 86.50.

8. Alaska Packers Ass'n v. Industrial Acc. Comm'n, 294 U.S. 532 (1935) is the leading case. See cases cited in note 7 *supra*.

9. The case of Magnolia Petroleum Co. v. Hunt, 320 U.S. 430 (1943), struck down a second state's award as barred by full faith and credit. However, in Industrial Comm'n v. McCartin, 330 U.S. 622 (1947), the Court allowed a second state to make an award and distinguished *Magnolia* on the ground that the foreign statute lacked an express prohibition against seeking additional relief under the laws of another state. As most statutes are similar, it would seem that *Magnolia*, even if not overruled, is of little importance. See, *e.g.*, 33 CORNELL L.Q. 310 (1947); 60 HARV. L. REV. 993 (1947). In Carroll v. Lanza, 349 U.S. 408 (1955), the Court allowed a Missouri worker, who was injured in Arkansas and who had begun to receive the automatic Missouri compensation, to sue a third party in Arkansas even though the Missouri act made the particular defendant immune from suit and provided that it should "exclude all other rights and remedies at common law or otherwise." MO. REV. STAT. § 287.110 (1949).

10. 2 LARSON, *op. cit. supra* note 6, § 85.60.

11. Double recovery is impossible except in a few rare fact combinations. 2 LARSON, *op. cit. supra* note 6, § 85.70. *But see* Shelby Mfg. Co. v. Harris, 112 Ind. App. 627, 44 N.E.2d 315 (1942); United Airlines Transp. Corp. v. Industrial Comm'n, 110 Utah 590, 175 P.2d 752 (1946).

the subrogation rights which arise upon the acceptance of benefits or election of suit under the acts.[12] Two situations are usually distinguished: first, where compensation has already been given in the foreign state and its subrogation statutes apply, the law of the foreign state will be respected;[13] second, where no compensation is claimed or awarded in the foreign state prior to the local action, the local forum may apply its statute.[14] The present case involves the novel situation where the injured employee first brought a tort suit in his home state against the third party who caused the foreign injury, making use of the foreign tort law for a cause of action.[15] He then filed for compensation in his home state, but was opposed by the employer who sought to defend by urging that full faith and credit be given to the foreign statutory election provisions.[16]

In the principal case the court accepted the concession made by counsel "that, under the full faith and credit clause . . . Arkansas is bound by the Oklahoma law as it relates to torts and the effect of a recovery against one tortfeasor,"[17] but distinguished tort, as based on a wrongful act, from workmen's compensation which is based on contract and public welfare. Thus it concluded there was "no sound reason why another state should be able to keep this state from discharging its contractual obligation to one of its citizens."[18]

12. Under the Arkansas act the party liable to pay compensation has the right of subrogation. Where compensation has been claimed and the party liable to pay compensation (the carrier) has joined in the third party suit, the carrier is entitled to a first lien on two-thirds of the suit proceeds up to the amount of compensation paid. If the employee chooses to sue the third party and then claims compensation, he may retain at least one-third of the proceeds of the tort suit, if any, with the remainder, up to the value of the compensation paid, going to the carrier. ARK. STAT. ANN. § 81-1340 (repl. 1960). On subrogation, see 2 LARSON, *op. cit. supra* note 6, §§ 74.00-74.42.

13. Usually the plaintiff has accepted the foreign compensation which works as an assignment of his tort suit to the insurance carrier. He then tries to sue in another jurisdiction without such a bar. See Dimardo v. Consumers Power Co., 181 F.2d 104 (6th Cir. 1950); Biddy v. Blue Bird Air Serv., 374 Ill. 506, 30 N.E.2d 14 (1940); 2 LARSON, *op. cit. supra* note 6, § 88.22.

14. "[T]he local third party rules would also apply except when . . . rights [are] already assigned under the laws of another state." 2 LARSON, *op. cit. supra* note 6, § 88.23, at 407. The leading case is Bagnel v. Springfield Sand & Tile Co., 144 F.2d 65 (1st Cir. 1944).

15. Oklahoma law had to be used for that was the only law under which there existed a cause of action in tort. Under Oklahoma law the employer was released of all liability as a co-tortfeasor by a satisfied judgment against the railroad company. Gentry v. Jett, 356 S.W.2d 736, 738 (Ark. 1962).

16. The recovery in tort would bar an Oklahoma compensation claim as an election of remedy. See note 3 *supra*.

17. 356 S.W.2d at 738.

18. *Ibid.* The court cited Alaska Packers Ass'n v. Industrial Acc. Comm'n, 294 U.S. 532 (1935), for two propositions: (1) where the contract is entered into within the state, even if foreign performance is expected, it is still subject to the legislative control of the state, and (2) the liability under workmen's compensation is imposed as an incident of the employment relationship, not for tort.

The opinion is unclear in its consideration of the effect of the foreign election provision. The court proceeded as if it were deciding whether Arkansas could apply its workmen's compensation act when another state might give relief under its own act.[19] However, the court probably reached the correct decision, for substantive rights granted by the Arkansas act should not depend on which action the workman took first when all proceedings had been in Arkansas.[20] Moreover, it seems that if the workman first sued the third party in Oklahoma, he should not be barred by full faith and credit from receiving a subsequent compensation award in Arkansas.[21] Practically, the employer was not attempting to avoid vexatious suits and double payment, but to avoid paying any compensation at all,[22] a result which is contrary to Arkansas policy.[23]

Constitutional Law—Advertising—Statute Restricting Size, Number, and Location of Gasoline Price Signs Is Unconstitutional

The plaintiff, an oil company, brought suit to restrain the enforcement of certain sections of a state statute[1] restricting the size, number,

19. Either Oklahoma, as the state of injury, or Arkansas as the state of contract, employment relation, etc., could have given compensation if relief were first sought there. See note 7 *supra*. The fact that another state also has jurisdiction does not require the forum state to subordinate its laws. Alaska Packers Ass'n v. Industrial Acc. Comm'n, *supra* note 18. The Arkansas court did cite Industrial Comm'n v. McCartin, *supra* note 9, but for the proposition that Arkansas had a *legitimate concern*, sufficient to allow it to apply its statute, and not for the conflicts holding which would allow a second award.

20. Arkansas does not require a workman to make an *election* which destroys his other remedy. ARK. STAT. ANN. § 81-1340 (repl. 1960).

21. *Cf.* Industrial Comm'n v. McCartin, *supra* note 9, where compensation was already paid in state *A*, yet state *B* was allowed to award; and Carroll v. Lanza, *supra* note 9, where compensation was already paid in state *A* yet a tort suit could be had in state *B* when state *A*'s laws would not allow such a suit.

22. The employer could not be liable in tort as a result of the prior tort suit. See note 2 *supra*.

23. See note 1 *supra*.

1. UTAH CODE ANN. § 41-11-45 (Supp. 1961): "(1) . . . prices shall be posted on the computing device of each individual pump or other dispensing device. . . . The price . . . shall be conspicuous and . . . shall not be covered by signs, decals or advertisements of any kind. . . . (3) Said price may also be posted on the pump or dispensing device on a sign or placard not less than seven inches in height and eight inches in width, nor more than twelve inches in height and twelve inches in width, stating clearly and legibly in numbers of uniform size the true retail selling price per gallon of such fuel including all taxes, together with the statutory grade of the fuel. . . . (4) No other sign or placard stating the price or prices of gasoline . . . shall be posted or maintained on the premises. . . ."

and location of price signs posted by retail vendors of motor fuel.[2] The contention of the plaintiff was that such regulation constituted an invasion of the right to own and enjoy property. The trial court found for the plaintiff. On appeal to the Supreme Court of Utah, *held*, affirmed. Allowing service station operators freedom of judgment and action as to the signs they use does not result in any substantial threat to public health, safety, morals, or welfare; and therefore the restriction imposed on this freedom by the statute is unconstitutional. *Pride Oil Co. v. Salt Lake County*, 370 P.2d 355 (Utah 1962).

In the past 23 years statutes, similar to the one in the instant case, regulating the advertising of retail gasoline prices have been subjected to judicial review in thirteen states, with a substantial majority of the courts holding the legislation to be invalid.[3] Of the states which have considered the question, only New York[4] and Massachusetts[5] have found the measures to be a valid exercise of the police power. No state has adopted the minority position since New York did so in 1940.[6] Aside from differing as to what the statutes mean on their face,[7] the essential difference between the positions taken pertains to the scope of judicial inquiry as applied to legislative enactments.[8] For this reason the courts adopting the minority position never reach some of the practical questions considered in the majority opinions. The minority courts have found that these legislative prohibitions indicate an attempt to prevent fraud; and, reasoning that a connection between the evil and the remedy provided by the statute could "possibly" exist, have concluded that this is a field of legislative policy which is not a

2. The stated purpose behind the statute is the elimination of deception in the posting of gasoline prices. The factual situation indicates that some service stations had been posting signs bearing large numerals, usually a few cents less than the current price of gasoline, to lure passing motorists when in reality the numerals referred to articles such as cigarettes, etc., rather than the price of gasoline.

3. State v. Miller, 126 Conn. 373, 12 A.2d 192 (1940); State v. Hobson, 46 Del. 381, 83 A.2d 846 (1951); State v. Blackburn, 104 So. 2d 19 (Fla. 1958); City of Lake Charles v. Hasha, 238 La. 636, 116 So. 2d 277 (1959); State v. Union Oil Co., 151 Me. 438, 120 A.2d 708 (1956); Levy v. City of Pontiac, 331 Mich. 100, 49 N.W.2d 80 (1951); State v. Redman Petroleum Corp., 360 P.2d 842 (Nev. 1961); Regal Oil Co. v. State, 123 N.J.L. 456, 10 A.2d 495 (Sup. Ct. 1939); Moreson v. City of Akron, 20 Ohio Op. 298 (C.P. 1941); Gambone v. Commonwealth, 375 Pa. 547, 101 A.2d 634 (1954); State v. Guyette, 81 R.I. 281, 102 A.2d 446 (1954).

4. People v. Arlen Serv. Stations, Inc., 284 N.Y. 340, 31 N.E.2d 184 (1940).

5. Slome v. Godley, 304 Mass. 187, 23 N.E.2d 133 (1939).

6. See note 3 *supra*. All of the states following the majority position have done so since 1940 except New Jersey which ruled on the question in 1939.

7. *Compare* "It is apparent from a reading of the statute that its design was to prevent fraud in the retail sale of gasoline," Slome v. Godley, *supra* note 5, 23 N.E.2d at 135, *with* "Obviously, on its face it is designed to restrict competition and foster monopolistic practices, and is not a legitimate exercise of the police power," City of Lake Charles v. Hasha, *supra* note 3, 116 So. 2d at 280.

8. For an excellent discussion of this proposition see 3 KAN. L. REV. 159 (1954).

proper subject for judicial review.[9] The majority position first emphasizes that freedom to advertise property for sale is an incident to the basic right of property ownership.[10] The courts then proceed to the proposition that the validity of a restriction of that right is dependent upon finding that a public interest of health, safety, morals, or welfare is endangered in such a way as to justify the exercise of the state's police power.[11] Looking to the legislative purpose, some courts conclude at this point that the interest involved is a private one—that of promoting the economic interest of the national oil companies at the expense of the independent gasoline distributor.[12] Other courts, accepting the avowed intent of the legislature to prevent fraud and price wars, have examined closely the reasonableness of the statutory restrictions in relation to the objectives sought. In finding the statutes invalid on this basis the courts have reasoned that, as to the prevention of fraud, there are already statutes prohibiting fraudulent advertising,[13] and that the limiting of the size of price signs does not have

9. "Those perils, including the exceptional facilities which the retail sale of gasoline affords for imposition upon the public, are not, however, a matter for our consideration. We may assume they were the subject of investigation and study by the City Council during its consideration of the necessity for and wisdom of the local law in question." People v. Arlen Serv. Stations, Inc., *supra* note 4, 31 N.E.2d at 185. "Judicial inquiry does not extend to the expediency, wisdom or necessity of the legislative judgment for that is a function that rests entirely with the lawmaking department. It is only when a legislative finding cannot be supported upon any rational basis of fact that can be reasonably conceived to sustain it that a court is empowered to strike down the enactment." Slome v. Godley, *supra* note 5, 23 N.E.2d at 135-36.

10. "The right to advertise one's merchandise is, subject to the police power mentioned, within the right to liberty and property." Levy v. City of Pontiac, *supra* note 3, 49 N.W.2d at 82; State v. Redman Petroleum Corp., *supra* note 3, at 845; Gambone v. Commonwealth, *supra* note 3, 101 A.2d at 638.

11. "Probably the most important function of government is the exercise of the police power for the purpose of preserving the public health, safety and morals . . . . [T]he power is not unrestricted. . . . By a host of authorities, Federal and State alike, it has been held that a law which purports to be an exercise of the police power must not be unreasonable, undnly oppressive or patently beyond the necessities of the case, and the means which it employs must have a real and substantial relation to the objects sought to be attained." Gambone v. Commonwealth, *supra* note 3, 101 A.2d at 636-37; 7 U. DET. L.J. 126 (1944).

12. "[The statute] has for its purpose and effect the promotion of the economic interest of the national oil companies at the expense of the independent gasoline distributors . . . ." State v. Miller, *supra* note 3, 12 A.2d at 193-94. With respect to the interest question, courts have found that the activity involved was not one with the requisite "public interest." "Gasoline is one of the ordinary commodities of trade, differing . . . in no essential respect from a great variety of other articles commonly bought and sold by merchants . . . . [T]he business of dealing in such articles, irrespective of its extent, does not come within the phrase 'affected with a public interest.'" Williams v. Standard Oil Co., 278 U.S. 235, 240 (1929); State v. Union Oil Co., *supra* note 3, 120 A.2d at 713; Levy v. City of Pontiac, *supra* note 3, 49 N.W.2d at 82; Gambone v. Commonwealth, *supra* note 3, 101 A.2d at 638.

13. City of Lake Charles v. Hasha, *supra* note 3, 116 So. 2d at 281; State v. Redman Petroleum Corp., *supra* note 3, at 844; Gambone v. Commonwealth, *supra* note 3, 101 A.2d at 637.

sufficient relevancy to the prevention of the perpetration of fraud.[14] In answering the contention that the legislation will prevent price wars, the courts find that price wars per se are not really an evil[15] and that such restrictions are only a means of eliminating competition.[16] Proceeding on the basis either that the legislation was motivated primarily by private rather than public interest or that the restrictions bear no reasonable relationship to a valid purpose, the courts rule that the legislation effects a deprivation of property without due process of law and a denial of protection of the laws under both state and federal constitutions.[17]

The court in the instant case extends its judicial inquiry not only to the degree of reasonableness of the assumption that the statutes will correct or eliminate the evil, but also to the motivation behind the statutes in question. Though conceding that the right of the plaintiff to use and enjoy his property is not an absolute right, it is pointed out that in order to justify depriving one of that right an important interest of the public health, morals, safety, or welfare must be at stake. After assuming that some evils of deceptive advertising may exist, the conclusion is reached that the situation is not so grave nor does it so seriously affect the public interest as to justify the limitation of a basic personal right. More important, the restrictions contained in these statutes do not impress the court as likely to be of substantial aid in correcting the situation,[18] there already being a

14. "It is quite impossible, however, to see how the size of the sign would have any relevancy to the perpetration of such fraud; on the contrary, it would seem that the larger the sign the more difficult it would be for the dealer to deceive the purchaser." Gambone v. Commouwealth, *supra* note 3, 101 A.2d at 637; State v. Hobson, *supra* note 3, 83 A.2d at 858; Levy v. City of Pontiac, *supra* note 3, 49 N.W.2d at 83; State v. Redman Petroleum Corp., *supra* note 3, at 846; Regal Oil Co. v. State, *supra* note 3, 10 A.2d at 498; State v. Guyette, *supra* note 3, 102 A.2d at 450. It should be noted that this reasoning would not appear to be valid in instances of deceptive, as opposed to false, advertising wherein the numerals do not refer to the price of gasoline but to the price of another product.

15. "Nor is price cutting, in fact or in law, really an evil, unless it be when its object is sinister, as, for example, to destroy a competitor and, by suffering a temporary loss, thereby gain an ultimate monopoly." Gambone v. Commonwealth, *supra* note 3, 101 A.2d at 638. City of Lake Charles v. Hasha, *supra* note 3, 116 So. 2d at 280.

16. "[The statute] operates injuriously on the purchasing public by tending to eliminate the only competitive basis in the industry . . . ." State v. Miller, *supra* note 3, 12 A.2d at 194. Levy v. City of Pontiac, *supra* note 3, 49 N.W.2d at 82; Regal Oil Co. v. State, *supra* note 3, 10 A.2d at 499; Gambone v. Commonwealth, *supra* note 3, 101 A.2d at 638.

17. Two states do not specifically find the legislation to be in violation of both their state and federal constitution. Regal Oil Co. v. State, *supra* note 3, 10 A.2d at 499, mentions only the federal constitution. State v. Guyette, *supra* note 3, does not make a direct reference to either constitution.

18. "For the purpose of analysis of the problem it can be assumed that there may be some evils of the type urged by the appellant. But the first observation to be made is that we are not persuaded that they are either so grave or so seriously affecting the public interest as to justify the measures proposed for their correction. The second and more important one is that we see no real likelihood that the restrictions they

statute in force prohibiting such false and deceptive advertising. The record of the hearing before the trial court was found to indicate "clearly" that the sponsors of the legislation were also motivated by a desire to control gas price wars.[19] Relying on the principle of open competition, the court is not convinced that price wars are in the long run inimical to the public interest.[20]

The question of the validity of restrictive legislation of this type is not quite the closed issue that a reading of the cases would indicate. A 1962 decision of the United States Supreme Court[21] has resulted in a revival of activity on the part of groups interested in sponsoring the enactment of similar statutes. After a divided New York Court of Appeals had upheld a conviction for action which was found to be an indirect circumvention of the statute, the Supreme Court granted a motion to dismiss for want of a substantial federal question.[22] The dismissal has been interpreted by some of the trade publications for the petroleum industry to mean that there is no longer any question as to the constitutionality of such legislation. These sources suggest that interested groups now have only the problem of successfully sponsoring legislation identical to that involved in the New York case.[23] This broad conclusion is questionable, since the opinion

place on the size and location of signs would materially aid in policing and preventing deception of the public." Pride Oil Co. v. Salt Lake County, 13 Utah 2d 183, 370 P.2d 355, 356 (1962).

19. *Id.* at 357.

20. "Oue of the basic tenets of our system is that free and open competition is a wholesome, stimulating force in our economy." *Id* at 357.

21. People v. Save Way Northern Blvd., Inc., 368 U.S. 349 (1962), *dismissing appeal from* 10 N.Y.2d 727, 219 N.Y.S.2d 271, 176 N.E.2d 839, 10 N.Y.2d 748, 219 N.Y.S.2d 604, 177 N.E.2d 47 (1961). The defendant was convicted under the New York statute in what is apparently the broadest application of this type of statute. The defendant had a sign on the premises bearing the legend "Save Way." The court found this to be an indirect circumvention of the statute whereas the defendant contended that the sign only advertised his trade name and made no reference to the price of gasoline. For other cases involving an indirect circumvention of the statute see People v. Al Oil Co., 32 Misc. 2d 374, 221 N.Y.S.2d 489 (Niagara County Ct. 1961); People v. 25 Stations, Inc., 3 N.Y.2d 488, 168 N.Y.S.2d 962, 146 N.E.2d 691 (1957); People v. Sav-4-On Gallon, Inc., 204 Misc. 708, 125 N.Y.S.2d 5 (N.Y. City Magis. Ct. 1953); People v. Pearl, 173 Misc. 467, 17 N.Y.S.2d 825 (N. Y. City Ct. Spec. Sess. 1940).

22. The opinion contained only the following: "The motion to dismiss is granted and the appeal is dismissed for want of a substantial federal question." People v. Save Way Northern Blvd., Inc., *supra* note 21, 348 U.S. at 349.

23. "The Supreme Court of the United States has upheld the right of local governments to banish gasoline price signs and price advertising from service stations, except for required signs of specified size on pumps." Gasoline Retailer, Feb. 28, 1962; "It now seems clear that the New York law is able to withstand the acid test—that of the U.S. Supreme Court. Therefore I'd suggest that interested jobbers should get a copy of the New York City regnlations and promote the identical provisions." Harper, *Should Gasoline Price Signs Be Regulated,* National Oil Jobber, April 1962, p. 8. Correspondence with various trade associations indicates that a bill patterned after the New York Ordinance was defeated in the 1962 Michigan Legislature and that a similar bill is now pending in the Florida Legislature. There are also indications of

indicates on its face that no finding at all was expressed on the constitutional question.

Judicial review of the statutes in question, whether it be of the motivation behind them or the reasonableness which they bear to the desired objective, would seem to require that the marketing structure of the oil industry be taken into consideration. There are two distinct categories of retail gasoline dealers—the independent retail dealer and the vendor of nationally advertised brands.[24] The industry leadership of the major oil companies is unquestioned.[25] Retailers representing the major oil companies favor the restrictive statutes because in the absence of large price signs consumers tend to purchase by brand name, and these retailers are thereby enabled to capitalize on the extensive advertising programs of the oil companies. The independent dealer opposes such statutory regulation because he is unable to compete by brand name advertising and must rely on large price signs to attract the passing motorist.[26] This is not to suggest that this conflict of interest is the only factor involved in these cases, but it does exist and should be considered along with the factors of each particular case. Further litigation in this area can be expected, but it appears that the majority position will continue to prevail until the courts find that there is a "public interest" involved. The proponents of the legislation seem to have relied primarily on the "prevention of fraud" purpose. As the cases indicate, very few courts have been impressed with this contention. Reduced to its simplest terms, the courts have been unable to make a substantial distinction between a service station operator advertising the price of his gasoline and a clothing merchant advertising the price for which he sells shirts. This view is supported by a Supreme Court decision of 1929 holding that the sale of gasoline "does not come within the phrase 'affected with a

current interest in this legislation for possible application in the "home rule" cities and towns of Texas.

24. "[W]e learn that prosecutor [defendant] is what is known, in the motor fuel industry, as an independent retail dealer as distinguished from a retail dealer in motor fuel who sells the standard product of major oil companies which sell such nationally advertised motor fuels, for example, as 'Esso,' 'Gulf,' 'Texaco,' 'Tydol,' etc." Regal Oil Co. v. State, *supra* note 3, 10 A.2d at 498.

25. Comment, *Conscious Parallelism in the Pricing of Gasoline*, 32 ROCKY MT. L. REV. 206 (1960).

26. "Because the independent dealer, as prosecutor [defendant] here, is unable to compete with the major companies in their unrestricted right and financial ability to advertise, in any form or size, the brand and qualities of their products, because the average user of such nationally advertised brands of motor fuel is not as a general rule greatly concerned with the price thereof, prosecutor's only legitimate weapon of competition is to sell its product at 'a slightly lower price' than that charged by dealers of nationally advertised motor fuels. But an independent dealer must of necessity be able to bring that fact to the attention of the approaching and passing motorists." Regal Oil Co. v. State, *supra* note 3, 10 A.2d at 498.

public interest.' "[27] Should the states begin to adopt the minority position it will probably be based on a finding that the effects of price wars are so inimical to the required "substantial" number of the populace as to justify this restrictive legislation as police power regulation for the welfare of the public.[28]

Evidence—Attorney-Client Privilege—Applicability When a Corporation Is the Client

In Case 1, plaintiff is a manufacturer of gas conversion burners. Defendant American Gas Association is a membership corporation, among the activities of which is the testing of gas conversion burners to ascertain whether such burners comply with the standards of the American Standards Association. This testing is available to both members and non-members of A.G.A. Plaintiff, a non-member, submitted to defendant a burner, which was tested and found not to meet the requisite standards. Plaintiff then sued for an injunction and damages, alleging that the various defendants had conspired to remove plaintiff from the market. A controversy arose during discovery proceedings concerning the scope of the attorney-client privilege as applied to corporations, with particular reference to eight letters from A.G.A. to its New York counsel. On motion to compel discovery, *held*: A corporation is not entitled to invoke the attorney-client privilege. *Radiant Burners, Inc. v. American Gas Ass'n*, 207 F. Supp. 771 (N.D. Ill.), *aff'd on rehearing*, 209 F. Supp. 321 (1962).

Case 2 is one of a series of treble damage antitrust cases arising out of the alleged electrical equipment price fixing conspiracy. The attorney-client privilege was asserted by defendant corporation to prevent discovery of certain memoranda prepared by its counsel following oral interviews with the general manager of one of defendant's departments. Such interviews, which concerned the general manager's activities relating to the alleged price-fixing conspiracy "were con-

27. "Gasoline is one of the ordinary commodities of trade, differing, so far as the question here is affected in no essential respect from a great variety of other articles commonly bought and sold by merchants and private dealers in the country. The decisions referred to above make it perfectly clear that the business of dealing in such articles, irrespective of its extent, does not come within the phrase 'affected with a public interest.' " Williams v. Standard Oil Co., 278 U.S. 235, 240 (1929).

28. This point of view becomes more convincing when the price war develops into a prolonged bitter affair such as occurred in New Jersey. See generally Fried v. Kervick, 34 N.J. 68, 167 A.2d 380 (1961); *The Report of the United States Senate Select Committee on Small Business on Petroleum Marketing Practices in New Jersey*, S. REP. No. 2810, 84th Cong., 2d Sess. (1956); *Bloody Jersey: 5 Years of Price War*, National Petroleum News, Nov. 1954, p. 49.

ducted by counsel in the context of certain investigations by juries . . . in order to advise their client General Electric Company with respect to those investigations and possible future criminal and civil litigation."[1] The trial judge ordered production of the memoranda. On motion to clarify, *held*: Although the attorney-client privilege is available to corporations, its attempted invocation is without basis unless "the employee making the communication, of whatever rank he may be, is in a position to control or even to take a substantial part in a decision about any action which the corporation may take upon the advice of the attorney, or if he is an authorized member of a body or group which has that authority."[2] *City of Philadelphia v. Westinghouse Electric Co.*, 210 F. Supp. 483 (E.D. Pa. 1962).

It is clear that the attorney-client privilege originally was that of the attorney.[3] Wigmore asserts that this privilege was based upon traditional notions of honor and the thought that it would be degrading to a lawyer, both as a gentleman and as a member of his profession, to compel disclosure of a communication given him in confidence by his client.[4] This theory seems to be conjecture on Wigmore's part. From the meager reports of early cases[5] it is in fact impossible to determine why the attorney was immune from examination; probably the granting of the privilege was due to the fact that the lawyer was an officer of the court and as such should no more be compelled to testify than the judge. At some time during the 18th century the privilege was mysteriously disengaged from the attorney and attached to the client.[6] No explanation for this switch is to be found in the reports; Wigmore attributes it to the "judicial search for truth."[7] Faced with the existence of a privilege in the client, the courts naturally enough felt that there must be some basis for such privilege; so they rationalized such a basis along the following lines: the function of courts is the administration of justice; the accretion of complexities to the law long ago rendered a layman incapable of conducting his affairs without the assistance of an enlightened bar, which is a *sine qua non* for the proper administration of justice; therefore to insure the proper functioning of the judicial system the law must assure

1. Memorandum of Defendant General Electric in Opposition to Plaintiffs' Motion for Production and Inspection of the Grand Jury Testimony and Statements of Clarence E. Burke, p. 1, City of Philadelphia v. Westinghouse, 210 F. Supp. 483 (E.D. Pa. 1962).

2. 210 F. Supp. at 485.

3. MODEL CODE OF EVIDENCE rule 210, comment *a* at 146 (1942); 8 WIGMORE, EVIDENCE § 2290 (McNaughton rev. 1961) (hereinafter cited as WIGMORE).

4. 8 WIGMORE §§ 2286, 2290.

5. See cases cited in 8 WIGMORE § 2290 n.1.

6. MODEL CODE OF EVIDENCE rule 210, comment *a* at 147 (1942); 8 WIGMORE § 2290.

7. 8 WIGMORE § 2290, at 543.

a client that he will obtain competent legal advice; moreover, counsel to serve effectively by accurately advising his client must be fully informed concerning all matters which might be relevant to the advice sought; the most obvious way to insure a complete revelation to the attorney is by prohibiting the disclosure of the content of communications relevant to the advice sought by the client to his attorney, absent the client's consent.[8] This reasoning seems to be in reality an afterthought, a policy justification for an extant privilege the basis of which is unrecorded in the tomes of history. Nevertheless this accepted characterization is helpful in defining the scope of the privilege. A general statement of the privilege as it exists today is as follows:

> (1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) except the privilege may be waived.[9]

As a general principle it is conceded that a communication between a client's agent and the client's attorney meets the above requirement of "confidentiality."[10] Likewise a communication from a client's agent on behalf of the client is said to meet the requirement that it be made "by the client," even when the subject matter of the communication "originated with the . . . agent."[11] While the privilege as a whole has not survived without detractors,[12] no one has previously expressed serious doubt about its availability to a corporate client;[13] there are

8. There is a very thorough discussion of this policy, including extensive quotes from many of the early cases, in 8 WIGMORE § 2291, at 545-48. One additional case containing an excellent discussion by Judge Selden is Rochester City Bank v. Suydam, Sage & Co., 5 How. Pr. 254, 256-61 (N.Y. Sup. Ct. 1851).

9. 8 WIGMORE § 2292, at 554. The enumerated elements are individually discussed in 8 WIGMORE §§ 2294-329. The privilege is statutory to some extent in at least 37 states; these statutes are set out in 8 WIGMORE § 2292 n.2, at 555-59. A reading of these statutes gives the impression that they are merely attempted codifications of the common law rule. See, *e.g.*, Johnson v. Patterson, 81 Tenn. 626, 649 (1884), in which the court required that the communication be confidential even though the statute did not so state.

10. 8 WIGMORE § 2311.

11. Russell v. Jackson, 9 Hare. 387, 68 Eng. Rep. 558 (Ch. 1851); 8 WIGMORE § 2317, at 618. It is clear that the communication is "by the client" if the agent acts only as a messenger or interpreter. On the other hand, Professor Morgan strongly questions this assertion when "the information comes to the agent personally and is embodied in a communication to the client's attorney." MORGAN, BASIC PROBLEMS OF EVIDENCE 110 (rev. ed. 1963). This problem is discussed later. See note 53 *infra* and accompanying text.

12. See, *e.g.*, Morgan, *Foreword* to MODEL CODE OF EVIDENCE 24-28 (1942). Professor Morgan's objections may be summarized by the following question: Who would be injured if there was no attorney-client privilege? He suggests that the privilege should be limited to situations in which the privilege against self-incrimination is involved.

13. Both the Model Code and the Uniform Rules define "client" as including a

numerous reported decisions in which the privilege has been accorded a corporation.[14] Since a corporation can act only through its agents, the question quite naturally arises concerning which of its agents in communicating with its attorney are sufficiently identified with the corporation so that the privilege may be invoked by the corporation itself. The state courts have not been concerned with the different types of agents of the corporation so long as the other requirements of the privilege have been satisfied; their chief concern seems to have been with "preventing ordinary business records from masquerading as attorney-client communications."[15] Federal authority on this point must be classified as muddled.[16] Commentators have suggested that

corporation. MODEL CODE OF EVIDENCE rule 209 (a) (1942); UNIFORM RULE OF EVIDENCE 26 (3)(a) (1953).

14. *E.g.*, American Cyanamid Co. v. Hercules Powder Co., 211 F. Supp. 85 (D. Del. 1962); United States v. Aluminum Co. of America, 193 F. Supp. 251 (N.D.N.Y. 1960); A. B. Dick Co. v. Marr, 95 F. Supp. 83 (S.D.N.Y. 1950); United States v. United Shoe Mach. Corp., 89 F. Supp. 357 (D. Mass. 1950); Holm v. Superior Court, 42 Cal. 2d 500, 267 P.2d 1025 (1954); Schmitt v. Emery, 211 Minn. 547, 2 N.W.2d 413 (1942); Stewart Equip. Co. v. Gallo, 32 N.J. Super. 15, 107 A.2d 527 (Super. Ct. 1954); *Ex parte* Schoepf, 74 Ohio St. 1, 77 N.E. 276 (1906).

In A. B. Dick Co. v. Marr, *supra*, Judge Medina, after quoting from early English authorities concerning the policy of the privilege (see note 9 *supra* and accompanying text), makes the following observation: "Since these early statements the necessity of protecting the attorney-client relationship has become even more apparent; the legal rights and duties of large corporations and those who dispute with them would not be susceptible of judicial administration in the absence of lawyers, nor, in the absence of the privilege could lawyers properly represent their clients. I am, frankly, hesitant to do anything which would contribute to the undermining of the protection afforded by the time-honored rule which excludes from evidence such confidential communications." 95 F. Supp. at 102. In *Ex parte* Schoepf, *supra*, the Supreme Court of Ohio states that "we see no reason to limit or modify the rule because the defendant is a corporation and obtained its information and made its memoranda for the purposes stated, through the usual agencies of a corporation." 74 Ohio St. at 15, 77 N.E. at 279.

The Supreme Court has discussed the privilege in only one case when the client was a corporation, United States v. Louisville & N.R.R., 236 U.S. 318 (1915). The communications were held privileged on the grounds that the particular statute in question, which applied only to corporations, should not be construed as abrogating the attorney-client privilege. Mr. Justice Day, speaking for a unanimous Court, noted that "the desirability of protecting confidential communications between attorney and client as a matter of public policy is too well known and has been too often recognized by text-books and courts to need extended comment now. If such communications were required to be made the subject of examination and publication, such enactment would be a practical prohibition upon professional advice and assistance." 236 U.S. at 336 (dictum). This is at least a pretty strong indication that the court recognized the application of the privilege to corporations.

15. Simon, *The Attorney-Client Privilege as Applied to Corporations*, 65 YALE L.J. 953, 961 (1956).

16. In Hickman v. Taylor, 329 U.S. 495 (1947), defendant was a partnership; one of its tugboats had sunk and five of the nine crew members had been killed in the accident. An action for wrongful death was brought by the administrator of one of the deceased crew members. The Supreme Court, per Mr. Justice Murphy, held that memoranda composed by defendant's attorney from statements to the attorney by the surviving crew members were not within the attorney-client privilege. "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

communications between the corporation's attorney and any employee concerning matters within the scope of his employment which may affect the legal rights of the corporation should be privileged.[17] A similar approach would add the qualification that documents originating with employees not connected with management should be treated as "prima facie business records," thus placing a burden on the corporate client to show that the documents were in fact made for the purpose of securing legal advice.[18]

In *Radiant Burners* Judge Campbell notes that the application of the privilege to corporations has rarely been questioned and that he himself on numerous occasions has assumed its applicability;[19] however, he finds no case in which the issue has actually been decided.[20] He analogizes the attorney-client privilege to that against self-incrimination, stating that both are "historically and fundamentally personal in nature";[21] he therefore concludes that since the privilege against self-incrimination may be claimed only by individuals,[22] the

anticipation of litigation." 329 U.S. at 508. (Emphasis added.) A number of district court cases have held various communications from a corporation to its attorney outside the privilege on the basis of this statement. See Simon, *supra* note 15, at 960 n.24. The fact that the client was a partnership in *Hickman* of course provides a distinction, but it is not a valid one—the "witnesses" in that case were agents of the partnership, and the same reasoning applies with equal force to a corporation's employees. Other possible distinctions are set out in Simon, *supra*, note 15, at 959 n.20. There is an additional factor which need be pointed out. Consider the following situation: *A* has two agents, *X* and *Y*. *X* is riding in the back of a truck which *Y*, who is acting within the scope of his authority, is driving when *Y* has an accident for which *A* may be legally responsible. If *X* discusses the accident with *A*'s attorney, he cannot be characterized as other than a witness to the accident even though he is *A*'s agent. This simple example seems to present the essence of the factual situation of the *Hickman* case and might well explain Mr. Justice Murphy's statement. Further, if *X* himself had been injured in the accident and had later brought suit against *A*, the communication by *X* to *A*'s attorney concerning the accident would not be privileged under the traditional common law rule. See 8 WIGMORE § 2311. This additional factor was also present in *Hickman*. To be contrasted with *Hickman* is Judge Wyzanski's sweeping statement in United States v. United Shoe Mach. Corp., 89 F. Supp. 357, 359 (D. Mass. 1950), that a communication to the corporation's attorney from "an officer *or employee*," as opposed to "a person outside the organization" of the corporation is a communication by the corporation and will be privileged if the other requirements are met. (Emphasis added.) One additional factor which might be of considerable practical importance should be noted. Both *Hickman* and *United Shoe* were landmark decisions on points entirely separate from that here discussed, the former for its pronouncement of the "work product" doctrine, and the latter for its ruling that a corporation's house counsel are "attorneys" as that term is used for purposes of the attorney-client privilege. Moreover, the above quoted portions of each of the opinions are just about all that each author said on the point here in question. Perhaps each was simply a bit sloppy in his phraseology concerning what at that time was a subordinate point.

17. Note, 56 NW. U.L. REV. 235, 242-43 (1961).
18. Simon, *supra* note 15, at 965.
19. 207 F. Supp. at 772.
20. *Ibid.*
21. *Id.* at 773.
22. A corporation cannot invoke the privilege against self-incrimination. Essgee

same should be true of the attorney-client privilege. On the other hand, Judge Campbell later admits that the basic rationale of the privilege[23] is applicable to corporations.[24] The real prophylactic found between the privilege and a corporate client is the requirement that the communication remain in strict confidence[25]—the difficulty, as Judge Campbell views it, is not the problem of who may be the communicating agent in order that the corporate client be entitled to invoke the privilege, but rather the question concerning the persons to whom the contents of the communication may be revealed without violating the requirements of confidentiality.[26] This problem is poignantly presented in the instant case because the executive committees of A.G.A. and those of its members, which include both utility companies and utility manufacturers, are interlocking.[27] Furthermore, asks Judge Campbell, how can such communications possibly be held in confidence in the face of both the stockholder's right of inspection of and the state's visitorial powers over a corporation's files and records?[28] He therefore concludes that the requirement of confidentiality is an insurmountable obstacle in the path of a corporation attempting to assert the privilege.[29] In his supplemental opinion[30] Judge Campbell makes it clear that he strongly believes that a corporation *should* be entitled to invoke the privilege because of "the large and complex nature of modern corporate business transactions."[31] He urges that if a higher court establishes the privilege it "spell out the necessary elements applicable to a corporation making claim thereto and that in so doing they expressly exclude the common law requirement of secrecy."[32]

In *Westinghouse* Senior Judge Kirkpatrick first notes Judge Campbell's decision in *Radiant Burners* but declines to follow this ruling because of the unanimous acceptance of the applicability of the privilege to corporations for so long.[33] He thus concerns himself with the requirement that the communication must be made to an attorney

Co. of China v. United States, 262 U.S. 151 (1923); Wilson v. United States, 221 U.S. 361 (1911).

23. See note 8 *supra* and accompanying text.

24. 207 F. Supp. at 775.

25. See note 10 *supra* and accompanying text.

26. 207 F. Supp. at 774.

27. *Ibid.*

28. *Id.* at 774-75.

29. *Id.* at 775.

30. 209 F. Supp. 321 (N.D. Ill. 1962).

31. *Id.* at 325.

32. *Ibid.* An interlocutory appeal has been filed under 28 U.S.C. § 1292(b) (1956).

33. 210 F. Supp. at 484. Another recent case expressly refusing to follow *Radiant Burners* is American Cyanamid Co. v. Hercules Powder Co., 211 F. Supp. 85, 88 n.12 (D. Del. 1962).

"by the client."[34] On the question of whether a particular communication between a corporate employee and an attorney is within the scope of the privilege, he frames the issue thus: "Is it the corporation which is seeking the lawyer's advice when the asserted privileged communication is made?"[35] Judge Kirkpatrick determines that there is a conflict between the ruling on this point by the Supreme Court in *Hickman v. Taylor*[36] and that of Judge Wyzanski in *United States v. United Shoe Machinery Corp.*[37] He rejects as a test the rank of the employee making the communication because of the vagaries of terminology applied by different corporations for various positions.[38] He further rejects a simple agency approach, which would make determinative the corporation's legal responsibility for the employee's activity which was disclosed in the communication.[39] He then adopts his own test, holding that it is the employee's relation to any decision which may be made by the corporation upon the lawyer's advice on the particular matter which is controlling.[40] If the employee is in a position to play a substantial role in the making of such decision, the communication is privileged. If not, there is no privilege. Moreover, it is necessary that the employee's authority in making any such decision be actual, not merely apparent.[41] Since in this case the matter discussed was of "overwhelming importance" to the corporation and no decision concerning possible corporate action would be made save by the very highest echelon of the corporation,[42] Judge Kirkpatrick holds the communication not privileged.

If it is granted that the attorney-client privilege is desirable for individuals, there is general agreement that it *should be* accorded to corporations;[43] Judge Campbell forthrightly admits this in his supplemental opinion.[44] However, courts which have heretofore dealt with the problem have transformed "should be" into "is" without adequate analysis. A strict requirement of secrecy is indeed a formidable prerequisite when the client is a corporation.[45] But the barrier

34. See note 11 *supra* and accompanying text.
35. 210 F. Supp. at 485.
36. 329 U.S. 495, 508 (1947). See note 16 *supra.*
37. 89 F. Supp. 357, 359 (D. Mass. 1950). See note 16 *supra.*
38. 210 F. Supp. at 485.
39. *Ibid.*
40. See note 2 *supra* and accompanying text.
41. *Ibid.*
42. 210 F. Supp. at 485-86.
43. See note 16 *supra* and accompanying text. Since the heart of the policy justification given for the privilege is the complexity of the law, such an attitude is easy to understand.
44. See note 31 *supra* and accompanying text.
45. It must be remembered that when the various conditions precedent to an allowance of the privilege were being developed, corporations as they exist today were virtually unknown. Only quite recently has the corporation achieved predominance in our economy. Furthermore, it is rather naive to assume that courts had not previously

raised by this requirement, even assuming that it should be strictly applied, is by no means insurmountable; only Judge Campbell's formalistic approach has made it so. He recognizes that immediate office personnel of a corporate client may see a document for which the privilege is asserted without violating the requirement of confidentiality.[46] The *possibility* that the corporation may be forced to reveal such documents to shareholders and/or the state does not seem sufficient to remove the privilege.[47] The mere possibility that such documents may be disclosed to an outsider[48] seems no more substantial than the ever-present possibility of a waiver of the privilege; an involuntary disclosure stands on the same footing as a waiver.[49] Whether a particular communication is privileged is determined not by what *might* happen, but by what in fact *has* happened—a factual determination which must be made for each communication for which the privilege is claimed.[50] Interlocking directorates admittedly may pose a difficult problem, but the effect of this circumstance is a question of fact, a determination as to whether the privilege has been abused and thus lost, for each assertedly-privileged communication. In summary, the question of disclosure which will remove the privilege from a particular communication seems clearly a factual one when the client is a corporation.[51] A general suggestion, not in-

recognized the problems inherent in an application of the privilege to corporations. More probably such courts made a conscious choice of taking a pragmatic approach to these problems, making *ad hoc* determinations as to the applicability of the privilege to the particular communication involved by looking to the circumstances surrounding each such communication. On the other hand, a conclusion that the privilege cannot apply to corporations, although courts for over one hundred years have unanimously held that it does, stands on rather shaky ground.

46. 207 F. Supp. at 774.

47. It must be admitted that both possibilities are remote, especially in light of requirements that a shareholder must show proper purpose.

48. There might be circumstances in which a particular stockholder would not be deemed an "outsider." See Simon, *supra* note 15, at 966-69.

49. "[I]nvoluntary disclosures . . . are not protected by the privilege, on the principle that, since the law has granted secrecy so far as its own process goes, it leaves to the client and attorney to take measures of caution sufficient to prevent being overheard by third person. The risk of insufficient precautions is upon the client. *This principle applies equally to documents.*" 8 WIGMORE § 2325 (3) (Emphasis added.) Moreover, it is submitted that Wigmore's interpretation of the requirement of confidentiality is unduly restrictive on this point. The requirement should call for no more than an objective manifestation by the client of his genuine desire that the communication not be made public. Holdings that the privilege is lost when overheard by an eavesdropper are singularly unimpressive.

50. The "question involves a determination as to whether or not each of said documents may be withheld by reason of the existence of the attorney-client privilege. Such determination is a question of fact. . . ." United States v. Aluminum Co. of America, 193 F. Supp. 251, 252 (N.D.N.Y. 1960).

51. Judge Campbell's analogy between the attorney-client privilege and the privilege against self-incrimination is questionable. The histories of the two are not even remotely similar. Wigmore discusses the history of the self-incrimination privilege in § 2250; Judge Wisdom presents an excellent brief history of this privilege in

tended to be applicable in all cases, is that a disclosure of the communication in question to anyone within the corporate structure who would be of significance in any decision the corporation might make on the basis of the communication would not violate the requirement of confidentiality.

In *Westinghouse* Judge Kirkpatrick was concerned not with the requirement of confidentiality, but with the problem of who may properly represent the "client" in a communication with the corporation's attorney. The following analysis is suggested:[52] (1) There are essentially two situations in which anyone will seek legal advice: (a) when one is considering whether to enter some prospective transaction and desires to know its legal ramifications and/or the steps which should be taken to protect himself legally in effecting the transaction; (b) when some event has already occurred which may affect his legal relations with another. When the client is an individual there is no need to distinguish between these two situations because communications made under either circumstance are "by the client." But when the client is a corporation and the question is as to what agent may properly be dubbed "the client" when a particular communication is made, the difference between the two basic situations is crucial. When the communication concerns possible future corporate action, Judge Kirkpatrick's analysis seems correct—for the privilege to apply the communicating agent must be one who will take a substantial part in making any decision based upon the legal advice given. But in the latter situation, when the communication to the corporation's attorney is ex post facto, his test is wholly inadequate. If the communicator is the agent whose involvement in a particular activity may have affected the legal relations of the corporation, the privilege should apply. No one else can "speak" for the corporation because no one else knows what happened. It should be noted that following such an "ex post facto" communication, there will normally be a com-

DeLuna v. United States, 308 F.2d 140, 144-50 (5th Cir. 1962). Moreover, "unlike the privilege against self-incrimination . . . [the attorney-client privilege] is not intended as a shield to the weak, but rather as an encouragement to all, strong and weak alike, to consult freely with counsel." Simon, *supra* note 15, at 955. "'[B]ecause of their impersonal nature, corporations have been denied the protection of the constitutional privilege against self-incrimination. But, unlike the privilege against self-incrimination, the lawyer-client privilege does not exist out of deferance to any personal right. Rather, it is a rule of policy designed to facilitate the workings of justice. Viewed in this light, it appears that the policy of the privilege gives it full application to corporate communications, since the group of agents and directors who motivate a corporation need the incentive of the privilege fully as much as do private clients to encourage full disclosure to counsel. . . . Indeed, the privilege may fulfill its function more effectively when corporate officers are involved, since these officers are more likely than the average private litigant to know of its existence." Note, 56 Nw. U.L. REV. 235, 241 (1961).

52. The considerations discussed are intended to be cumulative; *i.e.*, unless a particular communication should be privileged under each, it should not be privileged at all.

munication of the former type concerning what action the corporation should take as a result of the event; each of these communications should be treated separately in determining whether the privilege applies.[53] (2) Moreover, there are two methods of communication by a corporate client with its attorney: (a) by direct discussion between the attorney and an agent or group of agents of the corporation; (b) by some document sent to the attorney. If the communication was by written document, then the following question must be asked: Would the document have been made but for the fact that it would be turned over to the attorney? If the answer is yes, then the document was not prepared for the purpose of seeking legal advice and should not be privileged.[54] If the answer is no, or if the communication was by direct discussion, a problem may still arise when the lawyer has been consulted for business advice in addition to legal advice; but this is a pure fact question, and the applicability of the privilege in such a situation must be determined on the basis of the main tenor of each such communication. In the *Westinghouse* case, the documents for which the privilege was asserted were prepared by General Electric's attorney from notes made at an oral interview with the corporation's agent. That agent had been directly involved in certain activity for which the corporation would almost certainly be sued. Under the foregoing analysis, the documents should have been privileged.

Evidence—Attorney-Client Privilege—Doctor's Report to Attorney on Condition of Client Is Within Privilege

Plaintiff's counsel, to assist in preparing the pleadings in a personal injury action, referred her to a doctor for an examination and a report thereon. Defendant subpoenaed the doctor as a witness and attempted to examine him on the contents of the report. Plaintiff objected to this testimony on the ground that the report was privileged. The objection was sustained and judgment given for the plaintiff. On appeal, *held*, affirmed. When a doctor makes an examination pursuant to a request by the patient's attorney, he is acting as the attorney's agent, and his findings are within the scope of the attorney-

53. This factor was present in *Westinghouse* in that "the lawyer advised the employee that it might be necessary to report the disclosure to the management. . . ." 210 F. Supp. at 486. Under the suggested analysis this is irrelevant in a determination of whether each communication was "by the client."

54. See Holm v. Superior Court, 42 Cal. 2d 500, 267 P.2d 1025, 1031 (1954) (dissenting opinion of Traynor, J.); MORGAN, BASIC PROBLEMS OF EVIDENCE 110-11 (rev. ed. 1963); *cf.* note 18 *supra*.

client privilege. *Lindsay v. Lipson,* 116 N.W.2d 60 (Mich. 1962).[1]

The protection of the attorney-client privilege has often been given to communications made to a third person by a client for the purpose of transmission to his attorney.[2] In determining the application of the privilege, the courts, particularly in the earlier cases, have phrased their decisions in language customarily used in agency,[3] and the leading commentators have done likewise.[4] In most of these cases it could have been said with reason that the use of the third party was necessary to furnish the attorney with information he needed to enable him to prepare for or conduct any contemplated litigation or settlement negotiations,[5] and the third party might well have been a necessary agent. Recently, the more perceptive opinions have largely disregarded the agency theory and have emphasized the reasonableness of the use of the third party as a channel of communication in view of the confidential character of that information.[6] This is the approach taken by the Uniform Rules of Evidence.[7] One of the most logical and solidly entrenched applications of the privilege is that of communications to interpreters.[8] The position of the professional person whose specialized knowledge is required to give meaning to the client's disclosure of facts has been persuasively analogized to that of the interpreter.[9]

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1. The physician-patient privilege was held not to apply because the physician was not consulted for treatment.

2. Cases on this point are collected in 1 DE PAUL L. REV. 291 (1952); 1 KAN. L. REV. 91 (1952); 25 SO. CAL. L. REV. 237 (1952); 8 U.C.L.A.L. REV. 472 (1961); Annot., 139 A.L.R. 1250 (1942).

Thirty-seven jurisdictions, including Michigan, have statutes purporting to define the scope of the privilege, but these are generally held to be merely declarative of the common law. 8 WIGMORE, EVIDENCE § 2292 & n.2 (McNaughton rev. 1961).

3. *Ibid.*

4. See MCCORMICK, EVIDENCE 186 (1954); MORGAN, BASIC PROBLEMS OF EVIDENCE 110 (1962); 8 WIGMORE, EVIDENCE §§ 2301, 2317 (McNaughton rev. 1961). "A communication, then, by *any form of agency* employed or set in motion by the client is within the privilege." *Id.* § 2317, at 618.

5. *Cf.* MORGAN, *op. cit. supra* note 4, at 110.

6. See United States v. Kovel, 296 F.2d 918 (2d Cir. 1961) (privilege extended to accountant in tax evasion prosecution); Grand Lake Drive In, Inc. v. Superior Court, 179 Cal. App. 2d 122, 3 Cal. Rptr. 621 (Dist. Ct. App. 1960) (privilege not extended to engineer's report in personal injury case); State v. Kociolek, 23 N.J. 400, 129 A.2d 417, 423-26 (1957) (privilege extended to psychiatrist's report in homicide prosecution).

7. "A client has a privilege . . . to prevent any other witness from disclosing such communication if it came to the knowledge of such witness (i) in the course of its transmittal between the client and the lawyer . . . ." UNIFORM RULE OF EVIDENCE 26.

8. For an interesting example of the extreme to which this may be carried, see Mileski v. Locker, 14 Misc. 2d 252, 178 N.Y.S.2d 911 (Sup. Ct. 1958) where the privilege was allowed when the defendant was the interpreter for the plaintiff and her attorney.

9. "This analogy of the client speaking a foreign language is by no means irrelevant . . . . Accounting concepts are a foreign language to some lawyers . . . ." United States v. Kovel, *supra* note 6, at 922; *cf.* Lalance & Grosjean Mfg. Co. v. Haberman

This case marked the first time the problem had been considered in the jurisdiction. The court, after stating that the privilege should be liberally applied, embodied its reasoning in a lengthy quotation from *City & County of San Francisco v. Superior Court.*[10] The essence of that quotation was that since the communication would certainly have been privileged if made by the client directly to the attorney, the interposition of the physician as an agent to interpret the client's condition did not destroy the privilege.

If the analogy of a physician to an interpreter is well taken, the decision in the case clearly follows. The use of the agency terminology, however, is questionable. Had the court given full consideration under the orthodox rule to whether the doctor was an agent, either of the attorney or of the client, the conclusion might very easily have been that he was not. Certain key elements of the agency relationship are either absent or only minimally present in this type of doctor-patient relationship.[11] As is so often done, the court here has loosely used the word "agent," an exact legal term, to express its desired legal result.

The policy of the privilege, insofar as is relevant here, is to encourage full disclosure to the attorney.[12] To bring communications to interpreters within the scope of the privilege not only furthers this policy but is absolutely necessary to its effective use. Rather than analogizing the doctor (or any other expert witness) to an interpreter,[13] it would be more realistic to examine his position in relation to the fundamental policy. In a personal injury case would the plaintiff's attorney be less likely to seek relevant medical information if he knew that the defendant might also be allowed to use the information when obtained?[14] It seems that the answer is no. Gathering the medical facts is a necessary step for both sides in preparation for trial of a personal injury action; it would not likely be omitted except for the most pressing reasons. In all but six jurisdictions the defendant may

Mfg. Co., 87 Fed. 563 (C.C.S.D.N.Y. 1898) (expert may be "alter ego" of the client).

10. 37 Cal. 2d 227, 231 P.2d 26 (1957).

11. The agent should have the power to alter the relations between the principal and third persons, for example, to bind the principal in contract, buy or sell his goods, or subject him to tort liability; there should be a fiduciary relationship; and the principal should have some degree of control over the manner of the agent's performance. 1 RESTATEMENT (SECOND), AGENCY § 2, comment *b* (1958); *id.* § 12 & comments *a, c; id.* §§ 13, 14; *id.* § 14N, comment *b;* MECHEM, AGENCY § 14 (4th ed. 1952).

12. MODEL CODE OF EVIDENCE rule 210, comment (1942); 8 WIGMORE, EVIDENCE § 2291 (McNaughton rev. 1961).

13. See notes 8 & 9 *supra* and accompanying text.

14. The corollary question is whether disallowance of the privilege would encourage the plaintiff to manufacture symptoms for the doctor. It would seem that if the plaintiff were so inclined, he would do so even with the privilege in order to get the most favorable report possible.

compel the plaintiff to undergo physical examination,[15] and may thus usually obtain the allegedly privileged information. Twenty-nine of these jurisdictions[16] have adopted provisions similar to Rule 35 of the Federal Rules of Civil Procedure, which, under certain circumstances, allows the defendant to obtain a copy of the findings of the plaintiff's doctor,[17] thereby further limiting the number of situations where the privilege may be of value. Thus, extension of the privilege to cover communications to the plaintiff's physician does little to promote full disclosure to the attorney and, in most cases, does the plaintiff very little good unless imposing a slight inconvenience and expense upon one's adversary is considered good. In fact it appears that the plaintiff benefits from the privilege only when he seeks to circumvent the declared policy of the overwhelming majority of jurisdictions, that the defendant should be fully apprised of the medical evidence. When privilege is granted to suppress the truth without corresponding gain to the effective administration of justice, the concept of privilege is being abused.[18]

Federal Jurisdiction—In Federal Question Action Federal Court Is Competent To Exercise In Personam Jurisdiction Over Corporation if It Has Sufficient Contacts With United States

Plaintiff, a Tennessee corporation, brought suit under the Carmack Amendment against National Carloading Corporation, a Missouri corporation, in a federal court in Tennessee for damage to an interstate shipment of goods.[1] The defendant filed a third-party complaint

15. 2A BARRON & HOLTZOFF, FEDERAL PRACTICE AND PROCEDURE § 821 (Wright rev. 1961).

16. *Ibid.*

17. "By requesting and obtaining a report of the examination [had at the request of the opposing party] . . . the party examined waives any privilege he may have . . . regarding the testimony of every other person who has examined or may thereafter examine him . . . ." FED. R. CIV. PROC. 35 (b)(2). It has been generally assumed that the privilege waived will be the physician-patient privilege, see, *e.g.*, Sher v. DeHaven, 199 F.2d 777 (D.C. Cir. 1952); 2A BARRON & HOLTZOFF, *op. cit. supra* note 15, § 821 n.7.1, but this application of the attorney-client privilege is within both the letter and intent of the rule.

18. It is emphasized that the reasoning herein is limited to physician's reports in the typical personal injury case. Thus no attack on the reasoning of the cases cited in note 6 *supra* is to be inferred since those cases were of a different nature.

1. Plaintiff's claim was based on the Carmack Amendment as amended, 46 Stat. 251 (1930), as amended, 49 U.S.C. § 20(11) (1958), and possibly on the common law as well.

against three carriers which in turn had custody of the shipment.[2] One of the third-party defendants, Atchison, Topeka and Santa Fe Railway, moved to vacate the service of process and dismiss the complaint as to itself for lack of jurisdiction over it. Santa Fe, a Kansas corporation, was not licensed to do business in Tennessee and maintained only a small office, staffed by two employees, in Memphis, Tennessee.[3] It urged that this activity was insufficient to satisfy the "solicitation plus" rule[4] applied by Tennessee courts to determine in personam jurisdiction over foreign corporations.[5] *Held*, motion dismissed. In personam jurisdiction of a federal court, where the parties raise a claim under a federal statute, is to be determined by federal law, which permits a district court to exercise jurisdiction over a corporation where the corporation has such sufficient "minimum contacts with the United States that the exercise of jurisdiction does not offend traditional notions of fair play and substantial justice."[6] *First Flight Co. v. National Carloading Corp.*, 209 F. Supp. 730 (E.D. Tenn. 1962).

There has been disagreement and even confusion in the federal courts on the measure of their jurisdiction in actions in personam. It will make for clarity to distinguish between "the judicial jurisdiction" of the sovereign and the "competence" of a particular court to entertain a given case. The former concept is concerned with the basis of the legal power of a sovereign to exercise authority through its courts. This basis exists when a sovereign "has certain minimum contacts with the parties or their property" so as to satisfy the due process requirements.[7] The latter concept is a measure of the grant of authority to

2. The third-party plaintiff alleges a claim arising under 24 Stat. 386 (1887), 49 U.S.C. § 20(12) (1958).

3. This two room office has been maintained continuously since 1953. The employees solicit freight and passenger traffic, but the traffic contracts are executed outside Tennessee. The freight obtained through the office was about ½ of 1% of the company's freight traffic of 1,728,955 carloads in 1961. First Flight Co. v. National Carloading Corp., 209 F. Supp. 730, 734 (E.D. Tenn. 1962).

4. This rule was adopted by the United States Supreme Court as the test of the application of the due process clause of the fourteenth amendment in Green v. Chicago, B. & Q. Ry., 205 U.S. 530 (1907), but was later rejected in International Shoe Co. v. Washington, 326 U.S. 310 (1945). It is still adhered to by the Tennessee Supreme Court in the interpretation of the Tennessee statute specifying when foreign corporations are subject to actions. See TENN. CODE ANN. § 20-220 (1956). Under the "solicitation plus" rule, activity in addition to mere solicitation of orders which can be accepted or rejected outside the forum state is necessary to satisfy the due process requirements for a valid exercise of in persouam jurisdiction. See Morgan & Handler, *Procedure and Evidence–1961 Tennessee Survey (II)*, 15 VAND. L. REV. 921, 933-34 (1962).

5. The court considers it not material which employee was served, as the rules for service of process, subsections (3) and (7) of Rule 4(d), FED. R. CIV. P., relate to the *method* of service and not to the *amenability* of a corporation to service.

6. First Flight Co. v. National Carloading Corp., 209 F. Supp. 730, 738 (E.D. Tenn. 1962).

7. RESTATEMENT (SECOND), CONFLICT OF LAWS 37-38 (Tent. Draft No. 3, 1956).

a particular court. Thus, although a state may have "judicial jurisdiction," it may choose not to exercise it or, if so, to exercise it only through certain courts.[8] One aspect of the problem of competence is "venue." Another aspect is the authority to deal with the subject matter of a suit.[9] The competence of a given court is to be ascertained from the language of the applicable statutes containing the grant of authority to the courts.

The failure to observe the distinction between "judicial jurisdiction" of the sovereign and "competence" of a given court is a primary cause of the confusion in the federal courts, specifically over whether their authority is to be tested by the law of the state in which they are sitting or by independent federal courts standards. There are at least three areas of disagreement. The first is concerned with which due process limitation is applicable, that of the fifth amendment or that of the fourteenth amendment, and, more specifically, the disagreement is over the content of these clauses. Here, it appears that in general the same due process requirements have been applied to the federal courts as have served to determine state court jurisdiction—namely, those of the fourteenth amendment. Thus, a line of cases exists holding that a foreign corporation can be validly served in the absence of consent only where it is incorporated or "doing business."[10] Other cases[11] seek to apply the "minimum-contacts" test as set forth in the *International Shoe* case[12] to determine federal court in personam jurisdiction. On the other hand there is authority that recognizes that the same due process requirements do not necessarily apply to federal courts that control a state court's exercise of authority.[13] The second area of disagreement arises primarily in diversity cases and considers the application of the *Erie* policy to federal court competence.[14]

8. *Id.* at 39.

9. *Id.* at 39-40.

10. Louisville & N.R.R. v. Chatters, 279 U.S. 320 (1929); Bank of America v. Whitney Cent. Nat'l Bank, 261 U.S. 171 (1923); People's Tobacco Co. v. American Tobacco Co., 246 U.S. 79 (1918); Philadelphia & R. Ry. v. McKibbin, 243 U.S. 264 (1917); Green v. Chicago B. & Q. Ry., 205 U.S. 530 (1907); Rosenthal v. Frankfort Distillers Corp., 193 F.2d 137 (1951).

11. Lone Star Package Car Co. v. Baltimore & O.R.R., 212 F.2d 147 (1954); Jaftex Corp. v. Randolph Mills, Inc., 282 F.2d 508 (1960).

12. International Shoe Co. v. Washington, 326 U.S. 310 (1945). See note 17 *infra.*

13. See, *e.g.*, Robertson v. Railroad Labor Bd., 268 U.S. 619 (1925); Green, *Federal Jurisdiction In Personam of Corporations and Due Process,* 14 VAND. L. REV. 967 (1961). The fact that Congress has validly provided for nationwide service of process in certain special cases, such as interpleader and anti-trust, lends support to the contention that due process does not require contacts with the state in which the federal court is situated.

14. In Erie R.R. v. Tompkins, 304 U.S. 64, 78 (1938), the Court stated: "Except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State." As modified by Guaranty Trust Co. v. York, 326 U.S. 99 (1945), the resulting policy has been stated to mean "that on any matters having a substantial effect on the outcome of litigation, as distinguished from

Again, the same courts which would apply the due process requirements of the fourteenth amendment to federal court "jurisdiction" generally do so as part of the over-all effort to apply the *Erie* policy to federal court competence. The view of the authorities contra is to the effect that the competence of a federal court

> is to be considered so much a part of the make-up of a federal court that it is not lightly to be superseded, and the settled policy that federal courts should apply state substantive law in diversity cases does not go to the extent of requiring the contrary.[15]

Lastly, assuming federal law does determine federal court competence, do the Federal Rules of Civil Procedure concerning service of process carry an implication as to venue of the federal courts?

In the instant case, the court begins its analysis by clearly distinguishing the judicial jurisdiction of the United States from that of the states, proceeding from the basic premise that "a sovereignty has personal jurisdiction over any defendant within its territorial limits, and that it may exercise that jurisdiction by any of its courts able to obtain service upon the defendant."[16] Noting the manner in which the exercise of such jurisdiction by the states was controlled by the due process clause of the fourteenth amendment,[17] the court, adopting the explanation suggested by Professor Thomas F. Green, Jr.,[18] reasoned that the similar clause of the fifth amendment could well be thought to apply in an analogous fashion to the exercise of federal court jurisdiction. Therefore, the court, in accordance with Professor Green's view, concluded that due process required only that a corporation have "such minimum contacts with the United States [not with the state in which the federal court is sitting] that the exercise of jurisdiction does not offend traditional notions of fair play and substantial justice."[19] This would mean that there is judicial jurisdiction of the nation over all American corporations. Despite this nationwide jurisdiction there remain, as the court pointed out, restrictions on the competence of the courts which protect defendant corporations from

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the ways of conducting judicial business, federal courts must look to the law of the state where they sit. . . ." Jaftex Corp. v. Randolph Mills, Inc., 282 F.2d 508, 517 (1960).

15. *Id.* at 512.

16. 209 F. Supp. at 736.

17. *Compare* Pennoyer v. Neff, 95 U.S. 714 (1877), *with* Philadelphia & P. Ry. v. McKibbins, 243 U.S. 264 (1917) *and* International Shoe Co. v. Washington, 326 U.S. 310 (1945). The due process requirements under the fourteenth amendment have been defined successively in terms of "presence," then "doing business" within the state, and finally such "minimum contacts" with the state that the exercise of jurisdiction does not offend "traditional notions of fair play and substantial justice." 326 U.S. at 316.

18. See note 13 *supra*.

19. 209 F. Supp. at 738.

the harshness of defending most suits far from their places of business. Rule 4(f) of the Federal Rules of Civil Procedure[20] limits in general the exercise of authority to the territorial limits of the state in which the district court lies; and, under the general venue statute,[21] a corporation can usually raise an objection if it is not "doing business" in the district where the suit is brought. Finally, a motion for change of venue under the forum non conveniens statute[22] is always available to the corporation.

The court's analysis cuts through much of the confused thinking of prior cases and distinguishes between "judicial jurisdiction" and "competence." The judicial jurisdiction of the United States is made dependent upon sufficient contacts with the national territory to satisfy the due process requirements of the fifth amendment, and the inapplicability of the fourteenth amendment to federal court action is pointed out. This is clearly correct[23] and reveals the true area in question—namely, the *competence* of the district courts. Such competence is a measure of the grant of authority to the courts by the sovereign, and its source is statutory provision. Clearly, then, the competence of the federal courts is a distinct matter from that of jurisdiction or competence of the state courts, and there is necessarily a separate federal courts law as to the competence of the federal courts, though Congress may make the competence of these courts conform to that of the state courts. Much of the uncertainty as to competence of the federal courts is due to the lack of a definitive Supreme Court ruling in this area and the absence of a controlling federal statute. A ruling by the Supreme Court may be sufficient to clear up the question of the applicability of the *Erie* policy to federal court competence in diversity cases. Concerning the more basic problem of defining the federal courts law with respect to competence, it is apparent that the best solution is a federal statute which deals directly with the problem of venue and settles the dispute as to whether this is to be determined by independent federal standards or whether it is to conform to the requirements applicable to the courts of the state in which the federal court sits.[24] Such a statute

20. FED. R. CIV. P. 4(f) provides: "Territorial Limits of Effective Service. All process other than a subpoena may be served anywhere within the territorial limits of the state in which the district court is held and, when a statute of the United States so provides, beyond the territorial limits of that state . . . ."

21. 28 U.S.C. § 1391 (1958). Subsection (c) provides: "A corporation may be sued in any judicial district in which it is incorporated or licensed to do business or is doing business, and such judicial district shall be regarded as the residence of such corporation for venue purposes."

22. 28 U.S.C. § 1404(a) (1958).

23. See note 13 *supra*.

24. The exercise of a federal court's authority over a corporation is dependent upon a valid service of process, provisions for which are found in FED. R. CIV. P. 4(d), subsections (3) and (7). These provisions, although clearly worded, have generally

would take into account such matters as the provision of a court accessible to the plaintiff, the burden on the defendant of trying a case in a distant place, and the preservation of the independent role of the federal courts in our federal system.

Federal Rules of Civil Procedure—Counterclaim Not Compulsory in First Suit When Statute Requires Splitting of a Cause of Action

Plaintiff, a subcontractor of defendant prime contractor on two government projects located in Georgia and Tennessee, quit both jobs before completion; defendant was required by the Miller Act[1] to compensate plaintiff's supplier. Plaintiff later sued in the Federal District Court for the Middle District of Georgia for amounts allegedly due on both jobs and defendant counterclaimed for the amount paid plaintiff's supplier. However, plaintiff, pursuant to the Miller Act,[2] amended the Georgia complaint and filed a suit for the amount allocated to the Tennessee project in the Federal District Court for the Middle District of Tennessee. Defendant "dropped" the counterclaim in Georgia and claimed a credit in Tennessee for the amount paid supplier. Plaintiff contends that Rule 13(a) of the Federal Rules of Civil Procedure bars defendant's claim as such claim represented a compulsory counterclaim in the Georgia action. The trial court in Tennessee allowed defendant's counterclaim, but the United States Court of Appeals for the Sixth Circuit reversed.[3] On certiorari in the United States Supreme Court, *held*, reversed. Where a statute requires splitting of a cause of action, Rule 13(a) does not require assertion of a compulsory counterclaim common to both actions in whichever action is brought first. *Southern Construction Co. v. United States ex rel. Pickard*, 371 U.S. 57 (1962).

been held to relate only to the manner of service leaving unanswered the question of amenability to service of process. See, *e.g.*, Singleton v. Atlantic Coast Line R.R., 20 F.R.D. 15, 17 (D. Mich. 1956). See also Jaftex Corp. v. Randolph Mills, Inc., 282 F.2d 508, 511, 519 (2d Cir. 1960); Green, *Federal Jurisdiction In Personam of Corporations and Due Process*, 14 VAND. L. REV. 967, 968, 981 (1961); 1 BARRON & HOLTZOFF, FEDERAL PRACTICE AND PROCEDURE §§ 179, 182.1 (1960).

1. Under the Miller Act, 49 Stat. 794 (1935), 40 U.S.C. § 270b(a) (1958), Southern (defendant) as a prime contractor was secondarily liable to suppliers of the subcontractor (plaintiff).

2. 73 Stat. 279 (1959), 40 U.S.C. § 270(b) (Supp. III, 1962) requires that suits instituted under its provisions "shall be brought . . . in the United States District Court for any district in which the contract was to be performed and executed and not elsewhere . . . ."

3. The district court's opinion is unreported. The opinion of the Court of Appeals for the Sixth Circuit is reported at 293 F.2d 493 (1961).

Rule 13 of the Federal Rules of Civil Procedure is the embodiment of the common law remedies of set-off and recoupment[4] and is substantially the same as old Equity Rule 30.[5] Rule 13(a) requires a defendant to assert as a counterclaim any claim against the plaintiff which arises out of the same transaction or occurrence as the plaintiff's claim.[6] The purpose of the provision is to prevent a multiplicity of suits by requiring all matters determinable by the same facts or law to be litigated in one judicial proceeding.[7] The test generally formulated to determine if a counterclaim is compulsory or permissive is whether there is a logical relation between plaintiff's claim and the counterclaim.[8] Failure to assert a compulsory counterclaim has the effect of barring a subsequent proceeding based on the claim, with justification of this result predicated on theories of res judicata,[9] waiver,[10] or merger.[11] There are, however, exceptions to this result; if the counterclaim is not in existence at the time of initiation of plaintiff's action or is the subject of a pending action or if indispensable parties are unavailable, then failure to plead the counterclaim will not be a bar.[12] A litigious area of Rule 13(a) is the problem created by the institution of a subsequent suit, prior to judgment in the first, by either the plaintiff on his pending claim or by the defendant on his

4. See, *e.g.*, Nasco v. Ferguson, 70 Ohio L. Abs. 513, 121 N.E.2d 209 (Ct. App. 1953); FIELD & KAPLAN, MATERIALS ON CIVIL PROCEDURE 431-34 (1953); 3 MOORE, FEDERAL PRACTICE § 13.11 (2d ed. 1948). Common law set-off is equivalent to a permissive counterclaim and recoupment is equivalent to the compulsory counterclaim; the distinction becomes acute when the statute of limitations is involved as it runs on permissive and not on compulsory counterclaims. For a history of counterclaims see Howell, *Counterclaims and Cross-Complaints in California,* 10 So. CAL. L. REV. 415 (1937).

5. 3 MOORE, *op. cit. supra* note 4. For a construction of old Equity Rule 30 see American Mills Co. v. American Sur. Co., 260 U.S. 360 (1922).

6. FED. R. CIV. P. 13(a). For an example of a compulsory counterclaim see John R. Alley & Co. v. Federal Nat'l Bank, 124 F.2d 995 (10th Cir. 1942).

7. See, *e.g.*, Union Paving Co. v. Downer Corp., 276 F.2d 468 (9th Cir. 1960); Allstate Ins. Co. v. Valdez, 29 F.R.D. 479 (E.D. Mich. 1962). The logical reason for Rule 13(a) is to reduce litigation, but it does not necessarily promote trial convenience, as it may complicate the issues. See Blackmar, *Some Problems Regarding Compulsory Counterclaims Under the Federal Rules and the Missouri Code,* 19 U. KAN. CITY L. REV. 38 (1951).

8. See, *e.g.*, E. J. Korvette Co. v. Parker Pen Co., 17 F.R.D. 267 (S.D.N.Y. 1955). In West Coast Tanneries, Ltd. v. Anglo-American Hides Co., 20 F.R.D. 166 (S.D.N.Y. 1957) the court said "A compulsory counterclaim is any claim that a defendant has against a plaintiff which 'arises out of the transaction or occurence that is the subject matter of the [plaintiff's] claim.'" 20 F.R.D. at 168.

9. See, *e.g.*, Hancock Oil Co. v. Universal Oil Prods. Co., 115 F.2d 45 (9th Cir. 1940); Schott v. Colonial Baking Co., 111 F. Supp. 13 (W.D. Ark. 1953); 3 MOORE, *op. cit. supra* note 4, § 13.12. For discussion on theories and results of each see Wright, *Estoppel by Rule: The Compulsory Counterclaim Under Modern Pleading,* 39 IOWA L. REV. 255, 261 (1954); 56 COLUM. L. REV. 130 (1956).

10. See, *e.g.*, Dow Chemical Co. v. Melton Corp., 281 F.2d 292 (4th Cir. 1960).

11. See 48 VA. L. REV. 1158 (1962).

12. 3 MOORE, *op. cit. supra* note 4, § 13.13. See amended Rule 13(a), Federal Rules of Civil Procedure, as adopted by the Supreme Court, Jan. 21, 1963.

counterclaim in another court. Numerous situations can occur, *e.g.*, plaintiff sues in the federal court and defendant instead of asserting his compulsory counterclaim makes it the basis of a cause of action in a state court.[13] If the defendant uses his counterclaim as a cause of action in another federal court before plaintiff's action is completed, the federal courts will usually join the two actions.[14] As many states have procedure rules similar to Rule 13(a), the same problems exist on state court levels.[15]

In the instant case, one of first impression, the Supreme Court in a per curiam opinion recognized that the prevention of multiple suits based on the same circumstances via Rule 13(a) would not be accomplished by denying defendant's claim in the second suit.[16] The Court by applying principles of statutory construction looked at the purpose for the rule, *i.e.*, prevention of circuity of action by eliminating multiple suits based on the same circumstances, and acknowledged that this purpose is not opposed by allowing defendant's counterclaim.[17] The Court distinguished the situation in the instant case, in which federal law required plaintiff to split his cause of action, and the situation presented by *United States v. Eastport Steamship Corp.*[18] where defendant instituted a second action with the counterclaim he failed to assert in the first as the basis of his complaint.

The Court made a policy interpretation of Rule 13(a) which is apparently harmonious with the purpose of the rule. Although a strict application of the language of the rule would possibly require a compulsory counterclaim to be asserted in the first of the two suits statutorily required to be fragmented, the "evil" of multiple suits is not furthered by permitting the counterclaim in this situation. The Court reached a rational basis for determination of the non-application of the res judicata effect. As the rule is intended to eliminate potential litigation, it would serve no purpose to disallow defendant's

13. Federal courts have been held to be barred by 28 U.S.C. § 2283 (1958) from enjoining parties from prosecuting pending in personam proceedings in a state court merely on the ground of duplication. See HART & WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 1057-78 (1953).

There are numerous other examples, see, *e.g.*, Scott v. Holcomb, 49 Wash. 387, 301 P.2d 1068 (1956); *cf.* Williams v. Kaestner, 332 S.W.2d 21 (Mo. App. 1960), where a motorist and a taxicab were involved in an accident; in the first suit the cab driver sued for personal injuries, and in a second suit the cab owner sued for property damage. The motorist attempted to assert a counterclaim for personal injuries in the second suit, but the court said it should have been asserted in the first suit and consequently was barred.

14. See Fantecchi v. Gross, 158 F. Supp. 684 (E.D. Pa. 1957), *appeal dismissed*, 255 F.2d 299 (3d Cir. 1958).

15. See Annot., 22 A.L.R.2d 621 (1952) on similar state statutes and cases under Rule 13(a).

16. 371 U.S. at 60.

17. *Ibid.*

18. 255 F.2d 795, 801-02 (2d Cir. 1958).

counterclaim in the second of two split actions since two suits are necessary anyway. This decision, recognizing that the purpose of the rule is not served by denying the counterclaim, will serve as a guideline to future litigation.

Government Immunity and Liability—Tucker Act—No Liability for Noise, Smoke, and Vibrations Made by Jet Planes Flying Over Land Adjacent to That of Plaintiff

Plaintiff home owners sued the United States under the Tucker Act,[1] alleging that noise, smoke, and vibrations from jet planes using an Air Force base adjacent to their property constituted a taking of a property interest[2] for which compensation was due them under the fifth amendment.[3] Plaintiffs did not base their claims on flights over their properties, but rather on the disturbance created laterally by jets flying across land adjoining that of the plaintiffs. From an adverse judgment in the federal district court, plaintiffs appealed. *Held*, affirmed. While smoke, sound and shock waves from jet planes may pervade property neighboring that on which they have their source, they do not constitute an actual physical invasion or taking for which the federal government must make compensation under the fifth amendment. *Batten v. United States*, 306 F.2d 580 (10th Cir. 1962), *cert. denied*, 371 U.S. 955, *rehearing denied*, 372 U.S. 925 (1963).

In the past, the courts read the prohibition of the fifth amendment, "nor shall private property be taken for public use, without just compensation," literally.[4] Thus, property "taken" was distinguished from

1. "The district courts shall have original jurisdiction, concurrent with the Court of Claims, of: . . . .

(2) Any other civil action or claim against the United States, not exceeding $10,000 in amount, founded upon the Constitution, or any Act of Congress, or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort." 28 U.S.C. § 1346(a) (1958).

2. "[T]he diminution in value ranged from 55.3% to 40.8%." 306 F.2d at 583 n.3.

3. U.S. CONST. amend. V.

4. "Eminent domain implies a taking for public use, an acquisition, and appropriation, not a mere damage." JAHR, EMINENT DOMAIN 6 (1953). The early physical concepts of eminent domain were embodied in the Constitution in the words "take" and "property." However, in Pumpelly v. Green Bay Co., 80 U.S. (13 Wall.) 166, 177-78 (1871), the Supreme Court said, "It would be a very curious and unsatisfactory result, if in construing a provision of constitutional law, always understood to have been adopted for protection and security to the rights of the individual as against the government . . . it shall be held that if the government refrains from the absolute conversion of real property to the uses of the public it can destroy its value entirely, can inflict irreparable and permanent injury to any extent, can, in effect, subject it to total destruction without making any compensation, because, in the narrowest sense of

that "damaged," compensation being allowed only for a taking in the sense that the injury complained of "must be not only a direct physical invasion of private property, but must also act as an actual ouster and cause a practical destruction of the value of the land."[5] In 1946, the Supreme Court in *United States v. Causby*[6] held that low-altitude flights over the plaintiff's property constituted a "taking" under the fifth amendment. In that case, the noise and vibrations from heavy aircraft overhead interfered with the plaintiff's operation of a chicken farm and disturbed the plaintiff's family. In a number of cases following *Causby*, the courts adhered to the principle therein, allowing recovery for continuous flying at low levels over plaintiffs' property.[7] In each of these cases, there was an actual physical invasion in that the planes flew over the property, through the non-privileged[8] zone or column of airspace superadjacent to the plaintiff's property. The necessity of an actual physical invasion had been recognized in early decisions;[9] thus it was this column of airspace, a newly-defined concept of property,[10] which was of legal interest. This property concept, together with a physical invasion, was a sufficient basis to allow recovery under the "taking" provision of the fifth amendment. But where there was no physical invasion of the airspace above the plaintiff's property, recovery was denied on the ground that the fifth amendment affords no redress for consequential damages.[11] This was in line with early decisions distinguishing between a "taking" and

that word, it is not *taken* for the public use." The physical concept, however, was preserved by requiring a physical invasion of the land. Cormack, *Legal Concepts in Cases of Eminent Domain*, 41 YALE L.J. 221, 233 (1931).

5. Coleman v. United States, 181 Fed. 599, 603 (N.D. Ala. 1910).

6. 328 U.S. 256 (1946).

7. See, *e.g.*, Griggs v. Allegheny County, 369 U.S. 84 (1962) (fourteenth amendment); Matson v. United States, 171 F. Supp. 283 (Ct. Cl. 1959); Highland Park v. United States, 161 F. Supp. 597 (Ct. Cl. 1958).

8. "'Navigable airspace' means airspace above the minimum altitudes of flight prescribed by regulations issued under this chapter, and shall include airspace needed to insure safety in take-off and landing of aircraft." 72 Stat. 739 (1958), 49 U.S.C. § 1301(24) (1958).

9. In Bedford v. United States, 192 U.S. 217, 225 (1904), in denying compensation, the Court distinguished the *Pumpelly* case, note 4 *supra*, saying that in that case there had been "an actual invasion and appropriation of land as distinguished from consequential damage."

10. Noting that the ancient maxim *Cujus est solum ejus est usque ad coelum* was obsolete, the Court in *Causby* said, "The landowner owns at least as much of the space above the ground as he can occupy or use in connection with the land." United States v. Causby, 328 U.S. 256, 264 (1946).

11. "This diminution in value must at the same time result in a taking of property and not be a case of incidental damages arising from a legalized nuisance . . . or damages sustained by reason of noise, vibration, fear, anxiety, or nervousness resulting from planes operating near but not over the plaintiff's land. These, oft-times called 'proximity damages,' are not recoverable." Freeman v. United States, 167 F. Supp. 541, 544 (W.D. Okla. 1958). *Accord*, Bartholomae Corp. v. United States, 253 F.2d 716 (9th Cir. 1958); Pope v. United States, 173 F. Supp. 36 (N.D. Tex. 1959); United States v. 26.07 Acres of Land, 126 F. Supp. 374 (E.D.N.Y. 1954).

"damage."[12] Indeed, the harshness of these cases led some states to amend their constitutions in order to compensate for property "damaged" as well as that "taken."[13] The fifth amendment has not been so amended, nor have the courts given it such an expanded construction. The adjacent property owner who suffers injury from the federal government, however, may not be without remedy, for in 1946, following the *Causby* decision, Congress enacted the Federal Tort Claims Act,[14] under which some landowner plaintiffs have brought actions for damages.[15]

In invoking the Tucker Act, which provides for suit against the Government on claims "founded upon the Constitution,"[16] the plaintiffs in the instant case sought to have their claims established as a "taking." Through a strict construction of the Constitutional provision as established by precedent,[17] the court decided that lateral interference with the use and enjoyment of the plaintiffs' properties did not constitute a "taking."[18] Expressing sympathy for the vibrations which caused "windows and dishes to rattle," the noise for which Air Force personnel were required to wear ear plugs, the black smoke which left "an oily black deposit on the houses and laundry of the

12. *E.g.*, Bedford v. United States, *supra* note 9. However, in Richards v. Washington Terminal Co., 233 U.S. 546 (1914), the Court allowed recovery where a railroad, operating under a governmental grant, caused smoke and fumes to be directed across an adjacent landowner's property.

13. Spies & McCoid, *Recovery of Consequential Damages in Eminent Domain*, 48 VA. L. REV. 437, 446 (1962).

14. "The United States shall be liable, respecting the provisions of this title relating to tort claims, in the same manner and to the same extent as a private individual under like circumstances. . . ." 28 U.S.C. § 2674 (1958).

15. See, *e.g.*, Western v. McGehee, 202 F. Supp. 287, 290 (D. Md. 1962), where landowners sued under both the Tucker Act and the Tort Claims Act, for damages resulting from authorized flights in the superadjacent airspace, the court saying, "If such flights do not amount to a taking, but cause physical injury or damage, an action for damages may be maintained under the Federal Tort Claims Act. Weisberg v. United States, D. Md., 193 F. Supp. 815 (1961)." However, in Harris v. United States, 205 F.2d 765 (10th Cir. 1953), where a landowner brought separate actions under the Tucker Act and the Tort Claims Act for damages to crops from spraying operations conducted by the Government on adjoining property, the court held that a single instance of this type of interference was insufficient to establish a taking under the Tucker Act, and further that since "some act of misfeasance or nonfeasance is essential to governmental liability under the Tort Claims Act, there can be no liability without fault." *Id.* at 767. The opinion, written by Judge Murrah, who dissented in the instant case, noted, "If the result leaves a wrong by the sovereign without a judicial remedy, the deficiency lies in the limited scope of the government's tort liability. It does not justify the extension of the contractual liability of the government beyond its intended scope." *Id.* at 768. For a criticism of the *Harris* case, see Note, 22 GEO. WASH. L. REV. 496 (1954). See generally Johnson v. United States, 170 F.2d 767 (9th Cir. 1948) and Barroll v. United States, 135 F. Supp. 441 (D. Md. 1955).

16. 28 U.S.C. § 1346(a)(2) (1958).

17. *E.g.*, United States v. Kansas City Life Ins. Co., 339 U.S. 799 (1950); United States v. Willow River Power Co., 324 U.S. 499 (1945); United States v. Cress, 243 U.S. 316 (1917); Harris v. United States, 205 F.2d 765 (10th Cir. 1953).

18. 306 F.2d at 585.

plaintiffs,"[19] and the diminution in the value of the property,[20] the court said, "No amount of sympathy for the vexed landowners can change the legal principles applicable to their claims."[21] The holding of the decision was based squarely on the applicability of the Tucker Act. Thus, "damage alone gives courts no power to require compensation."[22] The "carefully preserved distinction between 'damage' and 'taking,' "[23] a distinction which, the court noted, was based on the physical invasion principle rather than on actual damage done, was reiterated here, and recovery denied. Chief Judge Murrah, dissenting, took the position that a constitutional taking could be established by indirect interference, the test being the substantiality of the interference.[24]

The *Causby* decision, while embracing the physical invasion theory, broadened the concept of "property taken" and stated additionally, "Flights over private land are not a taking, unless they are so low and so frequent as to be a direct and immediate interference with the enjoyment and use of the land."[25] Noting this aspect of the Court's decision, Justice Black, dissenting in *Causby*, pointed out that the allegation of noise and glare sounded in tort as a nuisance claim, rather than one founded upon the Constitution.[26] The confusion between "damaged" and "taken," and the action appropriate for each, has perhaps stemmed from two concepts of property[27] and has been accentuated by the advent of the air age. Property is not only the mere corporeal object, but also the rights which pertain thereto, which are created and sanctioned by law.[28] Thus, an interference with the rights of use and enjoyment would be an interference with the plaintiff's property. The dissenting opinion of the instant case utilized this theory, declaring that "the economic interest asserted here, is no different from that 'taken' in *Causby* . . . ."[29] The fifth amendment would therefore apply. This is in sharp contrast with Justice Black's view, which would place all such claims in the realm of tort law. Both

19. *Id.* at 582.
20. See note 2 *supra*.
21. 306 F.2d at 583.
22. *Ibid.*
23. *Id.* at 584.
24. *Id.* at 587.
25. United States v. Causby, 328 U.S. 256, 266 (1946).
26. *Id.* at 269-70.
27. Cormack, *Legal Concepts in Cases of Eminent Domain*, 41 YALE L.J. 221, 223-24 (1931).
28. 1 LEWIS, EMINENT DOMAIN § 63 (3d ed. 1909). In United States v. General Motors Corp., 323 U.S. 373, 377-78 (1945), of the term "property" in the fifth amendment, the Court said: "it may have been employed in a more accurate sense to denote the group of rights inhering in the citizen's relation to the physical thing, as the right to possess, use and dispose of it. . . . The constitutional provision is addressed to every sort of interest the citizen may possess."
29. 306 F.2d at 586.

views, however, ignore the relevance of physical invasion insofar as trespass must be established,[30] the primary factor being the degree of interference.[31] The court's insistence on a physical invasion, of course, would have fallen had the action been one in nuisance.[32] Plaintiffs, however, made no claim under the Tort Claims Act, but based their right on the fifth amendment, the interpretation of which was constrained by precedent.[33] Considerations of fairness and justice would seem to obviate the necessity of the invasion principle in order to put all claims of airplane interference on the same remedial level. Policy considerations, however, call other factors onto the judicial scene, such as increased liability for the Government, which, it has been argued, would seriously undermine the power of eminent domain.[34] While the price might ultimately be higher, it would appear that the public as a whole should and would be better able to bear

30. "Even more disrespectful of precedent is the third view, which would give to the landowner no ownership or possessory interest whatsoever in the space above his land . . . . [A]n entry into the air space would not constitute an actionable wrong unless it causes some actual damage or apprehension of damage to the landowner; but the landowner's remedy in such a case would be an action for a nuisance rather than an action for a trespass. Immediately, the question arises whether the landowner's interest would be adequately protected under this theory. Generally speaking, a nuisance involves the idea of continuity or recurrence; an isolated act is not sufficient." Hackley, *Trespassers in the Sky*, 21 MINN. L. REV. 773, 800 (1937). Mankiewicz notes that "in no Civil Law country can land ownership be invoked as a basis for an action for trespass against the operator of licensed aircraft" but "the way a given service, flight or airport is actually operated may entitle the victimized landowner to certain defensive action in the courts." Mankiewicz, *Some Aspects of Civil Law Regarding Nuisance and Damage Caused by Aircraft*, 25 J. AIR L. & COM. 44, 45 (1958). And Weibel, in *Problems of Federalism in the Air Age*, 24 J. AIR L. & COM. 127, 133 (1957) says, "[I]t may well be that had the *Causby* case followed the passage of the Federal Tort Claims Act, one of the more conventional avenues of approach would have been traveled by the plaintiff."

31. As one writer puts it, "there is no reason to place a landowner's cause of action in a different category merely because the noise source is not directly overhead." Note, 74 HARV. L. REV. 1581, 1583 (1961).

32. "Nuisance is commonly formulated as the redress for the protection of the use and enjoyment of land from *annoyances by indirect means*, which usually originate off the injured land." Sweeney, *Adjusting the Conflicting Interests of Landowner and Aviator in Anglo-American Law*, 3 J. AIR L. 531, 568 (1932). In Swetland v. Curtiss Airports Corp., 55 F.2d 201 (6th Cir. 1932) and in Atkinson v. Bernard, 223 Ore. 624, 355 P.2d 229 (1960), where landowners brought actions against private airports, the courts held that the correct action was one for nuisance. In Hornburg v. Port of Portland, 376 P.2d 100 (Ore. 1962), the Supreme Court of Oregon, deciding whether a noise-nuisance could amount to a taking under the state constitution, held that trespass was not a necessary element of the plaintiff's cause of action. Citing the *Batten* decision, the court found Chief Judge Murrah's dissent "the better-reasoned analysis of the legal principles involved." *But see* United States v. Cress, 243 U.S. 316, 328 (1917), where the Court said "But it is the character of the invasion, not the amount of damage resulting from it, so long as the damage is substantial, that determines the question whether there is a taking."

33. See cases cited note 17 *supra*.

34. Cormack, *Legal Concepts in Cases of Eminent Domain*, 41 YALE L.J. 221, 259 (1931).

the financial loss, rather than those who, directly and in undue proportion, now bear the expense of projects for the public's benefit.[35]

Insurance—Punitive Damages Must Be Excluded From Liability Coverage

Plaintiff was injured in an automobile collision and subsequently recovered judgment against the other driver in a Florida state court for compensatory and punitive damages.[1] The tortfeasor's insurer[2] denied liability for punitive damages,[3] and ancillary garnishment proceedings were brought in a federal district court, resulting in summary judgment against the insurer. On appeal in the United States Court of Appeals for the Fifth Circuit, *held*, reversed.[4] When ordinary[5] punitory[6] punitive damages are assessed against the party personally responsible for the wrong,[7] public policy requires that he not be

35. In Armstrong v. United States, 364 U.S. 40, 49 (1960), where governmental action destroyed plaintiff's liens by making them unenforceable, the Supreme Court held that this constituted a taking: "The Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensations was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."

1. Judgment was for $37,500 compensatory and $20,000 punitive damages.

2. Under a $50,000 policy, insurer was bound "To pay . . . all sums which the insured shall become legally obligated to pay as damages because of:

"A. *bodily injury*, sickness or disease, including death therefrom . . . sustained by any person. . . ."

Claims for "bodily injury . . . caused intentionally by or at the direction of the insured" were excepted.

3. The insurer argued that a claim for punitive damages was not a claim for "bodily injury" and further that insured's conduct was within the "intentional cause" exception, since a finding of intentional, reckless, or wantonly negligent conduct is prerequisite in Florida to an award of punitive damages. The court found it unnecessary to treat either of these points, holding that even if the contract expressly undertook to insure against punitive damages, public policy would require that the undertaking not be enforceable. Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432, 433-34 (5th Cir. 1962).

4. The court stated that the reversal was without prejudice to any future action by the insured against the insurer for breach of the insurer's duty to inform him before trial that they denied liability for punitive damages. *Id.* at 443.

5. By "ordinary" punitive damages is meant punitive damages awarded only after a finding of intentional, reckless, or willful and wanton misconduct. The court carefully restricts its holding to such circumstances, pointing out that in some jurisdictions punitive damages can be awarded upon a finding of simple negligence. *Id.* at 442.

6. The court uses the term "punitory" to describe the function of punishment and deterrence. *Id.* at 435. The holding is restricted so as to apply only in those cases where the damages called "punitive" actually serve a punitory function. *Id.* at 442.

7. The court approves those cases holding that an insurer is liable for punitive damages awarded against a principal for the tort of his agent, on the ground that in such cases public policy does not require that the principal be punished. *Id.* at 439-40. *Cf.* note 14 *infra*.

permitted to shift the burden to another, and thus that such damages be excluded from his liability insurance coverage.[8] *Northwestern National Casualty Co. v. McNulty*, 307 F.2d 432 (5th Cir. 1962).

Although it has been criticized,[9] the practice of awarding punitive damages is firmly established in most jurisdictions.[10] The prevailing view is that the dominant function of an award of punitive damages is to punish the defendant in order to deter repetition of the wrongful conduct.[11] Following this view, most commentators have felt that

8. It is important to distinguish between "excepted causes" and "excluded events." If the loss is caused by an "excepted cause" the insurer is liable for none of the consequences. *Cf.* the "intentionally caused" exception, note 2 *supra*. On the other hand, no matter what the cause of the loss, if it is an "excluded event" it is a consequence for which the insurer is not liable.

9. MCCORMICK, DAMAGES § 77 (1935) [hereinafter cited as MCCORMICK]. The classic statement of the case against punitive damages is made by Judge Foster in Fay v. Parker, 53 N.H. 342, 16 Am. Rep. 270 (1873). The most frequently raised criticisms are: (1) that imposition of punitive damages and criminal prosecution for the same act violates the spirit of the double jeopardy safeguard; (2) that assessing punitive damages amounts to a criminal punishment in circumstances where the defendant is deprived of the safeguards present in criminal proceedings, such as the requirement of proof beyond a reasonable doubt and the privilege against self-incrimination; and (3) that punitive damages are a windfall to the plaintiff, who has already been fully compensated for his loss. MCCORMICK § 77, at 276.

10. Only four states absolutely reject the doctrine: Louisiana, Massachusetts, Nebraska, and Washington. Indiana allows punitive damages only if criminal punishment cannot be imposed for the same act. In Connecticut punitive damages are limited to litigation expenses. MCCORMICK § 78; OLECK, DAMAGES TO PERSONS AND PROPERTY § 269, at 541 (1961) [hereinafter cited as OLECK]; *Developments in the Law—Damages—1935-1947*, 61 HARV. L. REV. 113, 119 (1947).

11. OLECK § 275A; *Developments in the Law—Damages—1935-1947*, 61 HARV. L. REV. 113, 119 (1947); Note, 46 VA. L. REV. 1036, 1041 (1960). *Cf.* the *Restatement* definition of punitive damages:

"'Punitive damages' are damages, other than compensatory or nominal damages, awarded against a person to punish him for his outrageous conduct." RESTATEMENT, TORTS § 908(1) (1939).

"The purposes of awarding punitive damages . . . are to punish the person doing the wrongful act and to discourage such person and others from similar conduct in the future. Although the purposes are the same, the effect of a civil judgment for punitive damages is not the same as that of a fine imposed after a conviction for a crime, since the successful plaintiff and not the State is entitled to the money . . . ." RESTATEMENT, TORTS § 908, comment *a* (1939).

In only three states is it expressly recognized that punitive damages serve a compensatory function. See Doroszka v. Lavine, 111 Conn. 575, 578, 150 Atl. 692-93 (1930); Wise v. Daniel, 221 Mich. 229, 233, 190 N.W. 746, 747 (1922); Fay v. Parker, 53 N.H. 342, 380-82, 16 Am. Rep. 270, 318-20 (1873). At least one case has recognized that punitive damages are a sort of public revenge, serving to discourage self-help. Gostkowski v. Roman Catholic Church of the Sacred Hearts of Jesus and Mary, 262 N.Y. 320, 324-25, 186 N.E. 798, 800 (1933). Another function sometimes mentioned is that of rewarding the plaintiff for bringing the action. *E.g.*, Tedesco v. Maryland Cas. Co., 127 Conn. 533, 536, 18 A.2d 357, 359 (1941).

Several factors lend weight to the theory that punitive damages are compensatory. Thus, many states follow the rule that the size of the punitive damages must bear some reasonable relation to the amount of compensatory damages. *Developments in the Law—Damages—1935-1947*, 61 HARV. L. REV. 113, 120 (1947). Such damages serve an obvious compensatory role in that they will go to defray plaintiff's litigation expenses. OLECK § 275A, at 560.1. Indeed, in a number of states litigation expense is a factor

public policy requires exclusion of such damages from liability insurance coverage when they are assessed against the party personally responsible for the wrong,[12] since otherwise the wrong-doing defendant is not deterred.[13] The few cases in point reach divergent results,[14] with those imposing liability generally failing to consider the

to be considered by the jury in awarding punitive damages. McCORMICK § 85. The "reward" function mentioned in the preceding paragraph can be considered compensation to the plaintiff for taking the trouble to bring the action.

However, although the compensatory role of punitive damages cannot be ignored, it seems clear that the dominant purpose of such damages is punishment for the sake of deterrence. OLECK § 275A, at 560.4; Note, 19 U. PITT. L. REV. 144, 154 (1957). The character of the defendant's conduct is the ultimate deciding factor in whether or not punitive damages will be given, and the conduct required is of a nature that would intuitively be called punishable. *Cf.* McCORMICK § 79. In addition, it is the general rule that evidence of the defendant's financial position may go to the jury to aid them in determining what amount will be sufficiently large to punish him. OLECK § 275C, at 560.7. A penetrating and illuminating study of punitive damages, emphasizing the admonitory function, may be found in Morris, *Punitive Damages in the Law of Torts*, 44 HARV. L. REV. 1173 (1931).

12. See OLECK § 275C, at 560.6; Logan, *Punitive Damages in Automobile Cases*, 1961 INS. L.J. 27; Note, 70 HARV. L. REV. 517 (1957); Comment, 7 MIAMI L.Q. 517 (1953); Comment, 14 MO. L. REV. 175 (1949); Comment, 19 U. PITT. L. REV. 144 (1957); Comment, 46 VA. L. REV. 1036 (1960). *But see* 7 APPLEMAN, INSURANCE LAW AND PRACTICE § 4312 (1962).

13. "It would seem that insurance against exemplary damages frustrates their purposes and should be considered contrary to public policy. It is doubtful whether a reckless or malicious defendant will be deterred if he knows that his liability insurer will pay all the damages levied against him." OLECK § 275C, at 560.6.

"It is certainly not socially desirable that the insured be protected from the consequences of his wanton conduct since the insured, knowing of this protection, is more apt to use less care even to the point of malicious behavior, than were he uninsured. Furthermore, if it be true that the purpose of the law in assessing punitive damages is solely to punish and deter, permitting the tortfeasor to insure against this punishment clearly defeats the purpose of the law." Note, 19 U. PITT. L. REV. 144, 154 (1957).

14. Holding the insurer not liable: Universal Indem. Ins. Co. v. Tenery, 96 Colo. 10, 39 P.2d 776 (1934); Tedesco v. Maryland Cas. Co., 127 Conn. 533, 18 A.2d 357 (1941). Note that the *Tedesco* case held the insurer not liable for statutory multiple damages on the ground that such damages were a penalty, and that the court indicated by way of dictum that it would reach the opposite result in the case of common law punitive damages. *Id.* at 538-39, 18 A.2d at 359. However it has been commented that "While this language can be justified on the ground that in Connecticut the purpose of awarding punitive damages is not to punish the defendant for his offense but to compensate the plaintiff for his injury, it certainly cannot be applied in support of a general rule of law since the majority do recognize the imposition of punitive damages as a penalty." Note, 19 U. PITT. L. REV. 144, 149 (1957). (Footnotes omitted.)

Holding the insurer liable: Pennsylvania Threshermen & Farmers' Mut. Cas. Ins. Co. v. Thornton, 244 F.2d 823 (4th Cir. 1957); General Cas. Co. of America v. Woodby, 238 F.2d 452 (6th Cir. 1956); United States Fid. & Guar. Ins. Co. v. Janich, 3 F.R.D. 16 (S.D. Cal. 1943); American Fid. & Cas. Co. v. Werfel, 231 Ala. 285, 164 So. 383 (1935); Morrell v. Lalonde, 45 R.I. 112, 120 Atl. 435 (1923), *appeal dismissed sub nom.* United States Fid. & Guar. Co. v. Morrell, 264 U.S. 572 (1924). It has been said of the *Werfel* case that it is "of little value for the purpose of establishing a general rule since its conclusion is based not on legal reasoning but is the product of a peculiar statutory scheme. . . ." Note, 19 U. PITT. L. REV. 144, 151-52 (1957). (Footnotes omitted.) In all the cases holding the insurer liable the courts were confronted with lump-sum judgments which they could not separate.

public policy argument.[15] In analogous circumstances, however, it has been held that punitive damages will not be shifted to a party not personally responsible for the wrong. Thus, it is usually held that a principal is not liable for punitive damages for a wrong committed by his agent.[16] Similarly, punitive damages generally will not be given against a deceased tortfeasor's estate.[17]

In the instant case the court first concluded that in both Florida, where the damages were imposed, and Virginia, where the policy was issued, punitive damages serve principally a punitory function,[18] and further that in neither of these jurisdictions have the courts passed on the question of insurer's liability for such damages.[19] Weighing the interests involved, the court decided that although even punitory punitive damages serve in part a compensatory function,[20] nevertheless the plaintiff's interest in receiving this extra compensation is greatly outweighed by the public interest in imposing punishment on the defendant.[21] The court felt this policy argument to be especially strong in the field of death and injury by automobile, which presents a problem that has not been solved by traffic regulation and criminal prosecution.[22] Indeed, not only would holding the insurer liable fail to deter the wrongdoer, but it would result in society's punishing itself, since the cost would be passed along to premium payers by the insurer.[23] The court also found several practical difficulties in allowing insurance against punitive damages,[24] notably the conflict between the rule that in assessing punitive damages evidence of the defendant's financial standing may go to the jury, and the rule against referring to the defendant's insurance in the presence of the jury.[25] Specially

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Ordinarily a principal is not liable for punitive damages for the tort of his agent, note 16 *infra*, but in those cases imposing such liability it is held that the principal's liability insurer will be liable for such damages. *E.g.*, Ohio Cas. Ins. Co. v. Welfare Fin. Co., 75 F.2d 58 (8th Cir. 1934), *cert. denied*, 295 U.S. 734 (1935). However, it is said that public policy is not violated by insurance in such cases. *Cf.* note 7 *supra*.

15. The two cases holding the insurer not liable, on the other hand, do discuss public policy. Universal Indem. Ins. Co. v. Tenery, *supra* note 14, 39 P.2d at 779; Tedesco v. Maryland Cas. Co., *supra* note 14, at 537-38, 18 A.2d at 359.

16. McCORMICK § 80; OLECK § 271; *Developments in the Law—Damages—1935-1947*, 61 HARV. L. REV. 113, 120-21 (1947). See, *e.g.*, Lake Shore & Mich. So. Ry. v. Prentice, 147 U.S. 101 (1893). *But cf.* OLECK § 275B; note 14 *supra*.

17. OLECK § 272.

18. Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432, 434-36 (5th Cir. 1962).

19. *Ibid.*

20. *Id.* at 442.

21. *Ibid.*

22. *Id.* at 441-42.

23. *Id.* at 440-41.

24. *Id.* at 441.

25. *Ibid.* The court also thought that to impose liability on the insurer would produce a conflict of interest between the insurer and the insured in settlement negotiations and in trial tactics, and that juries would be tempted to give exorbitant punitive damages which would be an unfair burden on the insurer. *Ibid.*

concurring, Judge Gewin was not as confident as the majority.[26] Not only, he felt, had the court underweighed the interest of the injured plaintiff,[27] but it also could be seriously questioned whether the rule adopted would serve as an effective deterrent,[28] particularly in light of the narrow line between conduct for which punitive damages will be awarded and that for which it will not.[29]

The court reached the proper result in the instant case, but the question is a closer one than the opinion indicates.[30] Even accepting that deterrence is a proper goal of damages in a civil action,[31] and that an award of punitive damages is an effective way to achieve this goal,[32] a strong case may still be made that such damages serve a significant compensatory function.[33] To the extent this function is valued plaintiff's interest in holding the insurer liable is enhanced.[34] On the other hand, to the extent punitive damages are considered a windfall to the plaintiff they are unjustifiable unless they serve their punitory function.[35] The defendant also has an interest in holding the insurer liable; apart from his desire to avoid payment it must be considered that he probably bought the policy believing it covered any liability he might incur,[36] that when the damages were assessed the jury may have assumed the same thing,[37] and that the line between willful or

26. *Id.* at 443.
27. *Id.* at 444.
28. *Ibid.*
29. *Ibid.*
30. There is no intention by this statement to detract from the brilliant and scholarly opinion by Judge Wisdom. It is the purpose of the following discussion merely (1) to delineate more carefully those factors which must be weighed against public policy, and (2) to pin down some of the elements that go to determine how strong the public policy factor is.
31. This has been questioned. Judge Foster felt that the "true rule, simple and just, is to keep the civil and criminal process and practice distinct and separate," Fay v. Parker, 53 N.H. 342, 397, 16 Am. Rep. 270, 338 (1873), and called punitive damages "a monstrous heresy . . . deforming the symmetry of the body of the law." *Id.* at 382, 16 Am. Rep. at 320. However, Morris's study presents powerful arguments for this role of civil damages. See Morris, *supra* note 11.
32. Complex and unanswered problems of psychology and sociology are raised when it is questioned whether imposition of a fine actually deters repetition of the conduct for which the fine is imposed. However, it is undoubtedly true that the belief that deterrence will result is widely held. As to the practical value of the availability of punitive damages, see Morris, *supra* note 11. *But cf.* Bass v. Chicago & N.W.R.R., 36 Wis. 450 (1874); 39 Wis. 636 (1876); 42 Wis. 654 (1877), where the same case was tried on three occasions before three different juries, twice with punitive damages allowed and once without, and each verdict was for the total amount of $4500.
33. See note 11 *supra.*
34. Plaintiff wants the insurer liable to assure collection of the judgment. Furthermore, it is probable that insurer liability would increase the size of verdicts. *Cf.* note 37 *infra.*
35. *Cf.* Note, 46 VA. L. REV. 1036, 1049 (1960).
36. This is Appleman's argument. See 7 APPLEMAN, *op. cit. supra* note 12, § 4312, at 132-33.
37. That this may happen is illustrated by the case of Phillips v. Campbell, 200 Va. 136, 104 S.E.2d 765 (1958). There was testimony by jurors which indicated they

wanton and merely negligent conduct is a fine one.[38] Against both of these interests must be weighed the interest of the state in punishing the wrongdoer, and in relieving insurers from punitive damages liability. With respect to the policy of punishment, it should be inquired what importance the decisions indicate the state attaches to the punitory function of punitive damages, and to what extent the circumstances of the case indicate a need for this deterrent.[39] As to the insurer, it should be considered that if liability is imposed the loss will be passed along to the public in the form of higher premiums,[40] while if it is not, insurance companies will be less interested in continuing their programs of safe driver education.[41] In addition, practical considerations weigh on both sides. Insurer liability would cause difficulty at the trial with respect to the introduction of evidence of defendant's financial position,[42] and might have the effect of inflating punitive damages awards, as juries attempt to get beyond insurance coverage and stick the wrongdoer himself.[43] On the other hand, nonliability would produce a conflict of interest between the insurer and the insured in settlement negotiations and trial tactics, the insurer being principally interested in minimizing the claim for compensatory damages, and the insured in minimizing the punitive damages claim.[44] Further difficulties would be caused in those jurisdictions where the jury must return a lump-sum verdict, which the appellate court would have difficulty separating.[45] Where such a multitude of factors is involved, and so much depends on the policy of the state, it would not be surprising to find courts applying the law of different jurisdictions arriving at opposite results in similar cases. The objection to most of the cases heretofore decided is not that they have reached the wrong result, but that they failed to give proper consideration to all the relevant factors.[46]

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had felt that the defendant should pay at least $5000 out of pocket, and, believing that he was covered by insurance up to $20,000, had therefore set the verdict (for compensatory damages) at $25,000.

38. Judge Gewin suggests this argument. Northwestern Nat'l Cas. Co. v. McNulty, *supra* note 18, at 444.

39. Thus, in the instant case the court felt it of considerable importance that the problem of death and injury by automobile is difficult, serious, and as yet unsolved by the use of criminal sanctions alone. *Id.* at 441-42.

40. Several commentators have mentioned this point. See, *e.g.*, Note, 46 VA. L. REV. 1036, 1050 (1960).

41. Another suggestion from Judge Gewin. Northwestern Nat'l Cas. Co. v. McNulty, *supra* note 18, at 444.

42. Note 25 *supra.*

43. *Cf.* note 36 *supra.*

44. See OLECK § 275C, at 560.6 & n.122. It is perplexing that the court in the instant case felt that the identical practical difficulty would be produced if the insurer were held liable. See note 25 *supra.*

45. OLECK § 275C, at 560.6,-.7.

46. Possibly a careful analysis along these lines would result in overturning the line of authority which holds an insurer liable for punitive damages assessed against a

Physicians & Surgeons—Private Hospital May Not Exclude Licensed Physician Merely Because He Is an Osteopath

Plaintiff, a licensed osteopath,[1] was refused admission to the courtesy staff of a private non-profit hospital which treated members of the general public and charity patients, for which it received public funds. Even though plaintiff was licensed by the state of New Jersey to practice medicine and surgery,[2] he was excluded from the hospital on the grounds that he was neither a graduate of a school of medicine approved by the American Medical Association nor a member of the AMA-affiliated county medical society.[3] Plaintiff brought an action in the Superior Court of New Jersey to review the legality of his exclusion. On cross motions for summary judgment, *held*, for plaintiff. A private hospital may not exclude a licensed physician from its staff solely on the grounds that he is not a graduate of an AMA-approved medical school or does not belong to a county medical association. *Griesman v. Newcomb Hospital*, 76 N.J. Super. 149, 183 A.2d 878 (Super. Ct. 1962).

Since the United States Supreme Court's pronouncement that admission to practice in a public hospital is a privilege rather than a right,[4] lower courts have consistently held that managing boards of both public and private hospitals may exclude physicians from their

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principal for the tort of his agent. *Cf.* note 14 *supra*. The argument is that in such cases it is acceptable to shift the burden from the principal, since there is no policy requiring his punishment. See note 7 *supra*. But since the general rule is that a principal is not liable for punitive damages for the torts of his agent, note 16 *supra*, there must be some policy in favor of punishing the principal to justify shifting the punitive damages to his shoulders. And this policy is ignored when the damages are shifted on over to the insurer. See OLECK § 275C, at 560.6.

1. A judicially acceptable definition of osteopathy is found in WEBSTER, NEW INTERNATIONAL DICTIONARY 1597 (3d ed. 1961). It is defined as "a system of medical practice based on the theory that diseases are due chiefly to a loss of structural integrity in the tissues, and that this integrity can be restored by manipulation of the parts supported by the use of medicines, surgery, proper diet, and other therapy."

2. For an excellent discussion of the comparative standing of osteopaths with medical doctors in the states, see Note, *State Recognition of Doctors of Osteopathy Compared with State Recognition of Doctors of Medicine*, 31 NOTRE DAME LAW. 286 (1955). Approximately thirty-six states give osteopaths equal rights with M.D.'s to practice medicine, including the right to prescribe drugs and perform major surgery. Practically all of this is by statute and has come about since 1930 as a result of an improved program of O.D. training. *Id.* at 294, 295.

3. For a survey-type article discussing the power and policy of the AMA, see *The American Medical Ass'n: Power, Purpose, and Politics in Organized Medicine*, 63 YALE L.J. 938 (1954).

4. Hayman v. City of Galveston, 273 U.S. 414 (1927). The Court held that there is no constitutional right for a physician to use the facilities of a public hospital. Permission to use the facilities is a right which may be subjected to reasonable regulations.

staffs pursuant to their own regulations.[5] In cases concerning public hospitals, the boards' authority to exclude depends upon the reasonableness of the exclusionary criteria. In general, rules concerued with safety or the orderly administration of the hospital have not been questioned.[6] Furthermore, courts have affirmed as reasonable, exclusions from public hospitals of physicians who were not members of the AMA,[7] or who were osteopaths.[8] But any requirement that staff members must belong to a county medical association has routinely been held unreasonable.[9] Also, a rule that a staff member must aid any other staff member on request was held unreasonable,[10] as was a rule holding a staff physician to a higher standard of care than was required by state law.[11] One court held unreasonable a hospital rule requiring staff members to be graduates of AMA-approved schools because of a state statute granting equal rights to all licensed physicians.[12]

Private hospitals, however, have not been required to justify their rules in the courts no matter how arbitrary or unreasonable they may be.[13] Furthermore, private hospitals have not lost this immunity by assuming the nature of a public charity[14] or by accepting public funds to meet deficits.[15] The tenor of the decisions has been that hospitals founded and maintained as private corporations remain private even though they are not operated for profit and exist solely for the benefit of the public.[16] Shielded by being characterized as private corporations, these hospitals have enjoyed the same immunity from close

5. See Wyatt v. Tahoe Forest Hosp. Dist., 174 Cal. App. 2d 709, 345 P.2d 93 (Dist. Ct. App. 1959); Newton v. Board of Comm'rs, 86 Colo. 446, 282 Pac. 1068 (1929); Munroe v. Wall, 66 N. Mex. 15, 340 P.2d 1069 (1959).

6. See, *e.g.*, Selden v. City of Sterling, 316 Ill. App. 455, 45 N.E.2d 329 (1942).

7. Richardson v. Miami, 144 Fla. 294, 198 So. 51 (1940).

8. Duson v. Poage, 318 S.W.2d 89 (Tex. Civ. App. 1958).

9. See, *e.g.*, Hamilton County Hosp. v. Andrews, 227 Ind. 217, 84 N.E.2d 469, *rehearing denied*, 227 Ind. 228, 85 N.E.2d 365, *cert. denied*, 338 U.S. 831 (1949). The court said: "[A]dmission to this society depends upon the sole determination of the society . . . . [This] amounts to a preference in favor of the society and a discrimination against those physicians who by choice or otherwise are not members . . . ." 84 N.E.2d at 472. Also see Ware v. Benedickt, 225 Ark. 185, 280 S.W.2d 234 (1955).

10. Findlay v. Board of Supervisors, 72 Ariz. 58, 230 P.2d 526 (1951).

11. Henderson v. City of Knoxville, 157 Tenn. 447, 9 S.W.2d 697 (1928).

12. Stribling v. Jolley, 241 Mo. App. 1123, 253 S.W.2d 519 (1952). This apparently is the only case holding such an exclusionary rule invalid in establishing criteria for admission to public hospital staffs.

13. Van Campen v. Olean Gen. Hosp., 205 N.Y. Supp. 554 (Sup. Ct. 1924), *aff'd per curiam*, 147 N.E. 219 (1925); Levin v. Sinai Hosp., 186 Md. 174, 46 A.2d 298 (Ct. App. 1946).

14. *Ibid.*

15. Hughes v. Good Samaritan Hosp., 289 Ky. 123, 158 S.W.2d 159 (Ct. App. 1942); Joseph v. Passaic Hosp. Ass'n, 35 N.J. Super. 450, 114 A.2d 317 (Super. Ct.), *aff'd*, 38 N.J. Super. 284, 118 A.2d 696 (Super. Ct. 1955).

16. See, *e.g.*, Washingtonian Home v. City of Chicago, 157 Ill. 414, 41 N.E. 893 (1895).

judicial scrutiny as do private profit-making corporations in matters concerning internal management.[17] Consequently, the power of private hospitals to regulate their staffs, including the power to systematically exclude osteopaths, homeopaths, and other non-medical doctors has been virtually unfettered.

In the instant case, the court based its decision on the opinion in *Falcone v. Middlesex County Medical Society*[18] in which a private county medical association was ordered to admit a licensed physician who had received part of his training at an osteopathic school in violation of the association's by-laws. The court concluded that the scope of *Falcone* should be extended to allow judicial scrutiny of private hospital rules of exclusion. It also noted the extent to which the defendant hospital had assumed the status of a public hospital, concluding that it should also assume the corresponding restrictions of one rather than hide behind a cloak of immunity made possible by its status as a private corporation.[19] Substantial injury, as required by *Falcone*, was established by showing that it was impossible for a physician to carry on a satisfactory practice without the emergency facilities, operating rooms, and technical assistants found only in a hospital. Since a requirement that physicians be members of a county medical association was struck down in *Falcone*, the court did not hesitate to strike down the same requirement in the instant case. In upsetting the requirement that members of the staff be graduates of AMA-approved schools, however, the court did not gloss over the need of the hospital for a skilled staff and was careful to point out that the AMA had, as a result of the *Falcone* decision, indicated that having osteopaths who were licensed physicians and surgeons on its staff would not jeopardize a hospital's accreditation, and that M.D.'s could practice with osteopaths without committing a breach of ethics as long as the osteopaths used the same scientific principles as members of the AMA.[20] Furthermore, the court interpreted the *Falcone* decision to stand for the proposition that every person receiving a license to practice medicine in New Jersey is entitled to practice to the same extent as every other licensee, an interpretation compelling the con-

17. For the difference in public and private corporations see FLETCHER, CYCLOPEDIA OF CORPORATIONS §§ 57-63 (perm. ed. 1931).

18. 62 N.J. Super. 184, 162 A.2d 324 (Super. Ct. 1960), *aff'd*, 34 N.J. 582, 170 A.2d 791 (1961). This case held that a county medical association could not exclude from its membership a licensed physician holding a doctorate of medicine on the grounds that the doctor had not spent four years in an AMA-approved medical school. For law review treatment, see 75 HARV. L. REV. 1186 (1962), and 7 VILL. L. REV. 140 (1961).

19. 183 A.2d at 882.

20. Hospitals live in the shadow of loss of AMA accreditation. Without accreditation, member doctors will not practice in the hospital, and interns and nurses will not jeopardize their careers in order to serve there. For elaboration, see 63 YALE L.J. 938, 948-53 (1954).

clusion that the plaintiff should be admitted to the hospital staff.

Ultimately this decision rests on the premise that the power of the state to license physicians pre-empts the field, leaving no room for further regulations. As a result, a private group has no authority to interpose itself as protector of the public, imposing further restrictions on would-be practitioners, and thereby limiting the practice of medicine to those physicians who espouse its views and disenfranchising those who do not. In upholding the general propositions that a license to practice medicine entitles the holder to the use of the state's hospitals, both public and private, and that the courts have a duty to impose a requirement of reasonableness on the power of a private hospital to exclude physicians from its staff, this court stands alone. It attempted to justify its stand by saying the hospital should be treated as if it were a public corporation because of the great public interest involved. But this reasoning has been repeatedly rejected by other courts.[21] There is no escape from the conclusion that the court has refused to follow a long series of decisions supporting the broad power of private hospitals to exclude arbitrarily. A pragmatic explanation of the decision is that New Jersey with a population in excess of 5,000,000 has only one medical school. Of necessity it must attract physicians from surrounding areas. Under these conditions, the state cannot afford to have qualified physicians prohibited from practicing there because of the doctrinal rift between medicine and osteopathy. In view of the AMA's somewhat questionable refusal to accept osteopaths as equals,[22] the decision must be applauded for the AMA, whose control over America's supply of physicians involuntarily relaxed a bit, was the loser—not private hospitals.

21. See notes 14 and 15 *supra.*

22. This conclusion is based on the testimony of Dr. Schaff, a member of the New Jersey State Board of Medical Examiners and a physician, in which he stated that the Philadelphia College of Osteopathy would probably be recognized as meeting the standards of the AMA simply by dropping the name "Osteopathy." 162 A.2d at 326. Also consider the Report of the Committee for the Study of Relations between Osteopathy and Medicine presented to the House of Delegates of the AMA in June, 1953:

"It is the opinion of the committee that the official viewpoint of the representatives of the American Osteopathic Association is that osteopathy includes the entire field of medicine and surgery but integrates manipulation of musculoskeletal structures with medical and surgical methods of therapy. No diagnostic or therapeutic procedure used in medicine or surgery is excluded.

"Osteopathy has undergone a process of evolution that has brought it to a point of such similarity to medicine that no marked fundamental differences exist between medicine and osteopathy. The entrance requirements for schools of osteopathy and schools of medicine are identical. The curriculums have the same content, except for the inclusion of osteopathic theory, diagnosis, and treatment. The period of instruction in both instances is four years. The clock hours devoted to teaching basic sciences, medicine, and surgery are as great in schools of osteopathy. The level of instruction in basic sciences is demonstrated by the record of osteopathic candidates in examinations in these subjects. Indirect and incomplete methods of evaluation of the quality of instruction in clinical subjects, insofar as they apply, indicate progressive improvement in the field." *Id.* at 14.

Products Liability—Breach of Warranty—Notice Requirement of Uniform Sales Act Not Applicable to Suit by Remote Consumer Against Manufacturer

Section 49 of the Uniform Sales Act[1] relieves a seller from liability for breach of warranty in the sale of goods if the buyer fails to give notice of the alleged breach to the seller within a reasonable time after acceptance of the goods. Two cases which deal with the necessity of notice by a consumer to a manufacturer in a breach of warranty action have recently been decided. Each, on appeal, *held*, for plaintiff-consumer. Notice to manufacturer as a condition precedent for an action for breach of warranty is not required by section 49 of the Uniform Sales Act if there is no privity between buyer and manufacturer. *Greenman v. Yuba Power Products, Inc.*, 23 Cal. Rptr. 282 (Dist. Ct. App. 1962), *aff'd*, 27 Cal. Rptr. 697, 377 P.2d 897 (1963); *Ruderman v. Warner-Lambert Pharmaceutical Co.*, 23 Conn. Supp. 416, 184 A.2d 63 (C.P. 1962).

The Uniform Sales Act was approved by the National Conference of Commissioners on Uniform State Laws in 1906 and has been adopted by a large number of states, most of them before 1934. In 1934 the case of *Baxter v. Ford Motor Co.*[2] set forth the first major recognition of general strict liability of the manufacturer to the consuming public for breach of warranty, basing liability on advertising representations made to the public concerning the product.[3] This was a major exception to the general privity of contract requirement, and recovery was not based on the Uniform Sales Act. The present trend seems to be toward imposing strict liability on the manufacturer for injuries suffered while using the product in the way for which it was intended and caused by a defect in the product that was unknown to the plaintiff.[4] As to section 49, itself, the notice of intention to sue the seller for breach of warranty is considered a condition precedent to the right

1. "In the absence of express or implied agreement of the parties, acceptance of the goods by the buyer shall not discharge the seller from liability in damages or other legal remedy for breach of any promise or warranty in the contract to sell or the sale. But, if, after acceptauce of the goods, the buyer fail to give notice to the seller of the breach of any promise or warranty within a reasonable time after the buyer knows, or ought to know of such breach, the seller shall not be liable therefor." UNIFORM SALES ACT § 49. Section 2-607(3)(a) of the UNIFORM COMMERCIAL CODE essentially retains this notice provision.

2. 168 Wash. 456, 12 P.2d 409, *aff'd per curiam on rehearing*, 15 P.2d 1118 (1932), *aff'd on second appeal*, 179 Wash. 123, 35 P.2d 1090 (1934).

3. Prosser, *The Assault Upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099, 1135 (1960).

4. See, *e.g.*, Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960); Prosser, *supra* note 3; 14 VAND. L. REV. 681 (1961).

of recovery and not as something akin to a statute of limitations.[5] A few scattered exceptions to the notice requirement have arisen, but they have no consistent underlying rationale. There are some holdings that notice is not required for personal injury actions;[6] the great weight of authority, however, is opposed to this position.[7] There is a Tennessee decision holding that the notice rule is not applicable to a deficiency in quantity.[8] An Oregon decision held that notice is not required for defects in title.[9] The only previous case found to have considered directly the problem of whether notice is required between a manufacturer and consumer, not in privity of sale, held that no notice was required.[10]

In the *Greenman* case the lower court distinguished between the warranty obligation of the manufacturer to the consumer and the warranty obligation of the seller to the buyer. The former, stated the court, is based on representations made by the manufacturer to the consuming public for the purpose of promoting the sale of his product. It is not dependent on privity of contract and exists independently of any buyer-seller relationship. The warranty obligation of the seller to the buyer, on the other hand, emanates from a sale and exists only where privity exists. The notice provision of the Sales Act, referring to "contract to sell," "sale," "buyer," and "seller," therefore argued the court, is applicable only when there is privity between the buyer and seller. Furthermore, the court saw no reason to impose a requirement of notice for breach of warranty against a manufacturer when no notice was required in a negligence action. Finally, the court suggested that such a requirement of notice would be an unfair burden on an injured consumer, who is likely to have no reason to be aware of the rule. In affirming the lower court decision, the California Supreme Court in an opinion by Mr. Justice Traynor found strict liability of the manufacturer to the consumer and said:

> [Section 49] deals with the rights of the parties to a contract of sale or a sale. It does not provide that notice must be given of the breach of a

5. Marsh Wood Prods. Co. v. Babcock & Wilcox Co., 207 Wis. 209, 240 N.W. 392 (1932).

6. Silverstein v. R. H. Macy & Co., 266 App. Div. 5, 40 N.Y.S.2d 916 (1943); Kennedy v. F. W. Woolworth Co., 205 App. Div. 648, 200 N.Y. Supp. 121 (1923) (complaint really grounded on "tortious elements").

7. See, *e.g.*, Whitfield v. Jessup, 31 Cal. 2d 826, 193 P.2d 1 (1948); De Lucia v. Coca-Cola Bottling Co., 139 Conn. 65, 89 A.2d 749 (1952).

8. Knoxville Sangravel Material Co. v. Dunn, 25 Tenn. App. 93, 151 S.W.2d 174 (E.S. 1940) (defendant cannot be enriched by failure to receive notice of something of which he should have been aware).

9. W. S. Maxwell Co. v. Southern Oregon Gas Corp., 158 Ore. 168, 74 P.2d 594 (1937), *aff'd on rehearing*, 158 Ore. 168, 75 P.2d 9 (1938) (no presumption ever existed from the acceptance of goods that seller's title was good).

10. La Hue v. Coca-Cola Bottling, Inc., 50 Wash. 2d 645, 314 P.2d 421 (1957).

> warranty that arises independently of a contract of sale between the parties. Such warranties are not imposed by the sales act, but are the product of common-law decisions that have recognized them in a variety of situations.[11]

The *Ruderman* court reasoned that since, when the Uniform Sales Act was enacted in the state, Connecticut only recognized breach of warranty actions where privity of contract existed, the present action for breach of warranty, with no privity, was not within the scope of the act. The court also reasoned that the action was one of "consumer" against "manufacturer," not "buyer" against "seller" as required by the Sales Act and then also drew a distinction between warranties within the Sales Act sounding in contract and based on promises and common law warranties sounding in tort and based on misrepresentations.

The decisions in these two cases seem well justified. The warranty recovery sought by the plaintiffs was grounded, not on the Uniform Sales Act where the warranty obligation of the seller to the buyer emanates out of the sale, but rather upon the recently arisen exception to the privity of contract requirement of strict manufacturers' liability —which was enunciated after the general adoption of the Uniform Sales Act. The most recent tentative drafts of the Restatement of Torts consider the strict liability of the manufacturer to the consumer as being tortial, and not contractual, in nature[12] and not subject to regulation by the Uniform Sales Act.[13] Moreover, the policy reasons for section 49 of the Uniform Sales Act do not warrant extension to the manufacturer-remote vendee situation. The chief purpose of the notice provision is to "ameliorate the harshness of the common law rule . . . that the mere acceptance by . . . the buyer of the goods constituted a waiver of . . . all remedies for breach of warranty . . . ."[14] However, this common law rule redressed by section 49 has always applied only to contracts between buyer and seller and never in the recently developed breach of warranty action brought against the manufacturer by a remote vendee. A principal reason for requiring notice is to prevent the buyer from simply retaining the goods of the sale until sued for the purchase price and then "interposing belated

11. 27 Cal. Rptr. at 699, 377 P.2d at 899.

12. RESTATEMENT, (SECOND) TORTS, Explanatory Notes § 402A, comment *l* at 6 (Tent. Draft No. 7, 1962); *id.*, Explanatory Notes § 402B, comment *d* at 45 (Tent. Draft No. 6, 1961).

13. "The rule stated in this Section ['Special Liability of Sellers for Intimate Body Use'] is not governed by the provisions of the Uniform Sales Act, or those of the Uniform Commercial Code, as to warranties . . . . Nor is the consumer required to give notice to the seller of his injury within a reasonable time after it occurs, as is provided by the Uniform Act." *Id.*, Explanatory Notes § 402A, comment *m* at 7 (Tent. Draft No. 7, 1962).

14. Whitfield v. Jessup, 31 Cal. 2d 826, 193 P.2d 1 (1948).

claims for damages."[15] This obviously has no relevance to the manufacturer-remote consumer situation. Moreover, no notice is required in negligence actions by the consumer against the manufacturer, and as the *Greenman* lower court opinion points out: "The different standard of liability applied in a so-called warranty action, from that applied in a negligence action, does not justify a notice requirement in the former that is not imposed in the latter."[16] Williston says that the notice requirement is "justified by business practice."[17] However, requiring notice by the consumer to the manufacturer, a remote seller, "may prove to be a trap to the unwary victim who will generally not be steeped 'in the business practice' which justifies the rule."[18] Thus it is submitted that the notice requirement of section 49 of the Uniform Sales Act—and, similarly, section 2-607(3)(a) of the Uniform Commercial Code—is not appropriate for the manufacturer-remote consumer breach of warranty situation.[19]

Suretyship and Guaranty—Subrogation Rights of a Surety on a Government Contractor's Bond

After the bankruptcy of a government contractor, a dispute arose between his trustee in bankruptcy and a surety over rights in a fund, hereafter called retainages, retained by the Government pursuant to an agreement with the contractor.[1] The surety on the performance and payment bonds[2] paid claims of materialmen and laborers resulting

15. Wildman Mfg. Co. v. Davenport Hosiery Mills, 147 Tenn. 551, 249 S.W. 984 (1923).

16. 23 Cal. Rptr. at 286.

17. 3 WILLISTON, SALES § 484b (rev. ed. 1948).

18. James, *Products Liability*, 34 TEXAS L. REV. 192, 197 (1955).

19. The neeessity of notice by a consumer to a manufacturer when the consumer is buying directly from the manufacturer and privity of sale therefore exists would pose an even more difficult problem. Perhaps the consumer should be given an election of remedies: the statutory remedy under the Sales Act of breach of warranty arising out of the sale, itself, and therefore requiring notice under section 49; and the common law breach of warranty remedy arising out of the expanding field of strict liability of the manufacturer to the consumer and therefore not requiring notice.

1. On a federal contract, ten per cent of the estimated amount is withheld from the progress payments, even though the contracting officer has discretion to pay all progress payments in full after fifty per cent of the work has been completed. See Standard Form 23-A, 26 Fed. Reg. 1050 (1961).

2. "(a) Before any contract, exceeding $2,000 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds. . . .:

"(1) A performance bond. . . .

"(2) A payment bond. . . ."

from the contractor's default. After completion of the contract by another contractor, the Government released the retainages to the trustee in bankruptcy. Surety's claim to rights superior to those of the trustee in the retainages was rejected by the referee in bankruptcy,[3] but was sustained by the district court.[4] The court of appeals affirmed.[5] On certiorari to the United States Supreme Court, *held*, affirmed. The laborers and materialmen had a right to be paid out of the retained fund; therefore the surety, having paid their claims, is subrogated to their rights in the fund. *Pearlman v. Reliance Insurance Co.*, 371 U.S. 132 (1962).

In order to exercise his right of subrogation after performing his obligations under a payment bond for private construction, the surety must be a non-volunteer[6] and pay the claims of laborers and materialmen in full;[7] then, the surety steps into the shoes of the laborers and materialmen, thereby enabling him to enforce their rights—*e.g.*, mechanics liens.[8] In the absence of statute, laborers and materialmen cannot obtain a mechanics lien against a government building[9] and generally, have no recourse against the Government on the contract between the principal (contractor) and the Government.[10] Recognizing this problem, Congress passed the Heard Act[11] and subsequently, the Miller Act, which requires a contractor to obtain a performance and a payment bond as a condition to the award of a

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Miller Act, ch. 40, 49 Stat. 794 (1935), 40 U.S.C. § 270(a) (1958), as amended, 73 Stat. 279 (1959), 40 U.S.C. § 270 (b) (Supp. III, 1961).

3. Pearlman v. Reliance Ins. Co., 371 U.S. 132, 134-35 (1962).

4. In the Matter of Dutcher Constr. Corp., 197 F. Supp. 441 (W.D.N.Y. 1961).

5. In the Matter of Dutcher Constr. Corp., 298 F.2d 655 (2d Cir. 1962).

6. Leslie v. Compton, 103 Kan. 92, 172 Pac. 1015 (1918).

7. United States v. National Sur. Co., 254 U.S. 73, 76 (1920).

8. "It is familiar law that a surety paying the debt of his principal is entitled to be subrogated to all the creditor's rights, privileges, liens, judgments, and mortgages . . . . The surety, by the mere fact of payment is put into the shoes of the creditor." United States Fid. & Guar. Co. v. Carnegie Trust Co., 161 App. Div. 435, 146 N.Y. Supp. 804, 807-08 (1914). "Upon his payment of the principal's debt, the surety has the right to be substituted to the position of the creditor whom he pays." SIMPSON, SURETYSHIP § 47, at 205 (1950).

9. "As against the United States, no lien can be provided upon its public buildings or grounds . . . ." United States *ex rel.* Hill v. American Sur. Co., 200 U.S. 197, 203 (1906).

10. See note 1 *supra*.

11. "[A]ny person or persons entering into a formal contract with the United States for the construction of any public building, or the prosecution and completion of any public work . . . shall be required, before commencing such work, to execute the usual penal bond . . . with the additional obligation that such contractor . . . shall promptly make payments to all persons supplying him or them with labor and materials . . . ." Heard Act, ch. 280, 28 Stat. 278 (1894), as amended, 33 Stat. 811, 812 (1905). "It was the purpose of this act to substitute the obligation of a bond for the security which might otherwise be obtained by attaching a lien to the property of the individual." United States *ex rel.* Hill v. American Sur. Co., *supra* note 9.

government building contract.[12] Generally, the Government also retains a portion of the progress payments until the completion of the contract,[13] and problems frequently arise as to who is entitled to the retainages after the contractor has defaulted and a surety has completed the contract or paid the claims of laborers and materialmen.[14] In two cases decided more than half a century ago, the Supreme Court established the subrogation rights of sureties for government contractors. *Prairie State Bank v. United States*[15] held that a performance bond surety, upon fulfilling the contractor's obligations to the Government, is substituted to the rights which the United States might have asserted in the fund and the right relates back to the time the bond was executed. Subsequently, *Henningsen v. United States Fidelity and Guaranty Co.*,[16] in which the dispute involved a surety on a combination payment and performance bond, held that the surety became entitled to equitable rights in the retained fund from the inception of the bond, since the surety had fulfilled the government's equitable obligations to the materialmen. The *Henningsen* opinion is subject to conflicting interpretations because it is not clear whether the Court predicated its decision on subrogation or reimbursement, and the basis for the surety's right is not explained.[17]

12. See note 2 *supra.*

13. See note 1 *supra.*

14. See, *e.g.*, Speidel, *"Stakeholder" Payments Under Federal Construction Contracts: Payment Bond Surety v. Assignee*, 47 VA. L. REV. 640 (1961); *Reconsideration of Subrogative Rights of the Miller Act Payment Bond Surety*, 71 YALE L.J. 1274 (1962).

15. 164 U.S. 227 (1896); *accord*, Hardaway v. National Sur. Co., 211 U.S. 552, 561 (1909); First Nat'l Bank v. Fidelity & Deposit Co., 65 F.2d 959 (10th Cir. 1933); Reid v. Pauly, 121 Fed. 652, 657 (9th Cir. 1903); Atlantic Ref. Co. v. Continental Cas. Co., 183 F. Supp. 478, 484 (W.D. Pa. 1960); Massachusetts Bonding & Ins. Co. v. Fago Constr. Corp., 82 F. Supp. 619, 621 (D. Md. 1949). See also Town of River Junction v. Maryland Cas. Co., 110 F.2d 278, 281 (5th Cir. 1940): The *Prairie State* decision is nothing "but an application of the general principle that a surety has a beneficial interest in all collateral pledged to the creditor by the principal debtor."

The surety's equitable lien arose at the time the bond was given but it does not become enforceable until the surety suffers a loss on the bond—*i.e.*, makes payment pursuant to the bond. *In re* Cummins Const. Corp., 81 F. Supp. 193, 197 (D. Md. 1948). *But see* Bank of Arizona v. National Sur. Corp., 237 F.2d 90 (9th Cir. 1956) (surety's right in fund terminates when Government pays fund to assignee bank). Compare United States Fid. & Guar. Co. v. City of Bristow, 4 F.2d 810 (E.D. Okla. 1925) (right continues—surety may reach fund paid to assignee bank).

16. 208 U.S. 404 (1908); *accord*, Riverside State Bank v. Wenty, 34 F.2d 419 (8th Cir. 1929).

17. In one portion of its opinion the Court said, "It [the surety] paid the laborers and material-men and thus released the contractor from his obligations to them, and to the same extent released the Government from all equitable obligations to see that the laborers and supply men were paid." 208 U.S. at 410. Later in the opinion the Court, quoting from the opinion of the court of appeals said, " 'Whatever equity, if any, the bank had to the fund in question, arose solely by reason of the loans it made to Henningsen. Henningsen's surety was, upon elementary principles, entitled to assert the equitable doctrine of subrogation; but it is equally clear that the bank was not, for it was a mere volunteer, and under no legal obligation to loan its money. *Prairie State Bank v. United States*, 164 U.S. 227 . . . .' " *Id.* at 411.

Nevertheless, most courts have followed *Henningsen* in upholding the surety's claim to the retainages without questioning the basis of this right or by characterizing it as a moral duty,[18] equitable obligation,[19] or equitable lien.[20] However, in 1947, the Supreme Court in *United States v. Munsey Trust*[21] cast doubt on the effect of *Henningsen* by allowing the government's right of set-off against the contractor to prevail over the surety's claim to the retainages. By a curious line of reasoning, it also concluded that the surety's claims through subrogation could rest only on non-existent rights, because unpaid laborers and materialmen have no right against the United States.[22] Several later cases have restricted *Munsey Trust* to the set-off situation;[23] yet, some courts, relying on *Munsey Trust*, have refused to recognize the surety's right to subrogation even where the Government is not asserting a set-off, reasoning that the laborers and materialmen have no right in the fund to which the surety can be subrogated.[24]

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18. American Sur. Co. v. Westinghouse Elec. Mfg. Co., 75 F.2d 377, 379 (5th Cir.), *aff'd*, 296 U.S. 133 (1935) (moral duty to protect furnishers of labor or materials); Belknap Hardware & Mfg. Co. v. Ohio River Contract Co., 271 Fed. 144, 148 (6th Cir. 1921) (moral or ethical duty).

19. California Bank v. United States Fid. & Guar. Co., 129 F.2d 751, 754 (9th Cir. 1942); Morgenthau v. Fidelity & Deposit Co., 94 F.2d 632, 635 (D.C. Cir. 1937).

20. Moran v. Guardian Cas. Co., 76 F.2d 438, 439 (D.C. Cir. 1935) (equitable right or lien); United States Fid. & Guar. Co. v. Sweeney, 80 F.2d 235, 238 (8th Cir. 1935) (equitable right); Philadelphia Nat'l Bank v. McKinlay, 72 F.2d 89, 91 (D.C. Cir.), *cert. denied*, 293 U.S. 583 (1934) (equitable lien); Farmers' Bank v. Hoyes, 58 F.2d 34, 37 (6th Cir.), *cert. denied*, 287 U.S. 601 (1932) (equitable right); Exchange State Bank v. Federal Sur. Co., 28 F.2d 485, 487 (8th Cir. 1928) (equitable lien). *But see* Seaboard Sur. Co. v. United States, 67 F. Supp. 969 (Ct. Cl. 1946), *cert. denied*, 330 U.S. 833 (1947) (surety has no equitable lien nor do unpaid laborers and materialmen have one).

21. 332 U.S. 234 (1947).

22. "[I]t is elementary that one cannot acquire by subrogation what another whose rights he claims did not have. Once the laborers and materialmen have been paid, either by contractor or surety, they have no rights in any fund. If before they are paid, the fund to which they are said to be entitled to look is unavailable for the very reason that they are unpaid, the surety relies on nothiug when it relies on those nonexistent 'rights.'" *Id.* at 242.

23. See, *e.g.*, Royal Indem. Co. v. United States, 93 F. Supp. 891 (S.D.N.Y. 1950); *In re* Cummins Constr. Corp., 81 F. Supp. 193, 200-02 (D. Md. 1948); United States Fid. & Guar. Co. v. Triborough Bridge Authority, 297 N.Y. 31, 74 N.E.2d 226 (1947). Another court refusing to follow *Munsey* said: "In . . . [*Munsey Trust*] the Supreme Court said that the United States was not legally liable to laborers and materialmen, but it did not say that laborers and materialmen could not assert an equitable claim to moneys in the hands of the United States payable under the contract. We think they can." National Sur. Corp. v. United States, 133 F. Supp. 381, 384 (Ct. Cl.), *cert. denied*, 350 U.S. 902 (1955).

24. In the following two cases involving a dispute between a surety and the trustee in bankruptcy over the retainages, the trustee prevailed over the surety. "The rights of a surety are largely derivative in nature. Having paid the laborers and materialmen . . . [the surety] may claim subrogation to their rights. But since laborers and materialmen have no enforceable rights against the United States [citing *Munsey Trust*] the surety can rise no higher than the basis of the subrogation." American Sur. Co. v. Hinds, 260 F.2d 366, 368 (10th Cir. 1958). In Phoenix Indem. Co. v.

In the instant case, the trustee advanced the following arguments in attempting to defeat the surety's claim to the retainages: the question is purely one of priorities governed exclusively by section 64 of the Bankruptcy Act;[25] the laborers and materialmen have no right against the Government, thus the surety has none; the Miller Act abrogated the case law of *Prairie State Bank* and *Henningsen*; and the *Prairie State Bank* and *Henningsen* cases were overruled by *Munsey Trust*. The bankruptcy priorities argument was rejected because the question is not one of priorities but rather one of determining whether the surety had any rights to the retainages prior to the adjudication of bankruptcy.[26] Recognizing the traditional doctrine of reimbursement and subrogation, the Court, citing *Prairie State Bank* and *Henningsen*, said: "It seems rather plain . . . that there is a security interest in a withheld fund like this to which the surety is subrogated. . . ."[27] Taken together, the *Prairie State Bank* and *Henningsen* cases established the proposition that the surety has a right of subrogation in retainages, regardless of whether he is a performance or payment bond surety.[28] The Miller Act was held not to abrogate this case law, for the legislative history of the act does not indicate, either expressly or by implication, any such congressional purpose.[29] Further, *Munsey Trust* was said to hold that the Government could exercise its right of set-off; it left undisturbed the rule in *Prairie State Bank* and *Henningsen*.[30] In concluding, the Court held that the Government had a right to use retainages to pay materialmen and laborers; that the laborers and materialmen have a right to be paid out of the fund; and that the surety, having paid the claims of laborers and materialmen, "is entitled to the benefit of all these rights."[31]

Earle, 218 F.2d 645, 649 (9th Cir. 1955), the court in holding for the trustee said: " 'nothing is more clear than that laborers and materialmen do not have enforceable rights against the United States for compensation' "; thus the surety has no right to which he can be subrogated.

25. Bankruptcy Act § 64(a), ch. 784, 30 Stat. 563 (1898), as amended, 11 U.S.C. § 104(a) (1958).

26. Pearlman v. Reliance Ins. Co., *supra* note 3, at 136.

27. *Id.* at 137.

28. *Id.* at 139.

29. The Miller Act requires a public contract surety to execute two bonds instead of the one formerly required under the Heard Act, yet the former bond covered both performance and payment. "Neither this slight difference in the new and the old Acts nor any other argument presented persuades us that Congress in passing the Miller Act intended to repudiate equitable principles so deeply embedded in our commercial practices, our economy, and our law as those spelled out in the *Prairie Bank* and *Henningsen* cases." *Id.* at 140.

30. *Id.* at 141. Furthermore, *Munsey Trust* held that the government's right to set-off is superior to any claim the payment bond surety might have in the fund. *Id.* at 140.

31. *Id.* at 141-42. The concurring opinion, by Mr. Justice Clark, would predicate the equities favoring the surety on the contract between the surety and the contractor. "Under that agreement in the event of any breach or default in the construction con-

As a result of the *Pearlman* decision, it can be said that *Munsey Trust* is restricted to the set-off situation and has no effect on the prior case law of *Prairie State Bank* and *Henningsen.*[32] However, this does not necessarily mean that the law has returned to the pre-*Munsey* era. It is now firmly established that the surety can exercise his right against the retainages through subrogation to the rights of the materialmen whose claims he has paid. The basic problem, the basis for the surety's subrogation, is left unanswered, although the Court in discussing the *Prairie Bank* and *Henningsen* cases appears to have recognized the "equitable" nature of the right.[33] Since the contest is between legitimate creditors of the contractor, the result may turn upon the following policy considerations: First, the general policy that funds arising from performing the contract should be utilized to pay expenses arising from such performance, rather than giving general creditors of the contractor a windfall as a result of the contractor's default;[34] second, the protection of the public against increased public construction costs, for if the trustee were to prevail, the surety's risk of failing to recoup his payments would be increased, thereby resulting in higher surety rates, which in turn would be passed on to the Government via the contractor.[35]

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tract all sums becoming due thereunder were assigned to the surety to be credited against any loss or damage it might suffer thereby." *Id.* at 143.

32. See note 31 *supra* and accompanying text.

33. *Id.* at 137. The fact that the right is referred to as an equitable one must refer to the fact that the materialmen and surety have no legal claim to the retained funds since they are not beneficiaries of the contract between the Government aud the contractor. Thus, the materialmen's claim arises from a moral right to be paid because they furnished materials and from the government's moral obligation to pay because it received the benefit of the materials; therefore the surety's claim arises from having satisfied the government's moral obligation to materialmen.

34. See, *e.g.*, Pacific Indem. Co. v. Grand Ave. State Bank, 223 F.2d 513, 521 (5th Cir. 1955).

35. The amicus curiae, representing the Association of Casualty and Surety Companies, presented the following consequences of a finding for the trustee to the Court:

"(1) Surety experience on federal contract bonds may necessitate a re-examination of the rate structure with a surcharge on federal contracts.

"(2) Some surety companies may deem it prudent to withdraw from across the board underwriting of contraetors on federal public work contracts.

"(3) Surety underwriters will undoubtedly tighten up their underwriting requirements for bidders on federal works.

"(4) Finally, and auxiliary to the last point, destruction of the salvage rights of the surety in the contract balance will also set up though operation of 3. above, a counterweight to the policy of the government to achieve the widest distribution of public and other contract work among the 'small business' community. Very few so called small business men will be able to qualify for surety bonds under conditions where the surety risk has been converted to an insurance risk." Brief for the Association of Casualty and Surety Companies as Amicus Curiae, pp. 26-28, Pearlman v. Reliance Ins. Co., 371 U.S. 132 (1962).

Taxation—Federal Estate Tax—Election by Surviving Spouse To Allow Community Property To Be Governed by Will of Deceased Spouse Is a Transfer for Consideration

Decedent's husband died in 1934. His will put her to an election. She could either: (a) retain her vested, fee interest in one-half of their community property and take nothing under the will, or (b) allow her community property to be governed by the will and become a beneficiary under it, receiving unlimited power[1] of disposition over all of their community property during her lifetime. The will provided for the remainder to be placed in trust for the benefit of the couple's lineal descendants. In addition, it provided for the termination of decedent's interest in the husband's half of their community in the event of her remarriage. Decedent elected to take under the will. She died in 1955 without having remarried. In assessing an estate tax deficiency, the Commissioner of Internal Revenue included in decedent's gross estate her half of the community property. The Tax Court affirmed this action,[2] holding that decedent's community had been gratuitously transferred to the trust at the time of election, but it remained includible in her gross estate under section 2036[3] of the Internal Revenue Code of 1954 because she retained a life estate. On appeal to the United States Court of Appeals for the Fifth Circuit, *held*, reversed and remanded. An election by the surviving spouse to allow her community property to be governed by the will of the deceased spouse effects a transfer for consideration, thereby limiting the amount of her community includible in her gross estate[4] under

1. Item Two of the husband's will read in part as follows: "'I give, devise and bequeath to my wife, Lela Barry Vardell, all property, real and personal and mixed, of which I may die seized and possessed, or in which I may have an interest at the time of my death, for the term of her life, and as long as she shall remain a widow, she to have, during such time, full and absolute authority to handle, manage, sell, and in any manner dispose of said properties, or any part thereof . . . .'" Ellis v. First Nat'l Bank, 311 S.W.2d 916, 918 (Tex. Civ. App. 1958). In the *Ellis* case the Texas Court of Civil Appeals construed this language as giving decedent the power to alienate the property by gift. At issue was the transfer of 1,000 shares of stock to one of decedent's daughters.

2. Estate of Lela Barry Vardell, 35 T.C. 50 (1960), *acq.*, 1961-1 CUM. BULL. 4.

3. "Transfers with Retained Life Estate.

"(a) General Rule.—The value of the gross estate shall include the value of all property . . . to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life . . .

(1) the possession or enjoyment of, or the right to the income from, the property . . . ." INT. REV. CODE OF 1954, § 2036.

4. "Transfers for Insufficient Consideration.

"(a) In General.—If any one of the transfers, trusts, interests, rights, or powers

section 2036 to the excess of its value over that of the interest received in the deceased spouse's estate as a result of the election. *Estate of Vardell v. Commissioner*, 307 F.2d 688 (5th Cir. 1962).

This is a pioneer estate tax decision, one which had been anticipated with considerable relish in community property jurisdictions.[5] It is not wholly without precedent, however, since the courts of appeals of the two circuits which embrace all of the community property states except New Mexico have held similar transfers to be for consideration under the gift tax provisions of the Code.[6] The gift and estate taxes have been construed as being *in pari materia* for purposes of determining whether a transfer is one for consideration[7] and therefore not subject to either tax.[8] In *Commissioner v. Siegel*,[9] the Ninth Circuit considered the will of a deceased spouse which left the couple's community in trust for the surviving spouse for life, with remainders over to their children, provided that the surviving spouse elected to take under the will rather than retain her vested one-half interest in their community. The court held that the transfer of the remainder interest in the widow's community as a result of her election to take under the will was a transfer for consideration to the extent of the value of the life estate she received in her husband's property. The Fifth Circuit reached the same conclusion in *Commissioner v. Chase Manhattan Bank*[10] when it was clear that the will of the deceased spouse put the surviving spouse to an election.

In the present decision the court expressly applied these gift tax definitions of consideration to the estate tax. Relying upon state decisions to define the interest which decedent received under the will as that of a life estate,[11] the majority of the court held that there had

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enumerated and described in sections 2035 to 2038, inclusive, and section 2041 is made, created, exercised, or relinquished for a consideration in money or money's worth, but is not a bona fide sale for adequate and full consideration in money or money's worth, there shall be included in the gross estate only the excess of the fair market value at the time of death of the property otherwise to be included on account of such transaction, over the value of the consideration received therefor by the decedent." INT. REV. CODE OF 1954, § 2043.

5. See Thurman, *Federal Estate and Gift Taxation of Community Property*, 1 ARIZ. L. REV. 251, 265 (1959).

6. These decisions considered the nature of the transfer under section 1002 of the Internal Revenue Code of 1939. Section 2512(b) is the gift tax consideration section of the present Code.

7. Merrill v. Fahs, 324 U.S. 308 (1945); Commissioner v. Bristol, 121 F.2d 129 (1st Cir. 1941).

8. Only gratuitous transfers of property interests are subject to taxation by the federal government under the gift and estate tax statute. See Note, *Consideration Under the Federal Estate and Gift Taxes*, 37 N.Y.U.L. REV. 82 (1962).

9. 250 F.2d 339 (9th Cir. 1957).

10. 259 F.2d 231 (5th Cir. 1958), *cert. denied*, 359 U.S. 913 (1959).

11. Two cases were cited as representative of Texas law for the propositions that the life tenant's unlimited power of inter vivos disposition did not enlarge her life estate into a fee, Edds v. Mitchell, 143 Tex. 307, 184 S.W.2d 823 (1945), and that such

been a transfer of decedent's remainder interest in her half of the community at the time of her election, but the property remained includible in her gross estate under Code section 2036[12] because she retained a life estate, or under section 2038[13] because she had the power to revoke the transfer by making an inter vivos disposition. In a vigorous dissent, Judge Wisdom argued that there had been no transfer at the time of election since decedent retained absolute control over her property. He urged that since there had been no inter vivos transfer, the property was includible in her gross estate under section 2033[14] as property in which she had an interest at the time of her death. To the disputed transfer the majority applied the gift tax decisions and held that it had been a transfer for insufficient consideration under section 2043(a).[15] Judge Wisdom did not quarrel with the gift tax decisions (he had authored the *Chase* opinion) nor question their application to the estate tax, but argued that they were inapplicable in the present case because there had been no inter vivos transfer. In determining the value of the consideration received by the decedent, the majority relied upon hindsight. It thereby eliminated the remarriage provision, holding the value of the consideration received to be the value of decedent's life estate in her husband's

power did not prevent the remainderman's interest from vesting, Caples v. Ward, 107 Tex. 341, 179 S.W. 856 (1915).

These decisions are representative not only of Texas law but of the vast weight of authority in the United States. See 1 SIMES & SMITH, FUTURE INTERESTS §§ 113 n.58, 150 (2d ed. 1956); 3 *id.* § 1488. It was necessary for the majority to establish both of these specific points of law. It needed to define the interest decedent received under the will as a life estate for purposes of excluding the husband's community from her gross estate and placing a value on the interest received as consideration. It needed to define the remainder as a vested property interest in order to find a transfer at the time of election.

12. See note 3 *supra.*

13. "Revocable Transfers.

"(a) In General.—The value of the gross estate shall include the value of all property . . . —

"(1) Transfers after June 22, 1936.—. . . .

"(2) Transfers on or before June 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of death. . . ." INT. REV. CODE OF 1954, § 2038.

14. "Property in Which the Decedent Had an Interest.

"The value of the gross estate shall include the value of all property . . . to the extent of the interest therein of the decedent at the time of his death." INT. REV. CODE OF 1954, § 2033.

Judge Wisdom's dissent revives the question of whether the *Clifford* income tax doctrine of substantial ownership is applicable to the estate tax to include property in the gross estate under 2033, a section to which 2043 does not apply. Helvering v. Clifford, 309 U.S. 331 (1940). See generally LOWNDES & KRAMER, FEDERAL ESTATE AND GIFT TAXES § 4.3 (2d ed. 1962).

15. See note 4 *supra.*

community at the time of election.[16] Again Judge Wisdom disagreed, declaring that the remarriage provision rendered the value of the interest in the husband's property uncertain and thus incapable of being reduced to its money value as of the time of election.

Judge Wisdom's objections seem well taken. The majority appears to have been too much concerned with the niceties of legal definition,[17] ignoring the reality of the control which decedent retained over her property. Such a practice is not consistent with the proper administration of the taxing statute.[18] As Judge Wisdom pointed out, treating decedent's election as effecting a transfer for consideration could have additional tax consequences, such as providing a cost basis for the interest acquired. For estate planning purposes, the practical effect of treating the election in the present case as effecting a transfer for consideration is nullified by Code section 2041(a)(2).[19] It is quite clear that if the election had occurred after October 21, 1942, *all* of the couple's community would be included in decedent's gross estate since her unlimited power to make inter vivos disposition of the

16. The majority added the dictum that if decedent had remarried, hindsight would be utilized to limit the amount of consideration to the value of the benefits received prior to remarriage or the value of the life estate at the time of election, whichever was less.

17. See note 11 *supra*.

18. The majority correctly placed the property interests involved in the present case in the general categories of life estate and vested remainder. *Ibid.* But by so doing, they reached the same result tax-wise that would have been reached if decedent had not retained her considerable control over her property. She possessed the power during her lifetime to dispose of the property as if she owned it in fee simple. If she had chosen to do so she could have completely divested the remainder interest. Hiding this power under a stack of legal definitions is violative of one of the basic principals of taxation. "[T]axation is not so much concerned with the refinements of title as it is with the actual command over the property taxed. . . ." Corliss v. Bowers, 281 U.S. 376, 378 (1930).

19. "Powers of Appointment.

"(a) In General.—The value of the gross estate shall include the value of all property . . . —

"(1) Powers of appointment created on or before October 21, 1942.—. . . .

"(2) Powers created after October 21, 1942.—To the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under sections 2035 to 2038, inclusive. . . .

"(b) Definitions.—For purposes of subsection (a)—

"(1) General power of appointment.—The term 'general power of appointment' means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate; except that—

"(A) A power to consume, invade or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment." INT. REV. CODE OF 1954, § 2041.

property amounted to a general power of appointment.[20] This fact, however, does not detract from the basic proposition for which the case stands. There is no reason to doubt that even Judge Wisdom would have found a transfer for consideration if decedent had relinquished control over her community as did the surviving spouses in both *Siegel* and *Chase*. In this respect, the decision remains a very useful one for planning purposes. It makes it possible for a married couple to effect estate tax savings (substantial if the surviving spouse is relatively young) with little or no sacrifice on the part of either spouse.

Taxation–Federal Income Tax–Taxability of Receipts From Sale of Membership Certificates

In two recent cases raising the issue of the taxability to a corporation of receipts from the sale of membership certificates the Tax Court and district court reached contrary results. In both cases non-profit California discount houses,[1] sold non-assessable, non-transferable membership certificates to applicants. These certificates entitled the member to purchase goods at a discount, vote for directors,[2] and share in the assets of the corporation upon dissolution. The board of directors of both corporations had the right to cancel membership certificates "for any cause deemed sufficient."[3] Upon the member's

20. Three years ago this court considered a joint and mutual will which gave the surviving spouse a life estate in all of the community coupled with an unlimited power of inter vivos disposition. The will had been exccuted in 1943; the husband had died in 1948. Upon the death of the widow, the court held all of the property passing under the will includible in her gross estate since the inter vivos power of disposition constituted a taxable general power of appointment, "which power was not limited by an ascertainable standard relating to Mrs. Kay's health, education, support, or maintenance." Phinney v. Kay, 275 F.2d 776, 781 (5th Cir. 1960).

1. The California corporations were organized under CAL. CORP. CODE ANN. § 9200: "A nonprofit corporation may be formed . . . for any lawful purposes which do not contemplate the distribution of gains, profits, or dividends to the members thereof and for which individuals lawfully may associate themselves, such as . . . for rendering services, subject to laws and regulations applicable to particular classes of nonprofit corporations or lines of activity. Carrying on business at a profit as an incident to the main purposes of the corporation and the distribution of assets to members ou dissolution are not forbidden to nonprofit corporations, but no corporation formed or existing under this part shall distribute any gains, profits, or dividends to any of its members as such except upon dissolution or winding up."

2. Even though the members had the teehnical right to vote, as a practical matter, this right was not exercised. Affiliated Gov't Employees' Distrib. Co., 37 T.C. No. 88, at 10 (Feb. 12, 1962), *appeal docketed*, No. 17985, 9th Cir., 1962.

3. Federal Emplovees' Distrib. Co. v. United States, 206 F. Supp. 330, 332 (S.D. Cal. 1962); Affiliated Gov't Employees' Distrib. Co., *supra* note 2, at 2.

death, the membership fee was refundable. The only material factual difference between the two cases is that only one corporation (Federal Employees' Distributing Company) had been required to pay the federal stock transfer tax on the membership certificates.[4] Procedurally there was also a difference; one suit was brought in the Tax Court on a tax deficiency,[5] whereas the other action was brought in the Federal District Court for the Southern District of California for a tax refund.[6] Both courts agreed that the receipts from the sale of memberships were not contributions to capital under section 118 of the Internal Revenue Code of 1954,[7] yet contrary results were reached because the courts differed on whether the membership certificates were stock under section 1032 of the Code. The Tax Court held the certificates were not stock, *Affiliated Government Employees' Distributing Co.*, 37 T.C. No. 88 (Feb. 12, 1962), *appeal docketed*, No. 17985, 9th Cir., 1962, while the district court held the certificates were stock, *Federal Employees' Distributing Co. v. Commissioner*, 206 F. Supp. 330 (S.D. Cal. 1962).

The Internal Revenue Code of 1954 made significant structural changes in the taxability of contributions by outsiders to a corporation.[8] One entirely new section of the Code concerns the taxability of an exchange of stock for consideration,[9] but nowhere in the Code is the indicia of stock provided.[10] Only sections 118 and 1032 of the Code are pertinent to this discussion. Section 118 excludes capital contributions to corporations from corporate gross income,[11] which is defined as "all income from whatever source derived."[12] The legislative history of section 118 indicates that existing case law was codified,[13] and section 118 exclusions were restricted to contributions to capital by individuals or organizations "having no proprietary interest in the

4. The tax was levied under INT. REV. CODE OF 1954, § 4301. "There is hereby imposed [a tax], on each original issue of shares or certificates of stock issued by a corporation . . . ."

This is a stamp tax or document tax. Edwards v. Wabash Ry., 264 Fed. 610, 614-15 (2d Cir. 1920); Malley v. Bowditch, 259 Fed. 809, 811 (1st Cir. 1919).

5. Affiliated Gov't Employees' Distrib. Co., *supra* note 2.

6. Federal Employees' Distrib. Co. v. United States, *supra* note 3.

7. Federal Employees' Distrib. Co. v. United States, *supra* note 3, at 333; Affiliated Gov't Employees' Distrib. Co., *supra* note 2.

8. See, *e.g.*, Note, 66 YALE L.J. 1085 (1957).

9. INT. REV. CODE OF 1954, § 1032.

10. The only definition of stock in the Gode appears in § 7701(a): "(7) Stock—The term 'stock' includes shares in an association, joint stock company, or insurance company."

11. INT. REV. CODE OF 1954, § 118. "In the case of a corporation, gross income does not include any contribution to the capital of the taxpayer."

12. INT. BEV. CODE OF 1954, § 61(a).

13. "This in effeet places in the code the court decisions on this subject." H.R. REP. No. 1337, 83d Cong., 2d Sess. 17 (1954); S. REP. No. 1622, 83d Cong., 2d Sess. 18 (1954).

corporation."[14] The other new provision, section 1032, provides that the exchange of a corporation's stock (including treasury stock) is not a taxable event to the corporation.[15] This section was designed to eliminate the taxation problem of gain or loss on treasury stock transactions by the corporation.[16] As a result of section 118, the taxation problem of contributions to capital by outsiders has been mimimized, while section 1032 resolves many problems concerning capital gains and losses on treasury stock transactions; yet problems of statutory interpretation concerning the meaning of the concepts of income,[17] capital,[18] and stock[19] still remain.

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14. "It [§ 118] deals with cases where a contribution is made to a corporation by a governmental unit, chamber of commerce, or other association of individuals having no proprietary interest in the corporation." H.R. REP. No. 1337, 83d Cong., 2d Sess. 17 (1954); S. REP. No. 1622, 83d Cong., 2d Sess. 18 (1954).

15. INT. REV. CODE OF 1954, § 1032(a). "No gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation."

16. "Section 1032, relating to the exchange by a corporation of its stock for property, has no counterpart under the 1939 Code. Under present law, whether the disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends, under certain decisions, upon whether the transaction constitutes the dealing by a corporation in its own shares which is to be ascertained from all of the facts and circumstances. The purpose of the section is to remove the uncertainties of the present law." H.R. REP. No. 1337, 83d Cong., 2d Sess. A268 (1954); S. REP. No. 1622, 83d Cong., 2d Sess. 426 (1954).

Before 1954, the issuance of stock was a non-taxable event. "The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock." Treas. Reg. 118, § 39.22(a)-15(a), 18 Fed. Reg. 5792 (1953) (now Treas. Reg. § 1.1032-1(a) (1956)). See also 7 MERTENS, FEDERAL INCOME TAXATION § 38.29 (Supp. 1962).

17. Aside from the Code, income has been defined "as the gain derived from capital, from labor, or from both combined. . . ." Stratton's Independence, Ltd. v. Howbert, 231 U.S. 399, 415 (1913). In Doyle v. Mitchell Bros. Co., 247 U.S. 179, 185 (1918), the Court said: "Whatever difficulty there may be about a precise and scientific definition of 'income,' it imports, as used here, something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax; conveying rather the idea of gain or increase arising from corporate activities."

18. "When used with respect to property of a corporation or association the term [capital] has a settled meaning; it applies only to the property or means contributed by the stockholders as the fund or basis for the business or enterprise for which the corporation or association was formed." Bailey v. Clark, 88 U.S. (21 Wall.) 284, 286-87 (1874). In a recent case, United Grocers, Ltd. v. United States, 186 F. Supp. 724, 729 (N.D. Cal. 1960), the term capital was defined as "the money, property or means contributed by stockholders as the fund or basis for the business or enterprise for which the corporation was formed." See also 1 DEWING, THE FINANCIAL POLICY OF CORPORATIONS ch. 2 (5th ed. 1953); Harvey, *Some Indicia of Capital Transfers Under the Federal Income Tax Laws*, 37 MICH. L. REV. 745 (1939).

19. The term "stock" has posed a multitude of problems for the courts. See note 38 *infra*. "The word 'stock' is not uniformly used to designate the capital of a corporation although its primary meaning is capital, in whatever form it may be invested. . . . Shares are the mere certificates which represent a subscriber's contribution to capital stock, and measure his interest in the company." Wright v. Georgia R.R. & Banking Co., 216 U.S. 420, 424-25 (1910). "Shares of Stock 'are intangible

Prior to 1954, a significant body of case law concerning capital contributions was developed. In the leading case of *Edwards v. Cuba R.R.*,[20] subsidy payments by the Cuban government to a company for building a railroad were held to be a contribution to capital and not a taxable event. On the other hand, government subsidy payments to subsidize operating expenses or to maintain a certain level of income were held to constitute income to the corporation.[21] Subsequent cases extended the *Cuba Railroad* doctrine to private contributions for the construction of utilities,[22] although contributions to trade associations,[23] and to mutual benefit associations[24] were held to be income and taxable. Payments to potential consumers for the extension of utility services were said to constitute income in *Detroit Edison Co. v. Commissioner*;[25] thus it appeared that the doctrine of *Cuba Railroad* had been restricted. Later in *Brown Shoe Co. v. Commissioner*,[26] after distinguishing *Detroit Edison*,[27] the

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and rest in abstract legal contemplation.' They are the interest or right which the owner has in the management, profits and assets of a corporation. . . . A certificate of stock . . . is a symbol or proper evidence of ownership of the shares; it is not the stock itself." Commissioner v. Scatena, 85 F.2d 729, 732 (9th Cir. 1936).

"[T]he essential fact remains that capital stock represents, at the last analysis, the ownership and the responsibility for management of the corporation and the rights to receive profits and experience losses from its operations as an enduring and functioning business enterprise." 1 DEWING, THE FINANCIAL POLICY OF CORPORATIONS 57 (5th ed. 1953).

"The term 'stock' is sometimes used in the same sense as 'capital stock' or 'capital,' and it has been said that "its primary meaning is capital, in whatever form it may be invested.' But it is used more generally, perhaps, to designate the shares of capital stock in the hands of individual stockholders, or the certificates issued by the corporation to them." 11 FLETCHER, PRIVATE CORPORATIONS § 5081, at 30-31 (rev. vol. 1958).

"The distinguishing feature of a stock is that it confers upon its holder a part ownership of the assets of the corporation and gives him a right to participate in the management of the corporation and to share in the surplus profits and on dissolution to share in the assets which remain after the debts are paid." *In re* Fechheimer Fishel Co., 212 Fed. 357, 360 (2d Cir. 1914). See Elko Lamoille Power Co. v. Commissioner, 50 F.2d 595, 598 (9th Cir. 1931).

20. 268 U.S. 628 (1925).

21. Texas & Pac. Ry. v. United States, 286 U.S. 285 (1932); Continental Tie & Lumber Co. v. United States, 286 U.S. 290 (1932); Boston Elevated Ry. v. Commissioner, 131 F.2d 161 (1st Cir. 1942). See also Denver & Rio Grande W.R.R., 32 T.C. 43 (1959), *aff'd*, 279 F.2d 368 (10th Cir. 1960).

22. See Tampa Elec. Co., 12 B.T.A. 1002 (1928); El Paso Elec. R.R., 10 B.T.A. 79 (1928); Wisconsin Hydro-Elec. Co., 10 B.T.A. 935 (1928); Liberty Light & Power Co., 4 B.T.A. 155 (1926).

23. United Retail Grocers Ass'n, 19 B.T.A. 1016 (1930).

24. Pontiac Employees Mut. Benefit Ass'n, 15 B.T.A. 74 (1929); Employees' Benefit Ass'n of Am. Steel Foundaries, 14 B.T.A. 1166 (1929).

25. 319 U.S. 98 (1943).

26. 339 U.S. 583 (1950).

27. *Detroit Edison* was distinguished because in this case, *Brown Shoe*, there were "neither customers [n]or payments for service . . . . The contributions to petitioner were provided by citizens of the respective communities who neither sought nor could have anticipated any direct service or recompense whatever, their only expectation being

Supreme Court extended the *Cuba Railroad* doctrine to community contributions to induce industry to locate or expand existing manufacturing facilities in the community.[28] Therefore, it appears that the nature of the donor and the purpose of the contribution are important factors in characterizing contributions as either capital or income.[29] This case law was codified in section 118.[30] Later cases have said dues paid to automobile clubs[31] and co-operatives[32] are income not capital. The recent television cases,[33] in which private companies sold "shares" to members of a community as a prerequisite for obtaining television reception, have presented the courts with the dual problem of what are contributions to capital under section 118 and what is stock under section 1032. Following *Detroit Edison*, the courts held that the payments were income for they were payments for services,[34] and the "shares" were not stock within section 1032 because an ordinary investor would not be interested in the shares.[35] The "thin corporation" cases[36] are a vivid illustration of the complexities involved in determining tax consequences in terms of the attributes of certificates themselves.[37]

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that such contributions might prove advantageous to the community at large." *Id.* at 591.

28. *Id.* at 593.

29. See, *e.g.*, Note, 66 YALE L.J. 1085 (1957). See also 29 N.C.L. REV. 198 (1951).

30. Note 14 *supra*. One of the main objections by the Internal Revenue Service, prior to 1954, was that a company was allowed a depreciation deduction for property received as a capital contribution. Section 362(c) of the Code has eliminated this objection.

31. See, *e.g.*, Automobile Club v. Commissioner, 353 U.S. 180 (1957); Keystone Auto. Club v. Commissioner, 181 F.2d 402 (3d Cir. 1950); Automobile Club, Inc., 32 T.C. 906 (1959). See also Chattanooga Auto. Club, 12 T.C. 967 (1949), *aff'd*, 182 F.2d 551 (6th Cir. 1950).

32. See United Grocers, Ltd. v. United States, 186 F. Supp. 724 (N.D. Cal. 1960).

33. Teleservice Co. v. Commissioner, 254 F.2d 105 (9th Cir.), *cert. denied*, 357 U.S. 919 (1958); Community T.V. Ass'n v. United States, 203 F. Supp. 270 (D. Mont. 1962); Warren Television Corp., 17 C.C.H. Tax Ct. Mem. 1053 (1958). See 107 U. PA. L. REV. 729 (1959); 44 VA. L. REV. 1339 (1958); Note, 66 YALE L.J. 1085 (1957).

34. *Ibid.*

35. Community T.V. Ass'n v. United States, 203 F. Supp. 270, 274 (D. Mont. 1962).

36. See, *e.g.*, John Kelley Co. v. Commissioner, 326 U.S. 521 (1946); Reed v. Commissioner, 242 F.2d 334 (2d Cir. 1957); Gooding Amusement Co. v. Commissioner, 236 F.2d 159 (6th Cir. 1956), *cert. denied*, 352 U.S. 1031 (1957); Kraft Foods Co. v. Commissioner, 232 F.2d 118 (2d Cir. 1956). See also Benjamin, *Thin Corporations—Whose "Substance Over Form?"*, 34 TUL. L. REV. 99 (1959); Chaplin, *The Caloric Count of a Thin Corporation*, N.Y.U. 17TH INST. ON FED. TAX 771 (1959); Schlesinger, *"Thin" Corporations: Income Tax Advantages and Pitfalls*, 61 HARV. L. REV. 50 (1947); Semmel, *Tax Consequences of Inadequate Capitalization*, 48 COLUM. L. REV. 202 (1948).

37. *Ibid.* Practically all the circuits are agreed that the formal name of the certificate is not the determinative factor in ascertaining the nature of the transaction. "There is no one characteristic, not even exclusion from management, which can be said to be decisive in the determination of whether the obligations are risk investments in the corporations or debts. So-called stock certificates may be authorized by corporations which are really debts, and promises to pay may be executed which

In the instant cases both courts agreed that the receipts from the sales of the membership certificates were not "contributions" to capital under section 118 as the receipts were payment for services.[38] The courts split on the issue of whether the sale of membership certificates was a stock transaction under section 1032. The Tax Court looked through the form of the transaction to the substance[39] and held this was not a stock transaction because the dominant purpose of the member in purchasing the certificate was to participate in discount merchandising, the members were not entitled to share in profits, the membership certificate was subject to revocation by the board of directors "for any cause deemed sufficient," no indicia of ownership was issued except a wallet sized card which was essentially a pass, and the right to vote was theoretical rather than real.[40] The federal district court held that this was a non-taxable transaction within the scope of section 1032.[41] These certificates were stock, for the members were entitled to participate in management and on dissolution and share in the assets, no requirement was present for annual dues, the certificates were not required to be renewed, and the corporation was required to pay the federal stock transfer tax on the certificates.[42] The fact that members were not entitled to share in profits does not negate this conclusion for this was a requirement of a California corporation statute,[43] nor is the cancellation clause material because the directors were under a fiduciary duty toward stockholders.[44] The district court rejected the motive test[45] in determining the nature of the transaction[46] and adopted the test of whether money or property had been received for the stock[47] because the legislative history of section 1032 indicates that intent or purpose was abolished in determining the nature of the

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have incidents of stock." John Kelley Co. v. Commissioner, 326 U.S. 521, 530 (1946).

The name of the security does not determine its real character. Jewel Tea Co. v. United States, 90 F.2d 451, 454 (2d Cir. 1937); Armstrong v. Union Trust & Sav. Bank, 248 Fed. 268, 270 (9th Cir. 1918). *Contra,* First Mortgage Corp. v. Commissioner, 135 F.2d 121, 124 (3d Cir. 1943); Commissioner v. O.P.P. Holding Corp., 76 F.2d 11 (2d Cir. 1935).

The court will look through the form to the substance to determine the character of the security. Thompson v. Commissioner, 205 F.2d 73, 78 (3d Cir. 1953); Commissioner v. Pittsburgh & W. Va. Ry., 172 F.2d 1010, 1014 (3d Cir.), *cert. denied,* 337 U.S. 939 (1949); Paxson v. Commissioner, 144 F.2d 772, 776 (3d Cir. 1944); Community T.V. Ass'n v. United States, 203 F. Supp. 270 (D. Mont. 1962).

38. Federal Employees' Distrib. Co. v. United States, *supra* note 3; Affiliated Gov't Employees' Distrib. Co., *supra* note 2.

39. Affiliated Gov't Employees' Distrib. Co. v. United States, *supra* note 2.

40. *Ibid.*

41. Federal Employees' Distrib. Co. v. United States, *supra* note 3.

42. *Id.* at 334.

43. *Id.* at 335. See note 1 *supra.*

44. Federal Employees' Distrib. Co. v. United States, *supra* note 3, at 335.

45. See note 30 *supra* and accompanying text.

46. Federal Employees' Distrib. Co. v. United States, *supra* note 3, at 336.

47. *Id.* at 335.

transaction.[48] Furthermore, the criteria of motive and intent are nebulous and difficult to apply.[49]

The basic problem remains one of meaningfully defining stock for purposes of section 1032. To resolve this problem, the indicia of stock cannot be controlled by state law;[50] the solution must be sought from the Internal Revenue Code, its legislative history, and its policies. The Tax Court reached the correct conclusion, although the analysis of the problem by the district court is superior to that of the Tax Court.[51] As a result of misinterpreting the legislative history of section 1032, the district court reached an undesirable conclusion. The legislative history of section 1032[52] and previous Treasury Regulations[53] clearly indicate that Congress was only concerned with the problem of taxing gains and losses on treasury stock transactions and did not consider the definitional aspects of stock.[54] The cases indicate that there is no general rule to determine the characteristics of stock for all purposes. For the purpose of section 1032 the following criteria are useful in determining what is stock. Would an ordinary investor desirous of earnings or appreciation (growth) consider purchasing the stock? Is the purported stock a means of procuring capital for the corporation or is the issuance of the stock designed to accomplish some other purpose? A merchant-consumer relationship between the corporation and the shareholder is another factor of relevance. The membership certificates in these cases possessed some indicia of stock, yet the certificates, in substance, were illusory stock because an investor, not interested in discount purchasing, would not acquire the stock. Rather, the primary purpose of the certificates was to serve as a pass to enable members to gain entrance to the premises and to participate in discount merchandising. The fact that the federal document tax was paid on the certificates by one corporation does not contravene this conclusion, for the document tax is levied

48. *Id.* at 336.
49. *Ibid.*
50. "The exertion of that [federal] power is not subject to state control. It is the will of Congress which controls, and the expression of its will in legislation, in the absence of language evidencing a different purpose, is to be interpreted so as to give a uniform application to a nationwide scheme of taxation." Burnet v. Harmel, 287 U.S. 103, 110 (1932).
51. Commenators have frequently argued that tax litigation should be within the exelusive province of the Tax Court for other federal courts are not familiar with the complexities and ramifications of tax law. See *e.g.*, Griswold, *The Need for a Court of Tax Appeals*, 57 HARV. L. REV. 1153 (1944); Lowndes, *Federal Taxation and the Supreme Court*, in THE SUPREME COURT REVIEW 222 (1960); Pope, *A Court of Tax Appeals: A Call for Re-examination*, 39 A.B.A.J. 275 (1953). The instant cases appear to refute this argument for the federal district court thoroughly analyzed the problem whereas the Tax Court decided the problem at hand with very little analysis.
52. See note 16 *supra*.
53. *Ibid.*
54. *Ibid.*

on the form of the certificate,[55] not on the substance of the transaction. The policy of such tax is obviously different. Besides, the relevant legislative history[56] does not indicate any policy to benefit discount merchandising. Taxation of the receipts from the sale of membership certificates will not appreciably affect discount selling, whereas a non-taxable status to these receipts will be an impetus to discount sellers to utilize comparable customer selection arrangements which offer them a windfall tax benefit.

Torts—Assumption of Risk—Doctrine Abolished in Master-Servant Cases

Plaintiff, employed as a nurse's aide by defendant hospital, was injured due to alleged negligence in the layout of one of the hospital's wards. The entrance door of the ward opened inward and stopped against a lavatory. On the inside of the door, in place of a doorknob, was a metal hook which enabled patients and employees to open the door with a forearm. While standing before the lavatory in the performance of her duties, plaintiff was struck in the back by the hook as a wheelchair patient pushed the door open to enter from the hall. Plaintiff sued defendant for her injuries, alleging defendant's negligent failure to furnish her a reasonably safe place to work. Defendant denied negligence and affirmatively pleaded contributory negligence and assumption of risk. At the close of all the evidence, the trial court ruled that plaintiff had assumed the risk of harm as a matter of law and dismissed the complaint. On appeal to the Supreme Court of Washington, *held,* reversed and remanded for new trial. In past decisions, "assumption of risk" of a dangerous condition negligently maintained by the employer has been equivalent either to a socially undesirable modification of the employer's duty of care which will no longer be retained or to a finding that the employee was contributorily negligent which should be left to the jury. *Siragusa v. Swedish Hospital,* 373 P.2d 767 (Wash. 1962).

Under the common law, the burden of an injury must lie on whom the injury falls unless the courts determine that the interests of the society of the day will be better served by placing the burden elsewhere.[1] The social context of the origin of the "doctrine of assumption

55. See Edwards v. Wabash Ry., 264 Fed. 610, 614-15 (2d Cir. 1920); Malley v. Bowditch, 259 Fed. 809, 811 (1st Cir. 1919).

56. See note 16 *supra.*

1. See Keeton, *Assumption of Risk in Products Liability Cases,* 22 LA. L. REV. 122, 149 (1961); HOLMES, THE COMMON LAW 94-96 (1881).

of risk" was the nineteenth century's period of industrial development, with its prevalent social philosophy of rugged individualism.[2] Every man, rich or poor, was supposed to be free to contract or act as he pleased—he was not protected against his own bad judgment.[3] Given this philosophy and accepting these premises, the fact that a plaintiff knew or should have known of a given danger and chose to encounter it or continue in its presence when he had an alternative (however unrealistic) was a quite cogent justification for denying him recovery. Although "assumption of risk" terminology was sometimes used in the early cases to illustrate the justice of a denial of recovery on another ground, it was also used in many cases to avoid an extended analysis of the relationship between the plaintiff and defendant in cases having the common element of plaintiff's actual or constructive awareness of the danger which caused him injury. Thus, "assumption of risk" was the language used in summarily dismissing plaintiff's claim where an extended analysis of the facts would have required a dismissal based on contract,[4] consent,[5] lack of duty,[6] lack of breach

2. 2 HARPER & JAMES, TORTS § 21.3, at 1174-75 (1956); Mansfield, *Informed Choice in the Law of Torts*, 22 LA. L. REV. 17, 23 (1961). Other manifestations of the philosophy of this period were the economic doctrine of *laissez faire* and the legal doctrines of *caveat emptor* and contributory negligence.

3. See, *e.g.*, Priestley v. Fowler, 3 M. & W. 1 (EX. 1837); Crichton v. Keir, 1 Sess. Cas. (3d Series) 407 (1863), where the court says, "This is a country of free labour. We have no such thing as *travaux forces*, still less have we anything approaching to slavery. . . . It has been said that the master is more powerful than the servant. But I rather think that in this country the servant is not less powerful than the master; and certainly he is quite as able to enforce the contract, and to defend his rights. Now, if a servant, in the face of a manifest danger, chooses to go on with his work, he does so at his own risk, and not at the risk of the master." *Id.* at 410-11.

4. A provision in a contract relieving a defendant from liability for his negligence is generally valid unless against public policy. The nineteenth century English courts, solicitous of the needs of an infant industrial economy, were quite willing to imply such a provision in contracts of employment. One of the clearest situations in which implied provisions of a contract should relieve defendant from liability for negligence is where plaintiff is employed to remedy a dangerous situation caused by defendant's negligence.

5. Although the English Employer's Liability Act of 1880 precluded an employer's contracting away his liability, the courts continued to use "assumption of risk" phraseology to reach the same results based on the servant's consent to incur the risk—*volenti non fit injuria*—as evidenced by his entering the employment or continuing to work with knowledge of the danger. 3 LABATT, MASTER AND SERVANT § 1192 (2d ed. 1913) [hereinafter cited as LABATT].

6. By his entering into the contract of employment, it was said that a servant agreed to undertake the hazards inherent in the work along with the duties. *E.g.*, Priestley v. Fowler, *supra* note 3. The master was not liable to a servant who expressly or impliedly "assumed the risks" which were contemplated at the time of the employment. See 3 LABATT § 1168(b). However, it was settled law at this time that the master owed no duty to a servant to protect him from the dangers inherent in the work, *i.e.*, the occupational hazards, and only a duty to warn of dangers which were not contemplated by the servant, 3 LABATT §§ 1143-45, 1165, so an argument based on the servant's assumption of risks contemplated at the time of the employment contract merely rephrased an argument based on lack of duty on the part of the master..

of an established duty,[7] or contributory negligence.[8] Through continued usage, however, "assumption of risk" was thought to have earned the appellation "doctrine." From its early beginnings in master-servant[9] and landowner cases,[10] the "doctrine of assumption of risk" spread to other areas of the law of negligence, either under its own name or its Latin equivalent, *volenti non fit injuria.*[11] Today several jurisdictions apply the "doctrine" only in master-servant cases, while the other jurisdictions apply it in only a few areas other than those of master-servant and landowners.[12] In traffic cases, "assumption of risk" is of little importance except in the host-guest situation,[13] but a considerable number of cases have arisen in this area,[14] especially in the drinking party situation.[15] Occasionally the defense is used in manufacturer and supplier cases.[16] The slip-and-fall cases and cases involving a subcontractor's employee against the general contractor are the occasion of the most frequent current use of the "doctrine" outside the master-servant or landowner fields.[17] In the earlier cases, although "assumption of risk" was frequently given as a basis of decision and was referred to as a "doctrine," its nature and boundaries were not clearly defined. Courts were not much troubled with the precise limits of the "doctrine" until the passage of statutes

7. It was said that the servant "assumed the risk" of extraordinary dangers—those created by the master's negligence—when he continued in the employment after he became aware of these dangers. See 3 LABATT §§ 1178-83. However, the master's only duty to a servant in such a case was a duty to warn, and once the servant knew of the danger, the master's duty was discharged. 3 LABATT §§ 1143, 1146. This also would apply in cases in which a defendant's duty of reasonable care is satisfied because a warning would constitute reasonable care under the circumstances and plaintiff appreciated the danger.

8. In the early cases involving master and servant, given the premise that the servant was completely free to resign at will, remaining on the job in the face of a known danger might have been characterized as unreasonable as a matter of law and the servant's action barred by contributory negligence. As the economic and social background changed, the "doctrine of assumption of risk" fell into disfavor and began to be limited by the courts. "Assumption of risk" was sometimes held to apply when no reasonable man would continue to work in the face of the negligently created danger under the circumstances, see, *e.g.*, Hull v. Davenport, 93 Wash. 16, 159 Pac. 1072 (1916), and therefore by definition only when the servant was contributorily negligent. Other cases applied "assumption of risk" where plaintiff "knew or should have known" of the danger.

9. See 2 HARPER & JAMES, TORTS § 21.4, at 1175 (1956); Meistrich v. Casino Arena Attractions, Inc., 31 N.J. 44, 155 A.2d 90 (1959).

10. Green, *Assumed Risk as a Defense*, 22 LA. L. REV. 77, 82 (1961).

11. See *id.* at 84.

12. *Id.* at 82-83.

13. *Id.* at 80-81.

14. Particularly in Wisconsin. See Greenwood, *Assumption of Risk in Automobile Cases*, 43 MARQ. L. REV. 203 (1959); Comment, *Distinction Between Assumption of Risk and Contributory Negligence in Wisconsin*, 1960 WIS. L. REV. 460.

15. See Pedrick, *Taken for a Ride: The Automobile Guest and Assumption of Risk*, 22 LA. L. REV. 90 (1961).

16. Green, *supra* note 10, at 81. See generally Keeton, *supra* note 1.

17. Green, *supra* note 10, at 84.

which limited the availibility of contributory negligence as a complete defense in certain areas.[18] These statutes were strictly interpreted as leaving "assumption of risk" intact, and it became vital to draw a definitive line between the two common law defenses.[19] In cases where "assumption of risk" meant "non-negligence" since no duty had been breached the required distinction was readily made; in cases where "assumption of risk" meant "unreasonable conduct in the face of known danger" the distinctions made were necessarily artificial.[20]

Because of the confusion and injustice which resulted from attempts to define sharply "assumption of risk," legal writers began to criticize the doctrine.[21] Other writers attempted to aid the effort to define its boundaries.[22] More recently, writers have advocated that the doctrine as it now stands be completely eliminated, on the grounds that the various policies given effect by "assumption of risk" are adequately implemented by other concepts of the law which are free from the ambiguity of the multifarious "doctrine of assumption of risk."[23] These writers point out that in practically every case in which assumption of risk has been given as the basis of denying recovery, it has been used in a sense which is virtually equivalent to a denial of recovery on the ground of another tort concept. "Assumption of risk" by express contract, by implied contract, or where the plaintiff expresses or implies his acquiescence in the risk so that the defendant acts on plaintiff's manifestation of consent would seem to be adequately covered by the doctrine of *consent*. In those cases where the only duty owed by defendant is a duty to warn and the plaintiff already knows of the danger, or where the duty of reasonable

18. *E.g.*, the Federal Employer's Liability Act, the comparative negligence statutes, and auto-guest statutes.

19. See, *e.g.*, the discussion of Black, J., in Tiller v. Atlantic Coast Line R.R., 318 U.S. 54, 58-64 (1943) where it is said that an amendment to the Federal Employer's Liability Act abolishing the defense of "assumption of risk" in an action for the employer's *negligence* not only denied "assumption of risk" in the sense of "contributory negligence" as a defense but also denied the defense of "assumption of risk" in the sense of "non-negligence," regardless of what the latter was called.

20. Often what was held to be "assumption of risk" on the part of the plaintiff would have been negligence if he had been the defendant. Distinctions between "assumption of risk" and "contributory negligence" on the ground that "assumption of risk" is essentially "venturousness" and "contributory negligence" essentially "carelessness," *e.g.*, Tiller v. Norfolk & W. Ry., 190 Va. 605, 58 S.E.2d 45 (1950), would be meaningless if the question were one of defendant's negligence rather than plaintiff's. See Wade, *The Place of Assumption of Risk in the Law of Negligence*, 22 LA. L. REV. 5, 11-12 (1961). The cases saying that the two defenses are entirely distinct and those saying that they are virtually identical seem about equal in number. See Annot., 82 A.L.R.2d 1218, §§ 4-9 (1962).

21. *E.g.*, Labatt, *The Relation Between Assumption of Risk and Contributory Negligence*, 31 AM. L. REV. 667 (1897).

22. *E.g.*, Bohlen, *Voluntary Assumption of Risk*, 20 HARV. L. REV. 14 (1906); Bohlen, *Contributory Negligence*, 21 HARV. L. REV. 233 (1908).

23. See, *e.g.*, 2 HARPER & JAMES, TORTS § 21.8 (1956); *Symposium—Assumption of Risk*, 22 LA. L. REV. 1 (1961).

care is discharged because the danger is obvious, the same results would be reached on the grounds of *no breach of duty* on the part of defendant. Where the plaintiff has been unreasonable in incurring the risk he is held to have assumed, he should be barred in any case by the doctrine of *contributory negligence*.[24] Although the current writers are not completely agreed as to the number of components into which "assumption of risk" should be divided, most agree that the embodiment of several policies in one "doctrine" is productive of confusion and obfuscation of the real issues involved in a particular case, and that since the purpose of any doctrine is to implement the imposition of a policy decision, one which does not clearly focus on the policy to be implemented is undesirable.[25] Most of today's legal writers advocate either the elimination of "assumption of risk" entirely[26] or confining the term to only one of its meanings.[27] As yet, the majority rule does not follow these recommendations. Quite recently, however, a few jurisdictions have modified or abolished "assumption of risk" as a defense. In 1959, the Supreme Court of New Jersey in *Meistrich v. Casino Arena Attractions, Inc.*,[28] putting aside "assumption of risk" in the sense of "consent" as inapplicable to the case, ruled that in prior New Jersey decisions "assumption of risk" had been synonomous with "no breach of duty" or "contributory negligence," so that a separate instruction on "assumption of risk" is improper, implying a separate issue where none exists. Oregon reached the same result in 1961; in *Ritter v. Beals*[29] the supreme court broke "assumption of risk" down into its components and concluded that an instruction as to "assumption of risk" is confusing and redundant. Also in 1961, the Supreme Court of Wisconsin in *McConville v. State Farm Auto Insurance Co.*[30] overturned a long line of cases attempting to define the scope of the "doctrine" under its auto-guest statute.[31] The Wisconsin court looked through the niceties of the "doctrine" as developed in its prior decisions to the underlying policies on which it was based and determined that in the present social context these policies were no longer valid. The court then redefined the duty of the driver to the guest and stated that the questions of the satisfaction of this duty and the question of contributory negligence were the only issues to be considered.

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24. See generally Wade, *The Place of Assumption of Risk in the Law of Negligence*, 22 LA. L. REV. 5 (1961).
25. See, *e.g.*, Malone, *Foreword* to *Symposium—Assumption of Risk*, 22 LA. L. REV. 1 (1961).
26. *E.g.*, Wade, *supra* note 24.
27. *E.g.*, 2 HARPER & JAMES, TORTS § 21.8 (1956).
28. 31 N.J. 44, 155 A.2d 90 (1959).
29. 225 Ore. 540, 358 P.2d 1080 (1961).
30. 15 Wis. 2d 374, 113 N.W. 2d 14 (1962).
31. See authorities cited note 14 *supra*.

The opinion in the instant case is a re-examination and re-evaluation of the "doctrine of assumption of risk" in the master-servant tort law of Washington.[32] Prior Washington decisions had applied "assumption of risk" both to cases where the servant was contributorily negligent[33] and to cases where the master breached no duty to the servant.[34] The court noticed considerable confusion in the attempts to distinguish the defenses of assumption of risk and contributory negligence.[35] Prior to the instant case, the usual statement of the rule in Washington was that while an employer has a legal duty to furnish his employees a reasonably safe place to work, the employee assumes the risks created by his employer's negligence if the risks are open and apparent.[36] The court pointed out that by using "assumption of risk" the courts had effected a modification of the frequently stated duty of care into a duty merely to warn.[37] The policy considerations which had resulted in the early rule that the employer's duty was only to warn—the same considerations embodied in the "non-negligence" meaning of "assumption of risk"—were examined by the court and found to be outdated.[38] For this reason, the court ruled that the employer has an unqualified duty to exercise reasonable care to furnish his employees a safe place to work,[39] overruling all inconsistent prior decisions.[40] The court examined the evidence on the issues remaining after this change in the law—the issues of negligence and contributory negligence—and determined that these issues should have gone to the jury.[41]

The instant case is of general interest not so much because of the change rendered in the law of Washington as because of the approach

32. The court undertook this re-examination without the suggestion having been raised or argued by either party. The lower court had applied the doctrine correctly as it stood before the instant case. The court's decision to review aud modify the "doctrine" in the master-servaut area was based on "the quantity of litigation in which the defense of assumption of risk has been raised and the current social and economic attitudes toward the master-servant relationship. . . ." 373 P.2d at 770.

33. See *id.* at 771-72.

34. See *id.* at 772.

35. 373 P.2d at 772.

36. *Ibid.*

37. "[To] permit an employer to escape liability . . . simply because the employee was aware of the danger when he reasonably elected to expose himself to it . . . is to affirm and deny, in the same breath, the employer's duty of care." 373 P.2d at 773.

38. *Ibid.*

39. *Ibid.*

40. *Id.* at 774. The court adopts the so called "Missouri Rule": "the servant assumes only such risks as are inherent in his work after the master has exercised [due] care in providing a safe place to work. . . ." Hines v. Continental Baking Co., 334 S.W.2d 140 (Mo. 1960) as quoted in 373 P.2d at 774. The court in the instant case pointed out that the employee's knowledge of the danger will still be an important consideration in determining the issues of the employer's negligence and the employee's contribntory negligence, 373 P.2d at 773.

41. *Id.* at 774-75.

taken by the court to the problem posed by the multifarious nature of the defense of "assumption of risk." The confusion which exists in regard to "assumption of risk" has been brought about by the attempts to synthesize into one "doctrine" several distinct ideas which have been expressed by the same phrase. The technical definitions and distinctions with which the courts became concerned have resulted in obscuring the policies behind the various aspects of the "doctrine." In response to criticisms of this situation, recent decisions in several states[42] have eliminated "assumption of risk" in senses other than contract or consent as being redundant and confusing,[43] or have repudiated the "doctrine" as embodying social policies which are now outdated.[44] The court in the instant case does not go so far as have these other states in demonstrating a willingness to distribute the function of implementing the various policies heretofore effected by "assumption of risk" to doctrines better designed for this function,[45] but it does manifest an encouraging willingness to examine the propriety of the policies effected by "assumption of risk" in the present social context rather than confining its inquiry within the limits prescribed by the nice theories and distinctions of the "doctrine."[46] In a subsequent case, it seems likely that Washington, too, will distribute "assumption of risk" among its components of consent, no breach of duty, and contributory negligence, agreeing that these components better serve their function of elucidating the actual grounds for

42. New Jersey in Meistrich v. Casino Arena Attractions, *supra* note 28; Oregon in Ritter v. Beals, *supra* note 29.

43. "Assumption of risk" in the sense of contract or consent was not before the courts.

44. Wisconsin in McConville v. State Farm Auto Ins. Co., *supra* note 30. The Wisconsin decision in *McConville* was foretold by the court in Baird v. Cornelius, 12 Wis. 2d 284, 107 N.W.2d 278 (1961).

45. Possibly the fact that the court in the instant case undertook to change the law on its own motion, without the benefit of counsel's research, accounts in part for the failure to expressly abolish "assumption of risk." See note 32 *supra*.

46. A possible obstacle to the abolition of the term "assumption of risk" might be encountered in some states where the workmen's compensation statutes expressly provide that "assumption of risk" and the other common law defenses are available to an employer against an employee who elects not to be covered by workmen's compensation. See, *e.g.*, FLA. STAT. ANN. § 440.07 (1952). It would seem, however, that such a legislative provision is not designed to preclude any further development of the common law in the area—to freeze the common law at its point of development at the passage of the statute. The purpose of such a statutory provision is rather to ensure that the employer retains his common law defenses in a suit at common law; to make clear that the abrogation of the common law defenses in a proceeding under the statute does not affect their status in a suit not under the statute. For this reason it would seem that the courts should be free to treat the common law defenses named in the statute as they would any other theory of the common law, free to modify and change the law just as before the statute. Since the abolition of the "doctrine of assumption of risk" would not change the law except incidentally through a clearer consideration of the policies embodied in the term, the statutory provisions providing for retention of common law defenses should not be a bar to clarifying them by abolishing the "doctrine of assumption of risk."

denial of recovery than the conglomerate "assumption of risk." In any event, it is believed that the instant case adds impetus to a just beginning trend toward the elimination of "assumption of risk" and the distribution of its functions to the various overlapping theories of negligence law which are more appropriate for the embodiment of the policies which have been heretofore effected by the manifold term, "assumption of risk."[47]

Torts—Defamation—Defamatory Remarks on Television Held To Be "Defamacast" and Actionable Per Se

Plaintiff, one of a group of sixteen guards involved in a prison transfer of Al Capone, brought an action for defamation allegedly committed upon him in a semi-fictionalized version of the transfer presented on "The Untouchables," a television program.[1] Plaintiff did not allege that a script was used in the broadcast.[2] Defendant's demurrers[3] were overruled in the trial court,[4] and he appealed. *Held,* affirmed. Defamatory remarks broadcast on television are neither libel nor slander but are "defamacast" and are actionable per

47. The willingness of these courts to re-examine the underlying policies and the social effects of "assumption of risk" rather than confining their inquiry to the scope of the "doctrine" is also significant as another instance of the increasing disposition of modern courts to be more concerned with underlying policies in the light of a changing society and less concerned with "doctrinal integrity." This trend can be recognized in the recent changes in the law of pre-natal torts and the inroads on the ancient doctrines of immunity. See, *e.g.*, Smith v. Breunan, 31 N.J. 353, 157 A.2d 497 (1960); Hargrove v. Town of Cocoa Beach, 96 So. 2d 130 (Fla. 1957).

1. The character allegedly referring to plaintiff was shown in the program accepting a $1000 bribe, attempting to bribe his officer, and aiding and abetting the criminal's unsuccessful attempt to escape from the prison train. American Broadcasting—Paramount Theatres, Inc. v. Simpson, 106 Ga. App. 230, 126 S.E.2d 873, 875 (1962). The program was broadcast on a national network and shown on a local Georgia station. 126 S.E.2d at 874.

2. It is worthy of note that, although there was no specific allegation as to the use of a script, the court took judicial notice of the unlikelihood of such a dramatic program being produced without a script. *Id.* at 877 n.5.

3. Although plaintiff was not named in the program, he sought to show damaging reference by introduction of extrinsic facts. He alleged that the following facts portrayed in the program corresponded with those in the real transfer (a) date of the transfer; (b) prison number worn by the prisoner; (c) names of the prisoner and two guards; and (d) barge transportation from the mainland to Alcatraz. *Id.* at 875. Authentic filmclips were allegedly used in the program. *Ibid.* The program was allegedly presented as factual and authentic. *Id.* at 874. Moreover, only one non-officer guard was shown in the train car with the prisoner so that, allegedly, only plaintiff could have been intended. *Id.* at 880.

Plaintiff also alleged "group" defamation. *Id.* at 882-83. These issues are beyond the scope of this treatment, however. See note 24 *infra.*

4. Superior Court of Fulton County, Georgia.

se. *American Broadcasting–Paramount Theatres, Inc. v. Simpson*, 106 Ga. App. 230, 126 S.E.2d 873 (1962).

Defamation, a field containing many anomalies and absurdities[5] has historically been divided into two separate torts, written defamation being libel and spoken defamation being slander.[6] Usually all libel is actionable per se, that is, without proof of actual damage, while slander, to be actionable per se must fall within certain prescribed categories.[7] The advent of radio and television has added to the fires of debate over the applicability of this distinction to modern forms of communication.[8] Where the broadcast defamation has been set down in a written script prior to publication, courts have generally held it to be libel,[9] regarding this as a logical extension of the rule that written defamation, read aloud, is libel.[10] However, where the remarks were extemporaneous, courts have experienced considerable difficulty in fitting them into the historical categories.[11] Those legal writers who wish to fit broadcast defamation into existing forms of action overwhelmingly advocate that all broadcast defamation be

5. PROSSER, TORTS 572 (2d ed. 1955).

6. RESTATEMENT, TORTS § 568, comment *b* (1938).

7. These are imputation of: serious crime, loathesome disease, unchastity in a woman, and effect on the business, trade, profession, or office of the plaintiff. PROSSER, *op. cit. supra* note 5, at 584.

8. See *e.g.*, DAVIS, RADIO COMMUNICATION 160-62 (1927); Farnum, *Radio Defamation and the American Law Institute*, 16 B.U.L. REV. 1 (1936); Haley, *The Law on Radio Programs*, 5 GEO. WASH. L. REV. 157, 184-85 (1937); Vold, *Defamatory Interpolations in Radio Broadcasts*, 88 U. PA. L. REV. 249 (1940); Vold, *The Basis for Liability for Defamation by Radio*, 19 MINN. L. REV. 611 (1935); Note, 46 HARV. L. REV. 133 (1932); Note, 11 NEB. L. REV. 325 (1933); 8 SO. CAL. L. REV. 359 (1935). See generally RESTATEMENT, TORTS § 568 (1938):

"(3) The area of dissemination, the deliberate and premeditated character of its publication, and the persistence of the defamatory conduct are factors to be considered in determining whether a publication is a libel rather than a slander." *Ibid.*

"*Radio Broadcasting.* A libel may be published by broadcasting over the air by means of the radio, if the speaker reads from a prepared manuscript or speaks from written or printed notes or memoranda. Whether an extemporaneous broadcast is a libel or a slander depends on the factors stated in Subsection (3)." *Id.* at comment *f*.

9. Gearhart v. WSAZ, Inc., 150 F. Supp. 98 (E.D. Ky. 1957), *aff'd*, 254 F.2d 242 (6th Cir. 1958); Charles Parker Co. v. Silver Crystal Co., 142 Conn. 605, 116 A.2d 440 (1955); Sorenson v. Wood, 123 Neb. 348, 243 N.W. 82 (1932); Landau v. Columbia Broadcasting Sys., 205 Misc. 357, 128 N.Y.S.2d 254 (Sup. Ct. 1954); Hartmann v. Winchell, 296 N.Y. 296, 73 N.E.2d 30 (1947); Hryhorijiv v. Winchell, 180 Misc. 575, 45 N.Y.S.2d 31 (Sup. Ct. 1943); Metropolitan Life Ins. Co. v. Knickerbocker Broadcasting Co., 172 Misc. 811, 15 N.Y.S.2d 193 (Sup. Ct. 1939); Gibler v. Houston Post Co., 310 S.W.2d 377 (Tex. Civ. App. 1958). *Contra*, Meldrum v. Australian Broadcasting Co., [1932] Vict. L.R. 425.

10. *E.g.*, Bander v. Metropolitan Life Ins. Co., 313 Mass. 337, 47 N.E.2d 595 (1943); Miller v. Donovan, 16 Misc. 453, 39 N.Y. Supp. 820 (Sup. Ct. 1896); Ohio Pub. Serv. Co. v. Myers, 54 Ohio App. 40, 6 N.E.2d 29 (1934). See PROSSER, *op. cit. supra* note 5, at 598.

11. *E.g.*, Riss v. Anderson, 304 F.2d 188 (8th Cir. 1962); Young v. New Mexico Broadcasting Co., 60 N.M. 475, 292 P.2d 776 (1956); Locke v. Benton & Bowles, 253 App. Div. 369, 2 N.Y.S.2d 150 (1938); Summit Hotel Co. v. National Broadcasting Co., 236 Pa. 182, 8 A.2d 302 (1939).

treated as libel, urging that the reasons for which libel was created, such as breadth of circulation and capacity for harm, are at least as applicable to radio and television as to printed matter.[12] Judge Fuld of New York, concurring in *Hartmann v. Winchell*,[13] is frequently cited as authority on this point, and many writers advocate that his opinion should be the basis of changes in the rules of liability.[14] A few courts have adopted this view,[15] and at least one court has analogized words spoken on radio to words printed in a newspaper.[16] However, many courts remain faithful to the old distinctions.[17] Some writers have advocated that the existing categories are ill-suited for dealing with broadcast defamation which, they say, is and should be treated as a new tort which is actionable per se;[18] several courts have so held.[19]

In the instant case the court considered whether defamation by radio and television is libel, slander, or some other form of defamation.[20] Recognizing much authority to the contrary, the court declared that the presence of a script is not the proper criterion upon which to base

12. 2 SOCOLOW, RADIO BROADCASTING § 467 (1939); Barry, *Radio, Television and the Law of Defamation*, 23 AUSTL. L.J. 203, 214-15 (1949); Donnelly, *The Law of Defamation: Proposals for Reform*, 33 MINN. L. REV. 609, 613 (1949); Finlay, *Defamation by Radio*, 19 CAN. B. REV. 353, 374 (1941); Haley, *The Law on Radio Programs*, 5 GEO. WASH. L. REV. 157, 184-85 (1937); 24 B.U.L. REV. 94, 96-97 (1944); 12 MO. L. REV. 361, 364 (1947); 27 NEB. L. REV. 107, 109 (1948); 25 N.Y.U.L. REV. 416, 418 (1950); 23 N.Y.U.L. REV. 212, 214-15 (1948); 9 OHIO ST. L.J. 179, 181 (1948); 2 WYO. L.J. 127, 130 (1948). By statute in England, all defamation broadcasted for general consumption is treated as libel. Defamation Act, 1952, 15 & 16 Geo. 6 & 1 Eliz. 2, c. 66.

13. 296 N.Y. 296, 300, 73 N.E.2d 30, 32 (1947) (concurring opinion of Fuld, J.). Judge Fuld stated that the distinction between libel and slander is based on permanence of form because of the harm which results from wide pnblication of permanent communications. He concluded that radio, with or without script, is certainly widely publicized and should be actionable per se.

14. 47 COLUM. L. REV. 1075, 1077 (1947); 19 MISS. L.J. 252, 253 (1948); 22 ST. JOHN'S L. REV. 161, 165 (1947).

15. Coffey v. Midland Broadcasting Co., 8 F. Snpp. 889 (W.D. Mo. 1934); Shor v. Billingsley, 4 Misc. 2d 857, 158 N.Y.S.2d 476 (Sup. Ct. 1957); Polakoff v. Hill, 261 App. Div. 777, 27 N.Y.S.2d 142 (1941).

16. Coffey v. Midland Broadcasting Co., *supra* note 15. "The latter [newspaper] prints the libel on paper and broadcasts it to the reading world. The owner of the radio station 'prints' the libel on a different medium just as widely or even more widely 'rcad.'" *Id.* at 890.

17. Remington v. Bentley, 88 F. Supp. 166 (S.D.N.Y. 1949); Correia v. Santos, 13 Cal. Rptr. 132 (1961); Locke v. Gibbons, 164 Misc. 877, 299 N.Y. Supp. 188 (Sup. Ct. 1937).

18. SEELMAN, LIBEL AND SLANDER IN NEW YORK ch. 1 ¶ 7 (1933); 2 SOCOLOW, *op. cit. supra* note 12, at 851-52; Bohlen, *Fifty Years of Torts*, 50 HARV. L. REV. 725, 729-31 (1937); Haley, *supra* note 12, at 185-86; 29 B.U.L. REV. 245, 250 (1949); 10 GA. B.J. 250, 252 (1947); 12 ORE. L. REV. 149, 153 (1933); 26 TEXAS L. REV. 221, 222-23 (1947).

19. Lahr v. Adell Chem. Co., 300 F.2d 256 (1st Cir. 1962); Kelly v. Hoffman, 137 N.J.L. 695, 61 A.2d 143 (Ct. Err. & App. 1948); Weglein v. Golder, 317 Pa. 437, 177 Atl. 47 (1935).

20. 126 S.E.2d at 876.

a distinction, and emphasized that the listener is ordinarily unaware of the script's use,[21] and that the use of a script has no relationship to the broadcast's ability to harm.[22] On these bases the court ruled that broadcast defamation is actionable per se and, declining to classify it as libel, held rather that it is a third category of defamation, which it called "defamacast."[23] The court postulated that libel and slander cases should not be controlling in this area and that rules dealing with "defamacast" must be developed by subsequent judicial determinations.[24]

The instant case's holding that broadcast defamation is actionable per se seems proper in light of the capacity-for-harm theory, which would appear to be the proper basis for determining whether special damages need be pleaded in an action for defamation. However, creation of a new tort without furnishing guidelines for its application[25] is not a constructive contribution toward clarifying this confused area. Although many writers have advocated a separate action for broadcast defamation,[26] others have insisted that all broadcast defamation should be treated as libel.[27] The latter would seem the better view, for, while capacity for change is an attribute of the common law,[28] unneeded change is destructive of stability and predictability—objectives implicit in our system of jurisprudence. There is no reason why the law of libel cannot effectively achieve justice and equity in dealing with broadcast defamation. Finally, since the court rules that "defamacast" is actionable per se, it would seem that "defamacast" adds nothing to the law of defamation not already present in the law of libel. In light of the foregoing, the creation of "defamacast" is at least questionable.

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21. *Id.* at 877.

22. *Ibid.* While the court does not cite authority for this statement, the same conclusion has been reached in Hartmann v. Winchell, *supra* note 13 at 300, 73 N.E.2d at 32 (concurring opinion of Fuld, J.); 47 COLUM. L. REV. 1075 (1947); 19 MISS. L.J. 252 (1948); and 22 ST. JOHN'S L. REV. 161 (1947).

23. 126 S.E.2d at 879, 882.

24. *Id.* at 879 n.8. The court then ruled that plaintiff's alleged identification with the fictionalized guard was sufficient to meet the extrinsic fact test on general demurrer. *Id.* at 881. The court also ruled that the group of guards was small enough so as not to exceed the maximum group size established in recent cases on group defamation. *Ibid.*

25. *Id.* at 879 n.8.

26. See note 18 *supra.*

27. See notes 12, 14 *supra.*

28. Washington v. W. C. Dawson & Co., 264 U.S. 219, 236 (1924) (Brandeis, J., dissenting); CARDOZO, THE GROWTH OF THE LAW 133 (1924); HOLMES, THE COMMON LAW 36 (1881).